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By Arthur E. Wilmarth, Jr.

Introduction

On March 17, 2020, the Federal Deposit Insurance Corporation (FDIC) issued a notice of proposed rulemaking, entitled "Parent Companies of Industrial Banks and Industrial Loan Companies."[1] The FDIC's proposed rule (the "Proposed ILC Rule") would apply to FDIC-insured industrial banks and industrial loan companies (hereinafter collectively referred to as "ILCs") that are controlled by "Covered Companies." Parent companies of ILCs would be treated as "Covered Companies" if they are not subject to consolidated supervision by the Federal Reserve Board (Fed). The Proposed ILC Rule would establish terms and conditions governing applications for deposit insurance, changes in control, and mergers involving such ILCs.[2] The Proposed ILC Rule would not restrict the permissible activities of Covered Companies and their nonbank subsidiaries.

If adopted, the Proposed ILC Rule would open the door to widespread acquisitions of ILCs by nonfinancial firms engaged in industrial, retail, information technology, and other types of commercial activities (hereinafter collectively referred to as "commercial firms"). The likelihood that many commercial firms would acquire ILCs is indicated by the FDIC's approval, on March 18, 2020, of deposit insurance applications filed by ILCs owned by Square and Nelnet. Square and Nelnet would not qualify for status as Fed-supervised bank holding companies under the Bank Holding Company Act (BHC Act) because they engage in both financial and nonfinancial activities.[3]

Professor of Law, George Washington University Law School. Unless otherwise indicated, this article includes developments through April 15, 2020.

The FDIC's issuance of the Proposed ILC Rule and the FDIC's approvals of Square's and Nelnet's applications represent a fundamental change in policy. Those actions effectively reverse the FDIC's previous policy of barring acquisitions of ILCs by commercial firms. The FDIC imposed an 18-month moratorium on acquisitions of ILCs by commercial firms between July 2006 and January 2008. The Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act) placed a three-year moratorium on such acquisitions between July 2010 and July 2013. The FDIC did not allow any firms engaged in nonfinancial (commercial) activities to acquire ILCs from the imposition of its moratorium in July 2006 until the agency approved Square's and Nelnet's applications in March 2020.[4]

Several applications seeking deposit insurance for commercially-owned ILCs are currently pending before the FDIC.[5] Rakuten recently announced that it was temporarily withdrawing its application "to incorporate feedback from the FDIC." At the same time, Rakuten stated that it "will continue to work constructively with the FDIC and the State of Utah to move forward with our applications."[6] Rakuten is a large Japanese company involved in e-commerce, information technology, and other commercial activities. Rakuten's global website says that Rakuten "has grown to encompass over 70 businesses across e-commerce, digital content, communications and fintech," ranging from "new open platforms for e-commerce, to experiments with drones, chatbots, deep learning and AI." Rakuten's website also declares that "we challenge the status quo" and "embrace new and disruptive ideas."[7]

Rakuten has been called the "the Amazon.com of Japan." If the FDIC approves Rakuten's application, that approval would encourage many other information technology firms and e-commerce firms to pursue opportunities to acquire ILCs.[8]

If adopted, the Proposed ILC Rule would be contrary to the public interest and unlawful for the following reasons:

(1) Further acquisitions of ILCs by commercial firms would (a) undermine Congress's longstanding policy of separating banking and commerce, (b) threaten to inflict large losses on the federal "safety net" for financial institutions during future systemic crises, and (c) pose grave dangers to the stability of our financial system and the health of our economy.
(2) Further acquisitions of ILCs by commercial firms would create toxic conflicts of interest and would also pose serious threats to competition and consumer welfare.
(3) The FDIC's limited supervisory powers over parent companies and other affiliates of ILCs are plainly inadequate to prevent the systemic risks, conflicts of interest, and threats to competition and consumer welfare created by commercially-owned ILCs.
(4) Adoption of the Proposed ILC Rule would be contrary to the public interest factors specified in the Federal Deposit Insurance Act and would also violate the Administrative Procedure Act (APA).

The following analysis explains why adopting the Proposed ILC Rule would be contrary to the public interest and unlawful. Moreover, the FDIC should not adopt the Proposed ILC Rule while our nation is preoccupied with the challenges of responding to the global COVID-19 pandemic. The FDIC should withdraw the Proposed ILC Rule or postpone any further action on the Rule, until (1) the enormous problems caused by the pandemic have been successfully resolved, and (2) as required by the APA, the FDIC has completed the following actions: (a) explaining the factual, legal, and policy basis for the FDIC's decision to change its policy on acquisitions of ILCs by commercial firms, and (b) providing public notice of that explanation and affording the public a reasonable opportunity to submit comments on the FDIC's change in policy and the agency's stated reasons for making that change. The FDIC should not approve any additional acquisitions of ILCs by commercial firms until all of the foregoing actions have been completed.

Analysis

1. Further acquisitions of ILCs by commercial firms would undermine the policy of separating banking and commerce, threaten to inflict large losses on the federal "safety net" for financial institutions, and pose grave dangers to the stability of our financial system and the health of our economy.

a. Adopting the Proposed ILC Rule would undermine Congress's longstanding policy of separating banking and commerce.

The BHC Act generally prohibits commercial firms from acquiring or exercising control over FDIC-insured banks, in accordance with Congress's longstanding policy of separating banking and commerce.[9] Under 12 U.S.C. 1841(c)(2)(H), which was enacted in 1987, ILCs are exempted from the definition of "bank" for purposes of the BHC Act if they do not accept demand (checking) deposits from for-profit business firms. ILCs are FDIC-insured depository institutions, and they are currently chartered and regulated by five states. Of the 25 existing ILCs (including Square and Nelnet), 16 are chartered by Utah and four are chartered by Nevada.[10]

When the ILC exemption was adopted in 1987, ILCs were small, locally-focused institutions that offered deposit and credit services to lower- and middle-income consumers. ILCs were first organized in the early 1900s as small loan companies that provided credit to industrial workers. ILCs did not become generally eligible for federal deposit insurance until 1982. The total assets of ILCs in 1987 were only $4.2 billion, and the largest ILC had less than $420 million of assets. In 1992, U.S. banks and trust companies held total assets of $3.5 trillion—500 times the size of the $7 billion of total assets held by ILCs. A 1993 report from the Congressional Research Service (CRS) confirmed that ILCs played only a "minor" role in the U.S. financial system.[11]

In July 2005, Walmart, the largest U.S. retailer, applied to acquire (and obtain deposit insurance for) a Utah ILC. Walmart's application triggered widespread public opposition and led to an extensive debate about the desirability of allowing large commercial firms to acquire ILCs. During one of the FDIC's public hearings on Walmart's application in April 2006, Senator Jake Garn (R-UT)—the sponsor of the 1987 exemption for

ILCs—stated that "it was never my intent, as the author of this particular section, that any of these industrial banks be involved in retail [commercial] operations."[12]

In response to the vigorous public attacks on Walmart's application, the FDIC imposed a six-month moratorium on acquisitions of ILCs by commercial firms in July 2006. In its moratorium notice, the FDIC observed that the "evolution" of the "ILC industry" was occurring "in ways that may not have been anticipated at the time [Senator Garn's exemption] was enacted in 1987."[13] In January 2007, the FDIC extended its moratorium for an additional year. In the FDIC's moratorium extension notice, the agency pointed out that "business plans" for ILCs owned by commercial firms "differ substantially from the consumer lending focus of the original industrial banks."[14]

Walmart withdrew its ILC application in March 2007, due to the FDIC's extended moratorium and the intense public hostility toward Walmart's application. The magnitude of the outcry against Walmart's proposed ILC—which included statements of opposition from many members of Congress—supported Senator Garn's view that Walmart's application went far beyond the intended scope of the exemption he sponsored in 1987.[15]

Notwithstanding Walmart's decisive defeat, the Proposed ILC Rule states that "the industrial bank exemption in the [BHC Act] . . . provides an avenue for commercial firms to own or control a bank."[16] However, there is no evidence indicating that Congress either intended or expected in 1987 that Senator Garn's exemption would lead to acquisitions of ILCs by commercial firms.

