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RETAIL INDUSTRY LEADERS ASSOCIATION
Retail's Future…Educate, Innovate, Advocate

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Retail Industry Leaders Association's Public Comments in Response to
the FDIC's February 5, 2007 Notice and Request for Comment
Regarding Industrial Loan Companies and Industrial Banks

On behalf of its members, Retail Industry Leaders Association ("RILA") respectfully submits its response to the Federal Deposit Insurance Corporation's ("FDIC") February 5, 2007 request for public comment. 72 Fed. Reg. 5217 (February 5, 2007). In particular, RILA appreciates the opportunity to respond to Question 10, which addresses the FDIC's moratorium regarding applications by commercial companies for industrial loan companies and industrial banks ("ILCs").

I. Introduction

By way of background, RILA promotes consumer choice and economic freedom through public policy and industry operational excellence. Our members include the largest and fastest growing companies in the retail industry --retailers, product manufacturers, and service suppliers--which together account for more than $1.5 trillion in annual sales. RILA members provide millions of jobs and operate more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

RILA believes that this ILC moratorium is improper because, as noted earlier this year by the Comptroller of the Currency, whether or not any commercial company should be allowed to control an ILC "is a policy decision for Congress to address, not the FDIC." *Statement of John C. Dugan Comptroller of the Currency Regarding ILC Moratorium Extension*, Meeting of the Federal Deposit Insurance Corporation Board of Directors at 2 (January 31, 2007), *available at* http://www.occ.treas.gov/ftp/release/2007-9a.pdf (emphasis in original). The "legislative history makes clear that Congress plainly authorized commercial companies to own ILCs." *Id*. This FDIC Board Member candidly concludes that he "frankly do[es]n't believe the FDIC can or should deny an application for deposit insurance to an ILC merely because of commercial affiliations." *Id*. at 3. As a practical matter, however, the FDIC's moratorium does effectively deny such applications on that very basis.

RILA respects the lawmaking process, but does not believe an independent agency of the federal government like the FDIC should ignore its "specific timetables for agency action" simply waiting for Congress to act. Moratorium on Certain Industrial Bank Applications and Notices, 72 Fed. Reg. 5290, 5293 (Feb. 5, 2007). Congress has had literally decades to pass legislation to change its prior legislative judgment that commercial companies should be allowed to control ILCs, and it has failed to do so despite the efforts of a minority of members. There is no reason

to believe Congress will change its mind in the foreseeable future. The FDIC should not suspend its regulatory duties merely to wait for congressional action that may never come.

With respect to the safety and soundness issues, the public "comments [the FDIC] received during the last six months have provided virtually no empirical evidence to support the proposition that commercially owned ILCs are more risky than non-commercially owned ILCs." *Comptroller of the Currency Statement* at 4. The FDIC concurred with this assessment in its February 5, 2007 notice to extend the moratorium, stating that "[t]he FDIC's experience and the comments suggest no risk or other possible harm that is unique to the industrial bank charter." 72 Fed. Reg. at 5292-3. The FDIC also concluded that "to date, commercially owned industrial banks have not resulted in serious problems." *Id*. at 5293.

"In short, denying an ILC application for deposit insurance based merely on commercial affiliation would be fundamentally inconsistent with first, the express congressional exemption of ILCs from the Bank Holding Company Act's restriction on commercial affiliation, and second, the FDIC's track record in addressing risks raised by such affiliations during the last 20 years." *Comptroller of the Currency Statement* at 4.

Accordingly, as discussed further below, RILA believes that the FDIC should immediately address all pending and new applications for ILCs submitted by commercial companies.

