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[6714-01-P]

FEDERAL DEPOSIT INSURANCE CORPORATION

Moratorium on Certain Industrial Bank Applications and Notices

AGENCY: Federal Deposit Insurance Corporation (FDIC)

ACTION: Notice; Limited Extension of Moratorium

SUMMARY: This notice announces a one-year extension of the termination date of the FDIC's existing moratorium on industrial loan companies and industrial banks¹ (collectively, "industrial banks") for deposit insurance applications and change in control notices with respect to certain industrial banks. The extended moratorium only applies to applications for deposit insurance and change in control notices with respect to industrial banks that will become subsidiaries of companies engaged in non-financial activities² ("commercial activities").

1 For purposes of the extended moratorium, the terms "industrial loan company" and "industrial bank" mean any insured State bank that is an industrial bank, industrial loan company, or other similar institution that is excluded from the definition of "bank" in the Bank Holding Company Act of 1956 (BHCA) pursuant to section 2(c)(2)(H) of the BHCA, 12 U.S.C. 1841(c)(2)(H).

2 For purposes of the extended moratorium, the term "financial activity" includes: (i) banking, managing or controlling banks or savings associations; and (ii) any activity permissible for financial holding companies under 12 U.S.C. 1843(k), any specific activity that is listed as permissible for bank holding companies under 12 U.S.C. 1843(c), as well as activities that the Federal Reserve Board (FRB) has permitted for bank holding companies under 12 CFR 225.28 and 225.86, and any activity permissible for all savings and loan holding companies under 12 U.S.C. 1467a(c). The term "non-financial activity" is any other activity. The FDIC intends to follow the written guidance of the FRB and the Office of Thrift Supervision (OTS) regarding permissible holding company activities in its interpretations of the term "financial activity" and to consult with the FRB and/or OTS before making any decisions.

Although the FDIC's existing industrial bank moratorium was originally set to expire on January 31, 2007 for all industrial banks, as a result of the extension, the moratorium will now expire on January 31, 2008 for certain industrial banks. The extended moratorium does not apply to any application for deposit insurance or change in control notice with respect to any industrial bank that will not become a subsidiary of a company, or any industrial bank that will become a subsidiary of a company engaged only in financial activities. The FDIC is also publishing elsewhere in the Federal Register today a notice of proposed rulemaking that proposes certain requirements on any industrial bank that will become a subsidiary of a company that is engaged only in financial activities and is not subject to consolidated bank supervision by the Federal Reserve Board (FRB) or the Office of Thrift Supervision (OTS) (hereinafter referred to as "Federal Consolidated Bank Supervision").

DATES: The extended moratorium is effective through January 31, 2008.

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SUPPLEMENTARY INFORMATION:

I. BACKGROUND

Industrial banks were first chartered in the early 1900's as small loan companies for industrial workers. Over time some of the chartering states expanded the powers of their industrial banks to the extent that some industrial banks now have generally the same powers as state commercial banks.

Since the passage of the Competitive Equality Banking Act of 1987 (CEBA),³ the industrial bank industry has changed significantly. Between 1987 and 2006 total assets held by industrial banks grew from \$4.2 billion to \$177 billion.

Since January 1, 2000, 24 industrial banks became insured.⁴ As of January 30, 2007, there were fifty-eight insured industrial banks with aggregate total assets of approximately \$177 billion.⁵ Six industrial banks reported total assets of \$10 billion or more; eleven other industrial banks reported total assets of \$1 billion or more. The remaining forty-one institutions, on average, reported total assets of approximately

3 Public Law 100-86, 101 Stat. 552 (codified as amended in various sections of title 12 of the U.S. Code)

4 During 2000, 4 new industrial banks were insured; 2 during each of 2001 and 2002; 5 during 2003; 6 during 2004; 4 during 2005; and 1 in 2006.

