October 11, 2024

Federal Deposit Insurance Corporation
550 17th St NW
Washington, DC 20429
Attention: James P Sheesley, Assistant Executive Secretary

RIN 3064-AF88
Parent Companies of Industrial Banks and Industrial Loan Companies

Ladies and Gentlemen:

The National Association of Industrial Bankers (NAIB)[1], the Utah Bankers Association (UBA)[2], and the Nevada Bankers Association (NBA)[3] appreciate the opportunity to submit the following comments on the proposed rule RIN 3064-AF88, Parent Companies of Industrial Banks and Industrial Loan Companies, which amends 12 CFR Part 354 (the Proposed Rule). We urge the FDIC to withdraw the Proposed Rule. The Proposed Rule ignores the financial record of industrial banks, which has been superior to other insured depository institutions in every measure for the last 40 years.

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[1] First chartered in 1910, industrial banks operate under a number of titles – industrial banks, industrial loan banks, industrial loan corporations, and thrift and loan companies. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the U.S. economy. NAIB members are chartered in Nevada and Utah.

[2] The Utah Bankers Association is the professional and trade association for Utah's commercial banks, savings banks, and industrial banks. Established in 1908, the UBA serves, represents, and advocates the interests of its members, enhancing their ability to be preeminent providers of financial services.

[3] Nevada Bankers Association is the united voice of Nevada's diverse banking industry: our members are dedicated to providing the best financial products, services and resources to drive and support economic growth, job creation and prosperity throughout the state of Nevada.

The Proposed Rule is counter to the intention of Congress and the legislative history granting federal deposit insurance to industrial banks and permitting new industrial bank charters. The Proposed Rule is arbitrary and capricious in failing to provide any empirical data or statutory change to support the significant change in the regulation of industrial bank parent companies since the amendments to Part 354 adopted by the FDIC in 2021. The Proposed Rule would foreclose the ability of most new applicants to successfully apply for federal deposit insurance. In addition, the Proposed Rule will place legacy industrial banks in jeopardy of having their current business model be deemed unsafe and unsound without any evidence or supporting data.

The Proposed Rule was adopted by the Board of the FDIC on July 30, 2024, in a 3-2 vote. The majority voting to propose the rule included the current chairman of the FDIC, Marty Gruenberg, who previously announced his resignation from the FDIC Board on May 20, 2024, pending the Senate confirmation of his successor. On June 13th, President Biden announced the nomination of Christy Goldsmith Romero to replace Chairman Gruenberg. With the November election of a new President, there is a reasonable chance of a change in control of the Administration and the US Senate.

The Proposed Rule should be withdrawn due to the timing of the adoption of the proposal by the FDIC Board. Given the lack of any empirical data or a changed economic position of industrial banks and their parent companies supporting the reversal of the Part 354 regulations adopted by the FDIC in January 2021, the Proposed Rule is an attempt by the lame duck Chairman to embed his personal bias into Part 354 prior to leaving the agency. There is a possibility that the US Senate may confirm Ms. Romero later this year. If the November election results in a change of party control of the Presidency, it is almost certain that a new nominee for chairman of the FDIC will be put forth by the new administration. Under either scenario, the incoming chair should be afforded the opportunity to review the effectiveness of the current Part 354 de novo.

There are currently 24 industrial banks with approximately $232 billion in assets. These industrial banks provide needed financial services to the customers and communities they serve. Since 2008, only three applications for deposit insurance for industrial banks have been approved by the Federal Deposit Insurance Corporation (FDIC). Nelnet Bank was approved in March 2020, as was Square Financial Services Bank. In June 2024, the FDIC Board approved the application of Thrivent Bank. More applications were filed. However, all were withdrawn after pending for years. There is no doubt that more applications would have been filed but for the perception that it is a waste of time and money to seek deposit insurance given the current FDIC Chairman's hostility toward non-financial parent companies of industrial banks and the apparent institutional bias at the FDIC against non-financial parent companies of industrial banks.

