

August 30, 2019

VIA ELECTRONIC DELIVERY

Ms. Kathy Moe  
Regional Director  
San Francisco Regional Office  
Federal Deposit Insurance Corporation  
25 Ecker Street, Suite 2300  
San Francisco, California 94105

Dear Ms. Moe:

This comment is in response to the Notice of Application for Federal Deposit Insurance and Application for Authorization to Commence Business as an Industrial Bank, published by Rakuten Card Co., Ltd (“Rakuten Card Japan”), a subsidiary of Rakuten, Inc. (“Rakuten”). We understand that Rakuten Card Japan has simultaneously filed this application for federal deposit insurance with the Federal Deposit Insurance Corporation (“FDIC”) to insure the deposits of Rakuten Bank America (“Rakuten Bank”), and an application with the Commissioner of the Utah Department of Financial Institutions to authorize Rakuten Bank to engage in business as a Utah industrial bank (or industrial loan company, “ILC”).

The American Bankers Association (“ABA”)<sup>1</sup> and the Bank Policy Institute (“BPI”, together, the “Associations”)<sup>2</sup> have reviewed the non-confidential portion of the Rakuten Bank interagency charter and federal deposit insurance application (“Application”). We first wish to emphasize that we believe in charter choice, including the option to charter an ILC. Our comments express no diminution of our commitment to our current ILC members. Moreover, we welcome interest in new ILC applications from companies that are primarily financial in nature, such as the application by AmeriNat, which also recently applied for an ILC charter.

The Associations, however, believe that the Application for Rakuten Bank raises significant issues inconsistent with the factors set forth in Section 6 of the Federal Deposit Insurance Act (“FDIA”) that the FDIC must evaluate in connection with an application for deposit insurance for a proposed depository institution.<sup>3</sup> As a foundational matter, the Application presents substantial concerns regarding the affiliation of banking and non-financial

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<sup>1</sup> The American Bankers Association is the voice of the nation’s \$18 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard nearly \$14 trillion in deposits, and extend more than \$10 trillion in loans. Learn more at [www.aba.com](http://www.aba.com).

<sup>2</sup> The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation’s leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation’s small business loans, and are an engine for financial innovation and economic growth.

<sup>3</sup> 12 U.S.C. § 1816.

businesses, the separation of which is a core principle in the structure of financial services regulation in the United States.

### **THREE KEY CONCERNS WITH RAKUTEN'S APPLICATION**

We raise to the attention of the FDIC three key concerns involved in the Application:

- **The business plan is excessively narrow, with elevated risk that lack of success in the affiliates closely connected to the bank could jeopardize the safety of the bank.** Rakuten Bank's proposed business plan is directly dependent on the success of its non-financial affiliates in the highly competitive and rapidly evolving e-commerce market. The planned interdependent relationship between Rakuten Bank and its non-financial affiliates not only means that troubles in the latter could be transmitted to the bank, but that, consequently, such potential could compromise the independent management and operation of Rakuten Bank, and therefore may create hazards for the federal deposit insurance fund ("DIF") emanating from outside of the depository institution.
- **Rakuten Bank's proposed business plan raises issues concerning the use, privacy, and security of customer information.** The unprecedented scale of use of ILC customer information, central to the interplay of services between the bank and its non-financial affiliates under Rakuten's business plan, will have significant implications both for its customers and for competition with other insured banks.
- **The precarious business model and the potential perils to privacy in the use of customer information, in turn, do not serve the convenience and needs of the community.** We have noted concerns with the business model, its reliance upon a busily traveled operational bridge between an institution holding federally insured deposits and its non-financial affiliates subject to the vicissitudes of a rapidly evolving and changing Internet platform. We have noted concerns about privacy and use of customer information. These pose likely *vulnerabilities* to the convenience and needs of the proposed bank's affected community.