Senator Garn's exemption was enacted as part of the Competitive Equality Banking Act of 1987 (CEBA). CEBA reaffirmed and strengthened Congress's policy of separating banking and commerce by closing the "nonbank bank loophole." During the 1980s, many commercial firms used the nonbank bank loophole to acquire FDIC-insured banks that either did not accept demand (checking) deposits or did not make commercial loans. CEBA closed that loophole by expanding the definition of "bank" in the BHC Act to include all "banks" that accepted FDIC-insured deposits. Senator Garn's exemption excluded ILCs from the definition of "bank" for purposes of the BHC Act. However, CEBA's legislative history did not include any explanation of the purpose or anticipated scope of Senator Garn's exemption.[17]

The Senate committee report on CEBA declared that "[n]onbank banks undermine the principle of separating banking and commerce, a policy that has long been the keystone of our banking system. . . . The separation of banking from commerce helps ensure that banks allocate credit impartially, and without conflicts of interest." The Senate committee report also explained that CEBA would close the nonbank bank loophole to "minimize the concentration of financial and economic resources" and enhance "the safety and soundness of our financial system."[18] During the floor debates on CEBA, "members of Congress emphasized that the nonbank bank loophole must be closed in order to preserve the general policy of separating banking and commerce and to ensure parity of regulatory treatment for all companies that controlled FDIC-insured banks."[19]

It is highly unlikely that Congress intended that CEBA would *reaffirm and strengthen* the policy of separating banking and commerce by closing the nonbank bank loophole, but would *undermine and weaken the same policy* by adopting Senator Garn's exemption for ILCs. The implausibility of such a self-contradicting purpose is heightened by the absence of any evidence indicating that Congress expected that Senator Garn's exemption could be used to break down the barrier between banking and commerce. In 1999—12 years after CEBA—Congress again reinforced the policy of separating banking and commerce by passing a statute that prohibited further acquisitions of FDIC-insured savings associations (thrifts) by commercial firms. In view of Congress's powerful expressions of support for the policy of separating banking and commerce in both CEBA and the 1999 statute, the unexplained text of Senator Garn's exemption should *not* be applied in a way that undermines that policy.[20]

Accordingly, the FDIC's policy toward ILCs should remain consistent with Congress's strongly articulated purpose of separating banking and commerce. The appropriate policy for the FDIC would be to allow acquisitions of ILCs by companies engaged in financial activities but *not* by firms engaged in commercial activities. As shown in Part 4 below, the appropriate policy is also supported by the public interest factors that the FDIC must consider under the Federal Deposit Insurance Act when the FDIC reviews applications for deposit insurance, changes in control, and mergers involving ILCs.

The FDIC followed the appropriate policy when it did not approve Walmart's application, imposed a moratorium on acquisitions of ILCs by commercial firms in June 2006, and extended that moratorium for another year in January 2007. The FDIC cited many of the risks and policy concerns described in this article when it adopted and extended its moratorium.[21]

The FDIC also followed the appropriate policy when it issued its CapitalSource order in June 2008. The FDIC permitted CapitalSource's parent companies to engage "only in financial activities," and the FDIC required those companies to divest any "non-conforming investments" within one year.[22] The CapitalSource order was the FDIC's last approval of deposit insurance for an ILC until it granted the Square and Nelnet applications.

In 2016, the federal banking agencies submitted a joint report to Congress and the Financial Stability Oversight Council (FSOC). The 2016 joint report evaluated the risks of bank activities and affiliations, as required by Section 620 of the Dodd–Frank Act. The Fed recommended that Congress should prohibit ownership of ILCs by commercial firms, based on many of the same risks and policy concerns cited by the FDIC when it adopted and extended its moratorium. The FDIC did not endorse the Fed's recommendation in the 2016 joint report, but the FDIC did not object to the Fed's recommendation and did not challenge the Fed's analysis of the risks and policy concerns created by commercially-owned ILCs.[23] As discussed in Part 4 below, the Proposed ILC Rule does not explain why the FDIC has decided to change its policy and now intends to permit acquisitions of ILCs by commercial firms, despite the risks and policy concerns the FDIC identified in 2006 and 2007.

b. Further acquisitions of ILCs by commercial firms would be likely to inflict large losses on the federal "safety net" for financial institutions during future systemic crises.

In view of the serious potential dangers posed by commercially-owned ILCs, the FDIC should not allow further acquisitions of ILCs by commercial firms. ILCs have frequently failed in the past, due to problems such as reckless lending, inadequate capital, and insufficient liquidity. Thirteen ILCs failed between 1982 and 1984. Two ILCs that were heavily engaged in subprime lending (Pacific Thrift and Loan and Southern Pacific Bank) failed in 1999 and 2003. Those two failures inflicted significant losses on the Deposit Insurance Fund. The number of ILCs declined from 58 to 23 between the beginning of the financial crisis in 2007 and the end of 2019, and the total assets of ILCs dropped from $177 billion to $141 billion.[24]

The Proposed ILC Rule greatly understates the risks posed by ILCs and their parent companies during a systemic crisis. The Proposed ILC Rule says that "the FDIC's supervisory approach with respect to industrial banks was effective" because "[o]nly two small industrial banks failed during the [financial] crisis" of 2007–09.[25] The Proposed ILC Rule does not refer to any problems that occurred at corporate owners of ILCs during that crisis.

In fact, as described below, several large corporate owners of ILCs failed or were rescued by the federal government during the financial crisis. In some cases, the problems that threatened the survival of those corporate owners were directly related to their ILCs. Four very large corporate owners of ILCs—General Motors Acceptance Corp. (GMAC), Merrill Lynch, Goldman Sachs, and Morgan Stanley—received huge bailouts from the federal government to prevent their failures. A fifth major ILC owner—GE Capital—encountered very serious liquidity problems during the crisis and received extensive financial assistance from federal agencies. A sixth corporate ILC owner—CIT Group—failed in 2009, thereby wiping out $2.3 billion of taxpayer-funded assistance that CIT received from the federal government's Troubled Asset Relief Program (TARP). A seventh corporate ILC owner—Fremont General—collapsed in 2008, after suffering large losses related to the subprime mortgage lending activities of its ILC (Fremont Investment and Loan).

Thus, as the Fed correctly pointed out in the 2016 joint report to Congress and FSOC, "companies that failed or required assistance at the outset of the 2008 financial crisis included a number of companies that owned and controlled ILCs." In the same report, the FDIC acknowledged that some "parent companies or affiliates [of ILCs] failed or experienced severe stress" during the financial crisis.[26]

In 2008, GMAC held over $200 billion of assets and owned a large Utah ILC with $33 billion of assets and $17 billion of deposits. GMAC was the primary source of financing for dealers and retail customers who purchased and leased General Motors (GM) vehicles. In 2007 and 2008, GMAC suffered crippling losses from its subprime mortgage lending business and additional losses from its auto lending business. To prevent GMAC's failure, the Fed approved GMAC's emergency conversion into a bank holding company in December 2008. Federal agencies provided over $40 billion of financial assistance to GMAC in the form of TARP capital infusions, FDIC debt guarantees, and purchases of commercial paper and emergency loans by the Fed. The federal government bailed out GMAC so that it could provide financing for vehicle sales and leases made by GM and Chrysler after federal agencies rescued both automakers.[27]

Merrill Lynch held almost $900 billion of assets and was the third largest U.S. securities broker-dealer in 2008. Merrill Lynch owned a Utah ILC with $60 billion of deposits as well as a federal savings association with $20 billion of deposits. Merrill Lynch suffered huge losses from its involvement in high-risk activities, including subprime lending and securitization. To avoid collapse, Merrill Lynch agreed to be acquired by Bank of America—at the urging of federal regulators—during "Lehman weekend" in September 2008. Federal agencies subsequently provided more than $300 billion of financial assistance to Bank of America and Merrill Lynch in the form of TARP capital infusions, asset and debt guarantees, purchases of commercial paper, and emergency Fed loans. A significant portion of that enormous rescue package covered Merrill Lynch's losses. Merrill Lynch would have failed, and it is doubtful whether Bank of America could have survived, without the federal government's bailout.[28]

Goldman Sachs and Morgan Stanley, the two largest U.S. securities brokers, each held $1 trillion or more of assets in 2008. Goldman Sachs and Morgan Stanley each owned a Utah ILC with over $25 billion of assets. Goldman Sachs and Morgan Stanley—like Merrill Lynch—were heavily involved in high-risk, subprime-related activities during the boom leading to the financial crisis. A week after Lehman Brothers failed, the Fed approved applications by Goldman Sachs and Morgan Stanley for emergency conversions into bank holding companies to ensure their survival. Federal agencies provided financial support totaling over $300 billion to Goldman Sachs and Morgan Stanley through TARP capital infusions, FDIC debt guarantees, and purchases of commercial paper and emergency loans by the Fed. Goldman Sachs and Morgan Stanley almost certainly would have failed without the federal government's support.[29]

