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Merrill Lynch

October 10, 2006

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: Notice and Request for Comment:
Industrial Loan Companies and Industrial Banks

Dear Mr. Feldman:

Merrill Lynch Bank USA, a Utah-chartered industrial bank ("MLBUSA"), the deposits of which are insured by the Federal Deposit Insurance Corporation ("FDIC"), and its parent holding company, Merrill Lynch & Co., Inc. ("Merrill Lynch"), appreciate the opportunity to comment on the Notice and Request For Comment issued by the FDIC relating to Industrial Loan Companies and Industrial Banks, 71 Fed. Reg. 49456-49459 (August 23, 2006) ("Notice"). The Notice requests comments on specific issues relating to the industrial loan company and industrial bank ("ILC") charter, including policy issues related to the types of companies that may own ILCs, potential risks to the FDIC's Deposit Insurance Fund ("DIF"), and emerging concerns over safety and soundness. We understand that the reason for this Notice is to assist the FDIC in determining whether any statutory, regulatory or policy changes should be made or recommended to the FDIC's regulation and supervision of ILCs to protect the FDIC or other "important Congressional objectives."

Executive Summary

MLBUSA and Merrill Lynch are pleased to respond to each of the questions raised by the FDIC in the Notice. As an initial matter, however, we note that Congress addressed the ILC charter almost 20 years ago in the Competitive Equality Banking Act of 1987 ("CEBA"),[1] and concluded that ILCs which were chartered in those states that required the deposits of such institutions to be FDIC-insured, and which complied with certain other restrictions set forth in the Bank Holding Company Act of 1956 ("BHC

[1] P.L. 100-86, 101 Stat. 552 (1987).

Act"), could affiliate with commercial companies not regulated by the Federal Reserve Board. When Congress in 1999 in the context of the Gramm-Leach-Bliley Financial Services Modernization Act ("GLB Act") limited ownership of savings institutions acquired after a grandfather date to entities engaged solely in financial activities, it did not similarly restrict ownership of ILCs. The effect of these provisions is to preserve the ILC industry that has provided needed products and services to the communities and customers it serves. MLBUSA is the largest of those institutions, having been FDIC-insured since October 31, 1988.

Our main points can be summarized as follows:

- **The Federal Deposit Insurance Act ("FDIA") and the FDIC's regulations, along with applicable state law and regulation, have been and continue to be adequate to regulate and supervise the safe and sound operations of ILCs, regardless of size or the type of entity that may own the ILC.** No additional or different regulation over ILCs is needed at this time. While we appreciate the thoughtful and measured approach of the FDIC with respect to the ILC issue, we believe the six-month moratorium on actions relating to the applications filed by ILCs for deposit insurance and notices of change in control should end in a timely manner.

- **The FDIC has existing authority under the FDIA to examine the ILC's parent holding company.** We believe existing law, as it has been applied by the FDIC to MLBUSA, adequately protects the safety and soundness of all ILCs, as well as the DIF.

- **The FDIC has the authority to impose conditions on deposit insurance or other applications or notices submitted by ILCs or entities proposing to acquire ILCs that is adequate to ensure the institution's safe and sound operation and protect the DIF.** In our experience, the FDIC has sufficient statutory and regulatory tools to evaluate applications and condition approvals with one-time or ongoing obligations that protect the ILC and the DIF.

- **Current law restricts tying by ILCs and other conflicts of interest even if the parent company is not a regulated holding company.** Conflicts of interest and tying are not dependent on the nature of the owner of the ILC. Existing federal law, including the restrictions on transactions with affiliates of Sections 23A and 23B of the Federal Reserve Act, the insider loan restrictions of Regulation O, the interlocking director restrictions of the Depository Institution Management Interlocks Act, and the anti-tying provisions of the BHC Act Amendments of 1970, already prohibit illegal conflicts of interest and tying between ILCs and their affiliates, regardless of the type of affiliate involved. We are not aware of complaints of abuses between any existing ILC, its affiliates or their customers.

- **ILCs do not have an unfair competitive business advantage solely because of their affiliation with a diversified parent company.** Depository institutions already face competitive pressures from both financial and non-financial companies for financial products and services. We do not believe that restricting the entities that may be eligible to own or control an ILC will reduce those pressures. And, as noted, existing federal law already prohibits any attempts by a holding company to unlawfully gain a competitive business advantage by, for example, attempting to unlawfully tie products and services, or to provide credit to customers to buy company products in any manner inconsistent with Sections 23A and 23B of the Federal Reserve Act.

