October 6, 2006

Via E-Mail and Regular Mail

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

Re: Comments on Issues Related to Industrial Loan Companies

Dear Mr. Feldman:

This letter contains the comments of Fireside Bank ("Fireside"), an industrial bank headquartered in the State of California, in response to the Federal Deposit Insurance Corporation's (the "FDIC's") notice and request for comments on specific issues related to industrial loan companies and industrial banks (collectively, "ILCs"). The notice and request for comments was published in the *Federal Register* on August 23, 2006.

1. Background Regarding Fireside

Not all ILCs fit the same mold. While the ILCs generating the greatest amount of attention in the trade press have been formed for the sole purpose of providing financial services to the customers of the ILC's parent or affiliated companies, there are some ILCs that operate as traditional banking institutions. Fireside has always operated as a traditional banking institution, and it would therefore be useful to provide a brief description of its history and business.

Unlike many of the more recent arrivals in the ILC industry, Fireside has been an ILC for 53 years. The company has been a member of the FDIC since 1984. In 1968, Fireside was purchased by Teledyne Inc., and in 1990 became part of Unitrin, Inc., a spin off of Teledyne. Unitrin, a publicly traded company, specializes in property and casualty insurance, life and health insurance, and consumer finance for individuals and families.

Since the beginning of its operations, Fireside has been a financial institution that provides credit to working people, many of whom do not have access to credit from traditional banking institutions. Today, Fireside has a remarkably simple business operation – it accepts time deposits and provides financing for motor vehicles. Thus, Fireside has a traditional, albeit specialized, banking business. This business has been consistently successful and today Fireside has assets in excess of $1.3 Billion.

Fireside operates independently of its parent and affiliated companies. Unlike many ILCs, Fireside finances its own operations, does *not* provide financial services to the customers of its parent or affiliates, does *not* receive referrals of customers from its parent or affiliates, and does *not* have an integrated business operation with its parent or affiliates. In short, Fireside functions as a stand alone business and should be regulated accordingly.

2. FDIC Question #1: Have developments in the ILC industry in recent years altered the relative risk profile of ILCs compared to other 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?

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By a letter to the U.S. General Accounting Office ("GAO") dated August 29, 2005 (the "FDIC Letter"), then FDIC Chairman Donald E. Powell concurred with the GAO's finding that "from an operations standpoint, industrial loan corporations (ILCs) do not appear to have a greater risk of failure than other insured depository institutions." Chairman Powell also concluded that consolidated supervision is "unnecessary from a safety and soundness perspective, and would inappropriately change the relationship between the federal banking agencies and the non-bank sector of the U.S. economy." He noted the FDIC's "excellent track record" in supervising ILCs with its existing supervisory tools, such as the Federal Deposit Insurance Act, Sections 23A and 23B of the Federal Reserve Act, and the Prompt Corrective Action provisions of the FDIC Improvement Act. Chairman Powell observed that the FDIC "has always been able to exercise its examination authority broadly enough to fulfill its supervisory duty."

Fireside believes that Chairman Powell got it exactly right – the existing supervisory tools held by the FDIC allow it to fully supervise ILCs, and the FDIC has an excellent track record in doing so. In the little more than one year that has passed since Chairman Powell issued the FDIC Letter, there have been no developments in the ILC industry that have altered the risk profile of that industry. That being the case, Fireside submits that no modifications of the FDIC's supervisory programs or regulations are necessary.

There may be a temptation to change the FDIC's regulatory tools even in the absence of compelling – or, indeed, any – evidence that it is necessary to do so. Fireside notes that the GAO report to which the FDIC Letter responded recommended a change toward consolidated supervision of ILC parent companies notwithstanding the absence of any finding of increased risk in the ILC industry. Chairman Powell wisely concluded that this was not necessary. Little more than one year later, the FDIC once again should resist the temptation to effect changes in the absence of necessity.

Fireside believes that any proposed changes to the regulatory process for ILCs should be based on concrete evidence, not speculation or the publicity surrounding the FDIC insurance applications of a handful of large commercial firms. In this regard, it would be appropriate to compare the measurable risks posed by ILCs with those posed by commercial banks and savings institutions. For example, a comparison should be made of the number of failed FDIC-insured ILCs versus the number of failed insured commercial banks and savings institutions over the past 20 years, the amount of assets held by the failed institutions, and the ultimate cost to the federal deposit insurance funds. It would also be useful to compare the risks posed by ILCs versus commercial banks and savings institutions at the present time, such as by comparing the relative capital levels, interest rate risk, and other measurable risks of each type of institution and the relative number of enforcement actions brought against each type of institution. Only by using concrete measurements of risk can it be determined if changes are needed in the supervisory process for the ILC industry. Although Fireside does not have the resources to undertake an empirical study of these risks, we suspect that any such study will corroborate the GAO's and Chairman Powell's finding that ILCs "do not appear to have a greater risk of failure than other insured depository institutions."