5 Based on reported assets as of September 30, 2006, the most recent reported data.

\$231.8 million. Forty-eight of those fifty-eight operated in Utah and California.⁶ Of the fifty-eight existing industrial banks, forty-three were either controlled by one or more individuals or controlled by a parent company whose business is financial in nature. As of January 30, 2007, thirty-one of the fifty-eight existing industrial banks were owned by companies that were engaged solely in financial activities and that were not subject to Federal Consolidated Bank Supervision; such companies are hereinafter referred to as “Non-FCBS Financial Companies.” Eight of the fifty-eight industrial banks (representing approximately sixty-nine percent of industrial bank industry assets) were owned by companies that are engaged solely in financial activities and are subject to consolidated supervision by the FRB or the OTS. Four of the fifty-eight industrial banks were owned by individuals. Fifteen industrial banks were subsidiaries of holding companies that are non-financial in nature, i.e., commercial.

In 2005, the Government Accountability Office (GAO) expressed its concern that industrial banks owned by commercial companies or other entities without a Federal consolidated supervisor created an uneven playing field when compared to banks and thrifts owned by holding companies subject to Federal consolidated supervision.⁷ The concerns regarding the lack of consolidated supervision and the possible limitations of

6 Industrial banks also operate in Colorado, Hawaii, Indiana, Minnesota and Nevada.

7 U.S. Gov’t Accountability Office, GAO-05-621, Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority 79-80 (2005) (hereinafter “GAO Report”).

the FDIC's authority echoed those previously expressed by the FDIC's Office of Inspector General (OIG) in a 2004 report.⁸

Some industrial banks continue to be small, community-focused institutions. However, the FDIC has noted a recent increase in the number of applications for deposit insurance and notices of change in control with respect to industrial banks that would be affiliated with commercial companies or other entities that would not be subject to Federal Consolidated Bank Supervision. Such institutions are often large organizations that tend to have complex business plans. Their subsidiary industrial banks tend to provide specialty lending programs or financial services or other support to the holding company. Whatever their purpose or structure, the industrial bank charter has generated a significant amount of public interest in recent years as various entities have explored the feasibility and business opportunities associated with including an industrial bank as part of their operations.

In 2006, the FDIC received more than 13,800 comment letters regarding the proposed Wal-Mart Bank's 2005 deposit insurance application.⁹ Most of these comments expressed opposition to granting deposit insurance with respect to this particular applicant; however, some commenters raised more universal concerns about industrial

⁸ 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) (hereinafter "OIG Report").

⁹ See the FDIC's web site at <http://www.fdic.gov/regulations/laws/walmart/>.

banks. Over 640 of the more general comments were specifically focused on the risk posed to the deposit insurance fund by industrial banks owned by commercial companies or by holding companies without a Federal consolidated bank supervisor. Similar sentiments were expressed by witnesses during three days of public hearings held by the FDIC regarding the Wal-Mart application. In addition, the Home Depot also filed a change in control notice in connection with its proposed acquisition of EnerBank, a Utah industrial bank. In response to the request for public comment on the change in control notice, the FDIC received approximately 830 comment letters; almost all of them expressed opposition to the proposed acquisition.

Congress also has had a continuing interest in the industrial bank charter. Most recently, on July 12, 2006, the House Committee on Financial Services (Committee) held a hearing regarding industrial banks. At the hearing, the General Counsels of the FDIC and FRB testified before the Committee regarding the history, characteristics, current industry profile, and supervision of industrial banks.¹⁰ The FDIC's testimony noted that today's industrial banks are owned by a diverse group of financial and commercial entities.

Among industrial banks owned by such entities are those that serve a particular lending, funding, or processing function within a larger organizational structure, and those that

¹⁰ Industrial Loan Companies: A Review of Charter, Ownership, and Supervision Issues: Hearing Before the H. Comm. on Financial Services, 109th Cong. (2006). The Committee also heard testimony from G. Edward Leary, Commissioner for the Utah Department of Financial Institutions; Rick Hilman, Director of Financial Markets and Community Investment, U.S. Government Accountability Office; George Sutton, Former Commissioner for the Utah Department of Financial Institutions; Terry Jorde, Chairman, President, and CEO of CountryBank USA, Chairman of ICBA; John L. Douglas, Partner, Alston & Bird; Arthur C. Johnson, Chairman and CEO of United Bank of Michigan; Prof. Lawrence J. White, Professor of Economics, Stern School of Business of New York University; Michael J. Wilson, Director, Legislative and Political Action Department, United Food and Commercial International Union. Also, several organizations submitted record statements.

directly support one or more affiliate's commercial activities. The business plans for these industrial banks differ substantially from the consumer lending focus of the original industrial banks.

