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VIA Electronic Mail

October 10, 2006

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
Room 3060
550 17th Street, NW
Washington, D.C. 20429
comments@fdic.gov

Re: Request for Comment on Industrial Loan Companies and Industrial Banks [FR Doc. E6–13941]

Dear Mr. Feldman:

American Express Travel Related Services Company, Inc. ("TRS") and American Express Centurion Bank ("AECB") appreciate the opportunity to comment on the series of questions posed by the Federal Deposit Insurance Corporation (the "FDIC") about the regulatory oversight of ILCs, including issues regarding the current legal and business framework of ILCs and the possible benefits, detrimental effects, risks, and supervisory issues associated with the industry. AECB is an FDIC insured, state chartered industrial loan company based in Salt Lake City, Utah and is a wholly owned subsidiary of TRS. AECB has total assets in excess of $15 billion and is the third largest ILC in operation by asset size. AECB was chartered in 1987 and today offers a broad range of credit cards and related lending products to consumers throughout the country.

The FDIC notes in seeking input from the public that "the growth of the ILC industry, the trend toward commercial company ownership of ILCs and the nature of some ILC business models have raised questions about the risks posed by ILCs to the Deposit Insurance Fund, including whether their commercial relationships pose any safety and soundness risks." While it is clear that the recent applications by Wal-Mart and Home Depot have fueled controversy over the ILC charter, it is important to note that the history of ILCs and their regulation demonstrate that they have fostered innovation and diversity while operating under strong and effective state and federal regulatory oversight.

The FDIC has a strong track record in supervising industrial banks. It is important to note that ILCs are subject to the same regulatory and prudential requirements as all other state chartered banks in which the FDIC serves as the primary federal supervisor. In addition, the regulatory requirements applicable to FDIC-insured banks, regardless of federal supervisor, have largely been harmonized. ILCs are subject to the full range of Community Reinvestment Act, capital and safety and soundness requirements that apply to all FDIC-insured depository institutions. In addition, ILCs are also subject to comprehensive regimen of examinations by the FDIC and the ILC's state chartering authority. In short, the level of prudential supervision at the level of the ILC is not unique or different in any way from other state chartered banks that are FDIC-insured.

TRS and AECB believe that the FDIC has ample statutory authority over industrial loan bank owners to address concerns about potential conflicts of interest, independence of management, or expansion of the federal safety-net that are sometimes voiced regarding the relationship of industrial loan banks to their holding companies. All ILCs must demonstrate that they strictly comply with the interaffiliate limits incorporated in Regulation W and Sections 23A and 23B of the Federal Reserve Act, which are made applicable to them through the Federal Deposit Insurance Act. Consequently, like other banks, ILCs are required to ensure that their transactions with affiliates are properly documented, subject to arms length pricing, and are governed by a rigorous system of internal controls to properly monitor such transactions to ensure that they comply with relevant quantitative limits and collateral requirements, as appropriate. A significant portion of the FDIC's examination process is devoted to scrutinizing the commercial arrangements between the ILC and its affiliates.

There is no empirical evidence to suggest that the FDIC's regulatory supervision has been inadequate. In fact, in responding to the GAO's 2005 report on Industrial Loan Companies, former FDIC Chairman Powell wrote "the FDIC believes that bank-centric supervision, as applied by the National Bank Act and the FDI Act, and enhanced by Sections 23A and 23B of the Federal Reserve Act and the Prompt Corrective Action provisions of the FDIC Improvement Act, is a proven model for protecting the deposit insurance funds, and no additional layer of consolidated federal supervision of ILC parents is necessary."[1]

In the case of AECB, the FDIC and the State of Utah have annually made trips in recent years to American Express' corporate offices in New York and to our operations centers in Phoenix, AZ, Ft. Lauderdale, FL and Greensboro, NC to examine various aspects of the parent company-affiliate relationship that may have a bearing on AECB's safety and soundness and regulatory compliance.

