

# Rules and Regulations

Federal Register

Vol. 86, No. 34

Tuesday, February 23, 2021

This section of the FEDERAL REGISTER contains regulatory documents having general applicability and legal effect, most of which are keyed to and codified in the Code of Federal Regulations, which is published under 50 titles pursuant to 44 U.S.C. 1510.

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## FEDERAL DEPOSIT INSURANCE CORPORATION

### 12 CFR Part 354

RIN 3064-AF31

#### Parent Companies of Industrial Banks and Industrial Loan Companies

**AGENCY:** Federal Deposit Insurance Corporation.

**ACTION:** Final rule.

**SUMMARY:** The Federal Deposit Insurance Corporation is adopting a final rule that requires certain conditions and commitments for each deposit insurance application approval, non-objection to a change in control notice, and merger application approval that would result in an insured industrial bank or industrial loan company becoming, on or after the effective date of the final rule, a subsidiary of a company that is not subject to consolidated supervision by the Federal Reserve Board. The final rule also requires that before any industrial bank or industrial loan company may become a subsidiary of a company that is not subject to consolidated supervision by the Federal Reserve Board, such company and the industrial bank or industrial loan company must enter into one or more written agreements with the Federal Deposit Insurance Corporation.

**DATES:** The rule is effective on April 1, 2021.

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#### I. Policy Objectives

The Federal Deposit Insurance Corporation (FDIC) monitors, evaluates, and takes necessary action to ensure the safety and soundness of State

nonmember banks,<sup>1</sup> including industrial banks and industrial loan companies (together, “industrial banks”).<sup>2</sup> In granting deposit insurance, issuing a non-objection to a change in control, or approving a merger, the FDIC must consider the factors listed in sections 6,<sup>3</sup> 7(j),<sup>4</sup> and 18(c),<sup>5</sup> respectively, of the Federal Deposit Insurance Act (FDI Act). Congress expressly made all industrial banks eligible for Federal deposit insurance in 1982.<sup>6</sup> As deposit insurer and as the appropriate Federal banking agency for industrial banks, the FDIC supervises industrial banks. A key part of its supervision is evaluating and mitigating the risks arising from the activities of the control parties and owners of insured industrial banks to ensure they do not threaten the safe and sound operations of those industrial banks or pose undue risk to the Deposit Insurance Fund (DIF).

Existing State and Federal laws allow both financial and commercial companies to own and control industrial banks. Congress expressly adopted an exception to permit such companies to own and control industrial banks, without becoming a bank holding company (BHC) under the Bank Holding Company Act (BHCA), as part of the Competitive Equality Banking Act of 1987 (CEBA).<sup>7</sup> Industrial banks today are owned by financial and nonfinancial commercial firms. The FDIC has in recent years received applications from groups seeking to establish new industrial banks that would be owned by commercial parents. Proposals regarding industrial banks have presented unique risk profiles compared to traditional community

<sup>1</sup> See 12 U.S.C. 1811, 1818, 1821, 1831o-1, 1831p-1.

<sup>2</sup> Herein, the term “industrial bank” means any insured State-chartered bank that is an industrial bank, industrial loan company, or other similar institution that is excluded from the definition of “bank” in the Bank Holding Company Act pursuant to 12 U.S.C. 1841(c)(2)(H). State laws refer to both industrial loan companies and industrial banks. For purposes of this rule, the FDIC is treating the two types of institutions as the same. The rule does not apply to limited purpose trust companies and credit card banks that also are exempt from the definition of “bank.”

<sup>3</sup> 12 U.S.C. 1816.

<sup>4</sup> 12 U.S.C. 1817(j).

<sup>5</sup> 12 U.S.C. 1828(c).

<sup>6</sup> Garn-St. Germain Depository Institutions Act of 1982, Public Law 97-320, 96 Stat. 1469 (Oct. 15, 1982).

