George Sutton
[redacted]

October 10, 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:

I appreciate the opportunity to submit the following comments on the proposed amendments to 12 CFR Part 354 described in RIN 3064-AF88, Parent Companies of Industrial Banks and Industrial Loan Companies.

For purposes of this letter, I will refer to the industrial loan companies that operated before FDIC eligibility as ILCs and those insured by the FDIC as industrial banks (IBs). For reasons described below, the differences are important.

My interest in these proposals, and in industrial banks generally, is based on my more than 40 year career as a regulator, attorney specializing in banking and corporate law, and my opportunities to serve on the boards of directors of three banks. I am familiar with the modern IBs because I was the regulator in Utah when they started and where most IBs are now based. I subsequently represented many of the applicants and banks as the industry developed.

I joined the Utah Department of Financial Institutions (UDFI) in 1983 as the deputy commissioner and staff attorney. At that time the UDFI it was closing the first depository institutions since the 1950s. In 1987 I was appointed the commissioner and served in that position until 1992. The UDFI charters and regulates all state chartered banks, credit unions, industrial banks and savings and loans. It also administers the consumer credit code and mortgage lenders. In Utah the UDFI is a standalone agency and the commissioner is a cabinet level officer appointed by the Governor and confirmed by the state Senate.

The 80s was a period of high inflation and recession nationwide called “stagflation.” Many banks, savings and loans, credit unions, privately insured industrial loan corporations and private deposit insurers failed during that period. Working with the FDIC, we had to close about one third of the banks in Utah (by number, not assets). As commissioner I would take possession of each failed bank as authorized by state law then appoint the FDIC receiver. The FDIC would arrange for an acquisition by another bank or liquidate the failed bank. We also closed about one third of the credit unions and privately insured ILCs and all of the state chartered savings and loans. We witnessed the failure of the federal deposit insurer of the savings and loans, the FSLIC, and its take over by the FDIC. We also closed the private deposit insurer for the ILCs in Utah and oversaw the liquidation of those institutions that could not convert to FDIC after they became eligible to apply. Another private deposit insurer of credit unions also failed and, working with the NCUA, we successfully converted all the privately insured credit unions to federal deposit insurance without any loss of access to deposits or disruption in the operation of those credit unions. At the time those credit unions held about one third of all personal checking accounts in the state.

My time as a regulator enabled me to see first hand the consequences of bank failures on customers and the communities they served. I learned that private deposit insurance is not capable of dealing with large numbers of failures caused by economic conditions. Deposit insurance only works if it is backed by the federal government. Private deposit insurance was allowed in several states in those years but all of those insurers failed in the 80s causing serious losses and problems for many people. I appreciate perhaps more than most the critical role the FDIC plays in maintaining the stability and public confidence in the nation's banking system. It is unquestionably one of the most beneficial and important government programs in the banking system and economy.

Another important event during this period was a new law making ILCs eligible for FDIC insurance. A typical ILC was a localized finance company operating through retail offices. Several of the ILCs in Utah were subsidiaries of bank holding companies offering deposit rates competitive with money market funds when deposit rates at banks were capped. Those ILCs merged into their affiliated bank when federal deposit rate caps were repealed. Over the next two years some of the independent ILCs successfully qualified for FDIC insurance. Those that could not convert by the time the private deposit insurer failed were closed and liquidated.

This new federal law also made it possible for a diversified company to own a federally insured bank if the bank did not offer demand deposits. Many diversified companies soon filed applications to organize an IB. There are two applications, one to a state to approve the charter and the other for the FDIC to grant deposit insurance. Utah accepts a copy of the FDIC application and the two regulators work independently but coordinate closely to process each application. For several reasons, most of these applications were filed in Utah. Not all applicants were successful but the contrast between the strength of these new banks, including the support provided through the parent, compared to the many institutions we were closing was stark.

Today Utah ranks fifth in the nation for assets held in banks chartered and regulated by a state. This includes many IBs. That is the case even after most of the largest IBs converted to national banks or commercial banks or were acquired by national banks. Since at least the 90s, Utah banks in the aggregate have consistently ranked first or second in the nation for capital and profitability as shown in the FDIC's quarterly state rankings. This is confirmed by the attached charts prepared by the Utah Department of Financial Institutions showing the condition of all Utah chartered banks as of the second quarter of 2024. The graphs break out IBs, commercial banks and community banks. Utah's community and commercial banks have some of the strongest financial rankings in the nation while the IBs rank higher than any other group of banks insured by the FDIC.

I resigned as commissioner in 1992 to become the CEO of an IB owned by a manufacturing company. When I started as CEO the bank was profitable and had a capital ratio of about 28%. It was the third largest issuer of MasterCard business cards in the nation. Not long afterward the parent decided to close the bank and I managed its liquidation. We sold all the credit card accounts and receivables to an independent bank issuing a related consumer credit card cobranded with the parent, collected the other loans and paid all our depositors and creditors in full, then paid a liquidating dividend to the parent. That process took about one year.

I then joined a law firm and began practicing banking and corporate law. For the next 30 years I primarily worked on new bank applications, mostly for IBs, and advised existing bank clients on regulatory matters. I represented at one time or another about half of the IBs and IB applicants. That enabled me to maintain my relationships with local and regional FDIC officials that began when I was the state regulator.

In 2009 I was invited to join the board of a federal savings bank that was a second tier subsidiary of another large and well known manufacturing company. That bank specializes in cobranding partnerships with merchants and medical providers to offer point of sale financing. The business was unrelated to the parent's other business lines. On the marketing side we were an independent bank that happened to be owned by a diversified parent. That parent also owned an IB that operated in a similar manner but specialized in business finance, especially financing fast food franchises, again unrelated to the parent's other business lines. Both banks utilized some of the parent's computer and communication systems but each had an independent board and management and business.

In about 2011 the bank where I was a director spun off from the parent and operates today as an independent, publicly traded FSB. Its operations are branchless. Its loans mostly originate at retail stores and health care providers with approvals given in a few minutes. It is the largest private label card issuer in the nation holding more than $100 billion in assets. It always maintained strong capital ratios, was consistently profitable, and had good relations with the OCC. As part of the same corporate reorganization of the parent, the companion IB was closed and liquidated at no cost to the FDIC. I left that board in 2016.

In 2018 I was invited to join the board of directors of a regional state chartered bank that is a "family of community banks." It has grown to about $25 billion in assets by acquiring high quality community banks that continue operating under their original name and management as divisions. It is a classic community bank serving mostly local businesses through branches spread throughout the intermountain west from Canada to Mexico. Its biggest concentrations are CRE and ADC loans to local developers. It also finances many hospitals and medical providers. This structure is attractive to the acquired banks because it provides a scale and level of support that enables the local bankers to continue serving borrowers through all stages of growth. This bank also consistently maintains strong capital ratios, above average profitability and efficiency, and good relations with its regulators. I left that board in 2022.

I have also served as counsel to two bank trade associations. However, I need to make the standard disclaimer that my views as stated in this letter are entirely my own and should not be imputed to any client or organization.

Recommendations Regarding Proposed Amendments to Part 354

For the following reasons, I urge the FDIC not to adopt the proposed amendments. Most are redundant while the remainder are unjustified, arbitrary, capricious, and exceed the FDIC's authority under applicable law.

In the alternative, I recommend deleting proposed §§ 354.2(a)(5) and 354.6(b) and (c). .

The FDIC chairman's pending resignation is one reason the proposed amendments should be withdrawn. The vote of the FDIC board to publish the proposals for comment was 3 to 2. The new chairman may not support these proposals and they could be withdrawn or possibly changed again. Good regulation requires stability and consistency. Frequently changing standards, even as proposals, discourages investments, complicates planning and erodes confidence in the system. I am unaware of any problems or other developments since the current version of Part 354 was adopted in 2021 that can explain the reason for these proposed changes. Whether to proceed or scrap this proposal should be decided by the next chairman.

History of Industrial Banks

Understanding the history of IBs helps explain the misguided and unjustified nature of the proposed amendments.

To begin, it is important to describe the differences between ILCs and IBs. They are polar opposites in terms of how they operate and their financial strength.

ILCs have been found in many states since the early stages of the industrial revolution. They began along with credit unions early in the last century to provide credit to industrial workers that were not adequately served by banks.

ILCs in Utah and other states were mostly local finance companies with private deposit insurance when they first became eligible for FDIC insurance. Most ILCs made smaller consumer loans at higher rates than banks and credit unions. A few had recently developed as affiliates of large banks to serve depositors seeking higher rates as inflation rose and deposit rates at federally insured banks were capped. The ILCs affiliated with banks held most of the assets in the industry by the early 80s. Those ILCs became almost immediately obsolete when Congress repealed the rate caps on federally insured deposits. As stagflation continued and worsened, loan losses rose and ILCs began to fail. The private ILC deposit insurer soon exhausted its reserves and failed. We notified the remaining ILCs that they had to convert to FDIC insurance or close. The Utah legislature enacted a law requiring FDIC insurance to eliminate private deposit insurance. The first FDIC insured ILC was a subsidiary of Citicorp named Citicorp Person-to-Person Finance. It converted into a branch of Citibank as soon as branching laws allowed.

This was also the time when new technologies and financial products began to develop such as credit cards. Visa, MasterCard, American Express and Discover developed as new electronic systems to process card transactions. The opportunity for diversified companies to own banks started as a de facto exemption from the Bank Holding Company Act (BHCA), which prohibited diverse businesses from owning a bank that offered commercial loans and.demand deposits. An FDIC insured bank that did not offer checking accounts was exempt. In 1987 Congress passed the Competitive Equality Banking Act (CEBA). It expressly adopted this exemption. It also made the exemption applicable only to IBs in states that required the bank to have FDIC insurance as of March 1987. It was meant to be an experiment to see how this new kind of bank would perform. At the time, about six states could qualify. Today it is a practical option only in Utah and Nevada.

The experiment turned out better than anyone imagined at the outset. Development of electronic delivery systems made the geographical structure of the financial services markets obsolete for things like credit cards and provided many new opportunities that diversified companies saw in connection with their other businesses. It was a natural expansion of businesses throughout the economy. Many of the nation's leading companies began organizing IBs.

Today, most IBs tend to operate without retail offices or branches and electronically deliver specialized credit nationwide and in some cases worldwide. The development of these IBs is entirely market driven. They compete with other financial services providers based on cost, convenience, rewards, and a customer's desire to deal with a company they already know and trust. They are among the pioneers of branchless banking, which has become one of the biggest sectors of the financial services markets. IBs are not the only banks operating branchless. There is also an array of federal savings banks, credit card banks, Delaware chartered nonbank banks and divisions within many of the largest national banks.

