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May 4, 2007

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street N.W.
Washington, D.C. 20429

VIA E-MAIL TO comments@FDIC.gov

Re: Proposed Rule Part 354—Industrial Bank Subsidiaries of Financial Companies, RIN number 3064-AD15

Dear Mr. Feldman,

The Utah Association of Financial Services ("UAFS") appreciates the opportunity to submit the following comments regarding the draft rule titled "Part 354—Industrial Bank Subsidiaries of Financial Companies" (the "Rule"), issued for comment on December 31, 2007. The UAFS is the trade association whose members include industrial banks in Utah and Nevada.[1]

Some UAFS members have pending deposit insurance applications and will be directly affected by the proposed Rule. Additionally, although the Rule as currently written would not apply to any parent of an operating bank that is a member of our association, we believe it will be helpful to comment on the substantive provisions in the Rule because they may apply more broadly in the future and potentially affect all of our members.

In principle, the UAFS supports adopting a regulation governing industrial bank holding companies that is consistent with existing law and not unduly burdensome. It will be helpful to specify the FDIC's authorities and procedures for regulating industrial bank parent companies and affiliates in one regulation. Currently those authorities and procedures are set forth in various statutes, regulations, policy statements, guidelines and informal practices, and can be difficult for the parent companies, affiliates and the banks themselves to locate and understand. A rule will also provide a more open system for considering and

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[1] Thrifts in Nevada have not formed a separate trade association. The Nevada banks that are members of a trade association have joined one or both of the association in Utah and California.

adopting new standards and procedures as the FDIC's oversight of holding companies evolves in the future.

As it is currently drafted, the Rule mostly implements procedures utilized for many years to regulate existing industrial bank holding companies and affiliates. Today, FDIC examiners obtain current financial information about parent companies and affiliates during each examination. Occasionally, additional information is requested and the bank affiliates have always responded promptly and completely. Examiners regularly examine facilities operated by a parent or affiliate that provide services to a bank to determine that they comply with all terms and conditions of the services contracts and the systems utilized to perform those services are adequate to comply with current banking standards. In these respects, the Rule only formalizes and reiterates the FDIC's current practices which are reasonable, prudent and not unduly burdensome, and we support the adoption of those provisions of the Rule.

Additional comments on specific sections are as follows.

§ 354.2(c)—This is the definition of "*Non-FCBS Financial Company*", which ". . . means a company that is not subject to Federal Consolidated Bank Supervision by the FRB or OTS . . ." UAFS strongly objects to not including companies regulated by the SEC as a consolidated regulator in this definition. The SEC is recognized world wide as a consolidated regulator along with the Federal Reserve and the OTS. This designation is critically important to the operations of many of the largest securities firms based in the U.S.

No lack of adequate regulatory oversight justifies excluding SEC consolidated regulation from the list of recognized regulators. Securities firms with industrial bank subsidiaries are currently subject to multiple levels of supervision. They are all regulated by the SEC as securities dealers, and all of the UAFS member securities companies that currently have industrial bank subsidiaries have elected to be subject to more comprehensive enterprise wide regulation by the SEC acting as a consolidated regulator.

The requirements relating to securities companies supervised by the SEC as "consolidated supervised entities" were adopted under the authority of the Securities Exchange Act of 1934 and are set forth in 12 C.F.R. Part 240.15c3-1. While regulation of a broker-dealer normally focuses on compliance with the investor protection provisions of the securities laws, the consolidated supervised entity structure focuses on the capital adequacy and risk management practices of holding companies. The option to be regulated as a CSE is available only to certain highly capitalized companies. Each must maintain tentative net capital of $1 billion, net capital of $500 million, and notify the SEC whenever tentative net capital falls below $5 billion. In addition, each company must:

- Provide information about the financial and operational condition of the ultimate holding company including certain capital, liquidity and risk exposure information
- Implement and document a comprehensive, group-wide management system for identifying, measuring, and managing market, credit, liquidity, legal, and operational risk
- Consent to SEC examination of the ultimate holding company and all material affiliates
- Compute on a monthly basis group wide allowable capital and allowances for market, credit, and operational risk in accordance with the standards adopted by the Basel Committee on Banking Supervision.

