

A NEW LOOK AT THE PERFORMANCE OF INDUSTRIAL LOAN CORPORATIONS

James R. Barth and Yanfei Sun

Department of Finance
Auburn University

JANUARY 2018

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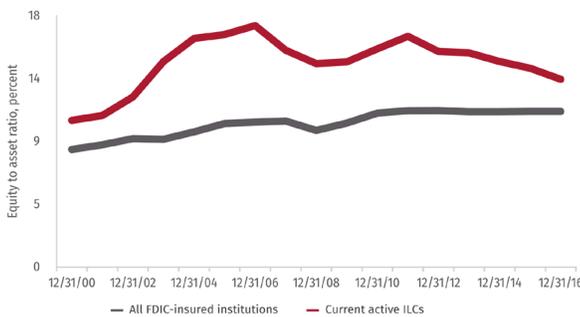


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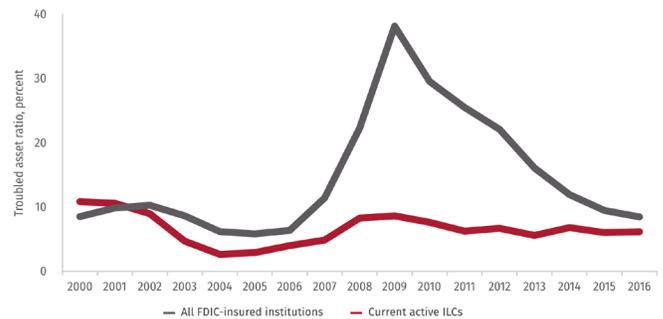
The Barth Study Finds ILCs Thriving

James R. Barth and Yanfei Sun of Auburn University conducted a study for the Utah Center for Financial Services (UCFS) on how Industrial Loan Companies (ILCs a.k.a Industrial Banks) have performed compared to other FDIC insured institutions. The findings demonstrate ILCs perform better than all other FDIC institutions.

Industrial loan companies over time better capitalized than all FDIC-insured institutions



Industrial loan companies have lower troubled asset ratios than all FDIC-insured institutions



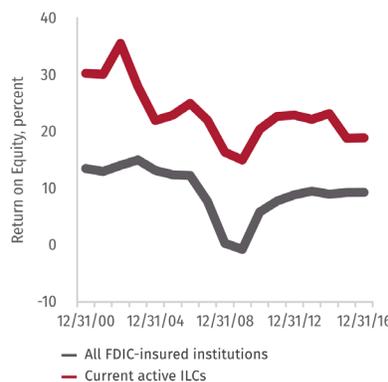
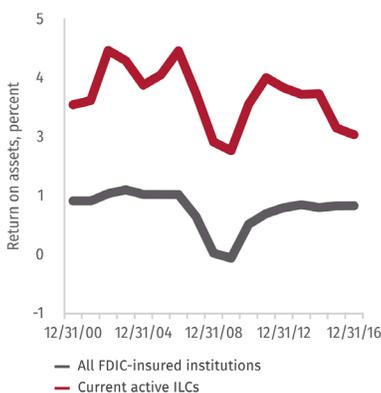
Industrial loan companies better capitalized and more profitable than all FDIC-insured institutions

Q4 2016

| | Capital ratios | | Profitability ratios | |
|-------------------------------|--------------------------|---------------------------------|----------------------|--------------|
| | Equity capital to assets | Tier 1 risk-based capital ratio | ROA | ROE |
| Financially owned ILCs | 13.0% | 19.3% | 2.60% | 19.5% |
| Commercially owned ILCs | 15.8% | 17.6% | 2.00% | 13.8% |
| All FDIC-insured institutions | 11.1% | 13.0% | 1.04% | 9.3% |

- ILCs have a hundred year history of supporting America's financial system, providing credit during the Great Depression and the severe 2007/2009 financial crisis.
- ILCs are subject to the same regulatory oversight as well as all the compliance and safety and soundness exams as other banks.
- With \$24 trillion in net worth, the non-financial corporate businesses possess an enormous pool of funds for ILCs that could be tapped to grow the sector, provide credit, create jobs and promote prosperity.

Industrial loan companies over time outperform all FDIC-insured institutions



UTAH CENTER FOR FINANCIAL SERVICES

utahcenter.org

AL LANDON

Executive Director

(435) 901-1040

al.landon@eccles.utah.edu

**A New Look at the Performance of Industrial Loan Companies
and Their Contribution to the US Banking System**

James R. Barth and Yanfei Sun
Department of Finance
Auburn University

JANUARY 2018

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EXECUTIVE SUMMARY

Industrial loan companies (ILCs), also known as industrial banks, got their start in the early 1900s as local consumer finance companies for industrial workers. Their creator, a young law school graduate from the University of Virginia who had studied economics and moral philosophy, found a way to fill a banking niche for his clients who had no collateral for loans. Chartered first in Virginia and then by other states, these institutions were restricted in their operations, although the restrictions varied by charter and were modified through the years. The loan companies survived the Great Depression and, indeed, increased their lending throughout the period—a role they reprised during the most recent severe financial crisis, when other financial institutions were unable or unwilling to do so.

Like banks, ILCs are federally insured these days, making them subject to Federal Deposit Insurance Corporation (FDIC) regulation, as well as the banking regulations in the states in which they are chartered. Data show that they perform very favorably compared to all other FDIC-insured institutions (5,865 in all) in terms of such performance indicators as return on assets, return on equity, capital-to-asset ratios, the soundness of their loan portfolios, and the efficiency of their operations. In fact, as this report will show, more than half of the active ILCs rank in the top 10% of *all* FDIC-insured institutions for return on assets; and nearly half ranked in the top 10% in terms of capital-asset ratios.

There is one characteristic of ILCs that has long provoked great debate, and this is the fact that the owner of an ILC may be a commercial business, and not necessarily a financial company. To the rest of the world, this debate is moribund; the US is one of just four countries—out of 142—that prohibit ownership of banks by commercial firms, according to a World Bank survey. But opponents of mixing commerce and finance argue, without sufficient supporting evidence, that commercial ownership of these institutions may lead down a slippery slope toward monopolization, unfair business advantages, the ruin of community banks, and unregulated mayhem.

As a result, and despite the fact that no commercially-owned ILC has ever failed over the 100-year history of the group, pressure has been brought to bear on legislators—and the channels to ownership by diversified commercial companies have been slowly choked off. Changes to law in the 1950s limited a commercial firm from owning more than one kind of bank; then in the 1960s commercial companies could own only one thrift (another kind of “special” institution); by the 1990s, they couldn’t own a single thrift unless it was one they already owned. After ILCs became eligible for FDIC insurance under the Garn-St Germain Act of 1982, Congress enacted the Competitive Equality Banking Act (CEBA) in 1987 stating that any institution having such insurance now fell under the definition of a bank, which meant that its parent company had to be a bank holding company, which excluded commercial firms. Existing ILCs that had obtained FDIC insurance, however, were exempted from the latter law, but the weight of so much limiting legislation has reduced the ILC industry to just 25 institutions from a high of 239.

Again, in 2006, in response to public, industry, and regulatory pressure, the FDIC imposed a moratorium on new ILCs applications for federal insurance coverage. That moratorium was extended once and then again, this time by Congress in 2010, under the

Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act). Congress also instructed the Government Accounting Office (GAO) to conduct a study of the ILC industry and the implications of removing the ownership exemptions once and for all. But GAO made no such recommendations. In fact, it reported that the regulatory and supervisory practices of the Office of the Comptroller of the Currency (OCC) —which charters, regulates, and supervises national banks—are like the FDIC’s own, meaning they are applicable whether or not the financial institution is owned by a bank holding company or some other kind of company. The GAO also reported that while the Federal Reserve wanted to kill the exemptions altogether, FDIC officials remained confident of their ability to adequately supervise the active ILCs.

It is important here to emphasize the government’s system of sometimes overlapping and dueling regulatory jurisdictions. The OCC charters and regulates national banks, and the Federal Reserve regulates state-chartered banks (and their holding companies) that are members of the Federal Reserve System. The state-chartered ILCs are not member banks. The GAO study did not conclude that this should change.

With the 2013 expiration of a moratorium on ICL applications, more commercial firms have expressed their intention of applying for ICL ownership. Many no doubt have the expertise, resources, capital, and perhaps even established credit businesses to do so. The total net worth of US non-financial corporate businesses was \$24 trillion as of Q1 2017. If even a small fraction of this capital were invested in ILCs, it could contribute to an expansion in the availability of credit, with positive ramifications for U.S. economic growth. It would also align the US with international norms that allow the mixing of banking and commerce, and give it greater capacity to compete globally. This suggests that legislators, regulators, and other officials should be careful not to put these particular US financial institutions at a competitive disadvantage.

I. INTRODUCTION

In most of the US, people may not be familiar with industrial loan companies (ILCs), known also as industrial banks. Yet these financial institutions have been around for more than a century and predate the establishment of the Federal Reserve in 1913. The label is a nod to their original mission, which was making loans to industrial workers who couldn't obtain credit elsewhere. The original ILCs were local finance companies operating through retail offices. Over time, ILCs evolved along with other financial institutions and expanded their customer base and geographical reach. Today they are modern financial institutions, serving nationwide markets, some operating without branches, and instead obtaining funds and delivering financial services electronically. They are all FDIC-insured as well, and offer a variety of financial services, although some still cater to a narrower group of customers than the typical bank.ⁱ These banks are concentrated today in seven states, and Utah most notably, for reasons that shall be discussed in this report.

If the term does ring familiar, it's likely because it brings to mind a flurry of news stories back in 2005, when retail giant Wal-Mart filed an application to obtain a charter for an industrial loan company and applied, as required by law, for deposit insurance from the Federal Deposit Insurance Corporation (FDIC). Other commercial (i.e., non-financial) firms like BMW, Toyota, General Electric, and Harley-Davidson, already owned ILCs, but Wal-Mart's application triggered a shockwave among community banks who joined in protest with others opposed the application.ⁱⁱ Utah had already approved the charter, but in response to outcry, the FDIC held public hearings on Wal-Mart's application and declared a six-month moratorium on new ILC insurance applications in July 2006, and then extended it again, to January 2008. The controversy was eventually defused when Wal-Mart withdrew its application for federal deposit insurance before the FDIC made a ruling.

A few years later, in July 2010, amid the aftermath of the severe financial crisis and the reform overhaul taking place in Washington, D.C., the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act) imposed another moratorium, this one for three years, on the approval of federal deposit insurance for new ILCs owned or controlled by commercial firms. Congress also instructed the Government Accountability Office (GAO) to evaluate of the role and regulation of ILCs, as well as other financial institutions (e.g., limited-purpose credit card banks, municipal deposit banks, and trust banks) not considered banks under the Bank Holding Company Act (BHC Act) of 1956. The purpose of the assignment, in the words of the GAO, was "to study the implications of removing the exemptions" on ILCs that keep them from falling under the BHC Act, and thus keep the companies that own them free from regulation and oversight of their own operations and activities. After the moratorium expired in July 2013, Square Inc. obtained an ILC charter and applied for FDIC insurance but no decision had been made regarding the insurance application as of the date of this report.

In fact, the only way a commercial or retail company could own a depository institution eligible for FDIC insurance was to establish or acquire a financial institution that is *not* defined as a bank under the 1956 law. (A "bank" subject to the act is an entity that offers both demand deposits and commercial loans; most ILCs accept deposits and make consumer loans but don't offer demand deposits, according to the GAO.) The GAO released its findings in January 2012

without recommending the repeal of any exemptions for ILCs owned by commercial firms. These two topics will be discussed at greater length in this report.

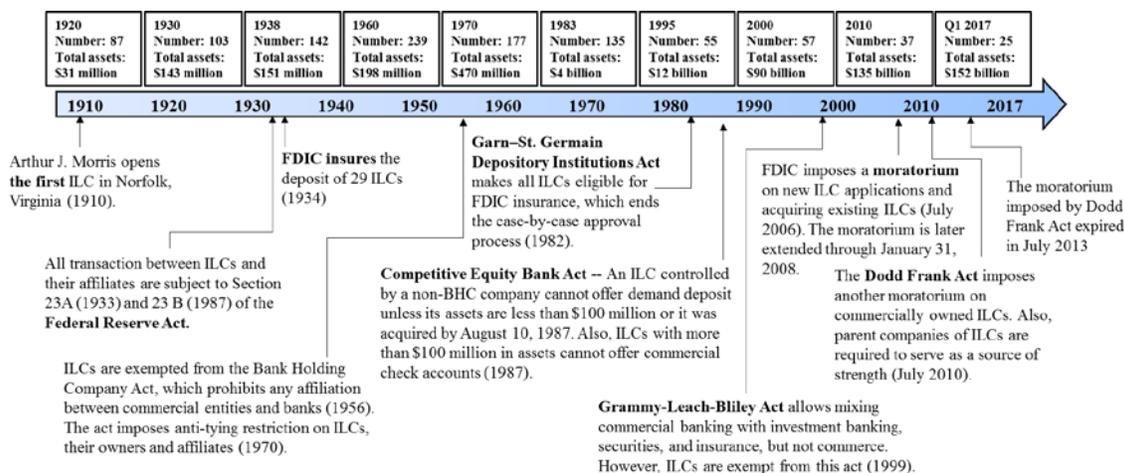
In this report we examine the differences between commercially-owned ILCs and those owned by financial firms,ⁱⁱⁱ and offer a current assessment of ILC performance, paying particular attention to commercially-owned ILCs, and their contribution to the US banking system. The rules governing their oversight, especially relative to bank regulation, occupy a significant part of this evaluation as we consider why the ILC ownership concept causes a stir when they're subject to the same FDIC regulation as any other banking institution. Most important, we look at the capitalization and performance of ILCs over the past few decades relative to the banking industry more generally. And because all ILCs are state-chartered, we specifically compare their size and performance to other state-chartered banks.

II. A CENTURY-OLD INDUSTRY

A Brief History of ILCs

Figure 1 provides a timeline of development of the ILC industry, from a single institution in 1910 in Norfolk, Virginia, to a high of 239 in 1960, before dropping to 25 in Q1 2017. These numbers have been shaped by legislation and regulation, rather than simply performance or risk, as will also be discussed.

Figure 1. An ILC industry timeline



Sources: Saulnier (1940), state regulatory authorities, FDIC.

It was attorney Arthur J. Morris who created a new industry in 1910, with the establishment of his Fidelity Savings and Trust Company in Norfolk, Virginia. Its mission was to provide loans to local industrial workers who had stable jobs but little or no collateral to offer. At the time, commercial banks primarily catered to businesses, while savings and loan associations focused on home loans. Mutual savings banks were largely confined to the New England states. This local vacuum provided an ideal opening for Morris, who had been lending funds to his clients out of pocket and recognized the greater need for a bank to assist the underbanked market.

When he applied for a state charter for his new bank, the Virginia Corporation Commission granted it, with this reply from its chairman: “I have carefully considered your application for a charter for your hybrid and mongrel institution. Frankly, I don’t know what it is. It isn’t a savings bank; it isn’t a state or national bank; it isn’t a charity. It isn’t anything I ever heard of before. Its principles seem sound however, and its purpose admirable. But the real reason that I am going to grant a charter is because I believe in you.”^{iv}

Morris decided at the outset to try to copyright his particular type of institution as a Morris Plan bank,^v but he never obtained that long-sought copyright for his lending model, and similar institutions sprouted up in various states, calling themselves, variously, industrial banking companies, industrial loan and thrift companies, and industrial loan associations. The differences in their names had to do with compliance with state chartering and licensing laws under which they were allowed to operate.^{vi} This early confusion has complicated the task of determining the exact number and assets of these institutions over their early history. Even though they were quite similar in overall orientation, with industrial workers as their primary customers, they offered different services to their particular mix of customers. To simplify matters, we refer to them simply as industrial loan companies throughout this report.^{vii}

To this day, ILCs remain subject to state charter or licensing, and these laws vary by state. In the early years, some states prohibited ILCs from accepting deposits, which meant they had little choice but to offer investment certificates, also called thrift certificates, to fund themselves. Other states, however, gave more operational leeway to their ILCs, which were allowed to accept either deposits or the thrift certificates, and sometimes both. Most tended to rely mainly on one or the other type of funding, in addition to self-funding with equity capital. For example, in Nebraska, the certificate was virtually the only source of ILC funding other than equity capital. By contrast, ILCs in New York relied almost entirely on deposits and equity capital.

Today there are still some non-depository ILCs, prohibited by state law from offering their customers demand deposit accounts. All depository ILCs have been FDIC-insured institutions since 1982, making them subject to federal as well as state supervision.

In terms of number of institutions and total assets, the banking industry has always dwarfed the ILC industry. In 1920, for example, there were just 87 ILCs, with \$31 million in total assets; in that same year there were some 30,000 commercial banks having nearly \$50 billion in total assets. But the number of ILCs and their total assets increased for several decades thereafter so that during the 1930s more than a hundred were in operation.

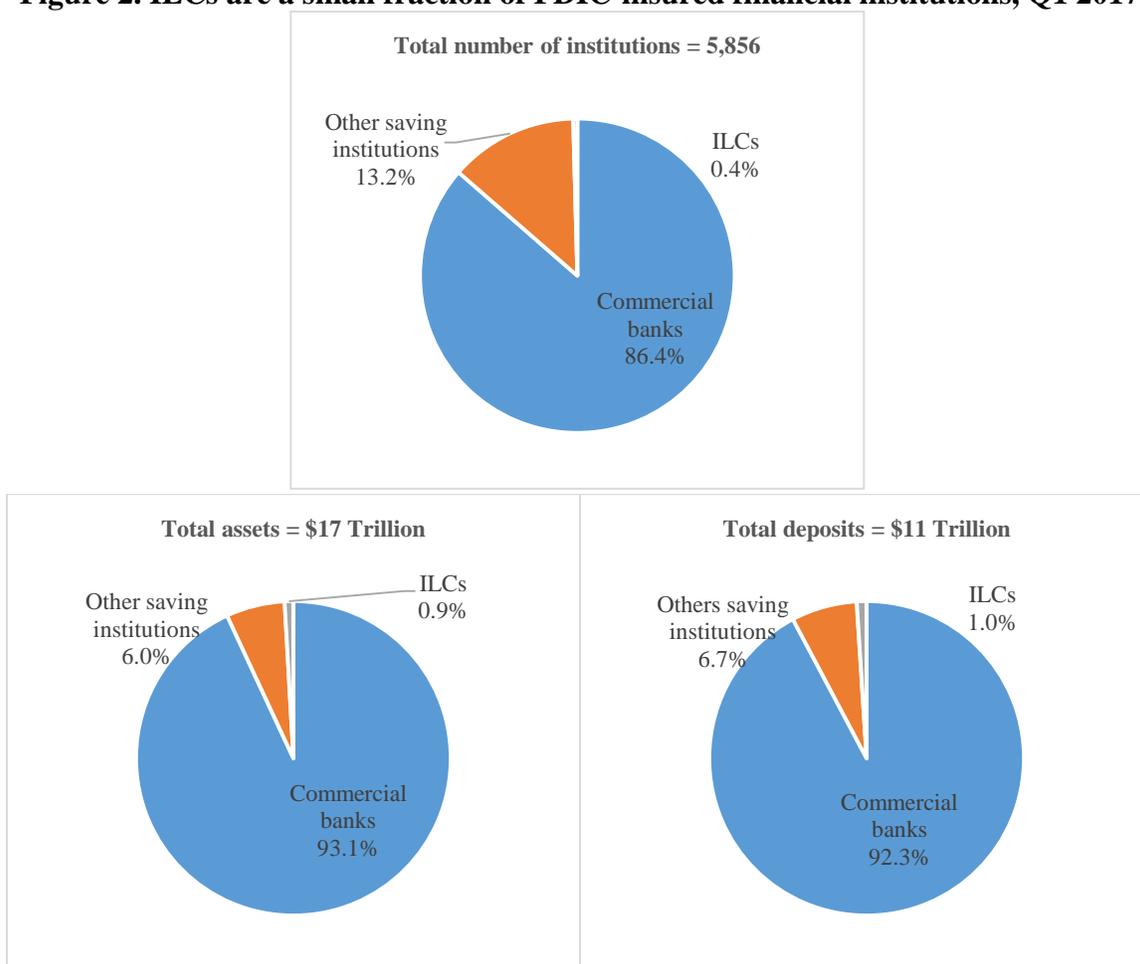
The Great Depression proved to be a pivotal period for ILCs; banks were failing in large numbers, but the ILCs, despite their relatively small role in the credit markets, became the leading providers of consumer credit to workers. Thus, from 1934 to 1938, total ILC assets and loans grew by 65% and 81%, respectively, while assets and loans at commercial banks grew, respectively, by only 22% and 9%. In addition, loans accounted for 74% of the ILC assets for the period, whereas for commercial banks this figure was 29%.^{viii}

ILCs also increased in number after the 1930s, eventually reaching a high of 254 institutions with \$408 million in assets in 1966 (though this was still low relative to more than

13,000 commercial banks holding \$403 billion in assets that same year). After 1966 the number of ILCs declined steadily, to 130 in 1977, before increasing again to 155 in 1983. Once again, the number declined, to 25 ILCs in Q1 2017, compared to 5,856 other banking institutions, or 0.4% of the total number of FDIC-insured institutions (see Figure 2 and Appendix Figure 1).

