July 1, 2020

Mr. Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20129

Via email to: comments@fdic.gov

Attention: Comments
Re: Industrial Banks RIN 3064-AF31

Dear Mr. Feldman,

On behalf of our member banks, the Utah Bankers Association[1] and the National Association of Industrial Bankers[2] appreciate the opportunity to submit the following comments in response to the Notice of Proposed Rulemaking ("NPR") announcing a proposed rule to regulate parents and affiliates of industrial banks (occasionally referred to as an "IB" or "IBs") announced by the FDIC on March 17, 2020 and published in the Federal Register on March 31, 2020. Members of our associations include the largest concentration of industrial banks in the nation. That has been the case since the FDIC began insuring IBs in the early 1980s. We are proud of the fact that these banks have consistently been among the strongest, safest and best capitalized group of banks insured by the FDIC over a period of nearly forty

[1] The Utah Bankers Association (UBA) is the professional trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates for the interests of its members, enhancing their ability to be preeminent providers of financial services.

[2] The National Association of Industrial Bankers (NAIB) is a national trade association for industrial banks. These specialized banks operate under the titles of industrial banks, industrial loan corporations (ILCs), and thrift and loan companies. NAIB champions innovative and safe financial services for Americans, including the underserved. ILCs comply with the Community Reinvestment Act. First chartered in 1910, ILCs provide a broad array of products and services to consumers and small businesses nationwide. They do not offer demand checking accounts, but do accept time deposits, savings deposit money market accounts and NOW accounts. Industrial banks are regulated by state chartering authority and the FDIC at the federal level. Currently ILCs are state supervised in California, Colorado, Hawaii, Indiana, Minnesota, Nevada, and Utah.

years. This outstanding record of safe and sound operations provides compelling proof that the FDIC and state regulators have successfully developed an adequate model for regulating IB parents and affiliates.

Good regulation begins with understanding what is being regulated. Because of their unique features, our comments will include a description of industrial banks, their parents and affiliates and the model developed by the FDIC and state regulators over the past forty years to regulate these entities and ensure their safe and sound operation. Except for the regulators, our associations and members, this critical detail is largely unknown, misunderstood and occasionally misrepresented. We support incorporating such information in a rule to help public awareness of what the regulators are doing and how this unique model is adapted to a new kind of bank.

Since IBs became eligible for FDIC insurance in the early 1980s, the FDIC and state regulators have developed a simple and effective model utilizing existing laws and well-established regulatory practices to regulate the relationship and transactions between an IB and its parent and affiliates. The model is informally called "bank centric." For sake of brevity we will call it the "IB model." It emphasizes establishing each bank as an independent entity with competent management and qualified assets, isolation from potential conflicts of interest and problems at a parent and affiliates, while ensuring that the unique strengths and resources of a diversified parent are committed to support the bank. With some exceptions discussed below, the standards and requirements of the proposed rule largely follow this model and currently apply to the existing IBs.

The record of federally insured industrial banks makes clear that the IB model achieves its regulatory goals. It represents a prudent balance between regulating what is needed to provide maximum benefits and safety for the bank while not overreaching into areas of holding company operations irrelevant to the bank. Holding companies regulated under this model tend to be stronger than most bank holding companies ("BHCs") regulated by Federal Reserve Board ('FRB"), which provides significant benefits for the subsidiary banks and results in lower bank failures, The record of bank failures in last recession absolutely refutes frequent assertions that exempting IB holding companies from the Bank Holding Company Act ("BHCA") creates a "blind spot" and presents risks to the FDIC and the banking system. In fact, any fair assessment of the record demonstrates the opposite is true.

Our members commend and thank the regulators for proactively developing this model. Because it operated until now as an informal procedure, only the regulators, banks and applicants are aware of its existence. We believe formalizing and publishing the rule will add transparency and help banks, applicants, policy makers and other interested parties better understand how this model works and provide constructive comments where it may be improved.

Preserving this model is important because the bank holding company model (the "BHC model") does not work for these banks. To explain why, the following comments include comparisons of the two models.

At the outset we want to be clear that we compare the IB and BHC models to highlight the strengths and benefits of the IB model, not to criticize or advocate eliminating the BHC model. We want to point out that the inherent strengths and weaknesses of each model do not present any valid support for critics who advocate eliminating the bank centric model and only allowing the BHC model in the future. We recognize that the BHC model is vitally important for GSIBS and banking SIFIs and works well enough for other kinds of banks. It has especially proved effective for regulating SIFI banks affiliated with SIFI investment banks. In reality there are actually three business models in the industry today: SIFI and GSIB banks, stand-alone banks with shell holding companies (or no holding companies), and branchless banks, many of which are industrial banks. Each model has unique features and issues. One size does not fit all.

We think the organizers of a bank should be able to choose the best model for the type of business they want to develop as long as they have a sound and well-developed plan. Among other things, that will help facilitate safe innovation and development of new banking models to serve changing needs and opportunities in the nation's banking markets.

Coordinated regulation

Industrial banks and their parents and affiliates are regulated by the by federal and state authorities in a seamless and coordinated process. The banks' regulators have an array of authorities to monitor conditions and directly deal with a problem involving a parent or affiliate or any other "institution affiliated party" that affects the bank. The regulators can examine the affiliates, obtain reports, issue cease and desist and consent orders, assess civil money penalties and prohibit individuals and entities from continuing to exercise any control or influence over the bank. In an emergency, the state regulator can take immediate possession of a bank and place it into receivership with the FDIC. This is truly "consolidated" regulation.