<sup>7</sup> Public Law 100-86, 101 Stat. 552 (Aug. 10, 1987).

bank proposals. These profiles have included potential owners that would not be subject to Federal consolidated supervision,<sup>8</sup> affiliations with organizations whose activities are primarily commercial in nature, and non-community bank business models.<sup>9</sup>

Given the continuing interest in the industrial bank charter and the evolving business models, the FDIC proposed a rule in March 2020 to codify existing practices utilized by the FDIC to supervise industrial banks and their parent companies, to mitigate undue risk to the DIF that may otherwise be presented in the absence of Federal consolidated supervision of an industrial bank and its parent company, and to ensure that the parent company that owns or controls an industrial bank serves as a source of financial strength for the industrial bank, consistent with section 38A of the FDI Act.<sup>10</sup> The proposed rule described certain commitments that would be required as a condition of the FDIC's approval of, or non-objection to, each deposit insurance application, change in control notice, or merger application resulting in an industrial bank becoming a subsidiary of a company not subject to consolidated supervision by the Federal Reserve Board (FRB; each such parent company a Covered Company). The proposed rule required such a company and the subsidiary industrial bank to enter into one or more written agreements with the FDIC that contain certain commitments to be undertaken by the company to ensure the safe and sound operation of such industrial bank. The required commitments include capital and liquidity support from the parent to the industrial bank that have been incorporated in some form in the FDIC's prior actions to create an appropriate supervisory structure for

industrial banks and their parent companies.<sup>11</sup>

The FDIC is now issuing a final rule, which is largely consistent with the proposed rule. The final rule makes four substantive changes to the proposed rule. First, the final rule requires compliance from covered entities on or after the effective date of the rule rather than simply after, as proposed. Second, the final rule requires additional reporting by Covered Companies regarding systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information. Third, the threshold regarding the limitation of a Covered Company's representation on the board of a subsidiary industrial bank has been raised in the final rule from 25 percent, as proposed, to less than 50 percent. Lastly, the final rule modifies the restrictions on industrial bank subsidiaries concerning the appointment of directors and senior executive officers to apply to the industrial bank only during the first three years after becoming a subsidiary of a Covered Company. These changes are discussed in sections IV.B.1., IV.B.4., and IV.B.5. of this Supplementary Information section below. In addition to providing this comprehensive framework for supervision, the final rule also provides interested parties with certainty and transparency regarding the FDIC's practices when making determinations on filings involving industrial banks.

## II. Background

### A. History

Industrial banks began as small State-chartered loan companies in the early 1900s to provide small loans to industrial workers. Initially, many industrial banks did not accept any deposits and funded themselves instead by issuing investment certificates. However, the Garn-St. Germain Depository Institutions Act of 1982,<sup>12</sup> among other effects, made all industrial banks eligible for Federal deposit insurance. This expanded eligibility for Federal deposit insurance brought industrial banks under the supervision

of both a State authority and the FDIC.<sup>13</sup> The chartering States gradually expanded the powers of their industrial banks so that today industrial banks generally have the same commercial and consumer lending powers as commercial banks.

Under the FDI Act, industrial banks are "State banks"<sup>14</sup> and all of the existing FDIC-insured industrial banks are "State nonmember banks."<sup>15</sup> As a result, the FDIC is the appropriate Federal banking agency for industrial banks.<sup>16</sup> Each industrial bank is also regulated by its respective State chartering authority. The FDIC generally exercises the same supervisory and regulatory authority over industrial banks as it does over other State nonmember banks.

### B. Industrial Bank Exclusion Under the BHCA

In 1987, Congress enacted the CEBA, which exempted industrial banks from the definition of "bank" in the BHCA. As a result, parent companies that control industrial banks are not BHCs under the BHCA and are not subject to the BHCA's activities restrictions or FRB supervision and regulation. The industrial bank exception in the BHCA therefore allows for commercial firms to own or control a bank. By contrast, BHCs and savings and loan holding companies (SLHCs) are subject to Federal consolidated supervision by the FRB and are generally prohibited from engaging in commercial activities.<sup>17</sup>

More specifically, the CEBA redefined the term "bank" in the BHCA to include: (1) Any FDIC-insured institution, and (2) any other institution that accepts demand or checkable deposit accounts and is engaged in the

<sup>8</sup> In the context of the proposed rule, "Federal consolidated supervision" referred to the supervision of a parent company and its subsidiaries by the Federal Reserve Board (FRB). Consolidated supervision of a bank holding company by the FRB encompasses the parent company and its subsidiaries, and allows the FRB to understand "the organization's structure, activities, resources, and risks, as well as to address financial, managerial, operational, or other deficiencies before they pose a danger to the BHC's subsidiary depository institutions." See SR Letter 08-9, "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations" (Oct. 16, 2008).

<sup>9</sup> See FDIC Deposit Insurance Applications, Procedures Manual Supplement, Applications from Non-Bank and Non-Community Bank Applicants, FIL-8-2020 (Feb. 10, 2020).

<sup>10</sup> Parent Companies of Industrial Banks and Industrial Loan Companies, 85 FR 17771, 17772-73 (Mar. 31, 2020). See also 12 U.S.C. 18310-1(b).