Eligible holding companies provide information to the SEC on a monthly, quarterly and annual basis. SEC oversight involves both on-site examinations and ongoing communications with consolidated supervised entities.

After reviewing these standards the European Union and the Financial Services Authority in Britain recognized SEC CSE regulation as a qualified form of consolidated regulation along with regulation of bank holding companies by the Federal Reserve and regulation of FSB holding companies by the Office of Thrift Supervision. This designation allows U.S. based financial services providers subject to regulation under those regimes to operate branches in Europe instead of having to organize separate subsidiaries regulated directly by regulators in those countries.

The standards used by the SEC for purposes of consolidated regulation also comply with the standards used by the Federal Reserve to assess whether a foreign regulatory regime qualifies as consolidated regulation for a foreign bank operating in the U.S. The Federal Reserve's standards are set forth in 12 C.F.R. § 211.24(c) (ii) and read as follows:

> (ii) Basis for determining comprehensive consolidated supervision. In determining whether a foreign bank and any parent foreign bank is subject to comprehensive consolidated supervision, the Board shall determine whether the foreign bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the foreign bank (including the relationships of the bank to any affiliate) to assess the foreign bank's overall financial condition and compliance with law and regulation. In making such determination, the Board shall assess, among other factors, the extent to which the home country supervisor:

> (A) Ensures that the foreign bank has adequate procedures for monitoring and controlling its activities worldwide;
>
> (B) Obtains information on the condition of the foreign bank and its subsidiaries and offices outside the home country through regular reports of examination, audit reports, or otherwise;
>
> (C) Obtains information on the dealings and relationship between the foreign bank and its affiliates, both foreign and domestic;
>
> (D) Receives from the foreign bank financial reports that are consolidated on a worldwide basis, or comparable information that permits analysis of the foreign bank's financial condition on a worldwide, consolidated basis;
>
> (E) Evaluates prudential standards, such as capital adequacy and risk asset exposure on a worldwide basis.

As described above, the SEC's CSE regime meets all of these tests.

This clearly demonstrates that there is no justification for refusing to recognize the SEC as a consolidated regulator. It contradicts determinations made by the primary regulatory authorities overseeing international operations of the leading financial services providers in the world and in casting doubt on those determinations exposes the leading U.S. based securities companies to risks of major disruptions in their international operations.

The UAFS strongly urges the FDIC to add the SEC to the list of Federal Consolidated Bank Supervisors in this definition.

§ 354.4(c)—This subsection will prohibit a holding company from engaging directly or indirectly in non financial activities. It should be deleted unless specifically authorized by new legislation. It functionally repeals the current exemption for industrial bank parent companies in the Bank Holding Company Act. That is beyond the FDIC's authority absent a change in the law itself. In addition to the lack of any legal authority to restrict an industrial bank holding company from engaging in diversified activities, there are no demonstrable safety and soundness issues that justify barring control of an industrial bank by an entity engaged in non financial activities. Indeed, this provision is more onerous than any proposed legislation before Congress.

§ 354.4(d)—We recommend deleting the provisions in this section requiring each industrial bank parent company that is not subject to consolidated supervision to submit reports to the FDIC regarding the parent's "systems for monitoring and controlling financial and operating risks". The FDIC has the authority now to request information about a parent's financial and operating risks to the extent they have any relevance to the bank. Our concern relates to requiring the FDIC to assess financial and operating risks relating to business activities that it does not have the expertise to oversee and which may be functionally irrelevant to the bank. The requirement is unduly burdensome and will not generate information that would be useful to the FDIC if it were applied to a large and diversified corporate group.

§ 354.4(g)—This subsection will limit holding company representation on the bank's board to 25% of the bank's directors. The current informal standard requires a majority of the bank's directors to be independent. We recommend formalizing the current standard and not replacing it with the 25% limit. The majority standard has worked well and we are aware of no reason why it should be changed. We agree with the FDIC's concern about the independent control of each industrial bank and support the existing measures to ensure structural independence at the board and senior executive level.