New technologies have resulted in broad segmentation of the financial services markets that didn't exist before the 1980s and different segments are best served by different kinds of banks. CRE and ADC lending still largely relies on relationships between local lenders and businesses to provide customized loans that meet the particular needs of those businesses. The community and commercial bank model remains best suited for those customers. The big change there is how branches are located. Convenience still matters but because of reduced foot traffic, many branches are now located where they are most convenient for employees and borrowers. But that model does not work as well for credit and debit cards. Cards are highly automated and standardized. Branches are not needed and sap profitability. A typical branchless bank is twice as efficient and twice as profitable as a bank with branches and those savings can fund rewards programs and better rates that even a credit union may not be able to compete with because they have branches too.

Branchless banking requires different kinds of funding strategies. Many of those banks raise direct deposits through Internet based programs but most also use brokered deposits, lines of credit at correspondent and wholesale banks, and securitizations. They must be well capitalized If they utilize brokered deposits to a significant degree, which most branchless banks can economically do because they are inherently more efficient and profitable.

I came to see these advantages when I was the commissioner in Utah. One of the first of the new IBs was owned by an insurance company. Laws at the time prohibited an insurance company from owning a commercial bank but it could own a single federal savings bank (FSB) insured at that time by the FSLIC. In response to positive customer surveys, the insurance company organized an FSB a few years earlier in Texas to issue credit cards. That bank had grown to about $12 billion in receivables by 1984. When I investigated the applicant, one rating service the UDFI used that rated every savings and loan in the nation on a scale of 1 to 300, 300 being the best score. It rated that FSB 300. It was one of five in the nation to achieve that rating. In stark contrast, of the hundreds of other savings and loans in Texas, two thirds were rated failed or failing and most did eventually fail. That FSB began by offering 250,000 of its parent’s insurance customers a plain MasterCard. Normally a credit card offering is considered successful if 1% accept. The bank geared up for a 10% response since its parent already had a good relationship with the customer base. Attesting to the strength of those relationships, 49% accepted the offer. I asked why the parent wanted an IB and was told its depositors preferred FDIC insurance as rumors spread that the FSLIC was becoming bankrupt, and interest rate caps in the bank’s home state prevented earning a profit due to the deposit rates the bank had to pay when inflation was topping 20%. It was a classic case of a rate risk that would eventually cause most of the nation’s savings and loans along with the FSLIC to fail. Moving to Utah solved the rate cap problem. Both the FSB and the IB continue to operate successfully today.

Another IB organized at this early stage was owned by a company operating a chain of truck stops nationwide. Long haul truckers at that time had no practical access to banking services on the road. Most independent operators had to live on whatever cash they could bring with them. That IB was able to offer basic banking services and factor completed bills of lading at each truck stop. A few years later, the parent of the truck stops filed Chapter 13 bankruptcy to reorganize and eventually sold the truck stops to a competitor. The bank continued operating normally throughout this period. The original owners of the truck stops took direct ownership of the bank and eventually converted to a commercial bank that still operates successfully today.

Another IB was organized in the 80s to finance the purchase of postage by bulk mailers. Its parent made postage machines. Over time the machines evolved into devices to arrange shippage of bulk goods by merchants, many of which sell over the Internet. The bank offers an option to finance the shipping costs in ways that are more convenient than using a line of credit issued by an unrelated bank. During the Great Recession I was present at a meeting with then FDIC chairman Sheila Bair who asked that bank's CEO how it was affected by the recession. He replied it had caused the bank's ROA – not.ROE – to decline from 17% to 14%. That was in the midst of the failure of 529 commercial banks costing the FDIC billions in losses. That IB still operates today.

Another IB organized in the 80s is a subsidiary of a company that manages vehicle fleets. Many of its customers are governments. The bank offers a convenient option to finance fuel purchases by those fleets. It still operates successfully today.

Another IB organized in the 80s was a subsidiary of a large telephone company. The bank issued MasterCard credit cards combined with a calling card feature. This was before mobile phones and the card was popular with travelers who used the calling card to call home and make other long distance calls avoiding the much higher rates charged by hotels. When mobile phones became popular that calling card feature became obsolete and the bank closed and liquidated at no cost to the FDIC.

Another IB organized during this period was a subsidiary of Lehman Brothers. It specialized in commercial lending to customers referred by the parent. When the parent filed bankruptcy, the bank renamed itself Woodlands Commercial Bank and began liquidation. Its loans were high quality and match funded with brokered deposits. Over about a two year period the bank collected its loans and paid all of its CDs in full. The most serious problem the bank faced was that it had booked its loans as held for sale and accounting rules required it to mark them to market at a time when the secondary market for loans had tanked. The loans were repaying normally and the bank was under no pressure to sell them but the market value write downs created a potential capital impairment. To remedy that, the bank went to the parent's bankruptcy trustee who, with the consent of the parent's creditors' committee, contributed additional capital to the bank to avoid receivership and protect its investment. In the end the bank closed after paying all deposits and other debts in full and paying a multi billion dollar liquidating dividend to the parent's trustee.

Three other IBs were owned by large investment banks at the beginning of the Great Recession. One was a subsidiary of Merrill Lynch. It merged into Bank of America along with the parent. The other two banks, one owned by Morgan Stanley and the other by Goldman Sachs, continued operating but converted to commercial banks. One became a national bank and the other a New York state chartered bank. Those conversions were intended to convert the parents into bank holding companies to make them eligible for liquidity support from the Federal Reserve. That helped prevent runs on the parents in the same way that FDIC insurance helps prevent depositor runs. Those banks continue operating successfully today.

The one failure of an IB was Advanta Bank. It occurred in 2010 due to large loan losses caused by the recession. The bank had operated for several years with minimal delinquencies specializing, along with its parent, in small business finance. Its parent had been in business for decades starting in Pennsylvania as a seasonal lender to teachers. The parent filed for bankruptcy in 2009.

All the IBs are or were legitimate, sustainable, sound and beneficial businesses that deserve a fair opportunity to exist and compete. The biggest problem IBs have faced since the beginning of the Great Recession is that the current chairman of the FDIC has done all in his power to deny them that opportunity. He has not explained why. It is not due to any experience with the IBs or their performance during the recession. The FDICs own data clearly shows IBs outperformed all other banks during that period.

Critics often say a problem with branchless banks is that they lack the “sticky” relationships with their customers that commercial and community banks enjoy. That is not correct. The history of IBs provides many examples of real goodwill and a strong relationship with customers they share with highly regarded affiliates. The insurance company owned bank that got a 49% acceptance of a credit card offering exemplifies this. Most banks sharing established customers with an affiliate have the additional advantage of being profitable from inception. Banks that need to build customer relationships from scratch usually operate at a loss for at least the first few years.

I began to question why diversified parents are prohibited by federal law from owning regular banks as I considered the stark contrast between the growing numbers of successful IBs and the large number of traditional savings and loans and banks and credit unions failing nationwide. During stagflation and then during the Great Recession the nation’s financial system was in crisis while banks owned by diversified companies were achieving some of the strongest financial ratings any depository institution could hope to achieve. These new banks had to develop outside of the traditional bank holding company structure, which led me to question whether that structure had become obsolete, at least to the extent that bank holding company regulators and certain community bank advocates oppose allowing branchless and other new kinds of banks to become part of the banking system. The Bank Holding Company Act was enacted in a different time and under different circumstances to prevent concentrations and preserve unit banking, which no longer exists. The proof of IBs' legitimacy and viability has been proven beyond doubt over the past forty years.

In terms of the market—where all banks thrive or fail—the larger point is that one size no longer fits all. Different kinds of banks are needed to efficiently and conveniently deliver the broad array of products and services found in today's market. Sound regulation must recognize and accommodate these differences. Instead, these proposed amendments are an attempt to fight the market and retard its natural development. That is a serious mistake for any regulator.

History of IB Regulation

The regulation of modern IBs by the FDIC thus far has gone through basically three stages.

During the 80s, the IBs and the regulators had a steep learning curve to understand each other and develop effective regulations for the new branchless model. Requirements for a majority of outside directors, separate management, fully independent decisioning and a thorough understanding of the requirements of affiliate transactions laws developed during this time.

The next phase began in the 90s as both the banks and regulators gained confidence in the branchless model and what became known as bank centric regulation. Instead of separately regulating the bank and its holding company, the bank centric model regulats the banks in the same way and subject to the same standards and requirements as other banks while simultaneously overseeing and regulating the bank's relationships with its parent and affiliates. Applications began to move smoothly during this period. Before 2007, several new banks formed and applications were being processed in months instead of years, as had been common in the 80s and 90s.

The third phase began when the current chairman first became the acting chairman in 2007. It soon became known that he intended to block applications for new IBs. He did not announce this policy or provide any information about why he believed IBs should not qualify for deposit insurance. There were some indications that he believed only traditional community banks merited deposit insurance and only deposits obtained through branches, commonly referred to as "core" deposits, should be insured. This policy was not adopted through rulemaking or other public announcement and discussion, or even acknowledged when Congress, for example, would ask what was going on.

This biased policy conflicts with and is designed to effectively repeal federal law. The Federal Deposit Insurance Act expressly makes industrial banks eligible for FDIC insurance. Blocking their development has caused significant harm to companies that would benefit from owning a bank and the customers they would have served. It represents a serious and continuing abuse of power.

New IBs were blocked in two basic ways. One was denying applications by just not approving them. Applications filed after 2006 pended for years going through a cycle of silence, ostensibly while examiners reviewed them, followed by questions that the applicant promptly answered, followed by another long period of silence, followed by more questions, and so on until the applicant gave up and withdrew the application. One application filed by a well known U.S. based manufacturing company that already owned a FSB was pending for about six years before being withdrawn. That company has existed for more than 100 years and was one of the leading manufacturers of farming and construction equipment in the world. It wanted to organize the bank to provide banking services to underbanked rural areas that it could not serve through its FSB due to restrictions on the kinds of products and services it could offer. That application was not blocked because it failed to meet the requirements for deposit insurance. It was blocked because it was an IB.