GE Capital Corporation was a subsidiary of General Electric (GE) and engaged in a wide range of financial activities. GE Capital held almost $700 billion of assets in 2008, including a Utah ILC. GE Capital experienced severe liquidity problems after Lehman Brothers failed, including great difficulty in selling short-term commercial paper to fund its operations. The Fed responded by purchasing $16 billion of GE Capital's commercial paper, and the FDIC guaranteed over $70 billion of GE Capital's newly-issued debt securities. GE Capital would have faced very serious funding challenges without the federal government's extensive financial assistance.[30]

CIT Group was a large nonbank financial firm that provided commercial lending and leasing services to small- and medium-sized businesses, as well as subprime mortgages and student loans to consumers. CIT held $80 billion of assets in 2008, including a Utah ILC. In December 2008, the Fed approved CIT's application for an emergency conversion into a bank holding company after CIT recorded large losses and experienced severe funding problems. CIT also received a $2.3 billion capital infusion from TARP. However, CIT's problems continued, and it filed for bankruptcy in November 2009. CIT's failure wiped out the federal government's entire TARP investment in the firm.[31]

Thus, the federal government provided massive bailouts to rescue GMAC, Merrill Lynch, Goldman Sachs, Morgan Stanley, and GE Capital during the financial crisis. In addition, the federal government lost its entire taxpayer-funded investment in CIT. Those bailouts and losses illustrate the enormous systemic risks that are likely to arise when large nonbank corporations acquire ILCs and combine the operations of those ILCs with their other activities.

Fremont General provides another example of the potential risks created by ILCs and their parent companies. Fremont General owned Fremont Investment and Loan, a California ILC with $13 billion of assets in 2006. Fremont Investment and Loan was a top-ten subprime mortgage lender, and it had one of the worst records among subprime lenders in terms of reckless underwriting, delinquencies, and defaults. The FDIC ordered Fremont to stop offering subprime mortgages in March 2007. However, that directive came too late to save Fremont. Fremont General filed for bankruptcy in June 2008, and the FDIC approved an emergency sale of Fremont Investment and Loan's branches, deposits, and other assets to CapitalSource, a newly-organized California ILC. That emergency sale prevented the failure of Fremont Investment and Loan. However, the toxic subprime mortgages and mortgage-backed securities issued by Fremont Investment and Loan resulted in foreclosures for many borrowers and heavy losses for many investors.[32]

Accordingly, there is no doubt that corporate owners of ILCs inflicted very significant costs on the U.S. financial system and taxpayers during the financial crisis of 2007–09. In addition, corporate owners eagerly exploited their ILCs' ability to generate federally-subsidized, low-cost funding by offering FDIC-insured deposits. For example, Merrill Lynch created "sweep" accounts that allowed its customers to transfer cash balances from their uninsured accounts at Merrill's securities broker-dealer to their FDIC-insured deposit accounts at Merrill's ILC. Merrill Lynch's sweep accounts were attractive to customers, but those accounts greatly increased the risk of losses to the Deposit Insurance Fund. Similarly, GMAC's ILC used its FDIC-insured deposits as a low-cost source of funding for loans that financed sales and leases of GM vehicles. Other commercial owners of ILCs—including Volkswagen, Toyota, and Target—also used their ILCs as captive financing agencies to support sales of their products.[33]

Corporate owners and their ILCs have used common brand names and coordinated business strategies to achieve a close integration of their operations. As shown above, close connections between ILCs and their parent companies forced federal bank regulators to deal with serious problems at large corporate owners during the financial crisis of 2007–09. Federal agencies rescued several of those corporate owners to reduce the danger of contagious spillovers of risks and losses between the financial system and the economy. As discussed in the next section, those rescues extended the federal "safety net" far beyond the banking system, thereby creating very large risks for the federal government and taxpayers.

c. Further acquisitions of ILCs by commercial firms would pose grave threats to the stability of our financial system and the health of our economy.

Merrill Lynch, Goldman Sachs, and Morgan Stanley were large financial conglomerates that functioned as "shadow banks" before the financial crisis of 2007–09. They offered federally-insured deposits, consumer loans, and commercial loans through the ILCs and thrifts they controlled. In addition, they provided "deposit substitutes" in the form of money market mutual funds, short-term commercial paper, and securities repurchase agreements (repos), all of which were payable in practice at par on demand. They also offered a wide array of substitutes for bank loans. The activities of "shadow bank" financial conglomerates effectively mirrored the functions of bank-centered financial holding companies, which were authorized by the Gramm–Leach–Bliley Act of 1999 (GLBA). GLBA marked the culmination of a 20-year campaign in which large banks, federal regulators, and Congress undermined and ultimately repealed the New Deal-era risk buffers that separated banks from the capital markets.[34]

GLBA's enactment produced a financial system that was dominated by large bank-centered and "shadow bank" financial conglomerates. The activities of those financial conglomerates created fragile, high-risk networks that connected systemically important financial institutions to all major segments of our financial markets. The hazardous networks produced by large financial conglomerates forced federal regulators to extend the federal "safety net" for banks so that it encompassed all major segments of our financial markets during the financial crisis of 2007–09. The federal "safety net"—including the FDIC's Deposit Insurance Fund, the Fed's emergency lending programs, and the Fed-supervised payments system—was originally intended to be available only to federally-insured depository institutions. However, the Fed and the Treasury Department created a wide array of emergency programs between 2007 and 2009, which provided comprehensive protection for the liabilities of banks, securities broker-dealers, insurance companies, and other "shadow banks."[35]

The Fed and other leading central banks also adopted "quantitative easing" (QE) policies to stabilize struggling economies and provide liquidity to highly stressed financial markets. Under those QE policies, central banks made extensive purchases of government bonds, mortgage-backed securities, and (in some cases) corporate securities. QE policies caused the balance sheets of the Fed, the Bank of England, the European Central Bank, and the Bank of Japan to expand from $4 trillion to $15 trillion between 2007 and 2018.[36]

QE policies provided huge infusions of liquidity into the world's financial markets. Repeated infusions of central bank liquidity caused market participants to view central banks as de facto guarantors of the stability of financial markets. Expectations of continued central bank support encouraged a massive expansion of credit for governments, businesses, and households. Total global debt levels increased from $167 trillion to $253 trillion between 2007 and 2019, and global debt as a percentage of global GDP rose from 275% to 322% during that period. The enormous growth of global debt after the financial crisis raised serious concerns about the sustainability of debt levels in both developed and developing countries.[37]

The huge debt burdens assumed by governments, businesses, and consumers left them in a highly vulnerable position when the COVID-19 pandemic suddenly struck countries around the world. Governments and central banks responded to the pandemic by recreating most of the emergency programs they used during the crisis of 2007–09. In addition, governments adopted major new stimulus programs, while central banks launched new types of liquidity assistance programs and aggressive new QE initiatives. The extraordinary speed and scope of the responses by governments and central banks to the COVID-19 pandemic demonstrated that global financial markets remain highly leveraged and dangerously fragile, despite all of the post-crisis reforms. One of the most troubling developments is that post-crisis reforms have not changed the basic structure of our financial system, including the unhealthy dominance of giant financial conglomerates within that system. Consequently, governments and central banks have again been forced to provide unlimited support for all major segments of the financial markets to ensure the survival of those conglomerates.[38]

As explained above, the creation of giant financial conglomerates broke down the risk buffers established during the New Deal and its aftermath. Those risk buffers prevented contagious spillovers of losses between the banking system and the capital markets from World War II through the 1980s. GLBA eliminated those buffers and allowed banks to establish full-scale affiliations with nonbank financial firms. By taking that fateful step, GLBA greatly increased the likelihood that serious disruptions occurring in one sector of our financial system would spread to other sectors. The systemic dangers posed by large financial conglomerates forced regulators to expand the federal "safety net" for banks to protect all important segments of our financial markets during the financial crisis of 2007–09 and again during the current pandemic. Those vast expansions of the "safety net" have imposed great risks and costs on the federal government and taxpayers, and they have severely undermined the effectiveness of market discipline in our financial system.[39]

The same spreading of risks and costs—and the same impairment of market discipline—would occur on an even larger scale if the FDIC allows further acquisitions of ILCs by nonfinancial (commercial) firms. The federal government's rescues of GMAC, GE Capital, and CIT demonstrate the hazards created by affiliations between commercial firms and ILCs. As explained in Part 2 below, allowing more acquisitions of ILCs by commercial firms would produce intense pressures for repealing our policy of separating banking and commerce, thereby permitting combinations between all types of banks and all categories of commercial firms.

