Retail Industry Leaders Association's Public Comments in Response to Federal Deposit Insurance Corporation's Notice and Request for Comment Regarding Industrial Loan Companies and Industrial Banks

The Retail Industry Leaders Association ("RILA") and its members respectfully submit their responses to the Federal Deposit Insurance Corporation's ("FDIC") Notice and Request for Comment on industrial loan companies and industrial banks (collectively referred to as "ILCs"). 71 Fed. Reg. 49,456 (August 23, 2006).

ILCs represent some of the most secure and well-funded financial entities in the banking industry today. ILCs increase competition by providing innovative banking products and services to meet emerging financial demands in a quickly-evolving global marketplace. Also, the federal and state regulatory schemes already in place for ILCs ensure that they abide by the existing law, comply with restrictions on transactions with affiliates and anti-tying provisions, serve and protect the public interest, and meet FDIC governance standards. This regulatory oversight includes FDIC's enforcement authority over ILCs, with the ability to levy stiff penalties for regulatory violations and impose conditions on bank charter applications.

RILA and its members request that FDIC carefully consider the facts regarding ILCs, refrain from imposing unnecessary, redundant, or burdensome regulations that would stifle competition, and allow ILCs to continue to provide innovative products and services in the financial marketplace.

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?

As noted just last year by the General Accounting Office ("GAO"), ILCs pose no greater risk than other types of banks from an operational perspective. *Industrial Loan Corporations Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority*, General Accounting Office, Report to Honorable James A. Leach, House of Representatives, GAO-05-621, at 5 (September 2005), *available at* http://www.gao.gov/new.items/d05621.pdf. In the same report, former FDIC Chairman Donald E. Powell stated that the existing ILC regulatory scheme "is a proven model for protecting the deposit insurance funds, and no additional layer of consolidated federal supervision is necessary." *Id.* at 82. Even more recently, the acting general counsel for the FDIC voiced similar conclusions, stating that ILCs "have a good safety and soundness track record to date." *ILCs—A Review of Charter, Ownership, and Supervision Issues: Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the House Comm. on Financial Services*, 109th Cong. (July 12, 2006) (Prepared

Statement of Douglas H. Jones), *available at* http://financialservices.house.gov/media/pdf/071206dhj.pdf.

Consistent with this conclusion by the GAO as well as former and current FDIC officials, RILA and its members believe that no modification of the existing FDIC supervisory programs or regulations are needed because the existing regulatory scheme ensures that ILCs operate within the law and protect the Deposit Insurance Fund and the public. Like any other banks, ILCs are subject to the FDIC Rules and Regulations, including standards for capital assets and standards for operations. In particular, Sections 325 and 326 of the Federal Reserve Act, together with the anti-tying provisions of the Bank Holding Company Act, guard against any potential for abuse. Also, ILC management falls under the purview of the FDIC and may be held responsible for compliance with federal and state regulations. In fact, according to Mr. Jones, four of the largest ILCs are under daily supervision.

The FDIC also has the authority to investigate affiliate relationships, and the FDIC may share information with other regulatory agencies, such as the Securities and Exchange Commission. FDIC and state regulators can take a variety of actions to investigate and penalize ILCs, including limiting transactions with affiliates, examining all affiliates that control or engage in transactions with the ILC, requiring production of information on any affiliate, issuing cease and desist orders with the force of law, banning any affiliate from further involvement, and taking possession of bank to liquidate or merge it. In addition, when the FDIC reviews an ILC charter application, it may impose conditions and operating standards on the ILC and its parent to protect the federal depository insurance fund and consumers.

Finally, the most important metric in assessing the overall risk profile for ILCs, like any other bank, is the failure rate. In this regard, it is important to note that many of the commercial firms that already hold ILC charters consist of multi-billion dollar corporations using their banks to build their businesses, innovate, and reduce costs in an intensely competitive global marketplace, including Target, General Electric, Toyota, and Harley Davidson. Not surprisingly, RILA has been unable to find any ILC failure owned by a commercial firm.

For the foregoing reasons, RILA and its members find the existing ILC regulatory scheme more than adequate. In addition to the fact that no non-financial ILC has failed, both the FDIC and GAO regard ILCs, under the current regulatory scheme, as posing no greater danger than any other type of bank.

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?

While the current regulatory schemes appear to provide adequate oversight with respect to all ILCs, history suggests that those owned by commercial entities pose the least risk. As previously stated, RILA has been unable to find a recorded failure of an ILC owned by a commercial firm. Moreover, of the ILC failures recorded between 1985 and 2003, according to "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," most were small finance companies that made high risk, high interest loans, which contributed to their demise during the Savings and Loan crisis of the late 1980s and early 1990s. Together, those banks held assets of a mere $23 million. Standing in stark contrast to those earlier, under-funded banks, commercially owned ILCs are usually organized for internal business operations only and are well-funded by financial strong parent companies. For example, Target alone has annual sales exceeding $52 billion and General Electric generates annual revenue of more than $149 billion. The financial strength of such commercial parents of ILCs provides financial security that can be matched only by the largest bank holding companies.