The total assets of ILCs also grew sharply, from \$3.8 billion in 1983 to \$9.0 billion a decade later, and eventually reached an all-time high of \$264 billion in 2007 before dropping to \$152 billion in Q1 2017. This compares to \$17 trillion of other banking institutions, or 1.0% of the total assets of institutions for Q1 2017 (see Figure 2 and appendix Figure 1).^{ix}

Figure 2. ILCs are a small fraction of FDIC-insured financial institutions, Q1 2017



Source: FDIC.

Table 1 shows the decline in both numbers and assets of ILCs from 2004 through Q1 2017. The drop was due in large part to a number of ILCs converting to commercial bank charters in response to the most recent financial crisis and severe recession. In terms of their numbers, 42 ILCs—32 financially owned and 10 commercially owned—converted and closed. Of the 32 financially owned, 13 (40%) converted to commercial banks; and of the 10 commercially owned, 5 (50%) converted. Voluntary closures accounted for the second-largest

number of declines for both ILC types: 10 of the financially-owned and 4 of the commercially-owned ILCs.

Over the period there were just two failures, both of which were financially-owned ILCs: Advanta Bank Corp., which had provided loans to small business and failed in March 2010, as its clients suffered the effects of the financial crisis and subsequent recession; and Security Savings Bank, which had specialized in commercial lending and failed in February 2009, under the same adverse effects.

Table 1 also shows that two of the four largest ILCs converted to commercial bank charters, Goldman Sachs Bank USA and Morgan Stanley Bank, and did so when their parent companies became bank holding companies (BHCs) in the fall of 2008. Of the other two largest ILCs, GMAC Bank converted to a commercial bank charter in October 2009, while GE Capital Bank voluntarily closed in April 2016. Both of these institutions took their actions as the economy was slowly recovering from the financial crisis and severe recession.

Table 1. Closed and converted ILCs, 2004–Q1 2017

| Industrial loan companies | State | Inactive date | Year-end assets as of the year before the inactive date (\$ millions) | Inactive type | Parent company |
|----------------------------------|--------------|----------------------|--|--------------------------|--------------------------------------|
| Financially-owned ILCs | | | | | |
| Finance and Thrift Company | CA | 7/31/2015 | 122 | M&A | |
| First Security Business Bank | CA | 12/26/2014 | 89 | VC | First American Financial Corporation |
| Capitalsource Bank | CA | 4/7/2014 | 8,079 | M&A | Capitalsource |
| Capmark Bank | UT | 12/31/2013 | 1,358 | VC | Capmark Financial Group |
| Centennial Bank | CA | 4/30/2013 | 546 | M&A | |
| Circle Bank | CA | 11/14/2012 | 316 | M&A | Circle Bancorp |
| Fireside Bank | CA | 3/30/2012 | 26 | VC | Unitrin Inc. |
| Woodlands Commercial Bank | UT | 12/30/2011 | 2,557 | VC | Lehman Brother Holdings |
| Golden Security Bank | CA | 8/23/2011 | 147 | M&A | No Affiliation |
| ADB Bank | UT | 12/30/2010 | 54 | VC | Leavitt Group Enterprises |
| Arcus Bank | UT | 9/20/2010 | 189 | VC | Wellpoint Inc. |
| Advanta Bank Corp. | UT | 3/19/2010 | 1,526 | Failed | Advanta |
| Trust Industrial Bank | CO | 12/1/2009 | 798 | VC | Fiserv |
| Merrill Lynch Bank USA | UT | 7/1/2009 | 67,995 | M&A | Merrill Lynch |
| Republic Bank Inc. | UT | 5/28/2009 | 554 | CB | No Affiliation |
| 5 Star Bank | CO | 5/1/2009 | 157 | CB | Armed Forces Benefit Association |
| Silvergate Bank | CA | 2/28/2009 | 327 | CB | Silvergate Capital |
| Security Savings Bank | NV | 2/27/2009 | 238 | Failed | Strampede Capital LLC |
| Marlin Business Bank | UT | 1/31/2009 | 84 | CB | Marlin Business Services |
| Tamalpais Bank | CA | 1/30/2009 | 702 | CB | Tamalpais Bancorp |
| Cit Bank | UT | 12/22/2008 | 3,117 | CB | Cit Group |
| Goldman Sachs Bank USA | UT | 9/26/2008 | 21,630 | CB | Goldman Sachs |
| Morgan Stanley Bank | UT | 9/23/2008 | 38,530 | CB | Morgan Stanley |
| Fremont Investment & Loan | CA | 7/25/2008 | 5,657 | VC | Fremont General Corp. |
| Home Bank of California | CA | 7/11/2008 | 148 | CB | La Jolla Savers And Mortgage Fund |
| Home Loan Industrial Bank | CO | 6/1/2008 | 41 | CB | Home Loan Investment Co. |

| Industrial loan companies | State | Inactive date | Year-end assets as of the year before the inactive date (\$ millions) | Inactive type | Parent company |
|--|-------|---------------|---|------------------|---|
| First Financial Bank | CO | 9/19/2007 | 152 | VC | First Data Corp. |
| Independence Bank | CA | 10/22/2006 | 133 | CB | Pacific Premier Bancorp |
| Universal Financial Corp. | UT | 9/30/2006 | 570 | CB | Citicorp Banking Corporation |
| Associates Capital Bank Inc. | UT | 9/15/2005 | 373 | VC | Associates First Capital Corporation |
| Franklin Bank of California | CA | 11/23/2004 | 2 | M&A | Cass Information Systems Inc. |
| Affinity Bank | CA | 10/7/2004 | 841 | CB | Affinity Bank Holdings Inc. |
| Subtotal | | | 157,058 | | |
| Commercially-owned ILCs | | | | | |
| GE Capital Bank | UT | 4/21/2016 | 21,174 | VC | General Electric Company |
| Target Bank | UT | 9/28/2015 | 119 | VC | Target Corporation |
| Transportation Alliance Bank Inc. | UT | 8/31/2015 | 603 | CB | Tab Bank Holdings Inc. |
| GMAC Bank | UT | 10/1/2009 | 28,404 | CB | Ally Financial |
| Escrow Bank USA | UT | 6/21/2008 | 35 | CB | Capmark Financial Group |
| Volkswagen Bank USA | UT | 10/29/2007 | 665 | VC | |
| Volvo Commercial Credit Corp. of Utah | UT | 1/16/2007 | 3 | CB | NHB Holdings Inc. |
| American Investment Financial | UT | 3/31/2004 | 73 | M&A | Leucadia National Corporation |
| GECC Financial Corporation | HI | 12/31/2003 | 9 | CB | GE Capital Hawaii Inc. |
| Yourbank.Com | UT | 3/24/2002 | 22 | VC | |
| Subtotal | | | 51,110 | | |
| Total | | | 208,168 | | |

Sources: FDIC (<https://Research.Fdic.Gov/Bankfind/>), National Information Center (www.Ffiec.Gov/Nicpubweb/Nicweb/Searchform.aspx).

Note: VC = voluntarily closed; CB = converted to commercial bank. M&A = merged with or acquired by other institutions.

The 42 ILCs held \$208 billion in total assets before they ceased operations, and by Q1 2017, the 25 ILCs still in business had \$152 billion in assets.^x Again, as shown in Figure 2, the ILC industry now represents about 0.4% of the total number of FDIC-insured institutions and roughly 1.0% of both total assets and total deposits of all the FDIC-insured institutions.

Commercial banks still dominate all other financial institutions in number, assets, and deposits. This striking disparity helps explain why so few people are aware of ILCs. More important, it clearly indicates that the ILC industry has never been a threat to banking industry stability. Table 1 in the appendix provides recent data for both financially- and commercially-owned ILCs on their share of (a) total deposits and (b) insured deposits of all FDIC-insured institutions over the period 2000–Q1 2017. Of note, the share of both total deposits and insured deposits in commercially-owned ILCs has never exceeded 0.43% of all deposits in any year during the period.

In the early years of the ILC industry, at least 40 states chartered or licensed depository and/or non-depository ILCs. During the past decade, however, this number has dropped to just seven states, and as of Q1 2017, only six states still had active FDIC-insured ILCs.

The rapid decline can be traced directly to CEBA, which broadened the original 1956 BCH Act “bank” definition to now include any institution that was FDIC-insured—meaning that going forward, new ILCs would fall under the definition of a bank, which would preclude ownership by non-financial businesses. Congress and the Federal Reserve did exempt existing ILCs, and non-financial (commercial) owners could still own them, but *only* if the ILCs had been chartered in states that had a statute in effect (or under consideration) that required (or that would require) those ILCs to be FDIC-insured as of March 5, 1987, some five months before the bill was signed into law.

Thus seven states with existing ILCs were “grandfathered” under the exemption and permitted to charter new ILCs, but the last ILC in Colorado became inactive in 2009, dropping that state from the small group.^{xi} The remaining states with active depository ILCs include: California, Hawaii, Indiana, Minnesota, Nevada, and Utah; see Tables 2a and 2b in the appendix for data by state on both the number and assets of ILCs from 2000 to Q1 2017. Importantly, despite their exemption, these ILCs are subject to the state and FDIC regulations.

Of the six states, Figures 3a and 3b show that Utah ranks a clear first in both number of institutions and total assets every year from 2000 to Q1 2017. California ranks second in the number of institutions for most of the period but fell to third place after Nevada in 2015. California also ranked second in terms of total assets until 2009, when again it fell behind Nevada.

Figure 3a. ILC distribution by state, 2000–Q1 2017

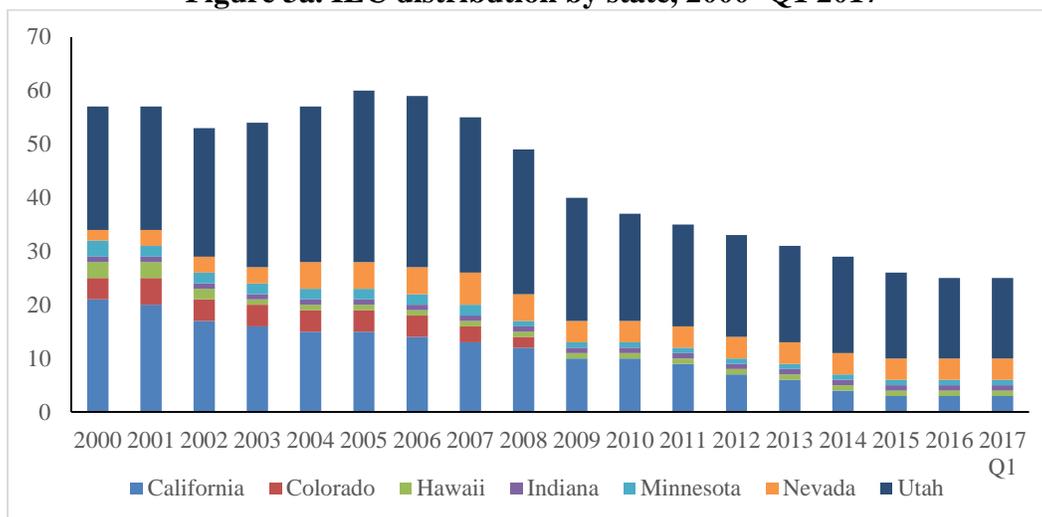
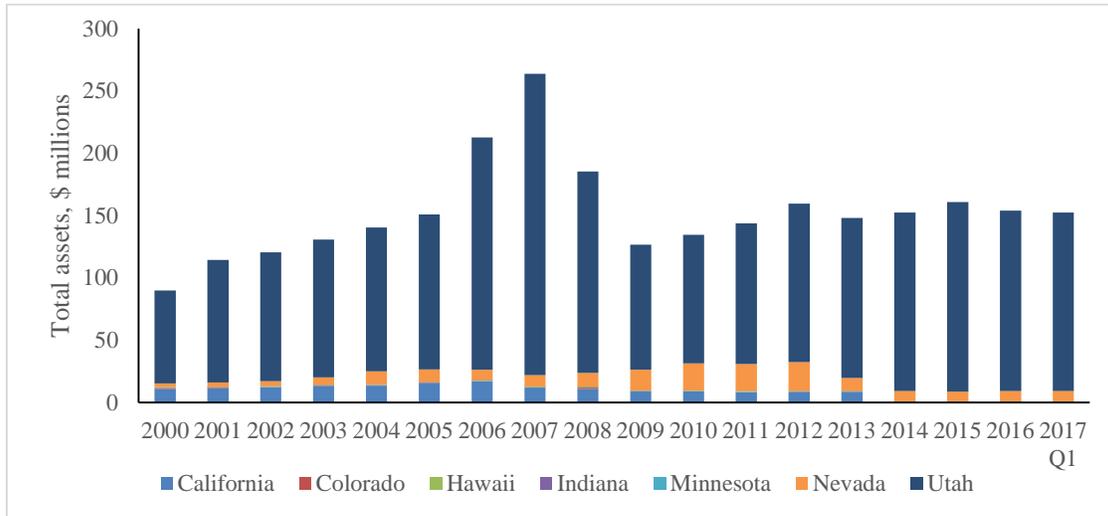


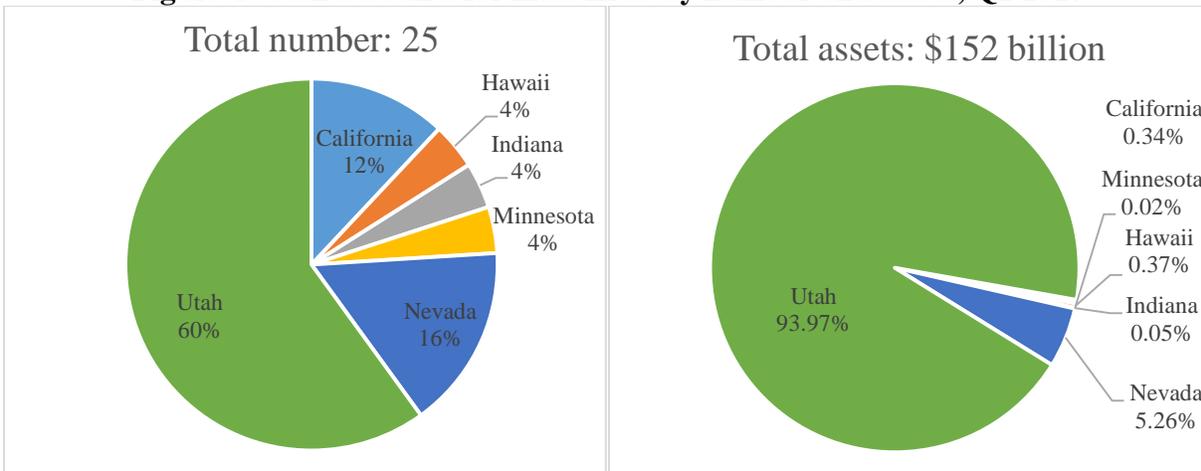
Figure 3b. ILC distribution by assets, 2000–Q1 2017



Source: FDIC.

Figure 4 illustrates Utah’s dominance in the industry, both in terms of ILC numbers and assets as of Q1 2017. With 15 ILCs, Utah alone accounts for 60% of the total number and, with \$ 143 billion, 94% of the ILC industry’s total assets. Nevada ranks a relatively distant second, with 16 percent of ILC institutions and 5% of assets. The remaining four states collectively account for 24% of all ILCs and roughly 1% of their assets. Thus, Utah and Nevada are by far the two most important states for the ILC industry today.

Figure 4. Utah accounts for most ILCs by number and assets, Q1 2017



Source: FDIC.

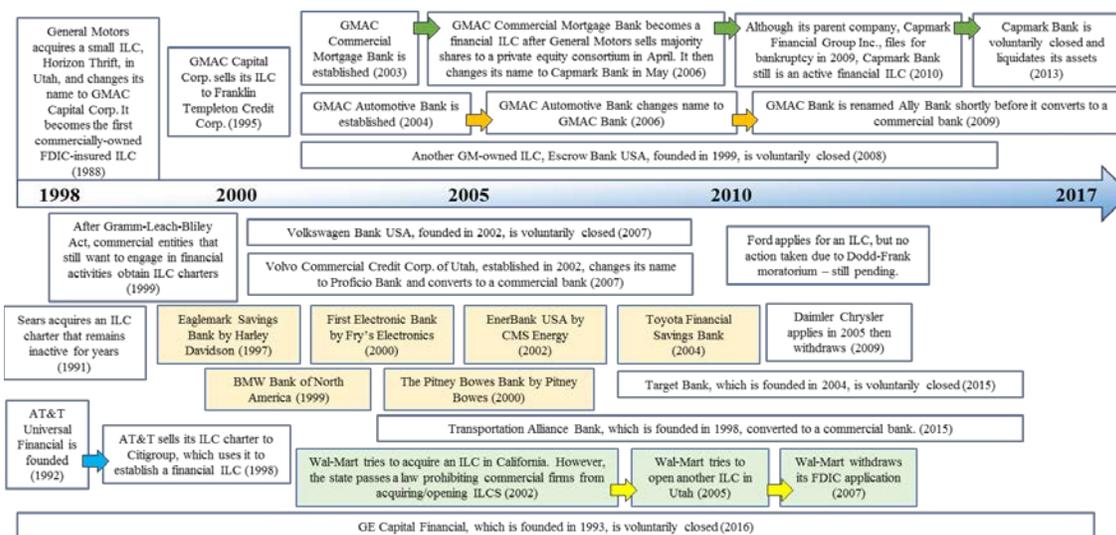
Two Ownership Types: Financially Owned and Commercially Owned

Throughout the industry’s history, most ILCs were either standalone entities or their parents were financial firms. In 1988, however, General Motors, which had already ventured into the business of offering car loans as well as servicing mortgage loans in 1985 through GMAC Mortgage, became the first non-financial company to acquire an ILC charter. GM purchased a

small ILC in Utah, one of those grandfathered states, and renamed it **GMAC Capital**. From that first transaction evolved the two ownership models: ILCs owned by financial firms and those owned by non-financial commercial firms. No clear demarcation exists for easily distinguishing one from the other, but the Dodd Frank Act now defines a commercial company as any company whose percentage of annual gross revenues derived from financial enterprise, including revenues from all affiliates as well as from its ownership or control of any insured depository institutions, is below 15% of its consolidated annual gross revenues.

Figure 5 provides a timeline of the major developments in the commercially-owned segment of the ILC industry. Of note, there have been entries and exits from this segment since the first one was established. Six commercially-owned ILCs remained active as of Q1 2017; yet while there are very few, their commercial parents cover the spectrum, ranging from automobile companies and transportation companies to retailers and even a motorcycle manufacturer.

Figure 5. A timeline for commercially-owned ILCs



Sources: Media reports, FDIC.

Figures 6a and 6b show, respectively, the domination of financially-owned ILCs over commercially-owned ILCs from 2000 to Q1 2017, with respect to both the number of institutions and their total assets. As of early 2017, financially-owned ILCs accounted for 91% of the total assets, with commercially-owned ILCs making up the remaining 9%.

In 2014, the commercially-owned ILCs accounted for their largest share of assets, at nearly 25%. But their share fell to 8% in 2016, following the voluntary closure of GE Capital that April, and only slightly rebounded, to 9%, at the end of the period.

In terms of numbers, the financially-owned ILCs also accounted for roughly 75–80% of all ILCs for nearly the entire decade, ending the period with a share of 76% of all ILCs.