3. **FDIC Question #2: Do the risks posed by ILCs to safety and soundness or to the Deposit Insurance Fund differ based on 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?**

Fireside believes that the risks to the FDIC insurance fund depend on the fundamental characteristics of each insured institution and the quality of its management, not on whether its parent company is a financial or commercial entity. There are both financial and commercial entities that pose no risk to the insurance fund, just as there are both financial and commercial entities that can, in some cases, pose

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significant risks to the insurance fund. As more fully discussed in the response to Question #1 above, any changes made to the regulatory process should be based on concrete evidence, not speculation.

The ILC industry is already subject to comprehensive regulation in every aspect of its business. To take but a few examples, Sections 23A and 23B of the Federal Reserve Act regulate affiliate transactions, Regulation O regulates insider lending, the anti-tying rules imposed on ILCs prohibit the tying of ILC and affiliate products, the federal compliance laws (*e.g.,* Truth-in-Lending Act, Truth-in-Savings Act, Real Estate Settlement Procedures Act, Home Mortgage Disclosure Act, Equal Credit Opportunity Act and other fair lending laws, Homeowners Protection Act, Electronic Fund Transfer Act, Fair Credit Reporting Act, flood hazard laws, privacy laws, insurance and securities sale protections, and the recently issued guidance on nontraditional mortgage loans) protect consumers, and the regulatory capital rules require ILCs to maintain appropriate levels of capital. The FDIC's examination process is rigorous and risk-based. The supervisory and enforcement tools provided by the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA") and the FDIC Improvement Act provide the FDIC with every imaginable tool to supervise ILCs and to take enforcement action against them and their institution-affiliated parties. Moreover, the tools currently held by the FDIC are flexible enough to tailor the FDIC's regulatory approach to the unique circumstances and needs of each ILC.

The proof of the flexibility and, indeed, the genius, of the current system is evidenced by the track record of the past 15 years. There have been relatively few insured institution failures since the post-FIRREA era. Insured institutions have weathered downturns in the economy, and have even thrived during those downturns, in sharp contrast with the state of affairs before FIRREA. In short, regardless of whether an ILC is held by a financial entity or a commercial entity, the FDIC has the tools it requires to regulate and supervise the ILC industry, to get the information it needs, and to take appropriate enforcement actions.

4. **FDIC Question #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 Letter contains an excellent analysis of this issue. Chairman Powell rejected the suggestion that consolidated supervision is necessary or that it will reduce the risk of the ILC industry: "The core of each banking agency's statutory mandate for supervision is preserving the safety and soundness of insured depository institutions. We believe the record shows the FDIC's authorities are as effective in achieving this goal as are the authorities of consolidated supervisors." Moreover, Chairman Powell warned that consolidated supervision "would represent a new level of government intrusion in the marketplace – in fact, it would amount to a radical restructuring of the longstanding role of the federal government relative to commercial firms." He also noted the practical restraints of consolidated supervision and the risk of extending the federal safety net.

Nothing has changed since Chairman Powell issued his letter one year ago. Consolidated supervision no more reduces the risk of the FDIC insurance fund today than it did last year. The FDIC already has the tools necessary to assess the risk of each ILC, regardless of whether it is subject to some form of consolidated supervision.

5. **FDIC Question #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?**

None.

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6. **FDIC Question #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?**

The existing factors are so broad that the FDIC already has all of the tools it requires to evaluate ILCs and their controlling persons (*i.e.,* regardless whether the ILCs are held by financial entities or commercial entities), the factors are flexible enough to tailor the FDIC's regulatory approach to the unique circumstances of each ILC and controlling person, and the FDIC has used the existing factors to do an excellent job. No changes are required.

7. **FDIC Question #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?**

The FDIC should not routinely place restrictions or requirements on all or certain categories of ILCs, nor should it do so based on whether the ILCs are owned by commercial entities or are subject to some form of consolidated federal supervision. As more fully discussed in Fireside's responses to earlier questions, this type of treatment should not even be considered in the absence of concrete evidence that it is necessary to do so. To date, no such evidence has been presented, which means that any such restrictions or requirements would be arbitrary and unfounded. Moreover, the FDIC's existing tools are sufficiently strong and flexible to fully regulate every ILC, regardless of its ownership or whether it is subject to consolidated supervision.

8. **FDIC Question #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?**

No such conditions or regulations are appropriate, and ownership of ILCs should not be limited to financial companies. See Fireside's responses to Questions #5 and #6.

