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May 7, 2007

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Re: Industrial Bank Subsidiaries of Financial Companies; RIN 3064-AD15

Dear Mr. Feldman:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on proposed rules that would impose conditions and requirements on corporate owners of insured industrial loan companies or industrial banks that are engaged solely in financial activities and that are not subject to consolidated bank supervision by the Federal Reserve Board or the Office of Thrift Supervision ("Federal Consolidated Bank Supervision").

Summary of ICBA's Position

ICBA commends the FDIC for proposing consolidated regulation of non-FCBS financial companies that own industrial banks**.** We agree with the recent Government Accountability Office Report[2] that consolidated regulation of industrial bank holding companies would better ensure the safety and soundness of industrial banks, protect the

[1] *The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 265,000 Americans, ICBA members hold more than $876 billion in assets $692 billion in deposits, and more than $589 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

[2] U.S. Governmental Accountability Office, GAO-05-621, Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority 79-80 (2005)

Deposit Insurance Fund, and level the existing playing field with regard to the regulation of depository institution holding companies. Non-FCBS financial companies that own industrial banks pose similar risks to the Deposit Insurance Fund as other bank or thrift holding companies. The limited transparency that now exists with these companies makes it very difficult for the FDIC to identify and monitor these risks. A financial company that owns an industrial bank should serve as a source of strength for the bank and therefore should be subject to consolidated Federal supervision which includes reporting, examination, and minimum capital requirements at the holding company level.

With regard to specific comments regarding the proposed rules, we recommend: (1) that the thirty-one existing non-FCBS financial companies that own industrial banks be subject to the final rules and not be grandfathered; (2**)** that financial companies that own industrial banks be subject to capital requirements similar to those imposed on bank and thrift holding companies; (3) that the FDIC impose reporting and recordkeeping requirements on these parent companies of industrial banks as well as on parent company's subsidiaries that are similar to reporting and recordkeeping requirements imposed on thrift and bank holding companies and their subsidiaries under the Bank Holding Company Act (BHCA) and its regulations; (4) that, regardless of their size, industrial banks be subject to annual independent audit requirements for the first three years after the industrial bank becomes a subsidiary of a financial company and then following the three year period be subject to the annual independent audit requirements of Part 363 of the FDIC regulations, subject to the exemptions provided under those regulations for smaller institutions; and (5) that the FDIC have divestiture powers similar to the Federal Reserve.

If, at the conclusion of the moratorium, Congress has not completed its action on ILC legislation, then ICBA strongly urges the FDIC to extend the moratorium for one more year to give additional time for Congress to act. This would be particularly true if the House of Representatives passes the Industrial Bank Holding Company Act (HR 698) but the Senate has not completed its work on a bill.

Background

Industrial banks were first chartered in the early 1900's as small loan companies for industrial workers. Over time, industrial banks have grown significantly and many now have generally the same powers as state commercial banks.

All industrial banks are state-chartered banks and their primary regulator is the FDIC. While industrial banks are "banks" under the Federal Deposit Insurance Act, [3] they are not considered 'banks' under the BHCA.[4] As a result, a company that owns an FDIC-insured industrial bank can engage in commercial activities and is not subject to Federal Consolidated Bank Supervision. By contrast, bank holding companies or savings and loan holding companies are generally prohibited from engaging in commercial activities and are subject to Federal Consolidated Bank Supervision.

[3] 12. U.S.C. 1813(A)(2)

[4] Sec 12 U.S.C. 1841©(2)(H)

In 2005, the Government Accountability Office (GAO) expressed its concern that industrial banks owned by commercial companies or other entities without a Federal Consolidated Bank Supervisor created an uneven playing field when compared to banks and thrifts owned by holding companies subject to Federal Consolidated Bank Supervision. The GAO questioned whether the FDIC's examination, regulation, and supervision authorities were sufficient to protect such industrial banks. The concerns regarding the lack of consolidated supervision and the possible limitations of the FDIC's authority echoed those previously expressed by the FDIC's Office of Inspector General in a 2004 report.[5]

Between 1987 and 2006 total assets held by industrial banks grew from $4.2 billion to $177 billion. Noting this substantial increase in ILC assets and the increase in the number of applications for deposit insurance or notices of change in control by ILCs, the FDIC published on August 23, 2006 in the *Federal Register* a Notice with Request for Public Comment on a wide range of issues concerning industrial banks.