Financial Record of Industrial Banks

Industrial banks have established a record dating back to 1984 as some of the strongest and safest banks insured by the FDIC. They have consistently been the among best capitalized and most profitable group of banks in the nation. A recently published report by the Utah Center for Financial Services found that as of the first quarter of 2024, capital for industrial banks was 11.6 % %, compared to 9.7% for all banks. Return on assets for industrial banks was 3.72% compared

to 1.09% for all banks while return on equity was 31.09% for industrial banks compared to 11.09% for other banks. These recent results for industrial banks are consistent with those found in earlier reviews for industrial bank performance. In 2018, James Barth and Yanfei Sun of Auburn University published an extensive review of the history of industrial banks and their financial performance compared to other commercial banks. The study found that since 2000 industrial banks had consistently higher capital ratios, return on equity, and return on assets than other commercial banks. Barth and Sun updated their review of industrial bank performance compared to all banks in 2021 and found in the period from 1986 through 2020 there were 23 industrial bank failures, of which 17 were in California and most were structured as traditional commercial banks. The total cost to the FDIC for these industrial bank failures was $780 million. During the same period, 2605 non-industrial banks failed and cost the FDIC $178 billion.

During the Great Recession of 2007-2010, only one industrial bank failed compared to 529 non-industrial banks insured by the FDIC. Many industrial banks were chartered and approved for federal deposit insurance prior to 2007. A significant number of these institutions were either converted to a commercial bank, merged with a commercial bank, or closed or self-liquidated due to changing market conditions or the parent companies' business operations. None of these conversions, mergers or liquidations resulted in a loss to the FDIC. Existing laws and regulations have proven effective in regulating affiliate relationships and innovative business plans. Barth and Sun conclude in their 2021 study that "[t]here is, therefore, no support for the argument that [industrial bank] holding companies should be subjected, like bank holding companies, to consolidated supervision by the Federal Reserve."

The Utah Center for Financial Services recently issued an update to the study by James Barth and Yanfei Sun mentioned above. This review was based on the quarterly call reports issued by the FDIC. Since January 2021 and through June 2024, industrial banks consistently provided superior results in the key measures of safety and soundness in banking including capital, asset quality, and profitability.

All the historical and recent documentation issued by the FDIC unequivocally compels the conclusion that the existing regulations and supervision are effective, and no evidence exists in any form to support the Proposed Rule.

Legislative History of Industrial Banks

Over a century ago, a new financial services provider was created with the purpose to provide loans to low- and moderate-income Americans who had stable jobs, but little access to bank credit. Because these institutions had industrial workers as their primary customers, they have been known ever since as "industrial loan companies" or "industrial banks". Industrial banks owned by diversified parents first developed in the early 1980s when they became eligible for FDIC insurance. Today, industrial banks provide critical lending to a wide array of customers including small businesses and families that have limited access to credit.

The 1987 Competitive Equality Banking Act (CEBA) specified that industrial banks chartered in states with statutes requiring industrial banks to be FDIC-insured as of March 5, 1987, were exempt from the definition of "bank" in the Bank Company Holding Act. In the Dodd-Frank Act of

2010, Congress imposed a 3-year moratorium on the approval of new industrial bank charters and ordered a study by the Government Accounting Office (GAO). The report issued by the GAO found no systemic risk arising from the commercial ownership of industrial banks and notably did not recommend any action by Congress.

Current Requirements of Part 354

In 2021, the FDIC adopted the current version of Part 354 to formalize the regulatory oversight of industrial bank parent companies not subject to consolidated supervision by the Federal Reserve. The amendments to Part 354 primarily codified practices that had generally applied to industrial bank parent companies for several years and were adopted with industry support.

Under current regulations, Part 354 of the FDIC regulations governing the parent companies of industrial banks is applied to the parent company of a de novo or acquired industrial bank after April 1, 2021. It is not retroactive, excluding parent companies with an industrial bank subsidiary prior to April 1, 2021. It also excludes industrial banks controlled by a company that is already subject to consolidated supervision by the Federal Reserve and industrial banks that are not subsidiaries of parent companies.

Part 354 currently defines the term 'control' as meaning the power to direct the management or policies of a company, or to vote more than twenty five percent of voting securities. The current regulations define 'covered company' as any company that is not subject to federal consolidated supervision by the Federal Reserve and that controls an industrial bank due to one of the following scenarios: 1) as a result of a change in bank control; 2) as a result of a merger transaction; or 3) the industrial bank was granted deposit insurance by the FDIC on or after April 1, 2021.