<sup>11</sup> In March of 2020, the FDIC approved two deposit insurance applications for industrial banks owned by firms whose businesses are predominantly financial in nature, Square Financial Services, Inc., Salt Lake City, Utah (Square Financial), and Nelnet Bank, Salt Lake City, Utah (Nelnet). As part of both approvals, the FDIC required the industrial banks and their parent companies to enter into written agreements with the FDIC that are consistent with the requirements of the proposed and this final rule.

<sup>12</sup> 96 Stat. 1469.

<sup>13</sup> Prior to 1982, the FDIC had allowed some industrial banks to become federally insured, but FDIC insurance was typically limited to those industrial banks chartered by States where the relevant State's law allowed them to receive "deposits" or to use "bank" in their name. For additional historical context regarding industrial bank supervision, see *The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective*, Supervisory Insights (2004).

<sup>14</sup> 12 U.S.C. 1813(a)(2).

<sup>15</sup> 12 U.S.C. 1813(e)(2).

<sup>16</sup> 12 U.S.C. 1813(q)(2).

<sup>17</sup> Section 4 of the BHCA generally prohibits a BHC from acquiring ownership or control of any company which is not a bank or engaging in any activity other than those of banking or of managing or controlling banks and other subsidiaries authorized under the BHCA. See 12 U.S.C. 1843(a)(1) and (2). The Home Owners' Loan Act (HOLA) governs the activities of SLHCs, as amended by the Dodd-Frank Act, which generally subjects these companies to the permissible financial holding company activities under section 4(k) of the BHCA (12 U.S.C. 1843(k)), activities that are financial in nature or incidental to a financial activity). See 12 U.S.C. 1467a(c)(2)(H).

business of making commercial loans.<sup>18</sup> This change effectively closed the so-called “nonbank bank” exception implicit in the prior BHCA definition of “bank.” The CEBA created explicit exceptions from this definition for certain categories of federally insured institutions, including industrial banks, credit card banks, and limited purpose trust companies. The exclusions from the definition of the term “bank” created in 1987 by the CEBA remain in effect today. To be eligible for the CEBA exception from the BHCA definition of “bank,” an industrial bank must have received a charter from one of the limited number of States eligible to issue industrial bank charters, and the law of the chartering State must have required Federal deposit insurance as of March 5, 1987. In addition, an industrial bank must meet one of the following criteria: (i) Not accept demand deposits,<sup>19</sup> (ii) have total assets of less than \$100 million, or (iii) have been acquired prior to August 10, 1987.<sup>20</sup>

Industrial banks are currently chartered in California, Hawaii, Minnesota, Nevada, and Utah. Under the CEBA, these States were permitted to grandfather existing industrial banks and continue to charter new industrial banks.<sup>21</sup> Generally, industrial banks offer limited deposit products, a full range of commercial and consumer loans, and other banking services. Although some industrial banks that have total assets of less than \$100 million accept demand deposits, most industrial banks do not offer demand deposits. Negotiable order of withdrawal (NOW) accounts<sup>22</sup> may be

offered by industrial banks.<sup>23</sup> Industrial banks have branching rights, subject to certain State law constraints.

### C. Industry Profile

The industrial bank industry has evolved since the enactment of the CEBA. The industry experienced significant asset growth between 1987 and 2006 when total assets held by industrial banks grew from \$4.2 billion to \$213 billion.<sup>24</sup> From 2000 to 2006, 24 industrial banks became insured.<sup>25</sup> As of January 30, 2007, there were 58 insured industrial banks with \$177 billion in aggregate total assets.<sup>26</sup> The ownership structure and business models of industrial banks evolved as industrial banks were acquired or formed by a variety of commercial firms, including, among others, BMW, Target, Pitney Bowes, and Harley Davidson. For instance, certain companies established industrial banks, in part, to support the sale of the manufactured products (e.g. automobiles) or other services, whereas certain retailers established industrial banks to issue general purpose credit cards. In addition, certain financial companies also formed or acquired industrial banks to provide access to Federal deposit insurance for brokerage customers’ cash management account balances. The cash balances their customers maintain with the securities affiliate are swept into insured, interest-bearing accounts at the industrial bank subsidiary, thereby providing the brokerage customers with FDIC-insured deposits during the period of time that cash is held for future investment.