Figure 6a. Most ILCs are financially-owned, 2000–Q1 2017

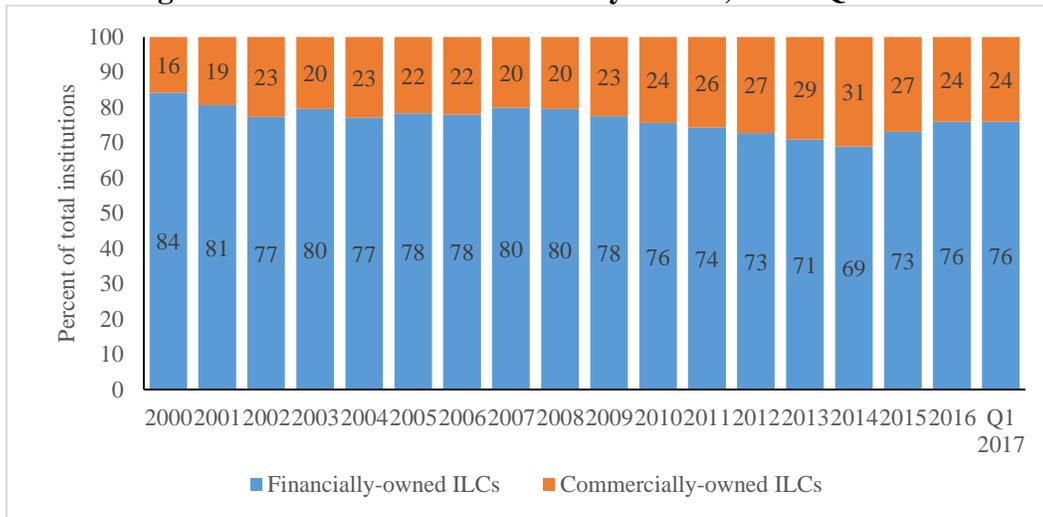
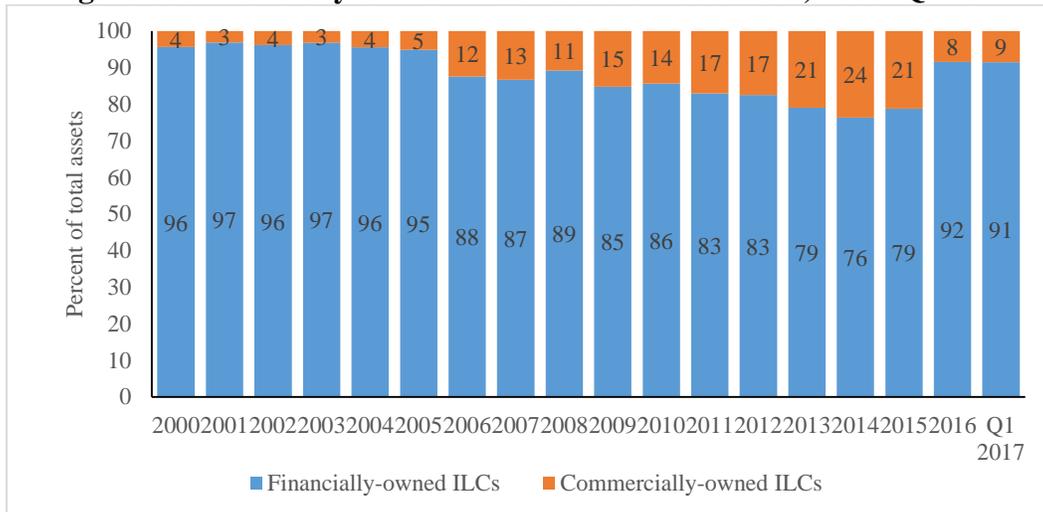


Figure 6b. Financially-owned ILCs hold the most assets, 2000–Q1 2017



Source: FDIC.

Figures 7a and 7b contain information on the distribution of financially-owned ILCs among the different states in which they are chartered (see Table 3a in the appendix for current information on each of these institutions, including date established, number of employees, total assets, description of business line, and parent company). Utah again dominates in terms of total assets, during the entire period 2000–Q1 2017, with its share always exceeding 70%. The total assets of all financially-owned ILCs increased from \$86 billion in 2000 to a high of \$229 billion in 2007, before falling to \$139 billion in Q1 2017. Most of this decrease occurred after two financially-owned ILCs in Utah converted to commercial banks in 2008, during the financial crisis and subsequent recession. Of note, both conversions occurred after the parent companies registered as bank holding companies.

The only state showing a sharp rise in ILC assets was Nevada, which saw its share of total assets in financially-owned ILCs increase from less than 4% in 2007 to nearly 18% in 2010, before declining to 5% in Q1 2017.

Figure 7a. State distribution: financially-owned ILCs by number, 2000–Q1 2017

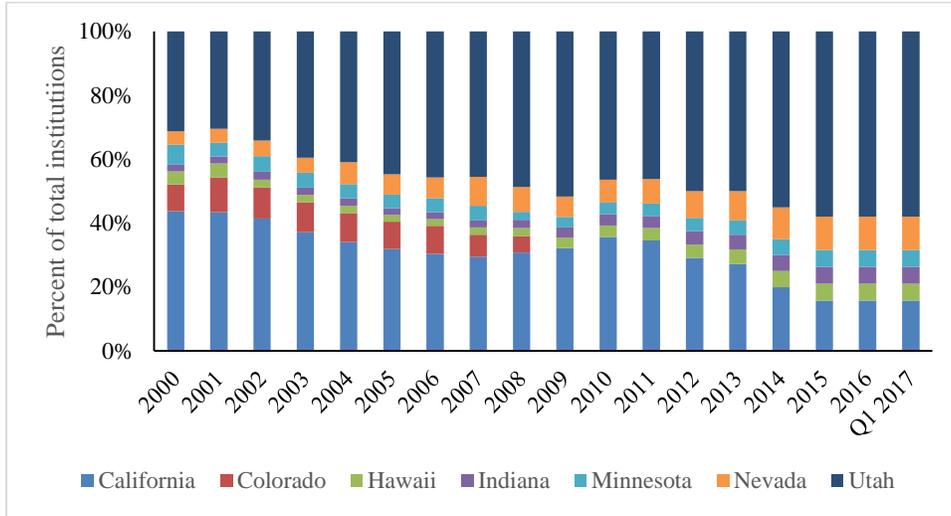
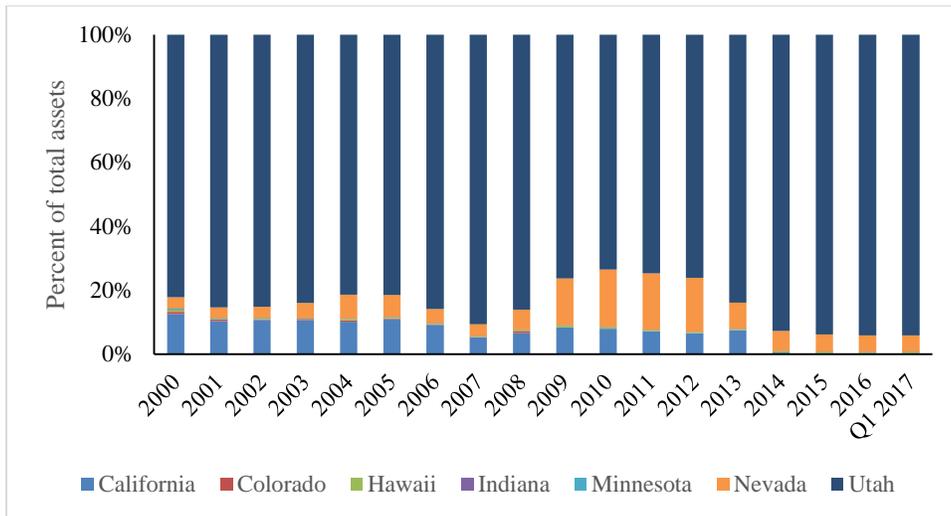


Figure 7b. State distribution: financially-owned ILCs by assets, 2000–Q1 2017



Source: FDIC.

There were 48 financially-owned ILCs in 2000, which was an all-time high over the period 2000–Q1 2017. Their number fell below 40 in 2008 and continued declining every year, to a low of 19 in 2015, 2016, and Q1 2017. As noted earlier, Colorado lost its last ILC in 2009.

Utah now accounts for 94% of the total assets of financially-owned ILCs and 58% of their number. California ranks second, at 16%, in number; and Nevada ranks second, at 5%, in share of assets.

Figures 8a and 8b show that over the past decade commercially-owned ILCs remained active in just Nevada and Utah (see Table 3b in the appendix for current information on these institutions, including date established, number of employees, total assets, description of business line, and parent company). As of Q1 2017, the vast majority (93%) of their assets are in Utah, and most of them (just under 70%) are located there as well.

The total assets of commercially-owned ILCs rose from \$4 billion in 2000 to a high of \$35 billion in 2007, before falling to \$13 billion in 2016 and Q1 2017. The greatest jump in assets occurred from 2005 to 2007, with an increase of \$26 billion, which was accounted for by GMAC Bank. As noted earlier, this institution converted to a commercial bank in 2009.

Figure 8a. Only Utah and Nevada charter commercially-owned ILCs, 2000–Q1 2017
(State distribution by number)

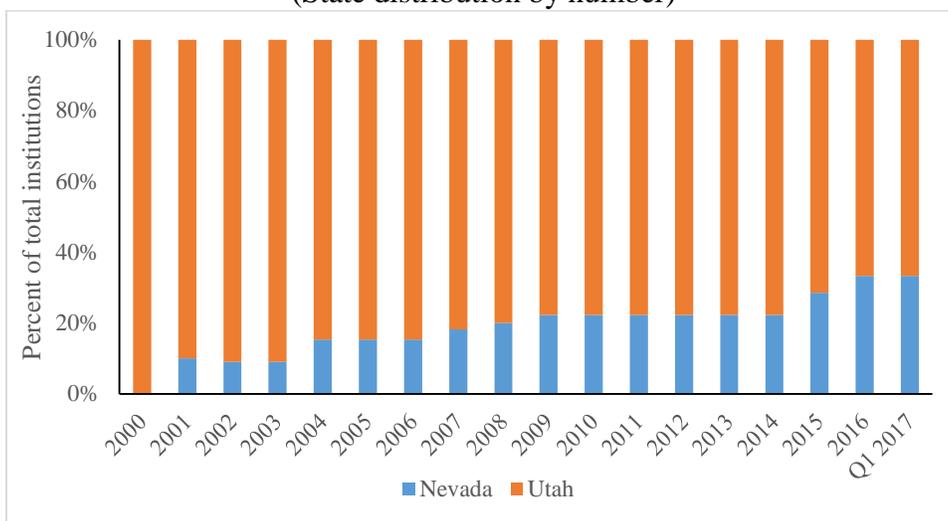
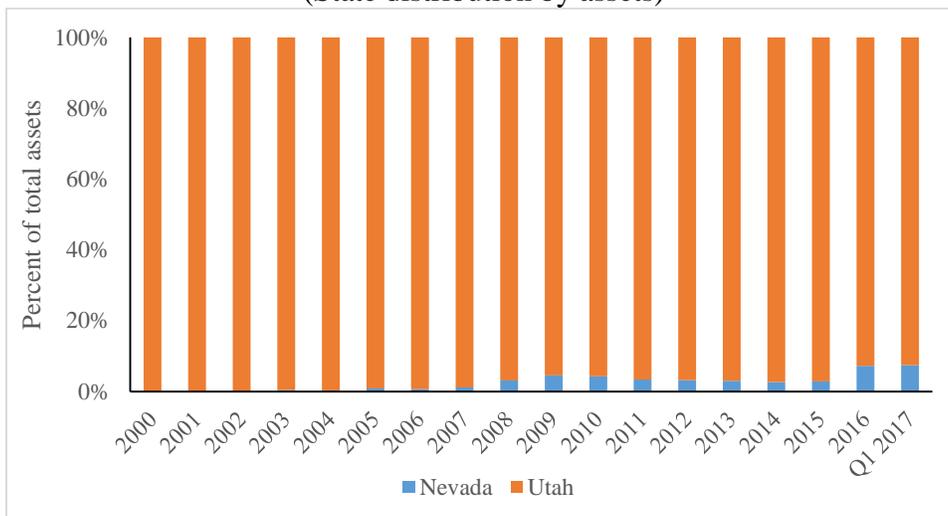


Figure 8b. Only Utah and Nevada charter commercially-owned ILCs, 2000–Q1 2017
(State distribution by assets)



Source: FDIC.

Figures 9a, 9b, and 9c cover financial performance over the same period and offer several comparisons, not just between all FDIC-insured institutions and ILCs, but also between the commercially and financially-owned ILCs themselves. The figures are for return on assets (9a); (9b) return on equity (9b); and capital-to-asset ratios (9c).

The whole group of 25 ILCs performed far better, in terms of ROA, than did all other FDIC-insured institutions. So did the two ILC ownership groups by themselves. In the early part of the decade, commercially-owned ILCs performed better on ROA than their financially-owned counterparts. But the performance results reversed over the remaining period. This also holds for ROE performance. The stronger ROE performance of the commercially-owned ILCs for most of the period was due to their lower, but still more than adequate, capital-to-asset ratios. In more recent years, they increased their ratios, resulting in the lower ROEs. Through almost the entire decade, until Q1 2017, financially-owned ILCs remained better capitalized than commercially-owned ILCs.

Figure 9a. ROA: Active ILCs outperform all FDIC-insured institutions, 2000–Q1 2017

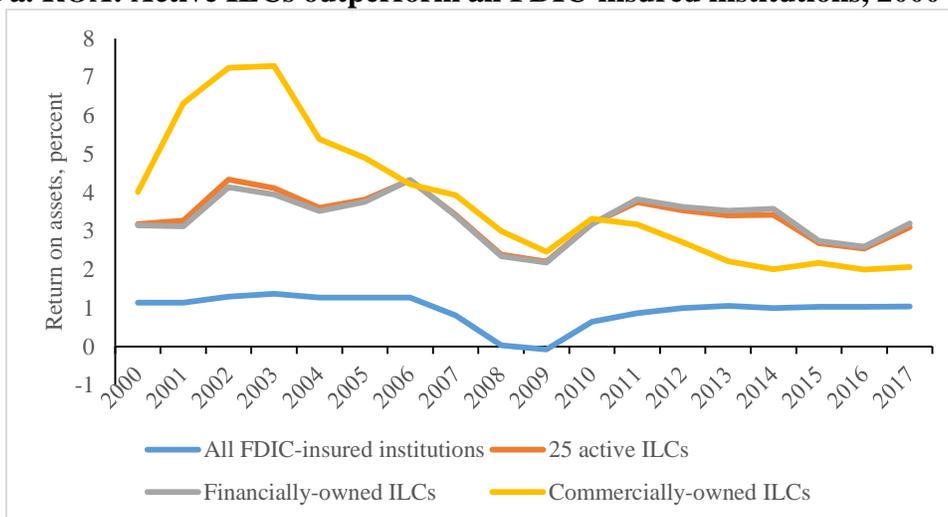


Figure 9b. ROE: Active ILCs outperform all FDIC-insured institutions, 2000–Q1 2017

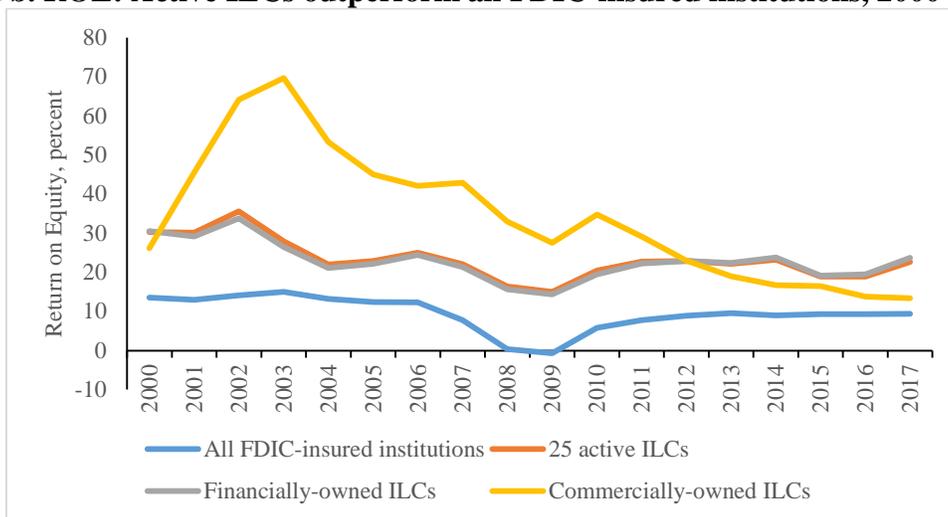
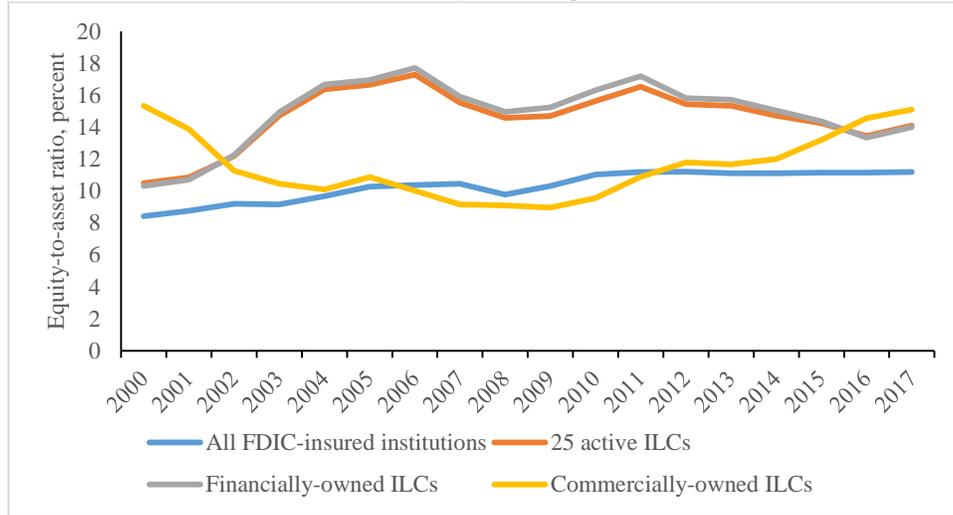


Figure 9c. Capital-to-asset ratio: Generally higher for active ILCs than all FDIC-insured institutions, 2000–Q1 2017



Source: FDIC.

As these figures indicate, ILCs have changed from their early and formative years, and their fairly narrow business scope and customer base. They’ve evolved and innovated, and now differ among themselves in their ownership models, products, and services, as well as their customer mix (see Tables 3a and 3b in the appendix). Financially-owned ILCs have \$42 million in assets per employee, while commercially-owned ILCs have \$24 million in assets per employee; by contrast, all FDIC-insured institutions have just \$8 million in assets per employee. The three largest ILCs—American Express Centurion Bank, UBS Bank USA, and Sallie Mae Bank—are financially owned^{xii} and account for slightly more than 70% of the total assets of the ILC industry.

III. REGULATION OF ILCs

Legislative Developments

In those early years, ILCs operated like local consumer finance companies. As such, they weren’t considered important competitors for banks. That perception began to change when the FDIC was established in 1934 in response to numerous bank runs and associated failures. That year the FDIC decided to insure the thrift certificates (those certificates of indebtedness) of 29 industrial loan companies that did not accept deposits, and later added more ILCs to the ranks of insured financial institutions on a case-by-case basis.

The Banking Act of 1935 also made ILCs eligible for membership in the Federal Reserve System. As a result, four ILCs—one each in Illinois, Michigan, North Carolina, and Ohio—were members as of 1940 (Saulnier, 1940). In subsequent years, more states began to permit their ILCs to offer both demand and time deposits. Then, with the passage of the Garn–St Germain Act in 1982, all deposit-taking ILCs became eligible for federal deposit insurance.^{xiii} Today ILCs can operate much like other insured state banks, offering consumer and commercial loans.

From the outset, states regulated the ILCs they chartered. After the establishment of the FDIC, depository ILCs acquiring FDIC insurance also came under its regulation. FDIC authority extends not just to the examination of the insured depository institution, but the examination of any affiliate, *including its parent company*. Thus the FDIC is able to determine the relationship between the ILC and its parent, as well as the effect of such a relationship on the ILC (West, 2004). In California, Nevada, and Utah, the state regulatory authorities also have the authority to conduct examinations of both the ILC parents and affiliates of ILCs, and Utah does conduct these examinations.