II. Overview of Recent FDIC Action Regarding the ILC Moratorium

On July 28, 2006, the FDIC imposed a six-month moratorium on FDIC consideration of all pending and new ILC applications. Moratorium on Certain Industrial Loan Company Applications and Notices, 71 Fed. Reg. 43482 (Aug. 1, 2006). The FDIC stated that "ILCs have not presented the FDIC thus far with any greater risk of failure than other types of insured depository institutions and the FDIC's current statutory authority has proved adequate to supervise ILCs." *Id*. at 43483. Notwithstanding these conclusions, the FDIC claimed it needed a moratorium to "further evaluate":

> (i) industry developments, (ii) the various issues, facts, and arguments raised with respect to the ILC industry, (iii) whether there are emerging safety and soundness issues or policy issues involving ILCs or other risks to the insurance fund, and (iv) whether statutory, regulatory, or policy changes should be made in the FDIC's oversight of ILCs in order to protect the deposit insurance fund or important Congressional objectives.

Id.

On August 23, 2006, the FDIC published a request for public comments regarding ILCs and obtained 12,600 comment letters in response. As noted above, the FDIC states in its February 5, 2007 notice to extend the moratorium that "[t]he FDIC's experience and the comments suggest no risk or other possible harm that is unique to the industrial bank charter." 72 Fed. Reg. at 5292-3. The FDIC also concluded that "to date, commercially owned industrial banks have not resulted in serious problems." *Id*. at 5293.

Despite conducting this "further evaluat[ion]" during the original six month moratorium, the FDIC now claims it "needs further study and consideration on two key issues: (1) What, if any, increased risks are created by ownership by commercial companies and (2) how well do current supervisory models apply to such owners." *Id.* As a result, the FDIC has extended the moratorium solely for ILCs that that would become subsidiaries of companies engaged in non-financial activities.

The FDIC has extended this moratorium for one full year despite the fact that the FDIC itself recognizes that (i) "the moratorium [extension] may appear inconsistent with specific timetables for agency action, including processing of approvals" and (ii) "there may be concerns that this results in disparate treatment for those commercial companies now seeking to control ILCs." *Id.*

III. ILCs do not pose greater risks than other insured depository institutions

As noted in September 2005 by the General Accounting Office ("GAO"), ILCs pose no greater risk than other types of banks from an operational perspective. *Industrial Loan Corporations Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority*, General Accounting Office, Report to Honorable James A. Leach, House of Representatives, GAO-05-621, at 5 (September 2005), *available at* http://www.gao.gov/new.items/d05621.pdf. In the same report, former FDIC Chairman Donald E. Powell stated that the existing ILC regulatory scheme "is a proven model for protecting the deposit insurance funds, and no additional layer of consolidated federal supervision is necessary." *Id.* at 82. Even more recently, the acting general counsel for the FDIC voiced similar conclusions, stating that ILCs "have a good safety and soundness track record to date." *ILCs—A Review of Charter, Ownership, and Supervision Issues: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the House Comm. on Financial Services*, 109th Cong. (July 12, 2006) (Prepared Statement of Douglas H. Jones), *available at* http://financialservices.house.gov/media/pdf/071206dhj.pdf.

Consistent with this conclusion by the GAO as well as former and current FDIC officials, RILA believes that no modification of the existing FDIC supervisory programs or regulations is needed because the existing regulatory scheme ensures that ILCs operate within the law and protects the Deposit Insurance Fund and the public. Like any other banks, ILCs are subject to the FDIC Rules and Regulations, including standards for capital assets and standards for operations. In particular, Sections 325 and 326 of the Federal Reserve Act, together with the anti-tying provisions of the Bank Holding Company Act, guard against any potential for abuse. Also, ILC management falls under the purview of the FDIC and may be held responsible for compliance with federal and state regulations. In fact, according to Mr. Jones, four of the largest ILCs are under daily supervision.