The regulators use these authorities to regularly examine the relationship and transactions between the bank and its parent and affiliates to ensure they are appropriate and compliant with applicable laws and regulations. They also periodically examine the parent and affiliates, while monitoring their financial condition and other significant developments to identify conditions that might present a risk to the bank. If problems develop, the regulators ensure the bank is isolated. That may require issuing formal orders restricting or prohibiting transactions and dividends until the problem is resolved.

In contrast, the BHC model regulates the bank and its affiliates separately. The banks' regulators regulate the banks while the Federal Reserve (FRB) independently regulates the holding company and non-bank affiliates. The bank's regulators must ask the FRB to deal with any problem involving a bank holding company or affiliate, which the FRB may or may not do in its own way and time. Coordination is not required and often does not happen.

The BHC model is described in the NPR as "Federal consolidated regulation", but it is consolidated only in the sense that the FRB encourages interlocking boards and management. That enables the FRB to indirectly regulate the bank by overseeing how the holding company directors and officers manage the bank, which is a bank holding company's ("BHC's") main, and often, only asset. That means a typical state nonmember community bank has three regulators—a state regulator, the FDIC and the FRB, all of which are independent and may, or may not, work together. At the same time, the holding company and affiliates are regulated solely by the FRB.

Because most BHCs are shells with no assets except the bank's stock, the FRB mostly regulates a BHC to not cause problems for the bank. Usually there is nothing else to directly regulate.

IB regulators also ensure that a holding company or affiliate do not cause problems for the bank in addition to ensuring that the relationship and transactions between an IB and its parent are appropriate and legally compliant and are conducted for the benefit of the bank. There tend to be more affiliate transactions and relationships to regulate in the IBs, but those also provide significant advantages and benefits, described in more detail below, that a shell parent cannot match. That becomes critically important if the bank needs additional capital, liquidity or operational support.

Source of strength

Parents and affiliates of most industrial banks are diverse and often much larger than the bank. This diversity has two significant benefits that largely account for the superior performance of the industrial banks.

Support for capital and liquidity

One benefit is ready access to all the capital the bank will ever need. It is a real source of strength that most BHCs could never provide. In an industry in which "capital is king", this is a very important advantage that significantly reduces the risk of loss to the deposit insurance fund. This is possible because diversified parents hold assets separate from the bank. Some IB parents have assets hundreds or even thousands of times larger than the bank.

For the past several years IB parents have signed legally enforceable agreements to maintain the bank's capital and liquidity at specified levels often referred to as a "CALMA" (Capital and Liquidity Maintenance Agreement), Under a CALMA, IB parents have a legal obligation to contribute capital and liquidity to a bank subsidiary. Unlike most BHCs, diverse holding companies usually have the ability to contribute capital and liquidity in any amounts whenever needed. For many industrial banks, additional capital to maintain healthy ratios, or to support expansion of the bank's business, requires nothing more than a phone call to the parent.

In contrast, most BHCs operate as a kind of inverted division or subsidiary of the bank. For reasons described further below, the bank is always the BHC's primary asset and most BHCs have no other assets. Most BHCs have a very limited ability raise new capital, especially if the bank is financially impaired because that problem cannot be disclosed to potential investors without potentially starting a run on the bank. Furthermore, courts have held that a BHC is not legally obligated to contribute capital to a subsidiary bank, even in one of the rare instances where it is able to do so, if it could be sued by shareholders for wasting assets.

A related benefit for most IBs is that diversified parents have trade names and market reputations of its non-bank subsidiaries to protect. Many industrial bank CEOs are told by the parent company that the greatest sin they can commit is to put the parent's name in a bad light. The parents will often act quickly and without any compulsion to avoid bad publicity due to problems at the bank.

A 2004 study by the Federal Reserve Bank of New York confirms this.[3] That study compared capital contributions by single and multibank BHCs. It began by noting that courts held that a BHC cannot be forced to contribute new capital to a failing bank subsidiary if the directors and officers could be sued by shareholders for wasting holding company assets. That essentially means that one of the few BHCs that has additional assets will only infuse fresh capital into a subsidiary bank that is healthy and growing, but not if it is failing. In response, Congress enacted a law requiring affiliated banks to cross guarantee the solvency of all banks in the group. The FRBNY study looked at the impact of the cross guarantee. It found that a voluntary capital contribution is less likely to be made by a single bank holding company at risk of being sued by its shareholders if it contributes more capital to a failing bank. A multibank holding company is more likely to contribute capital—if it is able—because the cross guarantee means it has to support a failing bank in order to preserve its investment in the other banks it controls. The same logic applies in an organization with other businesses and a well-recognized trade name.

Again, the cross-guarantee requirement only applies to affiliated banks, not the holding company. A BHC still cannot be forced to recapitalize a failing bank despite the statutory mandate that it serve as a source of strength. In contrast, an IB holding company subject to a CALMA is legally obligated to infuse new capital and liquidity whenever needed, and it typically

[3] *Are Bank Holding Companies a Source of Strength to Their Banking Subsidiaries?,* Federal Reserve Bank of New York, June 2004 Number 189.

has the ability to do that. There have even been instances where a bankrupt IB parent infused fresh capital into a bank subsidiary.

There are two main reasons why most BHCs hold no other assets.

Many banks and BHCs, especially community banks, only want to engage in banking. Community banks are viable and very important members of their communities and a shell holding company to hold the bank's stock is a natural structure for many of those banks. But the BHCA also prohibits a BHC from engaging in other activities, and that removes any incentive or ability to hold other assets, even cash, ensuring that most BHCs remain shells.