In response to the FDIC's Notice, ICBA commended the FDIC for imposing a six-month moratorium on deposit insurance applications for new ILCs and on change in control applications by ILCs.[6] ICBA reiterated its opposition to mixing commerce and banking and urged the FDIC to support legislation that would prohibit commercial ownership of ILCs and provide for comprehensive, consolidated regulation of ILCs and their parent companies. Citing the GAO report, ICBA noted the shortcomings of current ILC holding company regulation and the fact that the FDIC does not have the same powers to oversee and examine the entirety of a holding company's operations as does the Federal Reserve under the BHCA.

For instance, the BHCA provides the Federal Reserve with the authority to examine the bank holding company itself and any of its non-bank subsidiaries at any time, while the FDIC has only limited examination authority, and is unable to examine affiliates of banks unless necessary to disclose the direct relationship between the bank and affiliate and the effect of the relationship on the bank. The Federal Reserve can also establish consolidated capital requirements to ensure that bank holding companies are a source of financial strength for the subsidiary bank. Corporate parents of ILCs are not subject to these capital requirements. Finally, the Federal Reserve has broad enforcement authority under the BHCA, can issue cease and desist orders, impose civil penalties, and order a holding company to divest non-bank subsidiaries if it determines that ownership of the subsidiary presents a risk to the financial safety, soundness, or stability of an affiliated bank and is inconsistent with sound banking principles or the purposes of the BHCA.

In response to the 12,600 comment letters that the FDIC received from its Notice including several letters from members of Congress, the FDIC extended the moratorium by one year—or until January 31, 2008, on applications for deposit insurance and change

[5] See Federal Deposit Insurance Corporation Office of Inspector General, Report No. 2004-048, the Division of Supervision and Consumer Protection's Approach for Supervising Limited-Charter Depository Institutions (2004).
[6] See our letter to the FDIC dated October 10, 2006.

in control notices from industrial banks to be owned by companies engaged in commercial activities. The FDIC said the purpose of the extension is to allow more time for the FDIC to study the issues and for Congress to consider the issues presented by such an ownership model.

The FDIC also proposed rules directed only at industrial banks that will become subsidiaries of non-FCBS financial companies--that is companies that (i) are engaged only in financial activities, and (ii) are not subject to Federal Consolidated Bank Supervision. As of January 30, 2007, thirty-one of the fifty-eight industrial banks in existence are owned by financial companies that are not subject to Federal Consolidated Bank Supervision. The proposal makes clear that the FDIC is not proposing any changes in its regulation or supervision of industrial banks that (1) will be directly controlled by one or more individuals or (2) will become a subsidiary of an FCBS financial company, that is, a company that (i) is engaged only in financial activities and (ii) is subject to Federal Consolidated Bank Supervision (i.e., a bank holding company, a financial holding company, or a savings and loan holding company).

ICBA's Position

General Comments Regarding the Proposed Rules

ICBA commends the FDIC for proposing consolidated regulation of non-FCBS financial companies that own industrial banks. We agree with the GAO Report that there is an uneven playing field with regard to the regulation of holding companies. It is unfair, from a competitive standpoint, to allow companies that control one or more industrial banks to conduct essentially the same business as bank holding companies, financial holding companies, or thrift holding companies that are subject to Federal Consolidated Bank Supervision. To continue to permit this uneven playing field would encourage those institutions that are subject to consolidated supervision to migrate to the industrial bank model.

Furthermore, non-FCBS financial companies that own industrial banks pose similar risks to the Deposit Insurance Fund as other bank or thrift holding companies. The limited transparency that now exists with these companies makes it very difficult for the FDIC to identify and monitor these risks. Consolidated supervision offers broader examination and enforcement authorities that can be used to monitor and restrain those risks and keep them from developing into significant risks for the industrial bank. We agree with the GAO that the bank-centric approach that the FDIC has been using with industrial banks and their parent companies is not adequate, particularly in light of the growth, changes and evolution of industrial bank, and that the FDIC needs the tools of a consolidated regulator to adequately address the risks associated with insured depository institutions in a holding company structure.

In addition, the financial company should serve as a source of strength for the industrial bank and therefore should be subject to consolidated Federal supervision which includes reporting, examination, and minimum capital requirements at the holding company level. As a deposit insurer and as the primary Federal banking supervisor for industrial banks, the FDIC must ensure that the risks arising from the business activities of the owners of insured industrial banks do not impair the safety and soundness of those industrial banks or impose undue risks on the Deposit Insurance Fund. This requires a focus on the risks from the insured institution's activities as well as the activities of the owner.