Since 2007, the industrial bank industry has experienced contraction both in terms of the number of institutions and aggregate total assets. As of September 30, 2020, there were 23 industrial banks<sup>27</sup> with \$173 billion in

aggregate total assets. Four industrial banks reported total assets of \$10 billion or more; ten industrial banks reported total assets of \$1 billion or more but less than \$10 billion. The industrial bank sector today includes a diverse group of insured financial institutions operating a variety of business models. A significant number of the existing industrial banks support the commercial or specialty finance operations of their parent company and are funded through non-core sources.

The reduction in the number of industrial banks from 2007 to 2020 was due to a variety of factors, including mergers, conversions, voluntary liquidations, and the failure of two small institutions.<sup>28</sup> For business, marketplace, or strategic reasons, several industrial banks converted to commercial banks and thus became “banks” under the BHCA. Four industrial banks were approved in 2007 and 2008; however, none of those institutions exist today.<sup>29</sup> Moratoria imposed by the FDIC and Congress (as discussed below) were also a factor.

Since the beginning of 2017, the FDIC has received 12 Federal deposit insurance applications related to proposed industrial banks. Of those, two have been approved,<sup>30</sup> eight have been withdrawn, and two are pending.<sup>31</sup> The FDIC anticipates potential continued interest in the establishment of industrial banks, particularly with regard to proposed institutions that plan to pursue a specialty or limited purpose business model.

in Minnesota. An additional industrial bank, Nelnet Bank, began operations in November of 2020. Square Financial was approved in March and has not opened for business.

<sup>28</sup> Security Savings Bank, Henderson, Nevada, failed in February 2009, and Advanta Bank Corporation, Draper, Utah, failed in March 2010.

<sup>29</sup> In each case, the institution pursued a voluntary transaction that led to termination of the respective institution’s industrial bank charter. One institution converted to a commercial bank charter and continues to operate, one merged and the resultant bank continues to operate, and two terminated deposit insurance following voluntary liquidations. Such transactions generally result from proprietary strategic determinations by the institutions and their parent companies or investors.

<sup>30</sup> In March of 2020, the FDIC approved the deposit insurance applications of Nelnet Bank and Square Financial. Square Financial has not yet commenced operations.

<sup>31</sup> Decisions to withdraw an application are made at the discretion of the organizers and can be attributed to a variety of reasons. In some cases, an application is withdrawn and then refiled after changes are incorporated into the proposal. In such cases, the new application is reviewed by the FDIC without prejudice. In other cases, the applicant may, for strategic reasons, determine that pursuing an insured industrial bank charter is not in the organizers’ best interests.

<sup>18</sup> 12 U.S.C. 1841(c)(1).

<sup>19</sup> Regulation D, 12 CFR part 204, implements the reserve requirements of section 19 of the Federal Reserve Act and defines a demand deposit as a deposit that is payable on demand, or issued with an original maturity or required notice period of less than seven days, or a deposit representing funds for which the depository institution does not reserve the right to require at least seven days’ written notice of an intended withdrawal. Demand deposits may be in the form of (i) checking accounts; (ii) certified, cashier’s, teller’s, and officer’s checks; and (iii) traveler’s checks and money orders that are primary obligations of the issuing institution. Other forms of accounts may also meet the definition of “demand deposit.” See 12 CFR 204.2(b)(1).

<sup>20</sup> 12 U.S.C. 1841(c)(2)(H).

<sup>21</sup> Colorado was also grandfathered but it has no active industrial banks and has since repealed its industrial bank statute.

<sup>22</sup> A NOW account is an interest-earning bank account whereby the owner may write drafts against the money held on deposit. NOW accounts were developed when certain financial institutions were prohibited from paying interest on demand deposits. The prohibition on paying interest on demand deposits was lifted when the FRB repealed its Regulation Q, effective July 21, 2011. See 76 FR 42015 (July 18, 2011). Many provisions of the repealed Regulation Q were transferred to the FRB’s Regulation D.

<sup>23</sup> 12 U.S.C. 1832(a). Only certain types of customers may maintain deposits in a NOW account. 12 U.S.C. 1832(a)(2).

<sup>24</sup> Most of the growth during this period is attributable to financial services firms that controlled industrial banks offering sweep deposit programs to provide Federal deposit insurance for customers’ free cash balances and to American Express moving its credit card operations from its Delaware-chartered credit card bank to its Utah-chartered industrial bank.

<sup>25</sup> During this time period, the FDIC received 57 applications for Federal deposit insurance for industrial banks, 53 of which were acted on. Also during this time period, 21 industrial banks ceased to operate due to mergers, conversions, voluntary liquidations, and one failure (Southern Pacific Bank, Torrance, CA, failed in 2003).

