



July 1, 2020

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

RE: RIN 3064-AF31: Parent Companies of Industrial Banks and Industrial Loan Companies

Dear Mr. Feldman:

The Consumer Bankers Association (“CBA”) appreciates the opportunity to respond to the Federal Deposit Insurance Corporation’s (“the FDIC” or “the agency”) notice of proposed rulemaking (“the proposed rule” or “the current proposal”) regarding parent companies of industrial banks and industrial loan companies (“ILCs”). The future of the ILC charter is of particular interest to CBA because our association was formed in 1919 as the Morris Plan Bankers Association for the purpose of promoting America’s first industrial banks, then known as Morris Plan Banks.¹ Today, CBA is the only national trade association focused exclusively on retail banking; our 67 member banks employ nearly 2 million Americans, extend roughly \$3 trillion in consumer loans, and hold assets totaling \$14.5 trillion or 79% of all bank holding company, bank and thrift assets in the United States. While the vast majority of our current members are not ILCs, CBA remains committed to the need and purpose of consumer banking that inspired the nation’s first industrials.

CBA’s history and membership reflect our support for diverse business models and charter choice, including the ILC charter, to foster a competitive financial system. However, evolutions in the financial marketplace have allowed the ILC charter to stray from its simple beginnings of providing small loans to industrial workers. Our members are especially concerned the rise in non-financial commercial companies (“commercial companies” or “commercial parents”) seeking ownership of ILCs may facilitate perilous growth of shadow banking and threaten the Deposit Insurance Fund (“the DIF”) and the safety and soundness of the traditional banking system. The FDIC’s proposed strategies and safeguards for overseeing commercial companies, while well-intended, may in practice be inadequate substitutes for the consolidated supervision that applies to and is required of banks and their holding companies.

Although ILCs commonly support specialty finance operations for parent companies engaged in activities that have a strong nexus to finance (“financial companies” or “financial parents”), ILCs may also be leveraged by the largest commercial or retail enterprises (including global mega-conglomerates) to avoid the laws governing well-regulated banks and their holding companies. Through this rulemaking, the FDIC should ensure commercial companies cannot use the ILC charter as a conduit into the banking system and federal safety net while engaging in activities that have always been off limits for regulated

¹ In 1934 the Morris Plan Bankers Association was renamed the Industrial Bankers Association. Since 1946, the Association has operated under its current name, the Consumer Bankers Association.

banks and their holding companies. Accordingly, we urge the FDIC to only finalize a rule that honors the cardinal tenet of American banking: the mixing of banking and commerce is impermissible.²

In response to the specific questions set forth in the FDIC's proposal, and as discussed in further detail below, we offer the following views and recommendations: (1) the proposed rule should only apply prospectively and the FDIC should impose a temporary moratorium on its approval of applications for deposit insurance for the ILC charter³ ("applications") until the agency finalizes its pending rulemaking; (2) any final rule should maximize the FDIC's existing authority to ensure an even playing field between ILCs and banks so commercial parents cannot use the ILC charter to escape regulatory scrutiny; and (3) the FDIC should supply a "reasoned explanation" for why the proposal applies to commercial companies but the agency's 2007 notice of proposed rulemaking was limited to financial companies⁴.

I. The proposed rule should only apply prospectively, however, the FDIC should impose a temporary moratorium on its approval of applications until its rulemaking is finalized.

CBA supports prospective application of the proposed rule. Existing ILCs (except two ILCs approved in March of this year)⁵ have held the charter for 15 or more years, weathered economic downturns and other shocks, and tested the resilience of their business models. Although the FDIC regularly updates the agency's corpus of bank regulations through rulemakings and the issuance of guidance, the FDIC has never finalized a rule to impose conditions and requirements for approval of applications. For decades the FDIC has allowed existing ILCs to develop business models and investments that best serve their customers without frequent regulatory adjustments. Retroactive application of the proposed rule to existing ILCs is unnecessary and inequitable because these institutions do not pose the same risks to the financial system as new, untested ILC models. The FDIC should not unfairly disrupt existing ILC models developed in reliance on the FDIC's longstanding approach to regulation and supervision of ILCs.

However, we believe the FDIC should limit the universe of existing ILCs that could be grandfathered under a final rule. We urge the FDIC to impose a temporary moratorium on approval of applications until a rule is finalized. As noted in the proposal, a moratorium would not be unprecedented for the agency.⁶ Prospective application of the rule without a temporary moratorium may incent some entities to file applications for the purpose of "beating the deadline" or the effective date of a final rule. Companies with new or novel structures, particularly commercial companies, may be especially motivated to receive grandfathered supervisory treatment similar to existing ILCs with financial parents.⁷ However, unlike existing ILCs, newly formed or newly acquired and repurposed ILCs have not

² Section 4 of the Bank Holding Company Act generally prohibits a bank holding company from acquiring ownership or control of any company which is not a bank or engaging in any activity other than those of banking or of managing or controlling banks and other subsidiaries authorized under the Act. See 12 U.S.C. § 1843(a)(1)-(2) (2018).