The FDIC's regulatory approach to ILCs has been successful. No Utah ILC has ever failed. Of the two ILCs that have failed within the last 10 years, the FDIC

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[1] August 29, 2005 Letter from FDIC Chairman Donald Powell to the Government Accountability Office

concluded that both failures were the result of ineffective risk management and poor credit quality.[2] The FDIC noted in the case of Pacific Thrift and Loan, a California ILC, that there is no evidence to show that "an examination of the parent company by a consolidated supervisor would have prevented the failure of this insured institution."[3] The FDIC's record in regulating ILCs has been strong and there is no evidence indicating that their regulatory authority is insufficient. Former Comptroller of the Currency John D. Hawke stated that there is "a virtual total lack of evidence in the U.S. that affiliations between banks and nonbank firms present serious threats to the banking system. [Critics] are very frequently motivated less by philosophy than by a desire to segment markets in order to diminish competition."[4]

Many critics complain that ILCs lack adequate supervision at the parent company level. This concern lacks merit as the facts demonstrate that the vast majority of ILC assets are held by companies who have a consolidated supervisor at the parent company level. The Office of Thrift Supervision supervises holding companies that control approximately 70 percent of the total ILC assets nationwide.[5] (TRS also operates American Express Bank, FSB, (AEB) a wholly owned subsidiary regulated by the OTS. Through its ownership of AEB, TRS and is subject to consolidated supervision by the OTS.) Over 90 percent of Utah's ILC assets are overseen by a federal parent company regulator including either the Board of Governors of the Federal Reserve Board, the Office of Thrift Supervision or the Securities and Exchange Commission.[6] Given the overwhelming percentage of ILC assets subject to consolidated supervision and the sufficiency of the FDIC's supervision, examination and regulation of ILCs, TRS and AECB believe that ILCs do not pose a greater risk to the Deposit Insurance Fund, the safety net or the U.S. financial system. By contrast, ILCs benefit consumers by increasing competition in the U.S. financial services industry and by serving as an additional source of innovation within the financial services industry.

Even in the event that an ILC owner is not subject to consolidated supervision, the FDIC has sufficient authority to examine affiliate relationships to protect the ILC. Former FDIC Chairman Powell stated that "Congress has given us good tools to manage the relationship between parents and insured subsidiaries. . . .indeed the FDIC manages these relationships every day in the industrial loan company model with little or no risk to the deposit insurance funds – and no subsidy transferred to the nonbank parent."[7] In our judgment, the debate over whether ILCs should be subject to greater supervision at the parent company level is misguided. The facts demonstrate that the FDIC has the

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[2] Summer 2004, FDIC Supervisory Insights, Volume 1, Issue 1.
[3] August 29, 2005 Letter from FDIC Chairman Donald Powell to the Government Accountability Office.
[4] *American Banker,* November 17, 2005
[5] July 11, 2006 Letter from OTS Director John M. Reich to the Honorable Spencer Bachus, Chairman of the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services.
[6] July 12, 2006 testimony of Utah Commissioner of Financial Institutions G. Edward Leary before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services.
[7] Remarks of Donald E. Powell before American Bankers Association Annual Meeting, October 8, 2002.

appropriate tools it needs to ensure the safe and sound operation of the depository institution, and it maintains the ability to examine any affiliate of the ILC to determine the health of the bank.

It is also important to understand that the ILC industry remains small in comparison to the overall size of the retail banking industry both in the total number of institutions and total asset size. The 61 ILCs currently in existence represent less than one percent of the total number of insured depository institutions and less than 1.4 percent of the total assets of the banking industry.[8] Further, an analysis of the total insured deposits held by the top five banks as compared to the top five ILCs shows that the top five banks hold in excess of 40 percent of FDIC insured deposits compared to just 2 percent for the top five ILCs.[9]

Given the size of the ILC industry in comparison to the overall banking industry, it is simply inaccurate to suggest that ILCs as a whole pose a greater systemic risk to the Deposit Insurance Fund than other types of banking institutions. Moreover, according to the FDIC's Office of Inspector General, the risks to the Deposit Insurance Fund "are typically related to the type of business lines in which the depository charter is involved rather than the type of charter through which the depository institution is operating."[10] Former FDIC Chairman Powell reiterated this point when he wrote that "it is the FDIC's view that ILC charters pose no greater safety and soundness risk than other charter types."[11]

Most ILCs are typically specialized institutions focusing on discrete financial activities. For instance, many ILCs affiliated with commercial firms offer leasing, real estate lending and other targeted financing programs. ILCs affiliated with financial services parent companies offer tailored products to suit the needs of their customer base including sweep accounts, bridge financing, asset based lending, and credit card products. As a general rule, the activities of the ILC are very specialized and focused in providing products and services that meet a specific consumer demand. Even the Federal Reserve, which has questioned the adequacy of parent company supervision of ILCs, has recognized that parent company supervision should be calibrated to the size of the ILC and the risks it poses to the Deposit Insurance Fund. Accordingly, Former Federal Reserve Chairman Alan Greenspan testified that "the case is weak, in our judgment, for umbrella supervision of a holding company in which the bank is not the dominant unit

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[8] July 12, 2006 testimony of FDIC Acting General Counsel Douglas H. Jones before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services.