Widespread affiliations between banks and commercial firms would greatly increase the likelihood of contagious spillovers of risks and losses between the financial system and the economy. As commercial-financial conglomerates became systemically important entities, the federal government would have powerful incentives to spend massive sums to prevent serious disruptions from occurring in either the financial system or the economy.[40] The federal government's extraordinary responses to the COVID-19 pandemic indicate that our nation is already moving toward that perilous and very costly state of affairs.

Problems at large commercial-financial conglomerates have frequently served as catalysts for systemic financial and economic crises in the past. The first major U.S. banking crisis of the Great Depression was precipitated by the failures of two large commercial-financial conglomerates in late 1930. In November 1930, the downfall of Caldwell and Company—a large financial and industrial conglomerate headquartered in Nashville, Tennessee—caused a regional banking panic in several southern states. The following month, the collapse of Bank of United States—a large banking, securities, and real estate conglomerate in New York City—disrupted financial markets in the Middle Atlantic region and caused a serious loss of public confidence in the U.S. banking system. In February 1933, the failures of Michigan's two largest banks—which had extensive securities and real estate operations—forced Michigan to declare a statewide bank holiday, thereby triggering a nationwide banking panic.[41]

In May 1931, the collapse of Creditanstalt—Austria's biggest universal bank, which held ownership stakes in many Austrian commercial enterprises—set off a devastating financial and economic crisis that swept through Europe. The European crisis resulted in widespread failures and bailouts at large universal banks in Germany, Italy, and Belgium. The Great Depression's impact was especially severe in the U.S. and in European countries with universal banking systems. In both the U.S. and Europe, vulnerable networks that linked major banks, securities markets, and commercial firms produced catastrophic spillovers of risks and losses that destroyed entire financial systems and economies. In contrast, Canada and Great Britain did not experience systemic financial crises during the Great Depression. One reason for their superior performance was that banks in both countries were separated from securities markets and did not hold equity stakes in commercial firms.[42]

During the 1990s, systemic financial and economic crises occurred in Japan, Mexico, and South Korea. In all three countries, leading banks were closely connected to large commercial firms through cross-shareholding networks and other joint control arrangements. Conglomerate-style networks were known as *keiretsu* in Japan and *chaebol* in South Korea, and they were centered around wealthy families in Mexico. In the 1990s, all three nations experienced contagious crises that severely damaged their financial systems and devastated their economies. The catastrophic crises of the 1990s in Japan, Mexico, and South Korea provide strong warnings about the risks of allowing banks to affiliate with commercial firms. Such affiliations greatly increase the likelihood of contagious crises that could wreak havoc on both the financial system and the economy.[43]

2. Further acquisitions of ILCs by commercial firms would create toxic conflicts of interest and would also pose serious threats to competition and consumer welfare.

Acquisitions of ILCs by commercial firms produce dangerous and destructive conflicts of interest. In 1970 and 1987, Congress amended the BHC Act to stop commercial enterprises from acquiring FDIC-insured banks. On both occasions, Congress determined that the creation of commercial-financial conglomerates would seriously impair the objectivity of bank lending and encourage preferential and reckless credit practices. Congress recognized that commercially-owned banks have strong incentives to (A) make unsound loans to their commercial affiliates, (B) deny credit to competitors of their commercial affiliates, and (C) provide risky loans to help customers buy goods or services from their commercial affiliates. The Senate committee report on the 1987 legislation (CEBA) warned that allowing commercial firms to own banks "raises the risk that the banks' credit decisions will be based not on economic merit but on the business strategies of their corporate parents."[44]

Congress's strong concerns about the biased lending practices of commercially-owned banks were well-founded. Commercially-owned ILCs have frequently adopted lending policies that support the business activities of their parent company and other affiliates. The Proposed ILC Rule states that "[a] significant number of the 23 existing industrial banks support the commercial or specialty finance operations of their parent company."[45] In 2006, FDIC General Counsel Douglas Jones explained that two commercially-owned ILCs—Volkswagen Bank and Toyota Financial Savings Bank—provided loans to finance purchases of vehicles manufactured by their parent companies. A third commercially-owned ILC—Target Bank—issued proprietary credit cards to businesses to finance their purchases of goods at Target stores.[46] As discussed above, GMAC was the primary source of credit for dealers and consumers who bought or leased GM vehicles.[47] Square's newly-approved ILC will make loans to merchants who process their credit card transactions through Square's proprietary payments system.[48]

Preferential, high-risk lending and other conflicts of interest have frequently occurred at commercial-financial conglomerates in the past. Caldwell and Company, Bank of United States, American Continental (the parent company of Charles Keating's Lincoln Savings and Loan), and commercial-financial conglomerates in Japan, South Korea, and Mexico engaged in reckless lending, preferential transfers of funds, and other abusive transactions that benefited their commercial affiliates and inflicted devastating losses on the depository institutions they controlled.[49]

The subsidies and other benefits that FDIC-insured depository institutions receive from the federal "safety net" create powerful incentives for commercial firms to acquire ILCs. "Safety net" benefits include (1) low-cost funding from FDIC-insured deposits, (2) access to the Fed's emergency lending programs for depository institutions, and (3) access to Fed-supervised payments systems for checks, credit cards, debit cards, online and mobile payments, and wire transfers.[50]

Supporters of commercially-owned ILCs argue that the Federal Reserve Act's restrictions on affiliate transactions and insider lending will prevent commercial parent companies from abusing the federal "safety net." However, those complex and technical provisions are very difficult to enforce in a timely and effective manner. Troubled financial institutions have frequently violated those restrictions in the past. For example, two large ILCs that failed in 1999 and 2003—Pacific Thrift and Southern Pacific Bank—violated affiliate transaction rules before they failed. In 1994, the Government Accountability Office (GAO) studied 175 bank failures that occurred during the 1980s. The GAO determined that 82 of the failed banks breached insider lending limits, and 49 of the failed banks violated affiliate transaction rules. American Continental and its subsidiary, Lincoln Savings and Loan, collapsed after committing widespread and flagrant infractions of insider lending limits, affiliate transaction rules, and other prudential regulations. The Lincoln Savings debacle cost the federal government $2.7 billion.[51]

During serious financial disruptions, the Fed has repeatedly waived the quantitative limits on affiliate transactions under Section 23A of the Federal Reserve Act. The Fed's waivers have allowed big banks to provide huge amounts of financial assistance to their troubled nonbank affiliates. The Fed approved large-scale waivers of Section 23A after the terrorist attacks on 9/11 and granted even more extensive waivers of Section 23A during the financial crisis of 2007–09. The Fed's waivers permitted major banks to make enormous transfers of funds to support their affiliated securities broker-dealers, sponsored mutual funds, and other nonbank affiliates. The Fed also approved waivers that allowed GMAC to finance most of GM's and Chrysler's sales of vehicles after the federal government rescued both automakers.[52] As Saule Omarova pointed out, the Fed's extraordinary waivers of Section 23A during the financial crisis authorized "massive transfers of funds" that "purposely exposed banks to risks associated with their affiliates' nonbanking business and transferred [the] federal subsidy outside the [banking] system."[53]

Based on past experience, it is very unlikely that federal regulators would enforce affiliate transaction rules against large commercial owners of ILCs during future systemic crises. As shown by GMAC's example, regulators would probably allow commercially-owned ILCs to make large transfers of funds to support their commercial affiliates during future financial and economic disruptions. As a practical matter, those transfers would extend the federal "safety net" for FDIC-insured depository institutions into many commercial sectors of our economy.

The access of commercially-owned ILCs to the federal "safety net" would give significant competitive advantages to their parent companies. In addition to the low-cost funding provided by their ILCs' deposits, large commercial owners would receive implicit "catastrophe insurance" in the form of expected federal support during future systemic crises. In contrast, smaller commercial firms that could not satisfy the capital requirements and other conditions set forth in the Proposed ILC Rule would not able to acquire ILCs and would be placed at a serious competitive disadvantage. Thus, allowing commercial firms to acquire ILCs would create a highly skewed playing field favoring commercial firms that own ILCs and handicapping those that do not.[54]

The financial sector and many commercial sectors of our economy (including the information technology industry) already display very high levels of concentration and are dominated by a small group of giant firms. High concentration levels enable big incumbent firms to leverage their market power and capture unjustified super-profits by (i) imposing unfair prices on customers and suppliers, (ii) acquiring smaller competitors or destroying them with predatory pricing policies, and (iii) deterring entry by new competitors.[55] The Proposed ILC Rule would allow big commercial firms to gain an additional competitive edge by acquiring ILCs, thereby further impairing competition and harming customers and suppliers in many lines of commerce.

