July 1, 2020

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Proposed Rule: Parent Companies of Industrial Banks & Industrial Loan Companies (RIN 3064-AF31)

Dear Mr. Feldman:

Founded in 1916, the American Financial Services Association (AFSA) is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. In 1971, AFSA merged with the American Industrial Bankers Association, an organization of industrial banks, thrift and loan companies, and sales finance companies, and we are proud to continue to represent those banks. With this long history, AFSA has a keen interest in the outcome of this rulemaking.

Industrial banks are FDIC-regulated depository institutions chartered under the laws of Utah, California, Colorado, Nevada, Hawaii, Indiana, and Minnesota. Twenty-three industrial banks are currently in operation with over $140 billion in total assets.

Industrial banks are subject to the same banking laws and are regulated in the same manner as other depository institutions. They are supervised and examined both by the states that charter them and by the FDIC. They are subject to the same safety and soundness, consumer protection, deposit insurance, Community Reinvestment Act, and other requirements as other FDIC-insured depository institutions.

Most owners of industrial banks are exempt from Federal Reserve Board supervision as bank holding companies. Similar Bank Holding Company Act exemptions apply to thousands of institutions not owned by other companies, and to financial institutions that do not offer a full range of banking services, such as credit card banks, Edge Act banks, grandfathered non-bank banks, and trust banks.

These exemptions benefit bank customers by introducing additional competition into the marketplace, without increased risk to the deposit insurance system.

Industrial banks, which have existed since 1910, evolved from Morris Plan Banks, consumer lending institutions organized at a time when commercial banks generally did not make consumer loans or offer deposit accounts to individuals.[1] The word "industrial" in their names stems from the original mission of providing credit to industrial workers, not to the industries themselves.

Industrial banks engage in consumer and commercial lending on both a secured and unsecured basis. They may accept savings accounts, including Money Market Deposit Accounts, time deposits, and deposits that may be withdrawn through negotiable orders of withdrawal ("NOW") accounts.

During the past five decades, industrial banks have compiled among the best records of capitalization and profitability of any group of banks in the nation, and they represent a sector of the financial services industry that should be encouraged to grow.

Though not required to be regulated as federal bank holding companies, owners of industrial banks are not "unregulated." Indeed, they are subject to many of the same requirements as bank holding companies, such as strict restrictions on transactions with their bank affiliates. They are regulated under state law, they are subject to examination by the FDIC, and to "prompt corrective action" and capital guarantee requirements if the banks they control encounter financial difficulties.

The Proposed Regulation Should Be Prospective

While, as drafted, the proposed rule provides a grandfather for parent companies owning industrial banks, on or before the Effective Date,[2] Question One poses the question of whether the rule should cover existing institutions.

AFSA believes the proposed rule should be prospective and exempt existing industrial banks that are currently operating under the present, successful state and federal regulatory regime. Indeed, despite the ample experience of the FDIC and the state banking regulators, there have been no demonstrated supervisory failures, lack of capital support, or operational issues at any industrial bank or parent company that would support changing the current regulatory regime for existing industrial banks.

The proposed rule, if applied to existing institutions, would add unnecessary burdens to those institutions. This is unnecessary because the FDIC already has robust authority to address unsafe and unsound conditions. These burdens include:

- *Section 354.4(a)(1)* requires filing of lists of all affiliates—an unnecessary filing in the case of a global manufacturer;
- *Section 354.4(a)(6)* changes existing state law governing the number of outside directors;
- *Section 354.4(c)* mandates additional open-ended commitments from a parent company; and
- *Section 354.5(b)* allows the FDIC to impose additional restrictions at any time and for any reason.

[1] Predating the Federal Reserve System by three years and FDIC by twenty-three years.
[2] *See* 85 *Fed. Reg.* at 17,776-777.

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The questions accompanying the proposed rule also raise issues which, if enshrined in regulations, could dramatically impact existing institutions. These issues include asking if there is a need for an intermediate holding company structure which AFSA believes to be unnecessary (question five); changing existing state law governing the number of outside directors as referenced above (question eleven); unnamed "safeguards" in the case of foreign ownership (question twenty); as well as other issues need not be applied to existing institutions and their parent companies.

We are concerned that some commenters, masquerading behind concerns about safety and soundness, will see this rulemaking as an opportunity to hinder the growth of existing or future industrial banks for anti-competitive reasons. We urge the FDIC to resist such efforts.

The Proposed Regulation's Board Rules Should Be More Balanced

In order to limit the extent of each Covered Company's[3] influence over a subsidiary industrial bank, the FDIC proposes that each Covered Company would commit to limit its representation on the industrial bank's board of directors to 25 percent of the members of the board. The FDIC explains that it has chosen this threshold based on the fact that 25 percent is a key threshold for control purposes under the proposed rule. The FDIC expressly inquires whether another threshold is more appropriate. AFSA sees no logical connection between the rule's control threshold and the issue of board representation. So too is 25 percent the control threshold under the change in Change in Bank Control Act, but neither the FDIC nor other prudential regulators routinely apply this to required percentages of independent directors. Even with respect to deposit insurance applications for industrial banks, the FDIC has not imposed this limitation consistently.

While board independence is important, so is balance. Relevant literature suggests there can be too much of a good thing. One study of bank boards concluded that "the recent focus on board independence may have reduced the level of expertise on corporate boards which has made it difficult for the board to adequately monitor the risks that financial firms have taken."[4]

Moreover, inflexible and broad prophylactic rules imposed at the application stage are most appropriate when the FDIC otherwise lacks adequate supervisory tools. That is far from the case with respect to issues of board composition. Section 32 of the Federal Deposit Insurance Act authorizes the agency to disapprove of directors.[5] Indeed, the proposed rule itself otherwise provides that without the FDIC's prior written approval, an industrial bank that is controlled by a Covered Company shall not add or replace a member of the board of directors or any senior executive officer.

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[3] The term "Covered Company" means any company that is not subject to federal consolidated supervision by the Federal Reserve Board and that, directly or indirectly, controls an industrial bank.

[4] *See* Erkens, David, Mingyi Hung, and Pedro Matos. *Corporate Governance in the 2007-2008 Financial Crisis: Evidence from Financial Institutions Worldwide.* FDIC 9th Annual Bank Research Conference. August 2009.

[5] *See also*, FDIC RMS Manual of Examination Policies at 4.1-11, "When concerns are particularly elevated or prior supervisory actions do not effect corrective actions, consideration should be given, after consultation with the regional office, to recommending changes to board composition…"

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AFSA is not aware of any other standard, including from state chartering authorities, that establishes a similar 25 percent limit. Hence, if the board composition proposal were adopted, it will result in governance structures that are likely to be aberrational among banks generally and particularly among institutions that are wholly owned by a single entity. An independent board is distinct from a disconnected board, and this aspect of the proposal threatens to foster the latter. The FDIC's usual standard for deposit insurance applications—a simple majority of directors being independent of the bank's parent company and its affiliated entities—should apply.

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AFSA appreciates the opportunity to express our concerns and to share our data. I would be happy to address any questions you may have and may be reached at 202-776-7300 or cwinslow@afsamail.org.

Respectfully submitted,

Celia Winslow

Celia Winslow
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American Financial Services Association