In addition, ILCs are subject to Sections 23A and 23B of the Federal Reserve Act, which restrict transactions among ILCs, affiliates, and parents. More specifically, ILCs are prohibited from extending loans of any significance to their parents or affiliates, or from offering loans on preferential or non-market terms. Both Utah state regulations and the FDIC require a majority of ILC board members to be outside directors unaffiliated with the parent companies.

The ILC parent, however, is not subject to Federal Reserve oversight because it isn't a bank holding company. Specifically, it is exempt from the definition of a bank holding company under the BHC Act so long as its ILC retains its exemption—i.e., so long as it satisfies at least one of the following conditions: (1) it doesn't accept demand deposits (this restriction seems outdated); (2) its total assets are less than \$100 million; or (3) it hadn't been acquired by any company after August 10, 1987.^{xiv} Of the 25 active ILCs as of Q1 2017, five had less than \$100 million in total assets. This includes two of the commercially-owned ILCs (see Tables 3a and 3b in the appendix).

Regulatory Barriers to Commercial Companies Owning Banking Institutions

Commercial banks didn't voice much concern about competition from ILCs for a long time—not even in 1988, when GM became the first commercial firm to acquire an ILC charter.^{xv} From then on, a variety of commercial firms, including BMW, General Electric, Target, Pitney Bowes, and Harley-Davidson, acquired or formed ILCs, without generating controversy.

The banking industry began to take notice when the ILCs owned by the Merrill Lynch and Morgan Stanley began to grow dramatically by providing insured deposits to their customers. But it was giant retailer Wal-Mart's attempt to enter this market that gave rise to a storm of protests.

Wal-Mart made its first move in the financial market in 1999, when it tried to acquire a small savings and loan in Broken Arrow, Oklahoma. But the Gramm–Leach–Bliley Act (GLBA) of 1999, which prohibited the mixing of banking and commerce, took effect that year, and Wal-Mart missed the deadline. In 2001 the retailer tried to partner with Toronto-Dominion Bank USA to buy a thrift institution, but the Office of Thrift Supervision (which was merged with the Office of the Comptroller of the Currency in July 2011) denied its application. A year later in 2002, Wal-Mart tried yet again to purchase an ILC, this time in California, but the state quickly passed a law prohibiting such an acquisition.

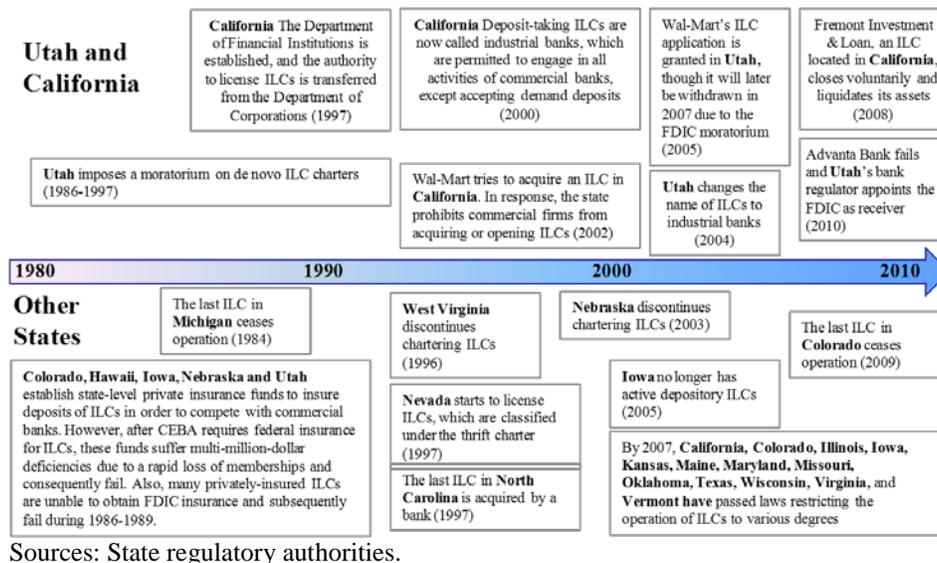
Finally, in 2005, Wal-Mart filed an application with the Utah Department of Financial Institutions and the FDIC to establish a federally insured ILC. The opposition from a large segment of banking industry was immediate, well-organized, and unequivocal: Wal-Mart would use the ILC to establish bank branches in all its stores, they warned, creating a financial services monopoly that could eventually offer a full line of banking services. Nor were they placated by Wal-Mart's insistence that it wanted to own an ILC not to enter the banking business, but in order to reduce the costs it was paying to banks for processing credit card, debit card, and electronic check transactions in its stores.

The FDIC held three days of hearings on the matter in April 2006, noting that nearly 13,000 comments, mostly in opposition to Wal-Mart, had been submitted. The agency decided not to approve the application for deposit insurance and, in July 2006, placed a six-month moratorium on all ILCS applications.^{xvi} The agency extended the moratorium again, in January 2007, for an additional year for ILC applications coming from commercial companies.^{xvii xviii}

On April 25, 2007, at the time of the moratoriums, and again that October 4, 2007, FDIC officials appeared before both chambers of Congress and testified that "ILCs have proven to be a strong, responsible part of our nation's banking system and offered innovative approaches to banking." Moreover, they noted, "commercially-owned ILCs have not resulted in serious problems to date." And then they passed the potato. Even though the FDIC had the authority to act alone, they assured legislators, and even though the FDIC would endorse no particular outcome, "These issues are complex and involve key questions of public policy that are most appropriately determined by Congress."^{xix}

Wal-Mart eventually withdrew its application, in March 2007, before the FDIC made a final ruling. The negative publicity campaign against it by the banking industry was successful, so much so that by 2007, California, Colorado, Illinois, Iowa, Kansas, Maine, Maryland, Missouri, Oklahoma, Texas, Wisconsin, Virginia, and Vermont all passed legislation restricting to various degrees the operation of ILCs within their borders.^{xx} Figure 10 provides information on state-level industry developments during the past four decades.

Figure 10. A timeline of ILC state-level events



By the time Congress got around to picking up the FDIC potato, the country was picking up the pieces of the worst financial crisis since the Great Depression. Amid the regulatory tinkering, as noted earlier, came the instructions through the Dodd Frank Act for the GAO study on the ramifications of doing away with the ILC bank definition exemption that was a “loophole” for non-financial ownership. The study included performance audits and examined: (1) BCH Act-exempt financial institutions; (2) the federal regulatory system for exempt financial institutions; and (3) potential implications of subjecting their ownership to BHC Act requirements. Among its findings. It was concluded in 2012, and among its findings:^{xxi}

“The implications of subjecting exempt institutions and their holding companies to the BHC Act vary. While many officials from the exempt institutions owned by commercial holding companies said that the institutions would be divested, data suggest that removing the exemptions would likely have a limited impact on the overall credit market given the overall market share of exempt institutions is small. Views varied on how removing the exemptions would improve safety and soundness and financial stability. Some officials from exempt institutions said that financial stability could be adversely affected by further concentrating market share. Federal Reserve officials noted that institutions that remain exempt are not subject to consolidated supervision but could grow large enough to pose significant risks to the financial system, an issue they plan to continue to watch” (inside-cover, “What the GAO Found”).

The GAO also found:

“On average, the holding companies of ILCs and credit card banks we analyzed had higher ratios of equity-to-total assets over the 5-year period than bank holding companies (see fig. 2). The higher ratio shows that these holding companies had a higher, stronger cushion against losses that might occur” (p. 23).

No doubt because of this conclusion, and GAO’s decision not to make a recommendation for the repeal of federal provisions allowing ILC ownership by commercial firms, Congress has thus far chosen not to take action with respect to the ILC industry.

Still, the odds of a commercial company acquiring ownership of an ILC—or for that matter, ownership of *any* federally insured depository institution—remain uncertain, with opposition still coming from lenders, banking associations, and those uncertain about fintech inroads.

Given the opposition, it is instructive to note that throughout most of US history, commercial firms could own any type of banking institution, be it a commercial bank, a savings and loan association, even an ILC. As far back as 1799, the State of New York granted a charter to Aaron Burr to use the surplus capital in a water company that he owned to establish a bank, and that bank ultimately became JPMorgan Chase. During the Great Depression, the federal government asked Henry Ford to convert a portion of his car company's deposits at Manufacturers National Bank of Detroit into stock to prevent the bank's collapse. He refused, but his son Edsel later recapitalized the bank with his own funds. General Motors, for its part, injected capital into the National Bank of Detroit to save it from insolvency during the Depression years.^{xxii}

Also of interest, Marriner Stoddard Eccles, who became the first chairman of the reorganized Federal Reserve Board during the 1930s, served as “president and owner of 26 banks and one trust company, vice president of one of the largest sugar companies in the country, president of a multistate dairy concern, president of the large Intermountain construction company and one of the builders of the Boulder Dam, among many other enterprises.”^{xxiii}

But 1956 marked the beginning of change, with passage of the HBC Act, the first federal law prohibiting commercial firms, i.e., those directly or indirectly engaged in any activity other than banking (and closely related products and services), from owning more than one bank (Shull, 1999). According to the FDIC (1987) (italics added):

“[T]he primary purpose underlying [the act]’s passage was fear of monopolistic control in the banking industry. Federal regulators and independent bankers lobbied Congress for over twenty years to pass more restrictive bank holding company legislation, but *it wasn’t until the Transamerica case was lost by the Federal Reserve Board that legislation was approved*. ... Transamerica controlled 46 banks, in addition to owning a large percentage of Bank of America. The Federal Reserve Board charged that Transamerica was in violation of the Clayton Antitrust Act by monopolizing commercial banking in the states of California, Oregon, Nevada, Washington and Arizona. In 1952, the Board ordered Transamerica to divest itself of all its bank stock, except for Bank of America, within two years.”

The prohibition on the establishment of multibank holding companies generated a dramatic rise in the number of one-bank holding companies, which were exempt from federal regulation, until 1970. Where before 1956, there had been only 83 one-bank holding companies, by 1970, an additional 1,235 were established (Federal Reserve, 1972). That same year, the HBC Act was amended to bar commercial firms from owning even one bank. As Alfred Hayes of the Federal Reserve Bank of New York noted in a speech to the New York State Bankers Association, “The 1970 amendments, therefore, bring all bank holding companies under the supervision of the Federal Reserve Board and eliminate loopholes by which a group might be free of Federal Reserve regulation while maintaining effective control of one or more banks.”^{xxiv}

Yet commercial firms could still own savings and loans—at least until Congress passed the Savings and Loan Holding Company Act of 1967, imposing restrictions on their ownership of this type of banking institution, too (See Barth and Regalia, 1988). Similar to the BHC Act, the 1967 law prohibited the establishment of multi-thrift holding companies.

Despite these legislative attempts to block the entry of commercial firms into banking, the door didn't shut entirely. The BHC Act defined a bank as a financial institution that offers demand deposits and made commercial loans. Thus, based on this definition, a commercial firm could acquire a bank but then stop offering either demand deposits or commercial loans. And this is exactly what happened.

These depository institutions, still federally insured, became known as “nonbank banks.” As the Treasury Department (1991) stated, “these nonbank banks were attractive to a wide range of business organizations seeking to capitalize on the efficiencies and ‘synergies’ that come with offering largely complementary services.”

By the mid-1980s, firms like General Electric, Textron, ITT, Gulf & Western, John Hancock, Prudential Bache, American Express, Merrill Lynch, Dreyfus, Household, Beneficial, Sears Roebuck, JC Penney, McMahan Valley Stores, Bankers Trust Corp., Bank of Boston Corp., and others had all established nonbank banks.^{xxv} And Congress responded again, this time with CEBA, as noted earlier, which expanded the original BHC Act definition to include any federally insured institution as a bank, grandfathered existing nonbank banks (while limiting their growth), and prohibited the formation of new nonbank banks.^{xxvi}

Table 4 in the appendix provides a list of nonbank banks as of June 1987, and their status after being grandfathered. Of the 17 nonbank banks that existed in 1987, only two survived into Q1 2017. The numbers suggest that once a type of institution is grandfathered, the result seems to be the eventual shrinkage, if not total disappearance, of that type of institution.

A commercial firm could still gain entry into banking by becoming a unitary thrift holding company that owned a single savings and loan. Although Congress had imposed restrictions in 1967 on the commercial ownership of multiple-thrift holding companies, the result was (as with one-bank holding companies) a sharp rise in the number of one-thrift holding companies (Office of Thrift Supervision, 1997). Once again, Congress stepped into action, passing the Gramm–Leach–Bliley Act (GLBA) in 1999.^{xxvii} As had CEBA, this law grandfathered in existing companies.

Table 5 in the appendix lists unitary thrift holding companies as of June 1996 and their status as of Q1 2017. Of the 28 companies in business in 1996, just 14 still existed as of March 2017. The largest, USAA, is the parent of USAA Federal Savings Bank, which in turn is the parent of an ILC. Of interest, per Table 5, are the diverse commercial businesses in which the parent holding companies were engaged or are currently engaged, despite their ownership of federally insured institutions.

Table 2 lists the major legislative actions taken by Congress over the past 50 years to block any entry into banking by commercial firms. Between 1987 and 1999, they had only two

choices: become a unitary thrift holding company or own an ILC. If the former, its subsidiary would be subject to the Qualified Thrift Lender Test, which meant the savings and loan institution had to hold a relatively high percentage of its loan portfolio in housing-related assets. It isn't surprising, then, that not all commercial firms would consider this option desirable. Some, therefore, like General Motors, decided to acquire ILCs; when GM got its ILC in 1988 in Utah, it changed the name of its acquisition to GMAC Capital Corp.

Table 2. Laws prohibiting commercial ownership of FDIC-insured depository institutions

| Legislation and year | Commercial firms may not own: | Commercial firms may own: |
|---|---|---|
| Prior to 1956 | — | Any type of depository institution |
| Bank Holding Company Act of 1956 | Individual banks and multiple-bank holding companies | <ol style="list-style-type: none"> 1. One-bank holding companies 2. Nonbank banks 3. Multiple thrift holding companies 4. Unitary thrift holding companies 5. ILCs |
| Savings and Loan Holding Company Act of 1967 | Multiple thrift holding companies | <ol style="list-style-type: none"> 1. One-bank holding companies 2. Nonbank banks 3. Unitary thrift holding companies 4. ILCs |
| Bank Holding Company Act Amendments of 1970 | One-bank holding companies (existing commercial ownership grandfathered) | <ol style="list-style-type: none"> 1. Nonbank banks 2. Unitary thrift holding companies 3. ILCs |
| Competitive Equality Banking Act of 1987 | Nonbank banks (existing commercial ownership grandfathered) | <ol style="list-style-type: none"> 1. Unitary thrift holding companies 2. ILCs |
| Gramm–Leach–Bliley Act of 1999 | Unitary thrift holding companies (existing commercial ownership grandfathered) | ILCs |
| Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 | Moratorium on new ILCs that ended in 2013 | ILCs |
| Government Accountability Office Study Required by Dodd Frank Act | Evaluated ILCs but did not recommend that the federal law provisions allowing ILC ownership by commercial firms be repealed | |

Note: Unless a law specifically prohibits a commercial firm from owning a depository institution, it is assumed here that such ownership is allowed. Credit unions and mutual savings and loans are excluded.

Source: Milken Institute.

By 1999, commercial firms had just one remaining point of entry: the acquisition or formation of an ILC,^{xxviii} and today there are just six of these. Of the 25 active ILCs, 19 others are financially owned. The six commercially-owned institutions account for 9% of the total assets of the ILC industry, and this segment could presumably account for even more, now that the moratorium on newly chartered commercially-owned ILCs has expired.

This resolve to insist on a separation of commerce and banking presents some striking contradictions. After all, Bill Gates can own a bank, but Microsoft cannot. Members of the Walton family, moreover, *do* own a commercial bank (the Arvest Bank, with some 200 branches in Arkansas, Oklahoma, Missouri, and Kansas), but Wal-Mart can't. Wal-Mart did, however, operate a full-service bank in Mexico until it was sold in 2014; and Wal-Mart could own banks in most of the foreign jurisdictions in which it operates. Under US law, an individual can own a bank and a company, and yet that same company cannot itself own a bank.

This makes the US out of step with most other countries. Only 4 of 142 countries surveyed by the World Bank prohibit the ownership of banks by commercial firms (see Table 6 in the appendix). But most important, the restrictions limit the ability of the US banking industry to draw upon the substantial equity of commercial firms (keep in mind that ILCs can receive funds from the parent but may not channel any funds back). As it loses options for enlarging its capital base, the banking industry necessarily finds it increasingly challenging to remain a major player in the competitive global arena.

Those who caution against allowing commercial firms to own ILCs, or to own banks more generally, tend to focus on the systemic risks posed by such entities. They also raise questions about oversight and the potential for parent companies to use their ILCs for anti-competitive practices. But regulation already in place appears to be adequate to address these concerns.

For example, some observers fear that the commercial parents of ILCs have the size and resources, and one objective: to use predatory pricing to drive local bank competitors out of business. Others have expressed concerns that ILCs may have incentives to deny credit to their parent firms' competitors or their competitors' customers; or to provide funds on preferential terms to their commercial parents; or to tie loans inappropriately to purchases of the parents' products. However, existing federal law prohibits unfair competition and conflicts of interest, and regulators have the authority and the tools to address these issues without eliminating an entire industry. Further, as discussed previously, the loans between the bank and its affiliates cannot be made on preferential terms.

While the size of some of the corporations, witness Wal-Mart, has been a flashpoint in the debate, the Dodd Frank Act provides a means to limit the growth of any company that might pose a systemic risk to the economy. And in times of systemic crisis, commercial firms don't gain direct access to the federal safety net (i.e., FDIC insurance and access to the Federal Reserve discount window) merely by owning an ILC.

Is systemic risk heightened because ILCs and their parents are regulated by the states and the FDIC, rather than the Federal Reserve? Recent history indicates that is not the case. There is no evidence that the Federal Reserve has done, or will do, a better job than state regulators or the FDIC. Indeed, in the most recent financial crisis, the Federal Reserve didn't do a particularly good job of overseeing bank holding companies (see Barth, Caprio and Levine, 2012). Meanwhile, not a single commercially-owned ILCs failed. This evidence refutes any claims that the ILCs aren't properly supervised.

It's also important to consider the potential impact of a parent company failure. Would an ILC be forced into insolvency if were largely in the business of financing purchases from the parent and the parent company went under? The record shows this has not been a problem. As a separately chartered and capitalized subsidiary, the ILC can continue to operate. In a worst-case scenario, it would undergo a controlled liquidation with the goals of paying depositors (no losses to the FDIC), paying all other creditors in full, and paying a liquidating dividend to the parent, as has been the case.

For instance, when Conseco filed for bankruptcy, its ILC subsidiary self-liquidated, paid all depositors and other debts, and then paid a large dividend to the bankruptcy trustee to pay the parent’s creditors. In another instance, the ILC owned by Lehman Brothers remained solvent and self-liquidated, despite the bankruptcy of its parent. (According to quarterly reports, in the two years prior to its voluntary closure in 2011, the ILC had shrunk from over \$6.4 billion in assets to \$2.8 billion, had a 26.6 percent capital ratio, and was earning a 2.4 percent ROA.) In two other instances, ILCs owned by companies that were reorganizing under bankruptcy laws continued normal operations under close regulatory oversight to ensure that their assets weren’t used to help rescue the parent.

More generally, these examples show that prudent regulation and supervision can prevent (and have prevented) any exploitation of the insured subsidiary by a troubled parent. Conversely, it is worthwhile to emphasize that the parent company can be an important source of strength for its ILC subsidiaries.

Given the range of concerns about this little-known corner of the banking industry, it is essential to understand exactly how ILCs are regulated. Table 3 compares the powers, ownership forms, and regulatory oversight of ILCs relative to state commercial banks. ILCs have more restrictions on the types of deposits they can offer, though otherwise both are subject to similar restrictions and oversight. More generally, both ILCs and their parent companies are subject to regulation by the bank’s regulators. They are examined and required to provide reports and other information specified by the regulators. The regulators can issue cease-and-desist orders, orders of prohibition, and civil money penalties to the parent company and every affiliate that has transactions with the bank or otherwise influences its operations, all individuals serving as officers or representatives of an affiliate, outside auditors, consultants and legal counsel, and anyone else who qualifies as an “institution-affiliated party,” as defined in the provisions under the Federal Deposit Insurance Act.

These powers are comparable to the Federal Reserve’s authority over bank holding companies and financial holding companies.

