October 4, 2006

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Chairwoman, Board of Directors
c/o Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Subject: FDIC request for Public Comment on Wide-Ranging Issues Involving Industrial Loan Company Charters as provided in August 17, 2006 press release and Federal Register 6714-01-P.

These comments are respectfully submitted in response to the 12 questions posed by the FDIC in regards to Industrial Loan Companies and Industrial Banks (collectively, ILCs). The FDIC has inquired whether "statutory, regulatory, or policy changes should be made in the FDIC's oversight of ILCs in order to protect the Deposit Insurance Fund or important Congressional objectives." The FDIC also requested opinions and information regarding the "potential mixing of banking and commerce that might be presented by an ILC."

I have worked in the banking industry for the past 14 years with banks that are regulated by the FDIC and those regulated primarily by the OCC. In my professional and personal career, I have had the opportunity to interact with a number of businesses, financial institutions and commercial organizations. I can state without hesitation that the Industrial Banks that I have had the pleasure to associate with are all outstanding corporate citizens. Their leaders and officers operate at the highest level of ethical conduct and work tirelessly to ensure that they meet the highest level of statutory and regulatory requirements. I assure you that they are well regulated by the FDIC and state officials. Also, the officers and employees of these banks are committed to providing quality services, at an efficient rate, to their customers.

I have nothing but the utmost respect for the FDIC and their regulatory capabilities. I hope these comments are taken in the context in which they are intended and will assist the FDIC in reaching an outcome that will most benefit the citizens of the United States. I know the ILCs are a great benefit to our economy and way of life. As such, I believe that neither the FDIC, nor the Congress, should allow the ILC industry to be regulated out of existence due to outside pressure based on political agendas or fear of competition.

Question #1

Q1-a. *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 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?*

No, the developments in the ILC industry in recent years have not altered the relative risk profile of ILCs any more so than the recent changes in technology, consumer fraud, the economy, and an assortment of other developments have altered the risk profile of *all* insured depository institutions.

As stated in one of the FDIC's Supervisory Insights, "The operational environment for many banks has evolved dramatically in recent years. Deregulation and globalization of financial services, the proliferation of new and highly complex products, large-scale acquisitions and mergers, and greater use of outsourcing arrangements have led to increased operational risk profiles for many institutions. Technological advances, including growth in e-banking transactions, automation, and other related business applications also present new and potentially heightened exposures from an operational risk standpoint.[1]

Risk has not increased based solely on a bank having an ILC charter, nor if the ILC's parent is a financial institution or a commercial entity. All banks have risk. A bank's size, customer base, products and services, and the method those products and services are delivered drive every bank's risk. These risks are minimized by the skill of the bank's management, their knowledge of the business, adherence to regulations, along with the oversight of their regulators.

The FDIC should continue to adapt its supervisory programs or regulations to address banking issues as they develop. However, no modifications to the FDIC's supervisory programs or regulations are needed simply due to the ILC industry.

Question #2

Q2-a. *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?*

There is no inherent difference with regards to safety and soundness, or risk to the deposit insurance fund, based on whether the owner of the ILC is a financial entity or a commercial entity. All of the ILCs, no matter who the owner is, must adhere to the same

[1] FDIC Supervisory Insights, June 28, 2006

laws and regulations as any state chartered bank and are supervised by both the FDIC and the state regulators.

However, a question we may want to pose is "Is the risk posed by the ILCs to safety and soundness or to the Deposit Insurance Fund more than those risks posed by other types of banks?" The answer, of course, is "no".

The ILCs are some of the most well capitalized and safe and sound banks in existence today. When you pull the Call reports from the FDIC's website[2] for all the ILCs listed on the Utah Department of Financial Services (UDFI)[3] website the capital ratios speak for themselves. After eliminating the four ILCs with capital ratios exceeding 100% the average capital ratios for the ILCs are: 1) Core - 22.09%, 2) Tier 1 Risk Based - 24.45% and 3) Total Risk Based – 25.59%. For a bank to be considered "well" capitalized they must have minimum ratios of 5.00%, 6.00% and 10.00%, respectively.

Many times in the ILC discussions the following questions have been posed: "What if Enron or WorldCom had had a bank? What would have happened to the banking system?"