I worked on other applications during this period that I considered among the strongest I ever saw presented for deposit insurance. They went into the same black hole. One was a leasing company that had operated successfully for more than thirty years relying on bank warehouse lines for funding. It specialized in small ticket leases such as hospital equipment that were largely unaffected by the recession. The problem it encountered during the recession was not reduced lease applications but cutbacks in its warehouse lines as banks downsized to increase capital ratios demanded by regulators. While the financial proformas presented by a new community bank applicant are purely speculative, the financial statements provided by this business were based on real seasoned data. It would have been profitable from the outset and shifting its business to its own bank would have avoided the funding problems it encountered. The person recruited to run the bank had a long successful career as CEO of other banks. There was no basis to deny this application on the merits and it would have made an already successful business even stronger. It failed to be approved only because of the rope-a-dope process imposed by the chairman.

The other tactic was to issue studies based on regression analysis and coefficients purporting to show that banks utilizing brokered deposits were more likely to fail than banks with core deposits. Regression analyses and coefficient metrics are not used in any other regulatory context I know of and are gibberish to most bankers and people. More to the point, the findings of these studies are facially disproven by the FDIC's own data on actual failures. That data shows the 530 failures that occurred between 2007 and 2017 were almost entirely concentrated in commercial banks with branches that held mostly or entirely core deposits. More than half of those banks held no brokered deposits. Another 45% held a majority of core deposits. 33, representing 6% of the failed banks, held a majority of brokered deposits but also held substantial amounts of core deposits and of those only two held more than 90% brokered deposits. The study could not identify any specific causal link between failure and holding brokered deposits. In comparison, there is a well known risk of runs on core deposits while brokered deposits are run proof.[1] Recent bank failures such as Silicon Valley Bank were caused by runs on core deposits, many of which were uninsured. There has never been an instance of runs on brokered deposits. If there was any correlation between deposits and failure it is clear core deposits pose the greater risk.

The conclusions of these studies are spurious and misleading. They were published to provide a basis to reject applications by branchless banks. Many applicants were told—but not in writing—that any proposed use of brokered deposits automatically precluded approval.

Blocking the formation of new IBs is a surreptitious policy clearly designed to avoid formal denials that could result in oversight hearings and lawsuits. It is telling that the chairman feels it is necessary to deny what is clearly happening and block the applications in secret. It is a classic example of "deep state" action without authorization or compliance with administrative law while avoiding the type of review that would reveal its deeply arbitrary and capricious origin.

In more candid moments FDIC officials told applicants that no application would be approved if it did not follow the model of a traditional community bank. I heard the chairman say exactly that in a private conference of bankers in about 2018. He said three things necessary for approval of a new bank is a plan to serve a specific geographic area, lend primarily to borrowers in that area, and raise all deposits at branches. In the years before 2007 between 100 and 200 new banks were approved in the U.S. each year. Under the current chairman's direction, between 2007 and 2010 only four banks were approved in the entire nation. There are many reasons for the dearth of applications for community banks—such as the difficulty of starting a new community bank in a chaotic market when 529 such banks were failing—but not for failure to approve many IB applications. The application moratorium on IBs is not authorized in any federal law or prompted by failures or other problems. It is the epitome of arbitrary and capricious agency action.

Another example of the arbitrary and capricious nature of this practice is how it does not make sense from an insurance perspective. IBs pay higher deposit insurance rates, supposedly because they present higher risks, but they make fewer claims and actually present fewer risks to the insurance fund. Their lower failure rates attest to this. Their superior capital ratios and profitability contradict any claim that they are more likely to fail. The stronger ability and commitment of a diversified parent to recapitalize a

[1] Brokered deposits are run proof for several reasons. Those held as CDs prohibit early withdrawal except if the depositor dies or is adjudicated incompetent. Other depositors rarely know where a broker has placed their deposit and they and the broker are only concerned that it is federally insured. A good example is a more than 100 year old bank in Utah that failed during the Great Recession. Local press reports about it failing started a run that lasted for days and depleted about 15% of its deposits and its liquidity. All the deposits withdrawn were core deposits. About a third of its deposits were brokered, none of which were withdrawn.

subsidiary bank also reduces risks.[2] All of the 529 failed community banks between 2007 and 2017 had traditional bank holding company parents that proved incapable of assisting the bank as it failed. In contrast, most IBs have access to all the capital they might ever need to cover losses or to expand the business. IBs effectively subsidize rates and claims for other banks. The FDIC has consistently ignored complaints and comments about this unfair practice.

It is worth noting that the existing IBs supported the adoption of the current Part 354 in 2021 during the tenure of then chairman Jelena McWilliams. It mostly formalized reasonable practices that had been common for years and helped dispel misinformation spread by IB critics that IB holding companies and affiliates were not regulated and amounted to a “blind spot” in the system.

A good regulatory system must understand the industries and markets it regulates and help or at least permit those it regulates to thrive while blocking bad actors and bad ideas and bad management. I am writing this letter to state for the record how the current chairman of the FDIC, who has served at various times since 2006 as chairman, vice chairman or acting chairman of the FDIC, has failed to understand or deliberately ignored the evolving financial markets banks serve to impose a policy that deposit insurance will only be approved for traditional community and commercial banks. The IBs approved before 2007 have shown beyond any credible doubt that they can provide financial products and services safely, efficiently and profitably. They are a paradigm of good banks and those with sound plans should be welcomed to apply for insurance.

The Proposed Amendments to Part 354

The chairman has announced his retirement. I believe he has proposed these amendments to Part 354 as a final effort to block the approval of branchless banks after he is gone. Nothing else has happened that could explain and justify these proposals.

The underlying purpose of these amendments is to characterize affiliations with non bank entities as inherently risky to a degree incompatible with safe and sound banking. It is a baseless fabrication.

Specific.risks.to.be.assessed.in.IB.applications

The proposed amendments include a new § 354.6(a) listing specific elements the FDIC must consider in each IB application. They are all reasonable, but they would add nothing since for years they have been routinely evaluated in every application along with any other identifiable risk.

[2] A bank holding company cannot be compelled to contribute whatever cash and other assets it might have to minimize losses at the bank if it would constitute wasting of assets claimed by the holding company’s shareholders. In contrast, most IB parents are contractually obligated to contribute capital and liquidity to an IB subsidiary whenever requested by the FDIC.

I advised clients preparing an application that they must do a thorough job of risk identification. I recommend a separate section similar to a securities offering listing all the risks a regulator should consider. It is important to demonstrate that an applicant understands all the risks and has credible plans to address them to build confidence in the competency of the proposed management.

Proposed new categories for "shell" and "captive" banks

A good example of arbitrary proposals is new categories of banks proposed in § 354.6(c) for "shell" and "captive" banks. Such banks have not existed in the past and cannot exist in the future. They are pejorative terms intended to impute risks to IBs that cannot exist without having to explain what they might be.

The normal meaning of a "shell" is an entity with no assets or business. No true shell can possibly satisfy the criteria specified in Section 6 of the FDI Act and other requirements and standards in federal laws and regulations governing an insured bank. An insured bank cannot exist if it doesn't engage in the business of banking, does not have capital and deposits, does not have management, and does not serve public needs and convenience.

A "captive" is normally understood to be an entity that is controlled by and operates for the benefit of its parent. That is prohibited for every IB by an array of federal laws and regulations including Sections 23A and 23B of the Federal Reserve Act (12 U.S.C. §§ 371c and 371c-1), Regulation W, Regulation O, Anti-Tying laws and the current Part 354 and regulations governing third party contracts.

The proposed rule would apply these inappropriate terms to any IB reliant on an affiliate for any of its operations or customers and create a presumption that any IB fitting that definition would not meet the standards of safety and soundness to qualify for deposit insurance. The history of IBs owned by diverse parents does not support this premise in any way. On the contrary, IBs have for decades been the strongest and safest banks insured by the FDIC.

The proposal sets as a goal requiring each IB to be a "standalone" operation, ignoring the fact that virtually no bank operates on a standalone basis. All banks outsource some services and operations. Some IBs outsource to an affiliate but using arms length contracts and subject to the same requirements as outsourcing to a non affiliate.

In my experience, the closest any bank can come to a captive relationship is cobranding. A bank in a cobranding program partners with a merchant or manufacturer to finance its partner's sales. The bank is entirely reliant on the merchant partner for customers and marketing and in some cases operating systems. The websites and contracts for cobranded accounts prominently display the merchant's name. Many customers think the merchant is providing the credit unless they read the fine print in the contract. Cobranding is increasingly common and branchless and involves many kinds of banks. Major competitors in that space include Citibank, Capital One, American Express, Comenity and Synchrony. The FDIC does not impose any presumption that cobranding is unacceptably risky even though the bank relies completely on the partner's marketing and sales. Financial promotions are common and often involves revenue sharing to ensure it is profitable for the bank.

I mention this because of IBs cannot cobrand with affiliates or otherwise finance an affiliate's operations. That highlights the arbitrary and capricious nature of the proposed classifications and the underlying presumption of undue and unique risk. Section 23A and Regulation W prohibit "covered transactions." That includes loans to an affiliate, loans secured by stock of the affiliate, and other transactions enumerated in the law. It also includes the "attribution rule" , which is enforced by following the money. If a money loaned to an independent customer is ultimately paid to an affiliate the loan is a "covered transaction." [3] For example, an auto loan by an IB affiliated with an auto manufacturer is a covered transaction if the money flows through an independent buyer to an independent dealer and then to the bank's parent to pay a flooring line used by the dealer to acquire the cars it sells. In some programs loan applications starting at a dealer may be sent initially to a bank affiliate and some of those applications meeting certain criteria set by the bank may be routed to the bank for decisioning. The bank's criteria include only accepting applications that meet the bank's credit standards from dealers that obtain their flooring finance from independent banks. These programs have operated for years with no problems.

Other IBs only offer financial products and services directly to customers who may also be customers of an affiliate. Some also outsource services to an affiliate using an arms length contract when the affiliate has the facilities and expertise to provide those services. The risks in those arrangements are no greater because an affiliate provides the services. In some ways it is less of a risk if the services are provided by an affiliate. Service providers are notorious for resisting customization or changing their operations except on their own schedule. Having a common parent can help get changes made when needed.

Fully understanding how these relationships work makes the concepts of "shell", "captive" and "standalone" as applied only to IBs in the proposed amendments to Part 354 nonsensical, arbitrary and capricious.

a. New.definitions.of.change.of.control

A new § 354.2(a)(3) would add FSB conversions pursuant to section 5(i)(5) of the Home Owners Loan Act to the list of changes of control. That would be redundant since charter conversions already require advance FDIC and state approval. Utah law requires all Utah IBs to be organized as a Utah corporation so a conversion from a federal to a state

[3] A covered transaction is prohibited unless it is secured dollar for dollar by a dedicated deposit in the bank or the receivable is sold without recourse and paid in full withing the same business day.

charter effectively creates a new bank that is the survivor when the old bank merges into the new corporation.

