EXECUTIVE SUMMARY

SOURCE OF STRENGTH AND CONSOLIDATED SUPERVISION:

A Comparative Assessment of Industrial Banks and Commercial Banks

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I Industrial Banks are regulated by the FDIC and state agencies

Industrial Loan Companies (ILCs) have successfully operated since the early 1900s. The business models of these financial institutions adapted to the changing financial marketplace by offering a changing mix of financial services, leading many to refer to them as industrial banks (IBs). They operate as state-charted banks subject to state regulation and supervision. 1982, the U.S. Congress made all IBs eligible for deposit insurance and subjected them to additional regulation and supervision by the Federal Deposit Insurance Corporation (FDIC). [Drs. Barth and Sun exhaustively reviewed and analyzed pertinent data in order to perform a comparison between industrial banks and commercial banks supervised by the Federal Reserve. This is a summary of their conclusions, and a complete copy of the report is available at industrialbankers.org.

II Industrial Banks are stronger than Banks supervised by the Federal Reserve

The parents of IBs are far better capitalized as compared to the parents of Fed banks. As a source of strength, it is the holding companies of IBs, rather than the holding companies of Fed supervised banks, that can fulfill this role. Indeed, since most bank holding companies have relatively few assets beyond the equity in their subsidiaries and thus little equity of their own apart from that of their subsidiaries, bank holding companies are typically unable to provide the necessary source of strength support to prevent their bank subsidiaries from failing.

AS A SOURCE OF STRENGTH, IT IS THE HOLDING COMPANIES OF IBS, RATHER THAN THE HOLDING COMPANIES OF FED SUPERVISED BANKS, THAT CAN FULFILL THIS ROLE.

	FINANCIALLY OWNED IBs	COMMERCIALLY OWNED IBs	BANKS
Parent capital-to-asset ratio (%)	17.09	20.70	9.72
Subsidiary assets as % of parent's assets	34.42	6.22	89.93
Subsidiary equity as % of parent's equity	36.84	23.67	89.92
Subsidiary capital-to-total assets (%)	20.32	15.49	9.70

III FDIC and State supervision of Industrial Banks is more rigorous than Federal Reserve Supervision of Commercial Banks

Data resulting from an exhaustive comparison of commercial and industrial banks reveal the following:

1. Consolidated supervision of bank holding companies by the Federal Reserve is NOT superior or more effective than oversight of IBs and their parent companies by the FDIC and state regulators.

2. FDIC and state regulators use the same supervisory tools as the Federal Reserve to regulate a bank holding company. They conduct examinations, obtain other relevant information, issue cease and desist orders when appropriate, ban individuals who abuse their positions from banking, assess civil money penalties as needed, and, in an extreme case, they can unilaterally take possession of a bank and thereby terminate all control by the parent.

3. Most bank holding companies of Fed Banks have few or no assets apart from the subsidiary bank and hence have no ability to support the bank if it needs additional capital or liquidity.

4. Diversified parents of IBs hold substantial amounts of additional assets and thus can provide additional capital and liquidity whenever needed.

5. To regulate a diversified parent of an industrial bank, the FDIC and state regulators have developed a model that captures the relationship and transactions between an industrial bank and its parent. They regulate what is relevant to the bank and not other parts of a diversified parent company that have nothing to do with the bank.

THE FDIC IS ARMED WITH SUFFICIENT OVERSIGHT AND ENFORCEMENT POWERS TO PROHIBIT CERTAIN OWNERSHIP ARRANGEMENTS AND TO STOP HARMFUL ACTIVITIES OF IB COMMERCIAL PARENTS.

6. Thousands of failed banks had holding companies regulated by the Federal Reserve. Clearly, those holding companies had insufficient financial strength to support the subsidiary banks. In contrast, most IBs have ready access to all of the capital they may ever need through a diversified parent with substantial assets apart from those of its subsidiary.

IV Industrial Banks have not been—and will not be—a threat to the nation's financial System

Only 25 IBs are in existence, 19 financially owned and 6 commercially owned, with $183 billion in total assets at year-end 2020. In contrast, there were 5,001 banks with $21,884 billion in total assets throughout the nation at year-end 2020. IBs represent

> **THIS SUGGESTS THAT THE SERIOUS THREAT TO OVERALL FINANCIAL STABILITY IS NOT THE 25 IBS, BUT INSTEAD THE TOP 25 BANKS.**

0.5 percent of all banks and 0.8 percent of all bank assets, which undermines any view that IBs represent a serious threat to overall financial stability, and certainly a more serious threat than banks. For a more comparable comparison, the top 25 banks, which also represent 0.5 percent of all banks, account for 65 percent of all bank assets. This suggests that the serious threat to overall financial stability is not the 25 IBs, but instead the top 25 banks.

IBs have higher equity capital-to-asset ratios and better financial performance measures (i.e., ROAs, ROEs, and efficiency ratios) than the non-IB, FDIC-insured institutions. The better overall financial condition of the IBs has existed for almost every year from 2000 to 2020, which includes the Great Recession.

