July 1, 2020

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

Re: Notice of Proposed Rulemaking with Request for Public Comment, Parent Companies of Industrial Banks and Industrial Loan Companies, RIN 3064–AF31, 85 Fed. Reg. 17771 (Mar. 31, 2020) ("Proposal")

Dear Mr. Feldman:

Better Markets[1] appreciates the opportunity to comment on the Proposal captioned above issued by the Federal Deposit Insurance Corporation ("FDIC").

The Proposal would impose conditions on the FDIC's grant of any application for deposit insurance, change in control, or merger that results in an insured industrial bank or industrial loan company (collectively, "IB") becoming a subsidiary of a company that is not subject to consolidated supervision by the Federal Reserve Board, including commercial enterprises. According to the Release, the principal purpose of the Proposal is to codify the FDIC's current, informal approach to the supervision of IBs and their parent companies. The release also cites other broader goals, including mitigating undue risk to the Deposit Insurance Fund ("DIF") that arises from the absence of consolidated supervision by the Federal Reserve, and ensuring that the parent companies of IBs serve as a source of "financial strength" for their IBs, as Congress mandated in the Dodd-Frank Act.[2]

[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

[2] Release at 17772.

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Better Markets strongly opposes the Proposal, which would facilitate the acquisition of IBs by both financial firms ***and*** nonfinancial commercial enterprises. The acquisition and control of IBs by non-financial commercial enterprises is especially troubling, as it violates the fundamental axiom in banking law that commerce and banking should remain separate. It also poses significant risks that cannot be adequately mitigated through any regulatory framework, let alone the inadequate requirements set forth in the Proposal. In short, this combination of commerce and banking increases the likelihood of instability in IBs; poses undue risk to the DIF; and fosters unfair competition. In some cases, this model can even contribute to systemic instability.

At the same time, this intertwining of banks and commercial firms has little if anything to recommend it. In fact, the Release fails to provide any convincing justification for perpetuating, let alone encouraging, this model. IBs themselves play a relatively minor role in the credit markets and pairing them with nonbank and commercial enterprises offers no significant benefits that might counterbalance the attendant risks. Finally, there is no comfort to be found in Congress's ill-considered decision to create the loophole for IBs in the first instance, as that 1987 amendment to the Bank Holding Company Act ("BHCA") has since been repudiated as unwise in light of the evolution of IBs in size and complexity and changes in our financial markets over the last 30 years.

On this record, finalizing the Proposal would constitute an unusually stark example of arbitrary and capricious rulemaking. Rather than facilitate the acquisition and control of IBs by non-bank financial firms and commercial enterprises, the FDIC should call upon Congress to eliminate the carve-out for IBs that was tucked into the BHCA in 1987. And until Congress takes that step, the FDIC should re-impose an explicit moratorium on such arrangements, just as Congress and the FDIC deemed necessary and appropriate for a substantial portion of the last 15 years.

SUMMARY OF PROPOSAL

The Proposal would provide that no IB may become a subsidiary of another company that is not subject to consolidated supervision by the Federal Reserve Board unless the parent enters into written agreements with the FDIC and the IB requiring compliance with eight specific conditions or commitments.[3] The Proposal does not limit the eligible parent companies to those engaged in financial activities, thus opening the way for ***any*** type of commercial enterprise to apply.

Those eight requirements focus on the parent company's submission of various lists and reports; preparation of annual audits; consent to examinations by the FDIC to assess compliance with the written agreement or other provisions of law; the maintenance of records; limitations on the parent's representation on the IB board; and capital and liquidity requirements so that the parent can provide financial support for the IB. It also includes a requirement that the parent execute a tax allocation agreement with the IB, which appears to be the only significant addition to the

[3] *See generally* Proposal, rule text, §§ 354.1-6.

informal protocols that the FDIC has traditionally relied upon to evaluate applications for the acquisition of IBs.

In addition, the Proposal would require prior FDIC approval if the IB seeks to make material changes in its business plan, change the composition of its board of directors, add or replace senior executives, or enter into any contract for material services with the parent or any affiliate. In the Proposal, the FDIC would reserve the right to require additional commitments from the parent and to impose additional restrictions on the activities or operations of the IB.