The combination of these factors leads to the conclusion, in our view, that the Application does not meet the standards set forth in Section 6 of the FDIA. Additionally, the Associations believe that these issues are of broad public interest and concern. Given the unprecedented nature and scope of prime elements of the Proposal, the FDIC should provide a fair opportunity for public comment, and thorough analysis of the results of such comment, before acting on the Application or any similar applications involving such proposed non-financial affiliations with ILCs.

### **DISCUSSION**

#### **I. THE APPLICATION HIGHLIGHTS FUNDAMENTAL RISKS INHERENT IN THE COMBINATION OF BANKING AND NON-FINANCIAL BUSINESS**

The risks of combining banking and non-financial businesses are a longstanding concern of US public policy. For example, the Bank Holding Company Act (“BHCA”) limits the affiliation of banks and non-financial businesses by generally prohibiting bank holding companies from owning more than five percent of the voting stock of non-financial companies, with limited exceptions.<sup>4</sup> This prohibition addresses a number of potential problems, including (i) a concentration of economic power, (ii) less stringent credit standards for and higher risk exposures to affiliates, (iii) less attractive credit terms to unaffiliated non-financial businesses, and (iv) other similar conflicts of interest. These adverse effects also could reduce the availability of credit to unaffiliated businesses and create vulnerabilities for the DIF. Under the BHCA, the activities of affiliates of a bank are subject to “consolidated supervision.”<sup>5</sup>

As a result of legislation from the 1980s, ILCs are eligible for federal deposit insurance,<sup>6</sup> and ILCs in a number of states—principally California, Nevada, and Utah—are excepted from the definition of “bank” in the BHCA. Therefore, the companies that own or control those ILCs are not generally subject to consolidated supervision under the BHCA, including the limitations on activities.<sup>7</sup> Historically, ILCs were small, state-chartered loan companies that served primarily the borrowing needs of industrial workers who were unable to obtain non-collateralized loans from banks. Today, the majority of active ILCs are owned and operated by financial services firms. Other ILCs operate within a narrow market as part of a non-financial organization. Others remain community-focused, stand-alone banking institutions.<sup>8</sup>

Based on the BHCA exception, however, in and around 2006, several large non-financial companies explored chartering or acquiring ILCs. These initiatives drew significant congressional attention and led to the FDIC placing a moratorium on approving deposit insurance or change-in-control applications for ILCs, and the ultimate withdrawal of those applications. No new ILC applications for deposit insurance have been approved since 2005.<sup>9</sup>

The emergence of technology companies that view financial services as an adjunct to a broader non-financial customer relationship presents fundamental and serious issues that currently existing ILCs do not. Technology companies’ interest in synergies with financial

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<sup>4</sup> 12 U.S.C. §§ 1843(a) and (b)(6).

<sup>5</sup> See, e.g., Federal Reserve Board Supervisory Letter SR 08-9 (Oct. 2008) (“The [BHC Act] provides a federal framework for the supervision and regulation of all domestic and foreign companies that control a bank and the subsidiaries of such companies. Among the principal purposes of the BHC Act is to protect the safety and soundness of corporately controlled banks. Financial trouble in one part of an organization can spread rapidly to other parts of the organization.... Risks that cross legal entities or that are managed on a consolidated basis cannot be monitored properly through supervision directed at any one of the legal entity subsidiaries within the overall organization.”).

<sup>6</sup> Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320 § 703.

<sup>7</sup> 12 U.S.C. § 1841(c)(2)(H). Exceptions would include ILCs that are owned by a bank holding company or an intermediate holding company.

<sup>8</sup> These existing ILCs generally do not market a broad suite of banking services to a non-financial company’s customers, as is the stated purpose in the Application.