For those industrial banks acquired or established de novo after April 1, 2021, Part 354 requires that any industrial bank that becomes a subsidiary of a parent company not subject to federal consolidated supervision by the Federal Reserve may only do so if that parent company enters into written agreements with the FDIC and the subsidiary industrial bank, an existing common practice. The elements of these written agreements include: an initial listing of all the parent company's subsidiaries that is updated annually; consent to FDIC examination of the parent company and its subsidiaries for compliance with the written agreement; submit to the FDIC an annual report that includes the parent company's financial condition, risk management system(s), transactions with parent company depository institution subsidiaries, data protection systems, and compliance with applicable laws. The written agreements also require that parent companies to maintain all relevant records, submit to an annual independent audit of each subsidiary industrial bank, maintain the independence of the industrial bank by limiting parent company representation on the bank's board to less than 50%, maintain capital and liquidity levels according to FDIC instruction, and execute a tax allocation agreement with its industrial bank stipulating that tax assets generated by the subsidiary industrial bank are held in trust for the bank's benefit and promptly returned to the bank. Written agreements also often contain additional provisions tailored to address specific risks or other considerations unique to that applicant.

Part 354 also currently requires parent companies to provide the FDIC with an approved contingency plan that outlines processes to weather financial or operational stress that would threaten the safety and soundness of the industrial bank. The plans must include one or more strategies for the orderly disposition of the bank without the need for a receiver or conservator.

And finally, current regulations place several restrictions on industrial bank subsidiaries of covered parent companies, stating that unless the industrial bank obtains prior FDIC approval, the industrial bank may not make a material change to its business plan, add or replace a member of its board for the first three years after becoming a subsidiary of the parent company, add or replace a senior executive for the first three years, employ a senior executive officer who in the past three years was in any manner associated with an affiliate of the industrial bank, or enter into any contract for services with the parent company that is material to the operations of the industrial bank.

Impact of Proposed Changes to Part 354

The current version of Part 354 was finalized in January 2021, less than four years ago. Since January 2021, no new legislation has been passed, and the Federal Deposit Insurance Act (FDI Act) has not been amended. Industrial bank performance continues to be strong, outperforming non-industrial bank insured depository institutions. Without economic justification or legislative changes, the Proposed Rule puts forth significant and substantial changes to the regulation of industrial bank parent companies. The result is a whipsaw effect of changing regulations based not on changes in law or on weakness that have developed among industrial banks, but simply due to a change in the control of the FDIC Board resulting from the 2020 election.

Shell and Captive Categories. The Proposed Rule creates new categories of industrial banks that are not defined by federal law. These so-called "shell" and "captive" industrial banks, which the Proposed Rule describes as structures in which "the industrial bank's operations and condition may be vulnerable to any financial stress or operations at the parent company" as a result of "concentration risks that are typically not present in the traditional community bank operating structures." However, the broadly understood meaning of the terms "shell" and "captive" do not match their usage here.

A "shell" is commonly defined as an organization with no assets or other operational substance. No shell could satisfy any of the factors specified in Section 6 of the FDI Act to qualify for deposit insurance. All industrial banks have assets, liabilities, and business operations that they control independent of their parent company. Further, they are subject to the same capital and liquidity requirements as other insured depository institutions.

A "captive" is a business controlled by the parent that operates for the benefit of the parent. An industrial bank is independently controlled by its own board and management and, in accordance with Section 23B of the Federal Reserve Act (FRA), any relationship with the parent or affiliate must primarily benefit the bank and only incidentally benefit the parent. An industrial bank is generally prohibited by federal law and regulation from operating as purely a "captive", by sections 23A and 23B of the FRA and its implementing Regulation W as well as Regulation O and

the anti-tying laws, together with the provisions of Part 354 and regulations governing contracting with third-party service providers.

In this context "shell" and "captive" are misleading and pejorative terms.

Rebuttable Presumption of Risk. The Proposed Rule adopts a presumption that institutions deemed to be a "shell" or "captive" institution, meaning institutions that are dependent or materially reliant on their parent companies, cannot satisfy the conditions specified in Section 6 of the FDI Act and pose a greater risk to the Deposit Insurance Fund (DIF) of the FDIC. This is arbitrary and capricious and exceeds any statutory authority granted to the FDIC. This presumption that the affiliate relationship between an industrial bank and its parent company is inherently higher risk is a reversal from the FDIC's 2021 rule, where the FDIC found that the activities of the parent company had no impact on the industrial bank's safety and soundness. Furthermore, the FDIC cites no data to support its claim of additional risk to the DIF; affiliate relationships are expressly permitted by federal law subject to compliance with the laws and regulations governing those relationships. Industrial banks operate safely and soundly in continuous compliance with the factors in Section 6 and all other laws and regulations governing federally insured banks. The implication that industrial banks present unacceptable risks to the DIF is a pure fabrication without any basis in fact and contradicts the FDIC's own data.

