October 5, 2006

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

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

Dear Mr. Feldman:

On behalf of the Colorado Bankers Association, I am pleased to respond to the FDIC's request for comments regarding industrial loan companies and industrial banks published in the Federal Register. The CBA is the general trade association for the banking industry in Colorado. Our diverse membership includes literally the largest and the smallest banks in Colorado, as well as urban and rural ones, national banks as well as state chartered ones, and those with one location and those with numerous branches. Colorado has substantial experience with industrial loan companies and industrial banks ("ILCs"); there were 154 industrial banks in this state at one time. Today, there are four. The first ILC insured by the FDIC was in Colorado. FDIC did not elect to provide coverage; it was required as a result of the ILC joining the Federal Reserve. In addition to the many changes we've seen in Colorado in the status, health, and number of ILCs, we have enacted needed legal changes. In 2003, Colorado law was modified to preclude ownership of ILCs here except by financial holding companies (federal definition) and to preclude interstate branching into Colorado except by institutions owned by financial holding companies. These measures do not remove our concern about ILCs in general, and therefore we submit these comments.

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, risks to the Deposit Insurance Fund, and other insured depository institutions? What modifications, if any, to its supervisory programs or regulations should the FDIC consider in light of the evolution of the ILC industry?

RESPONSE: We believe the risk to FDIC's Deposit Insurance Fund is in the lack of regulatory authority to deal with risks as they arise. FDIC administers the Deposit Insurance Fund for the public good, and protection of it is FDIC's highest priority. The needed supervisory framework exists for ILCs owned by financial holding companies. It does not exist for ILCs owned by entities other than financial holding companies. The ILC loophole constitutes a means of evading compliance with the decades-old federal policy of prohibiting the mixing of banking and commerce. It also is a means of avoiding the needed regulatory supervision of affiliate activities of these companies. Insuring entities without adequate supervisory authority is inconsistent with FDIC's responsibility. A basic premise of banking is regulation of the risk. The regulation of the risk – including in this case to the FDIC itself – is not present with ILCs owned by companies other than financial holding companies.

While some argue FDIC can supervise these related activities, we rely upon the GAO report that concluded FDIC's consolidated supervision authority is limited to a particular set of circumstances and may not be used at all times. GAO further stated that FDIC's authority has not been tested by a large ILC parent during times of economic stress.

In brief, it is irrelevant to discuss current ILC risks to the fund. The issue is that many activities of insured financial institutions pose some degree of risk to the fund from time to time as circumstances in the institution and the outside world change. The danger is in the FDIC not possessing the necessary regulatory powers to address those risks from time to time.

Modification to FDIC's authority is not the issue. Closing the ILC loophole is the issue. We understand that takes Congressional action. Congressional action also is necessary to grant additional regulatory authority to FDIC to deal with risks posed to the fund by unregulated risk. FDIC would not tolerate an insured institution exposing the institution's capital to risk it cannot manage. Specifically, FDIC would not approve a high risk transaction if it was an FDIC insured bank seeking to move into commerce, so FDIC should not approve itself engaging in unmanaged risk. That is exactly the situation that FDIC itself would be in by approving additional ILCs which FDIC lacks the authority to regulate thoroughly, thus exposing the fund to unmanaged risk.

We recognize closing the loophole is not FDIC's role, but FDIC should not aid and abet adding such risk to the fund, the protection of which is FDIC's highest duty.

2. Do the risks posed by ILCs to safety and soundness or to the Deposit Insurance Fund 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?

RESPONSE: Differences between financial entities and commercial entities are important. A basic tenet is that financial entities are highly regulated, and serve the public in a tightly controlled environment. They are reviewed on a regular basis and the safety and soundness of the financial institutions are measured by an oversight agency with experience in the financial area. Commercial entities are not highly regulated and normally do not have the oversight associated with financial institutions nor are they subject to regular audits as to the safety and soundness of their practices. To have different classes of businesses (one highly regulated, the other not) engaged in the same business makes no sense.

All risks to the fund need to be managed or regulated, regardless of source. The source is irrelevant but it has to be noted that some sources of risk to the fund are beyond FDIC supervision. FDIC cannot apply its authority in a different manner for institutions basically doing the same business since according to the GAO and others it lacks that authority which only Congress may grant.

FDIC can't expand ILC coverage without exposing the fund to unregulated risk. FDIC has a choice:

It can either protect the fund by denying more ILC coverage, or it can extend that coverage and expose the fund to risk it cannot manage. FDIC's highest duty is to protection of the fund. To us the choice is obvious. FDIC must protect the fund, and leave it to Congress – and to Congress alone – to stipulate that it is appropriate to insure this unmanaged risk or in the alternative to grant the authority to manage it.