<sup>9</sup> The ILC issue arose again in 2010 in the Dodd-Frank Wall Street Reform and Consumer Protection Act, which placed a three-year moratorium on applications for deposit insurance or a change in control for ILCs. Pub. Law No 111-203, § 603 (2010). That Act also called for a study by the Government Accountability Office, *inter alia*, on the implications of removing the exemptions from the definition of “bank” in the BHCA, but it did not focus on the potential for changes in the number or character of ILCs or the companies owning them. See GAO-12-160, Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions (Jan. 2012), <https://www.gao.gov/products/GAO-12-160>.

services they can control has renewed interest in the ILC charter as a vehicle for providing such services, without the consolidated supervision and activity limitations that come with the BHCA. If ILC charters were to be pursued by non-financial companies with this type of business plan, then the size and character of ILCs, the implications for financial stability, the risks to the DIF, and the hazards raised to the needs of the communities that they serve would raise significant public policy concerns as they relate to the standards set forth in Section 6 of the FDIA.

Specifically with respect to perils posed to the DIF, fluctuations in the business of the non-financial affiliates, to which, according to the Application, Rakuten Bank would be integrally tied, would likely be transmitted to the bank. This risk is especially significant for technology companies that prominently trade in data, which—aside from the privacy risks that are particularly acute—are inherently more susceptible to changes and shifts in consumer preference. Such shifts could seriously damage the business of the non-financial affiliate, and the dependence of the bank on the affiliate’s business model would likely transmit the risk to the bank. Furthermore, an adverse event, such as a major data breach at a non-financial affiliate of the ILC, could so impair public confidence in the entire corporate family that both the parent company and the ILC would experience reputational damage, funding problems, and other negative business impacts. While a similar risk exists for bank and financial holding companies, consolidated supervision reduces the likelihood of such an event and provides powerful supervisory tools for identifying, managing, and monitoring such risks.

In the instant case, Rakuten is an e-commerce platform in a highly competitive market. Management at Rakuten, or another information-based technology company with a similar business plan, might well subordinate the interests of the bank and the community it intends to serve in favor of advancing the non-financial affiliate’s core business. The bank’s board and management could be constrained from adjusting the bank’s business plan and operations to serve the interests of its community and preserve the safety and soundness of the bank, if doing so failed to optimize the non-financial affiliate’s business. This is a vulnerability not likely to be captured by *source of strength* regulatory requirements.

In addition, an information-based technology company’s reliance on data may lead to discriminatory pricing and provision both of banking services and of consumer products based on data flowing between the ILC and non-financial affiliates. For example, a non-financial affiliate providing an e-commerce platform linking customers and merchants could use data from customer accounts at the ILC to set pricing for consumer purchases<sup>10</sup> or to set loan terms for merchant borrowers. Congress traditionally has acted to preserve the separation of banking and non-financial business to avoid this type of anti-competitive effect. In addition to harm to customers, such a business model could enable non-financial companies to compete unfairly with banking institutions which are subject to comprehensive federal supervisory programs and permissible activities restrictions.

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<sup>10</sup> For example, the recent acquisition of a grocery retailer by an Internet marketing platform firm has seen the acquirer, to boost customer loyalty, provide notable grocery discounts to those customers who have signed up for special membership in the parent’s overall marketing service.

## **II. THE BUSINESS MODEL PROPOSED IN THE APPLICATION RAISES SIGNIFICANT PRIVACY ISSUES**

The Application also raises significant privacy issues that have implications both for customer privacy and for competition between such a bank as that in the Proposal and other insured banks. The Gramm-Leach-Bliley Act (“GLBA”) privacy provisions permit the disclosure of customer information by financial institutions to their affiliates without providing the customer with a prior notice of the ability to opt-out. The provision in the GLBA was largely premised on the bank holding company structure and cross-referenced the BHCA in defining covered financial institutions.

The affiliate disclosure provision is consistent with customer expectations and makes sense in the context of a bank holding company subject to limits on non-financial activities. However, the affiliate disclosure provision takes on a wholly different character in the context of an ILC with non-financial affiliates that trade in data. The disclosure of customer information between an ILC and a non-financial technology company with an information-based business model could involve the disclosure of customer information in a way and to an extent not contemplated by the GLBA. This information sharing would raise issues as to the appropriate uses of information obtained from ILC transactions, in view of customer expectations and ability to limit that disclosure. It also would create substantial competitive inequities between such ILCs and other insured banks, whose ability to disclose information that is not subject to opt-out is limited to financial affiliates and disclosures under carefully defined exceptions. An ILC that is affiliated with a non-financial company, like Rakuten, should not be permitted to undermine these fundamental expectations of consumer privacy.