³ Including applications for deposit insurance coverage, merger applications as well as non-objections to notices and changes in control that would result in a commercial company gaining control of an FDIC-insured ILC.

⁴ 72 Fed. Reg. 5217 (Feb. 5, 2007).

⁵ On March 17, 2020, the same day the FDIC announced the proposal, the agency announced the approval of two applications to Nelnet Bank and Square Financial Services, Inc., effectively ending a period of dormancy between 2008 and 2017 when the agency did not approve any applications.

⁶ See 71 Fed. Reg. 147 (August 1, 2006) and 72 Fed. Reg. 5290 (Feb. 5, 2007).

⁷ See e.g., Refiled application to insure the deposits of Rakuten Bank America ("Rakuten Bank") submitted by Rakuten Card Co., Ltd ("Rakuten Card Japan"), a subsidiary of Rakuten, Inc. ("Rakuten") dated May 29, 2020. See

demonstrated an ability to withstand economic shocks and their business models remain untested. The FDIC should impose a temporary moratorium on its approval of applications until its rulemaking is finalized or otherwise ensure ILCs are not grandfathered under a final rule if they were approved or acquired after March 17, 2020 when the proposal was announced.

II. Supervisory parity between banks and ILCs is necessary to ensure risk does not migrate outside the regulated financial system.

Unlike banks and their holding companies, ILCs and their parent companies are not subject to Federal consolidated supervision or the Bank Holding Company Act's ("BHCA") prohibition against mixing banking and commerce. This regulatory structure may incentivize commercial companies to choose the ILC charter to avoid heightened regulatory restrictions associated with the bank charter.⁸ If commercial parents are permitted to use ILC charters to engage in excessive risk-taking without adequate oversight from the agency, the FDIC and the DIF will ultimately pay the price for downside risk that flows back to ILCs. CBA believes the ILC charter and choice-of-charter plays an important role in facilitating a competitive financial system, however, the federal safety net should not be used to subsidize commercial parent companies unless these entities are subject to the same rigorous scrutiny as bank holding companies within the regulated financial system. Although Congress authorized the current framework, the FDIC can and should utilize this rulemaking to level the playing field and impose safeguards on the ILC charter to provide supervisory parity with the bank charter.

In this regard, CBA believes the proposed rule is a step in the right direction and we applaud the FDIC for formalizing and strengthening its existing processes for supervising ILCs to mitigate risk to the DIF in the absence of consolidated supervision. However, we believe the proposal could benefit from some adjustments to the written commitments contemplated by the agency. Any final rule should reflect as near a consolidated supervisory approach as possible and should maximize the FDIC's existing authority to supervise ILCs and examine their parent companies and affiliates.

Written commitments between the FDIC, ILCs and their parent companies requiring examination and reporting are necessary components of an effective supervisory approach. However, we encourage the FDIC to require ILCs and their parent companies to enter written commitments requiring *routine and ongoing* examination and reporting. A mere agreement to authorize an examination or provide a report at a later, unspecified date is not a guarantee examination and reporting will occur on a *routine and ongoing* basis. Written commitments between the FDIC, ILC and their parent companies will only be effective if the contracting parties agree examinations and reporting will occur on a fixed examination cycle like that of banks and their holding companies.

Further, the FDIC should require commitments from parent companies of ILCs to maintain their own defined capital levels, on a consolidated basis, and under all circumstances as guarantees these entities can serve as sources of strength to ILCs. These commitments, along with the proposed restrictions set

also the June 23, 2020 joint trades letter submitted to the FDIC re: Deposit Insurance Applications by Non-Banks signed by CBA, the American Bankers Association and the Bank Policy Institute.

⁸ In a 2012 Report to Congressional Committees, the U.S. Government Accountability Office confirmed these advantages and entities preference for the ILC charter when it determined "commercial holding companies would most likely divest themselves of their exempt institutions [i.e. their ILCs] if the BHCA exemptions were removed." GAO-12-160 at page 33 (Jan. 2012).

forth in §354.5 should not be temporally limited. The purposes of the source of strength doctrine and the proposed restrictions in §354.5 are to insulate insured depository institutions from economic or other shocks and protect the DIF. These shocks can occur at any time, with little warning, and do not have expiration dates. Therefore, the FDIC must ensure critical supervisory protections such as the source of strength doctrine remain in place for ILCs and their parent companies throughout the lifetime of their charters.

