Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

Barnett Sivon & Natter, P.C.
ATTORNEYS at LAW
WASHINGTON, DC

# FinTech and Banking and Commerce*

Jim Sivon

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Can a Fintech company own a bank? While the convergence of technology companies and financial services is relatively new, the mixing of banking and commerce is not a new question. Since the 1930s we have seen a recurring pattern in which market forces have pushed combinations of banking and commercial firms, only to be pushed back by laws aimed at limiting or prohibiting such combinations.

In the early 1930s, the debate over banking and commerce centered on affiliations between commercial banks and securities firms. The policy response to those affiliations was the passage of the Glass-Steagall Act, which barred affiliations between commercial banks and investment banks.

The 1950s gave rise to the growth of diversified bank holding companies. The Transamerica Corporation was symbolic of this trend. In the early 1950s, Transamerica owned a bank, an insurance company, real estate and oil development firms, and a fish packing company. The policy response to this development was the Bank Holding Company Act of 1956, which limited bank holding companies to activities closely related to banking, and required the divestiture of non-conforming businesses.

As the name suggests, the Bank Holding Company Act applied only to "banks"; it did not apply to savings and loan associations. As a result, the next pressure point in the debate over the mixing of banking and commerce was the combination of savings and loans and commercial firms. Lehman Brothers acquired a controlling interest in the Great Western Financial Corporation, and subsequently, a number of commercial and retail firms, including Ford and Sears, acquired savings and loans and became so-called "unitary" savings and loan holding companies. This unitary savings and loan holding company "loophole" eventually was closed in 1999 with the passage of the Gramm-Leach-Bliley Act. That Act, however, grandfathered the existing unitary companies.

In the 1980s, a number of commercial firms established FDIC-insured banks that either made commercial loans or accepted demand deposits, but did not do both. This permitted the commercial firms to oper-

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ate outside of the activity restrictions of the Bank Holding Company Act, and outside the supervision of the Federal Reserve Board. Congress closed this so-called "non-bank bank" loophole with the passage of the Competitive Equality Banking Act of 1987 (CEBA). Non-bank banks in existence at that time were grandfathered, subject to certain growth and acquisition limitations.

The 1990s saw the re-emergence of affiliations between commercial banks and investment banks through the establishment of Section 20 subsidiaries of bank holding companies. These companies were principally engaged in underwriting government securities, but could underwrite a limited amount of corporate securities. The growth of Section 20 subsidiaries eventually led to passage of the Gramm-Leach-Bliley Act (GLBA) in 1999, which repealed the restrictions on affiliations between commercial banks and investment banks that were imposed by the Glass-Steagall Act. Thus, GLBA stands as somewhat of an exception to the pattern of market expansion followed by a legislative prohibition or restriction. However, the Volcker Amendment to the Dodd-Frank Act took a step in the other direction by limiting the trading and investment activities of banks and their affiliates. Also, we recently have seen several policymakers call for the re-enactment of the Glass-Steagall Act.

Finally, in the run up to the passage of the Dodd-Frank Act, the debate over the separation of banking and commerce focused on industrial loan companies or ILCs. ILCs are state-chartered, FDIC-insured institutions that may engage in lending and deposit taking activities. When Congress closed the non-bank bank loophole in 1987, it carved out an exception for ILCs. That exception permits a commercial company to own an ILC as long as the ILC is chartered in one of the few states that chartered such institutions in 1987; the ILC is FDIC-insured; and the ILC does not accept demand deposits if it has assets over $100 million. This exception does not stop an ILC that has assets over a $100 million from accepting NOW accounts. Therefore, an ILC owned by a commercial firm can engage in most basic banking activities.

Until 1997, there were only about 30 FDIC-insured ILCs in operation. In that year, Utah lifted a moratorium on the chartering of ILCs and expanded the powers of its ILCs. Since then the number of ILCs has doubled, and several commercial firms, including Walmart, have sought to establish ILCs. In the Dodd-Frank Act, Congress barred the FDIC from issuing deposit insurance for any new ILCs. That prohibition expired last year, but the FDIC has shown little interest in acting on any applications for deposit insurance for ILCs.

Given this history, it may be difficult for technology firms to engage fully in the business of banking. Nonetheless, those firms have shown that they can be quite competitive in payments and other aspects of financial services, short of owning a bank.

*Jim Sivon is a partner with the law firm of* ***Barnett Sivon & Natter, P.C.***