<sup>26</sup> Of the 58 industrial banks existing at this time, 45 were chartered in Utah and California. The remaining industrial banks were chartered in Colorado, Hawaii, Minnesota, and Nevada.

<sup>27</sup> Of the 23 industrial banks existing as of June 30, 2020, 14 were chartered in Utah, four in Nevada, three in California, one in Hawaii, and one

#### D. Supervision

Because industrial banks are insured State nonmember banks, they are subject to the FDIC's Rules and Regulations, as well as other provisions of law, including restrictions under the Federal Reserve Act governing transactions with affiliates,<sup>32</sup> anti-tying provisions of the BHCA,<sup>33</sup> and insider lending regulations. Industrial banks are also subject to regular examination, including examinations focused on safety and soundness, Bank Secrecy Act and Anti-Money Laundering compliance, consumer protection including Community Reinvestment Act (CRA) compliance, information technology (IT), and trust services, as appropriate. Pursuant to section 10(b)(4) of the FDI Act, the FDIC has the authority to examine the affairs of any industrial bank affiliate, including the parent company, as may be necessary to determine the relationship between the institution and the affiliate, and the effect of such relationship on the depository institution.<sup>34</sup>

In addition, under section 38A of the FDI Act, as amended by the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),<sup>35</sup> the FDIC is required to impose a requirement on companies that directly or indirectly own or control an industrial bank to serve as a source of financial strength for that institution.<sup>36</sup> In addition, subsection (d) of section 38A of the FDI Act provides explicit statutory authority for the appropriate Federal banking agency to require reports from a controlling company to assess the ability of the company to comply with the source of strength requirement, and to enforce compliance by such company.<sup>37</sup>

Consistent with section 38A and other authorities under the FDI Act, the FDIC has historically required capital and liquidity maintenance agreements (CALMAs)<sup>38</sup> and other written agreements between the FDIC and controlling parties of industrial banks as well as the imposition of prudential conditions when approving or non-objecting to certain filings involving an

industrial bank. Such written agreements provide required commitments for the parent company to provide financial resources and a means for the FDIC to pursue formal enforcement action under sections 8 and 50 of the FDI Act<sup>39</sup> should a party fail to comply with the agreements.

#### E. GAO and OIG Reports

Beginning in 2004, the FDIC Office of Inspector General (OIG) conducted two evaluations and the Government Accountability Office (GAO) conducted a statutorily mandated study regarding the FDIC's supervision of industrial banks, including its use of prudential conditions.<sup>40</sup> An OIG evaluation published in 2004 focused on whether industrial banks posed greater risk to the DIF than other financial institutions, and reviewed the FDIC's supervisory approach in identifying and mitigating material risks posed to those institutions by their parent companies. A July 2006 OIG evaluation reviewed the FDIC's process for reviewing and approving industrial bank applications for deposit insurance and monitoring conditions imposed with respect to industrial bank business plans. A September 2005 GAO study cited several risks posed to banks operating in a holding company structure, including adverse intercompany transactions, operations risk, and reputation risk. The GAO study also discussed concerns about the FDIC's ability to protect an industrial bank from those risks as effectively as the Federal consolidated supervisory approach under the BHCA.<sup>41</sup>

These reports acknowledged the FDIC's supervisory actions to ensure the independence and safety and soundness of commercially owned industrial banks. The reports further acknowledged the FDIC's authorities to protect an industrial bank from the risks posed by its parent company and affiliates. These authorities include the FDIC's authority to conduct examinations, impose conditions on and enter into written agreements with an industrial bank parent company, terminate an industrial bank's deposit

insurance, enter into written agreements during the acquisition of an insured depository institution, and to pursue enforcement actions.

#### F. FDIC Moratorium and Other Agency Actions

In 2005, Wal-Mart Bank's application for Federal deposit insurance drew extensive public attention to the industrial bank charter. The FDIC received more than 13,800 comment letters regarding Wal-Mart's proposal. Most of the commenters were opposed to the application. Commenters also raised broader concerns about industrial banks, including the risk posed to the DIF by industrial banks owned by parent companies that are not subject to Federal consolidated supervision. Similar concerns were expressed by witnesses during three days of public hearings held by the FDIC in the spring of 2006 concerning the Wal-Mart application. Also in 2006, The Home Depot filed a change in control notice in connection with its proposed acquisition of EnerBank, a Utah-chartered industrial bank. The FDIC received approximately 830 comment letters regarding the notice, almost all of which expressed opposition to the proposed acquisition. Ultimately, the Wal-Mart application and The Home Depot's notice were withdrawn.