## **III. THE APPLICATION RAISES SIGNIFICANT ISSUES UNDER THE FDIA STATUTORY FACTORS**

In considering applications for deposit insurance for a proposed depository institution, the FDIC must evaluate each application in relation to the factors prescribed in Section 6 of the FDIA.<sup>11</sup> Those factors include—

- (1) The financial history and condition of the depository institution;
- (2) The adequacy of the depository institution’s capital structure;
- (3) The future earnings prospects of the depository institution;
- (4) The general character and fitness of the management of the depository institution;
- (5) The risk presented by such depository institution to the DIF;
- (6) The convenience and needs of the community to be served by such depository institution; and

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<sup>11</sup> 12 U.S.C. § 1816.

(7) Whether the depository institution’s corporate powers are consistent with the purposes of the FDIA.<sup>12</sup>

As a matter of policy, an applicant will receive deposit insurance if all of these statutory factors, plus the considerations required by the National Historic Preservation Act and the National Environmental Policy Act of 1969,<sup>13</sup> are resolved favorably.<sup>14</sup> Applications from non-financial companies raise significant questions concerning at least two of the statutory factors: (i) the risk presented by the affiliated ILC to the DIF,<sup>15</sup> and (ii) the convenience and needs of the community to be served by the affiliated ILC, which, taken together, suggest inconsistency with the purposes of the FDIA. ABA believes that the Application raises such significant questions and issues that it does not meet the requirements of these statutory factors under the FDIA.

**A. An ILC Affiliated with a Non-Financial Technology Company Presents Significant Risk to the DIF**

Section 6 of the FDIA requires that the FDIC consider the risk an applicant presents to the DIF.<sup>16</sup> According to FDIC policy, in order to resolve this factor favorably, the FDIC must be assured that the proposed institution does not present an undue risk to the DIF, based on any information available to the FDIC, including but not limited to the applicant’s business plan.<sup>17</sup> Further, the FDIC expects that the applicant’s business plan demonstrate, among other things, adequate policies and procedures to operate the proposed depository institution in a safe and sound manner and to be responsive to community needs.<sup>18</sup>

Rakuten is a form of an online marketplace for commerce. The Application describes Rakuten’s business as a “synergistic ecosystem linking [Internet services and financial services] in the form of an online marketplace that creates strong loyalty and value for both merchants and consumers who sell and shop there, respectively.”<sup>19</sup> Rakuten Bank plans to offer financial products and services, including “consumer loans, consumer credit cards, consumer deposits (NOW, savings, and time), merchant acquiring, commercial loans, and commercial savings accounts,” to support that activity in the online marketplace.<sup>20</sup> Rakuten Bank will market its products primarily in the existing Rakuten community to those who already are customers of the Rakuten affiliate network.<sup>21</sup>

Rakuten’s business of providing an online marketplace for electronic commerce would not be subject to direct regulatory supervision. In addition, because of the conditions under

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<sup>12</sup> *Id.*

<sup>13</sup> See Pub. L. No. 89-665, 80 Stat. 915 (1966); Pub. L. No. 91-190; 83 Stat. 852 (1970).

<sup>14</sup> See FDIC Statement of Policy on Applications for Deposit Insurance (“SOP”), <https://www.fdic.gov/regulations/laws/rules/5000-3000.html>.

<sup>15</sup> As we have discussed above, the excessively narrow business model of the proposed bank may also cast doubt on the Proposal meeting the conditions of the future earnings prospects of the bank.

<sup>16</sup> 12 U.S.C. § 1816(5).

<sup>17</sup> See SOP.

<sup>18</sup> *Id.*

<sup>19</sup> See Application at 2.