Let's discuss Enron. Apparently, Enron did not need to own a bank. It allegedly had at least two banks that were more than willing to assist them in their activities. In 2003, the SEC settled with J.P. Morgan for $135 million and Citigroup for $120 million, (a fine both banks agreed to pay, but not as an admission of guilt), for their roles in Enron Corp's manipulation of its financial statements (SEC release 2003-87).[4] The SEC alleged that both of these banks "helped Enron mislead its investors by characterizing what were essentially loan proceeds as cash from operating activities".

Citigroup Inc., a bank holding company, is regulated under the Bank Holding Company Act and is supervised by the OCC. At the time of Citigroup's alleged actions, they owned eight banks that were under the supervision of the OCC and two ILCs that were under the FDIC's supervision. Did their actions put the safety and soundness of their two ILCs at greater risk than they did their other eight banks? Was the Deposit Insurance Fund at greater risk because of Citi's two ILCs? Was the Deposit Insurance Fund at less risk because Citigroup, as well as J.P. Morgan Chase, are financial institutions? The answer to all three questions is, "no".

One of the major differences between Enron's banking arrangements with their outside banks and those of the ILCs with their parent companies and affiliates, is that unlike the actual Enron banking activities, a bank owned by Enron would have been scrutinized under Regulation W, Section 23A and 23B, the regulation that restricts transactions with affiliates. Under this regulation, the activities that allegedly occurred would not have been allowed, at least not with the ILC.

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[2] *Find an Institution*, FDIC Institution Directory
[3] *State Chartered Industrial* Banks, Utah Department of Financial Institutions.
[4] <u>SEC Settles Enforcement Proceedings against J.P. Morgan Chase and Citigroup</u>, 2003-87.

Also, the FDIC and state regulators would have regulated the bank during its entire existence. Once the news about Enron's trouble came to light, the FDIC and the state regulators would have been in the bank making sure that the troubles of the parent company did not affect the integrity of the bank. Perhaps the bank would have been sold to another parent company or liquidated, but the regulators would have made sure that the deposit insurance fund was secure and the bank's management was still working in the best interest of the bank.

The point is a business is only as good as the management. It does not matter if it is a commercial entity, a financial institution or a bank regulated under the Bank Holding Company Act. The ILCs are highly regulated and scrutinized, particularly in regards to the inter-company activities with their affiliates. The FDIC and the state regulators have oversight of the management of the bank and its board of directors (the majority of which must be outside directors with no direct affiliation with the ILC, the parent company or their affiliates) and they take that oversight very seriously.

Q2-b. *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?*

No, the FDIC should not apply its supervisory or regulatory authority differently based on whether the owner is a financial entity or a commercial entity. The only determining factor in how the FDIC applies its supervisory or regulatory authority should be based on its risk assessment of the bank and its activities.

According to the FDIC's website[5], the FDIC's purpose is to "preserve and promote confidence in the U.S. financial system by insuring deposits in banks and thrift institutions for at least $100,000; by identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system when a bank or thrift institution fails." The website also states "since the start of FDIC insurance on January 1, 1934, no depositor has lost a single cent of insured funds as a result of a failure."

The website goes on to point out that "the FDIC directly examines and supervises about 5,250 banks and savings banks, more than half of the institutions in the banking system. Banks can be chartered by the states or by the federal government. Banks chartered by states also have the choice of whether to join the Federal Reserve System. The FDIC is the primary federal regulator of banks that are chartered by the states that do not join the Federal Reserve System. In addition, the FDIC is the back-up supervisor for the remaining insured banks and thrift institutions."

However, nowhere on the website does it state that the FDIC will apply its supervisory or regulatory authority differently from one type of bank to another. Nor does it list

[5] *Who is the FDIC?* Federal Deposit Insurance Corporation Mission Statement

different FDIC regulatory goals for different types of banks. Which is appropriate, the FDIC should have the same regulatory goals for all banks under its authority.

The FDIC should scrutinize the each bank on a safety and soundness basis. If the bank's chosen business strategies are being handled in such a way that they are in line with all the laws and regulations and pose no undue risk to the bank, its customers, the bank's stockholders, the economy, the financial system, or the deposit insurance fund then how the FDIC applies its authority should not differ based on who the owner is.