The Release repeatedly makes clear that the principal purpose of the Proposal is to "codify existing practices utilized by the FDIC to supervise industrial banks and their parent companies" and thereby to provide "transparency to current and potential industrial banks."[4]

COMMENTS

I. Allowing commercial enterprises to own and control IBs poses risks that are substantial, widely recognized, and likely to intensify if the Proposal is finalized.

The most troubling aspect of the Proposal is that it will foster the proliferation of commercial enterprises that own and control IBs, which are federally insured banking institutions. The combination of commerce and banking violates a basic principle that Congress established nearly 70 years ago in the BHCA of 1956, when it determined that banking and commerce should remain separate. The BHCA generally prohibits a bank holding company from (a) acquiring ownership or control of any company that is not a bank, or (b) engaging in any activity other than banking or managing or controlling banks and related financial subsidiaries.[5] Congress imposed essentially the same limitations on savings and loan holding companies in the Home Owners Loan Act.[6]

However, in 1987, Congress created a little-noticed carve-out for IBs. Those amendments to the BHCA, known as the Competitive Equality Banking Act, generally ***expanded*** the definition of a "bank" so that the law would apply more broadly and to a wider variety of financial institutions. However, IBs were exempted from the "bank" definition and from the general prohibition against the acquisition of banks by enterprises that fall outside the bank holding company framework. It thus opened the way for commercial companies to own and control federally insured banks.

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[4] Release at 17772; *see also* Release at 17776 ("The proposed rule generally would codify the FDIC's current supervisory processes and policies with respect to industrial banks that would not be subject to Federal consolidated supervision."); Release at 17778 ("The requirements reflect commitments and additional provisions, that for the most part, the FDIC has previously required as a condition of granting deposit insurance to industrial banks.")

[5] 12 U.S.C. § 1843(a)(1) and (2).

[6] 12 U.S.C. § 1467a(c)(2)(H); *see also* 12 U.S.C. § 1467(a)(c)(1) (prohibiting savings and loan holding companies and subsidiaries from commencing or continuing "any business activity," subject to exceptions).

This loophole evidently arose from a concerted lobbying effort coupled with the prevailing view, at that time, that IBs played a relatively simple, limited, and benign role in the credit market. Industrial banks began as small, state-chartered loan companies in the early 1900s that did not accept deposits but were willing to make uncollateralized loans to factory workers and others with low or moderate incomes.[7] But they have evolved considerably since their humble beginnings, and today, IBs generally exercise the same commercial and consumer lending powers as commercial banks.[8] Moreover, they have experienced periods of "tremendous" growth in complexity, variety, and size, at times becoming major financing arms of large corporations that lie outside the banking system.[9]

The 1987 statutory exemption was unwise. Allowing IBs to be acquired by commercial enterprises raises essentially the same long list of underlying concerns that animated the general prohibition against the mix of commerce and banking in the BHCA of 1956:

- They pose unique and unmanageable challenges for bank supervisors, who are ill-equipped in terms of resources and expertise to oversee business models that incorporate a wide range of industries far afield from banking and finance;

- They increase the risk of instability in the banks as well as their parent companies, and in the case of large conglomerates, they can undermine the stability of the broader financial system;

- They present undue risk to the DIF and the other components of the taxpayer-funded federal safety net;

- They can foster unfair and imprudent lending practices fueled by conflicts of interest; and,

- They are likely to embody concentrations of economic power that lead to unfair competition.[10]

For these reasons, the mix of industrial banks and commercial parents has generated increasing concern and intense controversy, prompting both the FDIC and Congress to impose a series of moratoria on this model. Deep-seeded opposition to these conglomerations was starkly revealed in 2005, when Wal-Mart Bank applied to the FDIC for deposit insurance. The application triggered the submission of over 13,800 comment letters. The majority of those commenters

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[7] Release at 17772.

[8] Release at 17772.

[9] *See* Michelle Clark Neely, *Industrial Loan Companies Come Out of the Shadows,* Federal Reserve Bank of St. Louis, at 1-2 (July 1, 2007); Release at 17773, 17776.

