October 11, 2024

James P. Sheesley
Assistant Executive Secretary
Attention: Comments—RIN–AF88
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429.

RE: NOTICE OF PROPOSED RULEMAKING ON THE PARENT COMPANIES OF INDUSTRIAL BANKS AND INDUSTRIAL LOAN COMPANIES [RIN 3064 – AF88]

Dear Mr. Sheesley,

The Independent Community Bankers of America (ICBA)[1] appreciates this opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking (NPR) on the Parent Companies of Industrial Banks and Industrial Loan Companies (ILCs).[2] This proposed rule contains several clarifying changes that would allow the FDIC to apply its existing supervisory framework for ILC parent companies in several specific change in control scenarios not covered by the current regulation.

The proposed rule describes a new category of ILCs called "shell or captive industrial banks." A proposed ILC uses a "shell or captive" business model when the ILC could not function independently of the parent company, would be significantly or materially reliant on the parent company or its affiliates, or would serve only as a funding channel for an existing parent company or affiliate business line. If a proposed ILC is determined to be a "shell or captive industrial bank," there will be a rebuttable presumption that the shell or captive nature of an industrial bank will weigh heavily against favorably resolving one or more of the applicable statutory factors.

ICBA Position

ICBA has consistently opposed the ownership of ILCs by commercial, non-financial parent companies because we believe these arrangements violate the separation of banking and

[1] The Independent Community Bankers of America® has one mission: to create and promote an environment where community banks flourish. We power the potential of the nation's community banks through effective advocacy, education, and innovation. As local and trusted sources of credit, America's community banks leverage their relationship-based business model and innovative offerings to channel deposits into the neighborhoods they serve, creating jobs, fostering economic prosperity, and fueling their customers' financial goals and dreams. For more information, visit ICBA's website at www.icba.org.
[2] 89 Fed. Reg. 65556, available at: https://www.fdic.gov/system/files/2024-07/fr-proposed-rule-on-parent-companies-of-industrial-banks-and-industrial-loan-companies_0.pdf.

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commerce. ILCs create unavoidable conflicts of interest that risk harming consumers and undermining financial stability. Therefore, *we commend the FDIC for taking action to strengthen its review of applications by "shell and captive industrial banks" and we support the finalization of the rule as proposed.*

History of the ILC Loophole

ILCs began as small, state-supervised financial institutions created in the early 1900s to provide small loans to industrial workers. Because early ILCs were legally unable to accept deposits, they were not subject to FDIC supervision or eligible to receive deposit insurance. Over time, the distinctions between ILCs and commercial banks diminished, and today ILCs can make all the same types of commercial and consumer loans as full-service banks and can offer Negotiable Order of Withdrawal (NOW) accounts which are functionally identical to demand deposits and are FDIC insured.

In 1987, Congress passed the Competitive Equality Banking Act (CEBA) which exempted ILCs from the definition of "bank" in the Bank Holding Company Act. As a result, non-financial, commercial companies can control an industrial bank without being subject to the BHCA's activities restrictions or consolidated supervision by the Federal Reserve Board. This ILC Loophole provides a dangerous avenue for corporate giants to enter the business of banking and potentially to make risky loans to the customers of their commercial parent companies.

This backdoor has not escaped the notice of commercial giants. In 2005 and 2006, Wal-Mart and Home Depot both applied for ILC charters. These applications were ultimately withdrawn in the face of public backlash. The FDIC correctly responded by imposing a moratorium on new ILC charters owned by commercial firms until the danger they posed could be evaluated more fully. In 2010, the Dodd-Frank Act imposed a three-year moratorium on ILC deposit insurance applications. We remain concerned that, unless Congress acts to permanently close the ILC loophole, a Big Box or Big Tech company will exploit this loophole to obtain a bank charter, creating a Too-Big-To-Fail commercial-financial conglomerate and increasing systemic risk.

ILCs have a history of being owned by motor vehicle manufacturers for the purpose of lending to customers of the ILC's parent company. This history is marred by the failure of General Motors Acceptance Corporation (GMAC), which remains a case study in the dangers of the ILC business model. Due to losses incurred by GMAC, General Motors was forced to divest its ownership of the bank so that it could become eligible for a $5 billion bailout from the Troubled Asset Relief Program. This bailout was necessary not because GMAC itself was systemically important, but rather because General Motors was an important manufacturer that the government did not want to see bankrupted by its financing arm. Undeterred by this past failure and bailout, both General Motors and Ford applied for new ILC charters in 2021 and 2022, with GMs application being withdrawn earlier this year.