Question #3

Q3-a. *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?*

No, there is no evidence that consolidated Federal supervision increases the safety and soundness of a bank. For example, both Citigroup and J.P. Morgan were subject to some form of consolidated Federal supervision when fined by the SEC (see Question 2, above).

Q3-b. *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 supervisions?*

Of course, the FDIC should always consider potential risks and acknowledge that these risks may be unique to each bank, holding company and affiliate. It would be quite appropriate, and expected, for the FDIC to consider to what extent a holding company and affiliates are subject to supervision by another federal agency. The FDIC can address concerns pertaining to the lack of supervision for the holding company or their affiliates by another federal agency during the approval process.

There are several ways that the FDIC could address such risks. They could issue the bank's approval only upon the condition that they would be the acting regulator for the unregulated portion of the parent company and affiliates associated with the bank. They could forbid the bank from conducting business with certain affiliates, such as unregulated foreign entities. In other words, the FDIC has options as to how to address potential risks in regards to the applicant and its consolidated Federal supervision, or lack there of, on a case by case basis.

Q3-c. *How and why should the consideration of these factors be affected?*

It is expected that the FDIC would work to insulate the banks from risks relating to their affiliates and they have the authority to regulate those relationships and transactions. The only exception would be with those affiliates that have no connection to the bank, except for common ownership. In this type of affiliation, there would be no transactions between the two, nor could any officer of this affiliate be involved with the bank's operations, it would be as if they were two completely isolated and independent businesses. Therefore, this type of affiliate would pose no risk to the bank. Since the FDIC is concerned with minimizing risk to the bank, there would be no reason for the FDIC to regulate such an affiliate.

Question #4

Q4-a. *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?*

No one could ever create a complete and specific list of factors and aspects of a parent of an ILC that should affect the FDIC's evaluation of applications for deposit insurance.

Any feature or aspect of a parent, or affiliate, of an ILC that could pose risk to the safety and soundness of the bank, is not in the best interest of the public, would negatively affect the deposit insurance fund or could potentially adversely impact confidence of the U.S. financial system, would be relevant.

The FDIC has an obligation to the public to consider the reasons an applicant would want to start, or acquire, a bank and what services or products the bank would offer. The FDIC should perform a complete and thorough due diligence to ensure that there is a legitimate reason for the creation of the bank and that it will be operated in a safe and sound manner, as dictated by the laws and regulations as well as the FDIC and state regulators. They should also ensure that the bank's management is competent to run a bank, is autonomous from the parent company and affiliates, and will act at all times in an ethical manner that is in the best interest of the bank.

However, if the creation and existence of the bank will not negatively impact the community's access to a range of financial service providers, will not threaten or negatively affect the public's interest, or will not cause harm to the economy (local or national), an application should not be denied strictly on the basis of fear of competition.

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)).

Q5-a. *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?*

The statutory factors addressed in the question are worded broadly enough to accommodate all of the concerns addressed in the FDIC's prior questions and the responses given. The FDIC has the authority to consider all these statutory factors when evaluating an application for deposit insurance or change in control notice, and to interpret them appropriately in situations, which may be unique to an individual bank, based on potential risk factors. As discussed above, the FDIC has the right to impose regulation, or put restrictions on transactions that the bank can conduct in regards to unregulated affiliates.

There is no inherent advantage or disadvantage to the safety and soundness of a bank for its parent company to be a financial institution, commercial entity, bank holding company, or to be under consolidated Federal supervision. Nor is there an inherent ability for one above the other to satisfy all the statutory factors, comply with all the laws and regulations, or to serve the public need in a banking capacity. Since this is the case, each application should be considered on it own merits, taking into consideration all the aspects previously discussed concerning safety and soundness, potential risk, the purpose for the bank, management's skills and abilities, etc and the FDIC would be remiss in its duty to arbitrarily impose restrictions or conditions on, or to deny, an application based solely on whether the applicant is a commercial entity or whether or not it is subject to some form of consolidated Federal supervision.