There are important reasons why it is desirable to allow a minority of a bank's directors to be connected to a holding company. The parent typically provides all of the bank's capital and the bank also operates with the parent's most valued asset—its name. A holding company has a natural and legitimate interest in overseeing its subsidiary bank's operations and a fiduciary responsibility to its shareholders to do so. A holding company is not a mere sponsor of its bank, it has a substantial economic and reputational interest that the FDIC's interests supersede only in controlling risks of undue influence.

The most significant factor in the creation of any bank is a decision by an investor to commit money and other resources to the bank. The key considerations for a corporate parent investing in a bank that will operate independently are the value the bank will add to the corporate group and the parent's trust and confidence in the bank's management. Experience has shown that many successful banks have a deep relationship with the parent even though they operate as an independent entity within the corporate group. This is facilitated by allowing key representatives of the parent to sit on the bank's board. These people play critical roles in bridging the relationship between the bank and its affiliates. They ensure that the parent and affiliates understand the bank's role, requirements and limitations and reassure the parent that the bank is well managed and cognizant of its responsibilities to the corporate group.

The key to creating an effective and well balanced rule is keeping in mind the difference between independence and isolation. Independence is critical but too much isolation will constrain the development of the bank and in some cases result in its closure or termination of plans to organize it in the first place.

Controlling shareholders—Regulation of controlling shareholders of the holding company is not addressed extensively in the Rule. We recommend adding some additional provisions relating to controlling shareholders.

In an industry in which "capital is king", access to capital should be a primary consideration in the development of regulatory policies. Large holding companies rely extensively on institutional investors for new capital. Typically, an institutional investor will consider an investment only if it is above a minimum size and does not expose the investor to added regulation. Investing in a large bank holding company meets these standards because a sizeable investment will still be well below the threshold where it would be deemed a control party. At the other end of the spectrum, a community bank typically relies more on individual investors to raise capital. The level of investment below the control threshold for a community bank is usually too small to attract institutional investors but within the reach of many individuals.

A medium size company can be caught in the middle, too large to raise substantial amounts of capital from individuals but also near or below the control threshold for most institutional investors. That limits access to capital for a medium size company. This is partly responsible for the decline in the number of medium size banks in the U.S. during the past few years.

This has been the experience of UAFS members that have had to raise capital through a private or public offering in the past few years. They found many interested institutional investors but most were ultimately unwilling to invest because the minimum investment under their investment policies would make them a control party subject to regulation by the bank's regulators, which the same investment policies prohibit. We see no good policy reason to discourage these investors from investing in a medium size holding company or bank. Institutional investors include some of the leading mutual fund companies, retirement funds and venture capital funds in the nation. They are responsible professional investors who are already heavily regulated under the securities laws and fear the complication of another layer of detailed requirements if they become a control party under the banking laws.

Medium size banks need better access to capital from institutional investors to organize new banks and expand existing banks. Subjecting the investor to regulatory oversight if it acquires more than 10% of the holding company's shares is one challenge for banks of that size. This could be partially

addressed by providing an exemption or limited regulation for investors that are regulated as investment funds or financial advisors under the securities laws up to 25% of the holding company's total voting shares. That would be consistent with existing law and a significant increase over the current 10% limit imposed by rules and guidelines imposing a presumption of control. It would present no substantial risk to the bank since this exemption would apply to professional investors, not entities seeking to control the bank's business or build links between it and other businesses in which they invest.

It is also important not to impose activity restrictions on investors. Most institutional investors that might be willing to invest above the control threshold would be barred because they hold diversified investments including commercial companies. The number of institutional investors that only invest in banks is a miniscule portion of the capital available in today's capital markets. Barring all diversified institutional investors would be very counterproductive considering the amount of capital that would be cut off, the importance of capital to every bank, and the lack of any substantive risk in allowing a typical retirement fund, mutual fund, or similar institutional investor to hold shares in a bank or its holding company.

In addition to these comments on the Rule, we offer the following responses to the request for comments to specific questions set forth in the supplementary information regarding the Rule.