On February 23, 2021, the FDIC published a final rule governing the parent companies of industrial banks. This rule, codified as Part 354, "requires certain conditions and written commitments for each deposit insurance application approval, non-objection to a change in control notice, and merger application approval that would result in an industrial bank becoming a subsidiary of a company that is not subject to Federal consolidated supervision by the FRB. The rule also requires that, before any industrial bank may become a subsidiary of a company that is not subject to Federal consolidated supervision, such industrial bank and company must enter into one or more written agreements with the FDIC."[3]

Analysis of FDIC Proposal

The FDIC is currently proposing to update Part 354 to include conversions involving a proposed industrial bank under Section 5 of the Home Owners' Loan Act (HOLA) or other transactions as determined by the FDIC. The proposed rule would also make a parent company of an industrial bank subject to Part 354 if there is a change of control at the parent company or a merger in which the parent company is the resultant entity. Finally, the proposed rule would give the FDIC the regulatory authority to apply part 354 to other situations where an industrial bank would become a subsidiary of a company that is not subject to Federal consolidated supervision.

These proposed changes would fill gaps in the definition of "covered company" in Part 354 that would give the FDIC the ability to impose the substantive provisions of the regulation – namely the ability to require written agreements from commercial parent companies – in specific circumstances not covered by the original regulation. ICBA supports these clarifications of Part 354 as proposed.

The second substantive change to Part 354 is more novel and involves what the agency describes as "shell and captive industrial bank" business models. According to the proposed regulation a prospective ILC is a "shell or captive industrial bank" when it:

(i) Could not function independently of the parent company;
(ii) Would be significantly or materially reliant on the parent company or its affiliates; or
(iii) Would serve only as a funding channel for an existing parent company or affiliate business line.

A finding that a prospective ILC is a "shell or captive industrial bank" would cause the FDIC to "presume that the shell or captive nature of an industrial bank involved in a filing weighs heavily against favorably resolving one or more applicable statutory factors."[4] Companies would have the ability to attempt to rebut the presumption in writing.

In the proposal, the FDIC raises several concerns with the captive ILC business model, saying "[t]he FDIC's experience during the 2008–2009 Financial Crisis showed that business models involving an insured depository institution (IDI) inextricably tied to and reliant on the parent and/or its affiliates creates significant challenges and risks to the [Deposit Insurance Fund or] DIF, especially in circumstances where the parent organization experiences financial stress and/or declares bankruptcy."[5] This appears to be a direct reference to the problems encountered when GMAC became insolvent. The agency also says, "Where a proposal for an industrial bank is presumed to be a shell or captive institution … if the target market is such that the institution's products are only

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[3] 89 Fed. Reg. 65557.
[4] 89 Fed. Reg. 65568.
[5] 89 Fed. Reg. 65561.

available to customers of an affiliated company or a narrow segment of the community, this would weigh heavily against favorably resolving the convenience and needs statutory factor."[6]

In a previous comment letter to the FDIC, ICBA identified "Risk Presented to the Deposit Insurance Fund" and "Convenience and Needs of the Community to be Served" as the most significant Federal Deposit Insurance (FDI) factors that prospective ILCs are unlikely to satisfy.[7] In that letter, we argued that ownership of an ILC by a commercial parent company creates an undue risk to the Deposit Insurance Fund, particularly when the ILC is created to lend to the customers or affiliates of the parent company. In these circumstances, there is an unavoidable conflict of interest which foreseeably leads to the reduction of underwriting standards to increase the sales of the commercial parent company which leads to a greater risk of insolvency to the captive ILC.

We further argued that the convenience and needs of the community are not served by captive ILC arrangements because it is inherently anti-competitive for a lender to lend only to the customers of its parent company or to favor customers of its parent company in other ways. Captive ILCs are not designed to serve the entire community, but instead to serve a narrow subset of the community – namely the customers of its commercial parent.

We are pleased to see the FDIC echo some of these same concerns in the proposed rule. The proposed rule says, "Shell and captive bank business models create potentially significant supervisory concerns for industrial banks. The level of concern with these business models is inherently heightened due to the substantial reliance on the parent company or its affiliates, particularly with respect to the primary business operations of the industrial bank. This may include total or nearly exclusive reliance on the parent organization for sourcing business, conducting key operational elements (e.g., underwriting, administering, or servicing customer accounts or relationships), and obtaining a wide range of critical business support services."[8] What this paragraph highlights is that captive ILCs are essentially unable to operate independently of their parent companies for both operational reasons and because, without the commercial parent, their ability to acquire customers is substantially limited.

This is relevant to the FDIC because, in the event of an insolvency, the franchise value of a failed ILC is severely reduced. The captive ILC would not have the same value to any independent buyer as it would to the parent company because its operations are intertwined with that parent's operations. This loss of franchise value would require the FDIC to sell the failed captive ILC at a substantial discount, which would heighten losses to the DIF.