Another proposed amendment is a new section 354.2(a)(5) giving the FDIC unrestricted discretion to determine a change of control has occurred if the bank is given "an opportunity to present its views in writing as to why the provisions of this part should not apply." Such unrestricted discretion is not authorized by any federal law and violates common standards of federal administrative law. The preceding subparts (1) through (4) of § 354.2(a) all cite specific sections of the FDI Act or HOLA and represent acknowledged instances of change of control as Congress has defined them. Subpart (5) is entirely new and not linked to any authority granted by Congress. Furthermore, federal administrative law says Congress must define the scope of discretion in any delegation of authority. Any delegation of unrestricted discretion to an agency is generally considered unenforceable.

To be sure, any change of control is a matter of great regulatory importance. In my experience, a regulator's most important job is controlling who controls a bank. The surest way to avoid problems and ensure success is if only people with the highest skills, resources and integrity are allowed to control the bank, directly and indirectly. It is and should be a tough standard to meet. But this proposed addition to Part 354 would give the FDIC unlimited discretion both to declare a change of control and ignore the written reply in circumstances that do not amount to a change in control such as the appointment of a new executive officer of the parent even if that person does not play a role in the management of the bank. There have been instances of the FDIC withholding approvals for even insignificant routine changes at an IB such as moving a bank's main office from one space to another in the same area. In one instance the FDIC regional office said it could not allow an IB client of mine to move its main office without Washington's approval and Washington delayed responding for weeks even though the current lease was ending and the bank had to vacate that space. The new office was a short distance away and did not affect any customer of the bank, increase operating costs (the new space was cheaper) or increase environmental impact. The bank had to rent temporary offices in the old building for its senior officers until the approval finally came through while the rest of the office moved to the new location. It was such a no-brainer that I concluded the delay was intentional harassment. Delaying a similar approval for a change in the parent's executives would be an unnecessary and unjustified interference in normal corporate matters. Current parts of the FDI Act relating to "institution affiliated parties" and the ability to issue cease and desist orders would be sufficient to deal with specific concerns about a new executive of the parent or even a current executive exercising unauthorized or damaging control over the bank.

b. Franchise.value

Another new section, § 354.6(b)(2), places a new emphasis on "franchise value." That has always been evaluated in applications and is a legitimate consideration. But as drafted in the proposed amendments, finding a lack of franchise value could be a basis to deny an application, which is unprecedented and unjustified.

Franchise value relates to the value of a bank to a possible buyer if the bank fails. In many cases it is the value of expanding an acquirer's business. Part of that is goodwill but it can also include the value of assets such as loans, real estate, locations, licenses and technologies. When a community bank fails it is always desirable to have the whole bank acquired and reopened the next business day as a branch of the acquirer without any interruption of services. I was involved in many failures handled that way when I was the commissioner in Utah, all of which were community banks, not IBs. A few days before closure the FDIC usually solicits bids from potential acquirers to take all or most of the bank about to be closed. The bid consists of how much money the FDIC would have to provide to the acquirer as part of the deal. Franchise value is one of the factors a bidder might consider in calculating the amount of assistance to bid. Sometimes no bank bids and the FDIC has to pay the insured depositors in full and liquidate the assets at fire sale prices. This mostly damages borrowers' businesses when credit lines are terminated but collateral is still tied up.

Critics complain that branchless banks lack the sticky relationship with depositors that can have value to an acquirer seeking more customers. But that only matters if the bank fails, and no bank can be assured to have franchise value if it fails. Franchise value varies widely depending on market conditions. A single failed community bank in a healthy growing market will be worth more to another bank than one of hundreds of failed banks in a severely stressed market flush with deposits seeking safety, like in the Great Recession. Even in the best cases franchise value of a community bank's depositors often amounts to only 1% or 2% of the deposits. A branchless bank or any bank sold piecemeal can have significant franchise value if its loans are worth a premium, borrower relationships have goodwill value, and it has brokered CDs at below market rates. A thriving credit card or other credit program may easily have more franchise value than core deposits. The main reason there is no data about this regarding IBs is that only one has failed. Many have converted, merged or been acquired, but those have not been put into receivership and caused losses to the FDIC.

In the past, when the FDIC has identified what it considers significant risks such as a novel business plan in an IB application, it has required higher capital ratios, stronger liquidity plans, affiliate guarantees, growth restrictions, and similar measures specified in a written agreement binding on the bank and its affiliates. The current Part 354 and most written agreements require the bank to have preapproved contingency plans if a problem with an affiliate causes the bank to close along with credible plans to replace services provided by an affiliate. Those plans tend not to differ from plans for any bank to replace an independent service provider.

The point is that franchise value is highly variable and cannot provide a clear and predictable reason to approve or deny an application. There is no basis to justify assuming that any IB forced to close if an affiliate fails will cause higher than normal losses to the FDIC, or any losses at all. These make the proposed provisions in § 354.6(b) unnecessary and unjustified as a basis for the presumption described in proposed § 364.6(c) and as a criterion for denying applications.

Questions in the ANPR

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?

Additional definitions are not necessary or justified. This section is not needed to address unsafe and unsound conditions. It will work instead as a pretext to bring legacy banks into the proposed classifications of shell and captive banks and impose the presumption that affiliate relationships are unsafe and unsound regardless of how well those relationships have worked.

The main concern beyond routine changes of control is a person or entity improperly exercising control over a bank regardless of how that person or group is positioned to do it. That might happen if there is no change other than an officer of a parent suddenly attempting to interfere in the operation of a bank subsidiary. Section 8 of the FDI Act, 12 U.S.C.1818, provides broad authority for the FDIC to address such situations with cease and desist orders and, if necessary, prohibiting individuals from further participation in the industry. It authorizes such orders to address any unsafe and unsound condition and to impose orders and penalties on any "institution affiliated party" including affiliate officers, consultants, auditors, legal counsel, etc. Examiners carefully review all affiliate transactions and relationships to ensure the bank complies with all applicable laws. There is no evidence that these laws and regulations are not sufficient to protect the bank's legally mandated independence.

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?

It is misleading to imply that regulators have been unable to consider any risks or potential issues in an application because it was not expressly listed in Section 6 or other statutes and regulations. IB applications are thoroughly reviewed to identify all risks the proposed bank might present and how those risks will be addressed. No application is approved by the FDIC or the state regulator unless they are convinced the plan is safe and sound in every respect.

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?

The proposed shell and captive categories make no sense and should not be adopted. They would only impose a presumption of unacceptable risk in banks with affiliate relationships when no such problem exists. Affiliate relationships should be and always are reviewed in applications and in examinations of existing banks to determine that the bank complies with applicable laws and regulations and that relationships with an affiliate are structured and conducted in a safe and sound manner. There is no evidence that this is not sufficient or enforced or that IBs have not and cannot operate safely.

An underlying theme of the proposed amendments is that a bank qualifies as captive if it "[w]ould serve only as a funding channel for an existing parent company or affiliate business line." In fact, any arrangement in which an IB would fund a parent's business would violate Sections 23A and 23B and Regulation W. An IB cannot finance its affiliate's operations or conduct programs for the primary purpose of benefiting an affiliate to any degree, even if that is not all the bank does.

An IB properly benefits an affiliate in two basic ways. It can pay dividends to the parent out of profits like all other banks. The other is that some IBs help broaden the group's relationship with its customers. One key feature of today's economy is the increasing integration of commerce and finance. A truck stop offering banking services to long haul truckers who are otherwise unbanked or underbanked is a good example, and a good, safe business. There is nothing wrong or unduly risky about such convenient arrangements if the bank properly manages its credit programs. It is noteworthy that no examples are cited in the narrative where sharing customers with an affiliate resulted in losses to the FDIC.

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?

See answer to question 3. This question implies that regulators do not fully review and consider all risks and other matters relating to affiliate relationships, which is not the case.

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?

Having worked on multiple new bank applications, I cannot think of any significant issue that was not been raised by the regulators. It is misleading to imply that there are important areas federal and state regulators do not consider when processing applications and regulating operating banks. Regulation covers not just the areas specified in laws and regulations, it also generally covers all risks and anything relating to safety and soundness.

There is no basis or justification for the proposed amendment imposing a presumption that any affiliate relationship poses unacceptable and unmanageable risks to the bank and the FDI fund. The heart of affiliate risks is possible conflicts of interest. That is what the array of laws and regulations governing affiliate relationships address and they have proven effective.

6. How should the FDIC assess the ‘convivence” and “needs” of the “community” served by dependent bank business models?

Convenience and needs should be assessed the same way as other banks. Who are the bank’s customers? How do they benefit? Is the bank’s CRA program adequate?

A bank that only served the convenience and needs of an affiliate would not satisfy subsection (6) of Section 6 of the FDI Act. It refers to the “convenience and needs of.the. community.it.serves‹ .and a bank cannot serve only the convenience and needs of an affiliate without violating Sections 23A, 23B and Regulation W.

Conclusion

None of the proposed amendments is needed or justified and those detailed above are arbitrary, capricious and beyond the authority delegated to the FDIC by law.

I may not live to see it but I look forward to the time when IBs are once again treated fairly and regulated responsibly by the FDIC. Withdrawing these proposed amendments, or at least the objectionable parts, will be a good step in that direction.