[10] *See, e.g.,* Comment Letter of Arthur E. Wilmarth, Jr., Prof. of Law, George Wash. Univ. School of Law, on the Proposal (Apr. 10, 2020); Neely, *supra* n. 9, at 3-5; Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce,* 39 Conn. L. Rev. 1539 (May 2007).

opposed the application, citing in particular the heightened risks to the DIF "posed by industrial banks owned by holding companies that are not subject to Federal consolidated supervision."[11] In 2006, Home Depot sought approval for the acquisition of an IB known as Enerbank, triggering similarly uniform opposition.[12]

In July of 2006, as a result of this wave of opposition, the FDIC imposed a six-month moratorium on FDIC action on any applications for deposit insurance or change-in-control notices involving IBs.[13] The purpose of the moratorium was to explore and evaluate the larger concerns surrounding IBs that were raised by the Wal-Mart and Home Depot applications. The FDIC also issued a notice and request for comment on the problems associated with allowing commercial firms to own IBs.[14] That too triggered a massive wave of responses, including over 12,600 comment letters raising serious concerns about these banking and commercial combinations.[15] In January of 2007, the FDIC extended its moratorium for another full year.[16]

So serious were the concerns surrounding the ownership of IBs by companies not subject to consolidated federal banking supervision that Congress stepped in.[17] In 2010, the Dodd-Frank Act imposed new requirements, including a provision requiring any company that directly or indirectly controls an insured depository institution and falls outside the bank holding company framework to serve as source of "financial strength" for that institution. It also gave the appropriate federal banking agency the explicit statutory authority to require reports from the controlling company to ensure compliance with the "financial strength" mandate. Moreover, the

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[11] Release at 17774.

[12] Release at 17774.

[13] Release at 17774.

[14] Release at 17774-75.

[15] Release at 17775.

[16] Release at 17775.

[17] In a revealing development, even the original sponsor of the 1987 law creating the IB exemption, Sen. Jake Garn, voiced strong opposition to the Wal-Mart application, explaining that at the time of the law's enactment, IBs occupied a very limited role, one that the Senator had no desire to see expanded:

> [F]ormer Senator Jake Garn of Utah, a co-sponsor of the ILC exemption, explained his personal view of that exemption when he testified during the FDIC's public hearings on Wal-Mart's application. Senator Garn declared that he would strongly oppose any attempt by Wal-Mart to "expand their application" to offer retail banking services at Wal-Mart stores because "it was never my intent, as the author of this particular section, that any of these industrial banks be involved in retail operations . . . . I would be the most vociferous opponent of that because that was not my intent at the time CEBA was passed." Senator Garn's testimony indicates a congressional understanding in 1987 that ILCs would not be used as a platform for large commercial firms to offer full-service banking to consumers at the parent companies' retail outlets. In 1987, ILCs were small, state-chartered institutions that had limited deposit-taking powers and engaged principally in making consumer loans to middle-income and lower-income individuals.

See Wilmarth Article, *supra* note 10, at 1572.

Dodd-Frank Act imposed a fresh three-year moratorium on FDIC approval of any deposit insurance applications for IBs owned or controlled by commercial firms.[18]

Finally, the Dodd-Frank Act required the GAO to study the implications of removing all exemptions from the definition of "bank" in the BHCA, including the exemption in favor of IBs.[19] The resulting report validated a number of concerns surrounding the ownership of IBs outside the consolidated supervision framework. Most notably, the report set forth the Federal Reserve Board's emphatic view that the exemptions from the "bank" definition should be removed and that the holding companies of ***all*** federally insured depository institutions should be subject to consolidated supervision under the BHCA.[20] The Federal Reserve Board also raised concerns that if the exemptions were to remain intact, companies owning exempted banks might grow large enough in the future to pose significant risks to the U.S. financial system. Following these developments, the FDIC implemented a de facto moratorium that was in place from the expiration of the Dodd-Frank moratorium in July 2013 until March of this year, when the FDIC approved applications from Nelnet (a student loan servicer) and Square (a payment services provider).[21]

Thus, the history of IBs is replete with concerns about the potential risks they pose when they are acquired by nonbank commercial enterprises. While the FDIC tends to downplay or ignore these risks in the Release, they are nevertheless supported by history, likely to intensify, and even now attracting fresh attention among policymakers.[22]