To evaluate the concerns and issues raised with respect to the Wal-Mart and The Home Depot filings and industrial banks generally, on July 28, 2006, the FDIC imposed a six-month moratorium on FDIC action with respect to deposit insurance applications and change in control notices involving industrial banks.<sup>42</sup> The FDIC suspended agency action in order to further evaluate (i) industry developments; (ii) the various issues, facts, and arguments raised with respect to the industrial bank industry; (iii) whether there were emerging safety and soundness issues or policy issues involving industrial banks or other risks to the DIF; and (iv) whether statutory, regulatory, or policy changes should be made in the FDIC's oversight of industrial banks in order to protect the DIF or important Congressional objectives.<sup>43</sup>

In connection with this moratorium, on August 23, 2006, the FDIC published a notice and request for comment on a wide range of issues concerning industrial banks.<sup>44</sup> The FDIC received

<sup>32</sup> See 12 U.S.C. 1828(j)(1)(A).

<sup>33</sup> For purposes of section 106 of the BHCA, an industrial bank is treated as a "bank" and is subject to the anti-tying restrictions therein. See 12 U.S.C. 1843(f)(1).

<sup>34</sup> 12 U.S.C. 1820(b)(4).

<sup>35</sup> Public Law 111-203, 124 Stat. 1376 (July 21, 2010).

<sup>36</sup> 12 U.S.C. 1831o-1(b).

<sup>37</sup> See 12 U.S.C. 1831o-1(d).

<sup>38</sup> When the FDIC has required a CALMA, the capital levels required generally have exceeded the average thresholds required of community banks, due to the risks involved in the business plans of many industrial banks.

<sup>39</sup> See 12 U.S.C. 1818 and 1831aa.

<sup>40</sup> See OIG Evaluation 04-048, *The Division of Supervision and Consumer Protection's Approach for Supervising Limited-Charter Depository Institutions* (2004), available at <https://www.fdicig.gov/reports04/04-048.pdf>; OIG Evaluation 06-014, *The FDIC's Industrial Loan Company Deposit Insurance Application Process* (2006), available at <https://www.fdicig.gov/reports06/06-014.pdf>; U.S. Gov't Accountability Office, GAO-05-621, *Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority* (Sept. 2005), available at [https://www.gao.gov/products/GAO-05-621\(GAO-05-621\)](https://www.gao.gov/products/GAO-05-621(GAO-05-621)).

<sup>41</sup> GAO-05-621.

<sup>42</sup> See Moratorium on Certain Industrial Loan Company Applications and Notices, 71 FR 43482 (Aug. 1, 2006).

<sup>43</sup> *Id.* at 43483.

<sup>44</sup> See Industrial Loan Companies and Industrial Banks, 71 FR 49456 (Aug. 23, 2006). The Notice included questions concerning the current risk

over 12,600 comment letters in response to the notice.<sup>45</sup> The substantive comments related to the risk profile of the industrial bank industry, concerns over the mixing of banking and commerce, the FDIC's practices when making determinations in industrial bank applications and notices, whether commercial ownership of industrial banks should be allowed, and perceived needs for supervisory change.

The moratorium was effective through January 31, 2007, at which time the FDIC extended the moratorium one additional year for deposit insurance applications and change in control notices for industrial banks that would be owned by commercial companies.<sup>46</sup> The moratorium was not applicable to industrial banks to be owned by financial companies.

#### G. 2007 Notice of Proposed Rulemaking (NPR)—Part 354

In addition to extending the moratorium for one year with respect to commercial parent companies, the FDIC published for comment a proposed rule designed to strengthen the FDIC's consideration of applications and notices for industrial banks to be controlled by financial companies not subject to Federal consolidated bank supervision, identified as part 354 (2007 NPR).<sup>47</sup> The 2007 NPR would have imposed requirements on applications for deposit insurance, merger applications, and notices for change in control that would result in an industrial bank becoming a subsidiary of a company engaged solely in financial activities that is not subject to Federal consolidated bank supervision by either the FRB or the then-existing Office of Thrift Supervision (OTS). The rule would have established safeguards

profile of the industrial bank industry, safety and soundness issues uniquely associated with ownership of such institutions, the FDIC's practice with respect to evaluating and making determinations on industrial bank applications and notices, whether a distinction should be made when the industrial bank is owned by an entity that is commercial in nature, and the adequacy of the FDIC's supervisory approach with respect to industrial banks.