Table 3. ILCs vs. state commercial banks: Powers, ownership, regulatory oversight

| | State commercial banks | ILCs |
|--|-------------------------------|-----------------|
| Ability to offer full range of deposits and loans | Yes | Yes* |
| Ability to export interest rates | Yes | Yes |
| Ability to branch interstate | Yes | Yes |
| FDIC examination, supervision, and regulation | Yes | Yes |
| FDIC may conduct limited scope exam of affiliates | Yes | Yes |
| Federal Reserve Act 23A & 23B, Reg. O, CRA apply (see note) | Yes | Yes |
| Anti-tying restrictions apply | Yes | Yes |
| Full range of enforcement actions can be applied to the subsidiary depository institutions if parent fails to maintain adequate capitalization | Yes | Yes |
| Ability to accept demand deposits and commercial checking accounts | Yes | No** |
| Parent subject to umbrella federal oversight | Yes | No*** |
| Parent activities generally limited to banking and financial activities | Yes | No |
| Parent serves as a source of strength | Yes | Yes, Dodd Frank |

| | | Act makes explicit |
|--|-----|--------------------|
| Chartered as a national institution | Yes | No |
| Chartered as a state institution | Yes | Yes |
| Golden parachute restrictions apply | Yes | Yes |
| Parent could be prohibited from commencing new activities if a subsidiary depository institution has a CRA rating that falls below satisfactory | Yes | No |
| Parent could be ordered by a federal banking agency to divest of a depository institution subsidiary if the subsidiary become less than well capitalized | Yes | No |
| Control owners who have caused a loss to a failed institution may be subject to personal liability | Yes | Yes |
| Cross-guarantee requirement for affiliates | Yes | No |

Notes: * Including NOW (negotiable order of withdrawal) accounts. However, ILCs with more than \$100 million in assets cannot accept demand deposits or offer commercial checking accounts.

** Except those ILCs that have assets of less than \$100 million or ILCs that were not acquired after August 10, 1987.

*** Publicly traded parent companies are subject to SEC oversight. FDIC and Utah State regulators can perform examinations of ILC parents.

Federal Reserve Act Sections 23A and 23B limit bank transactions with affiliates and the parent company.

Regulation O limits loans to bank insiders and applies to all FDIC-insured institutions. CRA denotes the Community Reinvestment Act.

Sources: Adapted from West (2004); Milken Institute.

The primary difference between the regulation of an ILC holding company and a bank holding company is that ILC affiliates can engage in any lawful activity that poses no risk to the bank. ILC regulators don't supervise or govern the diversified parent's activities, such as manufacturing and retail sales operations, that have no relevance to the bank. The parents of commercially-owned ILCs must also now be sources of strength as a result of the Dodd Frank Act.

It's equally important to point out the relative importance of parent companies to their ILCs. Tables 4a and 4b lists the 25 active ILCs and provide information on their assets and equity capital as a percentage of their parent firms' assets and equity capital, respectively, as well as the ROA and ROE for both the ILCs and their parents.

Table 4a shows that the assets of financially-owned ILCs as a share of the parents' assets range from a low of 1% to a high of 160%, while the financially-owned ILCs' equity capital as a share of the parents' equity capital ranges from a low of 1% to a high of 100%. In general, these figures indicate that to the extent that the parents are financially healthy, they can serve as a source of strength for their subsidiary ILCs.

Moreover, parent firms can serve as an important source of governance over their ILCs. BMW and Toyota, for example, clearly don't want their brands tarnished by inappropriate behavior on the part of a subsidiary ILC; similarly, that an ILC operates with the full awareness of its overriding dependence on the parent's financial success.

Table 4a. Importance of corporate parents to financially-owned ILCs, Q1 2017

| Parent company | Parent company | Financially- | ST | ILC |
|----------------|----------------|--------------|----|-----|
|----------------|----------------|--------------|----|-----|

| | Total assets (\$B) | Total equity capital (\$B) | Equity capital to total assets (%) | ROA (%) | ROE (%) | owned ILC | | ILC assets as % of parent assets | ILC equity as % of parent equity | Equity capital to total assets (%) | ROA (%) | ROE (%) |
|--|--------------------|----------------------------|------------------------------------|---------|---------|---|----|----------------------------------|----------------------------------|------------------------------------|---------|---------|
| American Express Company | 161.39 | 20.94 | 12.97 | 3.07 | 23.64 | American Express Centurion Bank | UT | 21.38 | 30.98 | 18.8 | 6.32 | 35.15 |
| Hafif Bancorp | n.a. | n.a. | n.a. | n.a. | n.a. | Balboa Thrift And Loan Association | CA | n.a. | n.a. | 15.24 | 0 | 3.04 |
| Beal Financial Corporation | 7.37 | 2.16 | 29.25 | 4.29 | 14.66 | Beal Bank USA | NV | 71.36 | 100.1 | 41.03 | 3.93 | 11.04 |
| Celtic Investment Inc. | n.a. | n.a. | n.a. | n.a. | n.a. | Celtic Bank Corporation | UT | n.a. | n.a. | 17.17 | 4.4 | 25.81 |
| Alliance Data Systems Corporation | 24.64 | 1.36 | 5.53 | 2.37 | 42.83 | Comenity Capital Bank | UT | 27.04 | 66.04 | 13.51 | 3.36 | 25.35 |
| East Los Angeles Community Union | n.a. | n.a. | n.a. | n.a. | n.a. | Community Commerce Bank | CA | n.a. | n.a. | 27.14 | 1.21 | 4.42 |
| Finance Enterprises Ltd. | n.a. | n.a. | n.a. | n.a. | n.a. | Finance Factors Ltd. | HI | n.a. | n.a. | 10.97 | 0.75 | 6.91 |
| Lease Corporation of America | n.a. | n.a. | n.a. | n.a. | n.a. | LCA Bank Corporation | UT | n.a. | n.a. | 12 | 2.01 | 17 |
| Medallion Financial Corp. | 0.68 | 0.29 | 42.46 | 2.76 | 6.51 | Medallion Bank | UT | 160.19 | 57.64 | 15.28 | 1.55 | 10.2 |
| CardWorks Inc. | n.a. | n.a. | n.a. | n.a. | n.a. | Merrick Bank Corporation | UT | n.a. | n.a. | 20.83 | 2.65 | 12.77 |
| Minnesota Thrift Company | n.a. | n.a. | n.a. | n.a. | n.a. | Minnesota First Credit and Savings Inc. | MN | n.a. | n.a. | 14.51 | 0.76 | 5.25 |
| First Financial Corp. | 2.96 | 0.43 | 14.43 | 1.27 | 8.78 | Morris Plan Company of Terre Haute | IN | 2.63 | 5.05 | 27.67 | 2.44 | 8.83 |
| Unitedhealth Group Incorporated | 137.16 | 44 | 32.08 | 6.39 | 19.92 | Optumhealth Bank Inc. | UT | 5.58 | 1.97 | 11.31 | 1.42 | 12.31 |
| Semperverde Holding Co. | n.a. | n.a. | n.a. | n.a. | n.a. | Rancho Santa Fe Thrift and Loan Association | CA | n.a. | n.a. | 36.33 | 0.54 | 1.35 |
| Slm Corporation | 19.24 | 2.44 | 12.66 | 1.97 | 15.59 | Sallie Mae Bank | UT | 98.91 | 86.69 | 11.1 | 2.12 | 19.28 |
| UBS AG | 939.48 | 55.42 | 5.9 | 8.97 | 38 | UBS Bank USA | UT | 5.95 | 9.56 | 9.47 | 1.25 | 13.5 |
| United Services Automobile Association | 152.25 | 29.47 | 19.36 | 2.21 | 11.44 | USAA Savings Bank | NV | 1.17 | 0.89 | 14.73 | 14.47 | 112.35 |
| Steel Partners Holdings LP | 1.97 | 0.66 | 33.4 | -0.63 | -1.88 | WebBank | UT | 22.98 | 13.92 | 20.24 | 4.89 | 24.87 |
| WEX Inc. | 6.18 | 1.55 | 25.09 | 1.88 | 7.51 | WEX Bank | UT | 35.24 | 17.16 | 12.22 | 9.2 | 76.98 |

Table 4b. Importance of corporate parents to commercially-owned ILCs, Q1 2017

| Parent company | Parent company | Commercially- | ST | ILC |
|----------------|----------------|---------------|----|-----|
|----------------|----------------|---------------|----|-----|

| | Total assets (\$B) | Total equity capital (\$B) | Equity capital to total assets (%) | ROA (%) | ROE (%) | owned ILC | | ILC assets as % of parent assets | ILC equity as % of parent equity | Equity capital to total assets (%) | ROA (%) | ROE (%) |
|----------------------|--------------------|----------------------------|------------------------------------|---------|---------|-------------------------------|----|----------------------------------|----------------------------------|------------------------------------|---------|---------|
| BMW AG | 191.60 | 49.58 | 25.88 | 10.04 | 38.81 | BMW Bank Of North America | UT | 5.19 | 3.07 | 15.33 | 1.63 | 10.26 |
| Gms Energy Corp. | 21.62 | 4.41 | 20.40 | 3.68 | 18.05 | Enerbank USA | UT | 6.29 | 3.86 | 12.51 | 2.46 | 20.32 |
| Fry's Electronics | n.a. | n.a. | n.a. | n.a. | n.a. | First Electronic Bank | UT | n.a. | n.a. | 47.57 | 2.46 | 5.22 |
| Pitney Bowes Inc. | 5.75 | -0.05 | -0.81 | 4.53 | 562.24 | Pitney Bowes Bank Inc. | UT | 12.18 | -156.84 | 10.38 | 9.45 | 92.08 |
| Harley-Davidson Inc. | 4.24 | 1.99 | 47.04 | 17.59 | 37.40 | Eaglemark Savings Bank | NV | 0.91 | 0.45 | 23.09 | 8.09 | 30.39 |
| Toyota Motor Corp. | 405.00 | 146.70 | 36.22 | 4.96 | 13.70 | Toyota Financial Savings Bank | NV | 0.23 | 0.12 | 18.55 | 0.33 | 1.78 |

Sources: Federal Reserve, FDIC, Bloomberg, Company Reports.

Also, unlike some of the active ILCs, the bank subsidiaries of bank holding companies are generally vital to their parents' overall enterprise, and can account for a relatively large share of their holding companies' total assets. The reverse is generally the case for commercially-owned ILCs and their parents. Thus the risk that their performance will have a great impact on the parent company is much reduced, while the performance of a bank subsidiary may have a tremendous impact on the performance of its holding company.

IV. THE CAPITALIZATION AND PERFORMANCE OF ILCs

Just to be clear: ILCs weren't responsible for the financial crisis of 2007–2010. They accounted for a very small portion of the number and total assets of all financial firms during those years.

They also account for a very small fraction of the FDIC's insured deposits, just 4.1% or less of the total deposit share over the past decade. As of mid-2010, they accounted for less than 2%. Most of the ILC insured deposits, moreover, are held by financially-owned ILCs, not commercially-owned ILCs. If the FDIC had to write a check to all insured depositors to cover losses, the sum going to ILC depositors would be at most \$112 billion (assuming all ILC deposits are FDIC-insured), while the check going to all other depositors would be a daunting sum indeed, at more than \$5 trillion. In short, ILCs pose no serious threat to the FDIC insurance fund, either now or in the foreseeable future.

There have, of course, been some ILC failures. From 1986 to 2003, 21 ILCs failed, costing the FDIC \$212 million to resolve. But not a single ILC failed from 2004 to 2008, the period covering the recent financial crisis. And none of the failures involved *commercially-owned ILCs*. The two biggest ILCs accounted for 43% of the total FDIC resolution costs for all failed ILCs over the period.

Table 5 compares the failures of those 21 ILCs relative to all FDIC-insured failures over the period, those ILCs accounted for 1% of the total. The other 2,065 failed institutions cost the FDIC \$105 billion to resolve.

In terms of losses relative to assets, the ratio for the 21 ILCs was 14.4% over the period, compared to 16.4% for all other failed institutions. From 2004 to 2017, however, the ratio for ILCs rose to 33.8% due to two failures, while the ratio for the other 531 failed institutions was 10.5% percent. However, of the 758 banks receiving \$236 billion in financial assistance from the Troubled Asset Relief Program, only one (Medallion Bank) was an ILC.^{xxix}

Table 5. FDIC losses from failed institutions: ILCs versus all other FDIC-insured institutions, 1986–2017

| | ILCs | All other FDIC-insured depository institutions | ILCs as % of all other FDIC-insured depository institutions |
|--|---------------|--|---|
| 1986–2003 | | | |
| Number of failed institutions | 21 | 2,065 | 1.0% |
| Total assets of failed institutions (US\$ millions) | \$1,470 | \$642,575 | 0.2% |
| Total loss to FDIC (US\$ millions) | \$212 | \$105,309 | 0.2% |
| Total loss to total assets of failed institutions (%) | 14.4% | 16.4% | — |
| 2004–2017 | | | |
| Number of failed institutions | 2* | 531 | 0.38% |
| Total assets of failed institutions (US\$ millions) | \$1,694 | \$702,259 | 0.24% |
| Total loss to FDIC (US\$ millions) | \$572 | \$73,644 | 0.78% |
| Total loss to total assets of failed institutions (%) | 33.76% | 10.49% | — |
| 1986–2017 | | | |
| Number of failed institutions | 23 | 2,596 | 0.89% |
| Total assets of failed institutions (US\$ millions) | \$3,164 | \$1,344,834 | 0.24% |
| Total loss to FDIC (US\$ millions) | \$784 | \$178,953 | 0.44% |
| Total loss to total assets of failed institutions (%) | 24.78% | 13.31% | — |

Source: FDIC.

Note: The two failed ILCs are Advanta Bank Corp (March 2010) and Security Savings Bank (February 2009). Of the two institutions, Advanta incurred a loss to the FDIC of \$537 million. It had provided loans to small businesses and failed as its clients suffered the effects of the severe recession.

Figure 11a shows that the assets of the 25 active ILCs grew in every year except 2013 and Q1 2017. The 2013 decline is entirely due to USAA Savings Bank in Las Vegas, which mainly held the credit card assets for USAA until they were moved to USAA Federal Savings Bank in Texas. Also of note, the ILC assets grew faster than the assets for all FDIC-insured institutions, whose assets actually declined in 2009.

In terms of loan growth, Figure 11b shows that ILC growth exceeded that of all FDIC-insured institutions except in 2004, 2013, and Q1 2017. The decline in 2013 was again due to USAA Savings Bank.

Figure 11a. Asset growth for 25 active ILCs versus FDIC-insured institutions, 2001–Q1 2017

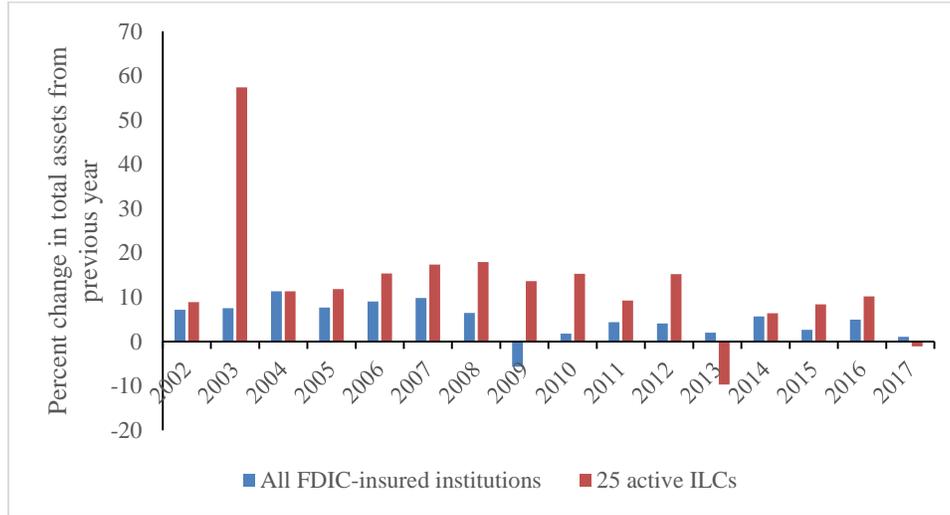
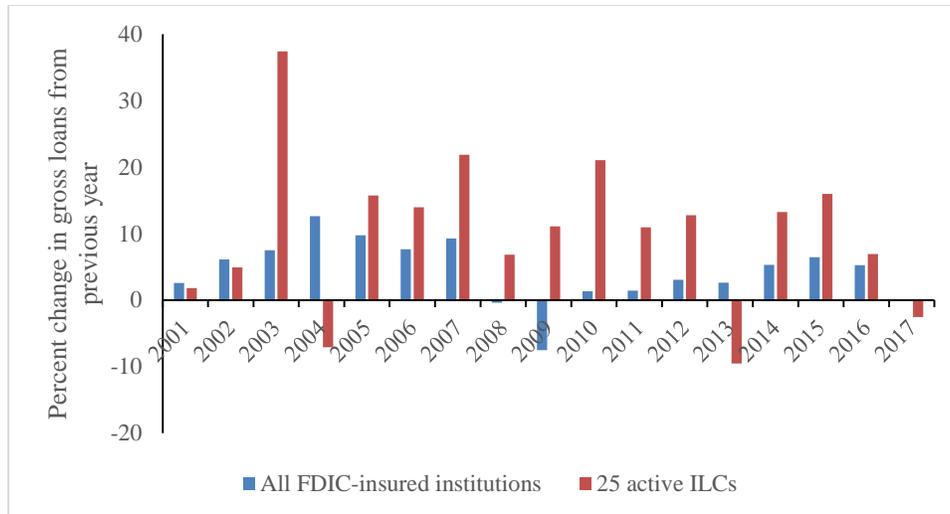


Figure 11b. Loan growth for 25 active ILCs versus FDIC-insured institutions, 2001–Q1 2017



Sources: Federal Reserve, FDIC, Milken Institute.

Note: The reason for the substantial increase in 2003 is due to UBS Bank USA becoming an ILC.

Continuing the comparison, we look at real estate-related loans as a share of total loans for the ILCs versus all FDIC-insured institutions. As shown in Figure 12a, among all FDIC-insured institutions, including ILCs, real estate loans accounted for 61% of total loans before the crisis, and declined slightly to 50% after the crisis. Figure 12b looks at financially-owned ILCs, and shows that real estate loans made up about 3% of their total loans before the crisis, and increased to 13% after the crisis. Figure 12c shows that commercially-owned ILCs, however, had a very small percentage of real estate loans; prior to the crisis, only 8% percent of total loans were real estate loans, while after the crisis, the percentage declined to 7% percent. Both types of ILCs now primarily provide consumer loans.