Question #6

Q6-a. *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?*

Like any industry or business, the banking industry needs to be allowed to change and grow based on current conditions, new developments, and consumer needs. The whole idea behind capitalism and America's entrepreneurial vision is based on allowing for new ideas and innovation and the right to bring them to fruition. Granted, banking is a unique industry and concerns must be addressed to ensure the continued confidence in the U.S. financial system. However, if the FDIC routinely places restrictions or requirements on ILCs because they fit in a certain category, and not used to mitigate risk, they will ultimately stifle the growth of certain ILCs and perhaps the entire industry. How will this benefit the economy and the public interest? Competition, if it does not create a monopoly or somehow negatively impact the community's access to service providers, is always a good thing. The FDIC has the obligation to accomplish its stated mission, not to stifle growth because one group's fear of another group.

Q6-b. *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?*

The restrictions should be based on the unique characteristics of the individual ILC and the risk it brings to the table. A blanket statement that commercial companies or companies not subject to some form of consolidated Federal supervision are incapable of providing financial services in the form of a bank is indefensible. If the FDIC has concerns about the capability of the company owning a bank, or there is not a legitimate reason for the bank to exist, then the FDIC and the state regulators have the right to deny such an application. The FDIC should address these issues through the application and examination process. They have the power to control the situation and have a proven track record in doing so.

Q6-c. *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?*

Whether the FDIC chose to establish requirements and restrictions through regulation or impose them during the approval process would depend upon the situation. If the conditions are unique to an individual bank, restrictions and conditions should be imposed on the bank during the approval process. However, if the conditions are a cause for concern across the entire banking world, then new regulations, or modifications to existing ones, may be in order.

Question #7

Q7-a. *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 conditions or regulations should be imposed on the ILC charter, or the ILC banks as a group, solely on that criterion. As discussed in the previous questions, there is no evidence that ILCs pose any more risk to the Deposit Insurance Fund, the U.S. financial system, the American consumer or are less safe and sound than any other bank in existence today. It doesn't matter if the parent company is a financial institution or a commercial company.

Potential risks should be considered and addressed for each individual bank, no matter what kind of charter a bank has, and addressed by the FDIC accordingly. In addition, potential risk assessments should be based on legitimate concerns not fueled by a group's, or an association's, political agenda.

Question #8

Q8-a. *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 supervisory steps can reduce or eliminate such risks?*

No, there is no more likelihood of conflicts of interest or tying between an ILC and its affiliates will occur than in any other banking affiliate situation. Most financial institutions, no matter what regulating body governs them, have one or more affiliates and these affiliations are growing more complex and more numerous in all areas of the banking industry. Regulation W implements provisions 23A and 23B of the Federal Reserve Act that regulates these affiliations, the transactions that can be carried out between them, and in what manner. This regulations applies to the ILCs just as it does to all other types of banks

Failure to comply with these regulations can lead to severe personal penalties for the bank's directors and management. One must ask, why would any bank officer, or director (the majority of which are outside directors), be more likely to put themselves, their livelihood, or their reputations at risk, for an affiliate that is a commercial company, or a company not subject to some form of consolidated Federal supervision, than for a financial affiliate?

In a presentation to the Utah Association of Financial Services, Utah Commissioner Edward Leary spoke about a unified goal with the federal regulators concerning the management personnel of the ILCs (the bank directors were included in the term "management"). He stated:

"We want a board of directors comprising competent people of integrity. The board members must be active and provide direction and supervision to management. Second, we want a management team that is autonomous from the larger corporation; that acts at all times in the best interest of the depository institution; that demands accurate, reliable accounting records on-site upon which to base their decisions; that retains the credit underwriting policy and decision-making authority; that ensures all transactions with the parent corporation or affiliates passes the strictest arms-length scrutiny."[6]

The FDIC and state regulators look at the bank's management team, their active participation in decisions pertaining to all aspects of the bank, the bank's interactions with its affiliates, and the affiliates themselves during the approval process, change of ownership request and at each and every safety and soundness and compliance exam. If conflicts of interest exist or if the bank is somehow violating Reg. W and sections 23A

[6] *Remarks by G. Edward Leary, Utah Commissioner of Financial Institutions before Utah Association of Financial Services,* September 8, 2000.

and 23B, then the FDIC has every right to ensure the activity is stopped or, in extreme cases impose a cease and desist order.