Allowing acquisitions of ILCs by "Big Tech" firms like Alphabet (Google), Amazon, Apple, Facebook, and Microsoft would fundamentally change our financial system and economy in ways that are likely to be very harmful to consumers and communities. "Big Tech" firms already enjoy significant potential advantages over banks in the fields of automation, artificial intelligence, data management, and mobile payments. The rapid growth of Alibaba, Ant Financial, and Tencent in China's financial system indicates that "Big Tech" firms could potentially dominate major segments of our financial industry if those firms are allowed to establish "in-house banks" and exploit their technological advantages. Financial regulators around the world are just beginning to grapple with a wide array of public policy issues related to the potential entry of "Big Tech" firms into the banking industry. Those issues include concerns about unfair competition, abusive sharing of customer data, violations of customer privacy rights, and operational and systemic risks resulting from ownership of banks by giant technology firms.[56] The FDIC should not preempt the ongoing consideration of those vitally important issues by allowing "Big Tech" firms to acquire ILCs.

Acquisitions of ILCs by "Big Tech" firms would produce intense pressures for removing all of the BHC Act's restrictions on joint ownership of banks and commercial firms. "Big Tech" firms would not be satisfied with making "toehold" acquisitions of ILCs. They would want to build a bigger competitive presence in the financial industry by acquiring large banks. Conversely, big banks would argue that Congress must create a "level playing field" by allowing banks to acquire technology firms. As shown by the demise of the New Deal's risk buffers that separated banks from the capital markets, the creation of "loopholes" in prudential buffers inevitably leads to the destruction of those protections.[57]

Thus, allowing "Big Tech" firms to acquire ILCs would almost certainly lead to large-scale combinations between giant technology firms and big banks. Those combinations would magnify the problems that already exist due to the excessive levels of concentration, the "too big to fail" subsidies, and the unhealthy political influence that our technology giants and megabanks currently command and exploit.

3. The FDIC's limited supervisory powers over parent companies and other affiliates of ILCs are plainly inadequate to prevent the systemic risks, conflicts of interest, and threats to competition and consumer welfare created by commercially-owned ILCs.

The FDIC's circumscribed supervisory authority over parent companies and other affiliates of ILCs cannot remove the grave dangers posed by commercially-owned ILCs. The Proposed ILC Rule cites only two statutes that specifically empower the FDIC to supervise Covered Companies that control ILCs. First, under 12 U.S.C. 1820(b)(4), the FDIC may examine "the affairs of any affiliate" of an ILC, including the parent company, to the extent "necessary to disclose fully . . . the relationship between the [ILC] and any such affiliate; and . . . the effect of such relationship on the [ILC]." Second, under 12 U.S.C. 1831*o*-1(b), the FDIC may require a Covered Company "to serve as a source of financial strength" for its ILC subsidiary.[58] Neither of those statutes would allow the FDIC to exercise consolidated supervision over Covered Companies.

The Proposed ILC Rule would require Covered Companies to enter into written agreements obligating Covered Companies and their nonbank subsidiaries to satisfy eight commitments.[59] The examination and reporting commitments set forth in proposed 12 C.F.R. 354.4(a)(1), (a)(3)(iii) & (iv), and (a)(4) appear to fall within the FDIC's limited supervisory authority over "affiliates" of ILCs under 12 U.S.C. 1820(b)(4). The capital and liquidity maintenance commitment set forth in proposed 12 C.F.R. 354(a)(7) seems to be consistent with the FDIC's authority to require a Covered

Company "to serve as a source of financial strength" for its ILC subsidiary under 12 U.S.C. 1831*o*-1(b). The commitment contained in proposed 12 C.F.R. 354(a)(5), requiring annual audits for ILCs, appears to be a proper exercise of the FDIC's general authority to supervise and ensure the safety and soundness of FDIC-insured depository institutions.

In contrast, it is doubtful whether the FDIC has authority to require Covered Companies and their nonbank subsidiaries to agree to the other commitments contained in proposed Section 354.4. The FDIC does not cite any specific sources of statutory authority that would (A) allow the FDIC to examine Covered Companies and their nonbank subsidiaries to the extent described in proposed Section 354.4(a)(2), or (B) require Covered Companies to provide annual reports covering all of the matters described in proposed Section 354.4(a)(3)(i) & (ii), or (C) require Covered Companies to accept the corporate governance restrictions and tax allocation obligation set forth in proposed Section 354.4(a)(6) & (8). Covered Companies could potentially file lawsuits to challenge the FDIC's authority to impose those commitments on an involuntary basis.[60]

Even assuming, for the sake of argument, that the FDIC could require Covered Companies to satisfy all of the commitments listed in proposed Section 354.4, the resulting regime would still fall well short of the comprehensive, consolidated supervision that the Fed exercises over bank holding companies. Under proposed Section 354.4, the FDIC could not conduct unlimited, full-scope examinations of Covered Companies and their nonbank subsidiaries. The FDIC also could not impose consolidated capital requirements or consolidated liquidity requirements on Covered Companies. Additionally, the FDIC could not require large Covered Companies to conduct stress tests or to prepare resolution plans pursuant to 12 U.S.C. 5365.[61]

In the 2016 joint report to Congress and FSOC, the Fed emphasized the risks created by the absence of a consolidated supervisory regime for parent companies and affiliates of ILCs:

> [T]he ILC exemption creates special supervisory risks because an ILC's parent company and nonbank affiliates are not subject to consolidated supervision. Lack of consolidated supervision is problematic because the organization may operate and manage its businesses on an integrated basis, and, in the Federal Reserve's experience, risks that cross legal entities and that are managed on a consolidated basis cannot be monitored properly through supervision directed at any one, or even several, of the legal entity subdivisions within the overall organization. Moreover, history demonstrates that financial distress in one part of a business organization can spread, sometimes rapidly, to other parts of the organization.[62]

In the same 2016 report, the FDIC acknowledged that parent companies of ILCs "are not subject to consolidated supervision." The FDIC also did not disagree with the Fed's analysis of the risks created by that lack of consolidated supervision, although the FDIC said that it used "prudential conditions" to "mitigate" those risks.[63] In fact, as shown above in Part 1(b), several large corporate owners of ILCs either failed or required federal bailouts to survive during the financial crisis. Those failures and bailouts revealed the risks and costs that resulted from the FDIC's inability to supervise those corporate owners effectively.

In January 2007, when the FDIC extended its moratorium on acquisitions of ILCs by commercial firms, the FDIC expressed its "continuing concerns regarding the commercial ownership of industrial banks and the lack of a Federal Consolidated Bank Supervisor" for commercial parent companies of ILCs. At the same time, the FDIC proposed a set of supervisory commitments for parent companies that owned ILCs and "engaged only in financial activities." The FDIC's proposed supervisory commitments for "financial" parent companies were similar to the commitments set forth in proposed Section 354.4. However, the FDIC made clear in 2007 that it was *not* willing to rely on those supervisory commitments as a satisfactory basis for regulating commercial owners of ILCs. Instead, the FDIC extended its moratorium to ensure that commercial firms would not acquire ILCs.[64]

Even if Congress designated the FDIC (or some other federal agency) as the consolidated supervisor of commercially-owned ILCs, that step would *not* remove the grave dangers posed by commercial-financial conglomerates. A consolidated federal supervisor for commercially-owned ILCs would be hobbled by at least four unsolvable problems. First, neither the FDIC nor any other federal agency has the experience and resources needed to regulate large commercial firms. Any consolidated federal supervisor would face enormous logistical challenges, including the great difficulty and expense of hiring personnel with expertise in many different commercial sectors of the U.S. economy. The well-documented failures of federal financial agencies to regulate bank-centered and "shadow bank" financial conglomerates effectively prior to the financial crisis of 2007–09 should convince us that any federal supervisor would be even less likely to succeed in regulating large commercial–financial conglomerates.[65]

Second, designating a consolidated federal supervisor for commercial owners of ILCs would imply that the supervisor was a reliable monitor of the soundness and solvency of those commercial firms. That implication would provide a highly undesirable "seal of approval" for commercial owners of ILCs. Consolidated supervision would also strengthen the expectation among market participants that the federal government would intervene to protect commercial owners of ILCs from failure during serious financial and economic disruptions.

Third, designating a consolidated federal supervisor for commercial owners of ILCs would greatly expand the scope and intensity of federal regulation over multiple commercial sectors of our economy. The resulting expansion of federal oversight would severely undermine the effectiveness of market pricing and market discipline within those affected sectors.

