May 7, 2007

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Industrial Bank Subsidiaries of Financial Companies
72 Federal Register 5217 (February 5, 2007), RIN 3064-AD15

Dear Mr. Feldman:

America's Community Bankers (ACB)[1] is pleased to respond to the Federal Deposit Insurance Corporation's (FDIC) request for comments on the very critical issue of supervisory concerns presented by elements of the modern industrial loan company industry. ACB fully supports the actions taken by the FDIC at its January 31, 2007 meeting to extend its moratorium on consideration of applications by commercial companies for deposit insurance for an industrial loan company (ILC) subsidiary or for a change in control of an existing ILC. As we have noted in our previous comment letters, in testimony before Congress, and in testimony before the FDIC on the Wal-Mart application, the ownership of ILCs by commercial entities raises serious concerns about conflicts of interest that would arise in the operation of an ILC by such a company and risks to the safety of the Deposit Insurance Fund.

ACB supports the existence and viability of the ILC charter as an option for financial institutions. However, we oppose any new affiliations between commercial firms and ILCs. We believe that ILCs must operate under commercial affiliation restrictions substantially similar to those Congress placed on unitary savings and loan holding companies in the Gramm-Leach-Bliley Act.[2] Legislation addressing commercial ownership of ILCs and ILC holding company regulation is currently pending in Congress. We applaud the FDIC for thoughtfully considering the comments of interested parties and determining that its moratorium should be extended to give Congress the opportunity to consider the issues associated with commercial ownership of ILCs.

At its January 31st meeting, the FDIC also approved the issuance of this Notice of Proposed Rulemaking (NPR), which would impose certain conditions and requirements on each company

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[1] America's Community Bankers is the national trade association committed to shaping the future of banking by being the innovative industry leader strengthening the competitive position of community banks. To learn more about ACB, visit *www.ACB.us*.
[2] 12 U.S.C. § 1467(a).

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that establishes or acquires an ILC subsidiary, if that company is engaged solely in financial activities and is not already subject to Federal Consolidated Bank Supervision (FCBS) by the Federal Reserve Board or the Office of Thrift Supervision (OTS). The NPR would implement these terms and conditions by requiring such financial companies to enter into one or more written agreements with the FDIC before approval of an application.

The NPR would not apply these terms and conditions to ILCs that are already owned by financial companies not subject to FCBS. In addition, pending the issuance of final rules, the FDIC will continue to consider deposit insurance applications and change in control notices for an ILC to become a subsidiary of a financial company not subject to FCBS, and impose conditions on a case-by-case basis.

The NPR specifically requests comments on how the FDIC should address future and pending applications by commercial companies and ILCs in the event that Congress does not act before the FDIC moratorium expires.

ACB Position

ACB supports Congressional action to address the issues associated with commercial ownership of ILCs. ACB supports H.R. 698, which is currently moving through the House of Representatives. We believe that it would not be appropriate for the FDIC to act on pending commercial ILC applications while Congress is considering the ILC issue.

The risks posed by ILCs to the safety and soundness of the financial system and to the Deposit Insurance Fund differ depending on whether the owner is a commercial entity or a financial company. Risk arises from inherent conflicts of interest between the safe-and-sound operation of the ILC and the interests of the commercial parent to ensure profitable operation of the commercial enterprises of the holding company. It is clear from recent applications involving ILCs that large commercial retailers intend eventually to engage in full retail banking operations. Such ILCs would likely be fast growing, and may dilute the Deposit Insurance Fund. Legislative or regulatory action is warranted to avoid these threats to the safety and soundness of the U.S. financial system.

In the event that the FDIC permits such commercial ILC affiliations in the future, the FDIC should, in conditions approving such affiliations, impose strict limitations on ILCs owned by commercial firms in order to contain risk to the Deposit Insurance Fund and maintain safety and soundness. First, the FDIC should prohibit commercially owned ILCs from branching on an interstate basis. Second, the FDIC should set limits on the growth of commercially owned ILCs. Third, the FDIC should place controls on the activities of such ILCs by requiring strict adherence to the business plan approved by the FDIC in connection with an application for deposit insurance or change in control. The FDIC should require such ILCs to seek permission to engage in any new activity, even if the activity is otherwise permitted by statute, and should only grant such approvals after a notice and comment period. Similarly, any changes to the business plan of commercially owned ILCs should be subject to agency approval and public notice and comment. Finally, in order to limit the influence of the commercial parent on the insured ILC, the FDIC should require the parent commercial company and the ILC subsidiary to commit that no more than 25 percent of the board of directors of each company may overlap.

With respect to financial company ownership of ILCs, ACB generally supports the FDIC's NPR to the extent that the FDIC's authority would parallel the authorities of the Federal Reserve and OTS over holding companies that contain ILCs and that are essential to ensure safety and soundness. The addition of some of the commitments proposed in the NPR would strengthen the ability of the FDIC to regulate ILC holding companies not already subject to FCBS and are necessary to fulfill the FDIC's current statutory obligations to monitor safety and soundness and protect the Deposit Insurance Fund. We note that H.R. 698, currently moving to the floor of the House of Representatives, would explicitly strengthen by statute the FDIC's powers to regulate holding companies on a consolidated basis. ACB generally supports H.R. 698 as reported by the House Financial Services Committee, and we note that final the outcome of the legislative process may necessitate a change to any supervisory regime adopted by the FDIC with respect to ILCs.

