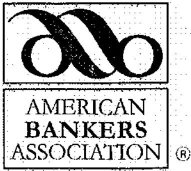

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October 10, 2006

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 on Industrial Loan Companies and Industrial Banks; FR Document E6-13941

Dear Mr. Feldman:

The American Bankers Association ("ABA") appreciates this opportunity to respond to questions recently proposed by the Federal Deposit Insurance Corporation concerning industrial loan companies and industrial banks (collectively, "ILCs"). The ABA brings together all categories of financial institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest banking trade association in the country.

The FDIC has invited interested parties to provide information on a number of topics ranging from the agency's ability to supervise ILCs to its authority. We applaud the FDIC for its careful and thorough review of the many issues presented by the ownership of ILCs by entities that are not bank holding companies. The issues raised by several pending applications go to the very core of our financial system, and the FDIC is to be commended for its thoughtful approach to resolving them before acting on the applications.

The ABA believes, however, that the fundamental issue is whether the ILCs of today are what Congress had in mind in 1987, the year Congress passed the Competitive Equality Banking Act ("CEBA"). If the answer to that question is no, then the issue should be resolved by Congress.

Accordingly, we wish to make the following points in our response to the FDIC:

- First, the ILC industry has evolved in significant ways since 1987. Whether changes in the industry warrant a change in the laws governing the regulation and supervision of ILCs and their parents is a question that should be answered by Congress.

- Second, the issues highlighted by the recent applications are so fundamental to our banking system that there are serious questions about whether an approval of pending applications with conditions designed to limit activity would be a durable solution.

Evolution of the ILC industry

The current exemption from the Bank Holding Company Act for companies that own ILCs was enacted in 1987. Since that time the ILC industry has experienced explosive growth, and the assumptions upon which the exemption was predicated no longer remain valid.

ILCs began in the early 1900s to provide uncollateralized consumer loans to low- and moderate-income workers unable to obtain such loans from existing commercial banks.[1] ILCs initially were not eligible for federal deposit insurance when the FDIC was created. However, the FDIC changed its policy over time until, with passage of the Garn-St Germain Depository Institutions Act of 1982, all ILCs were granted eligibility for deposit insurance, as were the thrift certificates they offered in lieu of deposits.[2] Some states thereafter *required* ILCs to obtain FDIC insurance as a condition of chartering, with the result that by 1987 the FDIC insured most ILCs and shared supervision with their state charterers.

In 1987, Congress enacted CEBA, one of the primary purposes of which was to close the "non-bank bank" loophole. Because the definition of "bank" in the Bank Holding Company Act ("BHC Act")[3] at that time included only entities that offered commercial loans *and* accepted demand deposits, a number of large retail commercial entities acquired institutions that made loans but did not offer demand deposits. This approach enabled them to avoid supervision as bank holding companies while offering banking services on an interstate basis.

When Congress amended the definition of "bank" in the BHC Act to eliminate the non-bank bank loophole, it also provided a "limited exception"[4] from that definition for ILCs that:

- do not accept demand deposits that can be withdrawn by check or similar means for payment to third parties;
- have total assets of less than $100 million; or
- have not undergone a change in control after 1987.[5]

The exemption applied to a comparatively few, small institutions. In 1987, most ILCs had less than $50 million in assets. The few states that were able to charter ILCs were not promoting the charter. In fact, Utah had a moratorium at the time on the creation of new ILCs. In short, there was no significant risk that problems caused by mixing banking and non-financial commerce would arise from the ILCs that existed at the time that the current exemption was codified. Thus, while the legislative history on the ILC provision is sparse, it appears that Congress felt comfortable exempting ILCs from the definition of "bank" in the BHC Act because ILCs were not being used to evade the requirements of the Act.

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[1] GAO-05-621 *Industrial Loan Companies*, September 15, 2005.
[2] Pub. L. No. 97-320 § 703.
[3] 12 U.S.C. §§ 1841 – 1850.
[4] H.R. CONF. REP. NO. 100-261, at 120 (1987).
[5] The exemption applies only to ILCs chartered in states that in 1987 required ILCs to have deposit insurance, namely, California, Colorado, Hawaii, Minnesota, Nevada and Utah.

Almost twenty years later, the characteristics of ILCs and their parents have changed dramatically. Between 1987 and the first quarter of 2006, aggregate ILC assets have grown almost 4,000 percent, from $3.8 billion to over $155 billion, with the average ILC holding close to $2.6 billion in assets. According to a 2005 report by the Government Accountability Office ("GAO"), only seven states have active ILCs, and California, Nevada, and Utah charter more than half, with the state of Utah leading in ILC asset growth.[6] There are a total 61 ILCs to date, with several other applications for federal deposit insurance pending.