Currently, eight industrial bank deposit insurance applications are pending before the FDIC. Also, in 2006 the FDIC received three additional deposit insurance applications that were either returned or withdrawn. In addition, the FDIC received seven change in control notices for the acquisition of industrial banks; four of which have been returned or withdrawn. None of the potential parent companies would be subject to Federal Consolidated Bank Supervision, and at least nine of the eighteen potential parent companies are engaged in activities that are considered commercial in nature.

To evaluate the concerns and issues raised with respect to industrial banks, on July 28, 2006, the FDIC imposed a six-month moratorium on FDIC action with respect to certain industrial bank applications and notices.¹¹ The FDIC declared the moratorium to enable it to further evaluate (i) industry developments, (ii) the various issues, facts, and arguments raised with respect to the industrial bank industry, (iii) whether there are emerging safety and soundness issues or policy issues involving industrial banks or other risks to the insurance fund, and (iv) whether statutory, regulatory, or policy changes

11 *See* Moratorium on Certain Industrial Loan Company Applications and Notices, 71 FR 43482 (August 1, 2006)

should be made in the FDIC's oversight of industrial banks in order to protect the deposit insurance fund or important Congressional objectives.¹²

Thereafter, on August 23, 2006, the FDIC published in the Federal Register a request for public comment on twelve questions.¹³ Among other things, the FDIC sought public comment on what modifications, if any, should be made to its regulations in light of the changing industrial bank industry; how and whether the attributes of consolidated supervision affect the safety and soundness of either industrial banks or the Deposit Insurance Fund; and how, and whether, the FDIC should differentiate and assess possible risks associated with financial or commercial ownership of industrial banks.

The FDIC received over 12,600 comment letters in response to the Request for Public Comment during the comment period.¹⁴ Approximately 12,485 comments were generated by what appears to be organized campaigns either supporting or opposing the proposed industrial bank to be owned by Wal-Mart or the proposed acquisition of Enerbank, also an industrial bank, by The Home Depot. Of this total, approximately 82 percent generally were opposed to the ownership of industrial banks by Wal-Mart or other commercial companies. The remaining comment letters were sent by individuals, law firms, community banks, financial services trade associations, existing and proposed

12 *Id.*

13 *See* Industrial Loan Companies and Industrial Banks, 71 FR 49456 (August 23, 2006).

14 *See* <http://www.fdic.gov/regulations/laws/federal/2006/06comilc.html>.

industrial banks or their parent companies, the Conference of State Bank Supervisors, and two members of Congress. Of the total comments received, seventy-one commenters addressed specific substantive issues concerning the industrial bank industry and its regulation.

The commenters who favored the current state of the industrial bank industry generally believed that the risks commonly associated with commercial company affiliations are overstated and that industrial banks affiliated with commercial companies generally maintain safe and prudent business relationships and financial and managerial support systems. They felt that the current restrictions on transactions with affiliates and tying provide ample protection for the industrial bank. The commenters who expressed a negative or neutral view of the industrial bank industry generally believed that affiliations with commercial companies and other entities not subject to consolidated supervision presented safety and soundness problems and unacceptable risks to the Deposit Insurance Fund by increasing the potential for conflicts of interest, excessive dependence on such affiliates, and tying. These commenters supported extending the moratorium until Congress acts on legislation to prohibit industrial banks from affiliating with non-financial entities. Some urged the FDIC to issue regulations restricting industrial banks from affiliating with non-financial entities. Still others suggested that the conditions imposed by the FDIC in the past were insufficient, standing alone, to offer adequate protections to the Deposit Insurance Fund. Several commenters cited the competitive advantages – in access to capital, customers, and marketing opportunities - that exist

when industrial banks are owned by commercial entities or otherwise lack a Federal Consolidated Bank Supervisor.

The FDIC's experience and the comments suggest no risk or other possible harm that is unique to the industrial bank charter. Rather, the concerns that have been raised focus on the ownership of the industrial bank and on the proposed industrial bank's business model or plan. Consequently, the FDIC's analysis of how to proceed focuses primarily on the proposed owners of industrial banks.

