June 29, 2020

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

Regarding: Proposed Rule: Parent Companies of Industrial Banks and Industrial Loan Companies; RIN 3064-AF31

Dear Mr. Feldman:

The Community Bankers Association of Illinois ("CBAI"), which proudly represents 300 Illinois community banks, appreciates the opportunity to comment on the Federal Deposit Insurance Corporation ("FDIC") proposed rule regarding Parent Companies of Industrial Banks and Industrial Loan Companies ("Proposed Rule" or "Proposal") which "would require certain conditions and commitments for approval or non-objection to certain filings involving an industrial bank or industrial loan company [collectively ("ILCs")] whose parent company is not subject to consolidated supervision by the Federal Reserve Board ("Federal Reserve" or "Fed"). The proposed rule would apply to deposit insurance, change in bank control, and merger filings that involve industrial banks." More specifically, "[t]he proposed rule would require a covered parent company [("Parent Company" or "Parent")] to enter into a written agreement with the

FDIC and the industrial bank to address the company's relationship with the industrial bank; require capital and liquidity support from the parent to the industrial bank; and establish appropriate record keeping requirements." CBAI acknowledges the FDIC's statement that "[t]he proposed rule would codify the FDIC's current supervisory processes and policies with respect to covered industrial banks and ensure safe and sound operations of these institutions as well as provide necessary transparency regarding the FDIC's supervisory practices."

Background

CBAI strongly opposes the mixing of banking and commerce, which ILCs represent, because of the risks they pose to the financial system, our economy and American taxpayers. Congress, however, has authorized a limited exception for ILCs and provided a framework for the FDIC to approve, regulate and supervise such institutions.

Notwithstanding this limited exception, Congressional action has restricted ILC activity based on evolving factors and circumstances, and refined their supervision and regulation. For example, the passage of the Bank Holding Company Act in 1956 ("BHCA") supported the separation of banking and commerce and the importance of holding company supervision; the non-bank loophole was closed in 1987; and the unitary thrift holding company loophole was closed in 1999. The FDIC imposed a moratorium on new ILC applications (2006-2008 and again from 2010-2013) over safety and soundness concerns and the broader impact of ILCs. The next logical step in properly regulating ILCs is to completely close the loophole which exempts their Parent Companies from consolidated supervision by the Federal Reserve. This supervision by the Fed, in coordination with the FDIC, is important to mitigate the risks posed by ILCs especially in times of economic stress.

Addressing this issue now is particularly important as a variety of companies are eying ILC charters as a way to enter the banking industry and enjoy its many benefits, particularly low-cost FDIC insured deposits to help fund their operations. These new e-commercial conglomerates, big data, social media, artificial intelligence, and financial technology companies are seeking to reshape the financial services landscape and extend an ominous reach into the economic lives of consumers and small businesses, with significant privacy and conflict of interest concerns. These companies must fail in their attempts to obtain ILCs charters, and escape consolidated

Federal Reserve supervision of their Parent Companies, as did Walmart and Home Depot before them.

CBAI was disturbed by the FDIC's March 18, 2020, approval of applications for deposit insurance by Square Financial Services, Inc., and Nelnet Bank, which occurred simultaneously with the publication of this Proposed Rule. The appropriate regulation of ILCs is the very subject of this Proposal, yet the Square and Nelnet applications were inexplicably approved before this rulemaking has been completed. CBAI opposes these two application approvals, and any additional pending ILC applications for deposit insurance, particularly from Rakuten. Now is the time for policymakers to successfully address the many risks of ILCs.

ILCs are promoted as being high performers and posing no risk to the financial system. ILCs are not risk-free financial institutions and there have been failures and losses to the deposit insurance fund (DIF). The mistakenly rosy characterization about their industry's performance suffers from "survivorship bias." More than a decade ago, almost half of the industry assets could be traced through ILCs to Wall Street banks and financial firms' holding companies (e.g., Lehman Brothers Holdings, Merrill Lynch, Goldman Sachs, Morgan Stanley, General Electric Company, and Ally Financial – formerly General Motors Acceptance Corp. or GMAC.) During the financial crisis, many of these giant institutions were saved from failure by taxpayer-funded bailouts, and their ILCs ceased to exist. This troubled history highlights the need for consolidated supervision by the Federal Reserve, in coordination with the FDIC, to prevent or minimize the impact of the demise of ILCs during times of economic stress.