The main benefit of a shell BHC is that it holds all of the bank's stock and can sell all of that stock to an acquirer by a majority vote of the shareholders. Dissident shareholders cannot hold out and complicate a sale the majority wishes to complete. The other advantage is a holding company can sell securities that would not count as capital for the bank such as trust preferred securities and contribute the cash from those securities to the bank as Tier 1 capital. Of course, those benefits only work if the bank is healthy and its financial condition can be disclosed to potential investors or buyers without risking a run.

One question that presents is why prohibit other activities? Why not allow each company to develop naturally in response to the opportunities in the markets it serves? The answer is not that diversity poses a risk to the bank as long as conflicts of interest are prevented. The IB model has proven to be a stronger, not riskier, model. The real answer is found in the history of the BHCA. The prohibition on other activities was intended to prevent the development of chain banking and multibank holding companies in the 1950s, an issue that is no longer relevant since all unit banking laws have been repealed and nationwide branching is allowed under federal law.[4][5]

The reason for retaining the BHCA today is to provide the FRB with a role in regulating the banks. It is the result of a compromise reached in the 1950s when the FRB sought to take over all bank regulation but was opposed by the Treasury Department and OCC. Treasury did not want to lose its ability to control the nation's banking policy. The FRB also faced a tradition of distrust of central banks going back to revolutionary days and the presidency of Andrew

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[4] Chain banking and multibank holding companies linked multiple unit banks into one integrated banking system. Unit banks were prohibited by law from branching in many states, and when it was allowed, branching was usually limited to certain geographic areas. Many of the chains and multibank holding companies were assembled by large and sometimes diverse companies that would convince shareholders of small banks to sell. The matter came to a head in the early 1950s when Transamerica Corporation attempted to acquire Bank of America. The BHCA was enacted after the Federal Reserve lost a court battle alleging Transamerica was acquiring a banking monopoly in some western states. Today that kind of market domination is prevented by a more surgical and targeted law limiting the concentration of deposits any single bank can hold in any state. See 12 U.S.C. 1842(d) and 12 U.S.C. 1835a.

[5] See 12 U.S.C. 1828(d).

Jackson.[6] The compromise gave the FRB jurisdiction over the holding companies and those state chartered banks that voluntarily chose the FRB as their primary federal regulator while preserving the OCC as an independent regulator within Treasury and the FDIC as an autonomous agency regulating most of the state chartered banks.

The resulting weakness in most BHCs highlights the fundamental contradiction in the FRB's often cited foundational principle that a BHC must serve as a "source of strength" for the bank. We agree with that principle, but in reality, most BHCs have no ability to support their bank subsidiaries and the FRB can only try to prevent them from causing problems for the bank. Characterizing them as a source of strength is a misleading slogan with no basis in reality. The activity restrictions in the BHCA ensure that is the case.

Of course, there are exceptions. The largest BHCs are publicly traded and well established in the capital markets and their banks have substantial franchise value even if the bank is struggling financially. But the 529 community banks that failed between 2008 and 2015—all or virtually all of which had an FRB regulated BHC. This important fact—demonstrates how pervasive and costly a BHC's inherent weakness is in a crisis. In contrast, only one IB that had a weak undiversified holding company that failed during the Great Recession.

In summary, the contrast could not be more stark between the IB model and the BHC model as a source of strength to an insured bank. An IB parent is both able and legally required to provide fresh capital and liquidity to its IB whenever needed and most IB holding companies are able to comply. In addition, they have strong incentives to support their bank in order to protect their trade names and other subsidiaries. A BHC is rarely able to provide additional capital or liquidity to its bank and cannot be compelled to do so if needed to recapitalize a failing bank.

Marketing support

The other benefit many industrial banks have is a ready-made market and source of business. Many industrial banks are organized to either provide a more stable and cost-effective platform for an existing financial services business or to offer complementary financial products and services to established customers of an affiliate. The business plans for these banks are not speculative and many industrial banks are profitable from the outset.

In contrast, every new community bank stands alone and must build its business from scratch while competing with established banks, credit unions and other financial services

[6] President Jackson vetoed a bill to extend the charter of a federally chartered central bank approved by Congress on a temporary basis after concerns about the concentration of economic power in a central bank were proven when the head of that bank, Nicolas Biddle, attempted to prevent Jackson's election to a second term by cutting off credit to Jackson supporters. The resulting scandal ultimately helped Jackson's campaign and the federal government then left the creation and regulation of banks entirely to the states until the Civil War.

providers. The success of a new community bank is always speculative. The hope is that each new bank can achieve profitability within three years.

Independent control

While maximizing the benefits of affiliation with established and successful companies, the IB model also addresses potential risks. Some of those risks are the same as all banks face while others are unique to the relationship with affiliated operating companies that might try to take advantage of their direct or indirect control of the bank.

To insulate the bank from conflicts of interest and other problems that may develop in a parent or affiliate, the IB model stresses independent control of the bank and segregation of sufficient assets to support the bank. Each IB must have an independent management team and a majority of outside directors on its board of directors. Regulators stress that control of the bank rests with its board and management and hold them accountable. The board and management make all final decisions about credit standards, programs, risk management, policies and other matters affecting the bank's safe and sound operation. Sections 23A and 23B of the Federal Reserve Act, which apply to all banks, prohibit loans and other programs to or for the benefit of a parent or affiliate. In effect, everything the bank does involving a parent or affiliate is at arms-length and on the same terms as if there were no affiliation, and the bank cannot finance the parent or affiliates except in very limited circumstances where the loan or other transaction poses no risk to the bank.