II. THE EXTENDED MORATORIUM

Scope

The original six-month moratorium imposed on July 28, 2006, deferred FDIC action on deposit insurance applications and change in control notices with respect to all proposed and existing industrial banks. However, recently the FDIC has noted a marked increase in deposit insurance applications for, and change-in-control notices with respect to, industrial banks that would be affiliated with commercial concerns and other companies that would not have a Federal Consolidated Bank Supervisor. This trend has led to heightened concerns by some members of Congress and commenters regarding the lack of Federal Consolidated Bank Supervision, the mixing of banking and commerce, and the potential for an "uneven playing field." Both the FDIC's observations and the bulk of the comments received indicate that these concerns about industrial banks focus on

commercial-company ownership and/or the lack of Federal Consolidated Bank Supervision.

Financial companies that are subject to Federal Consolidated Bank Supervision (“FCBS Financial Companies”), such as bank holding companies, financial holding companies, and savings and loan holding companies generally do not present these same issues. Many of the statutory and regulatory tools available to Federal Consolidated Bank Supervisors can substantially restrict the extent to which such companies may engage in commercial activities or affiliate with commercial companies. Moreover, the examination, reporting, and monitoring systems of Federal Consolidated Bank Supervisors can be effective tools in preventing an affiliate’s activities from causing a safety and soundness risk to the bank. Finally, holding companies that are expected to serve as a source of strength to their subsidiary insured depository institutions provide an important resource for an insured bank in need of additional capital. As a result, the FDIC believes that this class of industrial bank ownership does not need further study and that the supervisory tools currently available to the FDIC are adequate.

Generally, industrial banks owned by individuals also do not present the same issues that industrial banks owned by commercial companies present. In the case of an industrial bank owned by individuals, there is neither a parent company nor any subsidiary of a parent company that could present an opportunity for a safety and soundness risk or a conflict of interest with the industrial bank.¹⁵ Consequently, at this time, the FDIC

15 Since there is no parent company of the industrial bank, the BHCA does not apply.

believes that ownership of industrial banks by individuals presents no extraordinary issues that deserve further study or consideration.

Importantly, industrial banks to be owned by Non-FCBS Financial Companies present some of the same issues that industrial banks owned by commercial companies do. However, the FDIC believes that those issues can be controlled or minimized in such cases. In addition, some such companies are subject to well-established regulatory authorities, e.g., by state insurance commissions or the U.S. Securities and Exchange Commission. Such Non-FCBS Financial Companies engage only in financial activities and, so, do not engage in commercial activities either directly or indirectly. However, since these companies will not be subject to Federal Consolidated Bank Supervision, the FDIC believes that safeguards should be implemented that provide adequate protections for the safety and soundness of insured industrial banks and for the protection of the Deposit Insurance Fund. Through the publication of a notice of proposed rulemaking for part 354, the FDIC is proposing conditions and requirements to provide safeguards such as examination of, and reporting by, such companies and their subsidiaries, and binding commitments to serve as a resource for additional capital for the industrial bank subsidiaries. We anticipate that the proposed regulations will provide the safeguards that the FDIC believes could be helpful in identifying and avoiding or controlling, on a consolidated basis, the safety and soundness risks and the risks to the Deposit Insurance Fund that may result from that kind of company-ownership model.

Industrial banks that are to be owned or controlled, directly or indirectly, by commercial companies, however, continue to present concerns. Under current law, commercial companies would not be allowed to acquire a thrift or a bank, other than an industrial bank, and would not have a Federal Consolidated Bank Supervisor. In many instances, commercial activities are the predominant, if not sole, business of such companies. In such circumstances, not only would consolidated supervision not be present, but the current supervisory process and infrastructure may not produce the safeguards that the FDIC believes could be helpful in identifying and avoiding or controlling, on a consolidated basis, the safety and soundness risks and the risks to the Deposit Insurance Fund that may result from that kind of company-ownership model. The recent trend of increased interest in industrial banks by entities engaged in commercial activities makes an evaluation of the application of current supervisory structures to such owners timely and appropriate. As a result, the FDIC believes that this class of companies needs further study and consideration on two key issues: 1) what, if any, increased risks are created by ownership by commercial companies and 2) how well do current supervisory models apply to such owners.