Our more specific comments on the NPR are set forth below.

Commercial Ownership of ILCs

In 1999, in the Gramm-Leach-Bliley Act, Congress prohibited new commercial affiliations for savings associations and generally reinforced the policy of prohibiting commercial affiliations with banks. Commercial ownership of ILCs should not be used as an end run around the policies against commercial ownership of insured institutions adopted by Congress.

If an ILC is owned by a commercial entity, there is naturally a greater concern that credit decisions about loans to customers of the commercial parent or a commercial affiliate might be based on motives to sustain the sales of the parent or affiliate, rather than sound underwriting.

We noted in our testimony opposing Wal-Mart's application for deposit insurance special concerns related to the size of that particular enterprise and conflicts inherent in its business plan. Although Wal-Mart has at this time withdrawn its application for deposit insurance for an ILC, the serious risks presented by such an application are illustrative. As just one example, according to Wal-Mart's application, its bank would have processed billions of transactions as a credit card acquirer. The role of the acquirer (in this case Wal-Mart Bank) under current rules is to ensure that the merchant (in this case Wal-Mart stores) meets merchant qualification standards and is engaging in legitimate business. With the Wal-Mart Corporation on both sides of these transactions, there would be a conflict of interest that could place the consumer or taxpayer at risk. Further, there would be no effective barrier against financial problems in the commercial store spreading to the Wal-Mart Bank. In such a scenario, with hundreds of billions of dollars passing through the Wal-Mart Bank system, perhaps as high as 2 percent of the payments system overall, the risk of disruption stemming from financial problems at Wal-Mart would be great.

The high number of transactions and the large dollar volume increases the importance of the need for the acquirer and merchant to be independent and free of influence from each other.

The rapid growth of deposits from outside the traditional banking sector into some ILCs at the beginning of the decade caused a serious dilution of the Deposit Insurance Fund. This rapid growth also shifted the costs of protecting against losses from future bank failures to the rest of the banking system. We believe that Congress or the FDIC should act to limit dilution of the Deposit Insurance Fund by prohibiting or strictly conditioning commercial affiliations with ILCs.

FDIC Proposed Commitments for Financial Holding Companies

ACB believes that all ILCs in a holding company structure should be subject to consolidated supervision at the holding company level. The FDIC should have the same authorities in this regard as the Federal Reserve and OTS. We believe it is preferable that Congress provide the FDIC supervisory authority over the parents of ILCs that is comparable to the authority of the Federal Reserve and OTS over holding companies.

ACB supports the FDIC's proposed commitments requiring examination of the ILC holding company and all subsidiaries, and reporting requirements on such financial companies, to the extent that such requirements are consistent with the requirements imposed by the Federal Reserve or the OTS on the companies those agencies regulate.

The Federal Reserve requires bank holding companies to maintain specific levels of capital on a consolidated basis. The OTS requires a savings and loan holding company to maintain an adequate level of capital to support its risk profile. Under Federal Reserve and OTS policy, a holding company should stand ready to use its available resources to provide adequate funds to its subsidiary bank or association during periods of financial stress.[3]

The NPR would require a financial company with an ILC subsidiary to commit to maintain "the subsidiary industrial bank's capital and liquidity at such levels as the FDIC deems appropriate, and/or taking such other actions as the FDIC deems appropriate to provide the industrial bank with a resource for additional capital and liquidity, including for example, pledging assets, obtaining and maintaining a letter of credit, and indemnifying the industrial bank." ACB believes this commitment is appropriate and is consistent with the authorities held by the Federal Reserve and OTS. In particular, we believe that the OTS's approach of requiring a sufficient amount of capital to support the holding company's risk profile has worked well and would provide the needed flexibility for the FDIC to consider all of the facts and circumstances of each regulated ILC in determining the appropriate capital requirements.

ACB does not support a specific regulatory requirement that the holding company maintain a Tier 1 capital ratio for the company, on a consolidated basis, of at least 4 percent or any other

[3] See Government Accountability Office: "Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority," GAO-05-621 (September 2005), p. 31.

level. The NPR's capital commitment will be sufficient for the FDIC to evaluate the circumstances of each financial holding company and its ILC subsidiary and provide capital guidance accordingly.

ACB has some concerns with respect to the proposed commitment limiting representation by the financial company and the ILC subsidiary on the board of the other to 25 percent. For smaller institutions, this prohibition could be unworkable. Moreover, the other commitments required under the NPR will provide the FDIC with supervisory tools it needs to ensure that the parent financial company does not have undue influence over the subsidiary ILC. As noted above, we believe a commitment of this type is better suited to a situation involving commercial ownership of an ILC.

Conclusion

Thank you for the opportunity to comment on this important matter. Should you have any questions, please contact Patricia Milon at 202-857-3121 or pmilon@acbankers.org, or Greg Mesack at 202-857-3134 or gmesack@acbankers.org.

Sincerely,

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Chief Legal Officer and Senior Vice President,
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