DEPARTMENT OF FINANCIAL INSTITUTIONS

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June 29, 2020

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3064-AF31

Re: Federal Deposit Insurance Corporation's proposed rulemaking for Parent Companies of Industrial Banks and Industrial Loan Companies. (RIN 3064-AF31)

Mr. Feldman,

In advance, we thank you for the opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC") proposed rulemaking for Parent Companies of Industrial Banks and Industrial Loan Companies (RIN 3064-AF31). By this letter the Utah Department of Financial Institutions (the "Department") would like to respond to the invitation for public comment.

Background

The Department supervises and regulates state-chartered depository institutions and other financial institutions, including 14 FDIC-insured industrial banks. The proposed rule would have direct application and effect on the industrial banks supervised and regulated by the Department today, and in the future. All depository institutions supervised and regulated by the Department are required by law to have federal deposit insurance. As a result, the Department has always carried out its responsibilities to regulate and supervise industrial banks in close partnership with the FDIC.

The Department understands that the FDIC, by proposing this rule, is attempting to provide transparency and to formalize supervisory practices related to industrial banks and their parent companies. Many of the commitments required by the proposed rule have been previously deployed with the parent companies of industrial banks that are currently operating under charters granted by the Department with deposit insurance provided by the FDIC.

While the Department supports an effort to improve transparency and standardize practices, we do have some concerns about certain elements in the proposed rule. The Department will use this comment opportunity to suggest recommendations on how the proposed rule could be improved. We will also note additional observations informed by the Department's 33 years of experience supervising industrial banks.

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The Department has statutory authority to conduct inspections of industrial bank parent companies under Title 7 of the Utah Code. Formalized in 2006, the Department's industrial bank holding company inspection program is modeled on the Federal Reserve System's bank holding company inspection program. We routinely invite the FDIC to participate in industrial bank holding company inspections, and FDIC examiners often join us in these reviews. The Department's inspection program has been effective at contributing to prudent, bank-focused supervision of Utah industrial banks through an assessment of a parent company's ability to serve as a source of strength to its subsidiary bank. Should the rule be finalized, we look forward to continuing to supervise Utah's industrial banks, and their holding companies, in a collaborative manner with the FDIC.

Recommendations

I. Limit Section 354.5 Restrictions To The De Novo Period

The Department strongly encourages the FDIC to amend the rule to limit the industrial bank restrictions proposed in Section 354.5 to the de novo period of newly chartered industrial banks. The Section 354.5 restrictions resemble restrictions typically only imposed on new banks, or banks in troubled condition. The need for such extraordinarily assertive and perpetual oversight of industrial banks is not supported by (i) any unique powers inherent in the charter itself, or (ii) the historical financial and managerial performance of industrial banks, as evidenced by the industry's collective UFIRS ratings over time. Installing these requirements in perpetuity is unwarranted and disadvantages this class of state-chartered institution.

Adaptability is an essential attribute for the survival of any business. Financial institutions must be able to adapt and respond to current conditions in order to survive. Markets, consumer preferences, and competitive landscapes shift, often very quickly. The Department is concerned that requiring established, healthy, well-managed banks that compete in a 21st century marketplace to wait on regulatory approval for routine business decisions (e.g., hiring officers, recruiting board positions) could so disadvantage these institutions in the marketplace as to actually increase their strategic, reputational and operational risk.

The Department also cautions against constraints that, in perpetuity, only permit a bank to adapt its business model when its primary federal regulator agrees, in advance, with such strategic decisions. While such constraints are warranted in the new bank phase, perpetuating such oversight over the entire life of a bank could substantially limit a bank's competitiveness and also places the FDIC in the difficult position of having to regularly participate in routine management decisions.

II. Exclude Part 354 Written Agreements From Prompt Corrective Action Impacts

The Department strongly encourages the FDIC to amend the rule and explicitly clarify that for the purposes of determining an industrial bank's capital category under Part 324.403 of the FDIC Rules and Regulations, the written agreements contemplated by the proposed rule (including capital and liquidity maintenance agreements) shall not be deemed written agreements, orders, capital directives, or prompt corrective action directives issued by the FDIC pursuant to section 8 of the FDI Act (12 U.S.C. 1818), the International Lending Supervision Act of 1983 (12 U.S.C. 3907), or

the Home Owners' Loan Act (12 U.S.C. 1464(t)(6)(A)(ii)), or section 38 of the FDI Act (12 U.S.C. 1831o), or any regulation thereunder, to meet and maintain a specific capital level for any capital measure.