For example, the Release glosses over or minimizes the threats from IBs by claiming that the financial crisis of 2008 demonstrated the effectiveness of its regulatory approach because only two IBs failed during the financial crisis.[23] Yet that exceptionally narrow slice of history ignores many other cases in which IBs experienced stress and failure or in which parent companies imperiled the solvency of their IBs. For example, as detailed by Professor Wilmarth in his comment letter on the Proposal, since the 1980s, many IBs have failed, including 13 in just the two-year span from 1982 to 1984. Two of those failures inflicted significant losses on the DIF.[24] More recently, over the past 25 years, two dozen IBs have failed.[25] Also significant but omitted

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18 Release at 17775-76; Dodd-Frank Act, §§ 601 *et seq.*

19 Release 17776.

20 Government Accountability Office, *Bank Holding Company Act, Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions,* at Summary & p. 31 (Jan. 2012).

21 The 2012 GAO study was just one in a series of earlier studies and reports conducted by the FDIC Office of Inspector General and the GAO. Release at 17774; V. G. Comizio, *After the Dodd-Frank Industrial Loan Company Moratorium: What's Next*, 17 N.C. Banking Inst. 99 (2013). All of these studies reflected the importance of the issues surrounding IBs and the controversies they generated.

22 Even some in Congress are interested in revisiting the wisdom of allowing commercial companies to acquire and operate IBs. Late last year, Senator John Kennedy introduced a bill that would essentially prohibit commercial firms from controlling IBs. *See* S. 2839 (Nov. 12, 2019); *see also* Joe Adler, *GOP Senator Tries to Block Commercial Firms from Becoming Banks,* Amer. Banker (Nov. 13, 2019).

23 Release at 17776.

24 Wilmarth Comment Letter, *supra* note 10, at 6.

25 Neely, *supra* note 9, at 5.

from the Release is any mention of the collapse or near-collapse during the 2008 financial crisis of numerous major ***parent companies*** that owned IBs, including GMAC, Merrill Lynch, Goldman Sachs, Morgan Stanley, and GE Capital Corporation. These companies, which were not subject to consolidated supervision, received massive bailouts from the Federal government, and some cases, their perilous financial condition was directly related to their IBs.[26]

Moreover, the risks posed by IBs are likely to increase dramatically if the FDIC proceeds with its Proposal and essentially encourages the proliferation of these business and banking alliances. While IBs currently represent a relatively small segment of the credit market,[27] the potential for expansion is enormous, in terms of both size and complexity. IBs have already exhibited the potential for dramatic change, experiencing "tremendous growth" over the past 25 years.[28] For example, as observed in the Release, from 1987 to 2006, total assets held by IBs grew ***50 fold***, from $4.2 billion to $213 billion.[29]

The ownership structures and business models have also "evolved" in complexity. As the GAO report explained, the IB industry experienced significant asset growth during the 2000s and changed from a class of limited purpose banks to a diverse group of insured institutions with a variety of business lines.[30] IBs have been acquired by an increasing variety of companies (from BMW to Pitney Bowes) for an increasing variety of purposes (from product sales financing to credit card management and brokerage sweep accounts).[31]

There is now renewed interest in the acquisition of IBs by nonbank commercial enterprises, which is evidently the driving force behind the Proposal:

> In recent years, there has been renewed interest in establishing *de novo* institutions, including industrial banks. Proposals regarding industrial banks have presented unique risk profiles compared to traditional community bank proposals. These profiles have included potential owners that would not be subject to Federal consolidated supervision, affiliations with organizations whose activities are primarily commercial in nature, and non-community bank models.[32]

The Release goes on to explain that—

> Since the beginning of 2017, the FDIC has received nine Federal deposit insurance applications related to proposed industrial banks. Of those, four have been withdrawn and five are pending. None of the potential parent companies of the pending industrial bank applicants would be subject to Federal consolidated supervision. The FDIC anticipates potential continued interest in the establishment

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[26] Wilmarth Comment Letter, *supra* note 10, at 6-10.
[27] Release at 17773.
[28] Neely, *supra* note 9, at 1.
[29] Release at 17773.
[30] GAO report, *supra* note 20, at 13.
[31] Release at 17773.
[32] Release at 17772.