Linking this presumption to Section 6 of the FDI Act presents serious concerns for the existing industrial banks. Insured depository institutions must continually satisfy the conditions specifed in Section 6. It does not just apply to an applicant for deposit insurance. The Proposed Rule characterizes affiliate relationships as inherently unable to satisfy the Section 6 conditions or to operate in a safe and sound manner.

The Proposed Rule fails to show what problem with the current Part 354 it is trying to address with the creation of the so-called "shell or captive business model". Currently, Part 354 requires new industrial banks to have independent boards of directors and management, enter into written agreements with the FDIC to address concerns with concentration of operational risk and to develop contingency plans to provide for the order liquidation of the industrial bank in the case of the impairment or bankruptcy of the parent company. The Proposed Rule contains no evidence that the current regime is insufficient in protecting the safety and soundness of the industrial bank.

Section 354.2(a)(5) Catch-All. As drafted, Section 354.2(a)(5) of the "covered company" definition would empower the FDIC to determine that any parent company of an FDIC-insured industrial bank – regardless of when the bank was formed or acquired – is subject to the requirements and restrictions in Part 354. The FDIC, in fact, emphasizes in the Proposed Rule's preamble that this gives the FDIC authority to apply Part 354 to "any other situation where an industrial bank would become a subsidiary of a company that is not subject to Federal consolidated supervision." Notwithstanding this description, the preamble acknowledges that the change would give the FDIC authority to apply Part 354 to a "legacy" parent company and industrial bank subsidiary that are not currently subject to Part 354 due to the effective date of April 1, 2021. No justification for this substantial expansion in the scope of the definition of

"covered company" is provided. Instead, the Proposed Rule offers an affected company the opportunity to present views in writing if the company disagrees with the FDIC determination, albeit without any standards, timeframe, or process to govern the ultimate determination of whether the company and its subsidiary would be subject to Part 354. The effect of this expansion in scope would be to introduce significant uncertainty into the supervisory framework for the 24 FDIC-insured industrial banks that were chartered or acquired prior to April 31, 2021.

Change of Control Provisions. The Proposed Rule also proposed to amend the definition of "covered company" with the addition of Section 354.2(b) to include all companies that control an industrial bank if there is a change of control at the parent company on or after the effective date of the Proposed Rule. This "change of control" is not defined with any more specificity in the Proposed Rule and could by triggered simply by a routine change in the CEO or executive team member at the parent company. The resultant impact would be to sweep existing industrial banks that are currently approved by the FDIC for deposit insurance into the new "shell" and "captive" categories, which would apply to these institutions the FDIC's presumption that they are inherently unsafe or unsound. This is despite evidence that these existing institutions have been operating in a safe and sound manner and have already been approved for deposit insurance by the FDIC's own metrics.

Merger Provisions. In the Proposed Rule, we note that the definition of "covered company" in proposed Section 354.2(b) would apply to any company that controls an industrial bank without a carve-out for a company that is subject to Federal consolidated supervision by the FRB. The FDIC's stated purpose in promulgating Part 354 is to "formal[ize] the framework to supervise industrial banks and mitigate risk to the DIF that may otherwise be presented in the absence of Federal consolidated supervision." 89 FR 155 at 65556. It was on this basis that companies subject to Federal consolidated supervision by the FRB were carved out of the definition of "covered company." The rationale, however, applies equally in the context of the triggering events of 354.2(b), and we believe the intent is to carve out companies subject to Federal consolidated supervision by the FRB from 354.2(b) as well as from the definition of "covered company" in 354.2(a). For clarity, the language of 354.2(b) should be revised to reflect the same carve-out.