Any lack of confidence in the Federal Reserve's competency to supervise the Parent Companies of ILC's is unjustified. The Federal Reserve's stated purpose and function includes promoting "the safety and soundness of individual financial institutions and monitoring their impact on the financial system as a whole; and promot[ing] the stability of the financial system and seek[ing] to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad." The Federal Reserve is also responsible for "promoting the effective operation of the U.S. economy and, more generally, the public [not private commercial] interest." CBAI has every confidence that the Fed is able to supervise the Parent Companies of ILCs and believes the Federal Reserve's added involvement in coordination with the FDIC would make for a sounder and more robust regulatory regime to mitigate the risks posed by companies that own or control ILC charters. The additional cost of developing and maintaining the Fed's required expertise must, of course, be borne by the ILCs and their Parent Companies not the banking industry because of the limited focus and unique nature of the specialized expertise required to supervise this segment of the banking industry.

To characterize supporting the proper regulation of ILCs and their Parent Companies as protectionism, that the banking industry is being anti-competitive, or that the recommendation for consolidated Federal Reserve supervision is an attempt to put ILCs out of business is simply not true. Community banks compete vigorously among themselves, with the largest bank, credit unions, the Farm Credit System, commercial and consumer finance companies, internet lenders, check cashing services, and others (including ILCs). As long as all competitors are being appropriately and consistently regulated, and the playing field is otherwise level, community bankers have no objection to competition. However, if some financial service providers are subject to weaker regulatory requirements, as ILCs and their Parent Companies are now, they will have a competitive advantage which discriminates against community banks in addition to the risks they pose to the financial system, our economy and American taxpayers in the event of their failure.

The United States should not allow for a mixing banking and commerce. The serious eroding of this prohibition was largely responsible for the housing meltdown and the last financial crisis. CBAI shares the position of George Washington University Law School Professor, and renowned banking and regulatory expert, Arthur Wilmarth, who in an August 2, 2017, American Banker article titled ***Beware the Return of the ILC*** stated, “Events of the past decade demonstrate that further removing the firewalls between banking and commercial and industrial businesses would be a huge mistake for our financial system and our broader economy.”

CBAI Positions and Recommendations

CBAI is opposed to the mixing of banking and commerce which is at the foundation of our concerns with ILCs. We believe there is ample justification in the Federal Deposit Insurance Act to deny applications for deposit insurance by ILCs because it is not in the public interest for the many reasons stated in this letter. However, given their limited permitted existence, the regulatory loophole must at the very least be closed with consolidated Federal Reserve supervision of Parent Companies of ILCs in cooperation with the FDIC. Unfortunately, closing the loophole is not within the purview of the FDIC and it is not the subject of this Proposal. In light of this, CBAI makes the following recommendations.

> The FDIC should withdraw the Proposed Rule and impose an immediate and indefinite moratorium on the approval of any new ILC applications. These actions should be taken now given the national focus on coping with and recovering from the COVID-19 crisis which will result in unforeseen changes in our financial system, economy, and society. ILCs pose unique risks which should be thoroughly explored in post-pandemic Congressional hearings by the House Financial Services Committee and the Senate Banking Committee. Public hearings should also be held on each pending ILC application for deposit insurance before the FDIC acts on the application.

If the FDIC will not follow these recommendations, CBAI supports the FDIC's rigorous application of enhanced supervision of ILCs, and their Parent Companies, in our Question Responses below.