The response of MLBUSA and Merrill Lynch to the specific questions raised by the FDIC in the Notice is set forth below.

Responses to the FDIC Questions Raised in the Notice

1. **Have developments in the ILC industry in recent years altered the relative risk profile of ILCs compared to other insured depository institutions? What specific effects have there been on the ILC industry, safety and soundness, risk to the DIF, and other insured depository institutions? What modifications, if any, to its supervisory programs or regulation should the FDIC consider in light of the evolution of the ILC industry?**

The overall deposit base of ILCs has grown substantially since 1987, but there have been numerous changes in bank regulation since then that have applied to ILCs to the same extent as they apply to other banks. Like other insured depository institutions, ILCs are subject to risk-based capital requirements, a leverage capital ratio, the Prompt Corrective Action provisions of the FDIA, enhanced enforcement powers and tools, requirements for more highly developed internal controls and risk-based management policies, and more sophisticated examination procedures. These enhanced supervisory tools are adequate to regulate the safe and sound operation of ILCs even as they have grown, and any risk assumed by the DIF due to the growth of the deposit base.

With the supervisory tools available to it, the FDIC is capable of supervising large ILCs to the same extent that it supervises large state-chartered banks of equal or greater size.[2] In fact, the General Accounting Office last year said that "from an operations standpoint, ILCs do not appear to have a greater risk of failure than other types of depository institutions."[3] Between 1987 and 2004, there were only two failures of ILCs.[4] The two ILC failures involved smaller institutions located in California.

2. Do the risks posed by ILCs to safety and soundness or to the DIF differ based upon whether the owner is a financial entity or a commercial entity? If so, how and why? Should the FDIC apply its supervisory or regulatory authority differently based upon whether the owner is a financial entity or a commercial entity? If so, how should the FDIC determine when an entity is "financial" and in what way should it apply its authority differently?

We believe any risks posed by ILCs to safety and soundness or to the DIF do not differ based on whether the owner of the ILC is a financial entity or a commercial entity. The differences in the types of activities in which the parent company may be engaged do not subject an ILC to a different risk profile so long as the ILC itself is appropriately regulated. This belief is based on the strict regulation of the ILC itself by the relevant state regulator and the FDIC, and the FDIC's authority over the holding company, regardless of whether it is a commercial or financial company. As stated in the Notice, an ILC is subject to the same legal and regulatory restrictions as any state non-member bank.[5] These restrictions include FDIC rules and regulations governing their powers and activities, capital adequacy, liquidity, the restrictions on their ability to undertake transactions with affiliates and other principals (i.e., the affiliate transaction restrictions of Sections 23A and 23B of the Federal Reserve Act, the insider loan restrictions of

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[2] We note in this regard that, while the largest ILC has approximately $54 billion in deposits, some large state-chartered non-member banks supervised by the FDIC have deposits in excess of $85 billion.

[3] Government Accounting Office, *Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority*, GAO-05-621 (Sept. 2005) at 24.

[4] During this time period, there were over 1,200 failures of commercial banks. http://www2.fdic.gov/hsob/HSOBSummaryRpt.asp?BegYear=2004&EndYear=1987&State=1. There have been no bank failures in the United States since June 2004.

[5] 71 Fed. Reg. at 49457.

Regulation O and the interlocking director restrictions of the Depository Institution Management Interlocks Act), the anti-tying provisions of the BHC Act Amendments of 1970, the restrictions placed on an ILC's ability to declare dividends to their parent companies, the Prompt Corrective Action provisions, and consumer protection, the Community Reinvestment Act and fair lending laws and regulations, as well as the laws and regulations relating to privacy and information security.