If a problem develops at the parent, the priority goal of the IB model is to isolate the bank. There have been infrequent instances when an IB parent filed bankruptcy. Each time, regulators expected the industrial bank to continue operating normally if the parent reorganized under Chapter 11, and to self-liquidate if the parent filed Chapter 7. The IB model worked well in all cases (except one), resulting in no loss to the FDIC. (The exception was an IB that serviced small business and failed along with its weak and undiversified parent during the Great Recession.) When the parents closed and liquidated, the subsidiary IB also closed and self-liquidated after paying all debts full. These institutions ultimately paid a liquidating dividend to the parent's bankruptcy trustee. In the one instance when a parent reorganized under Chapter 11, which occurred several years ago, the bank continued operating normally and still operates today.

This contrasts sharply with the BHC model. The FRB seeks as much integration as possible between the parent and bank and expects the parent to be very hands-on in its control of the bank. Interlocking boards and management are common. This enables the FRB to indirectly regulate the bank by regulating how the parent controls the bank. In effect, the parent is a proxy for the bank that enables the FRB to become the bank's third regulator. Prohibiting other activities ensures that the BHC is a proxy for the bank for purposes of FRB "consolidated" regulation.

The NPR describes the BHC model as "Federal consolidated regulation", which we consider somewhat misleading. Technically, the FRB has no authority over a state nonmember bank or a national bank. It indirectly controls how the bank operates by regulating how the bank's owner manages the bank. To accomplish that the FRB expects the management of the holding company and the bank to be integrated as much as possible, often to the point of effectively erasing the operational boundaries between the two entities. The three regulators of a state nonmember bank in the BHC model each acts independently and have their own turf. They often coordinate but that is voluntary and contradictions among the regulators occasionally occur. Regulation under the BHC model is comprehensive for the FRB but it begs the question whether regulation of a BHC is overkill. The FRB regulates everything a BHC does (except for securities and insurance operations subject to another primary regulator) regardless of whether some parts of the BHC are irrelevant to the bank. Why is that necessary and why does a bank need a third regulator?

The BHC model would not work for a diversified holding company because the FDIC and state regulators require strong boundaries between the bank and its affiliates in order to protect the bank's assets and avoid conflicts of interest. The only way assets flow from a bank to a parent is as dividends paid out of the bank's net profits after fully reserving for potential losses and ensuring adequate capital for future needs. Beyond that, the FRB is not qualified to regulate other activities that require different business models, and there is no need or justification for such oversight if the other business activities are otherwise irrelevant to the bank.

Questions relating to mixing banking and commerce

Concerns have been raised about allowing diverse holding companies to own a bank. Some of those concerns present valid issues that are clearly recognized and adequately addressed in the bank centric model. Potential conflicts of interest are prevented by Section 23A of the Federal Reserve Act, 12 U.S.C. 371c, which applies to all banks including IBs. The risk of a large bank dominating a market is prevented by laws applicable to all banks limiting the total deposits one bank can hold in any state. These laws exist separate from the BHCA and make much broader restrictions in the BHCA redundant and unnecessary to address these risks.

The provisions in the BHCA prohibiting BHCs from engaging in non-banking activities were not enacted because affiliations with commercial companies caused bank failures. The problem it addressed was industry consolidation resulting from shareholders of mostly small banks selling to large companies over the objection of the banks' current managers.

If there had been problems with banks failing due to mixing banking and commerce it would have been evident prior to 1956, but no such problems occurred. In fact, commercial ownership of banks was common prior to 1956. For example, GM and Ford each owned a large national bank in Michigan which they created in the 1930s then divested when the BHCA was enacted.[7] Those banks were created during the Great Depression after banking had effectively collapsed in Michigan and new banks were needed to restart the economy.

Today, concerns remain about the development of banks too large to manage and regulate and in ensuring a sufficient supply of financial services to all people and communities in the nation. We understand that the development of companies that can dominate their markets has been a key concern of policy makers since revolutionary days and should be carefully evaluated by the regulators in every bank application. Preventing concentrations that limit competition and deprive outlying communities of needed financial services remains a fundamental regulatory principle. We support preventing the development of banks that would compete unfairly or concentrate resources to the detriment of any group or community. But good rulemaking and policy making requires understanding the limited circumstances in which such a dominant bank could exist and developing targeted and surgical policies to avoid that problem without unnecessarily suppressing innovation with sledgehammer prohibitions such as the activity restrictions in the BHCA.

One example often cited is a large retailer developing a bank that could capture enough business to kill competitors. But this cannot happen under current legal standards including Section 23A and the conditions for exemption from the Bank Holding Company Act.

Section 23A largely prohibits a retailer from owning a bank that would finance sales at the retailer or make loans to the retailer or another affiliate. A bank cannot make loans to buy goods and services from an affiliate unless the bank sells the loans without recourse or holds a cash deposit securing the loans it holds dollar for dollar.

Additionally, to qualify for the exemption from the BHCA an IB cannot offer checking accounts.

Combined, these restrictions mean an IB can only provide complementary financial products to the parent's customers or operate as a separate business within the corporate group that does not involve an affiliate or its customers. The prohibitions in Section 23A explains why large retailers including Amazon and Walmart partner with banks to provide store branded financing and other banking services to their customers. In most cases that is actually more profitable to the retailer than providing financing directly.

Another concern we share is protecting the confidentiality of customer information. This is fundamental to banking and all existing IBs maintain customer confidentiality as all other banks. We strongly support careful evaluation of how customer data will be used in all

[7] GM owned the National Bank of Detroit and Ford owned the Manufacturers National Bank of Detroit. They were formed in the Great Depression and were the largest banks in Michigan until they merged into even larger regional banks.

applications and existing operations and ensuring that any data sharing is clearly disclosed to customers and does not impair or impact privacy rights.