Respectfully,

/s/

George Sutton

All Utah Chartered Banks (34) — UDFI INDUSTRY TRENDS REPORT — 2Q2024

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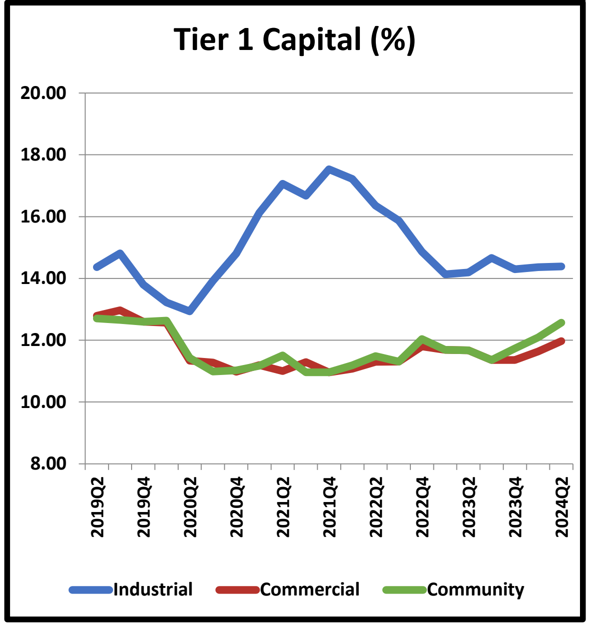

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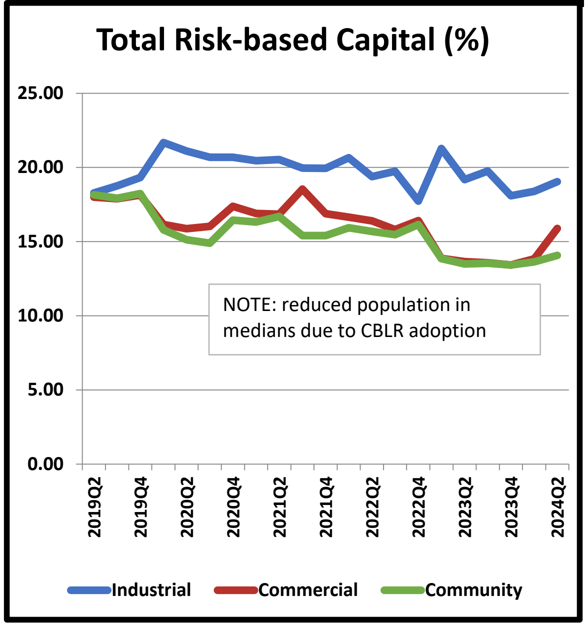

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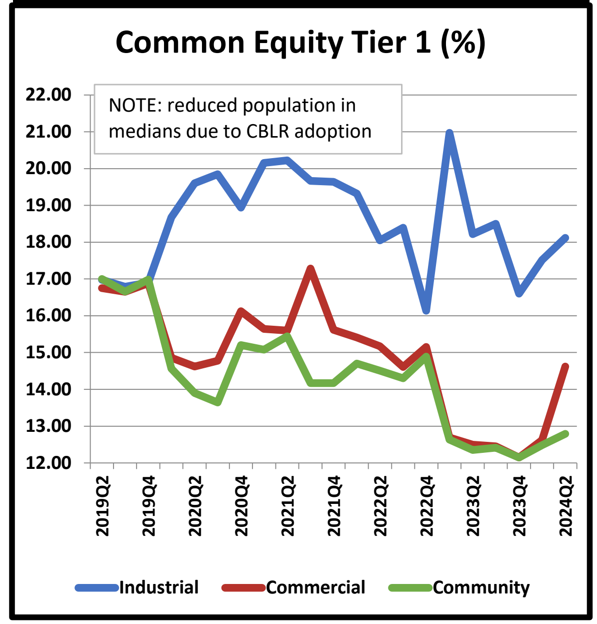

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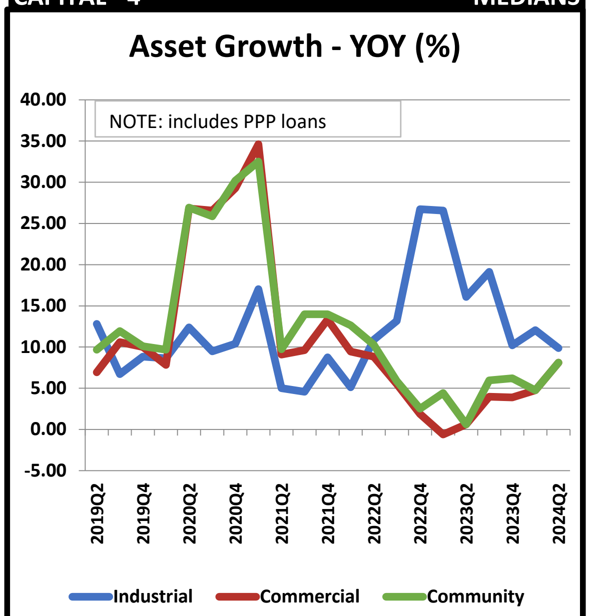

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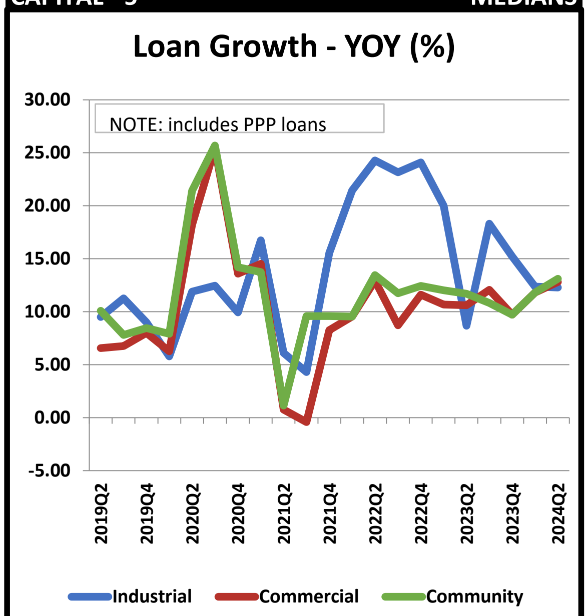

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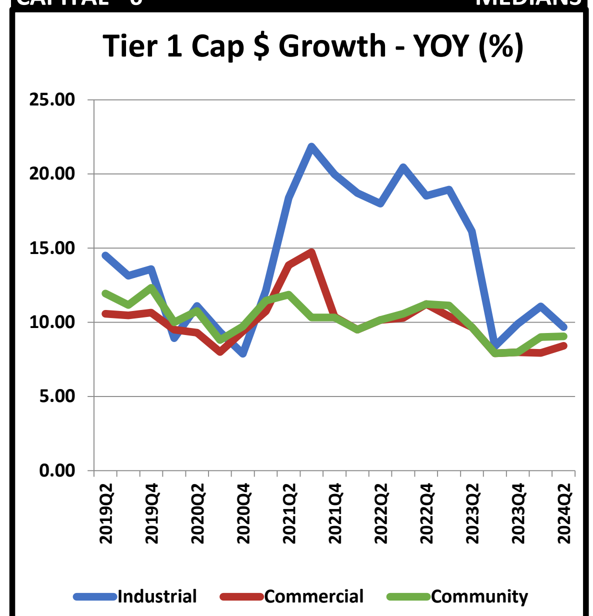

** Community = all commercial banks, excluding niche banks: Ally, Continental, Green Dot, Marlin, TAB*

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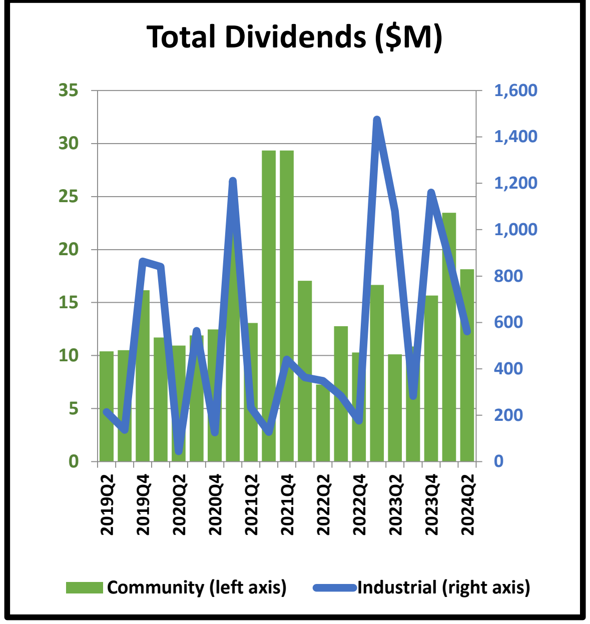

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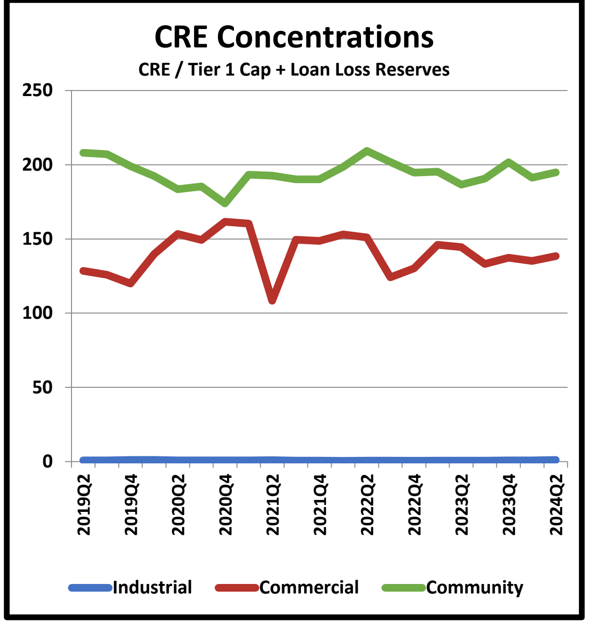

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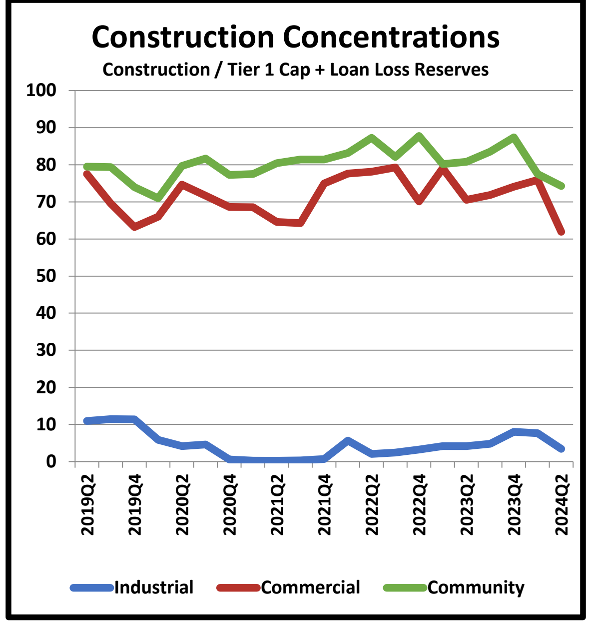