Figure 12a. All FDIC-insured institutions focused more on real estate loans both pre- and post-crisis

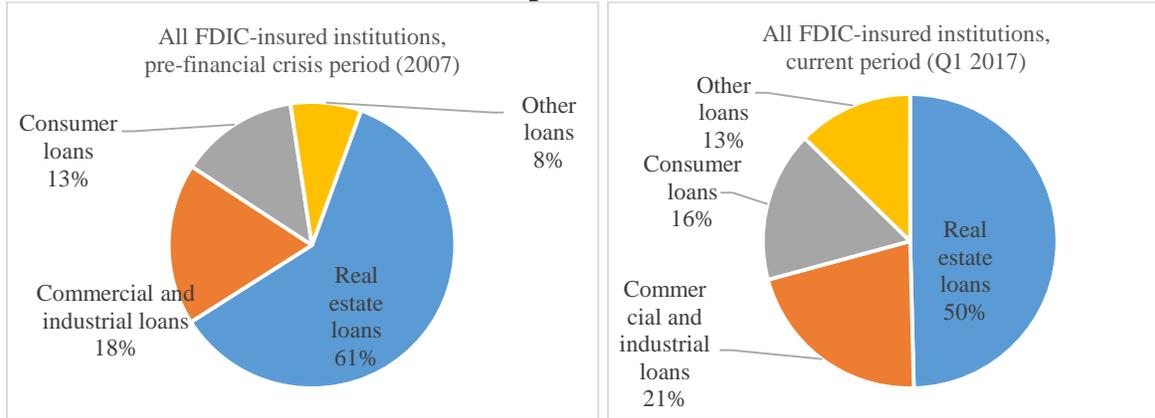


Figure 12b. Financially-owned ILCs focused more on consumer and commercial/industrial loans

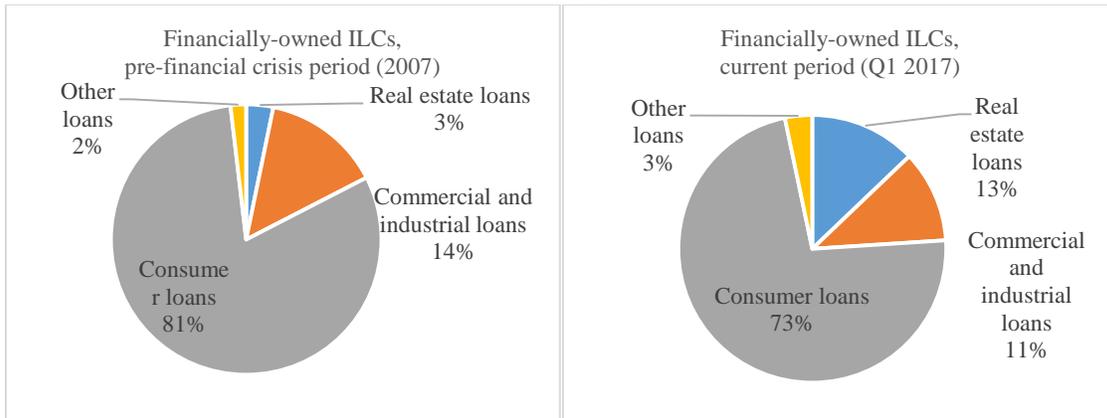
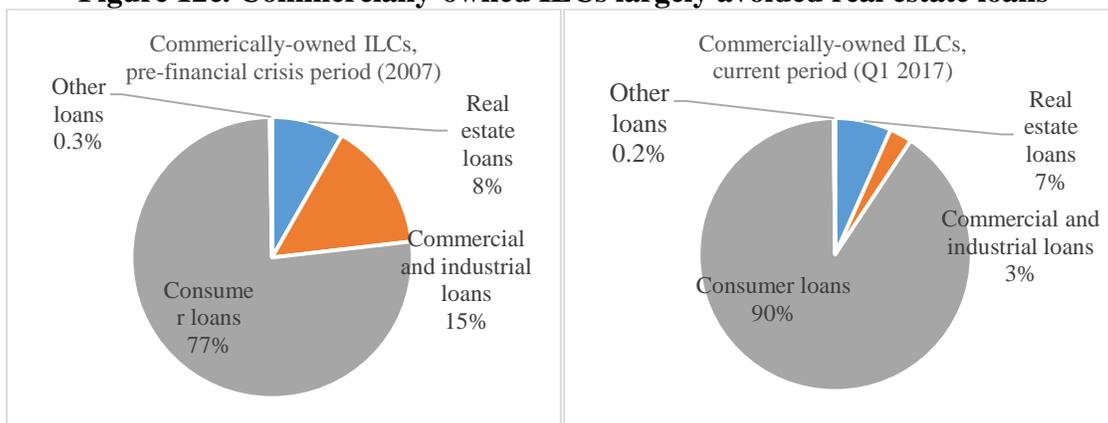


Figure 12c. Commercially-owned ILCs largely avoided real estate loans



Source: FDIC

Note: The data are for aggregate loan compositions of all commercially-owned ILCs. The pre-financial crisis period is as of the end of 2007. The data include all active ILCs in a given year; some of them closed or became inactive before Q1 2017.

Of the five major investment banks that existed prior to the financial crisis, two are still active, two were acquired, and one failed. The one that failed, Lehman Brothers, owned an ILC, Woodlands Commercial Bank in Utah.^{xxx} This ILC didn't cause the failure of Lehman Brothers. Furthermore, Lehman Brothers reportedly transferred \$75 million in cash and \$200 million in other noncash consideration to its ILC in December 2010, and the institution was voluntarily closed in 2011.^{xxxi} To this degree, the parent of the ILC was able to serve as a source of strength for its subsidiary, not the other way around. However, Julie Boyle, CEO of the ILC, stated in a conversation with one of the co-authors of an earlier paper on ILCs that Lehman's transfer of funds wouldn't have been necessary, if not for an earlier inappropriate seizure of some of Woodlands' assets (Barth and Li, 2011). This seems to show that inappropriate actions *are* possible by parents of ILCs, and that regulators do step in to require that ILCs are made whole. Furthermore, the ILC relied on mark-to-market accounting, according to Boyle, which contributed to a significant decline in the value of the institution's assets in 2008, but that value was subsequently reversed as markets improved, and the ILC became well capitalized before its closure.

The Dodd Frank Act provides greater authority for the Federal Reserve to deal with systemically important financial institutions, including potentially any ILC or parent company. In addition, the act requires parents of all FDIC-insured depository institutions to serve as a source of strength.

V. THE ILC BUSINESS MODEL HAS BEEN A SAFE AND SOUND ONE

The ILC industry has survived for more than a century, so clearly ILCs have been accepted in the financial marketplace. Moreover, no commercially-owned ILC has *ever* failed.

Table 6 looks at the group of the 25 active ILCs to show how they perform relative to all FDIC-insured institutions, all state-chartered institutions, and commercial banks of various asset size. In terms of ROA, 80% of the ILCs performed better than the average of all FDIC-insured institutions, while coincidentally 80% also outperformed the average of state-chartered institutions. When compared to commercial banks within the same size categories, 50% or more of the ILCs came out ahead in terms of ROA. Based on all the other measures, nearly half the ILCs performed better than all FDIC-insured institutions and state-chartered institutions.

This isn't always the case when ILCs are compared to commercial banks by size group, particularly with respect to noncurrent loans to loans, loss allowance to noncurrent loans, and net charge-offs to loans.

Table 6. ILCs generally outperform the average for all FDIC-insured institutions, Q1 2017

| | ROA (%) | ROE (%) | Equity capital to assets (%) | Efficiency ratio (%) | Net interest margin (%) | Non-current loans to loans (%)* | Loss allowance to noncurrent loans (%)* | Net charge-offs to loans (%)* | Number of ILCs under each category |
|--|---------|---------|------------------------------|----------------------|-------------------------|---------------------------------|---|-------------------------------|------------------------------------|
| Percentage of ILCs having better performance than: | | | | | | | | | |
| All FDIC-insured institutions | 80.0 | 68.0 | 84.0 | 72.0 | 80.0 | 66.7 | 85.7 | 45.8 | 25 |
| State-chartered institutions | 80.0 | 68.0 | 80.0 | 72.0 | 80.0 | 66.7 | 81.0 | 45.8 | 25 |
| Commercial banks | | | | | | | | | |
| Assets less than \$100M | 60.0 | 40.0 | 100.0 | 40.0 | 100.0 | 80.0 | 100.0 (3) | 60.0 | 5 |
| Assets \$100M to \$300M | 66.7 | 33.3 | 100.0 | 66.7 | 100.0 | 66.7 | 100.0 | 33.3 | 3 |
| Assets \$300M to \$500M | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | NA | 0.0 | 1 |
| Assets \$500M to \$1B | 50.0 | 50.0 | 75.0 | 50.0 | 75.0 | 75.0 | 50.0 | 50.0 | 4 |
| Assets \$1B to \$10B | 100.0 | 100.0 | 88.9 | 100.0 | 66.7 | 37.5 (8) | 62.5 (8) | 25.0 (8) | 9 |
| Assets greater than 10B | 100.0 | 100.0 | 33.3 | 100.0 | 66.7 | 100.0 | 100.0 | 33.3 | 3 |

Note: * Data for noncurrent loans to loans, loss allowance to noncurrent loans, and net charge-offs to loans are only available for 24, 21, and 24 ILCs, respectively.

Sources: FDIC; Milken Institute.

Table 7 shows that as of Q2 2010, both ILC types were better capitalized and had better profitability ratios than other FDIC-insured institutions. In particular, the ROA for commercially-owned ILCs was five times that of FDIC-insured institutions, and the ROE was nearly three times as great.

Table 7. ILCs are more safe and sound than all FDIC-insured institutions, Q1 2017

| | Capital ratios (%) | | Profitability ratios (%) | |
|-------------------------------|--------------------------|---------------------------------|--------------------------|------|
| | Equity capital to assets | Tier 1 risk-based capital ratio | ROA | ROE |
| Financially-owned ILCs | 16.5 | 20.2 | 1.9 | 11.2 |
| Commercially-owned ILCs | 15.1 | 14.8 | 2.9 | 17.6 |
| All FDIC-insured institutions | 11.0 | 12.4 | 0.6 | 5.5 |
| State-chartered institutions | 11.7 | 13.5 | 1.1 | 9.4 |

Source: FDIC.

Figure 8 ranks ILCs against all FDIC-insured institutions (5,865 total) for return on assets and equity capital-to-asset ratio as of Q1 2017. More than half (15) of the ILCs rank in the top 10% of the 5,865 for ROA, and 4 of these were commercially-owned ILCs (out of a total of 6). The worst-performing ILC was Toyota Financial Savings Bank, with \$931 million in assets. However, it still ranks in the top 10%, with an ROA of 18.6 percent. Nearly half of the ILCs also ranked in the top 10% for capital ratios, including three commercially-owned ILCs.

Table 8. Ranking of ILCs relative to all FDIC-insured institutions (5,865) based on ROA and equity capital-to-asset ratio, Q1 2017

| ROA | | | Equity capital-to-asset ratio | | |
|--------------------|--|----------------|-------------------------------|--|----------------|
| Rank | ILCs | Ownership type | Rank | ILCs | Ownership type |
| Top 10% | | | Top 10% | | |
| 13 | USAA Savings Bank | Financial | 40 | First Electronic Bank | Commercial |
| 19 | The Pitney Bowes Bank, Inc. | Commercial | 44 | Beal Bank USA | Financial |
| 21 | WEX Bank | Financial | 51 | Rancho Santa Fe Thrift & Loan Association | Financial |
| 26 | Eaglemark Savings Bank | Commercial | 72 | The Morris Plan Company of Terre Haute, Inc. | Financial |
| 31 | American Express Centurion Bank | Financial | 77 | Community Commerce Bank | Financial |
| 43 | WebBank | Financial | 131 | Eaglemark Savings Bank | Commercial |
| 47 | Celtic Bank | Financial | 177 | Merrick Bank | Financial |
| 56 | Beal Bank USA | Financial | 205 | WebBank | Financial |
| 76 | Comenity Capital Bank | Financial | 261 | American Express Centurion Bank | Financial |
| 119 | Merrick Bank | Financial | 274 | Toyota Financial Savings Bank | Commercial |
| 144 | First Electronic Bank | Commercial | 371 | Celtic Bank | Financial |
| 146 | EnerBank USA | Commercial | Top 10%-50% | | |
| 158 | The Morris Plan Company of Terre Haute, Inc. | Financial | 589 | BMW Bank of North America | Commercial |
| 260 | Sallie Mae Bank | Financial | 601 | Medallion Bank | Financial |
| 309 | LCA Bank Corporation | Financial | 608 | Balboa Thrift and Loan Association | Financial |
| Top 10%-50% | | | 703 | USAA Savings Bank | Financial |
| 654 | BMW Bank of North America | Commercial | 753 | Minnesota First Credit and Savings, Incorporated | Financial |
| 772 | Medallion Bank | Financial | 1066 | Comenity Capital Bank | Financial |
| 988 | Optum Bank, Inc. | Financial | 1521 | EnerBank USA | Commercial |
| 1424 | UBS Bank USA | Financial | 1701 | WEX Bank | Financial |
| 1514 | Community Commerce Bank | Financial | 1846 | LCA Bank Corporation | Financial |
| Bottom 50% | | | 2350 | Optum Bank, Inc. | Financial |
| 3457 | Minnesota First Credit and Savings, Incorporated | Financial | 2535 | Sallie Mae Bank | Financial |
| 3540 | Finance Factors, Ltd. | Financial | 2658 | Finance Factors, Ltd. | Financial |
| 4482 | Rancho Santa Fe Thrift & Loan Association | Financial | Bottom 50% | | |
| 4735 | Balboa Thrift and Loan Association | Financial | 3323 | The Pitney Bowes Bank, Inc. | Commercial |
| 5162 | Toyota Financial Savings Bank | Commercial | 4301 | UBS Bank USA | Financial |

Source: FDIC.

Tables 9a and 9b show the loan makeup of the financially-owned ILCs. In just 4 of the 19 do real estate loans constitute 50% or more of their total loans, while the rest either concentrate more heavily on commercial and industrial loans, or consumer loans. Indeed, 6 of the ILCs make only consumer loans, and for another 5, consumer loans account for more than 90% of total loans. In addition, none of the 25 ILCs make agricultural loans.

Based on these data, one can conclude, as does Baradaran (2010, p. 1196), “[t]he ILC structure is currently the only place where the stabilizing relationship between commerce and banking takes place and, as demonstrated, the small industry has remained sound through a systemic financial collapse largely due to its commercial relationships.”

Table 9a. Loan composition of financially-owned ILCs, Q1 2017

| ILC | State | Composition of portfolio (as % of total loans) | | | | | Loans to total assets (%) |
|---|-------|--|-------------|-------------|--------------|------------|---------------------------|
| | | Commercial and industrial | Real estate | Consumer | Agricultural | Other | |
| Current Financially-owned ILCs | | | | | | | |
| American Express Centurion Bank | UT | 0.7 | 0.0 | 98.8 | 0.0 | 0.5 | 64.2 |
| Balboa Thrift and Loan Association | CA | 0.1 | 19.6 | 80.3 | 0.0 | 0.0 | 91.8 |
| Beal Bank USA | NV | 67.4 | 31.0 | 0.0 | 0.0 | 1.6 | 70.7 |
| Celtic Bank Corporation | UT | 48.9 | 47.4 | 5.0 | 0.0 | 0.1 | 84.8 |
| Comenity Capital Bank | UT | 0.3 | 0.0 | 99.7 | 0.0 | 0.0 | 89.7 |
| Community Commerce Bank | CA | 0.0 | 86.6 | 13.4 | 0.0 | 0.0 | 69.9 |
| Finance Factors, Limited | HI | 0.0 | 99.1 | 1.5 | 0.0 | 0.0 | 68.2 |
| LCA Bank Corporation | UT | 3.4 | 0.1 | 0.0 | 0.0 | 96.5 | 95.1 |
| Medallion Bank | UT | 28.6 | 0.0 | 71.4 | 0.0 | 0.0 | 85.5 |
| Merrick Bank Corporation | UT | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 | 97.4 |
| Minnesota First Credit and Savings, Inc. | MN | 1.5 | 56.7 | 41.9 | 0.0 | 0.0 | 92.1 |
| Morris Plan Company of Terre Haute | IN | 0.5 | 6.6 | 92.9 | 0.0 | 0.1 | 86.5 |
| Optumhealth Bank Inc. | UT | 36.7 | 49.7 | 0.0 | 0.0 | 13.6 | 6.4 |
| Rancho Santa Fe Thrift and Loan Association | CA | 0.0 | 3.8 | 96.2 | 0.0 | 0.0 | 90.8 |
| Sallie Mae Bank | UT | 0.0 | 0.0 | 100.0 | 0.0 | 0.0 | 88.0 |
| UBS Bank USA | UT | 13.7 | 25.0 | 54.4 | 0.0 | 6.8 | 74.2 |
| USAA Savings Bank | NV | N/A | N/A | N/A | N/A | N/A | N/A |
| WebBank | UT | 33.0 | 0.5 | 66.5 | 0.0 | 0.0 | 39.2 |
| WEX Bank | UT | 99.9 | 0.1 | 0.0 | 0.0 | 0.0 | 81.2 |
| Average | | 18.6 | 23.7 | 51.2 | 0.0 | 6.6 | 76.4 |
| Weighted average | | 11.1 | 12.9 | 72.7 | 0.0 | 3.3 | 70.2 |

Table 9b. Loan composition of commercially-owned ILCs, Q1 2017

| ILC | State | Composition of portfolio (as % of total loans) | | | | | Loans to total assets (%) |
|--|-------|--|-------------|-------------|--------------|------------|---------------------------|
| | | Commercial and industrial | Real Estate | Consumer | Agricultural | Other | |
| Current commercially-owned ILCs | | | | | | | |
| BMW Bank of North America | UT | 0 | 0 | 100 | 0 | 0 | 75 |
| Eaglemark Savings Bank | NV | 0 | 0 | 100 | 0 | 0 | 33 |
| EnerBank USA | UT | 0 | 0 | 100 | 0 | 0 | 92 |
| First Electronic Bank | UT | 0 | 0 | 100 | 0 | 0 | 28 |
| The Pitney Bowes Bank Inc. | UT | 93 | <1 | 0 | 0 | 7 | 40 |
| Toyota Financial Savings Bank | NV | 0 | 100 | 0 | 0 | 0 | 69 |
| Average | | 15.4 | 16.8 | 66.7 | 0.0 | 1.1 | 56.3 |
| Weighted average | | 2.7 | 6.7 | 91.6 | 0.0 | 0.2 | 74.1 |

Source: FDIC.

The Potential Benefits of ILCs

Their long survival and sound performance provide evidence that ILCs offer benefits to both their customers and owners. It's impossible to distinguish between financially and commercially-owned ILCs in terms of their loan portfolios. All one can say is that the average loan-to-asset ratios for both ILC types are roughly similar, and that, judging by the weighted average ratios, commercially-owned ILCs have a slightly larger share of loans than their financially-owned brethren.

Financially-owned ILCs are in many respects quite similar to other banking institutions. Their parent financial firms could become financial holding companies by converting the ILCs to commercial banks. In this sense, there's nothing particularly unique about financially-owned ILCs relative to commercial banks. However, both financially and commercially-owned ILCs are state-chartered, rather than federally chartered, which is not the case for all commercial banks.

Apart from that difference, the only other major differences stem from the commercial ownership of some ILCs. These owners cannot convert their ILCs to commercial banks *and* at the same time become financial holding companies. Their only option for bank ownership is to hold on to their current ILCs.

Yet, as we've seen with performance, the business model associated with commercial ILCs has multiple characteristics that contribute to their stability:

- *Marketing advantages and economies of scale.* Many ILCs serve the lowest-risk parts of a broader financial operation. The bank obtains its business with little or no marketing cost and often only makes loans selected from a broad pool of applicants. Even if the broader pool is affected in an economic downturn, it may have little impact on the loans made by the bank.
- *Geographical risk reduction.* Most ILCs serve specialized customer groups spread across the nation, which helps reduce risk through geographical diversification. Access to such a large market is extremely difficult for a bank not owned by a large diversified parent.
- *Capital.* In times of stress, a diversified parent may be in a better position to provide capital support to a bank subsidiary than a banking holding company, whose assets consist almost entirely of a bank subsidiary.
- *Informational efficiencies.* An ILC parent engaged in multiple business lines may be better able to identify underserved markets and opportunities to provide banking services to customers of the parent. This information may enable the institution to make better loan decisions than traditional banks, to provide other financial services that are desired by the customers of the parent firm, and to make credit available when it is not readily available elsewhere. For example, the ILC owned by Harley-Davidson is in a much better position to assess the collateral value of a motorcycle than is a typical bank. Transportation Alliance Bank is affiliated with the company operating truck stops nationwide and was better positioned to serve the banking needs of long-haul truckers, though it changed its charter from an ILC to a commercial bank in July 2015.

- *Governance.* The parent company of an ILC provides an additional and important source of governance. It wouldn't want its subsidiary institution to damage its reputation, especially if the subsidiary ILC is small in relation to the parent.

In addition, financially-owned ILCs had net income of \$342,046 per employee, while commercially-owned ILCs had a net income of \$126,325 per employee for Q1 2017. In comparison, all FDIC-insured institutions had a net income of \$21,126 per employee.

Table 7 in the appendix lists a number of academic studies that have examined the issue of mixing banking and commerce, along with their findings. They present no evidence that the ownership of ILCs by commercial firms is unsound policy, or that whatever risks might exist cannot be contained by current regulation. In addition, according to the FDIC (1987), "the public policy implication of [this study's major] conclusion is that ... the Bank Holding Company Act ... should be abolished."

VI. CONCLUSIONS

Not only did ILCs survive the Great Depression, they increased their loans throughout the period—a role they reprised during the most recent financial crisis, when they continued to provide loans even as other financial institutions were unable or unwilling to do so, claiming a lack of liquidity or capital. Even so, after the crisis, the Dodd Frank Act requested that the GAO conduct a study of the ILC industry, this because there was renewed concern in some corners that this little-known corner of the banking industry could result in systemic risk.