<sup>20</sup> See *id.* at 3.

<sup>21</sup> *Id.*

which Rakuten Bank would propose to operate as an ILC, Rakuten would not be subject to the BHCA, including its activities limitations, or to consolidated supervision. Accordingly, there would be fewer safeguards than the FDIC generally would assume in evaluating applications for deposit insurance when affiliate businesses are involved.

As noted above, Rakuten Bank's non-financial affiliate would be vulnerable to quick, unexpected movements in the market and changing consumer preferences and tastes, with the potential for directly negative consequences for the ILC. The close relationship between Rakuten Bank and its affiliates presents risks to Rakuten Bank, and, therefore, to the DIF, that may be particularly difficult to assess in advance, especially given the absence of direct precedents.

This risk is not unique to Rakuten and could arise in other, similar ILC applications. As online markets for non-financial commerce continue to develop, such businesses may be particularly subject to changes in consumer preferences and tastes. Rakuten is seeking to compete in the highly competitive e-commerce market by offering banking services, and other non-financial technology companies are likely to seek to follow this path. The very efficiencies of the online marketplace business model on which the Proposal rests would also make these businesses distinctly susceptible to reputational risk in the form of changes in consumer preference and evolving concerns about privacy and the uses of data.

As noted above, such sudden changes could seriously compromise the business of the non-financial affiliate, and the dependence of the ILC on the affiliate's business model would likely transmit the risk to the insured institution. Furthermore, a single event, such as a data breach or some other misuse of personal information at Rakuten or at any other non-financial technology company, could quickly and irreparably damage public confidence in the entire corporate family. While this contagion effect is possible in traditional bank or financial holding companies, the concentrated business plan of the proposed ILC, tied inextricably to the success of the non-bank affiliate, makes its business prospects fragile and uncertain. Moreover, the experience with existing ILCs provides scant guidance on the nature and extent of such risks as presented in the Proposal. As noted above, the business models of emerging non-financial technology companies represent a point of departure from prior ILC applications. The interplay between the services offered by an insured depository institution and an information-based non-financial technology company is untested. Yet this interplay is the foundation of the Rakuten business plan.<sup>22</sup>

**B. An ILC Intended to Serve Its Non-Financial Affiliate's Customers Would Not Serve the Convenience and Needs of the Community**

Section 6 of the FDIA also requires that the FDIC consider whether an applicant serves the convenience and needs of its community.<sup>23</sup> According to FDIC policy, essential considerations in evaluating this factor are the deposit and credit needs of the community to be

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<sup>22</sup> See *id.* at 4. (“[Rakuten] Bank will work closely with a select few of its U.S.-based affiliates to individually or jointly market to an existing and known customer base, both consumers and merchants. Rakuten believes this business model with limited reliance on affiliates is unique and attractive for a banking entity in the U.S.”)

<sup>23</sup> 12 U.S.C. § 1816(6).

served, the nature and extent of the opportunity available to the applicant in that location, and the willingness and ability of the applicant to serve those financial needs.<sup>24</sup>

Banks perform a valuable credit intermediation role in their community by accepting deposits and making loans on an impartial basis. As noted above, Rakuten Bank's excessively narrow business plan involving close affiliation with an online marketplace and plans to market to the existing Rakuten community creates risks to the DIF. These same risks lead to uncertainty as to the ongoing availability of Rakuten Bank services to the community that it proposes to serve.

Further, to the extent that customers of Rakuten Bank are also, or even primarily, customers of Rakuten Bank's affiliates, services will not be available on an impartial basis, particularly as the Proposal rests upon viewing the activities of the bank as a mere *adjunct* to the activities of the non-financial technology company's affiliates. For these reasons, the application presents serious perils of harming, rather than serving, the public interest and does not support the criterion that the applicant would serve the convenience and needs of its community. Understanding the nuances of the appropriate "community" in the context of such a business model, and how the proposed ILC will serve its needs, presents questions that earlier ILC businesses did not. These novel issues highlight the need for a thorough public comment process and consideration of the results of that public commentary.