Accordingly, non-financial ownership of an ILC should not affect the applicable regulatory scheme but should be seen as a positive factor in the safety and security of the bank and be encouraged to help American companies compete and innovate in the global marketplace.

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?

The FDIC has stated that "[s]trategies to monitor and control a bank's relationship with affiliated and controlling entities are fundamental to effective bank supervision under any organizational form that banks adopt." As previously set forth, ILCs owned by commercial firms are subject to comprehensive regulatory oversight. While the non-financial parent is not subject to traditional umbrella regulatory oversight like other banks, the FDIC may share information with other agencies, including the Securities and Exchange Commission. Further, the FDIC retains authority to examine an ILC's transactions with its parent and affiliates, and the ILC management remains subject to FDIC supervision and inquiry.

In addition, just like any other bank, ILCs are subject to increasingly onerous penalties if their capitalization falls below acceptable levels pursuant to the Prompt Corrective Act provisions of the Federal Deposit Insurance Act. Moreover, when reviewing an ILC charter application, the FDIC could review the regulatory scheme covering the ILC and its parent and impose reasonable restrictions and conditions to rectify any potential gaps in supervisory authority.

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?

RILA and its members believe that the existing factors already set forth in Sections 5 and 6 of the Federal Deposit Insurance Act, Sections 303.20-25 of the FDIC Rules and Regulations, and the FDIC Statement of Policy on Applications for Deposit Insurance provide effective evaluation of the charter application. Those factors include financial history and condition, capitalization, future earning prospects, and general character and fitness of the management. In addition, an ILC's board of directors must be competent and experienced, and a majority of the board must be independent of the bank and its parent.

Much like the applicable regulations for evaluation of ILC charter applications, RILA and its members also believe that the existing regulations for evaluating change of bank ownership provided by Section 7 of the Federal Deposit Insurance Act and Sections 303.80-86 of the FDIC Rules and Regulations provide effective regulatory oversight. Those factors include whether the proposed acquisition would result in a monopoly or lessen competition, the financial condition of the acquiring entity, and the competency and experience of the acquiring entity's management team.

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?

RILA and its members refer the FDIC to their response to Question 4.

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 previously stated, RILA and its members believe that imposing restrictions because of commercial ownership of an ILC is inappropriate because ILCs owned by non-financial firms are safe, well-funded, and subject to a comprehensive regulatory scheme.

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?

RILA and its members refer the FDIC to their response to Question 6.

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?

RILA and its members do not believe that non-financial ownership of ILCs presents any greater risk of conflicts of interest or tying than any other type of bank. The existing regulatory scheme, including the applicable provisions of the Federal Reserve Act, the Bank Holding Company Act, and other statutes governing transactions between ILCs and their affiliates and parents. Safety and soundness is further promoted because an ILC owner must fully collateralize those transactions without recourse. Also, when examining bank charter applications or a proposed change of ownership, the FDIC scrutinizes, among many other factors, business plans and management competency and experience. Accordingly, no additional regulations or supervisory measures are necessary.

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?

Rather than seeking to compete with other banks, many of the commercial entities that currently operate ILCs or are currently engaged in the application process for an ILC charter undertake such ventures to assist their core businesses in operating more competitively and efficiently in their respective non-financial markets. For example, the ability of a large retailer to process credit card transactions internally as opposed to paying external banks to perform the same function translates into considerable cost savings for that retailer, which in turn can be passed on to the retailer's customers.

Moreover, businesses must continually innovate in order to survive, especially our member retailers. These companies constantly strive to find novel ways to return value to the consumer to retain their patronage. Our members value their freedom to experiment with new business methods and processes, and they have created tremendous value for the American consumer. ILC charters are an important part of their strategy to innovate and remain competitive by providing increasingly better value for their customers.

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?

As described in our response to Question 9, RILA and its members see many advantages to consumers through non-financial ownership of an ILC. First, in an intensely competitive economy, corporations that can cut costs will pass those savings on to their customers, increase revenue, and build value for their shareholders. In addition, ILCs represent innovation that increases competition for commercial banking services. Such competition, in turn, brings lower costs, greater efficiency, and higher quality services and products.

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?

RILA and its members believe that commercially owned ILCs are secure and well-funded, are subject to a comprehensive regulatory scheme, and play an important role in our members' innovation strategy. RILA and its members, however, stand ready to assist the FDIC should it need more information or facts on this subject in the future.

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?

While the FDIC cannot impose blanket restrictions on an ILC merely based on its parents' business activities without additional Congressional mandate, the FDIC may and already does place restrictions on owners and affiliates of ILCs on an individual basis. The FDIC can accomplish this by imposing conditions on applications approval and examination recommendations. In addition, the FDIC may also restrict ILC parents and affiliates to serve the needs of the public, such as restricting branching, transactions, or other operations.