The preamble of the Proposed Rule notes that the FDIC is proposing to add the triggering events in 354.2(b) to address a potential gap that could arise:

> where there is a change in control or merger that occurs at or above the level of the parent company that results in a change in the person that controls the parent company but does not result in a change in the relationship between the industrial bank and its parent company. Similarly, if the parent company were a party to a merger in which it is the resultant entity, then new management with a new plan for the industrial bank could be installed. The parent company would continue to control the industrial bank, but not as a result of one of the trigger events, thus failing to make the parent company a Covered Company subject to part 354. 89 FR 155 at 65,559.

Proposed Section 354.2(b), however, would capture any merger where the company is the resultant entity following a merger. To more accurately reflect the gap identified in the preamble, the scope of mergers that would be triggering events should be limited to *transactions* resulting in new management at the company controlling the industrial bank. Otherwise, the provision could be read to capture internal reorganizations where there is no change in the top-tier entity that controls the industrial bank or transactions with third parties where the company that controls the industrial bank is the acquirer and there will be no change in management of the company.

Finally, the Proposed Rule adds a general category of change of control granting the FDIC the authority to apply part 354 to "any other situation where an industrial bank would become a subsidiary of a company that is not subject to Federal consolidated supervision" after providing an opportunity for the affiliate or parent to present its views. This general authority to sweep in any legacy institution for any change deemed relevant by the FDIC is a transparent attempt to apply the shell and captive definitions to existing institutions, thus applying the presumption of risk.

Impact on Applicants

A major concern is the impact on potential applicants for industrial bank charters. The Proposed Rule's creation of "shell" and "captive" companies, paired with its presumption that these structures are inherently higher risk, results in a tacit disapproval of any new industrial bank application.

The most successful model for starting an industrial bank has been to serve the needs and convenience of a parent company's existing customer base. Often those needs are unmet by current financial service providers. Providing these services to their customers enables a parent company to expand and deepen its customer relationships, the very heart of the business. Parent companies seeking to meet these customer needs have a variety of approaches to create the financial services demanded by their customers, one of which is the chartering of an industrial bank. If adopted as drafted, the Proposed Rule makes clear that this option faces extreme bias by the FDIC against the business model. To overcome this bias and the need to rebut the presumption that the business model is inherently unsafe and unsound, the prospective parent company will face draconian limits on marketing and support for the industrial bank that will likely prevent the successful launch of an industrial bank to meet its customers' financial services needs.

These regulatory barriers are likely to eliminate the industrial bank charter as a viable alternative. This runs counter to the demonstrated Congressional intent to provide deposit insurance to new industrial bank applicants. In considering changes to the treatment of industrial banks while considering CEBA in 1987 and the Dodd-Frank Act in 2010, Congress was well aware of the operations of industrial banks as well as the prevalent business model that served the customers of the parent companies. Since the enactment of the Dodd-Frank Act and the 2021 changes to Part 354, Congress has held several hearings and considered legislation impacting industrial banks but has made no change in the current regulatory structure and the access to federal deposit insurance. If adopted as proposed, the Proposed Rule is contrary to the demonstrated

will of Congress and usurps the prerogative of Congress to determine which classes of depository institutions qualify for federal deposit insurance. The Proposed Rule will eliminate the ability of new industrial banks to be approved for deposit insurance.

Impact on Legacy Industrial Banks

The preamble of the Proposed Rule recognizes that proposed amendments to Part 354 may lead to the inclusion of legacy parent companies. That would plainly be arbitrary and capricious.

As mentioned above, the Proposed Rule appears to grant the FDIC the authority to apply the new requirements of Part 354, including the limitation of so called "shell and captive business models" to existing industrial banks and their parent companies. As discussed, the Proposed Rule would designate the prevailing business model for the overwhelming majority of existing industrial banks as "shell or captives" and inherently unsafe and unsound. Applying this designation to existing industrial banks could lead to the required sale or liquidation of the industrial bank by its parent company.

The change of control provisions of the Proposed Rule is unclear and internally inconsistent. The preamble to the rule discusses a "gap" created when a "person" controlling an industrial bank changes but the relationship between the parent company and the industrial bank does not change. In that regard, the preamble mentions a change in the management of the parent as an example. To address this perceived gap, the Proposed Rule adds to the definition of "Covered Company" two new sections.

Proposed Part 354.2(a)(5) grants to the FDIC the power to determine that any parent company of an industrial bank is a "covered company" without limit. This language is very concerning. It is a new, vague grant of authority to designate any parent company, including legacy parent companies, as a "covered company" while providing the parent company the opportunity to argue that the provision should not apply. Granting an opportunity for the bank or applicant to "present its views" does not mitigate the wholly unbounded discretion this would give to the FDIC. It would permit the FDIC to designate a parent company as a "covered company" for an internal reorganization or change in management has no impact on the industrial bank subsidiary.