Furthermore, as the FDIC itself indicates in the Notice,[6] pursuant to 12 U.S.C. § 1820(b)(4), the FDIC has the authority to examine any holding company of an ILC "as may be necessary to disclose fully: (1) the relationship between the institution and any such affiliate, and (2) the effect of the relationship on the institution." The FDIC also has enforcement authority over any company that controls an ILC as an institution-affiliated party. The Prompt Corrective Action provisions of the FDIA also allow the FDIC to require any company that controls an ILC, regardless of whether it is a bank holding company, savings and loan holding company engaged in commerce, or otherwise, to, among other things, (1) guarantee the performance of any undercapitalized ILC in meeting their required plans to regain "adequately capitalized" status and otherwise regain financial stability, and (2) provide appropriate assurances of such performance. 12 U.S.C. §1831o(e)(2)(C). The FDIC can even require the company to divest the ILC, if the ILC becomes undercapitalized, and the FDIC determines that divestiture would improve the ILC's financial condition and future prospects. 12 U.S.C. § 1831o(f)(2)(I).

3. Do the risks posed by ILCs to safety and soundness or to the FDIC differ based on whether the owner is subject to some form of consolidated Federal supervision? If so, how and why? Should the FDIC assess differently the potential risks associated with ILCs owned by companies that (i) are subject to some form of consolidated federal supervision; (ii) are financial in nature but not currently subject to some form of consolidated Federal supervision; or (iii) cannot qualify for some form of consolidated Federal supervision? How and why should the consideration of these factors be affected?

Merrill Lynch is a financial company that is subject to holding company supervision by the Securities and Exchange Commission ("SEC") and the Office of Thrift Supervision ("OTS"). However, we believe any risks posed by ILCs to safety and soundness or to the DIF do not differ based on whether the owner of the ILC is subject to

[6] 71 Fed. Reg. at 49457.

supervision by the SEC, the OTS, the Federal Reserve Board or other "consolidated supervisor," because the FDIC also has extensive supervisory and enforcement powers on its own over the ILC and its holding company to minimize the risk that the ILC itself will encounter financial or supervisory problems. In our case, MLBUSA is examined by the FDIC and the State of Utah, which have undertaken and continue to undertake a thorough analysis of its activities and risk profile. The FDIC also has requested information, as deemed necessary, from Merrill Lynch as the holding company for MLBUSA, and the FDIC has been provided access to the requested information.

In short, given the substantial supervisory and enforcement resources available to the FDIC to supervise ILCs and their holding companies, we believe that no change in the authority given the FDIC to undertake that regulation or supervision over ILCs and their holding companies is necessary or appropriate at this time.

4. What features or aspects of a parent of an ILC (not already discussed in Questions 2 and 3) should affect the FDIC's evaluation of applications for deposit insurance or other notices or applications? What would be the basis for the FDIC to consider those features or aspects?

In our view, the FDIC should continue to evaluate applications relating to ILCs as it currently does, on a case-by-case basis, taking into consideration the statutory factors set forth in the FDIA. As discussed further in the response to Question 5, in making this evaluation, the FDIC already has the authority to evaluate (1) the activities and structure of the parent holding company, (2) any proposed relationships with its subsidiary ILC, and (3) the proposed control and oversight over the ILC, in each case to determine whether the overall structure would pose an undue risk to the DIF. As discussed in the response to Question 5, the FDIC also evaluates if the holding company has the financial and managerial resources to support the institution. We believe that the FDIC's exercise of this authority over ILCs is sufficient at this time.

Once an ILC is operating, as noted in the responses to Questions 2 and 3, the FDIC also has the right to and does review and examine the ILC's parent, on a case-by-case basis, to determine if any risks to the ILC or the DIF are posed by the activities of the parent.

5. The FDIC must consider certain statutory factors when evaluating an application for deposit insurance (see 12 U.S.C. 1818) and certain largely similar statutory factors when evaluating a change in control notice (see 12

U.S.C. 1817(j)(7)). Are these the only factors the FDIC may consider in making such evaluations? Should the consideration of these factors be affected based on the nature of the ILC's proposed owner? Where an ILC is to be owned by a company that is not subject to some form of consolidated Federal supervision, how would the consideration of these factors be affected?