We agree with the FDIC that access to current and complete information about the potential risks to an insured industrial bank that may be created by the operations of its parent company or its affiliates is especially critical today because of the speed with which an industrial bank or its parent company can move into new and more risky business operations. Changes in the business plans of the owners of even well-rated institutions could lead to participating in risky or emerging activities that could jeopardize the insured institution's safety and soundness well before supervisory ratings would typically be adjusted. Under current regulations, the FDIC does not have timely access to information about the risks posed by changes in the business focus of parent companies without direct access to these owners.

Specific Comments Regarding the Proposed Rules

(1) Existing ILC Companies Should Be Subject to the New Rules and Not Be Grandfathered.

As proposed, the regulations would not affect the thirty-one existing financial companies that own industrial banks and that are not subject to consolidated Federal supervision. However, the FDIC says it will continue to exercise close supervision of these industrial banks and any risks that may be created in the future from their parent companies or affiliates to ensure that these institutions continue to operate in a safe and sound manner. **We recommend that the FDIC not grandfather existing non-FCBS financial companies that own industrial banks**. Without adequate consolidated regulation, these institutions are large enough that they pose significant risks to the Deposit Insurance Fund and the safety and soundness of the banking system. We believe that these existing financial institutions should be subject to the final rules, but should be given a period of time—say one or two years—to come into compliance. Not only is it a risk to allow these institutions to operate without consolidated regulation, it is unfair from a competitive standpoint to allow these institutions to be grandfathered.

(2) Parent ILC Companies Should Be Subject to Minimum Capital Requirements.

Under the proposed rules, non-FCBS financial companies would be prohibited from controlling or owning an industrial bank without entering into an agreement with the FDIC and agreeing to certain commitments. **In addition to committing to maintain each industrial bank's subsidiary's capital at such levels as the FDIC deems appropriate, the holding company should be subject to capital requirements similar to those imposed on bank and thrift holding companies.** We believe the holding company should commit to maintaining a 4% Tier 1 capital ratio on a consolidated basis and be subject to the same leverage ratios and risk-based minimum capital requirements that bank and thrift holding companies are subject to. This would ensure that each parent financial company can serve as a source of strength to its industrial bank subsidiary and fulfill its obligation under a capital maintenance agreement.

(3) Parent ILC Companies and Their Subsidiaries Should Be Subject to Reporting and Recordkeeping Requirements

ICBA also agrees it is appropriate for the FDIC to impose reporting and recordkeeping requirements on a parent company of an industrial bank as well as on the parent company's subsidiaries that are similar to reporting and recordkeeping requirements imposed on thrift and bank holding companies and their subsidiaries**. All industrial bank holding companies should be required to submit financial data similar to the FR Y-9s that bank holding companies submit to the Federal Reserve.** If the holding company is an SEC reporting company, it should be required to submit quarterly and annual reports on Forms 8-K, 10-K and 10-Q to the FDIC in addition to the SEC. The FDIC should have the authority to review and examine records maintained by the parent company and its subsidiaries including board records, financial records, and records of all transactions between the industrial company and its affiliate for a minimum period of time (e.g., five years) after the reporting event occurs. This will allow the FDIC to quickly identify any potential risks that the holding company or its subsidiaries pose to the industrial bank subsidiary.

(4) ILCs Should Be Subject To Annual Independent Audit Requirements.

ICBA also recommends that all industrial banks regardless of their size be subject to annual independent audit during the first three years after the industrial bank becomes a subsidiary of the financial company. Thereafter, the industrial bank should be subject to the annual independent audit requirements of Part 363 of the FDIC regulations subject to the exemptions provided under that section for smaller institutions. Annual audits will help the FDIC to detect any potential financial problems that the ILC has early enough to resolve the issue. We believe the audit requirement should be a permanent one and that industrial banks with over $1 billion in assets should be subject to other Part 363 requirements just as other financial institutions are subject to those requirements including the internal control attestation requirements, the requirement for an independent audit committee, and management internal control reporting requirement.

We would also make all of the requirements cited in Section 354.5 of the proposed regulations permanent. For instance, the FDIC should approve any material change in the industrial bank's business plan that occurs at any time, not just in the first three years after becoming a subsidiary industrial bank. This should also be true of adding or replacing board members or senior executive officers. An ILC should be required to obtain written approval from the FDIC prior to adding or replacing a board member or senior executive officer at anytime, not just in the first three years after becoming a subsidiary industrial bank.