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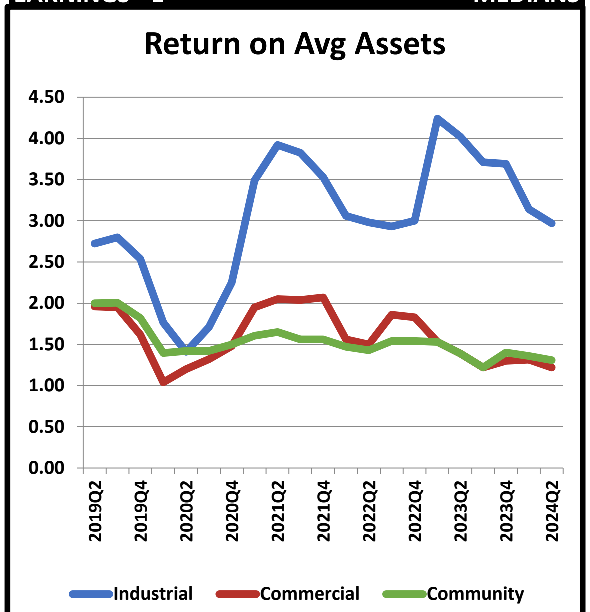

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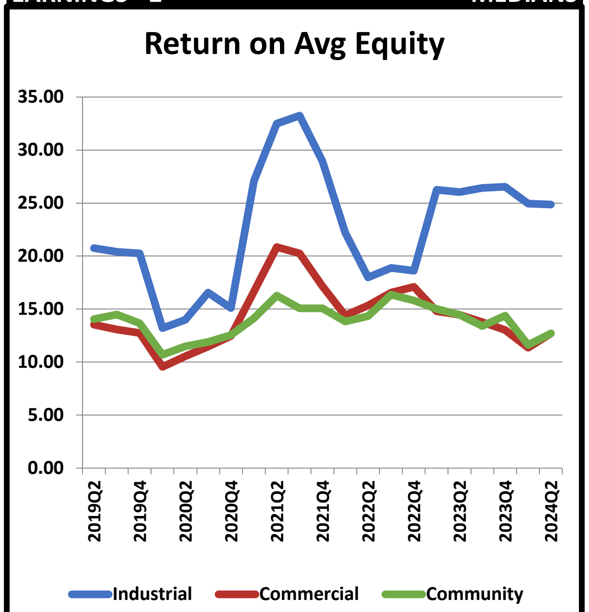

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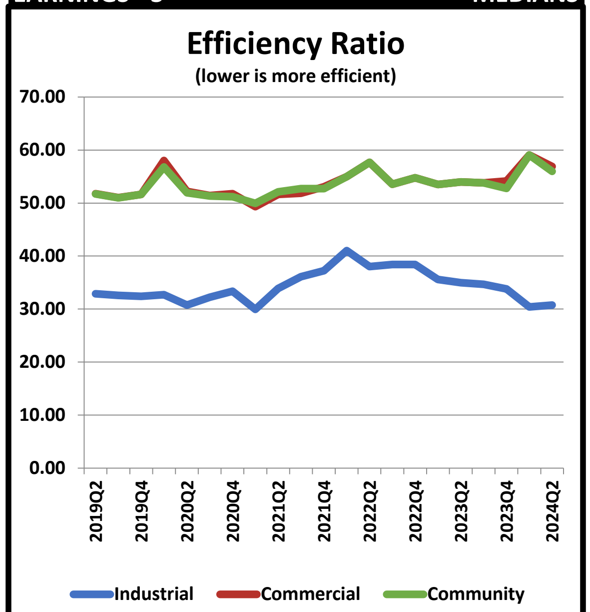

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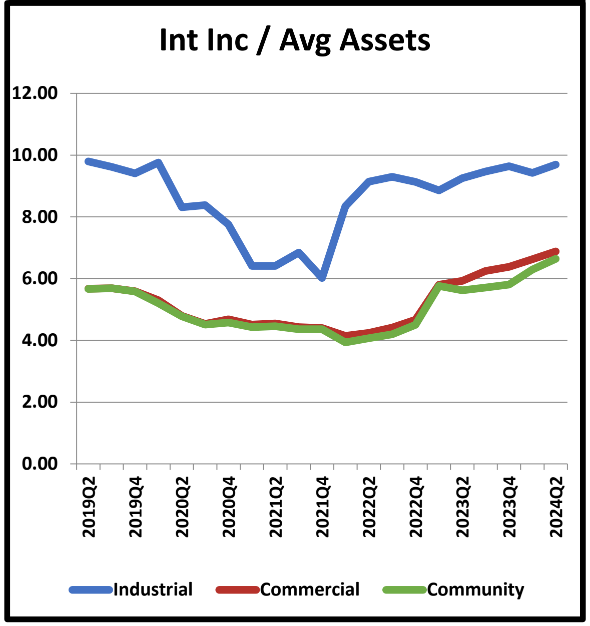

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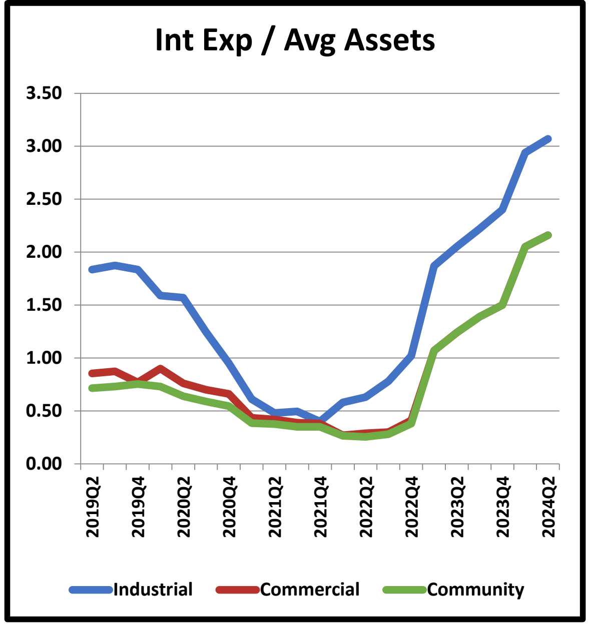

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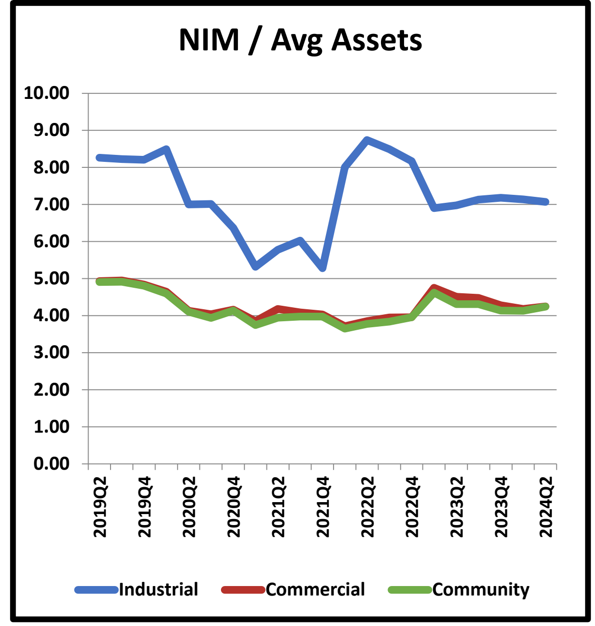

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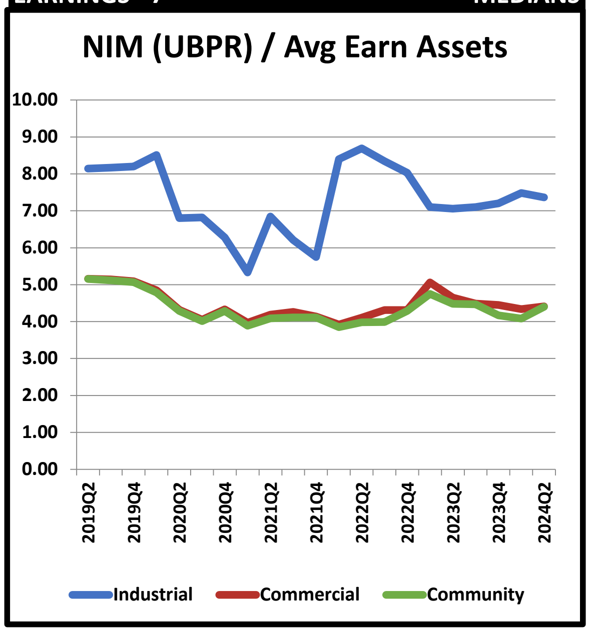

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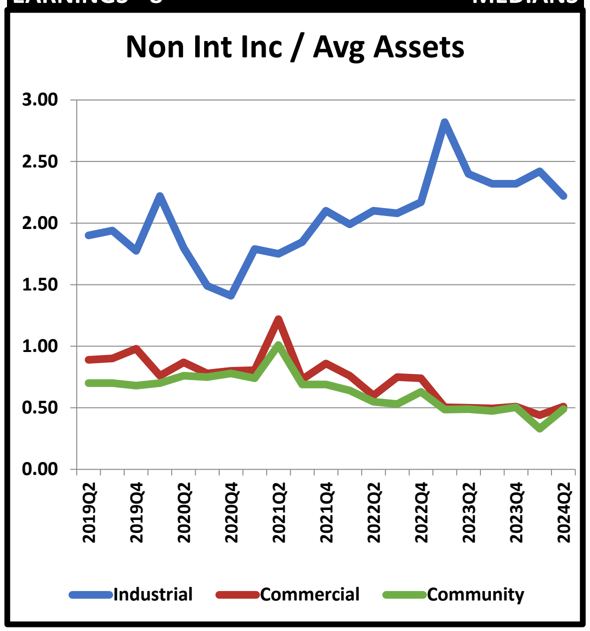