Fourth, large commercial owners of ILCs would almost certainly be considered "too big to fail" by regulators and market participants. Their presumed "too big to fail" status, along with their extensive lobbying resources and political influence, would also make them "too big to discipline adequately." For all four reasons, any attempt to create a system of consolidated supervision for commercial–financial conglomerates would be unworkable and undesirable. The impracticability and adverse effects of consolidated supervision for commercial–financial conglomerates present additional persuasive reasons for prohibiting their existence.[66]

4. Adoption of the Proposed ILC Rule would be contrary to the public interest factors specified in the Federal Deposit Insurance Act and would also violate the Administrative Procedure Act.

Under the Federal Deposit Insurance Act (FDI Act), the FDIC must consider several public interest factors when it reviews applications for deposit insurance, changes in control, and mergers involving ILCs. Those public interest factors give the FDIC broad discretion to deny transactions that (1) present serious risks to the Deposit Insurance Fund or the stability of the U.S. banking system or financial system, (2) are likely to have significant anticompetitive effects, or (3) are inconsistent with the "convenience and needs of the community to be served." As the Supreme Court has explained, the "ultimate test imposed" by such factors is the agency's assessment of the overall "public interest."[67]

Under 12 U.S.C. 1815 and 1816, the FDIC may deny applications by ILCs for deposit insurance after considering the "risk presented . . . to the Deposit Insurance Fund" as well as the "convenience and needs of the community to be served." Under 12 U.S.C. 1817(j)(7), the FDIC may reject proposed changes in control of ILCs after considering the "anticompetitive effects" of such transactions, their impact on the "convenience and needs of the community to be served," and any "adverse effect on the Deposit Insurance Fund." Under 12 U.S.C. 1828(c)(5), the FDIC may disapprove proposed mergers involving ILCs after considering the "anticompetitive effects" of such mergers, their impact on the "convenience and needs of the community to be served," and any "risk to the stability of the United States banking or financial system."

If adopted, the Proposed ILC Rule would allow widespread acquisitions of ILCs by commercial firms. As shown above, those acquisitions would threaten (1) to inflict large losses on the Deposit Insurance Fund and other components of the federal "safety net" for banks during future crises, (2) to undermine the stability of the U.S. banking and financial systems, (3) to injure competition by creating an unlevel playing field between commercial firms that own ILCs and those that do not, and (4) to harm the welfare of consumers and communities by promoting conflicts of interest, impairing competition, endangering customer privacy, aggravating the risks of systemic economic and financial crises, and increasing the likelihood of taxpayer-financed bailouts of commercial–financial conglomerates.

For all of the above reasons, adoption of the Proposed ILC Rule would be contrary to the public interest factors that the FDIC is required to consider under the FDI Act. When the FDIC imposed a moratorium on acquisitions of ILCs by commercial firms in July 2006 and extended that moratorium in January 2007, the FDIC expressed significant concerns about the potential dangers of such acquisitions, including risks to the Deposit Insurance Fund and the U.S. financial system, harmful conflicts of interest, adverse effects on competition, and the absence of consolidated supervision for commercial owners of ILCs.[68] The FDIC stated that it had authority to impose the moratorium based on "the broad statutory objectives of the FDI Act which include maintenance of public confidence in the banking system by insuring deposits and maintaining the safety and soundness of insured depository institutions." The FDIC also concluded that it should not approve acquisitions of ILCs by commercial firms until it completed an evaluation that "carefully and comprehensively" studied the relevant risks and public policy concerns. Without such an evaluation, the FDIC determined that approving such acquisitions "may frustrate the substantive policies the agency is charged with promoting." In the 2016 joint report to Congress and FSOC, the Fed cited many of the same risks, policy concerns, and public interest factors to support its recommendation that Congress should prohibit ownership of ILCs by commercial firms.[69]

The Proposed ILC Rule does not include any discussion of the FDIC's current evaluation of the risks and public policy concerns that the FDIC identified in 2006 and 2007 and the Fed reiterated in 2016. The Proposed ILC Rule only briefly refers to those risks and public policy concerns, and it does not provide the FDIC's current assessment of either the significance or the validity of those risks and concerns. The Proposed ILC Rule does not argue that the FDIC's moratorium was misguided, or that the risks and concerns motivating that moratorium are no longer relevant.[70]

Similarly, the Proposed ILC Rule does not provide the FDIC's current evaluation of the public interest factors that the FDIC must consider in connection with transactions involving ILCs under 12 U.S.C. 1816, 1817(j)(7), and 1828(c)(5). The Proposed ILC Rule cites those public interest factors only briefly, and it does not explain whether the FDIC currently agrees or disagrees with the agency's previous consideration of those factors when it imposed its moratorium in 2006 and extended that moratorium in 2007.[71]

In sum, the Proposed ILC Rule (1) does not provide the factual, legal, and policy basis for the FDIC's current decision to consider and approve acquisitions of ILCs by commercial firms, and (2) does not describe the FDIC's current evaluation of the risks, public policy concerns, and statutory public interest factors that the agency cited when it imposed an 18-month moratorium on acquisitions of ILCs by commercial firms between July 2006 and January 2008 (and that the agency presumably considered when it did not approve any such acquisitions between January 2008 and March 2020). In addition, the Proposed ILC Rule does not specifically invite the public to comment on the risks, concerns, and factors that the FDIC cited in July 2006 and January 2007, or to comment on the FDIC's current decision to change its policy and permit acquisitions of ILCs by commercial firms. None of the twenty "Questions" included in the Proposed ILC Rule refers to the risks and concerns identified by the FDIC in 2006 and 2007, or to the reasons why the FDIC now intends to change its policy.[72]

In view of the glaring omissions described above, the Proposed ILC Rule is unlawful and invalid under the public notice requirement of the Administrative Procedure Act (APA), 5 U.S.C. 553(b)(3). The Proposed ILC Rule violates Section 553(b)(3) because it does not provide adequate public notice of (1) the FDIC's current evaluation of the risks and public policy concerns that the FDIC identified in 2006 and 2007 with regard to acquisitions of ILCs by commercial firms; (2) the FDIC's current evaluation of the public interest factors that the FDIC must consider under the FDI Act; and (3) the factual, legal, and policy basis for the FDIC's decision to change its policy on acquisitions of ILCs by commercial firms. Accordingly, the Proposed ILC Rule violates Section 553(b)(3) because it does not provide the public with adequate notice of, and a reasonable opportunity to submit informed comments on, the FDIC's assessment of crucially important issues as well as the FDIC's reasons for changing its policy.[73]

If adopted, the Proposed ILC Rule would also be "arbitrary and capricious," and therefore unlawful, under a separate provision of the APA, 5 U.S.C. 706(2)(A). As explained above, the Proposed ILC Rule represents a fundamental change in policy from the position taken by the FDIC when it imposed a moratorium on acquisitions of ILCs by commercial firms in July 2006, extended that moratorium in January 2007, and did not approve any acquisitions of ILCs by commercial firms between January 2008 and March 2020 (as indicated by its CapitalSource order in June 2008). As also shown above, the Proposed ILC Rule does not provide an adequate explanation of the factual, legal, and policy basis for the FDIC's decision to change its policy on such acquisitions. Indeed, the Proposed ILC Rule lacks any discussion of the reasons why the FDIC now disagrees with the agency's previous assessment of the relevant risks, public policy concerns, and statutory public interest factors. The Proposed ILC Rule is therefore "arbitrary and capricious" and invalid under the APA because it does not provide "good reasons" for the FDIC's decision to change its policy, including "a 'reasoned explanation for disregarding' the 'facts and circumstances' that underlay its previous decision."[74]

Consequently, adoption of the Proposed ILC Rule would violate the APA unless the FDIC first completes the following steps: (1) the FDIC must evaluate the risks, public policy concerns, and statutory public interest factors that the agency considered and cited when it imposed its moratorium in July 2006 and extended that moratorium in January 2007; (2) the FDIC must provide "good reasons" for changing its policy with respect to acquisitions of ILCs by commercial firms, including a "reasoned explanation" why the FDIC now disagrees with the agency's previous assessments of those risks, public policy concerns, and public interest factors; and (3) the FDIC must provide public notice of the factual, legal, and policy basis for its change in policy, and the FDIC must give the public a reasonable opportunity to submit comments on the FDIC's change in policy and its stated reasons for making that change.

There is an additional compelling reason why the FDIC should withdraw the Proposed ILC Rule or indefinitely postpone further action on that Rule. Our nation is currently preoccupied with the challenges of responding to the global COVID-19 pandemic. The pandemic has severely disrupted our financial system, economy, and society, thereby creating the equivalent of a wartime emergency. It would be highly inappropriate for the FDIC to adopt the Proposed ILC Rule during the pandemic, especially in view of the Rule's far-reaching and potentially very harmful effects on our financial system, economy, and society.