(5) The FDIC Should Have Divestiture Powers Similar to the Federal Reserve Under the BHCA.

ICBA recommends that the FDIC have divestiture powers similar to the Federal Reserve to enforce the conditions and restrictions on ILCs and their parent companies. We do not believe that civil money penalties and cease and desist powers provide sufficient remedies for the FDIC to enforce some of its restrictions. For instance, the FDIC should have the authority to require a parent company to divest its ILC if it engages in non-financial activities or if it refuses to maintain the industrial bank's capital and liquidity at sufficient levels. We recommend that the final rules specifically authorize such divestiture powers and that the divestiture powers be specifically mentioned in the written agreement with the parent company and the industrial bank.

Commercial firms seeking to acquire an industrial bank should completely divest themselves of their commercial activities before acquiring an industrial bank. In other words, a commercial firm should not be given a period of time to divest itself of its commercial activities while owning or controlling an industrial bank. The risks to our banking system and to the Deposit Insurance Fund of integrating banking and commerce are too substantial to allow commercial firms even a limited amount of time to integrate both activities.

The FDIC Should Extend the Moratorium Again If Congress Has Not Enacted ILC Legislation.

If, at the conclusion of the moratorium, Congress has not completed its action on ILC legislation, then ICBA strongly urges the FDIC to extend the moratorium for one more year to give additional time for Congress to act. This would be particularly true if the House of Representatives has passed the Industrial Bank Holding Company Act (HR 698) but the Senate has not completed its work on a bill. As we have said in previous comments to the FDIC and in testimony to Congress, it is important that Congress have the opportunity to consider the serious public policy issues presented and pass legislation to permanently close the ILC loophole, maintain the separation of banking and commerce, and provide for comprehensive, consolidated regulation of ILCs and their parent companies.[7] The ownership of industrial banks by commercial firms threatens our nation's historic separation of banking and commerce and undermines our system of holding company supervision, harming consumers and threatening financial stability. The fact that Wal-Mart has withdrawn its application to establish a federally insured ILC does not diminish the need to close this loophole.

ICBA strongly supports the Industrial Bank Holding Company Act (HR 698) and is encouraged by the recent action of the House Financial Services Committee to approve and recommend the legislation. HR 698 is expected to pass the House in the near future and prospects for Senate action are good**. However, if legislation has not passed both houses by the time the moratorium is ended, we urge the FDIC to extend the moratorium for another year to give the Senate additional time to act.**

[7] See ICBA letter to the FDIC dated October 10, 2006 and the recent testimony of James P. Ghigleiri, Jr., Chairman of ICBA before the House Committee on Financial Services on April 25, 2007.

Conclusion

ICBA commends the FDIC for proposing rules that provide for the consolidated regulation of all non-FCBS financial companies that own industrial banks. We agree that this will help to level the playing field and provide needed tools for the FDIC to monitor and supervise the significant risks involved when a parent company owns an industrial bank. A financial company that owns an industrial bank should serve as a source of strength for the bank and therefore should be subject to consolidated Federal supervision which includes reporting, examination, and minimum capital requirements at the holding company level.

ICBA's specifically recommends (1) that the thirty-one existing non-FCBS financial companies that own industrial banks be subject to the final rules; (2) that ILC parent companies be subject to capital requirements similar to those imposed on bank and thrift holding companies; (3) that the FDIC impose reporting and recordkeeping requirements on parent companies of industrial banks as well as on the parent company's subsidiaries that are similar to reporting and recordkeeping requirements imposed on bank and thrift holding companies and their subsidiaries under BHCA and its regulations; (4) that regardless of size, industrial banks be subject to annual independent audit requirements for the first three years after becoming a subsidiary of a financial company and then be subject to the annual independent audit requirements of Part 363 of the FDIC regulations thereafter, subject to the exemptions provided in that section for smaller institutions; and (5) that the FDIC have divestiture powers similar to the Federal Reserve to enforce the conditions and restrictions on ILCs and their parent companies.

If, at the conclusion of the moratorium, Congress has not completed its action on ILC legislation, then ICBA strongly urges the FDIC to extend the moratorium for one more year to give additional time for Congress to act.

ICBA appreciates this opportunity to comment. If you have any questions about our letter, please do not hesitate to contact the undersigned or Chris Cole at 202-659-8111 or Karen.Thomas@icba.org or Chris.Cole@icba.org.

Sincerely,

Karen M. Thomas

Karen M. Thomas
Executive Vice President
Director, Government Relations