New Part 354.6 Additional Considerations

The addition of new "Part 354.6 Additional considerations" are arbitrary and capricious and without statutory or experiential support. They are in many instances vague and lack the specificity needed to apply to current industrial banks and their parent companies as well as new applicants.

Proposed Part 354.6(a)(5) adds a factor "(5) The novelty of the parent company's primary business model and the extent to which new or innovative processes are being developed or utilized". According to the text of the Proposed Rule, the FDIC could reject the application for an industrial bank from any parent company that is innovative or creative. There is no data or experience to support the idea that innovative or creative parent companies create an unsafe or unsound condition for a potential industrial bank. Most companies consider themselves to be creative and innovative to foster competition and better meet the needs of their customers. A

parent company seeking to start an industrial bank to meet the needs of its customers could be considered innovative and creative. Furthermore, there is no definition or background provided in the Proposed Rule or preamble for what is risk of "[t]he novelty of the parent company's business model" or why "new or innovative processes being developed or utilized" is an impediment to the safe and sound operation of an industrial bank by a parent company. It appears the FDIC is concerned with successful, creative, and innovative companies and would disfavor application for an industrial bank from such a company.

Proposed Part 354(b)(2) requires the business model for a proposed industrial bank to be viable without its relationship with the parent company. This would eliminate the current successful business model for most industrial banks, current and future. As stated in the preamble to the Proposed Rule "[a] significant number of existing industrial banks support the commercial and specialty finance operations of their parent companies."   An industrial bank cannot finance transactions involving an affiliate either directly or indirectly. It meets the financial needs of a group of customers that in many cases are the affiliate's existing customers by providing unrelated financial services that those customers either cannot get or get elsewhere in a less convenient way. As discussed above, this business model has resulted in superior performance by industrial banks in every measure compared to other insured depository institutions. It has resulted in far fewer troubled institutions through all economic cycles and a fraction of the failures experienced by "traditional" insured depository institutions over the past 50 years.

The proposed requirement for a "viable standalone business model" is inconsistent with the other requirements of Part 354. Some industrial banks could be spun off successfully if the parent failed but others would need to self-liquidate. There are several examples where the parent company of an industrial bank is forced into bankruptcy and the industrial bank was resolved with no loss to the DIF. These include Lehman Brothers Holdings Inc., CIT Group, Inc., and Flying J.

For those industrial banks that would have to liquidate, Part 354 already requires that existing and applicant industrial banks have FDIC-approved contingency plans for the orderly disposition of an industrial bank without cost to the DIF. The requirement for a contingency plan for the orderly winding down of the industrial bank at no cost to the DIF alleviates the need for the standalone business model. Experience with industrial banks suggests the liquidation of the industrial bank is a superior result for the FDIC and the DIF than a traditional bank resolution.

There is no evidence to support the contention in the preamble of the Proposed Rule that an industrial bank model "results in significant concentrations of risks that are not typically present in traditional community bank operation structures." This statement displays a shocking lack of understanding of both the operation of industrial banks and "traditional community banks". Very few, if any, traditional community banks are truly "standalone" operations. All are dependent on third-party vendors for most support and operational systems. The fact that those vendors are not affiliates does not change the risk of a disruption in those services. All vendor relationships are governed by arms-length contracts even when affiliates provide the services.

The preamble to the Proposed Rule fails to provide any data or experience that supports the FDIC's preference for a standalone business model based on franchise value. Admittedly there is

very little failure data available for industrial banks. However, the few cases that do exist suggest the FDIC and the DIF are better off with the execution of the winding down of the industrial bank through the FDIC-approved contingency plan. Experience with parent company bankruptcy has shown that the liquidation of the industrial bank resulted in no loss to the DIF and sometimes a positive contribution to the creditors of the parent company.