of industrial banks, particularly with regard to proposed institutions that plan to pursue a specialty or limited purpose model.[33]

Among the most recent applications is Rakuten, a large e-commerce conglomerate sometimes referred to as the Amazon.com of Japan.[34] While massive retailers such as Wal-Mart and Home Depot were once pressing for expanded use of IBs, if the Proposal is finalized, we can expect large tech companies to pursue that strategy and combine banking with their already extraordinary economic power, data collection capabilities, and market share.[35]

Notwithstanding this long history of controversy surrounding IBs owned by commercial enterprises and the ever-increasing threats they pose to bank stability, the DIF, and fair competition, the FDIC is now intent on revitalizing this model. However, as shown below, there is no supervisory framework that can adequately neutralize these concerns. Certainly, the limited requirements in the Proposal, which the FDIC has cobbled together from its collection of informal policies and procedures, are not up to the task. Moreover, the Release fails to provide any credible justification for the FDIC's desire to encourage this risk-laden combination of banking and commerce.

II. The FDIC lacks the authority and capacity to effectively oversee IBs owned by large commercial companies, and the Proposal is a wholly inadequate substitute.

As a threshold matter, there is no supervisory framework in the banking realm that can adequately mitigate the risks posed by the acquisition of IBs by non-financial commercial enterprises. Neither the FDIC nor any other banking regulator is properly equipped with the resources and expertise that would be necessary to oversee the increasingly large and complex commercial firms that seek to acquire IBs. Bank supervisors are not trained to assess risks to commercial firms, nor are they currently equipped to assess the inter-group risks to an IB that stem from being a member of a broader commercial entity. And the range of possible commercial enterprises they would have to oversee is essentially unlimited, ranging from retailers and manufacturing enterprises to service providers and high-tech firms. Thus, even the consolidated supervision framework that applies to bank holding companies would be insufficient. Indeed, this

[33] Release at 17773-74; *see also* Release at 17776 (citing recent "interest" in IBs among companies that "operate unique business models, some of which are focused on innovative technologies and strategies").

[34] Wilmarth Comment Letter, *supra* note 10, at 2.

[35] Even some in Congress are interested in revisiting the wisdom of allowing commercial companies to acquire and operate IBs without consolidated supervision. Late last year, Senator John Kennedy introduced a bill that would essentially prohibit commercial firms from controlling IBs. *See* S. 2839 (Nov. 12, 2019); *see also* Joe Adler, *GOP Senator Tries to Block Commercial Firms from Becoming Banks,* Amer. Banker (Nov. 13, 2019).

reflects Congress's decision in the BHCA to generally prohibit—not merely condition—the combination of banking and commerce.[36]

As to ***financial*** companies that seek to own and control an IB, it is equally clear that a robust, consolidated supervision framework is minimally necessary to ensure adequate oversight of the entire complex of financial firms with which the IB is affiliated. Yet the Proposal falls well short of that authority.

The importance of having in place a consolidated supervisor with an effective supervision program for banking organizations has been recognized for decades. It became even more apparent during the financial crisis of 2008. The crisis exposed the risks to the entire corporate group, including the depository institution subsidiary, that arise from poorly run parent companies and affiliates. The failures of supervision for bank holding companies and other large financial firms, including Lehman Brothers and Bear Stearns, highlighted by the financial crisis, point to the enormous challenges presented by such complex combinations of entities, even where they are all engaged in some type of financial activity.

Consolidated supervision is critical for ensuring that relationships between depository institutions and their affiliates, including parent companies, do not pose undue risk to the depository institutions. A deep understanding of the relationships and interactions across the entire group of companies is critical for understanding how risks arising from both regulated and unregulated affiliates may increase risks to the depository institution, and by extension the DIF.

Thus, to properly regulate these corporate conglomerations, supervisors must have the ability to look across all entities in the group to understand the interrelationships between them and to effectively assess the ways in which the parent or the affiliates may present risks to the depository institution. Risks stemming from such a structure can include both direct financial risks and also risks that are difficult to identify, quantify, and control, such as the effect on the depository institution if the commercial parent or affiliates of an IB were to come under serious financial or reputational distress.