In reality, banking and commerce is already integrated throughout the U.S. economy. Most higher volume merchants offer in-store financing as it is critical to their business. These organizations partner with a bank to provide financing, often in the merchant's name. Customers frequently are unaware they are dealing with an independent bank. Several of the largest financial institutions in the nation provide these services to merchants including Citibank, Capital One, American Express, Synchrony and Comenity. Any business can offer all of the banking products and services it wants through a bank partnership. This indicates such services to customers will happen regardless of whether the commercial business partners with a bank or owns one.

Entry of large technology companies is another often cited but nebulous concern. The most probable area is for a phone company to develop a bank to provide phone-based banking services that will enhance the functionality of its phones. Apple has done this to a degree but again it is partnering with banks. Apple Pay, for example, is a point of sale terminal that facilitates payments on the customer's bank issued credit card. Apple also recently announced its own credit card, but it is issued by a partner bank. These mobile systems are in high demand and will develop regardless of whether a phone manufacturer is allowed to own an IB. The only bank that will not have to deal with this competition in the future is the one partnering with Apple or another phone company.

In reality, competition relating to banking technology is happening in three main areas. The largest banks understand the growing importance of mobile banking and are meeting that competition by using their large resources to develop proprietary technology that leads the market. Pure technology companies are trying to develop new systems outside of the industry that they hope can eventually become banks or be used broadly by banks. The third group is the smaller banks, which face the biggest competitive hurdles in technology because they don't have the resources to develop their own proprietary mobile systems and must rely on outside vendors that thus far have struggled to keep up with the large banks. Whether a company can own an IB will have very little impact on those competitive forces.

Ultimately, regulators should focus on ensuring that newly developing banking models are safe and sound while serving public needs and convenience. Blocking innovation creates obsolescence and significant risks for existing banks in the development of viable new banking models in the future. The bank-centric model allows innovation in safe and sound ways, as the record of existing industrial banks clearly shows.

Parity

Some critics of the bank centric model criticize the lack of parity with regard to the regulatory requirements imposed on a BHC compared to the diversity permitted for an IB holding company.

To be sure, parity is critically important in some instances such as the unfair competitive advantage credit unions have because they are exempt from taxes. But there is no justification for imposing the BHC model on IB parents and affiliates solely for the sake of parity if they are not competing unfairly-which they are not. More specifically, requiring diverse holding companies to conduct bank model stress tests and hold bank capital and liquidity levels, as some critics demand, would serve no legitimate purpose.

Apart from the holding companies that are GSIBS and SIFIS, the BHC model is designed for a particular kind of company that only owns a bank. Most BHCs financial statements are consolidated and consist almost entirely of the bank's assets and liabilities. Stress tests measure whether the bank can survive a downturn because that is the only consideration relevant to the survival of the BHC. That is why in most cases there is only one stress test for a bank and its holding company. The same is true for a BHC's capital and liquidity requirements. The same ratios are used because they relate to the same assets and liabilities.

Bank stress tests would not work for an IB holding company because they do not measure stresses on non-bank activities that may constitute the vast majority of an IB parent's business. Different stress tests would be needed to measure the resiliency of those entities. For the FDIC's purposes, the most relevant question relating to an IB parent is whether it has the capacity to fulfill its contractual obligation to provide capital and liquidity to the bank if needed. The parent's capital ratios are otherwise irrelevant as long as it can pay its general creditors.

Similarly, requiring a diversified holding company to maintain capital and liquidity levels appropriate for a bank is unjustified and unacceptable. Capital and liquidity are a function of the business model. Banks maintain minimum capital levels to absorb loan losses, protect depositors and create leverage for shareholders. A utility or manufacturer or retailer holds capital for different reasons and those reasons result in different optimal levels of capital. Selling electricity or manufacturing are not leveraged businesses and their debts are not insured by the federal government. Most can continue operating with no capital. While capital ratios are a crucial measure of a bank's health, they are essentially insignificant to the continuing operation of many other businesses conducted by IB affiliates.

Additionally, the capital and liquidity levels specified for most BHCs are actually the bank's capital and liquidity presented in a consolidated statement. That is why the same ratios are used. Excluding the bank, the actual capital and liquidity of a typical shell BHC is negligible or zero. In contrast, a capital ratio for a typical IB holding company would include other assets that may be much larger than the bank. As such, a capital ratio for an IB holding company would not compare in any meaningful way to the ratios for a BHC.

Another important difference is the fact that bank regulators do not have the expertise to regulate other kinds of businesses. It would be a serious mistake to require a bank regulator to determine minimum capital and liquidity levels and processes for a non-bank business they do not understand, especially when the bank may only constitute a very small fraction of the group's total assets.

Parity is a legitimate issue when the lack of it presents a competitive disadvantage such as the credit union situation. But not imposing a requirement for bank specific stress tests or minimum capital levels on a company primarily engaged in non-banking businesses does not present any competitive disadvantage for other banks. IBs still have to conduct the same stress tests as other banks. Bank specific stress tests applied to diversified parents would be meaningless because they would not measure the things that would actually be stressed such as reduced sales and delinquent utility accounts. Requiring a diverse company to hold bank appropriate capital ratios would most likely affect the ability of an IB parent and affiliates to compete effectively in its other businesses, which is why it is unacceptable.

The only real competitive advantage an IB has is the much higher level of financial and marketing support many diverse parents can provide to their bank. The overarching fact is that most IB holding companies can actually provide a source of strength to their banks while most BHCs cannot and do not add any real value to their banks. The difference can be seen in the 529 community banks that failed in the Great Recession, almost all of which had a traditional BHC. It can also be seen in the banks that have eliminated their BHC because they added so little value to the organization compared to the costs. An IB can end up in a similar situation only if its parent becomes completely unable to pay its general creditors. That, not the lack of Federal Reserve supervision of a company with no assets, is the most significant difference in the two models. Every other consideration pales in comparison.