Importantly, the GAO didn't recommend a repeal of federal law provisions allowing ILC ownership by commercial firms. In fact, the GAO reported that regulatory and supervisory practices by the Office of the Comptroller of the Currency (OCC) are the same, regardless of whether the institution is owned by a bank holding company or not. The GAO also reported that FDIC officials believe that they can adequately supervise ILCs. The bottom line? The GAO did not endorse any new regulatory or supervisory requirements for ILCs.

No commercially-owned ILC has failed, and ILCs have performed well over the years—better in many respects than most other FDIC-insured institutions. Furthermore, there is no evidence whatsoever to suggest that the US financial system and economy would be on sounder footing if diversified firms were prohibited from owning ILCs.

Many diversified companies have the expertise, resources, capital, and perhaps even established credit businesses to contribute to a bank, both during its startup phase and over time. As the Treasury Department (1991) has pointed out, "the development of these broadly diversified firms has often proven beneficial to the economy at large, and financial markets in particular. Most important has been the ability and willingness of such firms to strengthen the capital positions of their financial services subsidiaries. ... The stability brought to the financial markets in this way is a net benefit to the economy overall."

The total net worth of US non-financial corporate businesses was \$24 trillion as of Q1 2017. If some of these firms now prohibited from owning an ILC were instead allowed to help the ILC industry grow, new sources of capital would open—and even a small percentage of this capital channeled to ILCs would contribute to an expansion in the availability of credit, a development that could have positive ramifications for US economic growth.

Furthermore, such a move would help US financial institutions compete in the global marketplace. The US is out of step with international norms because the vast majority of countries do permit the mixing of banking and commerce. This suggests that legislators, regulators, and other officials should be careful not to put such US financial institutions at a competitive disadvantage.

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ACKNOWLEDGEMENTS

The authors are extremely grateful for the financial support provided by the Center for Innovation in Banking and Financial Services, University of Utah, and to helpful comments provided by George Sutton, Sherrie Rees, Kirk Weiler, Dave Young, Frank Pignanelli, and Aimee McConkie. Also, thanks are due to Bijie Jia, Nguyen Nguyen, Jiayi Xu, and Wenjuan Guo for helpful assistance.

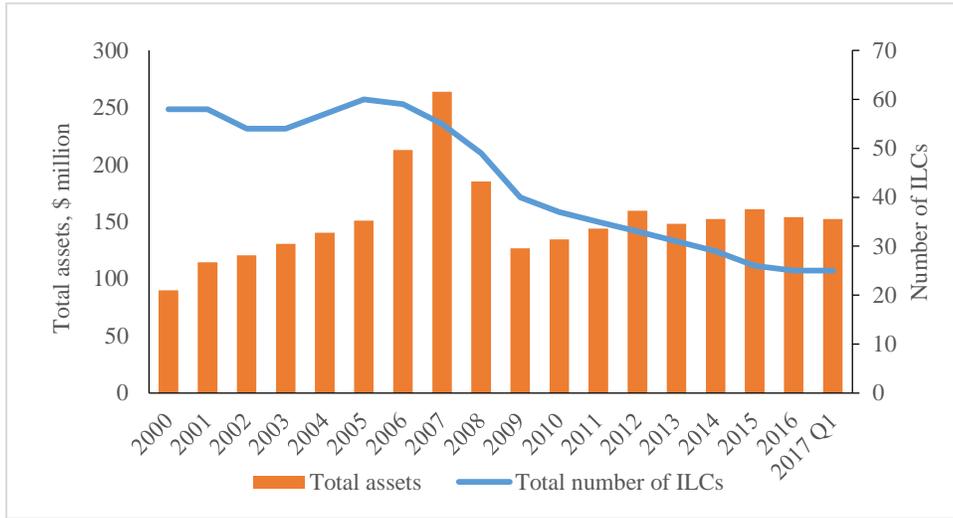
AUTHOR BIOGRAPHIES

James R. Barth is the Lowder Eminent Scholar in Finance at Auburn University, a Senior Fellow at the Milken Institute, and a Fellow at the Wharton Financial Institutions Center. Barth was an appointee of Presidents Ronald Reagan and George H.W. Bush as chief economist of the Office of Thrift Supervision and previously the Federal Home Loan Bank Board. He has also held the positions of professor of economics at George Washington University, associate director of the economics program at the National Science Foundation, and Shaw Foundation Professor of Banking and Finance at Nanyang Technological University. He has been a visiting scholar at the US Congressional Budget Office, Federal Reserve Bank of Atlanta, Office of the Comptroller of the Currency, and the World Bank.

Barth has testified before several congressional committees. He has authored articles in professional journals and has co-authored and co-edited several books, including *Rethinking Bank Regulation: Till Angels Govern* (Cambridge University Press), *The Rise and Fall of the U.S. Mortgage and Credit Markets: A Comprehensive Analysis of the Meltdown* (John Wiley & Sons), *China's Emerging Financial Markets: Challenges and Opportunities* (Springer), *Guardians of Finance: Making Regulators Work for Us* (MIT Press), *Fixing the Housing Market: Financial Innovations for the Future* (Wharton School Publishing-Pearson), and *Research Handbook on International Banking and Governance* (Edward Elgar Publishing). Barth is included in *Who's Who in Economics: A Biographical Dictionary of Major Economists, 1700 to 1995*.

Yanfei Sun is a fourth-year Ph.D. student in the Finance Department at Auburn University. She is a co-author of "Do State Regulations Affect Payday Lender Concentration?" *Journal of Economics and Business*, March–April 2016, 84:14–29.

Appendix Figure 1. ILCs by number and total assets



Source: FDIC.

Appendix Table 1. ILCs account for a small share of all FDIC-insured deposits, 2000–Q1 2017

| Year | All deposits at FDIC-insured institutions (\$ billion) | All FDIC-insured deposits (\$ billion) | ILC deposits (\$ billion) | | ILCs deposits as % of all deposits at FDIC-insured institutions | | ILCs deposits as % of all FDIC-insured deposits | |
|---------|--|--|---------------------------|------------------------|---|------------------------|---|------------------------|
| | | | Commercially-owned ILCs | Financially-owned ILCs | Commercially-owned ILCs | Financially-owned ILCs | Commercially-owned ILCs | Financially-owned ILCs |
| 2000 | 4,915 | 3,054 | 0.6 | 58.9 | 0.01 | 1.2 | 0.02 | 1.93 |
| 2001 | 5,189 | 3,214 | 0.6 | 80.2 | 0.01 | 1.55 | 0.02 | 2.5 |
| 2002 | 5,569 | 3,382 | 0.7 | 79.6 | 0.01 | 1.43 | 0.02 | 2.35 |
| 2003 | 5,960 | 3,452 | 1.3 | 84.4 | 0.02 | 1.42 | 0.04 | 2.45 |
| 2004 | 6,585 | 3,621 | 1.9 | 92.6 | 0.03 | 1.41 | 0.05 | 2.56 |
| 2005 | 7,141 | 3,890 | 2.5 | 105.4 | 0.04 | 1.48 | 0.06 | 2.71 |
| 2006 | 7,825 | 4,147 | 2.9 | 143.8 | 0.04 | 1.84 | 0.07 | 3.47 |
| 2007 | 8,415 | 4,286 | 3.3 | 173.1 | 0.04 | 2.06 | 0.08 | 4.04 |
| 2008 | 9,036 | 4,744 | 15.4 | 139.1 | 0.17 | 1.54 | 0.32 | 2.93 |
| 2009 | 9,227 | 5,399 | 13.7 | 72.4 | 0.15 | 0.78 | 0.25 | 1.34 |
| 2010 | 9,447 | 6,302 | 13.3 | 74.1 | 0.14 | 0.78 | 0.21 | 1.18 |
| 2011 | 10,220 | 6,973 | 18.6 | 79.1 | 0.18 | 0.77 | 0.27 | 1.13 |
| 2012 | 10,863 | 7,402 | 20.7 | 90.5 | 0.19 | 0.83 | 0.28 | 1.22 |
| 2013 | 11,242 | 5,998 | 23.3 | 90.2 | 0.21 | 0.80 | 0.39 | 1.50 |
| 2014 | 11,827 | 6,197 | 26.5 | 90.8 | 0.22 | 0.77 | 0.43 | 1.46 |
| 2015 | 12,261 | 6,523 | 25.2 | 98.3 | 0.21 | 0.80 | 0.39 | 1.51 |
| 2016 | 12,942 | 6,916 | 8.2 | 107.1 | 0.06 | 0.83 | 0.12 | 1.55 |
| 2017 Q1 | 13,130 | 7,078 | 8.2 | 103.4 | 0.06 | 0.79 | 0.12 | 1.46 |

Source: FDIC.

Appendix Table 2a. State distribution of ILCs assets, 2000–Q1 2017 (\$ millions)

| Year | California | Colorado | Hawaii | Indiana | Minnesota | Nevada | Utah | Total |
|-------------|-------------------|-----------------|---------------|----------------|------------------|---------------|-------------|--------------|
| 2000 | 10,777 | 662 | 465 | 44 | 293 | 3,117 | 74,568 | 89,925 |
| 2001 | 11,475 | 672 | 488 | 44 | 54 | 3,515 | 98,304 | 114,552 |
| 2002 | 12,414 | 270 | 494 | 43 | 58 | 3,977 | 103,383 | 120,640 |
| 2003 | 13,499 | 456 | 466 | 47 | 60 | 5,769 | 110,425 | 130,722 |
| 2004 | 13,705 | 467 | 596 | 51 | 53 | 10,190 | 115,389 | 140,451 |
| 2005 | 15,676 | 467 | 653 | 65 | 46 | 9,790 | 124,324 | 151,022 |
| 2006 | 17,159 | 370 | 673 | 55 | 29 | 8,221 | 186,208 | 212,716 |
| 2007 | 12,152 | 204 | 707 | 52 | 31 | 8,849 | 241,824 | 263,820 |
| 2008 | 10,969 | 1,092 | 690 | 55 | 27 | 10,887 | 161,660 | 185,381 |
| 2009 | 8,980 | 0 | 653 | 60 | 29 | 16,682 | 100,296 | 126,700 |
| 2010 | 9,224 | 0 | 573 | 66 | 29 | 21,505 | 103,286 | 134,683 |
| 2011 | 8,614 | 0 | 488 | 72 | 30 | 21,847 | 112,921 | 143,972 |
| 2012 | 8,665 | 0 | 477 | 76 | 30 | 23,186 | 127,311 | 159,744 |
| 2013 | 8,754 | 0 | 482 | 73 | 29 | 10,503 | 128,274 | 148,116 |
| 2014 | 556 | 0 | 487 | 75 | 29 | 8,247 | 143,028 | 152,421 |
| 2015 | 463 | 0 | 527 | 74 | 28 | 7,706 | 152,252 | 161,051 |
| 2016 | 491 | 0 | 573 | 77 | 28 | 8,046 | 144,899 | 154,114 |
| 2017 Q1 | 513 | 0 | 569 | 78 | 28 | 8,012 | 143,242 | 152,441 |

Source: FDIC.

Appendix Table 2b. State distribution of ILCs, 2000–Q1 2017

| Year | California | Colorado | Hawaii | Indiana | Minnesota | Nevada | Utah | Total |
|---------|------------|----------|--------|---------|-----------|--------|------|-------|
| 2000 | 21 | 4 | 3 | 1 | 3 | 2 | 23 | 58 |
| 2001 | 20 | 5 | 3 | 1 | 2 | 3 | 23 | 58 |
| 2002 | 17 | 4 | 2 | 1 | 2 | 3 | 24 | 54 |
| 2003 | 16 | 4 | 1 | 1 | 2 | 3 | 27 | 54 |
| 2004 | 15 | 4 | 1 | 1 | 2 | 5 | 29 | 57 |
| 2005 | 15 | 4 | 1 | 1 | 2 | 5 | 32 | 60 |
| 2006 | 14 | 4 | 1 | 1 | 2 | 5 | 32 | 59 |
| 2007 | 13 | 3 | 1 | 1 | 2 | 6 | 29 | 55 |
| 2008 | 12 | 2 | 1 | 1 | 1 | 5 | 27 | 49 |
| 2009 | 10 | | 1 | 1 | 1 | 4 | 23 | 40 |
| 2010 | 10 | | 1 | 1 | 1 | 4 | 20 | 37 |
| 2011 | 9 | | 1 | 1 | 1 | 4 | 19 | 35 |
| 2012 | 7 | | 1 | 1 | 1 | 4 | 19 | 33 |
| 2013 | 6 | | 1 | 1 | 1 | 4 | 18 | 31 |
| 2014 | 4 | | 1 | 1 | 1 | 4 | 18 | 29 |
| 2015 | 3 | | 1 | 1 | 1 | 4 | 16 | 26 |
| 2016 | 3 | | 1 | 1 | 1 | 4 | 15 | 25 |
| 2017 Q1 | 3 | | 1 | 1 | 1 | 4 | 15 | 25 |

Source: FDIC (www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html).

Appendix Table 3a. Selected information on active financially-owned ILCs, Q1 2017

| Name | ST | Date established | Date FDIC-insured | Number of employees | Total assets (\$ in thousands) | Description of business line | Registered holding company: immediate parent | Parent company |
|------------------------------------|----|------------------|-------------------|---------------------|--------------------------------|--|--|----------------------------|
| American Express Centurion Bank | UT | 3/20/1989 | 3/20/1989 | 293 | 34,496,339 | A broad range of financial products, including credit cards, consumer travel service | American Express Travel Related Services Company, Inc. | American Express Company |
| Balboa Thrift And Loan Association | CA | 12/11/1980 | 7/3/1986 | 92 | 246,227 | Financial services, including savings and investment products, residential loans, auto financing, more. | Hafif Bancorp | Hafif Bancorp |
| Beal Bank USA | NV | 8/2/2004 | 8/2/2004 | 138 | 5,260,105 | Financial services with specialization in purchasing loans and portfolios of loans in the secondary market | Beal Financial Corporation | Beal Financial Corporation |

| Name | ST | Date established | Date FDIC-insured | Number of employees | Total assets (\$ in thousands) | Description of business line | Registered holding company: immediate parent | Parent company |
|--|----|------------------|-------------------|---------------------|--------------------------------|--|--|-------------------------------------|
| Celtic Bank Corporation | UT | 3/1/2001 | 3/1/2001 | 183 | 571,846 | Business loans, real estate loans, asset-based lending, equipment/construction financing | Celtic Investment, Inc | Celtic Investment, Inc |
| Comenity Capital Bank | UT | 12/1/2003 | 12/1/2003 | 77 | 6,663,672 | | Alliance Data Systems Corporation | Alliance Data Systems Corporation |
| Community Commerce Bank | CA | 10/1/1976 | 9/10/1985 | 38 | 191,495 | A wide range of loan products and deposit accounts | East Los Angeles Community Union | East Los Angeles Community Union |
| Finance Factors, Limited | HI | 5/14/1952 | 6/4/1984 | 119 | 568,723 | Financial services to local companies | Finance Factors, Limited | Finance Enterprises Ltd. |
| LCA Bank Corporation | UT | 1/26/2006 | 1/26/2006 | 10 | 167,313 | Full service leasing company | Lease Corporation of America | Lease Corporation of America |
| Medallion Bank | UT | 12/22/2003 | 12/22/2003 | 67 | 1,083,931 | Recreation, health care, taxi medallion loans. | Medallion Financial Corp. | Medallion Financial Corp. |
| Merrick Bank Corporation | UT | 9/22/1997 | 9/22/1997 | 255 | 2,980,106 | Loans for boats and RV customers. | Cardholder Management Services Inc. | Cardholder Management Services Inc. |
| Minnesota First Credit and Savings, Incorporated | MN | 1/1/1956 | 8/7/1986 | 13 | 27,651 | Consumer loans and home mortgage | Minnesota Thrift Company | Minnesota Thrift Company |
| Morris Plan Company of Terre Haute, The | IN | 7/27/1962 | 3/23/1990 | 27 | 77,854 | | First Financial Corporation | First Financial Corp. |
| Optumhealth Bank, Inc. | UT | 7/21/2003 | 7/21/2003 | 177 | 7,655,605 | Financial products and services to individuals and families to pay for health care. | Unitedhealth Group Incorporated | Unitedhealth Group Incorporated |
| Rancho Santa Fe Thrift and Loan Association | CA | 1/2/1982 | 12/17/1984 | 3 | 75,429 | Consumer lending. | Firsttrust Savings Bank | Semperverde Holding Co. |
| Sallie Mae Bank | UT | 11/28/2005 | 11/28/2005 | 1,300 | 19,027,250 | Education loans to students and their families. | SLM Corporation | SLM Corporation |
| UBS Bank USA | UT | 9/15/2003 | 9/15/2003 | 324 | 55,943,089 | A broad range of financial services. | UBS Americas Inc | UBS AG |

| Name | ST | Date established | Date FDIC-insured | Number of employees | Total assets (\$ in thousands) | Description of business line | Registered holding company: immediate parent | Parent company |
|---------------------|----|------------------|-------------------|---------------------|--------------------------------|---|--|--|
| USAA Savings Bank * | NV | 9/27/1996 | 9/27/1996 | 47 | 1,781,018 | Financial services, primarily serving the military, veterans, and their families. | USAA Federal Savings Bank | United Services Automobile Association |
| WebBank** | UT | 5/15/1997 | 5/15/1997 | 75 | 453,627 | Loans and credit cards | Steel Partners Holdings LP | Steel Partners Holdings LP |
| WEX Bank | UT | 6/1/1998 | 6/1/1998 | 42 | 2,176,331 | | WEX Bank | WEX Inc |

Sources: FDIC, company websites, National Information Center.

Notes: *USAA Savings Bank was established as a credit card bank and licensed as an industrial loan company in 1997, according to state regulatory authorities.

**WebBank informed us that it should be considered a commercially-owned ILC, rather than a financially-owned ILC, because its parent is a conglomerate with controlling business interests in a number of different industries, including financial, industrial, and others. However, since insufficient data were available to us regarding different sources of revenue, and others have classified WebBank as a financially-owned ILC, we have also done so in this paper.

Appendix Table 3b. Selected information on active commercially-owned ILCs, Q1 2017

| Name | ST | Date founded | Date FDIC-insured | Number of employees | Total Assets (\$ in thousand) | Description of business line | Registered holding company-immediate parent | Ultimate parent |
|-------------------------------|----|--------------|-------------------|---------------------|-------------------------------|--|---|----------------------|
| BMW Bank of North America | UT | 11/12/999 | 11/12/999 | 38 | 9,942,712 | Financial services for BMW customers | BMW Bank of North America | BMW AG |
| Enerbank USA | UT | 6/3/2002 | 6/3/2002 | 259 | 1,359,402 | Home improvement and consumer energy product financing | Enerbank USA | Gms Energy Corp. |
| First Electronic Bank | UT | 10/5/2000 | 10/5/2000 | 50 | 20,742 | Financial and private label credit card services | Fry's Electronics | Fry's Electronics |
| Pitney Bowes Bank Inc. | UT | 1/16/1998 | 1/16/1998 | 15 | 700,241 | Small business credit cards | Pitney Bowes Inc. | Pitney Bowes Inc. |
| Eaglemark Savings Bank* | NV | 8/25/1997 | 8/25/1997 | 119 | 38,574 | Financial services for Harley-Davidson customers | Harley-Davidson Inc. | Harley-Davidson Inc. |
| Toyota Financial Savings Bank | NV | 8/16/2004 | 8/16/2004 | 51 | 931,874 | Financial services for Toyota dealers and customers. | Toyota Financial Savings Bank | Toyota Motor Corp. |

Sources: FDIC, company websites, Milken Institute.

Note: *Eaglemark Savings Bank was established in 1997 but changed organization type to become an industrial loan company in 2001.