In our experience, the statutory factors required to be reviewed by the FDIC as part of the application process provide for a comprehensive review and allow the FDIC to evaluate virtually all the activities, policies, procedures, capabilities and flaws of the ILC and its proposed holding company during the review process. [7]

For example, in deposit insurance applications, the FDIC must evaluate the activities, structure and control of the parent holding company to determine if the holding company has the financial and managerial resources to support the institution. See, e.g., FDIC Policy Statement on Applications for Federal Deposit Insurance, at page 2. In undertaking that evaluation, the FDIC can conduct examinations and other investigations to determine if the proposal meets the statutory factors in a manner consistent with approval. As the Notice indicates, the FDIC also considers the complexity and risk of the proposal, and the relationships with affiliated entities, including the parent company.[8] In undertaking this review, we understand that the FDIC evaluates the company's adherence to, or willingness to comply with industry-wide information security measures, Bank Secrecy Act compliance, and affiliate transaction restrictions. The FDIC also reviews capital and ownership structures within a corporate group to ensure that capital can be

[7] For example, as the Notice indicates, in considering applications for federal deposit insurance, the FDIC must evaluate the following factors:

- The financial history and condition of the depository institution;
- The adequacy of its capital structure;
- The future earnings prospects of the institution;
- The general character and fitness of its management;
- The risk presented by the institution to the FDIC insurance fund;
- The convenience and needs of the community to be served; and
- Whether the corporate powers are consistent with the purposes of the FDIA.

12 U.S.C. § 1816. Similar factors are required to be assessed in connection with changes in control notices or merger applications. See 12 U.S.C. §§ 1817(j); 1828(c).

[8] 71 Fed. Reg. at 49457.

raised easily in times of economic stress. If the FDIC believes that circumstances warrant, it has the power to condition approval of the application on the ILC or its holding company meeting certain conditions either on a one-time or a continuing basis. We understand that these conditions can include maintaining certain capital levels, restructuring a proposed capital structure, restricting dividend payments, replacing management, restricting asset growth, and restricting the ILC's activities to those specifically set forth in the institution's business plan.

We believe this authority is adequate at this time to ensure the safe and sound operation of the ILC and proper support from its holding company. Each application should be evaluated on its own merits and no particular set of restrictions should apply to ILCs as a group merely because of their charter or their ownership structure. A particular application may require a particular condition while another application would not. Such case-by-case flexibility in our view is the best way to adequately protect the safe and sound operation of ILCs as well as the DIF.

6. **Should the FDIC routinely place certain restrictions or requirements on all or certain categories of ILCs that would not necessarily be imposed on other institutions (for example, on the institution's growth, ability to establish branches and other offices, ability to implement changes in the business plan or capital maintenance obligations)? If so, which restrictions or requirements should be imposed and why? Should the FDIC routinely place different restrictions or requirements on ILCs based on whether they are owned by commercial companies or companies not subject to some form of consolidated Federal supervision? If such conditions are believed appropriate, should the FDIC seek to establish the underlying requirements and restrictions through a regulation rather than relying upon conditions imposed in the order approving deposit insurance?**

As noted in the response to Question 5, the FDIC should not place special requirements or restrictions on one or more categories of ILCs merely because of the charter or because of the type of company that owns the ILC. Each ILC application should be reviewed on its own merits, and the approval order tailored to address whatever concerns are raised by that particular application. Such case-by-case flexibility, in our view, is the best way to adequately protect the safe and sound operation of ILCs as well as the DIF.

7. Can there be conditions or regulations imposed on deposit insurance applications or changes of control of ILCs that are adequate to protect an ILC from any risks to safety and soundness or to the DIF that exist if an ILC is owned by a financial company or a commercial company? In the interests of safety and soundness, should the FDIC consider limiting ownership of ILCs to financial companies?

As noted in the responses to Questions 5 and 6, the FDIC has the authority under current law and regulation to impose conditions in individual approval orders that are adequate to protect an ILC from any risks to safety and soundness or to the DIF. Such conditions should be based on the particular facts of each application or notice filed by the ILC, rather than on the type of entity that may own the ILC.

8. If there a greater likelihood that conflicts of interest or tying between an ILC, its parent, and affiliates will occur if the ILC parent is a commercial company or a company not subject to some form of consolidated Federal supervision? If so, please describe these conflicts of interest or tying and indicate whether or to what extent such conflicts of interest or tying are controllable under current laws and regulations. What regulatory or supervisory steps can reduce or eliminate such risks. Does the FDIC have authority to address such risk in acting on applications and notices? What additional regulatory or supervisor authority would help reduce or eliminate such risks?