Responses to the questions in the NPR

With this background, we respond to the questions in the NPR as follows:

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?*

Answer: Our members believe the rule should be prospective only. Although industrial bank parents and affiliates are already subject to most of the standards and requirements in the proposed rule, we see no need or justification to apply it retroactively, especially when the form of the final rule is not yet known. The standards and requirements in place now will continue regardless of whether the proposed rule is adopted. The rule is not addressing an existing problem at any bank or IB parent and the regulators have extensive authority to act if an actual problem arises.

Additionally, our members have issues with some new provisions in the proposed rule (discussed below) and imposing those requirements on existing banks would create potentially significant problems.

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?*

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

Answer: To our knowledge, every industrial bank has a parent company. Nevertheless, we note that shareholders of other banks that do not have a parent company are not subject to regulation, nor are they required to serve as a source of strength to the bank. For purposes of facilitating investments in a bank or bank parent we believe it is important to maintain limits on the liability of passive shareholders common to all corporations and LLCs.

One goal of all holding company regulation should be to impose no unnecessary obstacles to raising capital. Without capital, banks cannot exist, and investors provide all of the capital banks hold. Investors have many investment options and always make judgments about whether and how much to invest by balancing risks and rewards. We are aware of no other investments an individual or institutional investor could make that would entail assuming risks beyond losing the money invested.

The typical IB parent already makes perpetual and unlimited commitments to provide capital and liquidity to their banks backed by substantial amounts of additional assets. This is a much higher level of support for the bank than virtually any BHC can or would be willing to provide. Requiring the parent's investor shareholders also provide open ended guarantees will drive all but a very small number of investors away from banking and largely kill the industry except for a few of the largest BHCs. It is hard to imagine anything more counterproductive.

Consider, for example, whether some prominent and successful residents of a particular community would be willing to join together to organize a new community bank if they had to guarantee the bank's ultimate success. It would not happen except, perhaps, in some very rare cases. Potential investors in a company controlling an IB would have the same concerns.

Many institutional investors already prohibit investments in companies with a bank subsidiary unless the parent is so large that the investor can meet its investment goals without becoming subject to regulation as a bank parent. This favors the largest BHCs, some of which are so large that an investment would need to be billions of dollars to reach the threshold of control that would trigger regulation as a BHC. In contrast, intermediate size holding companies frequently encounter problems with investor reluctance to undertake additional regulatory risks.

Many of the questions posed in questions 2, 3 and 4 above, and in other questions below, involve requirements for investors and shareholders that would be unworkable for these reasons.

We understand that recent approval orders have required controlling shareholders to commit to vote their shares to comply with a CALMA signed by the IB parent and other conditions of an approval order. That presumably will prevent that shareholder from attempting to interfere with enforcement of the CALMA and approval order. Again, that should be considered on a case by case basis and required only if it will not impact the IB parent's ability to attract investors and raise capital.

Question 5: *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 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?*

Answer: Our members would strongly oppose such a requirement.

Most industrial banks are owned by corporate groups involved in other activities that require different financial structures and management than a bank. Many IBs are a small fraction of the group's total assets and play a very small role in the group's overall activities. Such a corporate group is not going to allow U.S. bank regulators to require it to reorganize all of its financial services operations to a separate regulated entity or dictate how it conducts its other businesses. It would be a hair on the tail wagging the dog.

In the case of the savings and loans, an intermediate holding company was required primarily to provide a role for the FRB to regulate those institutions. This kind of structure serves no other regulatory purpose. It would provide no benefit, reduced risk, or efficiency for an industrial bank, its parent, its customers or the economy generally. On the contrary, it would potentially intrude into the group's operations to a degree that would result in divestiture or closure of the bank.

The main, overarching point is that the BHC model does not work for a diversified parent. Bank regulators excel in regulating banks and parents that have no interests apart from their banks. Bank regulators are not equipped to regulate other businesses with different funding and operational needs such as manufacturing and retailing, and those businesses cannot operate efficiently and compete effectively if forced to conform to a banking business model. That is why the IB model focuses on regulating the bank and its relationship and transactions with the parent and affiliates. It is a proven and effective model that does not need to be unduly complicated in ways that would likely end up being so unworkable that it would preclude ownership of a bank.

Question 6: *Should the proposed rule also apply to other institutions that are excluded from the BHCA definition of "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 requirement 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*.

Answer: Our members see no reason why the IB model would not work for the other kinds of banks whose owners are exempt from the BHCA, but there may be unique issues with those bank parents and affiliates that we do not understand and those should be considered before expanding this rule. That also presumes that the final form of the rule is fair and workable, as discussed in this letter.

Question 7: *Are the definitions clear in their meaning and application? Should any other terms used in the proposed rule be defined?*

Answer: Generally, yes. However, we recommend incorporating statutory definitions such as control rather than repeating the definition. That will avoid questions about whether other rules of interpretation apply such as the recent rule relating to presumptions of passivity in control situations.

Question 8: *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?*

Question 9 : *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. Federal banking agencies, including the FRB, impose 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?*

Answer: We generally support reporting and examination requirements necessary for the regulators to monitor and evaluate financial and other conditions in a parent and affiliates that are relevant to a bank.

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?*

Answer: While the regulators need to understand which entities and people the bank is transacting with within the corporate group, we suggest a different approach to this question.

Some industrial banks are part of a large multinational corporate group. Providing a complete list of all direct and indirect subsidiaries worldwide would be burdensome and unnecessary since the list could consist of thousands of entities, most of which would be irrelevant to the bank.