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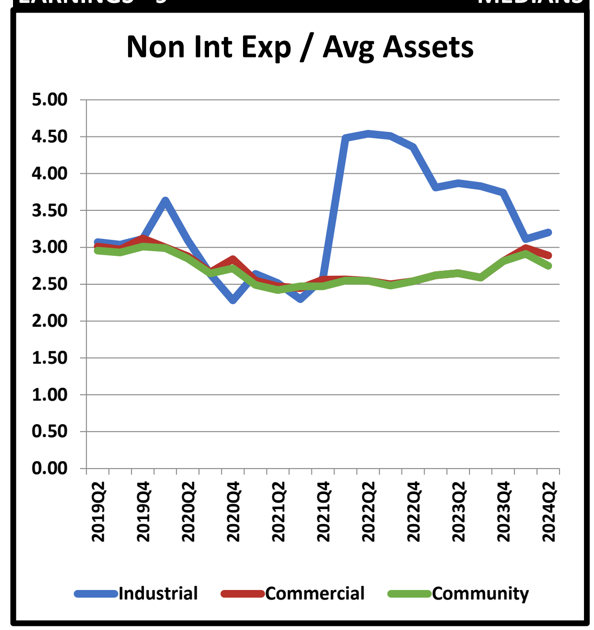

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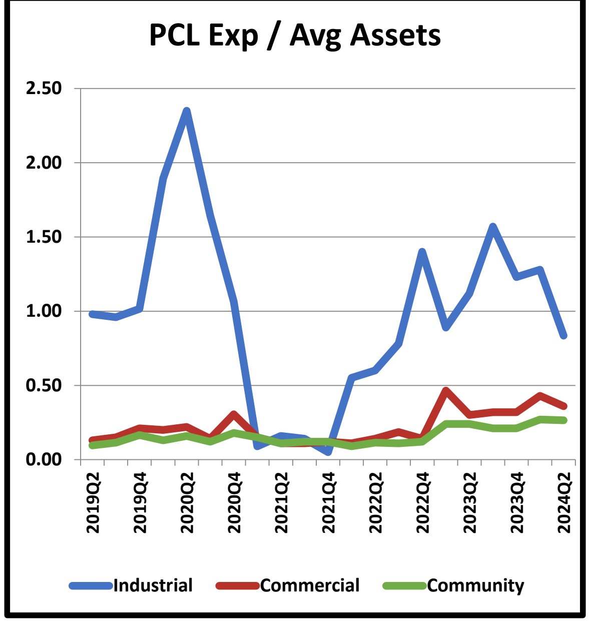

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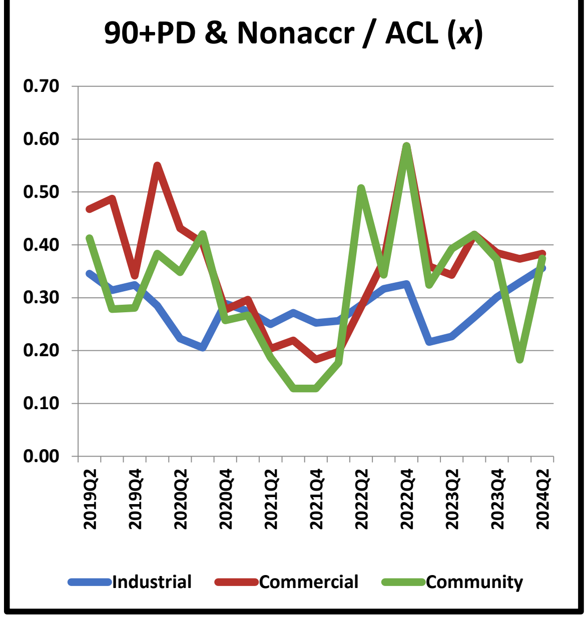

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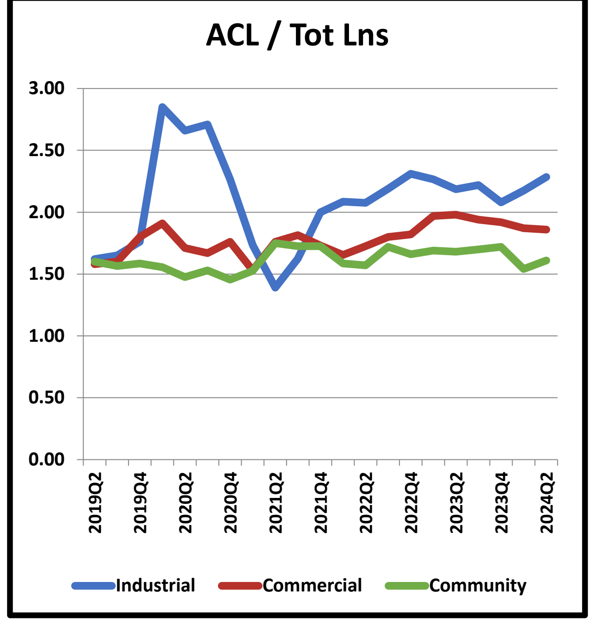

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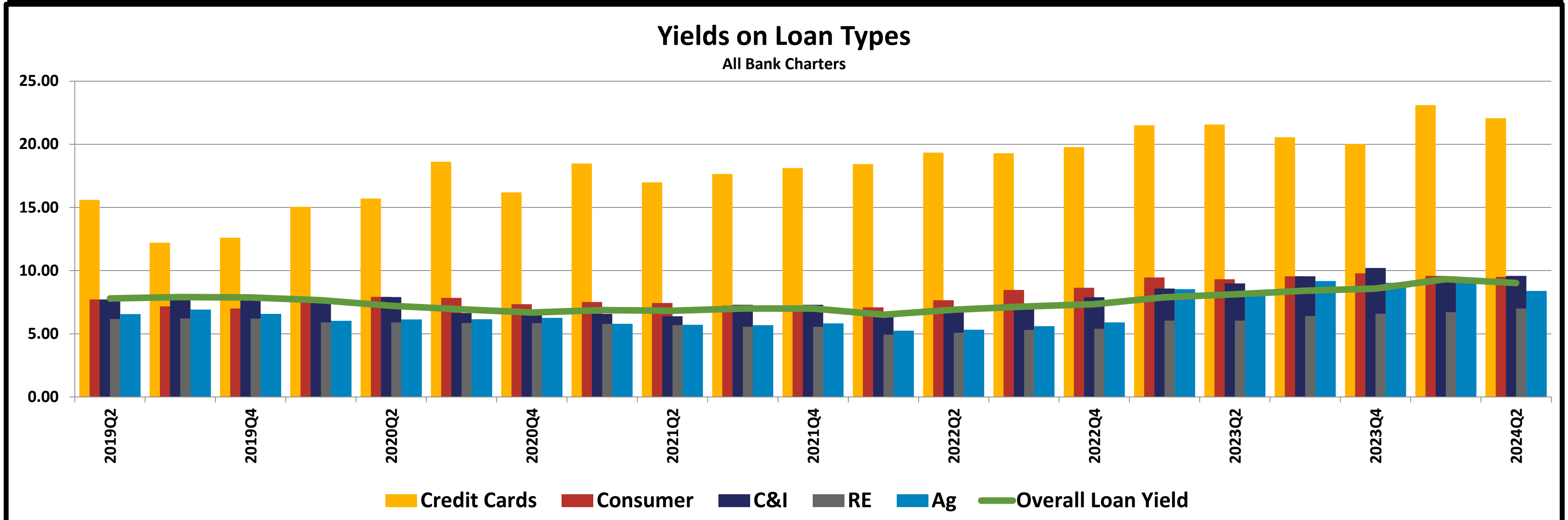

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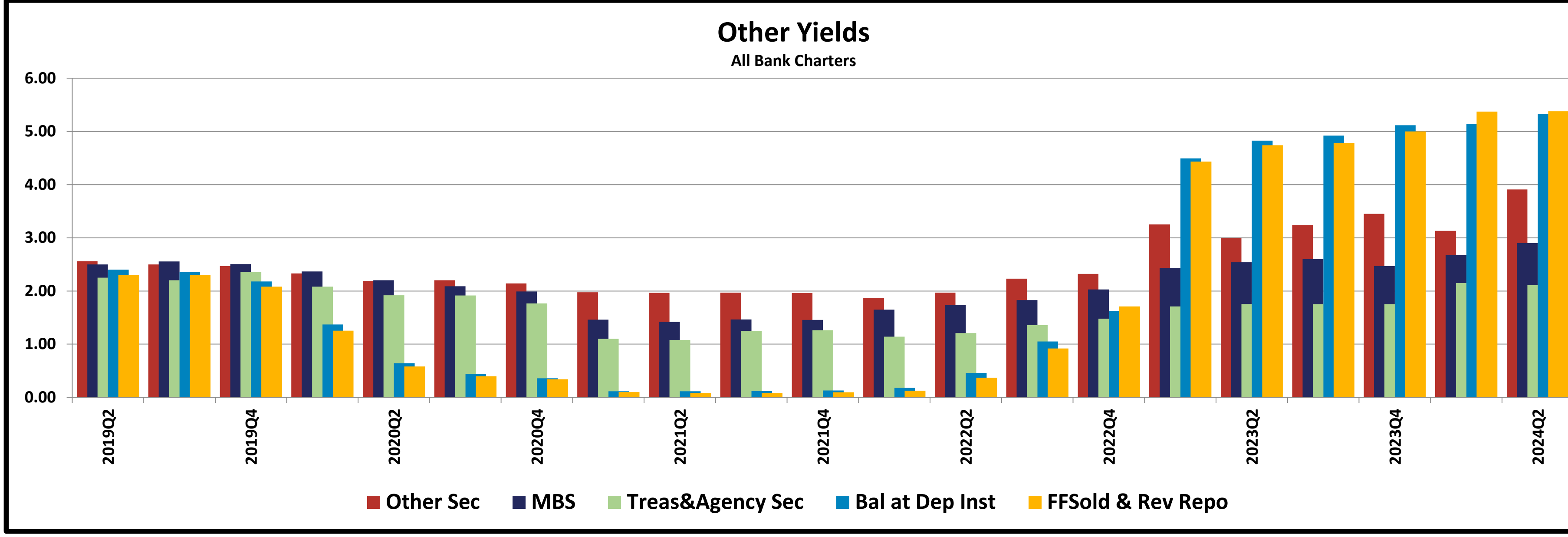
EARNINGS - 14 **MEDIANS**



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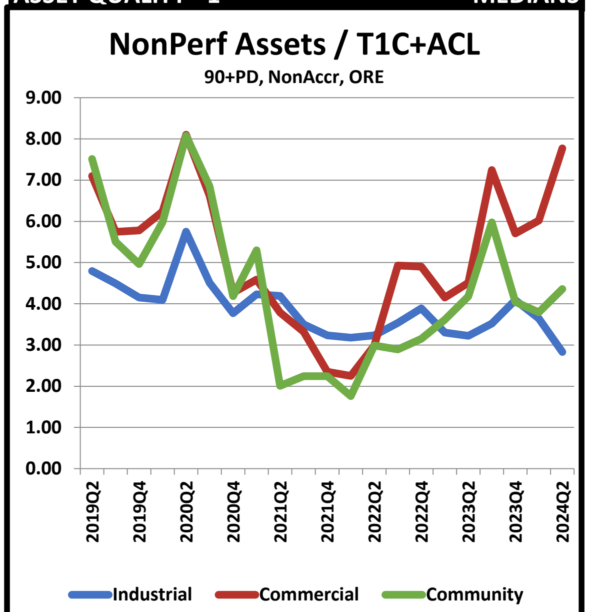

