

The Return of the ILC: The FDIC Issues Its Final Rule

December 18, 2020

On December 15, 2020, the Federal Deposit Insurance Corporation (the “FDIC”) finalized its regulatory framework to strengthen and codify the FDIC process for approving federal deposit insurance applications for industrial banks and for supervising industrial bank holding companies (the “Final Rule”). The Final Rule becomes effective on April 1, 2021.

As background, an “industrial bank” (also referred to as an “industrial loan company” or “ILC”) is an FDIC-insured state-chartered bank that can be established in certain states, such as Utah, Nevada and California. Generally, industrial banks can provide the same products and services as any other FDIC-insured state-chartered bank, particularly to retail customers. However, unlike other state charters, the parent(s) of an industrial bank do not become bank holding companies regulated or supervised by the Federal Reserve Board. These charters became popular before the financial crisis for non-bank-centric firms, including Wall Street brokerage houses and insurance firms, to provide banking services to their customers. Most recently, the FDIC approved applications for federal deposit insurance for Square Financial Services, Inc., a proposed Utah-chartered industrial bank, and for Nelnet Bank, a Utah-chartered industrial bank that became operational last month.

The Final Rule, summarized below, largely adopts the framework in the March 17, 2020 proposal (the “Proposal”), but with a few key differences.¹ A discussion of the Final Rule’s implications follows.

APPLICABILITY & OVERVIEW

The Final Rule covers industrial banks that, on or after the effective date, become subsidiaries of companies that are “Covered Companies.” A “Covered Company,” in turn, is generally defined to include any company that is not subject to federal consolidated

¹ For additional information refer to our Debevoise InDepth describing the Proposal found [here](#). A redline of the Final Rule against the Proposal is found [here](#).

banking supervision by the Federal Reserve Board. The Final Rule does not apply to industrial banks in existence before the Final Rule's effective date (the "Grandfathered Industrial Banks") or their parent companies. Requirements also do not apply to an industrial bank that is controlled by a company supervised by the Federal Reserve Board or that is wholly owned by one or more individuals. However, a Grandfathered Industrial Bank would become subject to the requirements under the Final Rule following a change in control, merger or grant of deposit insurance occurring after the Final Rule's effective date.

Conditions for Approval of Federal Deposit Insurance

Covered Companies and industrial banks are required to enter into a written agreement with the FDIC, which will require Covered Companies and industrial banks to take the actions as described in Appendix A. A key change from the Proposal is that the FDIC has increased the percentage of directors that a Covered Company may have on the board of directors of a subsidiary industrial bank from up to 25 percent, as proposed, to up to (but not including) 50 percent.

Supervisory Industrial Bank Requirements

Under the adopted framework, an industrial bank controlled by a Covered Company needs prior written FDIC approval before taking any of the actions as described in Appendix A. Most notably, a Covered Company must inform the FDIC about its systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information as part of the Covered Company's commitment to submit an annual report to the FDIC.

Based on the size and complexity of a particular industrial bank, the nature and scope of its activities, the sensitivity of any customer information at issue, and the unique facts and circumstances of the filing before the FDIC, the FDIC may consider imposing heightened requirements regarding the use of consumer financial data for commercial purposes.

The Final Rule clarifies that the Consumer Financial Protection Bureau has the authority to enforce unfair, deceptive, and abusive acts and practices related to consumer financial products and services offered by industrial banks, and that industrial banks are subject the following statutory regimes regarding nonpublic personal information: Title V of the Gramm-Leach-Bliley Act and its implementing regulations; the Fair Credit Reporting Act; Section 5 of the Federal Trade Commission Act; and state law, as applicable.

IMPLICATIONS

The Final Rule largely implements the framework proposed in March, which will give non-bank-centric companies a path forward for pursuing an industrial bank. Despite controversy over the Final Rule, the FDIC is committed to making this option for providing banking services available to qualifying companies, and the Final Rule seeks to demonstrate industrial banks can operate in a safe and sound manner. The FDIC Chair, Jelena McWilliams, is currently serving a five-year term as Chairman of the FDIC, which will continue into 2023. It remains to be seen whether legislative or regulatory changes (due to the change in composition of the FDIC Board) will affect the charter's ongoing viability.

* * *

Please do not hesitate to contact us with any questions.