The FDIC also has the authority to investigate affiliate relationships, and the FDIC may share information with other regulatory agencies, such as the Securities and Exchange Commission. FDIC and state regulators can take a variety of actions to investigate and penalize ILCs, including limiting transactions with affiliates, examining all affiliates that control or engage in transactions with the ILC, requiring production of information on any affiliate, issuing cease and desist orders with the force of law, banning any affiliate from further involvement, and taking

possession of bank to liquidate or merge it. In addition, when the FDIC reviews an ILC charter application, it may impose conditions and operating standards on the ILC and its parent to protect the federal depository insurance fund and consumers.

Finally, the most important metric in assessing the overall risk profile for ILCs, like any other bank, is the failure rate. In this regard, it is important to note that many of the commercial firms that already hold ILC charters consist of multi-billion dollar corporations using their banks to build their businesses, innovate, and reduce costs in an intensely competitive global marketplace, including General Electric, Toyota, and Harley Davidson. Not surprisingly, RILA has been unable to find any ILC failure owned by a commercial firm.

For the foregoing reasons, RILA finds the existing ILC regulatory scheme more than adequate. In addition to the fact that no non-financial ILC has failed, both the FDIC and GAO regard ILCs, under the current regulatory scheme, as posing no greater danger than any other type of bank.

IV. The risk profile of ILCs does not differ based upon whether the owner is a financial or commercial company

While the current regulatory schemes appear to provide adequate oversight with respect to all ILCs, history suggests that those owned by commercial companies pose the least risk. As previously stated, RILA has been unable to find a recorded failure of an ILC owned by a commercial firm. Moreover, of the ILC failures recorded between 1985 and 2003, according to "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," most were small finance companies that made high risk, high interest loans, which contributed to their demise during the Savings and Loan crisis of the late 1980s and early 1990s. Together, those banks held assets of a mere $23 million. Standing in stark contrast to those earlier, under-funded banks, commercially owned ILCs are usually organized for internal business operations only and are well-funded by financial strong parent companies. For example, General Electric alone generates annual revenue of more than $149 billion. The financial strength of such commercial parents of ILCs provides financial security that can be matched only by the largest bank holding companies.

Accordingly, non-financial ownership of an ILC should not affect the applicable regulatory scheme but should be seen as a positive factor in the safety and security of the bank and be encouraged to help American companies compete and innovate in the global marketplace.

V. The risk profile of ILCs does not differ based upon whether the owner is subject to some form of consolidated federal supervision

The FDIC has stated that "[s]trategies to monitor and control a bank's relationship with affiliated and controlling entities are fundamental to effective bank supervision under any organizational form that banks adopt." As previously set forth, ILCs owned by commercial companies are subject to comprehensive regulatory oversight. While the non-financial parent is not subject to traditional umbrella regulatory oversight like other banks, the FDIC may share information with other agencies, including the Securities and Exchange Commission. Further, the FDIC retains

authority to examine an ILC's transactions with its parent and affiliates, and the ILC management remains subject to FDIC supervision and inquiry.

In addition, just like any other bank, ILCs are subject to increasingly onerous penalties if their capitalization falls below acceptable levels pursuant to the prompt corrective action provisions of the Federal Deposit Insurance Act. Moreover, when reviewing an ILC charter application, the FDIC could review the regulatory scheme covering the ILC and its parent and impose reasonable restrictions and conditions to rectify any potential gaps in supervisory authority.

VI. ILCs owned by commercial companies do not have a competitive advantage over other insured depository institutions

Businesses must continually innovate in order to survive. RILA's member companies constantly strive to find novel ways to return value to the consumer to retain their patronage. RILA members value their freedom to experiment with new business methods and processes, and they have created tremendous value for the American consumer. ILCs represent innovation that increases competition for commercial banking services. Such competition, in turn, brings lower costs, greater efficiency, and higher quality services and products.

VII. Conclusion

For the foregoing reasons, RILA believes that the FDIC should immediately address all pending and new applications for ILCs submitted by commercial companies. If you should have any additional question, please contact Katherine Lugar, Senior Vice President, Government Affairs at katherine.lugar@retail-leaders.org or (703) 600-2098.