The Department opposes the agreements envisioned by the rule having any potential bearing on an industrial bank's capital category. This is particularly important given the liquidity consequences inherent under Part 337 of the FDIC Rules and Regulations when a bank is designated less than "well capitalized." The Department is charged with the responsibility of taking possession of a failed institution; we have concerns that the Department could be placed in a position to act at a strongly capitalized institution, only because a preventable liquidity crisis developed inside the bank due solely to the presence of Part 354 agreements.

Uncertainty on the applicability of Part 337 could have the unintended consequence of unnecessarily sparking a liquidity crisis at an industrial bank simply because unrelated economic conditions at the parent company temporarily prevent it from performing on a Part 354 agreement. In our supervisory experience with banks of all charter types, it is preferable to insulate a subsidiary bank from parent distress, rather than to inextricably link them together, which we fear the proposed rule inadvertently does without the explicit clarification above.

III. Moderately Increase Limits on Parent Representation on Industrial Bank Boards

The Department encourages the FDIC to amend the rule to moderately adjust the proposed 25 percent limit on parent company bank board representation. Limiting parent company influence on the board of directors of an industrial bank is an important control that has served both the Department and the industry well. However, in our supervisory experience, parent company representatives on the bank board also act as important allies for the insured depository institution within the broader organization and help to promote stronger understanding and support of the bank's obligations to operate in a safe, sound, and fully compliant manner. We are concerned a limit as tight as 25 percent could suppress this parent advocacy benefit. For example, for a seven-member board of directors, such a limit would restrict parent company representation to one director. Simply limiting parent representation on the board to a minority of directors, or even increasing the limit to 33 percent, would effectively limit parent company influence over a subsidiary bank while still preserving the benefit of bank advocacy within the parent company.

Also, it would be helpful if the FDIC explicitly clarified in the rule whether or not bank officers (e.g., a bank president) serving on an industrial bank board are included in the currently proposed 25 percent limit. In our experience, having the bank president serve on the board of directors is an important factor that helps promote the bank's autonomy. If the FDIC chooses to retain a 25 percent limit, we recommend the FDIC exempt bank officers from the calculation. We are concerned that including bank presidents in a percentage limit may incentivize organizers to not put bank presidents on the board. In the Department's view, this would be an undesirable outcome that would weaken a bank's autonomy.

IV. Continue to Use Authority to Examine Affiliates under a Bank-Focused Approach

The Department generally supports the proposed rule's requirements for parent company reporting and consent to examination authority. However, the Department encourages the FDIC to continue examining industrial bank affiliates, including parent companies, using an approach that is tailored to assessing risk to the insured depository institution and determining compliance with the commitments under Section 354.4 of the proposed rule.

State nonmember banks, including industrial banks, are subject to the restrictions on affiliate transactions found in Sections 23A and 23B of the Federal Reserve Act. The Department and the FDIC regularly assess bank compliance with these restrictions as an important element of industrial bank supervision. Compliance with Sections 23A and 23B requires an industrial bank to have procedures for identifying affiliates and affiliate transactions, documented analysis to ensure all agreements and transactions are on arm's length, market terms, and a system for ongoing monitoring of transactions. The Department believes that assessing compliance with affiliate transactions limitations at the bank level adequately protects a bank from the potential risk from affiliate relationships, and also promotes bank independence and governance.

Other Observations

Section 354.1 - Scope

Applicability – The Department believes that the proposed rule should only apply prospectively to industrial banks approved after the effective date of the rule. The shareholders of currently operating industrial banks were not given the opportunity to consider the requirements imposed by the proposed rule in their decisions to establish their industrial bank subsidiaries.

Industrial Banks Without Parent Companies – The primary motivating factor for proposing the rule for industrial banks appears to be the absence of Federal consolidated supervision at the holding company level. The Department suggests that applying the proposed rule to an industrial bank where such an ownership structure is not applicable is unnecessary and punitive. Natural persons who ultimately own or control other state nonmember and member commercial banks, other CEBA exempted banks, national banks, or bank holding companies are not formally obligated in a similar way.