Q8-b. *Does the FDIC have authority to address such risks in acting on applications and notices?*

Yes, the FDIC has the authority to address such risks at any stage of an ILC's business cycle, including when acting on applications and notices. Section 23A and 23B restrict the amount of loans to and purchases of assets from affiliates on the bank, in order to prevent fraud on the bank by the bank's owners.

Section 23A limits transactions between a bank and its affiliates to 10 percent of the bank's capital stock and surplus, aggregate transactions to 20 percent of the bank's capital stock and surplus, and addresses both the quantity and quality of the collateral that secures that transaction.

Section 23B ensures that transactions between banks and their affiliates are carried out on market terms and conditions.

Q8-c. *What additional regulatory or supervisory authority would help reduce or eliminate such risks?*

No additional regulatory or supervisory authority is needed to address these risks. The FDIC has the authority to regulate all affiliate transactions, no matter what the nature or the size of the transaction, or who the affiliate might be. This is more supervisory authority than it, or any other regulating body, has over any bank's dealings with various businesses in which there is no "official" or documented affiliation.

Question #9

Q9-a. *Do ILCs owned by commercial entities have a competitive advantage over other insured depository institutions? If so, what factors account for that advantage?*

No, ILCs owned by commercial entities do not have a competitive advantage over other insured depository institutions.

However, the question should be asked "Are commercial entities at a disadvantage when they are compelled to conduct all their financial activities through non affiliated banks?" The answer to this question is "yes".

For example, when a financial institution or commercial entity issues a service or product, such as a private label or co-branded credit card, through an outside bank, the bank has access to that entity's entire customer list. In most instances, the bank gets a ready-made list of customers and does not have to exert any effort in building the list from the start, or even during the growth period of the program. However, the bank has all the accumulated customer history, such as what types of items are purchased, how much the customer is spending, the average amount of each transaction and customer's payment history. Since the bank has all the information they have the ability to cross-sell to those customers. Based on this information they can pick and choose which of the entity's customers to cross-sell to (this generally being the best customers), and potentially steal them away from the commercial entity. This definitely has a negative impact on the commercial entity's bottom line through the loss of sales and revenues.

As I stated before, for the most part competition is good and should not be stifled. However, if the information that creates the competitive advantage is gleaned from information the unaffiliated bank would not be privy to if the entity was able to offer these products and services through their own bank and keep their customer lists to themselves, then that competition is unfair and should not be mandated.

The only way that financial institutions and commercial entities can protect themselves from giving away their customer information is to bring those activities in-house. One way this can be accomplished through an ILC. By being affiliated with an ILC, the financial institution or commercial entity can build its customer base without being forced to divulge their information to an outside bank.

In addition, the users of these products and services are better served through the direct relationship with the entity and the entity's ability to address their specific needs. Plus, these entities can offer better customer service through discounts, loyalty programs, and their ability to address their customers' unique credit requirements (for example commercial clients versus consumers or farmers versus trucking companies). Also, the savings realized by the bank can be passed through to their customers, thus creating a monetary benefit as well.

All this can be accomplished with an ILC that is regulated by both the FDIC and the state regulatory agency and that is subject to all the laws and regulations as is any state chartered bank, thus allowing the FDIC to achieve its mission of "preserving and promoting confidence in the U.S. financial system…; …identifying, monitoring and addressing risks to the deposit insurance funds; and by limiting the effect on the economy and the financial system…", while still allowing the economy to flourish.

Q9-b. *To what extent can or should the FDIC consider this competitive environment in acting on applications and notices?*

The FDIC should consider the competitive environment only to the extent that the application or notice would have a negative impact on the community that bank serves (such as limiting the public's access to financial service providers). Actions taken based solely on the type of charter, or the owners of that charter should not be allowed. In 1999, William Poole, the President of the Federal Reserve Bank of St. Louis, discussed the benefits of letting the market decide the structure of the changing banking industry.

He stated in his presentation to the Missouri Bankers Association Senior Bank Management Conference:

"…while maintaining deposit insurance and the financial safety net for banks, we should rely on market forces rather than regulation as much as possible to shape the structure of the banking industry. Attempts to preserve the roles of particular types of banks, like community banks, through regulation would not be in the public interest. Such regulations would interfere with the public's ability to freely choose its providers of financial services, and in our highly competitive economy, would eventually be self-defeating for banks themselves."