The FDIC does not have this robust consolidated supervision authority, which is necessary to protect the stability of the IBs and the DIF. The Proposal attempts to compensate for this deficiency, but it falls short. Its core provisions are set forth in a list of eight commitments that parent companies must make through written agreements with the FDIC. The commitments placed on parent companies include providing an annually updated list of all subsidiaries; periodic self-reporting on their financial condition and related matters; maintaining records; procuring audits;

[36] In 2007, the FDIC drew a careful distinction between IBs owned by other financial companies and IBs owned by "companies engaged in commercial activities." It proposed a rule that would have facilitated applications seeking control of IBs by companies not subject to consolidated supervision, but only if they were engaged "solely in financial activities." Release at 17775. At that time, at least, the FDIC was unwilling to pave the way for the more dangerous acquisition of IBs by commercial enterprises. Now, of course, the Proposal does just that by inviting all types of firms—financial and commercial alike—to seek ownership and control of IBs. As explained below, this exemplifies the FDIC's change in position, without a sufficient explanation or justification.

limiting representation on IB boards; and maintaining capital and liquidity levels sufficient to ensure they can financially support their IBs.

These requirements do not go far enough to ensure that the FDIC can effectively supervise IBs and their parents and affiliates. For example, the FDIC does not have the authority to conduct full-scope examinations across any and all affiliates, including the parent company. This is a critical gap, since ensuring the efficacy and strength of these commitments requires a more robust examination authority. Moreover, of course, the FDIC has no ability to place consolidated capital or liquidity requirements on the group or even at the parent level.

Thus, this approach falls well short of what is needed to ensure that a parent company or any affiliates do not pose undue risks to the depository institution or to ensure that the parent company does in fact truly represent a source of strength, as required under the Dodd-Frank Act. By simply re-stating and formally codifying its limited approach to the supervision of IBs owned by other firms, including a variety of reporting and application requirements that cannot be appropriately complemented by in-depth examinations of an IB's parent or key affiliates, the FDIC has not adequately addressed the challenges it would face supervising these entities and protecting the DIF from the costs associated with the collapse of such a firm. And as shown below, the FDIC has failed to demonstrate that it is desirable or necessary to accept these formidable risks.

III. The Release offers no persuasive reason why regulators should tolerate, let alone promote, the acknowledged risks attending the acquisition of IBs by commercial firms.

In the Release, the FDIC clearly recognizes the exceptionally fraught history of the IB exemption and the dangers posed when firms outside the regulatory framework for bank holding companies—especially commercial firms—acquire IBs. The Release recounts the vast changes in the IB model since its humble origins; the uproar following Wal-Mart's 2005 application to acquire an IB; the numerous reports raising grave concerns or outright objections to the practice; and the series of explicit and de facto moratoria on the approval of IB/commercial parent applications that Congress and the FDIC itself saw fit to impose for years.

Yet at the same time, the Release fails to provide a compelling justification. It makes cursory reference to some "commenters" who contend that the model increases competition and benefits underserved communities.[37] Yet it does not test or substantiate these claims. Moreover, it concedes that they are countered by at least equally "legitimate" objections based on risks to the DIF.[38]

On this record, the FDIC arrives at the stunning non-sequitur that now is an appropriate time to formalize its process for reviewing applications seeking the acquisition of IBs by all manner of firms and signal its willingness to approve them:

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[37] Release at 17772.
[38] Release at 17772.

> Given the continuing evolution in the use of the industrial bank charter, the unique nature of applications seeking to establish *de novo* industrial banks, and the legitimate considerations raised by interested parties—both in support of and opposed to the industrial bank charter—the FDIC believes a rule formalizing and strengthening the FDIC's existing supervisory processes and policies that apply to parent companies of industrial banks that are not subject to federal consolidated supervision is timely and appropriate.[39]