Conclusion

For the reasons set forth above, the FDIC should withdraw the Proposed ILC Rule or postpone any further action on the Rule, until (1) the enormous problems caused by the COVID-19 pandemic have been successfully resolved, and (2) the FDIC has taken all of the steps required by the Administrative Procedure Act, as described in Part 4 above. The FDIC should not approve any additional acquisitions of commercial firms by ILCs until all of the foregoing actions have been completed.

Notes

1. FDIC Docket RIN 3064-AF31, 85 Fed. Reg. 17771 (Mar. 31, 2020) (proposed regulation to be codified in a new 12 C.F.R. Part 354) [hereinafter "Proposed ILC Rule"].
2. *Id.* at 17771–72 (including note 7), 17776–77.
3. *See* statements by FDIC Director Martin J. Gruenberg regarding the FDIC's approval of deposit insurance for ILCs owned by Square and Nelnet, available at *https://www.fdic.gov/news/news/speeches/spmar1820b.html* (Gruenberg Square Statement), and *https://www.fdic.gov/news/news/speeches/spmar1820c.html* (Gruenberg Nelnet Statement).
4. *See* Proposed ILC Rule, *supra* note 1, at 17772–76; Brendan Pedersen, "14 years after Walmart, banks face a new ILC bogeyman," *American Banker* (Oct. 25, 2019), available on Westlaw at 2019 WLNR 32164813. In June 2008 (five months after the FDIC's moratorium expired), the FDIC approved deposit insurance for CapitalSource Bank, a newly-organized California ILC. The FDIC allowed CapitalSource's parent companies to engage "only in financial activities," and the FDIC required those companies to divest any "non-conforming investments" (investments not permitted by the BHC Act) within one year. Thus, the FDIC did *not* allow CapitalSource's parent companies to engage in commercial activities. The FDIC did not approve deposit insurance applications for any other ILCs until the FDIC approved Square's and Nelnet's applications on March 18, 2020. *See* Proposed ILC Rule, *supra* note 1, at 17773; and the FDIC's CapitalSource order dated June 17, 2008, ¶ 7 [hereinafter "FDIC CapitalSource Order"], available at *https://www.fdic.gov/regulations/laws/bankdecisions/depins/capital_source.pdf*.
5. Proposed ILC Rule, *supra* note 1, at 17773–74, 17776.
6. Brendan Pedersen, "Rakuten withdraws ILC application, plans to refile," *American Banker* (Mar. 23, 2020), available on Westlaw at 2020 WLNR 8486374 (quoting Rakuten's announcement).
7. Rakuten's global website ("About Us" and "Leadership"), available at *https://global.rakuten.com/corp/about/*.

8. Joe Adler, "GOP senator tries to block commercial firms from becoming banks," *American Banker* (Nov. 14, 2019), available on Westlaw at 2019 WL 34223566; Rachel Witkowski, "ABA voices 'serious concerns' about e-commerce firm's ILC bid," *American Banker* (July 26, 2019), available on Westlaw at 2019 WLNR 22961305.
9. *See* 12 U.S.C. 1843; Arthur E. Wilmarth, Jr., "Wal-Mart and the Separation of Banking and Commerce," 39 *Connecticut Law Review* 1539, 1566–73, 1587 (2007), available at http:*//ssrn.com/abstract=984103* [hereinafter Wilmarth, "Wal-Mart"].
10. Proposed ILC Rule, *supra* note 1, at 17772–73, 17780.
11. *Id.* at 17772–73; Wilmarth, "Wal-Mart," *supra* note 9, at 1550, 1569–73 (quoting 1993 CRS report on p. 1573).
12. Wilmarth, "Wal-Mart," *supra* note 9, at 1541–53, 1572 (quoting Sen. Garn's statement on April 10, 2006, during one of the FDIC's three public hearings on Walmart's application).
13. Fed. Deposit Ins. Corp., "Moratorium on Certain Industrial Loan Company Applications and Notices," 71 Fed. Reg. 43482, 43483 (Aug. 1, 2006) [hereinafter "2006 FDIC Moratorium Notice"].
14. Fed. Deposit Ins. Corp., "Moratorium on Certain Industrial Bank Applications and Notices," 72 Fed. Reg. 5290, 5291 (Feb. 5, 2007) [hereinafter "2007 FDIC Moratorium Extension Notice"].
15. Wilmarth, "Wal-Mart," *supra* note 9, at 1542–47, 1552–53; Arthur E. Wilmarth, Jr., "Subprime Crisis Confirms Wisdom of Separating Banking and Commerce," 27 *Banking & Financial Services Policy Report* No. 5, May 2008, at 1–2, available at http:*//ssrn.com/abstract=1253453* [hereinafter Wilmarth, "Subprime Crisis"); "Wal-Mart confirms it withdraws ILC application," *Reuters* (Mar. 16, 2007) (quoting Wal-Mart's announcement), available at *https://www.reuters.com/article/idUSIN20070316110341WMT20070316.*
16. Proposed ILC Rule, *supra* note 1, at 17772.
17. Wilmarth, "Wal-Mart," *supra* note 9, at 1569–73; *see also id.* at 1572 and note 181 (discussing the sparse and uninformative legislative history of Senator Garn's exemption for ILCs).
18. *Id.* at 1569–73 (quoting Senate Report No. 100-19 (1987) at 2, 8, 9, reprinted in 1987 U.S. Code Cong. & Ad. News 492, 498, 499).
19. *Id.* at 1571 (note 175) (summarizing floor statements by 11 Senators and House members).
20. *See id.* at 1584–86 (discussing Congress's passage of the 1999 law that prohibited further acquisitions of thrifts by commercial firms); *Kanikal v. Attorney General*, 776 F.3d 146 (3d Cir. 2015) (refusing to interpret the literal text of one federal statute to override the clearly intended purpose of another federal law because the second law's legislative history confirmed Congress's strong intent that the second law's policy should take priority). In the course of its opinion, the Third Circuit stated, "In resolving ambiguity, we must allow ourselves some recognition of the existence of sheer inadvertence in the legislative process." 776 F.3d at 152–53 & note 5 (quoting *Cass v. United States*, 417 U.S. 72, 83 (1974)).
21. 2006 FDIC Moratorium Notice, *supra* note 13, at 42482–83; 2007 FDIC Moratorium Extension Notice, *supra* note 14, at 5291–93.
22. *See* FDIC CapitalSource Order, *supra* note 4, ¶ 7, and the discussion of the CapitalSource order in note 4.
23. Board of Governors of the Fed. Res. Sys., Fed. Deposit Ins. Corp., and Office of the Comptroller of the Currency, *Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act* (Sept. 2016), at 28–29, 32–35 (Fed's recommendation that Congress should prohibit ownership of ILCs by commercial firms); *id.* at 52, 74 (FDIC's discussion of ILCs and recommendations to Congress) [hereinafter "2016 Joint Report to Congress and FSOC"], available at *https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160908a1.pdf.*
24. Proposed ILC Rule, *supra* note 1, at 17772–73, 17775–76; Wilmarth, "Wal-Mart," *supra* note 9, at 1549–53, 1572–73, 1597, 1615–16.
25. Proposed ILC Rule, *supra* note 1, at 17776; *see also id.* at 17782.
26. 2016 Joint Report to Congress and FSOC, *supra* note 23, at 34 (note 116) (Fed's statement); *id.* at 52 (FDIC's statement).
27. Congressional Oversight Panel, March Oversight Report, *The Unique Treatment of GMAC under the TARP* (Mar. 10, 2010) [hereinafter "COP March 2010 Report"], available at *https://cybercemetery.unt.edu/archive/cop/20110401232836/http://cop.senate.gov/reports/library/report-031110-cop.cfm*; Saule T. Omarova, "From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act," 89 *North Carolina Law Review* 1683, 1756–61 (2011); *see also* the Fed's order, dated Dec. 24, 2008, approving GMAC's emergency conversion into a bank holding company, available at *https://www.federalreserve.gov/newsevents/pressreleases/files/orders20081224a1.pdf.*
28. Arthur E. Wilmarth, Jr., "A Two-Tiered System of Regulation Is Needed to Preserve the Viability of Community Banks and Reduce the Risks of Megabanks," 2015 *Michigan State Law Review* 249, 257–64, available at *http://ssrn.com/abstract=2518690*; Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report* (Jan. 2011) [hereinafter "FCIC Report"], at xix–xx, 8, 23, 53–56, 63–66, 88–89, 129–34, 149–54, 188–95, 202–04, 256–59, 277–79, 296–98, 325–28, 333–41, 353–55, 374–77, 382–86, available at *https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf*; *see also* the Fed's order, dated Nov. 26, 2008, approving Bank of America's acquisition of Merrill Lynch, available at *https://www.federalreserve.gov/newsevents/pressreleases/orders20081126a.htm.*
29. FCIC Report, *supra* note 28, at xix–xx, xxiv–xv, 23, 42–44, 50–56, 61–66, 88–89, 130–34, 140–46, 150–54, 166–70, 192–93, 202–04, 226–27, 235–38, 296–300, 339, 353–56, 360–63, 371–79; *see also* the Fed's orders, dated Sept. 22, 2008, approving the emergency conversions of Goldman Sachs and Morgan Stanley into bank holding companies, available at *https://www.federalreserve.gov/newsevents/pressreleases/orders20080922a.htm*; Better Markets, "Goldman Sachs Failed 10 Years Ago Today: Email shows Goldman admitted it was 'toast' and only survived due to government bailouts" (Sept. 20, 2018), available at *https://bettermarkets.com/newsroom/goldman-sachs-failed-10-years-ago-today*; Matt Taibbi, "Turns Out That Trillion-Dollar Bailout Was, In Fact, Real," *Rolling Stone* (Mar. 18, 2019), available at *https://www.rollingstone.com/politics/politics-features/2008-financial-bailout-809731/.*
30. FCIC Report, *supra* note 28, at 345–46, 358–59, 371, 374; Jeff Gerth, "Paulson Book: Behind the Scenes, GE's Top Exec