We believe it would work better to require an applicant and existing banks to provide a current list of all entities in their chain of ownership and control, all other banks within the group, all affiliates with which the bank may transact, and all U.S. based affiliates, and to update that list prior to engaging in transactions with any previously unlisted affiliate.

Question 11: *The proposed rule would limit board of directors (or similar body) representation to 25 percent of the members of the board of directors (or similar entity). The FDIC has chosen this threshold with the idea that 25 percent is a key threshold for control purposes. Is another threshold more appropriate? If so, what and why?*

Answer: Our members strongly oppose this proposal.

Requiring a majority of outside directors has worked well and we are aware of no reason to change it. On the contrary, it could cause problems in some banks.

Independent does not mean disconnected. One of the most important jobs of an IB's board and management is bridging the cultures of the bank and the parent. The bank needs to be independent, but it is also part of a larger organization and must integrate into that structure as well. The parent has legitimate ownership interests in the bank, and it is accountable to its shareholders for how it manages that investment. For example, a parent is legally required to compile accurate and complete consolidated financial statements. At the same time, the CFO of an IB parent cannot directly control the bank's recordkeeping and accounting. The solution is for the parent CFO to be very familiar and comfortable with how the bank's CFO manages the bank's books. This kind of collaboration is especially needed when the parent and affiliates are the source of the bank's business. The ideal situation happens when the parent knows what the bank is doing and trusts the people that manage it. That is critical to the parent's commitment to the bank and for the bank to thrive. Conversely, a bank that has a difficult relationship with its parent will become increasingly dysfunctional and some have ended up closing.

One of the best ways to build that independent but trusted relationship is for key executives of the parent to serve as directors on the bank's board. They know first-hand what is happening in the bank and often serve as the bank's mentors in the corporate group. Requiring three outside directors for every insider would be counterproductive for that reason. It would either limit an inside director to one for a five-person board or require the board to have nine if there are two insiders and 13 if there are three insiders.

We see no relevance to the definition of control that would justify this change in policy. The parent of every industrial bank owns 100% of the bank, not 25. Why does that control threshold matter? Boards with a majority of outsiders have not presented a problem that needs fixing.

It also presents potential logistical problems when combined with other provisions of the proposed rule requiring advance approval of new directors. Our members report significant delays in electing new directors that must be approved in advance. If one outside member of a five-member board quit, would the one inside director be forced to cease participating on the board until the new outside director is elected?

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?*

Answer: No. See answer to questions 2, 3 and 4. Demanding that shareholders undertake perpetual and unlimited liability would simply kill these investments and the banks along with it. This is not required of shareholders of any other kind of bank, even in BHCs when the shareholder has substantial assets while the holding company is a shell, and other banks would not develop if it were required.

Investing in a bank is not like requiring a developer to guarantee a construction loan to a development company the developer controls. That type of guarantee is finite in both time and amount. Investing in a bank is unlimited in both time and amount.

The net effect of requiring shareholder guarantees of IB parents would be to drive away the strongest and safest holding companies that otherwise would be attracted into the banking industry.

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?*

We recommend expressly authorizing the FDIC to specify a cure period on a case by case basis. The circumstances that may arise causing noncompliance are too potentially varied to create a good rule that fits all situations.

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?*

Answer: Emphatically, no. See answer to question 5.

It will not work to impose a BHC model on a diversified IB parent. A large corporate group in which the bank plays a minor role will not allow a bank regulator to dictate capital levels for the overall group with different businesses the bank's regulators do not understand are not equipped to regulate.

We note again that IB holding companies typically have more resources and substantial strength than almost any BHC. The vast majority of BHCs have no ability to assist a failing bank. They are helpless bystanders if their bank is in trouble. Some new BHCs cannot even raise the startup capital for a new community bank. In contrast, capital is simply not an issue for most industrial banks. We do not support suggestions that push against capable holding companies from banking.

Comparisons with requirements for BHCs to maintain minimum capital levels are misleading in this context. When regulators refer to capital levels in a BHC it is really the bank's capital, which is included in a consolidated financial statement. Capital levels in a typical IB holding company represent real independent assets. Intruding into the operations of a diversified parent beyond its relationship and transactions with the bank will mostly result in that company deciding not to own a bank.

Question 15: *Should the FDIC further define "services material to the operations of the industrial bank" as that phrase is used in the proposed § 354.5(e)? If so, how should the term be defined?*

Answer: We assume that this actually refers to proposed section 354.5(a)(5). Considering the broad range of services the question may refer to, we don't consider it necessary to further define the phrase. It will apply to any service the regulators consider material in any event.

Question 16: *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?*

Answer: With the possible exception of 354.5(a)(4) relating to new officers with connections to an affiliate, we see no justification for imposing these restrictions on just IBs after they have become established. Similar restrictions do not apply perpetually to other banks. If there is a compelling need for such restrictions, they should apply to all banks.

Question 17: *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?*

Answer: The question is somewhat confusing. The regulators always have the ability to require a bank to enter into written agreements and impose conditions when circumstances warrant. That is provided by existing laws and regulations and reaches every institution affiliated party.

The answer is an emphatic no if the question is whether the regulators should be able to impose new agreements and conditions when they are not prompted by a particular problem or issue. Industrial banks are real banks subject to the same laws, regulations and oversight as all other banks and should be treated similarly. Investors and holding companies will not be willing to own a bank if their commitments and obligations can be changed at any time and in any way at a regulator's sole discretion. That would make it impossible to assess investment risks, which would be an unacceptable risk in itself for most investors.

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?*

Answer: The regulators should continue to evaluate how a bank's business plan would potentially affect all markets, not just consumer products, and especially if it could potentially result in market dominance. It would also be reasonable for regulators to consider the viability of a bank's proposed business plan in light of the performance of an affiliate's related business activities.