The benefits of the deposit insurance system should not be made available to commercial parents unless these companies are subject to sufficient FDIC oversight. To this end, the FDIC should, at a minimum, require ILC parent companies to disclose to the agency affiliates and portfolio companies that could engage in transactions with, or otherwise impact, the subsidiary ILC. The FDIC should also examine ILCs, parent companies and affiliates for compliance with the affiliate transaction rules set forth in Sections 23A and 23B of the Federal Reserve Act and Regulation W. Federal consolidated supervision is an effective tool because it requires the regulated entity to be fully transparent in its operations and affords the prudential regulator a holistic understanding of the business model. Failure to disclose and monitor affiliates and portfolio companies through routine examinations will limit the FDIC's knowledge of entities and activities that increase risk to the ILC and the DIF, and will ultimately impair the FDIC's ability to commence swift enforcement actions when necessary. If the Federal Reserve requires banks and their holding companies to disclose affiliates and portfolio companies and examines these entities under consolidated supervision, supervisory parity requires the FDIC to collect this same information from ILCs and their parent companies, and examine these relationships.

CBA also believes any final rule should apply existing financial privacy and information security requirements to commercial companies. The FDIC should codify necessary safeguards to protect and limit the use of consumer financial data for commercial purposes, especially where a commercial company owns an ILC. At a minimum, the FDIC should require commercial companies to develop and implement information security programs that comply with "the safeguards rule" under the Gramm-Leach Bliley Act⁹ as well as the Federal Financial Institutions Examination Council's Information Technology requirements¹⁰.

III. The FDIC should supply a "reasoned explanation" for the differences between the proposed rule and the 2007 notice of proposed rulemaking.

Additional information about the FDIC's 2007 notice of proposed rulemaking ("the 2007 proposal") would better inform public comment on the pending rulemaking. While the current proposal explains some of the FDIC's reasons for delaying its rulemaking between 2008 and 2020, the proposal does not make clear why the proposed rule applies to both commercial and financial companies while the 2007 proposal did not apply to commercial companies. The 2007 proposal extended the FDIC's moratorium on applications submitted by commercial companies "to allow more time for study by the FDIC and to allow time for Congress to consider the issues presented by such an ownership model."¹¹ However, the current proposal does not specifically explain what the FDIC studied in 2007, whether the FDIC made any findings about the distinctions between financial and commercial companies, or the reasons the

⁹ See 15 U.S.C. § 6801(b), 6805 (b)(2) and 16 C.F.R. § 314.

¹⁰ <https://ithandbook.ffiec.gov/it-booklets/information-security.aspx>.

¹¹ 72 Fed. Reg 5217, 5223 (Feb. 5, 2007).

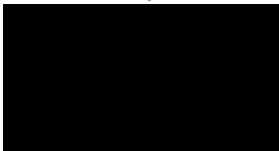
agency did not approve any applications for commercial companies after the moratorium (and subsequent Congressional moratorium) expired.

Without this information, questions remain whether the complicated policy trade-offs involving the mixing of banking and commerce require the FDIC to differentiate between financial company and commercial company applications, and whether the FDIC's policies for evaluating applications (both financial and commercial) has materially changed since 2007. The limited scope of the 2007 proposal coupled with the agency's non-approval of commercial charters since then suggests the FDIC may have maintained a policy of differentiating between financial and commercial companies until the agency published the current proposal. If the FDIC's policies in evaluating commercial company applications have changed, the FDIC should provide a "reasoned explanation" for its decision subject to notice and comment before any rule is finalized.¹²

IV. Conclusion.

CBA appreciates the FDIC's efforts to provide increased transparency on the supervisory framework governing applications, ILCs, and their parent companies. To further inform this rulemaking, we encourage the FDIC to conduct a public hearing. The public hearings the agency conducted in 2006 materially impacted the 2007 proposal and Congress' subsequent mandate for the FDIC to halt its review and approval of applications. We welcome the opportunity for further engagement on this topic. Should you have any questions or wish to discuss these comments, please contact Jenna Burke at jburke@consumerbankers.com or (202) 552-6366.

Sincerely,



Jenna Burke
Vice President, Associate General Counsel
Consumer Bankers Association

¹² Agencies are free to change their existing policies as long as they provide a reasoned explanation for the change. *Encino Motorcars v. Navarro*, 136 S. Ct. 2117, 2126 (2016) citing *Natl. Cable & Telecomm. Assn. v. Brand X Internet Servs.*, 545 U. S. 967, 981–982 (2005).