1. Cure period—Permitting a discretionary cure period is prudent and reasonable for all requirements, particularly if a violation arises inadvertently and poses no or only a minimal risk to the safety and soundness of the bank. This is the standard generally used for the bank itself. Imposing inflexible standards on a holding company may result in more harm to both the holding company and the bank than would be warranted in most circumstances, particularly when the penalty would be divestiture of the bank. Divestiture would result in a loss of some or all of the holding company's investment in the bank and probably result in closure of the bank as well. Such extreme consequences could be justified only if the safety of the bank was seriously threatened. The period to cure a problem should provide for taking strong actions without delay when needed to address a serious issue but also allow for a longer period to resolve less serious problems or implement solutions that may take longer than a specific term would allow.

The 180 day cure deadline imposed on some conditions in the case of a Financial Holding Company is a good example of the potential problem. The conditions covered by that cure deadline include a capital impairment, poor management rating and below satisfactory CRA rating at the subsidiary bank. The bank regulators will be attacking those problems at the bank level and could be near a resolution when the cure period expires. It could take longer than 180

days if the holding company must perform a new securities offering to raise new capital for the bank. Conducting a nationwide search for a new CEO or management team could take longer than 180 days to find the best qualified person and for that person to leave his/her current position, take over the troubled bank and make substantial progress to resolve its problems sufficient to warrant raising the management rating. Implementing new CRA programs could take longer than 180 days, particularly if the bank develops a strategic plan, and time must be allowed to conduct a new examination within that period to confirm that a new rating is warranted. These constraints are potentially unworkable and are themselves a threat to the safety and soundness of the bank. Regulators should be able to weigh the seriousness of a violation, the efforts undertaken to cure the problem and the likelihood of a successful resolution in determining whether further sanctions are needed.

2. Actions beyond cease and desist orders and civil money penalties under current legal authority—We do not believe additional authority is needed beyond what is currently available to the FDIC and the state regulators. Divestiture is an extreme action that would be warranted only in rare and unusual circumstances directly threatening the safety and soundness of the bank. A more effective authority in such circumstances is the ability to take possession of the bank, a power the Utah Commissioner of Financial Institutions has over Utah chartered institutions if he believes that is necessary to protect the bank from a serious risk.

A regulator dealing with one or more significant problems at a bank must continuously assess the ability and willingness of the bank's owner(s) and management to resolve the problem on their own. If they can, it is clearly appropriate to allow them to do so. If they cannot or will not, regulators should take action as soon as possible to implement other solutions. Many state banking commissioners can take possession of any bank chartered by their state at any time simply by posting a notice on the bank premises. After taking possession, the state commissioner can sell or merge the bank, close it, or turn it over to the FDIC as receiver. It would be prudent for the FDIC to ensure that state regulators have this authority and can use it expeditiously if needed.

The sections of the Bank Holding Company Act cited in this question relate to the divestiture of a bank that is a going concern from a company engaging in activities that are not authorized for a bank holding company. We do not believe the FDIC has the authority to require divestiture of an industrial bank solely because of activities occurring outside the bank unless those activities threaten the safety and soundness of the bank. Attempting to impose activity restrictions on industrial bank affiliates that do not pose a safety and soundness risk to the bank would effectively repeal existing law, something only Congress can do.

3. Period to divest commercial activities or industrial bank— As stated in the prior question, this presumes that the FDIC can require the parent of an industrial bank to not engage in otherwise legitimate commercial activities permitted by existing law. Apart from issues of safety and soundness, such restrictions conflict with the exemption for industrial bank parent companies and affiliates from the Bank Holding Company Act and are beyond the FDIC's authority.

4. Further define "services essential to the operations of the industrial bank"?—We believe this is unnecessary. It is unlikely that a general list could anticipate or adequately define what is essential in every instance. A service that is essential in one case may be only marginally important in another. The FDIC and state regulators already closely regulate all interactions between a bank and it affiliates even if they are not deemed "essential". Continuing that practice should be sufficient to ensure that all affiliate relationships and transactions are conducted appropriately.