<sup>45</sup> Approximately 12,485 comments on the notice were generated either supporting or opposing the proposed industrial bank to be owned by Wal-Mart or the proposed acquisition of Enerbank, also an industrial bank, by The Home Depot. The remaining comment letters were sent by individuals, law firms, community banks, financial services trade associations, existing and proposed industrial banks or their parent companies, the Conference of State Bank Supervisors, and two members of Congress.

<sup>46</sup> See *Moratorium on Certain Industrial Bank Applications and Notices*, 72 FR 5290 (Feb. 5, 2007).

<sup>47</sup> See *Industrial Bank Subsidiaries of Financial Companies* 72 FR 5217 (Feb. 5, 2007); see also <https://www.fdic.gov/news/news/press/2007/pr07007.html>.

to assess the parent company's continuing ability to serve as a source of strength for the insured industrial bank, and to identify and respond to problems or risks that may develop in the company or its subsidiaries.

Similar to this final rule, the 2007 NPR would have required a parent company to enter into a written agreement with the FDIC containing required commitments related to the examination of, and reporting and recordkeeping by, the industrial bank, the parent company, and its affiliates. The majority of commenters did not oppose these requirements, noting the FDIC already has authority to collect such information under section 10(b)(4) of the FDI Act.<sup>48</sup> Many commenters, however, objected to limiting parent company representation on the industrial bank subsidiary's board of directors to 25 percent, and argued instead for requiring that a majority of directors be independent. The majority of commenters stated that the FDIC should not impose capital requirement commitments as contemplated in the 2007 NPR on commercial parents of industrial banks because a one-size-fits all regulatory approach to capital requirements would not be appropriate due to the idiosyncratic business models and operations of such parent companies.

Though the 2007 NPR did not affect industrial banks that would be controlled by companies engaged in commercial activities, several commenters addressed the distinction between industrial banks owned by financial and nonfinancial companies. Two commenters contended that the FDIC lacked authority to draw a distinction between financial and nonfinancial industrial bank owners absent a change in law. Several commenters argued that drawing such a distinction would essentially repeal the exception of industrial banks from the definition of "bank" in the BHCA. There was little consensus among commenters as to whether commercially owned industrial banks pose unique safety and soundness issues.

The FDIC did not finalize the 2007 NPR. Although multiple factors contributed to the FDIC's decision to not advance a final rule, the most significant factor was the onset of two interconnected and overlapping crises: the financial crisis of 2008–09, and the banking crisis from 2008 to 2013.<sup>49</sup> With

<sup>48</sup> See 12 U.S.C. 1820(b)(4).

<sup>49</sup> See *Crisis and Response, An FDIC History, 2008–2013*, available at <https://www.fdic.gov/bank/historical/crisis/>. The financial crisis in 2008 and 2009 threatened large financial institutions of all

the advent of the crises, applications to form *de novo* insured institutions, or to acquire existing institutions, declined significantly, including with respect to industrial banks.

#### H. Dodd-Frank Act and Industrial Banks

As discussed above and in reaction to the 2008–09 financial crisis, the Dodd-Frank Act amended the FDI Act by adding section 38A.<sup>50</sup> Under section 38A, for any insured depository institution that is not a subsidiary of a BHC or SLHC, the appropriate Federal banking agency for the insured depository institution must require any company that directly or indirectly controls such institution to serve as a source of financial strength for the institution.<sup>51</sup>

Through the Dodd-Frank Act, Congress also imposed a three-year moratorium on the FDIC's approval of deposit insurance applications for industrial banks that were owned or controlled by a commercial firm.<sup>52</sup> The Dodd-Frank Act moratorium also applied to the FDIC's non-objection to any change in control of an industrial bank that would place the institution under the control of a commercial firm.<sup>53</sup> The moratorium expired in July 2013, without any further action by Congress.

In addition, the Dodd-Frank Act directed the GAO to conduct a study of the implications of removing all exceptions from the definition of "bank" under the BHCA. The GAO report was published in January of 2012.<sup>54</sup> This report examined the number and general characteristics of

kinds, both inside and outside the traditional banking system, and thus endangered the financial system itself. Second, a banking crisis, accompanied by a swiftly increasing number of both troubled and failed insured depository institutions, began in 2008 and continued until 2013.

<sup>50</sup> See 12 U.S.C. 1831o–1.