Appendix Table 4. Selected FDIC-insured “nonbank banks”

| FDIC-insured “nonbank bank” | Assets as of June 30, 1987 (\$ million) | Assets as of March 31, 2017 (\$ million) | Parent company |
|--|--|--|------------------------------|
| Merrill Lynch Bank & Trust | 115 | Merged into Bank of America 11/2/2009 | Merrill Lynch & Co. Inc. |
| Custodial Trust Co. | 306 | 288 | Bear Stearns & Co. |
| Dreyfus Consumer Bank | 61 | Closed voluntarily 3/16/1993 | Dreyfus Corp. |
| Harbor Trust Co. | 12 | Dissolved 10/1990 | Drexel Burnham Lambert |
| Investors Fiduciary Trust | 340 | Acquired by State Street Bank 1/31/1995 | Kemper Corp. |
| Liberty Bank & Trust | 24 | Merged into Commercial Federal Bank 2/13/1998 | Aetna |
| First Signature Bank & Trust | 38 | Merged into First Republic Bank 1/31/2006 | John Hancock |
| Prudential Bank & Trust | 88 | 21 | Prudential Insurance Co. |
| Boston Safe Deposit & Trust | 10,298 | Acquired by Mellon Financial Corp. 1993 | Shearson/American Express |
| American Express Centurion Bank | 614 | 34,496 (became an FDIC- insured ILC in 1989) | American Express Co. |
| Greenwood Trust Co. | 2,287 | 93,651 (now Discover Bank) | Sears Roebuck & Co. |
| Hurley State Bank | 7 | Acquired by Citibank USA 1/2002 | Sears Roebuck & Co. |
| Clayton Bank & Trust | 24 | Merged into PNC Bank 8/21/2009 | Mobil Corp. |
| City Loan Bank | 598 | n.a. | Control Data Corp. |
| Hickory Point Bank & Trust | 45 | 652 (currently a FSB) | Archer Daniels Midland |
| Fireside Thrift Co. | 317 | Closed voluntarily 3/31/2012 | Teledyne Inc. |
| GECC Financial Corp. | 357 | Deposits accepted by First Hawaiian Bank 6/26/1995 | General Electric Co. |

Sources: FDIC, Milken Institute, company websites.

Appendix Table 5. Diversified unitary thrift holding companies and selected information of their thrift subsidiaries

| Holding company | Type of business | Thrift name | Thrift assets (\$ millions) | | | Note |
|--|-------------------------------------|------------------------------------|-----------------------------|-----------|----------|---|
| | | | June 1996 | June 2010 | Mar 2017 | |
| Acacia Mutual Life Insurance Co. | Insurance | Acacia Federal Savings Bank | 516 | 1,314 | n.a. | Inactive 11/1/13 |
| American Mutual Holding Co. | Life insurance | Amerus Bank | 1,198 | n.a. | n.a. | Inactive, 7/31/1998 |
| B.A.T. Industries | Tobacco, cigarettes | First FS&LA of Rochester | 7,341 | n.a. | n.a. | Inactive, 3/20/1997 |
| Carpenters Pension Trust Fund Southern California | Pension trust | United Labor Bank FSB | 71 | 260 | 463 | |
| Club Corp. International | Resorts | Franklin Federal Bancorp FSB | 900 | n.a. | n.a. | Inactive, 1/1/1997 |
| Equity Holdings Ltd. | Real estate | Firststate Financial FA | 103 | n.a. | n.a. | Inactive, 4/18/1997 |
| Estate of Bernice Pauahi Bishop | Nonprofit education | Southern Cal. FS&LA | 1,695 | n.a. | n.a. | Inactive, 11/13/2001 |
| First Pacific Investment Ltd. and Ltd. II | Numerous holdings | United Savings Bank | 1,527 | 10,895 | 340 | Name is now United Commercial Bank |
| Hawaiian Electric Industries Inc. | Public electric | American Savings Bank FSB | 3,413 | 4,875 | 6,560 | |
| Heritage Mutual Insurance Co. | Insurance | Westland Savings Bank SA | 91 | n.a. | n.a. | Heritage Mutual Insurance is now Acuity |
| Hy-Vee Food Stores | Grocery | Midwest Heritage Bank FSB | 97 | 149 | 257 | |
| Illinois Mutual Life & Casualty Co. | Insurance | Bankplus FSB | 190 | n.a. | n.a. | Inactive, 7/31/2007 |
| Krause Gentle Corp. | Gas and food | Liberty Savings Bank FSB | 77 | 152 | 666 | |
| The Langdale Co. | Manufacturing/forest-based products | Commercial Banking Co. | 34 | 198 | 234 | |
| Massachusetts State Carpenters Pension Fund, Guaranteed Annuity Fund | Pension trust/trust | First Trade Union Savings Bank FSB | 286 | 636 | 973 | |
| McMorgan & Co. | Manages union pension funds | United Labor Bank FSB | 71 | 260 | 463 | |
| The Monticello Cos., Inc. | Medicine sales | Monticello Bank | 24 | n.a. | n.a. | Inactive, 9/15/2007 |
| P H M Corp. | Home building | First Heights Bank FSB | 252 | n.a. | n.a. | Inactive, 9/9/2005 |
| Pacific Electric Wire & Cable | Manufacturer | Pacific Southwest Bank | 1,337 | n.a. | n.a. | Inactive, 3/19/2001 |
| Prudential Insurance Co. | Insurance | The Prudential Savings Bank FSB | 204 | 1,957 | 21 | |
| Raymond James Financial Inc. | Security brokerage | Raymond James Bank FSB | 190 | 7,465 | 19,179 | |
| Southwest Gas Corp. | Gas transmission | Primerit Bank FSB | 1,705 | 1,608 | 1,608 | |
| Sun Life Assurance Co. | Insurance | New London Trust FSB | 289 | n.a. | n.a. | Inactive, 10/30/1999 |
| Temple Inland Inc. | Paper | Guaranty Federal Bank FSB | 9,153 | n.a. | n.a. | Failed, 8/21/2009 |
| USAA | Insurance | USAA Federal Savings Bank | 5,806 | 41,749 | 81,283 | |
| Watts Health Systems Inc. | Health plans | Family Savings Bank FSB | 167 | n.a. | n.a. | Inactive, 12/31/2002 |
| State Farm Mutual Auto Insurance Co.* | Mortgage lending specialization | State Farm Bank FSB | n.a. | 15,663 | 17,352 | |
| Nordstrom Inc.* | Credit-card specialization | Nordstrom FSB | n.a. | 196 | 240 | |

Note: As of July 9, 1996, the OTS reported the following number of first-tier thrift holding companies: 28 diversified unitary holding companies and 650 nondiversified unitary holding companies. There were no diversified multiple holding companies and 44 nondiversified multiple holding companies. A diversified thrift holding company is defined by statute as one in which the subsidiary savings association and certain other financial activities represent less than 50 percent of consolidated net worth and consolidated net earnings.

* Non-diversified thrift holding companies.

Appendix Table 6. US out of step with most 142 countries that allow commercial ownership of banks

| Allow | | | | | | | | | Prohibit |
|---------------------|--------------------------|--------------------|------------------|-----------------|----------------|------------------|------------------------------|-------------------|----------------------|
| Algeria | Bosnia & Herzegovina | Cook Islands | Gabon | Israel | Luxembourg | Nicaragua | Seychelles | Tajikistan | Fiji |
| Angola | Botswana | Costa Rica | Germany | Italy | Macao, China | Niger | Singapore | Tanzania | Guernsey |
| Anguilla | Brazil | Côte d'Ivoire | Ghana | Jamaica | Macedonia, FYR | Nigeria | Slovak Republic | Thailand | Isle of Man |
| Antigua and Barbuda | British Virgin Islands | Croatia | Gibraltar | Japan | Malawi | Norway | Slovenia | Togo | |
| Argentina | Bulgaria | Cyprus | Greece | Jersey | Malaysia | Oman | South Africa | Trinidad & Tobago | United States |
| Armenia | Burkina Faso | Czech Republic | Grenada | Jordan | Maldives | Pakistan | South Korea | Uganda | |
| Australia | Burundi | Denmark | Guatemala | Kazakhstan | Mali | Panama | Spain | United Kingdom | |
| Austria | Cameroon | Dominica | Guinea-Bissau | Kenya | Malta | Papua New Guinea | Sri Lanka | Uruguay | |
| Bahrain | Canada | Dominican Republic | Guyana | Kosovo | Mauritius | Peru | St. Kitts and Nevis | Venezuela | |
| Bangladesh | Cayman Islands | Egypt | Honduras | Kuwait | Mexico | Philippines | St. Lucia | Zimbabwe | |
| Belarus | Central African Republic | El Salvador | Hong Kong, China | Kyrgyz Republic | Moldova | Poland | St. Vincent & the Grenadines | | |
| Belgium | Chad | Equatorial Guinea | Hungary | Latvia | Montserrat | Portugal | Suriname | | |
| Belize | Chile | Estonia | Iceland | Lebanon | Morocco | Romania | Sweden | | |
| Benin | China | Ethiopia | India | Lesotho | Mozambique | Russia | Switzerland | | |
| Bhutan | Colombia | Finland | Indonesia | Liechtenstein | Netherlands | Saudi Arabia | Syrian Arab Republic | | |
| Bolivia | Congo, Rep. | France | Ireland | Lithuania | New Zealand | Senegal | Taiwan, China | | |

Source: World Bank, Bank Regulation and Supervision Survey (2012).

Appendix Table 7. Selected studies on the mixing of banking and commerce

| Author | Purpose | Finding |
|--|--|---|
| Haubrich and Santos (2005) | Examines the advantages and disadvantages of mixing banking and commerce using the “liquidity” approach to financial intermediation. | The authors extend previous research on asset liquidation and argue that mixing banking and commerce increases a bank’s efficiency in disposing of defaulted loans by creating an internal market. |
| Huertas (1988) | Discusses whether banking and commerce should be permitted to continue to mix, and if so, how this should be done and what regulations may be required. | Affiliations between banking and commerce have been common throughout American history. The author argues that mixing banking and commerce is beneficial and fair to customers, and does not jeopardize the safety of consumer deposits or threaten the stability of the payment system. Consequently, the finding is that the mixing of banking and commerce should be permitted. |
| Krainer (2000) | Discusses potential benefits and costs of banking and commerce affiliations. | The author concludes that the benefits of ILCs would be in the form of enhanced efficiency, both operational and informational. These benefits are likely to grow because of changes in technology. The author also notes that costs of banking and commercial affiliations are likely to be felt on a small scale. |
| Haubrich and Santos (2003) | Investigate the history of banking and commerce in the US by considering the two-way interlocking that takes place between banks and commercial firms. | The extensive linkages between banking and commerce have changed with shifting definitions of “bank” and changing methods of “control.” It is shown that regulations per se do not eliminate these linkages. Furthermore, it is pointed out that “at times political pressures have forced banking and commerce apart; at times economic pressure has pushed them together.” |
| Blair (2004) | Examines two dominant views on the separation of banking and commerce by presenting its potential benefits and risks from the public policy perspective. | <ul style="list-style-type: none"> • Although the current prohibitions on corporate ownership of banks are justified on the grounds that banking and commerce have always been separate, there is no evidence of a long-term separation in U.S. banking history. Extensive links between banking and commerce have existed and continue to exist. • Despite the potential risks of mixing banking and commerce, the evidence suggests that with adequate safeguards in place, the careful mixing of banking and commerce can yield benefits without excessive risk. |
| Raskovich (2008) | Evaluates the major arguments of mixing of banking and commerce by relating each of those arguments with existing theoretical and empirical research. | The author concludes that major concerns that have been raised are theoretically weak or lack empirical support. |
| Barth, Caprio, and Levine (2001, 2006) | Examines the effect of regulation and ownership on bank performance and stability using a cross-country empirical analysis. | The authors construct a measure of mixing banking and commerce based the ability of nonfinancial firms to own and control commercial banks and vice versa for each country in the sample. The authors find no significant relationship between the measures of mixing banking and commerce and the level of banking sector development or the degree of industrial competition. They also find that countries that restrict banks from owning nonfinancial firms are more likely to experience a banking crisis. They conclude that some of the major reasons for restricting the mixing of banking and commerce—to reduce financial fragility or to promote financial development—are not supported by empirical evidence. |
| Bystrom (2004) | Estimates the probability of systemic banking crises using a sample of different countries, and examines how it can be explained by various institutional factors. | Included in the list of institutional factor is an index of regulatory restriction, and banks owning nonfinancial firms are among one of the variables used to construct this index. The paper’s empirical findings show that the probability of bank failure is systematically higher in countries with more regulatory restrictions. |

| Author | Purpose | Finding |
|---|--|---|
| Wall, Reichert, and Liang (2008a and 2008b) | Assesses the potential practical effects of integrating banking and commerce using economic theory, past experience with deregulation, and observed cross-industry combinations. | <ul style="list-style-type: none"> • Economic theory suggests that joint corporate ownership of banks and commercial firms has several potential benefits, including economies of scale and scope, increased internal capital markets, and diversification. These benefits offset costs associated with some combinations of banking and commercial firms. • Empirical analysis of the potential gains is conducted for the specific case of Wal-Mart acquiring a bank. The authors find that if Wal-Mart owned a bank with an earnings distribution similar to that of the average U.S. bank, it would generate a modest decline in average ROE but with a reduction in risk that would be two to three times as large. • Using empirical methodologies and industry-level financial data from Internal Revenue Service corporate income tax filing to examine gains from portfolio diversification, the authors find that banks affiliating with nonbanking activities (permitted by the Gramm–Leach–Bliley Act of 1999) provides potential gain from diversification. |
| Angkinand (2009) | Using a cross-sectional study, investigates the impact of bank regulations on the severity of banking crises. | The author finds that the decline in economic activity following a banking crisis will be less severe for those countries with fewer restrictions on bank activities, including banks owning nonfinancial firms and vice versa. |

ⁱ Industrial banks were also known as industrial loan companies/corporations in Utah until 2004, when state law was amended to rename this class of institution to better reflect their legal status as fully fledged FDIC insured depository institutions. Outside Utah, industrial banks are often still referred to as ILCs (see <https://dfi.utah.gov/financial-institutions/industrial-bank>). Industrial banks in Utah are different from the industrial loan companies/corporations or industrial banks operating in a state like California, where they historically and even today typically operate as small local finance companies.

ⁱⁱ See White (2006).

ⁱⁱⁱ This report draws heavily upon and updates Barth and Li (2011), Barth, Chiang and Li (2011) and Barth, et al. (2012).

^{iv} Response from Judge Robert R. Prentiss, chairman of the Virginia Corporation Commission, as noted in the biographical sketch of Arthur J. Morris, courtesy of the “Inventory of the Papers of Arthur J. Morris” at the University of Virginia Law Library (www.law.virginia.edu/main/Morris,+Arthur+J).

^v It has been reported that the Morris Plan was originated by a Mr. Stein as early as 1898. He is said to have established the first such company, the Merchants-Mechanics Savings Association, in Newport News, Virginia, in 1901. There is documentation that a judge held that there are “vital difference” between the Morris and Stein plans; see *The Survey* (1915) and (1916). For more information on Morris Plan lending institutions, see Mushinski and Phillips (2008).

^{vi} See Saulnier (1940). Also, in some states like Minnesota, state law prohibited industrial loan companies from using the word “banking” in their titles.

^{vii} The Dodd Frank Act of 2010, as noted earlier, refers to these institutions as both industrial loan companies and industrial banks.

^{viii} These calculations are based on data from Saulnier (1940).

^{ix} There is a difference in the number and total assets for ILCs when obtaining data from the FDIC or state regulatory authorities. These differences are due to (1) the inclusion of non-depository ILCs in data provided by the state regulatory authorities; (2) not all states with ILCs supplying information; and (3) other relatively minor issues involving the period in which ILCs become inactive. For more information on this issue, see Barth and Li (2011, Appendix 4).

^x We are unable to obtain any financial information on non-depository ILCs. Almost all of the paper therefore focuses on depository ILCs, which is most appropriate since these are the institutions that have access to the federal safety net.

^{xi} See GAO (2005). In this report, it is noted that at the time of the CEBA exemption, there were six states that qualified (California, Colorado, Hawaii, Minnesota, Nevada, and Utah). However, an ILC that was already in existence prior to the law in Indiana obtained FDIC insurance in 1990, and apparently, the Federal Reserve considered Indiana to also be a grandfathered state.

^{xii} We were told that American Express established its ILC in Utah because there were many missionaries who spoke a variety of languages that were useful to the firm, given its worldwide operations. We were also told that USAA Savings Bank was established in Nevada because its immediate parent was a savings and loan operating in Texas and therefore subject to interest rate ceilings that became binding in a high inflationary period. These ceilings were not applicable for its ILC in Nevada.

^{xiii} However, that CEBA did bar ILCs from offering demand deposits unless their assets were less than \$100 million or an ILC had been acquired before the law was enacted. See www.govtrack.us/congress/bills/100/hr27/text, pp. 611–631.

^{xiv} According to the Section 2(c)(2)(H) of the Bank Holding Company Act:

(H) An industrial loan company, industrial bank, or other similar institution which is—

(i) an institution 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 which required or would require such institution to obtain insurance under the Federal Deposit Insurance Act—

(I) which does not accept demand deposits that the depositor may withdraw by check or similar means for payment to third parties;

(II) which has total assets of less than \$100,000,000; or
(III) the control of which is not acquired by any company after the date of the enactment of the Competitive Equality Amendments of 1987; or
(ii) an institution which does not, directly, indirectly, or through an affiliate, engage in any activity in which it was not lawfully engaged as of March 5, 1987, except that this subparagraph shall cease to apply to any institution which permits any overdraft (including any intraday overdraft), or which incurs any such overdraft in such institution's account at a Federal Reserve bank, on behalf of an affiliate if such overdraft is not the result of an inadvertent computer or accounting error that is beyond the control of both the institution and the affiliate.

^{xv} ILCs had an advantage over commercial banks because they were not subject to Regulation Q; thus the ownership of ILCs provided an option when competing with money market funds after 1975, when interest rates rose. An additional advantage was that ILCs, unlike bank holding companies, were not blocked from going nationwide with their operations.

^{xvi} In November 2007, the FDIC granted an exception to the moratorium when it approved an application by a consortium of investors to acquire GMAC Automotive Bank, an ILC in Utah. At the same time, Utah approved the change of control and name change of this ILC to GMAC Bank. According to FDIC chairman Sheila C. Bair, “The FDIC Board decided to act on this notice during the moratorium to avoid the potential for substantial interference with a major restructuring by General Motors Corporation.” See www.fdic.gov/news/news/press/2006/pr06103.html.

^{xvii} According to Bovenzi (2007), “At the time that the initial moratorium expired on January 31, 2007, eight ILC deposit insurance applications and one change in bank control notice were pending before the FDIC.”

^{xviii} Subsequent to the moratorium, JC Flowers in December 2007 withdrew its application to acquire Sallie Mae Bank; Home Depot in January 2008 withdrew its application to acquire EnerBank USA; and Chrysler Financial in June 2009 withdrew its application for FDIC insurance.

^{xix} See Bair (2007) and Bovenzi (2007).

^{xx} Wal-Mart Watch, “Wal-Mart’s Industrial Loan Company Talking Points,” <http://walmartwatch.com/img/documents/ILC.pdf>. This article refers to six states that prohibited commercial firms from owning ILCs in 2006. Two states had prohibited such ownership before 2006. Also, see Falanga (2007).

^{xxi} US Government Accountability Office. “Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions.” GAO-12-160: Published: Jan 19, 2012. Publicly Released: January 20, 2012. www.gao.gov/products/GAO-12-160

^{xxii} *Time* (1933).

^{xxiii} “How Marriner Eccles Saved America,” *The Salt Lake Tribune*, January 17, 2011.

^{xxiv} Alfred Hayes, “The 1970 Amendments to the Bank Holding Company Act: Opportunities to Diversify.” Speech, January 25, 1971, 43rd annual midwinter meeting, New York Scale Bankers Association, New York City. See www.newyorkfed.org/medialibrary/media/research/monthly_review/1971_pdf/02_1_71.pdf.

^{xxv} US Treasury Department (1991).

^{xxvi} It should be noted that there are credit card banks. For example, Cabela’s, the World’s Foremost Outfitter, has a wholly-owned bank subsidiary, World’s Foremost Bank. This is a special purpose, FDIC insured, Nebraska state-chartered bank, which is limited to issuing only consumer credit cards and certificates of deposit of one hundred thousand dollars or more.

^{xxvii} For a discussion of this Act, see Barth, Brumbaugh, Yago (1997) and Barth, Brumbaugh, Wilcox (2000).

^{xxviii} There was also the ownership of a limited, credit-card-only bank charter.

^{xxix} See <https://projects.propublica.org/bailout/list>.

^{xxx} Lehman Brothers filed for bankruptcy in December 2008.

^{xxx} Reuters, “Lehman Units’ Refinancing Deals Go Through,” December 3, 2010,
www.reuters.com/article/idUSN0329600320101203