5. What is needed to assure transparency regarding a bank's parent and affiliates?—We find this Rule is reasonable in providing for the FDIC to examine holding companies and affiliates for compliance with the Federal Deposit Insurance Act or other laws administered by the FDIC. The FDIC already has the authority to require companies that control a bank to provide information and submit to examination. The FDIC exercises this authority now to the extent if believes necessary and appropriate to understand the condition of a bank's parent and the sufficiency of the services it provides to the bank. To our knowledge, the FDIC has never requested information from or sought to conduct an examination of a bank's parent or affiliate where the parent or affiliate did not cooperate fully.

Concern exists regarding an agreement authorizing the FDIC to examine any affiliate if it leads to unnecessary regulatory burdens on affiliates that have no connection to the bank other than common ownership. This concern increases if the Rule is expanded to cover existing industrial banks. For example, some industrial banks have hundreds of affiliates, many of which are based in foreign countries. The U.S. bank may have no dealings with any of those affiliates. Audits of affiliates in foreign nations may be prepared under different accounting rules and not available in English. The activities of the affiliates may be wholly outside the expertise of bank examiners. Requiring those affiliates to be examined by U.S. bank examiners or provide annual audits prepared under U.S. accounting standards would be burdensome and unjustified unless a particular affiliate engages in transactions with the U.S. bank.

We believe no change is needed from the current practice that allows the FDIC to decide what information it needs and examinations it should conduct to

properly supervise the bank. The regulation should not require anything that is not somehow pertinent to the bank.

6. Recordkeeping requirements on parents and non bank affiliates.—See answer to preceding question.

7. Regulation of insurance and securities affiliates of a bank?— The regulatory burden must be considered and weighed against the possible benefit to the FDIC of imposing concurrent authority over affiliates subject to primary regulation by another regulator.

It would clearly be undesirable for the FDIC to duplicate the regulatory oversight of a securities or insurance affiliate by its primary regulator. The FDIC should defer to the securities and insurance regulators to the extent they provide the same oversight and obtain the same information the FDIC would if it directly regulated that entity. The FDIC should be sure that the other regulator can and will share its information with the FDIC if it is pertinent to the FDIC's oversight of the bank. It would also seem prudent for the FDIC to reserve the authority to ask for additional information and conduct examinations if the information is necessary for the FDIC to properly regulate the bank.

Like the standards for functional regulation of securities and insurance affiliates in a financial holding company group, the UAFS believes the FDIC should defer to the primary regulators of securities and insurance affiliates with regard to capital requirements and other standards. As stated in greater detail below, capital and other requirements vary depending on the business in which a company engages. Bank capital requirements are appropriate for a bank, not a securities or insurance company, which may need less or more capital to be considered sound. That determination is best made by regulators that know securities or insurance companies.

The same holds true for affiliates that engage in other activities such as retailing or manufacturing. The FDIC is simply not qualified to comprehensively regulate business activities other than banking.

8. Should the SEC be recognized as a consolidated federal regulator?—Yes. The SEC understands the business and needs of a securities company better than other regulators and is best suited to regulate that type of company. It would not be appropriate to impose the standards of a bank holding company on a securities company without first determining that those standards are compatible with a company primarily engaged in the securities business.

9. Require minimum capital standards at each parent company?— The UAFS strongly opposes any change that would establish a minimum capital requirement for all parent companies of industrial banks.

Minimum capital requirements make sense for a company that only owns a bank and whose only activity is supporting its subsidiary bank. The capital needed to properly support a traditional bank holding company is relatively easy to determine based upon the same factors used to determine adequate capital for the bank.

The capital needed to support other kinds of activities will vary significantly and depends on different factors than those pertinent to a bank. They may require less capital as a percentage of total assets than a bank to be financially sound, in which case a bank minimum capital requirement would be burdensome, or they may need to hold more capital, in which case a bank capital standard would not properly reflect the risk of a capital impairment at that parent company.

Requiring a parent company to hold more capital than it needs may be economically unrealistic or result in a competitive disadvantage. In those circumstances, the minimum capital requirement would effectively preclude ownership of a bank even though it is legally permitted.