In reality, and for these very reasons, breathing new life into the acquisitions of IBs, especially by commercial parents, is ***ill-advised.*** Far from supporting the FDIC's approach, the "continuing evolution" in the IB charter and the "unique" nature of recent applications to establish IBs all point ominously in the direction of further concentrations of already enormous economic power and ever more complex business models (many unrelated to banking and finance) that will prove impossible for bank regulators to regulate adequately. That means greater risk to systemic stability if these alliances fail, potentially huge drains on the DIF in that event, and almost certain market dominance at the expense of community banks and other competitors. All of these weighty concerns are stacked against vague and unsubstantiated assertions that this trend, if fostered, will somehow promote competition and underserved communities. And while the Release gives a nod to "strengthening" the FDIC's policies and procedures governing IBs and their acquisition by companies outside the framework for consolidated banking supervision, the Proposal in fact does little to fortify the informal approach that the FDIC has followed in dealing with these combinations of banks and businesses, nor does it represent the type of robust consolidated supervision authority that would be minimally necessary to protect financial stability of IBs and safeguard the DIF.

This is, accordingly, a clear example of irrational or "arbitrary and capricious" rulemaking in violation of the Administrative Procedure Act. It is axiomatic that when engaged in rulemaking, an agency must "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[40] Conversely, the agency may not rely on factors "which Congress has not intended it to consider."[41] And agency actions that are based too heavily on speculation rather than evidence are likely to be deemed arbitrary and capricious.[42]

Here, the FDIC has drawn precisely the wrong conclusions or "connections" from its own rulemaking record. That record provides ample and credible evidence of likely harm from the Proposal that will almost certainly dwarf the speculative benefits, such as they are. And to the extent that the FDIC's underlying purpose—the dominant "factor" in its analysis—is catering to corporate America's search for ever-more profitable business models, that is decidedly a factor outside of its core mission, which is protecting the stability of insured depository institutions and safeguarding the DIF.

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[39] Release at 17772.

[40] *See Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 103 S. Ct. 2856, 2866 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

[41] *See State Farm*, 103 S. Ct. at 2867.

[42] *Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 708 (D.C. Cir. 2014).

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The violation of the APA is especially egregious here since the Release fails to provide the concrete and persuasive explanation that the law requires if an agency seeks to ***change*** a prior regulatory position. The law provides that when an agency departs from a prior position, it must "display awareness that it ***is*** changing position" and "must show that there are good reasons for the new policy."[43] Moreover, when a "new policy rests upon factual findings that contradict those which underlay [an agency's] prior policy," the agency must "provide a more detailed justification than what would suffice for a new policy created on a blank slate."[44]

The Proposal violates these principles as well. The FDIC has a long history of acknowledging the threats posed by the acquisition of IBs by companies that are not subject to consolidated supervision under the BHCA, and the even greater risks posed when those parent entities are commercial enterprises. Moreover, as explained above, it has repeatedly and for years imposed explicit and de facto moratoria against the practice. It now proposes to essentially reverse its position. It has in effect declared that far from extending any form of moratorium on applications from commercial firms seeking to acquire an IB, it is welcoming them. And rather than acknowledging or justifying this dramatic shift, the FDIC has in effect camouflaged it by portraying the Proposal as an effort to strengthen regulatory requirements and protections—goals that it barely advances.

For all of the foregoing reasons, the FDIC should abandon the Proposal, impose a moratorium on applications by both non-bank financial and commercial firms to acquire IBs, and urge Congress to close the statutory loophole exempting IBs and their parents from the regulatory and supervisory framework normally applicable to bank holding companies.[45]

CONCLUSION

We hope you find these comments helpful.

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43 *F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009) (emphasis in original).

44 *F.C.C. v. Fox,* 556 U.S. at 515.

45 If the FDIC insists on proceeding with its "open for business" approach to the acquisition of IBs by firms that fall outside the consolidated supervision framework, including commercial parents, it must strengthen the Proposal to the maximum extent of its legal authority. As a general proposition, it should fortify the requirements in the Proposal so they approximate, to the closest extent legally possible, a consolidated supervision model. Furthermore, in answer to a number of specific questions in the Release, we urge the FDIC to (1) make any final rule retroactive, not just prospective; (2) expand it to include other institutions excluded from the "bank" definition (credit card banks and limited purpose trust companies); (3) require the disclosure of all affiliates or portfolio companies of the parent; (4) require dominant shareholders of a parent company to maintain appropriate levels of capital and liquidity; and (5) require the parent company to maintain its own capital at a level sufficient to ensure that it can serve as a source of financial strength to its IB subsidiary.

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Sincerely,

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