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INDUSTRIAL LOAN CORPORATIONS

Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority

GAO

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Highlights

Highlights of GAO-05-621, a report to the Honorable James A. Leach, House of Representatives

Why GAO Did This Study

Industrial loan corporations (ILC) emerged in the early 1900s as small niche lenders that provided consumer credit to low and moderate income workers who were generally unable to obtain consumer loans from commercial banks. Since then, some 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 report (1) discusses the growth and permissible activities of ILCs and other insured depository institutions, (2) compares the supervisory authority of the FDIC with consolidated supervisors, and (3) describes ILC parents' ability to mix banking and commerce.

What GAO Recommends

GAO is not recommending executive action but believes Congress should consider strengthening the regulatory oversight of ILCs and more broadly consider the advantages and disadvantages of a greater mixing of banking and commerce by ILCs or other financial institutions. In commenting on a draft of this report, the Board agreed with both the findings and matters for congressional consideration. FDIC agreed with one of the findings but generally believed that no changes were needed in its supervisory approach.

www.gao.gov/cgi-bin/getrpt?GAO-05-621.

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 one-time, small, limited purpose institutions to a diverse industry that includes some of the nation's largest and more complex financial institutions. Between 1987 and 2004, ILC assets grew over 3,500 percent from $3.8 billion to over $140 billion. In most respects, ILCs may engage in the same activities as other depository institutions insured by the FDIC and thus may offer a full range of loans, including consumer, commercial and residential real estate, small business, and subprime. ILCs are also subject to the same federal safety and soundness safeguards and consumer protection laws that apply to other FDIC-insured institutions. 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 provide 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 other entities. Although FDIC has supervisory authority over an insured ILC, it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of 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 and take certain enforcement actions against them 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.

An exemption in federal banking law currently allows ILC parents to mix banking and commerce more than the parents of other depository institutions. Three of the six new ILC charters approved during 2004 were for commercial firms, and one of the largest retail firms recently applied for an ILC charter. 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 merit in Congress more broadly considering the advantages and disadvantages of a greater mixing of banking and commerce.