In addition, the capital ratio of a parent becomes less relevant to a bank subsidiary when the bank is just a small portion of the parent's total assets. In that event, the parent will be able to support the bank better than any traditional bank holding company even if its capital to assets ratio is much lower than a bank holding company. It is also unreasonable for the regulator of a bank subsidiary of a much larger diversified holding company to intrude into the basic management of the holding company when the bank regulator is not qualified to understand the parent's other businesses.

Today, the FDIC considers each holding company's ability to provide support to its subsidiary bank on a case by case basis. As a result, industrial banks currently hold significantly more capital than at traditional banks. If the FDIC sees weakness at a parent company it can require higher capitalization levels in the bank to compensate. In most instances the parent companies of industrial banks offer a stronger source of capital than a bank holding company. The existing governing structure is adequate and gives wide latitude to the regulators.

10. What should the FDIC do if Congress passes no legislation affecting industrial banks before the moratorium expires?—The FDIC is responsible for administering the laws Congress has enacted, not those it may pass at some point in the indeterminate future. Congress enacted a law in 1987 that specifically exempts holding companies of industrial banks from the Bank Holding Company Act (except the tying provisions). Unless Congress amends or repeals this law, the FDIC has a responsibility to process applications for new

banks and acquisitions of existing banks by companies with the resources, expertise and integrity to successfully operate a bank even if they are also engaged in commercial activities that do not present any threat to the bank. We respectfully submit that fashioning regulations in anticipation of legislation that may or may not pass is contrary to the outstanding legacy and traditions of the FDIC.

Furthermore, our Association considers it inappropriate to propose any regulation that would constrain commercial activity by a bank parent or affiliate except in circumstances where such an activity would present a specific risk to a bank. Congress and the FDIC have created the existing policies allowing companies engaged in legitimate commercial activities to control a bank as provided in law, and regulated by this agency. The impact upon the American economy and American families and individuals of this visionary policy has consistently been positive.

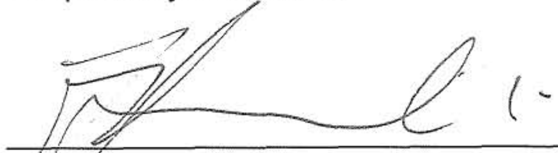
Industrial banks, including those owned by entities engaged in commercial activities, are demonstrably the strongest banks insured by the FDIC today. When the ultimate goal of regulation is ensuring the safety and soundness of the nation's banks, we find no logic or legitimate purpose in restraining and harming such strong institutions.

The moratorium on new industrial bank applications has damaged the industry by creating uncertainty over the conditions of ownership. A successful industry has developed around the exemption for industrial bank parents from the Bank Holding Company Act. That is what Congress intended when it created the exemption twenty years ago. Suddenly imposing restrictions on commercial activities of parent companies of industrial banks creates a strong disincentive to make new investments or even maintain existing investments in industrial banks. That effect is the opposite of what Congress intended.

Over the years, Industrial bank owners have relied on the FDIC's prior pronouncements regarding industrial banks. Shortly before Congress adopted the existing laws governing industrial banks in 1987, the FDIC issued a study recommending repeal of the Bank Holding Company Act in its entirety. Among other things, the study expressly found that the restrictions on affiliations between banks and commercial companies were unjustified and counterproductive. Since then the FDIC has, on numerous occasions, publicly stated its confidence in the industrial bank industry and the authority to regulate the industry under existing law. Unfortunately, the possibility of a shift by the FDIC towards restricting the commercial activities of industrial bank parents has shaken confidence in the industry. To avoid further damage, we urge the FDIC to enforce existing laws and terminate the moratorium if Congress fails to enact any new laws before the moratorium expires.

We appreciate the opportunity to submit these comments and hope you find them helpful.

Respectfully Submitted,



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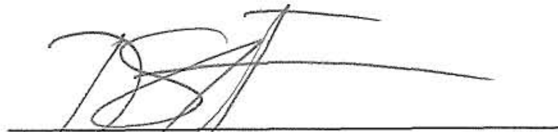

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