Question Responses

Question 1: *Should the proposed rule apply only prospectively, that is, to industrial banks that become a subsidiary of a parent company that is a Covered Company? Or should the proposed rule also apply to all industrial banks that, as of the effective date, are a subsidiary of a parent that is not subject to Federal consolidated supervision by the FRB? What are the concerns with each approach?*

CBAI supports applying the Proposed Rule to existing and new ILCs that become a subsidiary of a Parent Company. A bifurcated regulatory regime will allow existing ILCs to enjoy an unjustified regulatory advantage over new ILCs when the only difference is the date they became subsidiaries of their Parent Companies. Requiring all ILCs to be subject to the Proposed Rule will give the FDIC an equal ability to impose regulatory requirements on ILCs as situations demand and will enhance the ability of the FDIC to successfully perform its supervisory responsibilities.

Question 2: *Should the proposed rule apply to industrial banks that do not have a parent company? How should the rule be applied in such a case?*

CBAI supports the application of the Proposed Rule to ILCs that do not have a Parent Company. In fact, there must be even more stringent regulatory requirements to maintain the safety and soundness of these ILCs. A Parent Company serves as a source of strength to the subsidiary ILC. Without that source of strength, the ILC poses greater risks which must be mitigated by additional regulatory requirements to ensure the ILCs survival in times of economic stress. The requirements that would be particularly important for these ILCs would include, but not be limited to, annual audited financial statements, higher capital levels, greater liquidity, more frequent regulatory examinations, stress testing requirements, sound risk management practices, resolutions plan requirements, and shorter timeframes to respond to and successfully resolve any examination criticisms and enforcement actions.

Question 3: Should the proposed rule apply to industrial banks that are controlled by an individual rather than a company?

CBAI supports the Propose Rule applying to ILCs that are controlled by an individual rather than a company. That individual should have the personal responsibility and liability to act as a source of strength for the ILC and should not be able to escape that by choosing to control an ILC individually rather than through a Parent Company.

Question 4: If an individual controls the parent company of an industrial bank, should the individual be responsible for the maintenance of the industrial bank's capital and liquidity at or above FDIC-specified levels? Should an individual who controls a parent company be responsible for causing the parent company to comply with the written agreements, commitments, and restrictions imposed on the industrial bank? How should the rule be applied in such a case?

CBAI supports the position that if an individual controls a Parent Company of an ILC that individual should be responsible for the maintenance of the ILC’s capital and liquidity at or above FDIC-specified levels, and be responsible for causing the Parent Company to comply with the written agreements, commitments, and restrictions imposed on the ILC. The controlling individual should not be able to use the Parent Company as a shield to escape the personal responsibility and liability for the ILC maintaining these levels, agreements, commitments, and restrictions.

<u>Question 5:</u> *Would there be any benefit in having or requiring a Covered Company that conducts activities other than financial activities to conduct some or all of those of its financial activities (including ownership and control of an industrial bank) through an intermediate holding company similar to what a grandfathered unitary savings and loan holding company may be required to do pursuant to section 626 of the Dodd-Frank Act? What other approaches may be appropriate?*

CBAI supports the position that a Parent Company which conducts activities other than financial activities should conduct its financial activities (including an owned or controlled ILC) through an intermediate holding company. There will be future applications for ILCs by e-commercial conglomerates, big data, social media, artificial intelligence, and financial technology companies. For example, Rakuten withdrew its ILC application but has recently refiled. This requirement will make it possible for the Financial Stability Oversight Council (FSOC) to designate the intermediate holding company a Systemically Important Financial Institution (SIFI) under Section 113 of the Dodd-Frank Act and place the intermediate holding company under the Federal Reserve's supervisory authority. The Fed, in cooperation with the FDIC, would provide a necessary level of enhanced supervision to address the risks posed by these companies.

The real question is not 'Would there be any benefit?' but 'Why shouldn't this be required?' It is inconceivable that the policymakers who have crafted (post Dodd-Frank) resolution strategies (e.g., Orderly Liquidation Authority ("OLA") for dealing with large financial holding companies would now allow the formation of commercial-financial conglomerates that would not be governed by those strategies. It is therefore essential that the FDIC require each Parent Company which conducts activities other than financial activities (including an owned or controlled ILC) to organize an intermediate holding company that will be subject to the resolution procedures established by the OLA.