New Part 345.6(c) regarding shell or captive business models is arbitrary and capricious and counter to the intent of Congress

The creation of the "shell or captive business model" ignores the successful structure of most current industrial banks and parent companies. It creates a prejudicial misnomer for the current business model for most industrial banks and ignores the fact that industrial banks are neither shell nor captives and cannot be either under the requirements of the existing Part 354 and the application of Sections 23A and 23B of the Federal Reserve Act to all industrial banks and their affiliates. The Proposed Rule fails to provide any data or experiential support for the notion that the current business model for most industrial banks is a higher risk to the DIF. This notion is counter to the actual performance of industrial banks during the last 40 years. The Proposed Rule also ignores the safeguards currently in place in Part 354 for industrial banks and their parent companies that mitigate the risk to the DIF and prevent any industrial banks from being "shells or captives".

Proposed Part 345.6(c)(1) creates a rebuttable presumption that any new industrial bank is a shell or captive business model. It says the FDIC will use this misapplied presumption to "weigh heavily against favorably resolving one or more of the applicable statutory factors." The purpose of this section is to discourage the creation of any new industrial banks by warning potential applicants that the FDIC has not only its finger on the scale against the applicant but its whole hand. This is a circumvention of the statutory structure of the FDI Act and the demonstrated intent of Congress to ensure new industrial banks. This is a sweeping aggrandizement of agency power that short circuits the application process. It effectively communicates to potential new applicants that their efforts will fail; they should not bother to apply to the FDIC, regardless of the underlying statute.

Questions posed by the Proposed Rule

1. What situations – other than those that require a notice subject to section 7(j) of the FDI Act or an application subject to section 5 or 18(c) of the FDI Act or of section 5(i)(5) of the HOLA – present similar risks such that they would subject the industrial bank and its parent to part 354?

The Proposed Rule fails to show the need for the amendments to Part 354 less than 4 years following the adoption of the current rule. The Proposed Rule is apparently based solely on the changing in the personal views of a narrow majority of the Board of the FDIC without any change in the underlying statute or to the economic performance of industrial banks. As discussed above, the financial performance of industrial banks is strong and is outperforming in every measure of non-industrial banks insured by the FDIC.

Without some change in the underlying statute or the economics of industrial banks, the amendments to Part 354 are arbitrary and capricious and in conflict with the statute and the demonstrated intent of Congress to provide federal deposit insurance to industrial banks.

We would also note that a change of control is not needed for the FDIC and state regulators to address situations that might arise at the parent or affiliate if it poses a specific risk to the bank. The regulators have broad authority to recommend actions to mitigate risks and to issue cease and desist or consent orders to address those risks if they arise. The proposed subpart 354.2(a)(5) appears more designed to provide a pretext to capture legacy companies.

2. What other clarifications, if any, to part 354 and its relationship to the FDIC's evaluation of the statutory factors should the FDIC consider?

The FDIC should recognize that the commitments made in the written agreements by the industrial banks and its parent company strengthen the ability of the industrial banks to meet the statutory requirements. While it is appropriate for the FDIC through the Proposed Rule to make clear that the written commitments do not replace the statutory requirements, it is inappropriate for the FDIC to ignore or discount the impact of the written agreements on meeting the statutory requirements.

3. What features or aspects of a shell or captive bank business model (not already discussed above) should affect the FDIC's evaluation for industrial bank filings?

We urge the FDIC to delete proposed subsections 354.6(b) and (c). Since the "shell or captive bank business model" is a prejudicial misnomer of the current industrial bank business model, the FDIC should focus on the potential success of the application without the apparent institutional bias against industrial banks present in the Proposed Rule. Experience has shown that many successful industrial bank business models focus on providing needed banking services to the existing customers of the parent company and do not create any additional risk to the DIF or the financial system.

4. Should the FDIC assess the potential risk to safety and soundness and the DIF differently for shell and captive bank business models involving significant or material reliance on the parent organization?

In addition to eliminating the use of "shell" and "captive" altogether, the FDIC should look beyond its apparent institutional bias against industrial banks and evaluate the applications for industrial banks on the actual record of similarly situated existing industrial banks and their parent companies. It should look at the ability of an industrial bank to meet the unmet needs of the customers of the parent company and its other affiliates. The operational support being provided by the parent company and its affiliates should be evaluated similarly to the evaluation of an application for a community bank's reliance on third-party vendors for operational support and services. In addition, the application of the industrial bank should be informed by the written agreements and the contingency plans of the applicant industrial bank.

5. Are there other issues or facts that the FDIC should consider in determining whether to strengthen its supervisory frameworks with respect to industrial banks and how the FDIC evaluates potential risks and concerns presented in an industrial bank filing?

