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Highlights

Highlights of GAO-06-961T, testimony before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, House of Representatives

July 12, 2006

INDUSTRIAL LOAN CORPORATIONS

Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority

Why GAO Did This Study

Since their origin in the early 1900s, industrial loan corporations (ILCs) have grown significantly in size, and some have expressed concern that ILCs may have expanded beyond the original scope and purpose intended by Congress. Others have questioned whether the current regulatory structure for overseeing ILCs is adequate.

This testimony is based on our September 2005 report that, among other things, (1) described the growth and permissible activities of the ILC industry, (2) compared the supervisory authority of the FDIC—the current federal regulator for ILCs—with consolidated supervisors, and (3) described the extent to which ILC parents could mix banking and commerce.

In this testimony GAO is reiterating that Congress should (1) consider options for strengthening the regulatory oversight of ILCs and (2) more broadly consider whether allowing ILCs a greater degree of mixing banking and commerce is warranted or whether other entities should be permitted to engage in this level of activity.

www.gao.gov/cgi-bin/getrpt?GAO-06-961T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov.

What GAO Found

The ILC industry has experienced significant asset growth and has evolved from once small, limited-purpose institutions to a diverse industry that includes some of the nation's largest and more complex financial institutions. Between 1987 and 2006, ILC assets grew over 3,900 percent from $3.8 billion to over $155 billion. In most respects, ILCs may engage in the same activities as other depository institutions insured by the FDIC and are subject to the same federal safety and soundness safeguards and consumer protection laws. Therefore, from an operations standpoint, ILCs pose similar risks to the bank insurance fund as other types of insured depository institutions.

Parents of insured depository institutions that present similar risks to the bank insurance fund are not, however, being overseen by bank supervisors that possess similar powers. ILCs typically are owned or controlled by a holding company that may also own or control other entities. Although FDIC has supervisory authority over an insured ILC, this authority does not explicitly extend to ILC holding companies and, therefore, is less extensive than the authority consolidated supervisors have over bank and thrift holding companies. Therefore, from a regulatory standpoint, these ILCs may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company. For example, FDIC's authority to examine ILC affiliates is more limited than a consolidated supervisor. While FDIC asserted that its authority may achieve many of the same results as consolidated supervision, and that its supervisory model has mitigated losses to the bank insurance fund in some instances, FDIC's authority is limited to a particular set of circumstances and may not be used at all times. Further, FDIC's authority has not been tested by a large ILC parent during times of economic stress.

Because of an exception in federal banking law, ILC holding companies can mix banking and commerce more than the holding companies of most other depository institutions. In addition, there are a number of pending applications for deposit insurance with FDIC involving commercial firms, including one of the largest retail firms. While some industry participants assert that mixing banking and commerce may offer benefits from operational efficiencies, empirical evidence documenting these benefits is mixed. Federal policy separating banking and commerce focuses on the potential risks from integrating these functions, such as the potential expansion of the federal safety net provided for banks to their commercial entities. GAO finds it unusual that a limited ILC exemption would be the primary means for mixing banking and commerce on a broader scale and sees merits in Congress taking a look at whether ILCs or other entities should be allowed to engage in this level of activity.