<u>Question 6:</u> *Should the proposed rule also apply to other institutions that are excluded from the BHCA definition of a "bank" pursuant to section 2(c)(2), such as credit card banks and trust banks? For example, the CEBA amended the BHCA to exempt certain other institutions from the requirements that the parent company of a bank must be a BHC, meaning that the parent*

companies of such institutions are not subject to Federal consolidated supervision. Explain what types of institutions should be addressed by the proposed rule and why.

CBAI supports a level playing field for all bank and financial service companies including ILCs and other institutions that may heretofore have been excluded from the definition of a "bank" including credit card and trust banks. To the extent financial service institutions perform some or all of the same functions of a bank that is included in the definition stated above, (particularly if they have access to FDIC insurance) then the Parent Company should not be excluded from Federal consolidated supervision.

<u>Question 8:</u> *For purposes of transparency and identifying any potential risks to the industrial bank, we have included commitments requiring examination and reporting. Is this approach the best way to gain that transparency, or is there a better way? To what extent, if any, is the FDIC's supervision enhanced by requiring a Covered Company to consent to examination of the Covered Company and each of its subsidiaries as proposed? Is there another way to identify any potential risks?*

CBAI supports the FDIC's requirements for examination and reporting by ILCs which will enhance supervision to identify all potential risks, and require a Parent Company to consent to the examination of itself and each of its subsidiaries.

<u>Question 9:</u> *The Gramm-Leach-Bliley Act of 1999 imposed certain restrictions on the extent to which a Federal banking agency may regulate and supervise a functionally regulated affiliate of an insured depository institution. Conversely, the Federal banking agencies, including the FRB, imposed various periodic reporting requirements on depository institutions and their parent companies. In view of these restrictions and requirements, are the commitments and requirements appropriately tailored to adequately carry out the purpose and intent of the proposed rule?*

CBAI believes the Gramm-Leach-Bliley Act seriously eroded the separation of banking and commerce which resulted in severe and ongoing damage to the nation's financial system, economy, and taxpayers, as illustrated by the recent mortgage meltdown and financial crisis. To the extent that non-regulated financial service providers are performing the same functions as regulated financial service providers but are not similarly regulated, the result will be regulatory discrimination against the later and in favor of the former. When regulatory discrimination exists, regulatory requirements should be tailored to the extent necessary to eliminate this discrimination without compromising safety and soundness.

Question 10: *The proposed rule would require a Covered Company to disclose to the FDIC the subsidiaries of the Covered Company. Should the proposed rule also require disclosure to the FDIC of certain additional affiliates or portfolio companies of the Covered Company, given that such entities could engage in transactions with, or otherwise impact, the subsidiary industrial bank?*

CBAI supports the requirement for disclosure to the FDIC of subsidiaries, additional affiliates or portfolio companies of the Parent Company because it provides the FDIC with a complete picture of all of the entities that are directly and indirectly associated with the Parent Company owners of ILCs. These related entities will impact the financial condition and results of operations of the Parent which may negatively impact its ability to serve as a source of strength for the ILC.

Question 12: *If there is an individual who is the dominant shareholder of a Covered Company, should that individual be required to commit to the maintenance of appropriate capital and liquidity levels?*

CBAI supports the position that an individual who is the dominant shareholder of a Parent Company which owns an ILC should be required to commit to maintaining the appropriate capital and liquidity levels. CBAI’s responses to Questions 3 and 4 support the recommendation that the Proposed Rule should apply to ILCs and Parent Companies that are owned and/or controlled by an individual, in which case the individual should be responsible for the maintenance of the ILC's capital and liquidity at or above FDIC-specified levels, and be responsible for causing the Parent Company to comply with the written agreements, commitments, and restrictions imposed on the ILC; and that ownership structure and the level of control is a choice which should not allow an individual to escape the responsibility and liability for maintaining the levels, agreements, commitments, and restrictions for the ILC simply because there is (or is not) an intervening Parent Company.