CFPB Director and FDIC Board Member Rohit Chopra states these concerns even more clearly in his statement accompanying this proposed rule, saying "GM Financial Bank would have been almost fully reliant on GM for loan and deposit customers. If GM or GM Financial Bank had experienced stress, there would not have been any acquirers for the bank. It is worth noting that the proposed

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[6] 89 Fed. Reg. 65562.
[7] ICBA, "Re: Pending FDIC Deposit Insurance Applications by Industrial Loan Companies" (Feb. 10, 2023), available at: https://www.icba.org/docs/default-source/icba/advocacy-documents/letters-to-regulators/letter-to-fdic-board-regarding-pending-ilc-applications.pdf?sfvrsn=ea511117_0.
[8] 89 Fed. Reg. 65561.

insured bank would have been a monoline lender, much like the existing nonbank GM Financial, exposed to the same auto market fluctuations as GM. A stress scenario would have likely occurred during a downturn in the auto industry, making it very costly for the FDIC to liquidate the bank and its auto loans."[9]

In our view, the captive structure of commercially owned ILCs always presents an undue risk to the DIF because captive ILCs cannot serve a bank's primary function – which is to be a neutral arbiter of credit. No matter how many superficial steps are taken to make the ILC's board independent of its commercial parent, it is impossible to fully cure the conflict of interest that lies at the heart of such arrangements. The purpose of captive ILCs is not to make impartial credit decisions or to manage credit and interest rate risk, it is to drive the sales of its commercial parent company. This is not consistent with safe and sound banking practices and unacceptably increases the risk of failure.

With respect to Convenience and Needs, the proposed rule highlights some of the same concerns about anticompetitive or oligopolistic behavior raised by ICBA in our previous comments. The proposed rule states, "The public purpose of a bank charter with deposit insurance is that the bank will serve the convenience and needs of the community broadly. Business models that are not generally available to the members of the community absent purchasing a product by an affiliated entity raise serious questions as to whether the general community is sufficiently served to merit the grant of deposit insurance."[10]

Being an FDIC-insured bank comes with several important advantages. In particular, it is easier for an insured institution to raise funds for depositors because those depositors know they are protected by FDIC insurance. In exchange for offering customers this protection and certainty, banks become subject to a wide array of regulations – including the Community Reinvestment Act, to ensure that they are serving their entire communities, including low- and moderate- income customers and geographies. Being an FDIC-insured institution, in other words, is a privilege rather than a right and it is a privilege conditioned on meeting the needs of the entire community a bank serves.

There are business reasons that a company like an automaker or a retailer would want to own a bank so that it could offer its customers credit on favorable terms, thus driving its own sales higher. However, serving a narrow subset of customers of a commercial parent company, rather than the entire community, does not justify extending the privilege of raising federally insured money from depositors. If commercial firms want to lend money to their customers, they should do so using their own working capital or money raised from public debt markets that is unsubsidized by federal deposit insurance.

Because of these inherent flaws in the structure of captive ILCs, we believe such models are highly likely not to favorably satisfy all of the FDI Act factors required to obtain FDIC insurance. We believe

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[9] Director Rohit Chopra, "Statement of CFPB Director Rohit Chopra, Member, FDIC Board of Directors, on the Proposed Rulemaking on Industrial Loan Companies" (July 30, 2024) available at: https://www.consumerfinance.gov/about-us/newsroom/statement-of-cfpb-director-rohit-chopra-member-fdic-board-of-directors-on-the-proposed-rulemaking-on-industrial-loan-companies/.

[10] 89 Fed. Reg. 65562.

the FDIC's approach of creating a rebuttable presumption that the shell or captive nature of an industrial bank will weigh heavily against favorably resolving one or more of the applicable statutory factors is an appropriate step to address the risk to consumers and the financial system posed by new commercially owned ILCs. We further believe that this rule sends an important signal to the market that FDIC disfavors such applications .

Finally, it has historically been very uncommon for the FDIC to formally deny applications for deposit insurance. Instead, it has generally tried to allow institutions the opportunity to cure applications that do not satisfy the FDI Act factors. When that hasn't been possible, the FDIC has generally communicated unfavorable feedback to applicants for deposit insurance and waited for those applications to be withdrawn. In our view, there would be value in issuing written denials of deposit insurance applications in cases where applicants propose a business model that does not satisfy one or more of the FDI Act factors. This would provide the agency with the ability to create written precedents that make it more clear which business models are generally ineligible to receive deposit insurance or which prior consumer compliance violations might potentially be disqualifying.

Conclusion

In conclusion, ICBA strongly supports the FDIC's proposed rulemaking concerning the parent companies of industrial banks and industrial loan companies. By addressing the risks associated with "shell or captive industrial banks," the FDIC is taking a crucial step toward enhancing the integrity and stability of the banking system. The need for robust regulations is underscored by the historical challenges posed by commercial ownership of ILCs, which can lead to conflicts of interest and undermine the essential role of banks in serving their communities. We believe that establishing a rebuttable presumption against the approval of captive ILCs will help mitigate systemic risks and protect consumers from the potential pitfalls of such business models.

Once again, we appreciate the opportunity to provide feedback on this important rulemaking and we are thankful for the FDIC's attention to this issue. Please feel free to reach out to me at Mickey.Marshall@icba.org if you have any questions about the position stated in this letter.

Sincerely,

[redacted]

Mickey Marshall
AVP and Regulatory Counsel