

Massachusetts Bankers Association

October 10, 2006

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
Attention: Comments
550 17th Street, NW
Washington, DC 20429

Dear Mr. Feldman:

On behalf of our 210 member commercial, savings, cooperative, and savings and loan member banks throughout New England, the Massachusetts Bankers Association (MBA) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) notice and request for comment regarding Industrial Loan Companies (ILCs) and industrial banks. MBA has been an active participant in the debate over the ILC charter, having presented testimony to the FDIC during the public hearings held in Washington, DC on the application for deposit insurance of an ILC owned by Wal-Mart Stores, Inc. Our member institutions have serious concerns with the rapid growth of the ILC industry and its impact on local community banks and the safety and soundness of the deposit insurance fund.

In the request for comment, the FDIC poses a number of questions to the public. Our comments will focus on our views on several of the issues raised in the notice.

Questions 1-3

As you know, the ILC industry has experienced rapid growth in recent years. Due to the unique nature of the ILC charter, specifically the lack of restrictions on commercial ownership, many entities that are prohibited from owning other types of depository institutions have chartered or purchased ILCs.

The commercial ownership of ILCs raises a number of troubling issues regarding the safety and soundness of the deposit insurance fund (DIF). The historic separation between banking and commerce, which has been reaffirmed by Congress most recently in the passage of the Gramm-Leach-Bliley Act of 1999, has served our nation's financial system well. There are important reasons for the prohibition: preventing conflicts of interest and ensuring the safety and soundness of our banking system.

ILCs owned by commercial firms are far more likely to be subject to these conflicts. Specifically, an ILC could extend credit unwisely or improperly to its commercial parent in times of economic distress. The potential failure of the parent company in this scenario would put the DIF, the rest of the banking industry, and ultimately the taxpayers at risk.

If restrictions on commercial ownership of ILCs are not enacted by Congress, we believe, at the very least, the FDIC should be granted the statutory authority to examine the holding company, similar to the authority currently in place for the Federal Reserve System under the Bank Holding Company Act. Consolidated supervision is essential in cases of commercial ownership, since banking regulatory agencies currently have no oversight responsibilities for these firms. Supervisory authority, through the FDIC or another banking regulatory agency, could help prevent some of the conflicts of interest

mentioned above and ensure that effective “Chinese walls” are erected between commercial and banking operations.

Our members are also concerned about the rapid growth in insured deposits at ILCs owned by some non-commercial firms. These ILCs have been responsible for adding significant amounts of insured deposits to the system in recent years, thereby diluting the deposit insurance funds. In fact, if Congress had not enacted deposit insurance reform earlier this year, it is likely that banks could have faced significant deposit insurance premiums to bring the funds back to the statutorily mandated 1.25 percent Designated Reserve Ratio. This rapid growth could have had a serious negative impact on other depository institutions, particularly community banks.

Questions 4 and 5

We strongly believe the commercial ownership of ILCs should be prohibited or at least severely restricted. We support the Gillmor-Frank legislation that restricts ILC ownership to companies with more than 85 percent of their gross revenues derived from activities that are “financial in nature”.

However, because this legislation is unlikely to be enacted before the FDIC’s six-month moratorium on ILC applications expires, and given that there are several pending applications before the board, we believe the FDIC should use all of its current statutory authority to carefully evaluate all ILC applications. Applicants that are commercial firms or are not subject to consolidated federal supervision should be subject to enhanced evaluation. Specifically, the character of management requirement should be strictly enforced. Because the FDIC lacks enforcement authority over the commercial firm, it is vital that management is thoroughly vetted before an application is approved. For example, Wal-Mart is now opening bank branches in its retail stores in Mexico, despite the company’s claims that it has no interest in entering the retail banking market. We would argue that enhanced ongoing monitoring should be a condition of approval in these cases as well. Banking regulatory agencies have broad supervisory and enforcement authority with regards to the management of insured depository institutions. Similar oversight is even more important when a commercial firm with many potential conflicts of interest owns a bank.

Questions 6 and 7

We believe that the FDIC should use its authority to restrict ILCs owned by commercial companies from branching, accepting deposits from, and making loans to the general public. Some commercial firms have claimed that they intend to use the ILC charter only to process payments and perform other back office operations. While we disagree with commercial ownership of ILCs in general, we believe that under current law these could be deemed appropriate uses of the ILC charter.

The FDIC should determine whether it has enough authority under current law to impose and effectively enforce any restrictions placed on an ILC during the application approval process. We believe that statutory authority should be granted by Congress if it does not already exist. We do not believe the FDIC should rely solely on conditions imposed in the order approving the application, since typically restrictions on de novo institutions are only effective for three years. Since there is no legal precedent for the FDIC to make these conditions permanent, they could be challenged by the parent company or the ILC at a later date.

Questions 8 and 9

While ILCs owned by commercial firms do not necessarily have an inherent competitive advantage over other insured depository institutions, many do. For example, if Wal-Mart's application for an ILC is approved and the company decides to use the charter to engage in retail banking, it could conceivably create a network of almost 3,700 branch locations in its stores almost overnight. Because of the sheer size of Wal-Mart and its reach into thousands of cities and towns throughout the nation, the ability to create a branch network at a reduced cost in existing stores would pose a significant competitive advantage over community banks and even some of the largest, national banks.

In addition, because of the lack of consolidated supervision, commercial firms could subsidize the products and services offered at their ILC branches through sales of retail products or in other ways. For example, Wal-Mart already charges very low fees to cash checks and provide wire services for its customers. What would stop them from subsidizing other products and services, even if the result is a loss to the ILC, in order to build market share and force competitors out of the market?

Question 10

We do not believe the potential benefits to consumers of commercial ILC ownership outweigh the significant risks they pose to the deposit insurance fund, the safety and soundness of the banking system, and the taxpayers. In Massachusetts, there are more than 200 banks operating thousands of branches in an extremely competitive market. These institutions offer a wide range of products and services for individual and business customers. Consumer convenience would not be enhanced if a commercially-owned ILC were to operate in our region.

Conclusion

MBA strongly believes that the rapid growth in the ILC industry in recent years has had a negative impact on the banking system. We believe the FDIC should act to restrict commercially-owned firms from using ILCs to service retail banking customers, and we urge Congress to pass legislation further restricting the commercial ownership of ILCs.

Thank you again for the opportunity to comment. If you have any questions or need additional information about our comments, please contact me at (617) 523-7595 or via email at jskarin@massbankers.org.

Sincerely,



Jon K. Skarin
Director, Federal Regulatory & Legislative Policy