Question 13: *Some of the provisions include continuing commitments, such as to maintain capital. Should the proposed rule include a cure period in the event that the industrial bank or its parent company initially comply with these commitments, but later fall out of compliance? If so, should such a cure period be provided for all commitments or certain commitments (please specify)? Alternatively, should the FDIC rely on its enforcement authorities under sections 8 and 50 of the FDI Act to take action as appropriate?*

CBAI supports reasonable regulatory requirements and reasonable actions in enforcing those requirements including an appropriate cure period. The FDIC's approach to cure periods should depend on the importance of regulation that falls out of compliance, the extent to which is out of compliance, the overall circumstances within which that violation occurs, the likelihood of promptly coming back into compliance, as well as the severity of the damage that could result by remaining out of compliance.

The FDIC's degree of flexibility should be no less stringent for ILCs and their Parent Companies than for community banks, and should actually be more stringent given the additional risks posed by ILCs and their Parents because of their narrow business focus (concentration risk), commercial ties (the risk of mixing of banking and commerce), and because many ILCs are funded through non-core sources (non-core funding risk), all of which combine to logically limit regulatory flexibility and suggest urgency in enforcing actions against an ILC and its Parent Company to remedy safety and soundness concerns and comply with all appropriate levels, agreements, commitments, and restrictions. CBAI believes the FDIC has sufficient tools to command compliance and enforce regulations (or should obtain them) and vigorously utilize those tools in supervising ILCs and their Parent Companies.

Question 14: *In order to ensure that each Covered Company can serve as a source of financial strength to its industrial bank subsidiary and fulfill its obligations under a capital maintenance agreement, should the FDIC include a commitment that the parent company will maintain its own capital at some defined level on a consolidated basis in all circumstances? How should the FDIC determine the level?*

CBAI supports ensuring that each Parent Company serve as a source of strength and fulfill its obligations to its ILC. To further that objective, the FDIC should include a commitment that the Parent Company maintain its own capital, and other appropriate financial benchmarks including liquidity, at well-defined levels in all circumstances. To not do so would be to ignore the results of operation and financial condition of the entity that the FDIC is relying on to be a source of strength for the ILC.

The appropriate capital and liquidity levels of the Parent Company can be determined by knowing the industry standard and ranges, how those levels have served the Parent in times of stress, assessing the capital and liquidity needs of the Parent Company based on stress testing, the adequacy of the Parent's risk management practices, the reasonableness of its resolution plans, and then factoring in a sufficient multiplier in case this assessment underestimates the needed support.

<u>Question 16:</u> *Should any of the restrictions in § 354.5 be temporally limited, for example, to the first three years after becoming a subsidiary of such Covered Company?*

Given the unique and significant risks posed by ILCs and their Parent Companies, the restrictions should not be limited to the first three, or even five or more, years after an ILC becomes a subsidiary of a Parent Company.

<u>Question 17:</u> *Should the FDIC retain the authority to require additional written agreements, commitments, or conditions on or by an industrial bank or Covered Company after the nonobjection to a change in bank control, approval of a merger transaction, or a grant of deposit insurance by the FDIC? Should the FDIC retain the power to require additional written agreements, commitments, or conditions on or by an industrial bank or parent company of an industrial bank that became a subsidiary of a parent company that is not subject to Federal consolidated supervision by the FRB prior to the effective date?*

CBAI supports the FDIC retaining the stated authority and power in both circumstances because it is important to maintaining an adequate level of supervision. The FDIC should include compliance with federal consumer protection, privacy, data security, Bank Security Act ("BSA"), and data sharing standards and requirements in the written agreements, commitments, or conditions with ILCs and their Parent Companies.