Many members of Congress have urged the FDIC to extend the moratorium with respect to industrial banks that would be controlled by commercial firms. On December 7, 2006 one hundred and seven members of the House of Representatives sent a letter to the FDIC urging the FDIC to extend the moratorium for at least an additional six months. The Representatives requested the extension “to allow the 110th Congress an opportunity to act on this important public policy issue.” While the FDIC is not expressing any

conclusion about the propriety of ownership of industrial banks by commercial companies, it is appropriate to provide Congress with a reasonable period for consideration of these developments and, if necessary, revisions to existing statutory authority.

Furthermore, even though the FDIC has authority to act on any particular application, notice, or request involving an industrial bank, the FDIC has continuing concerns regarding the commercial ownership of industrial banks and the lack of a Federal Consolidated Bank Supervisor. The FDIC recognizes that commercial companies that currently own industrial banks will not be affected by the extended moratorium and that there may be concerns that this results in disparate treatment for those commercial companies now seeking to control ILCs. However, the FDIC has considered the potential impact of the extended moratorium on individual applicants and proponents, including commercial companies, and because the issues raised by such ownership have the potential for broad and substantial impact on the entire banking system and, potentially, the nation's economy, the FDIC believes that Congressional resolution of these issues may be appropriate.

The FDIC also recognizes that the moratorium may appear inconsistent with specific timetables for agency action, including processing of approvals. However, adherence to a strict statutory timeline without an opportunity to re-evaluate its standards for determining the public interest risks frustrating the substantive policies the agency is charged with promoting. Consequently, the FDIC has concluded that a limited

moratorium should be extended through January 31, 2008. The extension will both allow the FDIC needed time to evaluate the various issues, facts, and arguments associated with the ownership of an industrial bank by a commercial company, and allow Congress time to consider legislation concerning industrial banks.

Summary

For the reasons discussed above, the scope of the extended moratorium is narrower than the scope of the FDIC's original six-month moratorium. Under the extended moratorium, the FDIC will take no action to accept, approve, or deny any application for deposit insurance, or to accept, disapprove, or issue a letter of intent not to disapprove any change in control notice, with respect to any industrial bank that would become a direct or indirect subsidiary of a company engaged in commercial activities. While to date, commercially owned industrial banks have not resulted in serious problems, in light of the concerns that have been expressed and the recent trend of increased ownership of industrial banks by commercial entities, the FDIC will continue to monitor closely existing industrial banks that currently are controlled by commercial companies.

Thus, the extended moratorium will not apply to, and the FDIC may proceed with action on, any application for deposit insurance or any change in control notice with respect to: (i) any industrial bank that would become a subsidiary of a company engaged only in financial activities that is subject to Federal Consolidated Bank Supervision by the FRB, or the OTS (i.e., a FCBS Financial Company); (ii) any industrial bank that would not become a subsidiary of any company; or (iii) any industrial bank that would become a

subsidiary of a company engaged only in financial activities that is not subject to Federal Consolidated Bank Supervision by the FRB or the OTS (i.e., a Non-FCBS Financial Company). While the notice of proposed rulemaking for part 354 is pending, the FDIC will consider deposit insurance applications and change in control notices with respect to industrial banks within group (iii) above on a case-by-case basis. After any final rules are adopted, the FDIC will consider requests to modify any conditions and requirements agreed to during the period between issuance of the proposed rule and the effective date of the final rules to conform such conditions and requirements to those in the final rules.

During the extended moratorium any application, notice or request with respect to any industrial bank that is not subject to the moratorium will be acted upon only by the FDIC's Board of Directors.

The extended moratorium is effective through January 31, 2008 for applications for deposit insurance and change in control notices with respect to industrial banks that will become subsidiaries of companies engaged in commercial activities.

By Order of the Board of Directors

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Dated at Washington D.C., this _____ day of January 2007.

FEDERAL DEPOSIT INSURANCE CORPORATION

Robert E. Feldman
Executive Secretary