Question 19: *The current Interagency Charter and Federal Deposit Insurance Application*[78] *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?*

Answer: The basic consideration is whether there is sufficient demand for the bank's proposed products and services. That determines whether the bank can succeed as a business. Customers choosing the bank is the clearest and surest sign that it is serving the public's needs and convenience. We think it is appropriate for the regulators to consider any factor relevant to that assessment. It is also important to ensure that those products and services will be delivered in compliance with all applicable laws and regulations, including the CRA.

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?*

Answer: We think this should be determined by the facts of each particular case. We note that some foreign owned industrial banks are subsidiaries of very substantial U.S. based parents that can serve as a much stronger source of strength to the bank than just about any

BHC. At the same time, many of the non-U.S. subsidiaries have no relationship or relevance to the bank beyond common ownership. It makes sense to us to ensure the support of the U.S. parents and affiliates but not waste time compiling information and asserting authority over foreign affiliates that are otherwise irrelevant to the bank.

Other foreign owned banks might be direct subsidiaries of the foreign parent. In those cases, different conditions ensuring support for the bank may be needed and justified.

Asserting authority over a foreign parent company is needed only if a bank's U.S. based parents and affiliates lack the resources to support the bank. Some foreign owners with worldwide operations have legitimate and significant concerns about becoming subject to comprehensive regulation by a U.S. bank regulator. This needs to be considered when determining the conditions the regulators will require to approve a new U.S. based bank.

The proposed rule

With this background, we recommend the following changes in the final rule. Apart from these changes, we support the remainder of the proposed rule.

Section 354.4(a)(1) regarding lists of affiliates—instead of a complete list, we recommend requiring a list of all affiliates in the chain of control and ownership over the IB, all other banks that are part of the affiliate group, all U.S. based affiliated, and all affiliated entities with which the bank will engage in transactions subject to Sections 23A and 23B and Regulation W. Require the bank to update the list whenever necessary to remain current. This would capture all information relevant to the bank without requiring additional reporting that would not be relevant and in some cases would be burdensome and require preparing lengthy reports consisting of information of no real relevance to the bank.

Section 354.4(a)(2) regarding consent to examinations—we recommend deleting or providing further specification about the meaning of "all relevant laws and regulations." The remainder of the paragraph captures all information about the parent and affiliates relevant to the bank so that phrase appears redundant.

Section 354.4(a)(3) regarding annual reports—we recommend clarifying that a parent company's annual report to shareholders will suffice. Some parent groups are many times larger than the industrial bank and the possibility of requiring a separate comprehensive audit of the whole corporate group will be a concern in terms of cost, inconvenience and ultimate purpose. For example, it is certainly appropriate for the bank's regulators to examine how the bank underwrites credits and manages risks and whether an affiliate providing origination and other services for the bank is adhering to those standards. But it would serve no purpose to require an affiliate that operates separately from the bank to provide reports or be examined with regard to how that affiliate underwrites financing for its products and services. The scope of that authority is often a concern for bank affiliates even though the regulators have not imposed unreasonable burdens on parents and affiliates in the past.

Section 354.4(a)(6) relating to board composition—for the reasons stated in response to question 11, we urge the FDIC to delete this section limiting inside directors to 25% of the total board. We would not object to replacing it with a requirement to have a majority of outside directors. It would also help to add a provision stating that the requirement for a majority of outside directors applies to the authorized number of directors and temporary vacancies would not cause the bank to be out of compliance if it is diligently recruiting and interviewing a new director.

Section 354.4(c) requiring additional commitments from a parent or controlling shareholder—this represents an open-ended authority to change the obligations of a parent and controlling shareholder at any time and for any reason. That is unreasonable and will likely cause parent companies and shareholders to avoid investing in a bank. It would also be unlawful and unenforceable to the extent it would prevent a parent or shareholder from disputing a new requirement that is arbitrary and capricious in violation of federal law. The FDIC can and should negotiate an agreement at the outset that ensures the parent will support the bank with capital and liquidity whenever needed. That represents a level of support that no BHC is obligated to provide. The regulators will always have authority to identify potential problems after the bank begins operating that can be addressed in a number of ways including negotiating a consent order or unilaterally imposing a cease and desist order. Deleting this section will not limit the regulators' ability to exercise their authorities over parents, affiliates and other "institution affiliated parties," making this section unnecessary.

Section 354.5(a) requiring certain advance approvals—except for subsection (4) covering employment of a senior executive officer who is also currently associated with an affiliate of the bank, for the reasons described above in response to Question 16 we recommend limiting these requirements to the de novo period unless special circumstances require extending the period in which they apply.

We believe it would be reasonable to permanently require advance approval before appointing an executive officer that might have divided loyalties and conflicts of interest due to a role the person plays at an affiliate.

Section 354.5(b) regarding imposing additional restrictions at any time and for any reason—we strongly object to this section as written. It would waive a bank's and affiliate's rights to dispute actions by the FDIC that are arbitrary and capricious and otherwise unlawful under federal administrative law. That makes this section unlawful and unenforceable on its face. This section is not needed in order for the FDIC to impose restrictions on a bank or affiliate that are reasonable and not arbitrary and capricious using its authority to address unsafe and unsound conditions.

Conclusion

Again, we commend the FDIC for adopting a rule formalizing the standards and requirements currently imposed on industrial banks, their parents and affiliates, their directors and officers, and applicants for deposit insurance. We hope these comments will help develop a final rule that is fair and reasonable for all parties and that will help dispel the false notion that the banks and their affiliates are not regulated and pose unnecessary risks to the Deposit Insurance Fund.

Sincerely,

[redacted]

[redacted]

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