He later stated:

"Under deposit insurance and other elements of the financial safety net for the banking industry, it is reasonable for the government to set standards for granting charters. These standards include checks on the backgrounds of bank organizers, to prevent granting charters to criminals. These standards also require a minimum level of capital for new banks. Under my approach of letting the market decide, these would be the only standards for granting charters. All applicants who qualify would receive charters."[7]

He finished his presentation by saying:

My bottom line is simple. Small firms are prospering across the entire U.S. industrial landscape. In only a handful of industries are large firms increasing their market share because of compelling economies of scale. Banking is no different in this respect from the typical U.S. industry. Although large banks are growing as artificial branching and line-of-business restrictions are swept away, small banks are prospering when they are well managed and when they select the proper market niches. A banker's life is certainly more intense than it used to be in the old, highly regulated days, but the rewards for entrepreneurial bankers and their customers are to be celebrated rather than bemoaned."

The public should be free to choose the financial products they want to utilize. Some of these products and services may be through companies that own ILCs. Some of the ILCs will be owned by financial institutions while others will be owned by commercial entities. All of them are, and will continue to be, strictly regulated by the FDIC and the state regulators. Their existence, growth and success should be determined by the public's desire to utilize their services, not outside pressure on the FDIC to regulate the competition because of political agendas.

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[7] The Structure of Our Changing Banking Industry: Let the Market Decide. January 12, 1999.

Q9-c. *Can those elements be addressed through supervisory processes or regulatory authority? If so, how?*

Yes, the elements can be addressed through supervisory processes or regulatory authority, if necessary. The FDIC has all the power and authority as allotted them through the statutes, existing laws and regulations. These existing statutes, laws and regulations give the FDIC the ability to disallow unscrupulous competitive forces, as necessary. Once again, not based on outside pressures to regulate competition, but genuine threats to the financial system and negative threats to the public's best interest.

Question #10

Q10-a. *Are there potential public benefits when a bank is affiliated with a commercial concern?*

Yes, there are potential public benefits. Not in the sense that a bank without an affiliation with a commercial concern is put at a disadvantage. When a bank is affiliated with a commercial concern, a vast amount of intellectual knowledge comes along with that affiliation. This intellectual knowledge is usually directly related to a specific market or industry. The bank gains an almost instant understanding of the affiliate's business, the related industry, their customer base, and most of all, an understanding of an industry's business cycle.

In this type of situation, the consumers within that industry can benefit. A bank with a thorough understanding of its clients' business cycles, payment capabilities and service needs has the ability to tailor the services it offers to fit the client's requirements. These services can often times be offered at a lower cost to the customer because they are the only services offered by the bank. Therefore, the bank is not required to inflate the price of the service in order to help pay for other, less profitable, services outside their chosen market niche. This allows the commercial business to pass along the savings to their customers.

However, reduced costs are not the only reason that specific customers tend to migrate to banks with intellectual knowledge about their industry. Take the trucking industry for example. In the article, *Beyond the Rates*, George Payne, Executive VP of Interstate Distributor Co. explains why it is import that lenders have a complete understanding of the industry. He points out that many lending banks don't understand that when the price of fuel increases, there is a time lag until the surcharges imposed by the trucking companies can help recover those costs. "Knowledgeable bank lenders understood the issue and didn't panic." Unfortunately for truckers, there are conventional commercial banks that shy away from lending to them due to their lack of knowledge of the trucking industry.

The public benefits from the existence of ILCs. What other banks offer services specifically for buying postage? What other banks take the time to negotiate with merchants to get discounts for truckers on the fuel they purchase, which in turn reduces the price of consumer goods? What banks would cut a retailer's interchange rate on their credit and debit card transactions so significantly that the retailer could pass on millions of dollars worth of savings to their customers each year? Very few, if any. Banks are in the business of making money for their stockholders, not saving money for a business's customers. Plus, the cost for providing specific products and services to a business's customers would cut deeply into their profits. ILCs, on the other hand, are created to do just that and their highly regulated existence serves the public well.