### **C. The Business Plan Proposed in the Application Raises Significant Section 23A and 23B Issues**

The types of business models proposed by non-financial technology companies such as Rakuten raise significant questions related to the "Attribution Rule" in Section 23A of the Federal Reserve Act.<sup>25</sup> In adopting Regulation W, which implements Sections 23A and 23B of the Act, the Federal Reserve Board stated that the Attribution Rule was included in Section 23A "to prevent a member bank from evading the restrictions in the section by using intermediaries and to limit the exposure that a member bank has to customers of affiliates of the bank."<sup>26</sup> Regulation W states that "[a] member bank must treat any of its transactions with any person as a transaction with an affiliate to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, an affiliate."<sup>27</sup> Under this language, the proceeds of a transaction by the bank with a third party that are ultimately transferred to an affiliate are treated as transactions with the affiliate. Other transactions with third parties that benefit an affiliate, such as transactions that result in fees to an affiliate, may be viewed as for the benefit of the affiliate, at least to the extent of the fees.

The typical application of the Attribution Rule is the making of a loan by a bank to enable the borrower to purchase a good or service from an affiliate of the bank. In such a transaction, the proceeds of the loan can be traced to the affiliate and the loan results in a benefit to the affiliate (i.e. the sale of the good or service) that would not occur but for the loan by the

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<sup>24</sup> See SOP.

<sup>25</sup> 12 U.S.C. § 371c.

<sup>26</sup> 67 Fed. Reg. 76,560, 76,576 (Dec. 12, 2002). See also 12 C.F.R. pt. 223.

<sup>27</sup> 12 C.F.R. § 223.16(a).

bank. The use of the phrase “used for the benefit of, or transferred to, an affiliate” in the Attribution Rule requires the tracing (i.e., determining a link or nexus to) the transfer of funds through multiple parties. For example, Regulation W specifically addresses certain credit card transactions where a credit card issued by a bank is used to make purchases from an affiliate.<sup>28</sup> In the case of a credit card purchase from an affiliate, the card issuer’s extension of credit for the transaction is traceable directly through the use of a particular credit card. There is thus a nexus through the credit card settlement process between the proceeds of the loan by the card issuer and the funds received by the merchant through the credit card settlement process. The “for the benefit of” language is even broader and may apply to transactions when the proceeds of the loan are not traceable to an affiliate, but when the affiliate directly receives some other benefit.

Rakuten Bank plans to offer, among other financial products and services, consumer loans, consumer credit cards, and commercial loans to support that activity in the online marketplace, a violation under Regulation W.<sup>29</sup> We expect that this could be a common business model for similar information-based technology companies. This business model creates significant issues under the Attribution Rule.

## CONCLUSION

The Associations believes that Rakuten Bank’s proposed reliance on synergies between banking and non-financial business models, the related implications for use, security, and privacy of customer data, and the resulting questions raised under FDIA’s standards for approval of deposit insurance lead to the conclusion that the Application does not meet the standards set forth in Section 6 of the FDIA.

Additionally, the Proposal raises broad and important questions that require an opportunity for broad public input. The issues clearly transcend the specifics of the Application. The public and the FDIC would benefit from thorough public input and analysis, as the Application threatens to undermine two long-standing pillars of U.S. bank regulation—the separation of banking and non-financial businesses, and the value of consolidated supervision of banking organizations.

The precedential nature of this application cannot be overestimated. The decision made by the FDIC on this application will send a clear message about the degree to which concern for these two pillars will carry weight when applied to other proposals. ABA would welcome the opportunity to comment on these critical issues as part of such a process.

Sincerely,



Hugh C. Carney  
Senior Vice President  
American Bankers Association



John Court  
SVP & General Counsel  
Bank Policy Institute

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<sup>28</sup> *Id.* § 223.16(c)(4).

<sup>29</sup> *See*, Application at 3.