Obligating Controlling Natural Person Shareholders of Industrial Bank Parent Companies – If the FDIC's goal is to compensate for the absence of Federal consolidated supervision at the holding company level, then once holding company matters are addressed by the rule, extending additional requirements beyond the holding company to that entity's natural person shareholders creates a unusual regulatory burden. The Department is not aware that the Federal Reserve applies such direct obligations to the natural person shareholders of bank holding companies.

Section 354.2 - Definitions

Intermediate Holding Company For Financial Activities – The Department sees limited benefit and potential risk in 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. Any potential benefit could be significantly outweighed by the complexity and cost of standing up an intermediate holding company structure, and may only serve to organizationally distance the bank from the primary source of strength, most commonly the top tier parent company.

Section 354.3 – Written Agreement

Please see our comments under "Recommendations" above, and in the section immediately following.

Section 354.4 - Required Commitments and Provisions of Written Agreement

Parent Company Subsidiary Reporting Requirements – If the final rule includes a requirement for parent companies to provide the FDIC with a list of subsidiaries, we recommend the FDIC consider defining a materiality threshold for this disclosure. For example, such criteria could include subsidiaries that transact with the bank, any subsidiary generating more than a certain percentage of revenue to the consolidated organization, and any subsidiaries that hold and maintain licenses to deliver financial services to the customers. This type of approach would limit the burden on parent companies that have global operations with thousands of entities that have no material relevance to the industrial bank.

FDIC Imposed Parent Capital Limits – Regarding whether the FDIC should require an industrial bank parent company to maintain a certain capital level, the Department supports the proposed rule as drafted. The proposed rule and existing supervision of industrial banks and their parent/affiliate relationships adequately ensure that an industrial bank parent company has the ability to serve as a source of strength.

Industrial bank parent companies operate across a wide range of industries with substantial variations in business models, balance sheet compositions, and access to capital markets. Industrial bank parent companies provide a unique source of strength that is not typically available from traditional shell bank holding companies. However, unlike a traditional bank holding company that is limited to engaging in permissible activities under the Bank Holding Company Act, for many industrial bank parent companies, measures of tangible equity are not often the most pertinent indicator of the financial health of the company or its ability to serve as a source of strength. In the Department's experience, the diversity of industrial bank parent companies operations inherently requires a tailored approach based on an understanding of each company's business model and relationship with its subsidiary industrial bank.

Section 354.5 - Restrictions on industrial bank subsidiaries of Covered Companies

Please see our comments under "Recommendations" above.

Section 354.6 Reservation of authority

Expanding Assessment Factors For Convenience and Needs – The Department does not support the FDIC expanding the assessment factors and assessing convenience and needs differently for a single class of state-chartered institution. We note that the choice to operate a bank from a single location, or to rely on technology to deliver products, is a business model choice and not a function

of a bank's charter type. While some industrial banks operate in this paradigm, so do many other state nonmember banks, member banks, and national banks. Singling out industrial banks for this process change ignores the presence of similarly unique business models deployed by banks with other charter types.

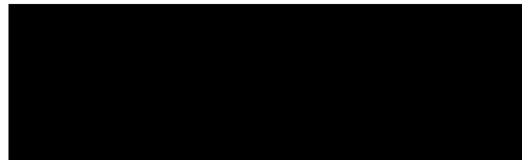
Foreign Ownership – The additional commitments pursued by the FDIC for foreign based parent companies of industrial banks have proven effective and sufficient. In the Department's view, no further commitments are warranted or necessary.

Conclusion

The Department appreciates the opportunity to comment on the proposed rule to formalize the FDIC's supervisory processes and policies regarding parent companies of industrial banks. The Department supports an effort to improve transparency and standardize practices. We do have concerns about certain elements in the proposed rule. We believe that the proposed rule should be amended in the following areas: (i) limiting the proposed Part 354.5 restrictions to the de novo period, (ii) clarifying that proposed Part 354 written agreements do not have bearing on an industrial bank's capital category for purposes of prompt corrective action impacts, (iii) moderately increasing limits on parent representation on industrial bank boards, and (iv) using authority to examine affiliates under a bank-focused approach.

Your attention to this serious matter is appreciated.

Sincerely,



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