Q10-b. *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?*

Yes, these benefits could provide greater access to banking services for consumers.

There are several estimates on how many Americans are unbanked. Estimates have ranged from as many as 40 million Americans do not use mainstream banking services[8] to estimates that 35 to 45 percent of low-income households do not possess a bank account.[9] In 2002, Senator Sarbanes, pointed out in his opening statement to the Committee on Banking, Housing and Urban Affairs, on the matter of bringing more unbanked Americans into the financial mainstream. According to his statement there are a variety of reasons why millions of families do not have accounts with insured depository institutions. He listed two of barriers to entry for low-income individuals as being "in the form of high costs and lack of convenient bank branches".[10]

In her testimony before the committee[11], now-FDIC Chairman Bair's testimony confirmed Senator Sarbanes reasons for so many unbanked individuals in the United States. Her research came up with the following reasons:

- Bank fees or minimum balance requirements were too high;
- The types of accounts offered by traditional financial institutions do not meet the needs of the unbanked;
- A person may not write enough checks or have enough month-to-month savings to make worthwhile to maintain an account; or
- The unbanked are simply not comfortable dealing with banks or letting them know their private financial information.

She went on to state "We believe that an individual should have the right to choose where he or she will seek financial services. This right to choose, however, is an illusory right if people do not have accurate and complete information that will enable them to make educated decisions and access to a range of financial service providers."

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[8] Treasury Department Announces Availability of $8 Million for ""First Accounts"" to Reduce Number of Unbanked Americans. January 2, 2002.
[9] The Journal of Human Resources. 2006.
[10] Bringing More Unbanked Americans into the Financial Mainstream. Senator Paul S. Sarbanes. May 2, 2002.
[11] Bringing More Unbanked Americans into the Financial Mainstream. FDIC Chairman Sheila C. Bair, May 2, 2002

Some of the concerns about one of the pending applications revolve around the potential of this bank branching into communities throughout the United States and siphoning all the available deposits from the surrounding community banks. This applicant has stated that the only purpose for the bank is to become a merchant acquirer to lower the cost of processing credit and debit card transactions.

However, let's just take a minute to discuss the benefits to the public if this, or a similar application, were approved with no restrictions or pre-set conditions. First, based on the capitalization of the bank, they cannot accept demand deposits because their initial capitalization will put their asset size above the $100 million threshold. Plus, all banks are rated on their Capital, Assets, Management, Earnings, Liquidity, and Sensitivity to Market Risk. No matter who their owner is, if a bank consistently over paid for deposits and under charged for loans, their earnings would suffer. The regulators would down grade the bank's ratings and put a stop to those practices.

Also, in the business world, this retailer has the ability due to size and volume to persuade their vendors to sell them products at extremely low cost. Realistically though, their bank could not go to the discount window and get funds any lower than any other bank. So, any additional funding required by the bank should be fairly in line with any other bank's cost for those funds.

Now, back to the question. How could this affiliation bring greater access to banking services for customers? First, this applicant serves many of the individuals that are included in the "unbanked" category. Maybe they would be able to make a profit while requiring lower minimum balances or charged lower bank fees. Maybe they have intellectual knowledge of this customer base that would allow them to come up with products and services that better serve the needs of the unbanked. Plus, some of this retailer's stores are located in many areas that don't have a single bank branch. Many of these areas do have a bank branch, but there is only one. In some instances, the local banker does not have the trust of all the people and the unbanked in these areas might just feel more comfortable banking with this bank than the local, town banker. This retailer, or a similar retailer, might just be able to provide needed banking services that will be more widely accepted and utilized by the unbanked in the United States. Remember, all of these benefits would be under the strict supervision of the FDIC and the state regulators. They would restrict any unfair competition and any negative impact on the U.S. financial system and Deposit Insurance Fund.

On the flip side, there are apparently a large number of people in the United States that would never choose to bank with this bank no matter what service and products they provided and no matter at what rates these products and services were offered. But that all comes back to the public's right to choose, not the government's duty to regulate banking solely on competition.

Question #11

Q11-a. *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 change should be made in the FDIC's oversight of ILCs?*

First, the FDIC should take pride in their foresight and leadership role in developing a strong, productive banking structure that meets the needs of the modern financial services market and the American consumer.