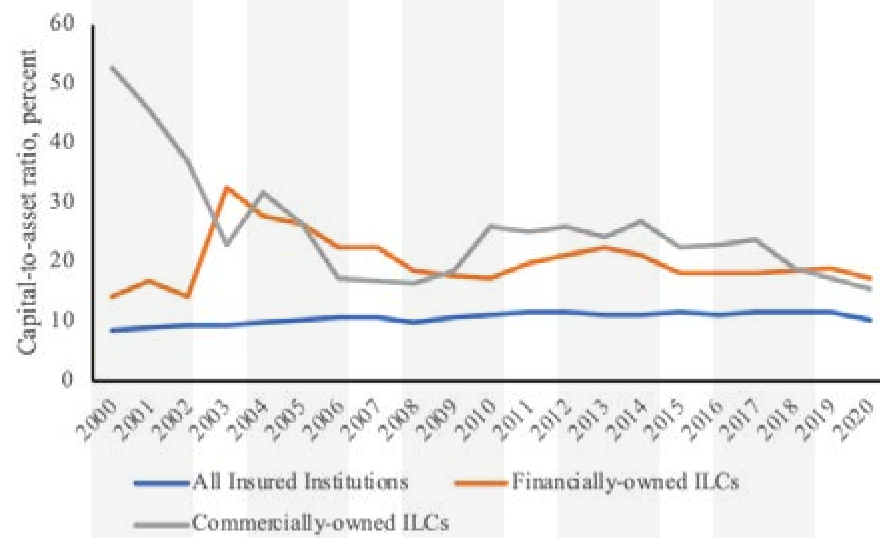
TARP Distribution

	NUMBER OF RECIPIENTS	TOTAL DISBURSEMENT ($MM)
Top 25 Firms	25	551,604
Total for All Firms	987	634,264
Banks	758	236,192
IBs	1	21

Figure 1. Return on Assets: Currently Active IBs Outperform All FDIC-Insured Institutions

Source: FDIC. Note: The ROA for IBs is the average of the IBs' ROA. The negative ROA for the commercially owned IBs in the earlier years is due to three IBs that were established and lost money in those years.

Figure 2. Capital-to-Asset Ratio: Currently Active IBs Have Higher Ratios Than All FDIC-Insured Institutions

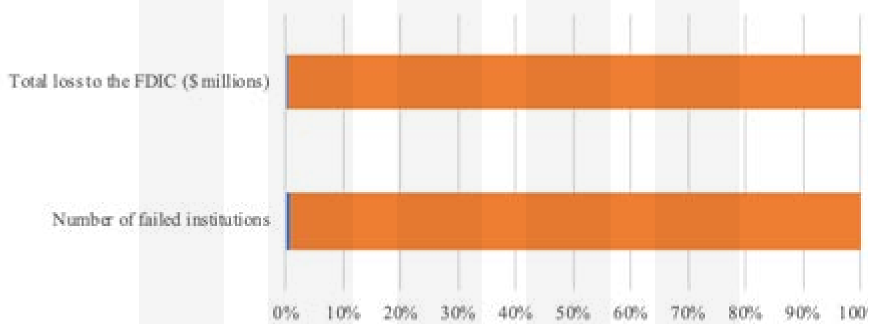


Source: FDIC. Note: The capital-to-asset ratio for IBs is the average of the IBs' capital-to-asset ratios. The high capital-to-asset ratio for the commercially owned IBs in the earlier years is due to three IBs that were established and highly capitalized in those years.

B. Comparative Performance of IBs and Banks During Stressful Periods

In contrast to the 23 IB failures, 2,605 non-IB banks failed with associated losses to the FDIC of $178 billion. Given these substantial differences, one can barely see the percentage of failures and losses due to the limited role played by IBs in the two charts in Figure 3.

Figure 3. Bank and IB Failures and Losses During the Period 1986 to 2020



	Number of failed institutions	Total loss to the FDIC ($ millions)
ILCs	23	$780
All other FDIC-insured depository institutions	2,605	$177,966

Source: FDIC bank failures and assistance data, https://banks.data.fdic.gov/explore/failures.

V Conclusion

The data and facts are undisputed. There is no support for the argument that IB holding companies should be subjected, like bank holding companies, to consolidated supervision by the Federal Reserve. The bottom line is that the evidence presented indicates no corrective legislative action is needed to deal with industrial banks.

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James R. Barth is the Lowder Eminent Scholar in Finance at Auburn University, a Senior Fellow at the Milken Institute, and a Fellow at the Wharton Financial Institutions Center. Barth was an appointee of Presidents Ronald Reagan and George H.W. Bush as chief economist of the Office of Thrift Supervision and previously the Federal Home Loan Bank Board. He has also held the positions of professor of economics at George Washington University, associate director of the economics program at the National Science Foundation, and Shaw Foundation Professor of Banking and Finance at Nanyang Technological University. He has been a visiting scholar at the US Congressional Budget Office, Federal Reserve Bank of Atlanta, Office of the Comptroller of the Currency, and the World Bank.

Barth has testified before several US Congressional Committees. He has authored articles in professional journals such as the American Economic Review and Journal of Finance as well as co-authored and co-edited several books, including Rethinking Bank Regulation: Till Angels Govern (Cambridge University Press), The Rise and Fall of the US Mortgage and Credit Markets: A Comprehensive Analysis of the Meltdown (John Wiley & Sons), China's Emerging Financial Markets: Challenges and Opportunities (Springer), Guardians of Finance: Making Regulators Work for Us (MIT Press), Fixing the Housing Market: Financial Innovations for the Future (Wharton School Publishing-Pearson), and Research Handbook on International Banking and Governance (Edward Elgar Publishing). Barth is included in Who's Who in Economics: A Biographical Dictionary of Major Economists, 1700 to 1995.

Dr. Yanfei Sun is an assistant professor of Finance at Ted Rogers School of Management. She received a Ph.D. in Finance from Auburn University in 2019. Her research focuses on financial markets and institutions, financial regulation, and international finance. She has published in such scholarly journals as the Journal of Consumer Affairs, Journal of Economics and Business, Quarterly Review of Economics and Finance, and Journal of Management, Spirituality & Religion. Sun currently teaches Advanced Corporate Finance at TRSM.