This growth is not by accident. In 1997, Utah lifted its moratorium on new charters, permitted ILCs to call themselves "industrial banks," and authorized them to engage in virtually all of the powers of state-chartered banks. Today the Utah Department of Financial Institutions touts the benefits of ILCs on its web site, stating –

> Generally, IBs [*i.e.*, industrial banks] are authorized to make all kinds of consumer and commercial loans and to accept federally insured deposits, but not demand deposits if they have total assets greater than $100 million. * * * The flexibility of an IB charter has made it an attractive vehicle for some large and well-known corporations. IBs offer a versatile depository charter for companies that are not permitted to, or that choose not to, become subject to the limitations of the Bank Holding Company Act or the Glass Steagall Act.[7]

Today, an ILC—even one with assets in excess of the $100 million threshold codified in CEBA—may effectively compete with full-service insured depository institutions. As observed by former Federal Reserve Board Chairman Alan Greenspan, ILCs may engage in the "full range of commercial, mortgage, credit card and consumer lending activities; offer payment-related services, including Fedwire, automated clearing house and check clearing services, to affiliated and unaffiliated persons; [and] accept time and savings deposits, including certificates of deposit from any type of customer."[8]

The flexibility of the ILC charter has made it an attractive vehicle to serve the business needs of a wide range of entities, many of whom engage in non-financial commercial activities. While this is a perfectly legal and logical development given the laws in place, it stands the basic "source of strength" doctrine – where companies owning banks serve as sources of strength to the banks, not *vice versa* – on its head. It also has serious implications for the continued effectiveness of the barrier between banking and non-financial commerce. As such, we believe it is appropriate for Congress to revisit the question of whether ILCs should remain outside a system that subjects owners of other types of insured depository institutions to consolidated supervision and regulation.

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[6] The GAO report states that "As of December 31, 2004, there were 29 ILCs, representing 82 percent of the ILC industry assets, with headquarters in Utah. According to officials at the Utah Department of Financial Institutions, ILC growth in Utah occurred because other state laws are not as 'business friendly' as Utah. These officials also stated that Utah has state usury laws that are more desirable than many other states and the state offers a large well-educated workforce for the financial institutions industry." GAO-05-621, *Industrial Loan Companies,* September 15, 2005 at 19.

[7] http://www.dfi.utah.gov/whatisIB.htm.

[8] Letter from Federal Reserve Board Chairman Alan Greenspan to Congressman James Leach, dated January 20, 2006.

Durability of Conditional Approvals

The FDIC has invited comments on the utility of imposing conditions on approvals of applications for deposit insurance for ILCs and notices of changes in control of ILCs. This question, as well as the others going to the effectiveness of, and authority for, the FDIC's supervision of ILCs and their parents, are entirely appropriate for the FDIC to raise, given the position it has been placed in. However, we believe the FDIC is not the appropriate arbiter of the more fundamental issues concerning the role of ILCs.

Given our view that Congress needs to decide these issues, we believe that the FDIC should not attempt to resolve the current debate by approving the pending applications with conditions that limit the nature or extent of activities the ILCs in question may engage in. Even a conditional approval is a significant step down the path of approving the ILC to exercise the full range of activities permitted by its charter. Once an operational track record of an ILC is established, the FDIC likely will find it difficult to decline subsequent requests for modifications to, or termination of, the conditions.

The FDIC also has sought industry feedback on whether it is confined to reviewing only those factors set out in the statutes governing applications for deposit insurance and notices of change in bank control. While we appreciate the FDIC's openness to solving the current dilemma by reviewing factors beyond those set out in the Federal Deposit Insurance Act, we believe the FDIC is confined to reviewing only the factors that Congress has identified. That said, several of the factors are broad in scope and permit the FDIC significant latitude to consider a wide range of factors that bear on, for instance, the risk that an institution seeking deposit insurance presents to the Bank Insurance Fund. Thus, the FDIC can, and should, consider any matter that informs the consideration of the statutory factors, but the FDIC may not extend its inquiry beyond the limits set by the statute.

* * *

For the reasons suggested above, we believe that the decision about what role ILCs will play should be made by Congress. We commend the FDIC for its efforts to advance the debate, and we appreciate the care with which the FDIC is approaching these issues. However, in the final analysis, this is a problem that only Congress can solve.

Sincerely,

Mark J. Tenhundfeld