Second, the controversy over the ILCs is purely political and banks that work under the Bank Holding Company Act view them as threat. They used certain pending applications to inflame the issues and to rally support to stop legitimate competition.

The FDIC should take into consideration that many of the financial services that are being offered through the ILC charters are unique services that their parent companies and their affiliates created out of necessity. In some cases, the same banks that are calling fowl for the ILCs' ingenuity are the very banks that didn't see the value of the business lines that are being offered through the ILC charters. Now these banks are seeing that these business lines are legitimate, and more importantly profitable, and want to get legislation that would restrict legitimate competition and force these companies back to the banks.

In other cases, the need to bring the services into an ILC was due to a lack of response by the banks. Some of these entities and their business lines were not the most profitable for the banks and the banks were slow to respond to the needs of the entity and its customers. Slow response, or no response, can cause businesses to lose customers, and can cause irreparable harm to the business itself through the loss of those customers. How does that benefit the American consumer and the economy?

Sometimes, it just comes down to economics for the business and their customers. By performing the service through an insured institution, the company can provide better services, keep their customer lists away from their potential competitors, lower the company's cost to produce the services (in some cases lower the cost considerably) and in turn, pass these savings on to their customers. All of this can be done in a highly regulated arena.

The bank centric model has worked to create some of the safest banks insured by the FDIC. The current laws and regulations are working and they should be revised in response to future developments as they pertain to all banks and legitimate concerns. For the most part, industrial banks offer unique banking services and products as compared to the community and national banks. They have developed a market niche, have a solid client base and are doing very well.

The current system is not broken; therefore, don't try to fix it.

Question #12

Q12-a. *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?*

The FDIC has the duty to ensure the safety and soundness of the banks that it supervises. It also has the duty to accomplish it mission as stated on its website. Laws and regulations have been established that help the FDIC accomplish these tasks. The FDIC can place restrictions on the owners and affiliates of ILCs through conditions imposed upon the approval of a *de novo* bank, approval in a change of ownership and examination recommendations with the use of cease and desist orders, if necessary. It can also restrict the ILC's banking activities that do not promote the public's best interest (such as restricting branching that might diminish the availability of financial services in a particular area).

The banking system has changed dramatically since 1934, and the FDIC's track record demonstrates its ability to adapt with those changes. The fact that no depositor has lost a single cent of insured funds as a result of a bank failure since its inception in 1934, says a lot to the FDIC's authority to impose needed restrictions upon all banks under their supervision.

In 1997, then-Chairman Ricki R. Helfer directed the FDIC's Division of Research and Statistics, to perform a study of the banking problems of the 1980's. In their written analysis, History of the Eighties – Lessons for the Future, they stated that although all three regulating agencies (the FDIC, OCC and Federal Reserve) were sensitive to the issues of safety and soundness and the importance of modernizing bank powers, when it came to specific issues, the OCC tended to emphasize a bank's need for more power to compete and seek profits, while the FDIC tended to lean more toward protecting the deposit insurance fund and the Federal Reserve often took a position somewhere in between the other two agencies.[12] Based on this analysis, the ILCs are exactly where they should be, under the supervision of the FDIC and their strict attention to the protection of the deposit insurance fund.

Conclusion

The fact that the ILCs exist and they are growing in size and number should be a sign to the FDIC, and Congress, that they are, in fact, a needed commodity in the U.S. banking system. They each have their unique clients, who still use, and need, traditional bankers to fulfill their other financial requirements. But the key here is *the ILCs have unique customer bases and those customers are using the ILCs' products and services to make their businesses work better*. If the ILCs were not functioning as a necessary part of our society, they would be out of business.

[12] History of the Eighties-Lessons for the Future, December, 1997.

In conclusion, it is assumed that the FDIC will continue to lean toward protecting the deposit insurance fund, adhering to its mission statement, and ensuring the safety and soundness of the banks it supervises, including the ILCs. Absent any further Congressional regulation, the banking industry will continue to grow and adapt to the current needs of the American public. There in no need for the ILC industry to be regulated out of existence and in fact, the ILCs should be looked upon as one of the great banking success stories.

Sincerely,

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