3. Do the risks posed by ILCs to safety and soundness or to the Deposit Insurance Fund 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?

RESPONSE: See above responses.

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?

RESPONSE: While we cannot suggest how you accomplish this, it is nonetheless important that FDIC consider the nature and scope of activities of the parent. For example, within recent memory we have witnessed the substantial change of fortune of such American business giants as Sears, K-Mart, Ford, Enron, various airlines and others. Banking is heavily regulated to protect the public from the losses experienced by shareholders of such companies. That is why bank regulators need to possess the requisite supervisory tools to deal with market risks of insured entities in order to protect depositors and our financial system, not to protect shareholders.

The long held belief that commerce and finance should be separate for the health and safety of the economy is sound. Financial institutions have strict oversight and regulations. Commercial organizations have an entirely different environment; this would appear to put them at odds with operating a banking organization. It is unthinkable to allow a commercially owned ILC the ability to withhold credit or capital from a business they feel is a strong competitor. It is a monopolistic practice. Separation of these activities is basic and should be maintained.

The basis for FDIC actions is FDIC's ultimate duty: protection of the fund.

5. The FDIC must consider certain statutory factors when evaluating an application for deposit insurance (see 12 U.S.C. 1816), 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 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?

RESPONSE: The risk presented by such depository institution to the fund (Factor #5) is the paramount one that addresses systemic risk. We believe that regulators have the authority to manage that risk for all insured institutions, except for the lack of such oversight for ILCs not owned by financial holding companies.

Just as FDIC should not insure an institution with unreasonable risk (although meeting all other criteria), it should not insure a kind of institution over which it lacks appropriate regulatory oversight even when that kind of institution meets all other criteria.

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?

RESPONSE: While FDIC can condition an activity with good result for foreseeable events, FDIC cannot assure Congress, the public and other insured institutions that it can foresee all circumstances and that conditional action would be upheld in court in all cases. Modifying regulation or placing restrictions does not address all the possible ramifications.

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 Deposit Insurance Fund that exist if an ILC is owned by a financial company or a commercial company? In the interest of safety and soundness, should the FDIC consider limiting ownership of ILCs to financial companies?

RESPONSE: Absolutely yes. FDIC should limit insurance to ILCs owned by financial holding companies. As we stated in the preamble, Colorado in 2003 limited ownership of ILCs based upon the requirement of ownership by financial holding companies.

8 Is 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 those 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 risks in acting on applications and notices? What additional regulatory or supervisory authority would help reduce or eliminate such risks?

RESPONSE: We believe there is both a greater likelihood of such conflicts and – equally important – the likelihood of the appearance of such conflicts. Minimizing both are important to maintaining public confidence. We could provide pages of commentary about the forms such conflicts could take, but let it suffice to say that with today’s focus on privacy (especially including financial matters) possession of financial information about consumers’ assets, income, spending patterns and otherwise personal information. held by one entity pose a variety of unresolved social and legal issues. There certainly is great risk in tying banking services to retail product utilization, which clearly would create an unfair situation for the consumer and provide an advantage over other banks which would be difficult to address given the lack of a clear regulator.

We know of no laws that apply to the situations that would arise with a commercial company (including the largest company in the world) also having detailed financial information on consumers and on business competitors that could be forced to come to it as a source of credit. Those laws don't exist because this activity is not authorized in the U.S. other than if allowed through the dangerous and unwise use of the ILC loophole.

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?

RESPONSE: A competitive advantage would exist in the form of data on consumer buying habits, assets and income, and a dominant retail presence. We don't believe those can be addressed by regulation. We believe these factors are the basis for the federal policy precluding mixing of banking and commerce.

There is the potential for less public benefit by having large commercial firms owning banks. For a large commercial firm, banking is not their primary business. Unlike financial institutions which rely on a reasonable margin from this core business to support the company's stock value, to a large commercial firm this is simply a side business. Consequently, it could treat banking as a loss leader to attract business to stores, thereby driving community banks from their neighborhoods and leaving the community and its businesses and consumers with limited or no banking options. This damages the competitors, the competitive environment, and the businesses and consumers needing financial services.

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?

RESPONSE: Benefits to the public such as greater access to banking services can be provided by third party arrangement with banks not owned by the commercial company, as is a common practice now. This current arrangement not only provides those benefits referenced by FDIC, but avoids the many pitfalls we've discussed above of common ownership.

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?

RESPONSE: We believe that our responses above address the other issues that FDIC should consider.

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?

RESPONSE: We believe that in general it does take Congressional action. Until that authority is granted, we do not believe the FDIC should insure an unmanaged risk by insuring such institutions.

Sincerely,

Don Childears