New York



Gregory J. Lyons
gilyons@debevoise.com



David L. Portilla
dlportilla@debevoise.com



David G. Sewell
dsewell@debevoise.com



Clare K. Lascelles
cklascelles@debevoise.com



Brenna Rae Sooy
brsooy@debevoise.com



Satish M. Kini
smkini@debevoise.com

Washington, D.C.

APPENDIX A

FDIC ILC Final Rule Overview	
<i>Proposal</i>	<i>Final Rule</i>
<p>Conditions for Approval of Federal Deposit Insurance: Covered Companies and industrial banks will be required to enter into a written agreement with the FDIC. The written agreement will require Covered Companies to take the actions below:</p>	
Provide the FDIC with an initial listing including annual updates of all of the Covered Company’s subsidiaries;	Adopted as proposed.
Consent to the FDIC’s examination of the Covered Company and each of its subsidiaries to monitor compliance with written agreements, commitments, conditions and certain provisions of law subject to FDIC oversight;	Adopted as proposed. The FDIC clarified that the FDIC has authority, under certain conditions, to examine affiliates in connection with its examination of an industrial bank in order to ascertain the relationship between the bank and a given affiliate, as well as the effect of that relationship on the bank. 12 U.S.C. § 1820(b)(4).
Provide the FDIC with an annual report of the Covered Company and its subsidiaries and other requested reports, which the Covered Company can expect will include its financial condition, systems for identifying, measuring, monitoring and controlling financial and operational risks, transactions with depository institution subsidiaries and compliance with any law or regulation, including the Federal Deposit Insurance Act;	Includes a requirement for a Covered Company to inform the FDIC about its systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information.
Maintain records as the FDIC deems necessary to assess the risk to the industrial bank and to the Deposit Insurance Fund;	Adopted as proposed.
Cause an annual independent audit of the industrial bank;	Adopted as proposed.
Ensure the Covered Company represents no more than 25% of the board of directors or board of managers, as applicable, of the industrial bank;	Increases the requirement such that the Covered Company must represent less than 50% of the board of directors or board of managers, as applicable, of the industrial bank. (Even so, the FDIC retains the authority to require a higher threshold of director independence.)
Maintain capital and liquidity levels of the industrial bank as required by the FDIC and take action to provide the industrial bank with a resource for additional capital or liquidity, including, having the controlling or dominant shareholder of a Covered Company join as a party to the written agreements, as required by the FDIC; and	Adopted as proposed.
Enter into a tax allocation agreement regarding tax assets generated by the industrial bank that expressly recognizes an agency relationship between the Covered Company and the industrial bank that provides that all tax assets are held in trust by the Covered Company.	Adopted as proposed.

<i>Proposal</i>	<i>Final Rule</i>
Covered Companies and industrial banks could be required to adopt, maintain and implement an FDIC-approved contingency plan regarding stress scenarios. If required, the plan would include a contingency plan for disposition of the industrial bank without the need for a receiver or conservator.	Adopted as proposed.
Section 354.4(c) of the proposed rule would have provided that the FDIC may require such additional commitments from a Covered Company or controlling shareholder of a Covered Company in addition to those described above.	12 CFR § 354.4(c) was removed to avoid confusion that the FDIC would unilaterally impose additional commitments (or restrictions) not contemplated in the agreed upon written agreements. Notwithstanding this deletion, the FDIC clarified that it retains its general supervision, examination, and enforcement authorities to take any actions beyond the scope of the Final Rule. 12 CFR § 354.6.
Supervisory Industrial Bank Requirements: An industrial bank controlled by a Covered Company will need prior written FDIC approval before taking any of the actions below:	
Implementing material changes in its business plan;	Clarifies that this restriction is perpetual and provides a list of situations that would constitute a “material change.”
Adding or replacing a member of the board of directors;	Clarifies that this provision will apply during the first three years after an industrial bank becomes a subsidiary of the Covered Company.
Adding or replacing a senior executive officer;	Clarifies that this provision will apply during the first three years after an industrial bank becomes a subsidiary of the Covered Company.
Employing a senior executive officer who is associated in any manner with an affiliate, including as a director, officer, employee, agent, owner or consultant; and	Clarifies that this restriction is perpetual, but expands the restriction to cover a senior executive officer who is or was during the past three years associated with an affiliate of the industrial bank.
Entering into a contract for services material to the operations of the industrial bank with the Covered Company or any subsidiary of the Covered Company.	Clarifies that this restriction is perpetual.