[9] FDIC Quarterly Banking Profile; June 2006 quarterly financial information from Bank of America, Citigroup, JPM Chase, Wachovia and Wells Fargo; and June 2006 FDIC Call Reports for American Express Centurion Bank, Fremont Investment & Loan, Merrill Lynch Bank, USA, Morgan Stanley Bank and UBS Bank USA.

[10] September 30, 2004 FDIC Office of Inspector General Evaluation Report entitled "The Division of Supervision and Consumer Protection's Approach for Supervising Limited-Charter Depository Institutions."

[11] April 30, 2003 Letter from FDIC Chairman Donald Powell to Senator Robert F. Bennett.

and is not large enough to induce systemic problems should it fail."[12] As previously mentioned, the largest ILCs are all subject to parent company supervision by the Office of Thrift Supervision because these companies also operate federal savings associations.

It is also useful to dispel some common misperceptions about the mixing of banking and commerce. Critics of the ILC charter often claim that it pierces the longstanding separation between banking and commercial activities. However, specialized financial firms have owned banks for many years without disruption to the financial system. In addition, for a period of more than two decades beginning in the 1970's, retailers (including the then-largest retail companies, Sears, JCPenney and Montgomery Ward) entered and exited the banking industry without harm to the financial system. These companies chartered or acquired credit card banks, so-called "nonbank banks" and industrial loan banks, and used these institutions principally to provide credit cards to consumers. None of these relationships resulted in harm to consumers, competitors, or the deposit insurance system. None of the banks controlled by these retailers was used to establish a network of bank branches. All of these retailers subsequently decided to provide banking services through arrangements with unaffiliated financial institutions, rather than through company-owned banks.

Another common misperception is that ILCs operate under a so-called "loop-hole" in the law. Congress has considered ILCs on a number of occasions and expressly permitted the chartering of new ILCs in certain states. For instance, when Congress passed the Competitive Equality Banking Act of 1987, it expressly granted ILCs an exemption from the Bank Holding Company Act if certain conditions were met. When Congress passed the Gramm-Leach-Bliley Act in 1999 ("GLBA"), it maintained the exemption granted to ILCs and liberalized certain restrictions that had prevented industrial banks from allowing "interday" overdrafts on behalf of affiliates. The fundamental premise behind GLBA was to lift restrictions on affiliations among banking, insurance and security firms, but in so doing, Congress left open the option for companies to charter new ILCs if they so desired.

Based on our analysis, we do not believe there is a credible case that ILCs pose a safety and soundness risk within the banking industry. ILCs serve as an important source of innovation in the financial services industry. Wayne Abernathy, former Assistant Secretary for Financial Institutions at the Department of the Treasury, testified that "I think ILCs are a great example, emblematic of the strength of the constitutional federal system of government that we have. They are emblematic of the kind of variety that we have in financial institutions because of the innovation that our dual banking system allows."[13] ILCs have been a useful model for allowing diversified ownership of limited

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[12] Testimony of Alan Greenspan, Federal Reserve Chairman, before the Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises of the House Committee on Financial Services, 105th Congress, 1997.

[13] March 5, 2003 testimony of the Hon. Wayne Abernathy on the Business Checking Freedom Act of 2003 before the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services.

purpose financial institutions. Moreover, ILCs have addressed specific consumer needs in the financial marketplace, and the availability of the industrial bank charter serves as a competitive force, encouraging innovation and competition in the financial services industry.

TRS and AECB believe a regulatory structure that accommodates diversity is critically important. The ILC charter has been a catalyst in driving innovation in the marketplace, and we oppose efforts to diminish the charter by placing restrictions on who can own a charter or on what activities an ILC could undertake. We believe that the current regulatory authority given to the FDIC is sufficient to adequately oversee the activities of industrial banks, that ILCs do not pose a systemic risk to the Deposit Insurance Fund and that it would be inappropriate to treat ILCs differently solely on the basis of their corporate ownership structure.

Thank you for the opportunity to comment on this important matter.

Sincerely yours,

Paul David Patton
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American Express Travel Related Services Company, Inc.

David E. Poulsen
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