The FDIC should base its analysis on the safety and soundness record of industrial banks and the strength of the contingency plans without the institutional bias shown applicants in the past and inherent in the Proposed Rule. By proposing significant amendments to Part 354 within four years of adopting the current rule without any statutory change or underlying problems with existing industrial banks, the FDIC has shown an its unwillingness to fairly review industrial bank applications. The proposed amendments represent an attempt to expand these arbitrary and capricious policies by significantly changing the regulatory structure of the industrial banking industry. Such disruptive and unjustified changes are the epitome of arbitrary and capricious regulatory action in violation of 5 U.S.C. §706(2) of the Administrative Procedures Act. The FDIC should judge all applicants in the light of their performance compared to other insured depository institutions. In the absence of any data supporting the need for proposed changes to Part 354, the FDIC is attempting through regulatory fiat to eliminate any new industrial banks, and possibly most existing industrial banks. The Proposed Rule creates a situation where there can be no successful application for deposit insurance by an industrial bank applicant even where the state chartering authority has approved the application. This conflicts with demonstrated congressional intent to permit the chartering of new industrial banks.

6. How should the FDIC assess the 'convenience" and "needs" of the "community" served by dependent bank business models?

The FDIC should modernize its view of banking to recognize that much of 21st-century banking is not geographically based. Convenience and needs relate to what a customer wants and chooses. All successful banking depends on the provider of financial services understanding what customers want and the best way to provide those products and services. This has led to an increasing segmentation of the market and different models are often needed to best serve specific segments. The best measure of needs and convenience is successfully meeting the needs of the bank's consumers, wherever they may be located.

Regarding shared customers, an affiliate that already provides other products and services to an existing customer base is often in an ideal position to see opportunities to expand those relationships by providing other products and services.

Conclusion

NAIB, UBA, and NBA urge the FDIC to withdraw the Proposed Rule. Industrial banks have outperformed their commercial bank counterparts in every measure of safety and soundness over the last 40 years. Only one industrial bank failed during the Great Recession, and it was owned by a financial holding company. There have been no failures of an industrial bank owned by a diversified parent company in the past 100 years.

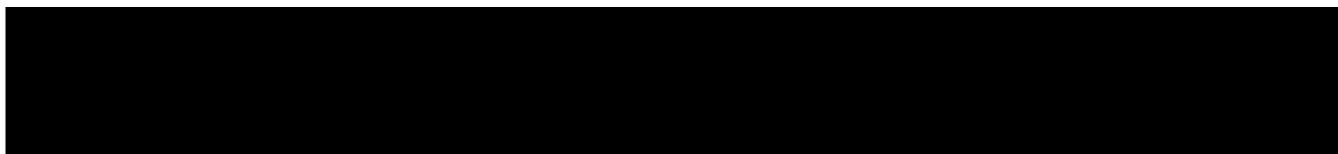
The Proposed Rule ignores the demonstrated intention of Congress and the legislative history granting federal deposit insurance to industrial banks and permitting new industrial bank charters. Congress has considered industrial banks and their parent companies in several hearings since the expiration of the Dodd-Frank Act moratorium in 2013, including hearings with the FDIC leadership since the adoption of Part 354. In addition, Congress has considered and rejected legislation that would limit access to federal deposit insurance by industrial banks.

The Proposed Rule is arbitrary and capricious. The Proposed Rule is a significant and substantial change to the regulation of industrial banks and their parent companies. The Proposed Rule would eliminate the ability of non-financial parent companies to establish an insured depository affiliate to serve the financial needs of those who choose to become its customers. The Proposed Rule is effectively retroactive as it grants the FDIC authority to determine any legacy industrial bank parent company is a "covered company" without any standards, timeframe, or process to govern the ultimate determination The Proposed Rule fails to provide any empirical data or statutory change to support the significant change in the regulation of industrial bank parent companies since the amendments to Part 354 adopted by the FDIC in 2021.

In summary, industrial banks are among the safest and soundest banks in the U.S. system, and they do not create systemic risk. What they do create is competition and innovation in the U.S. banking system and provide much needed credit to millions of American families and small businesses.

Again, we appreciate the opportunity to submit these comments for the record. Please let us know if you have any questions or need additional information.

Sincerely,



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