9. **FDIC Question #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 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**

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additional regulatory or supervisory authority would help reduce or eliminate such risks?

The ILC industry does not present an increased risk of conflicts or tying. The risk of conflicts or tying depends on the quality and honesty of the managements of the ILC and its parent and affiliates. There is nothing in the ILC structure that is inherently more risky than in a consolidated federal supervisory structure. The FDIC's existing tools – Sections 23A and 23B of the Federal Reserve Act, Regulation O, the anti-tying rules, the FDIC's examination process, the supervisory and enforcement tools provided by FIRREA and the FDIC Improvement Act – are more than sufficient to manage these risks.

10. **FDIC Question #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?**

Any claims of a competitive advantage on the part of ILCs are unfounded. Commercial banks and savings institutions can, and routinely do, enter into arrangements with commercial entities, such as co-branded credit card deals, affinity deals, referral deals, bank branches in retail stores, ATMs in retail locations, etc. These arrangements provide commercial banks and savings institutions with the ability to fully compete with ILCs that enter into similar arrangements with their commercial affiliates. In addition, the many savings and loan holding companies that were grandfathered under the Graham-Leach-Bliley Act are authorized to engage in commercial activities, which gives their savings institution subsidiaries the same ability as ILCs to establish arrangements with commercial affiliates. Finally, note that commercial banks and savings institutions are able to offer demand deposit accounts to their customers, which gives those banks and savings institutions a tremendous competitive advantage over the ILCs, which generally cannot offer such accounts. The inability to offer demand deposit accounts precludes ILCs from competing for lucrative commercial relationships with corporations and other business entities, thereby sending those relationships to commercial banks and savings institutions by default. In short, any competitive advantage afforded by the current regulatory structure is enjoyed by commercial banks and savings institutions, not the ILCs.

11. **FDIC Question #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 extend can or should the FDIC consider these benefits if they exist?**

Fireside does not believe that ownership of a banking institution by a commercial concern necessarily provides any special public benefits, other than the benefits of increased competition in the marketplace for financial services. While it is true that many commercial entities that own ILCs refer their affiliates' customers to the ILCs for financial services, there is no reason to believe that those customers would lack access to depository institution services in the absence of the affiliated ILCs. Moreover, a commercial entity and its affiliates could easily refer those financial services to other depository institutions and profit from doing so (except where prohibited by law). The FDIC should look to the business plan of each individual ILC to determine whether and to what degree its financial services benefit the public.

12. **FDIC Question #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?**

Fireside wishes to bring two items to the FDIC's attention. First, the reality is that many commercial firms need to provide loan products to their customers. They can do this within a heavily regulated ILC

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structure or within an unregulated finance company structure. An ILC must comply with the Community Reinvestment Act ("CRA"), which requires it to meet a lending test, an investment test, and a service test, all to the benefit of the communities it serves. An unregulated finance company is not subject to the CRA, and it is not obligated to meet such community needs. It is to the benefit of communities throughout the Nation to encourage these commercial firms to provide their lending products through ILCs rather than through unregulated finance companies, because this will provide the communities served with the benefits of the CRA. At the same time, adding additional regulatory burdens to the ILC charter will discourage the use of that charter, which will deprive the communities served of the benefits of the CRA.

Second, if the FDIC determines that it is necessary to further regulate ILCs, Fireside feels strongly that ILCs (a) which operate independently of their parents and affiliated companies (*i.e.,* ILCs that finance their own operations, have separate customer bases, do not receive referrals of business from their parent or affiliates, and do not have integrated business operations with their parent or affiliates), and (b) whose business operations are limited to traditional banking services, should not be saddled with the additional regulatory restrictions. ILCs that fall into this category have no more risk than ordinary community banks, and they should be regulated no differently.

13. FDIC Question #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?

In light of the ILC exemption from the Bank Holding Company Act that was established by Congress, the FDIC is not empowered to promulgate any regulation that undermines the effect or spirit of that exemption. Before even considering the promulgation of a new regulation, Fireside recommends that the FDIC reconsider the dangers of such regulation that are discussed so eloquently in the FDIC Letter issued just over one year ago. Fireside observes that any such regulation should be founded upon the existence of concrete evidence that it is necessary, rather than unfounded speculation. Finally, Fireside reminds the FDIC that, as discussed above, the FDIC already has all of the supervisory tools that it needs to regulate all ILCs, regardless of their size, ownership, or degree of consolidated supervision.

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Fireside thanks the FDIC for the opportunity to submit these comments, and trusts that they will be useful.

Sincerely,

Bruce Adams
Senior Vice President

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