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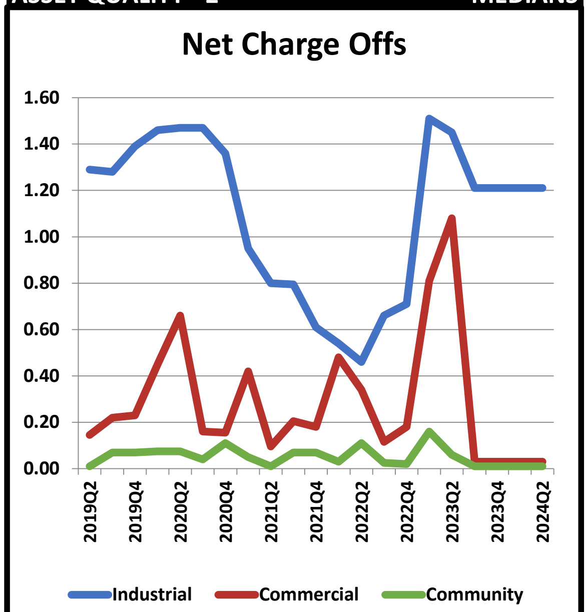

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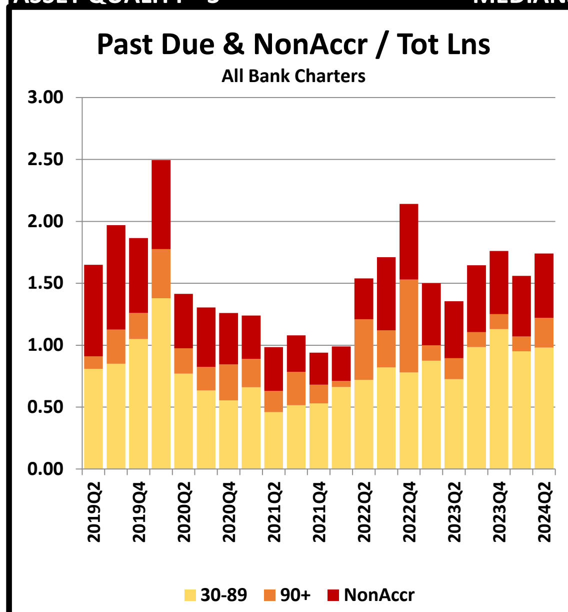

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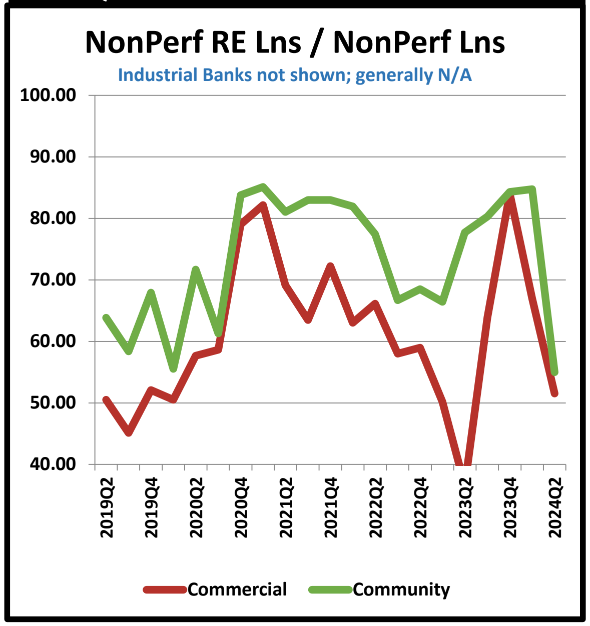

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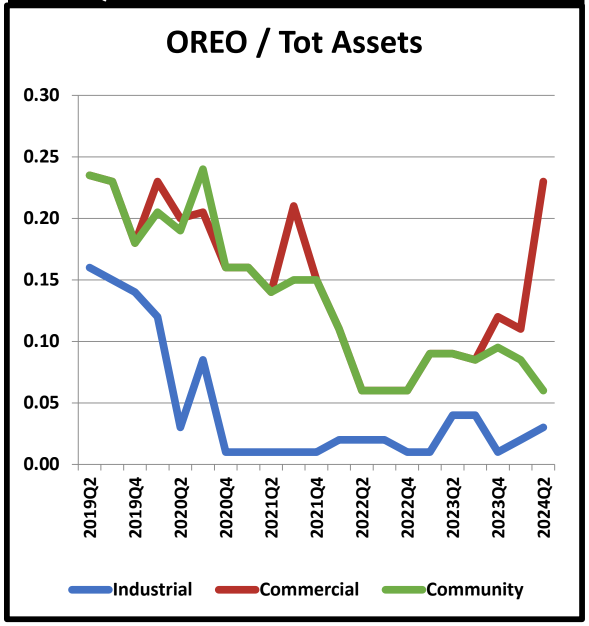

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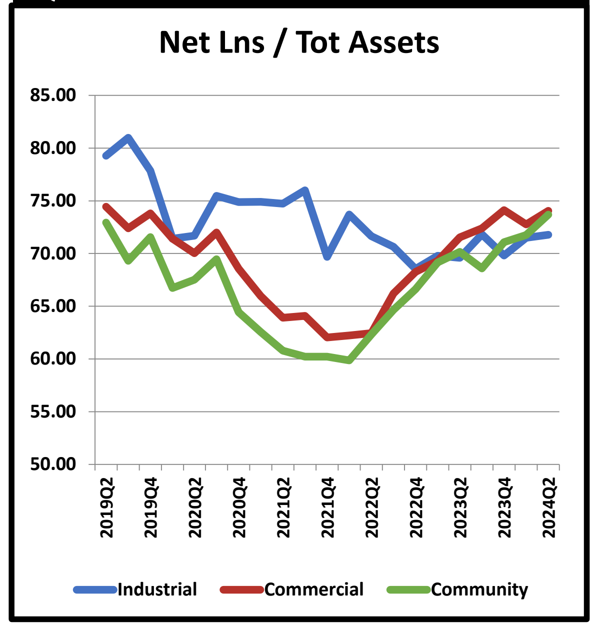

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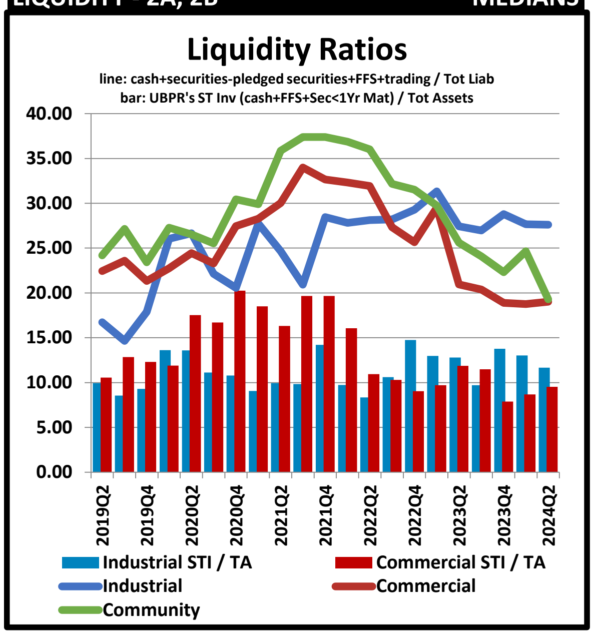

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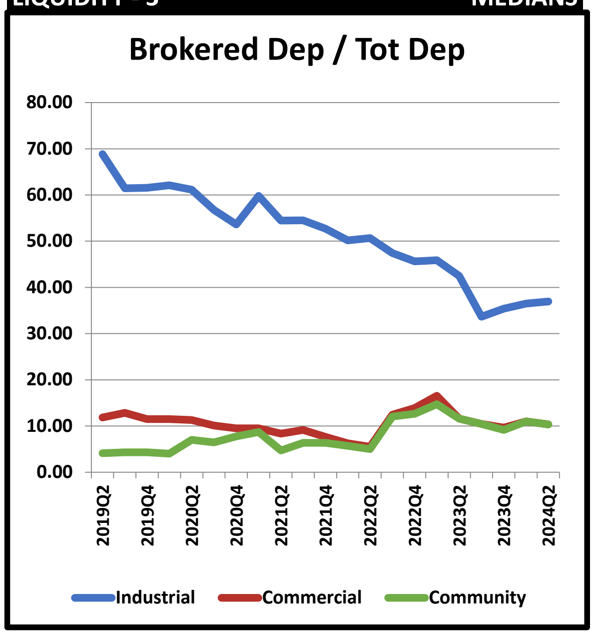

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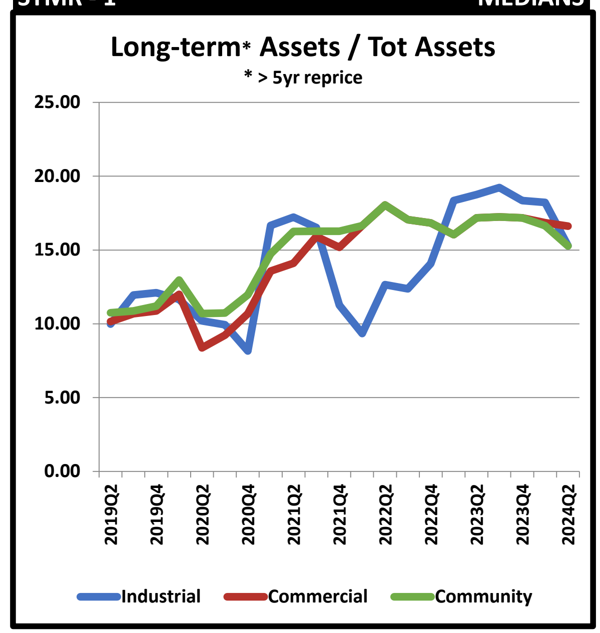

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