Question 18: In evaluating the statutory factors under section 6 of the FDI Act for deposit insurance applications, should the FDIC consider an evaluation of the competitive effects of the parent company's or the parent company's affiliates' provision of consumer products aggregated with the activities of the industrial bank?

CBAI believes that a complete evaluation of the aggregate competitive effects on consumers of the Parent Company, its affiliates and the ILC is within the scope of what should be accomplished and found acceptable during the consideration of an application for approval and periodically for ongoing compliance purposes.

Question 19: The current Interagency Charter and Federal Deposit Insurance Application requests information related to two broad categories, market characteristics and Community Reinvestment Act Plan, to assist the FDIC in determining whether the convenience and needs of the community to be served by an industrial bank will be met with the overall purpose of maintaining a sound and effective banking system. Are there any other categories of information that the FDIC should consider in evaluating an industrial bank's ability to meet the convenience and needs of the community to be served by such industrial bank where the industrial bank will have a limited physical presence or will rely heavily on technology to deliver products and services?

CBAI responded to the OCC and FDIC's ("Agencies") proposal to modernize the Community Reinvestment Act ("CRA"). There is a need for changes in the CRA to reflect new technologies and customer preferences in the delivery of banking services. CBAI urged that all financial service providers comply with the CRA in a comparable manner to community banks.

The modernization of the CRA should reflect and reinforce the importance and value of face-to-face interaction with individuals and small businesses which is a hallmark of community banks and how they serve their customers and communities. The Agencies should view the non-traditional delivery of financial services as an additional (or incremental) but not superior method of delivering services, and a limited number of financial services being offered is not completely serving the needs of consumers and communities. CBAI believes that enhanced CRA credit should be given to community banks that provide a full range of banking services predominantly within their own brick-and-mortar main office and branch facilities in their communities. For ILCs to receive a *Satisfactory* or *Outstanding* CRA rating there should be additional rules and requirements and their performance bar should be raised.

Question 20: *The FDIC has typically required, as conditions for approval, a number of additional commitments when considering applications involving foreign ownership of a proposed insured depository institution. These conditions address matters regarding service of process and access to information on the operations and activities of the parent company and its subsidiaries. Are there additional safeguards, commitments, or restrictions the FDIC should consider for a foreign Covered Company? Should additional capital or liquidity levels be considered?*

CBAI opposes foreign ownership of ILCs because of the insurmountable cross-border challenges and risks of dealing with these individual or company owners and the additional risks posed by ILCs. If foreign ownership is permitted, CBAI supports imposing a number of additional appropriate commitments by the ILC and its Parent Company to assure their proper regulation and risk mitigation. CBAI supports the addition of a requirement to hold sufficient high-quality and long-term liquidity to keep the ILC operating independently of its foreign Parent Company by requiring the maintenance of a very high net stable funding ratio ("NSFR"). CBAI also supports the addition of a requirement for a substantial and segregated cash reserve – a prefunded orderly liquidated fund ("OLF") – to help mitigate failure risk of foreign-owned ILCs.

Conclusion

CBAI supports the separation of banking and commerce. CBAI recommends the FDIC withdraw this Proposal, a moratorium should be placed on any new ILCs, and the supervisory loophole should be closed by Congress with consolidated federal supervision of the Parent Companies of ILCs by the Federal Reserve. CBAI's recommendations in the answers to the Proposal's questions would enhance the FDIC's supervision of the ILCs and provide needed insights and control over their Parent Companies. This enhanced regulatory regime must be robust because of the particular risks posed by ILCs and their Parent Companies. CBAI's recommendations are not anti-competitive, and will not prohibit future ILC applications, or require existing ILCs to cease their operations. The FDIC must be able to assess and address the risks and contain the potential harm posed by these institutions to the financial system, our economy and American taxpayers.

Thank you for the opportunity to respond to this Proposal. If you have any questions or need additional information, please do not hesitate to contact me at (847) 909-8341 or davids@cbai.com .

Sincerely,

[redacted]

David G. Schroeder
Senior Vice President
Federal Governmental Relations