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31. COP March 2010 Report, *supra* note 27, at 67–70; Damian Paletta, Serena Ng & Randall Smith, "The CEO Left Off the Lifeboat: CIT's Peek Staked It All on a Bailout," *Wall Street Journal* (July 18, 2009), at A1; Meena Thiruvengadam, "TARP Stake in CIT Is Wiped Out," *Wall Street Journal* (Feb. 11, 2010), at C6; Dan Wilchins & Elinor Comlay, "CIT files for prepackaged bankruptcy," *Reuters* (Nov. 1, 2009), available at *https://www.reuters.com/article/us-cit/cit-group-files-for-prepackaged-bankruptcy-idUSTRE5A01NX20091101*; *see also* the Fed's order, dated Dec. 22, 2008, approving CIT's emergency conversion into a bank holding company, available at *https://www.federalreserve.gov/newsevents/pressreleases/files/orders20081222a1.pdf*.
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45. Proposed ILC Rule, *supra* note 1, at 17773.
46. Wilmarth, "Wal-Mart," *supra* note 9, at 1595 (citing the July 12, 2006 statement of FDIC General Counsel Douglas H. Jones).
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50. *Id.* at 1545–52, 1588–93; *see also* 2016 Joint Report to Congress and FSOC, *supra* note 23, at 32–33 (Fed's statement of concerns about permitting commercially-owned ILCs to gain access to the federal "safety net" for banks).
51. Wilmarth, "Wal-Mart," *supra* note 9, at 1576–78, 1594–98; Wilmarth, "Subprime Crisis, *supra* note 15, at 8–9.
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59. *See id.* at 17778–82, 17785–86 (discussing and quoting proposed 12 C.F.R. 354.3 and 354.4).
60. *See Securities Industry Ass'n v. Board of Governors*, 839 F.2d 47, 67–68 (2d Cir.) (invalidating the "market share limitation" imposed by the Fed on broker-dealer subsidiaries of bank holding companies because that limitation was beyond the Fed's statutory authority), *cert. denied*, 486 U.S. 1059 (1988).
61. *See* 2016 Joint Report to Congress and FSOC, *supra* note 23, at 17–22, 32–34 (Fed's discussion of the FDIC's lack of consolidated supervisory authority over parent companies and affiliates of ILCs); *see also* Wilmarth, "Wal-Mart," *supra* note 9, at 1613–17 (discussing the same subject).
62. 2016 Joint Report to Congress and FSOC, *supra* note 23, at 33–34 (Fed's discussion).
63. *Id.* at 52 (FDIC's discussion).
64. 2007 FDIC Moratorium Extension Notice, *supra* note 14, at 5293*; see also* Fed. Deposit Ins. Corp., "Industrial Bank Subsidiaries of Financial Companies," 72 Fed. Reg. 5217, 5222–23 (Feb. 5, 2007) (explaining that the supervisory commitments proposed by the FDIC in 2007 would apply to ILC parent companies that "engaged only in financial activities"; the proposed commitments would *not* apply to "companies engaged in commercial activities" because commercial firms would be subject to the FDIC's extended moratorium on ILC acquisitions).
65. Wilmarth, "Road to Repeal," *supra* note 34, at 445–49, 460–64, 519–24, 530–47; Wilmarth, "Wal-Mart," *supra* note 9, at 1617–18; *see also* FCIC Report, *supra* note 28, at xviii, xxiii–xxvii, 3–4, 9–17, 20–23, 44–51, 54–56, 75–80, 92–101, 111–14, 125–26, 150–55, 170–74, 187–89, 197–200, 204–06, 279–83, 288–91, 302–08, 328–52; Lev Menand, "Too Big to Supervise: The Rise of Financial Conglomerates and the Decline of Discretionary Oversight in Banking," 103 *Cornell Law Review* 1527, 1551–74, 1583–88 (2018).
66. For discussions of the second, third, and fourth problems described above, *see* Wilmarth, "Wal-Mart," *supra* note 9, at 1618–21; Wilmarth, "Subprime Crisis," *supra* note 15, at 14; Statement of E. Gerald Corrigan, President, Federal Reserve Bank of NY, on April 11, 1991, before the Subcommittee on Telecommunications and Finance of the House Committee on Energy and Commerce, reprinted in 77 Fed. Res. Bull. 411, 418–20 (1991).
67. *United States v. Third National Bank in Nashville*, 390 U.S. 171, 184–85 (1968); *see also Vial v. First Commerce Corp.*, 564 F. Supp. 650, 666 (E.D. La. 1983).
68. 2006 FDIC Moratorium Notice, *supra* note 13, at 43482–83; 2007 FDIC Moratorium Extension Notice, *supra* note 14, at 5291–93.
69. 2006 FDIC Moratorium Notice, *supra* note 13, at 43483; *see also* 2007 FDIC Moratorium Extension Notice, *supra* note 14, at 5293; 2016 Joint Report to Congress and FSOC, *supra* note 23, at 28–29, 32–35.
70. *See* Proposed ILC Rule, *supra* note 1, at 17774–75.
71. *See id.* at 17771–72, 17776, 17782.
72. Only two of the twenty "Questions" in the Proposed ILC Rule refer to public interest factors specified in the FDI Act, and those Questions do not deal with the risks and public policy concerns identified by the FDIC in July 2006 and January 2007. *See* Proposed ILC Rule, *supra* note 1, at 17782–83 ("Question 18," asking for comments on an unrelated issue involving "competitive effects," and "Question 19," asking for comments on an unrelated issue involving "convenience and needs"). Neither "Question 18" nor "Question 19" refers to the FDIC's moratorium on acquisitions of ILCs by commercial firms or the FDIC's decision to change its policy on such acquisitions.
73. The APA's public notice requirement, 12 U.S.C. 553(b)(3), ensures that (1) a proposed agency rule will receive adequate scrutiny from a diversity of public views, and (2) affected parties will be given a fair opportunity to present their objections to the proposed rule. *Daimler Trucks North America LLC v. EPA*, 737 F.3d 95, 100 (D.C. Cir. 2013). The "adequacy" of an agency's notice of proposed rulemaking "must be tested by determining whether it would fairly apprise interested persons of the 'subjects and issues' before the agency." *Prometheus Radio Project v. FCC*, 373 F.3d 372, 411 (3d Cir. 2004) (quoting *American Iron & Steel Institute v. EPA*, 568 F.2d 284, 293 (3d Cir. 1977)). "A notice of proposed rulemaking is legally inadequate if it does not 'adequately frame the subjects for discussion.'" *Citibank Federal Savings Bank v. FDIC*, 836 F. Supp. 3, 7 (D.D.C. 1993) (quoting *Connecticut Power & Light Co. v. NRC*, 673 F.2d 525, 533 (D.C. Cir. 1982)).
74. *Organized Village of Kake v. U.S. Dept. of Agriculture*, 795 F.3d 956, 966, 968 (9th Cir. 2015) (en banc) (quoting *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515, 516 (2009)).