In our view, there is no greater likelihood that conflicts of interest or illegal tying between an ILC, its parent or any affiliates will occur merely because the ILC parent is a commercial company or not subject to some form of consolidated Federal supervision. Existing federal law, including the restrictions on transactions with affiliates of Sections 23A and 23B of the Federal Reserve Act, the insider loan restrictions of Regulation O, the interlocking director restrictions of the Depository Institution Management Interlocks Act, and the anti-tying provisions of the BHC Act Amendments of 1970, already prohibit illegal conflicts of interest and tying between ILCs and their affiliates, regardless of the type of affiliate involved. We are not aware of complaints of such abuses between any existing ILC, its affiliates, or their customers. If any were to occur, the FDIC has existing supervisory and enforcement authority to stop these practices and impose penalties on those who violate these laws. Private parties also may bring actions for violations of the anti-tying laws.

9. Do ILCs owned by commercial entities have a competitive advantage over other insured depository institutions? If so, what factors account for that advantage? To what extent can or should the FDIC consider this competitive environment in acting on applications and notices? Can those elements be addressed through supervisory processes or regulatory authority? If so, how?

We believe the fact that an ILC is affiliated with a commercial company does not, by itself, provide any unfair competitive advantage to the ILC subsidiary over other depository institutions. Depository institutions already are subject to competition from other depository institutions, regardless of charter or size, or specialty, as well as from a host of non-banks, including mortgage companies, finance companies, insurance companies, securities companies and credit unions. Depository institutions also already face pressures from alliances between retailers or other commercial entities and financial services companies, for products and services such as co-branded and affinity credit cards, auto financing, or branch banking in retail stores. We do not believe that competition from an ILC owned by a diversified company poses any materially different competitive pressures than the pressures institutions already face from these other entities and alliances.[9]

Furthermore, as noted in the response to Question 8, existing federal law already would restrict any attempts by a holding company to unlawfully tie products and services or to provide credit to customers to buy company products in any manner inconsistent with Sections 23A and 23B of the Federal Reserve Act.

10. Are there potential public benefits when a bank is affiliated with a commercial concern? Could those benefits include, for example, providing greater access to banking services for consumers? To what extent can or should the FDIC consider those benefits if they exist?

ILCs can provide public benefits regardless of ownership. MLBUSA provides substantial community development support in several communities. Increasing the number of ILCs, regardless of ownership, increases the number of depository institutions offering financial services to the public, thus allowing healthy competition for products.

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[9] As the Notice indicates, there are only 61 ILCs operating in the U.S. and several only offer niche products and services to a narrow client base. 71 Fed. Reg. at 49457.

We believe that the retention or creation of any active market for financial services benefits the public because it increases the availability of products and services at lower cost, compared to less competitive markets.

11. In addition to the information requested by the above questions, are there other issues or facts that the FDIC should consider that might assist the FDIC in determining whether statutory, regulatory, or policy changes should be made in the FDIC's oversight of ILCs?

We do not have other issues or facts for the FDIC to consider with respect to the ILC charter other than those already set forth in this letter.

12. Given that Congress has expressly excepted owners of ILCs from consolidated bank holding company regulation under the Bank Holding Company Act, what are the limits on the FDIC's authority to impose such regulation absent further Congressional action?

Congress reviewed the ILC structure in detail in 1987 and determined that no consolidated regulation is necessary over the parent companies of those ILCs that limit their activities as set forth in the BHC Act. That determination was not altered in connection with the enactment of the GLB Act. Moreover, as noted in the response to Question 2, the FDIC has the authority to examine the parent of the ILC to the extent that parent affects the ILC. The FDIC has exercised that power over Merrill Lynch to promote the safe and sound operation of MLBUSA and the protection of the DIF. In our experience, the FDIC more than adequately regulates ILCs and its affiliates.

Conclusion

In light of the foregoing, we believe that no change in the statutory or regulatory framework for the regulation or supervision of ILCs by the FDIC is required at this time. The Notice and the questions to which we have responded highlight the lack of evidence of any real supervisory issues relating to ILCs. In light of the lack of any such issues, we believe the FDIC should continue to regulate, supervise and examine ILCs as it has in the past. The regulation and supervision, of course, can continue to evolve within the existing legal framework. In addition, the six-month moratorium on actions relating to the applications filed by ILCs for deposit insurance and notices of change in control should end in a timely manner.

MLBUSA and Merrill Lynch greatly appreciate this opportunity to comment on the Notice. If you have any questions or would like to discuss our comments with you in further detail, please contact the undersigned at (801) 526-5304.

Sincerely,

Preston P. Jackson