<sup>51</sup> 12 U.S.C. 1831o–1(b). This amendment also requires the appropriate Federal banking agency for a BHC or SLHC to require the BHC or SLHC to serve as a source of financial strength for any subsidiary of the BHC or SLHC that is a depository institution. 12 U.S.C. 1831o–1(a).

<sup>52</sup> Public Law 111–203, title VI, section 603(a), 124 Stat. 1597 (2010). Section 603(a) also imposed a moratorium on FDIC action on deposit insurance applications by credit card banks and trust banks owned or controlled by a commercial firm. The Dodd-Frank Act defined a "commercial firm" for this purpose as a company that derives less than 15 percent of its annual gross revenues from activities that are financial in nature, as defined in section 4(k) of the BHCA (12 U.S.C. 1843(k)), or from ownership or control of depository institutions.

<sup>53</sup> *Id.*

<sup>54</sup> See U.S. Government Accountability Office, GAO–12–160, *Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions* (Jan. 2012), available at <https://www.gao.gov/products/GAO-12-160>.

exempt institutions, the Federal regulatory system for such institutions, and potential implications of subjecting the holding companies of such institutions to BHCA requirements. The GAO report noted that the industrial bank industry experienced significant asset growth in the 2000s and, during this time, the profile of industrial banks changed: Rather than representing a class of small, limited-purpose institutions, industrial banks became a diverse group of insured institutions with a variety of business lines.<sup>55</sup> Ultimately, the GAO found that Federal regulation of the exempt institutions' parent companies varied, noting that FDIC officials interviewed in connection with the study indicated that supervision of exempt institutions was adequate, but also noted the added benefit of Federal consolidated supervision. Finally, data examined by the GAO suggested that removing the BHCA exceptions would likely have a limited impact on the overall credit market, chiefly because the overall market share of exempt institutions was, at the time of the study, small.<sup>56</sup>

### III. The Proposed Rule

On March 31, 2020, the FDIC published a notice of proposed rulemaking (NPR or proposal) to establish a supervisory framework for industrial banks and their parent companies that are not subject to Federal consolidated supervision.<sup>57</sup> The proposed rule required certain conditions, commitments, and restrictions for each deposit insurance application approval, non-objection to a change in control notice, and merger application approval that would result in an industrial bank becoming a subsidiary of a company not subject to consolidated supervision by the FRB. The proposal required such a Covered Company to enter into one or more written agreements with the FDIC and the industrial bank subsidiary. The commitments included:

- Furnishing an initial listing, with annual updates, of the Covered Company's subsidiaries.
- Consenting to FDIC examination of the Covered Company and its subsidiaries.
- Submitting an annual report on the Covered Company and its subsidiaries, and such other reports as requested.
- Maintaining such records as the FDIC deemed necessary.

- Causing an independent annual audit of each industrial bank.
- Limiting the Covered Company's representation on the industrial bank's board of directors or managers (board), as the case may be, to 25 percent.
- Maintaining the industrial bank's capital and liquidity at such levels as deemed appropriate and take other action necessary to provide the industrial bank with a resource for additional capital or liquidity.
- Entering into a tax allocation agreement.<sup>58</sup>

The proposal also set forth the FDIC's authority to require, as an additional commitment, a contingency plan that, among other items, provides a strategy for the orderly disposition of the industrial bank without the need for the appointment of a receiver or conservator.

Recently, a number of companies have considered options for providing financial products and services by establishing an industrial bank subsidiary. Many companies have publicly noted the benefits of deposit insurance and establishing a deposit-taking institution. Although many interested parties operate business models focused on traditional community bank products and services, others operate unique business models, some of which are focused on innovative technologies and strategies, including newer business models employed by fintech firms that utilize novel or unproven products or processes.

Some of the companies recently exploring an industrial bank charter engage in commercial activities or have diversified business operations and activities that would not otherwise be permissible for BHCs under the BHCA and applicable regulations. Given the continuing interest in the establishment of industrial banks, particularly with regard to proposed institutions that plan to implement specialty or limited purpose business models, including those focused on innovative technologies, the FDIC believes a rule is appropriate to provide necessary transparency for market participants. Through this final rule, the FDIC is formalizing its framework to supervise industrial banks and mitigate risk to the DIF that may otherwise be presented in the absence of Federal consolidated supervision of an industrial bank and its parent company.

The FDIC has the authority to issue rules to carry out the provisions of the

FDI Act,<sup>59</sup> including rules to ensure the safety and soundness of industrial banks and to protect the DIF. Moreover, as the only agency with the power to grant or terminate deposit insurance, the FDIC has a unique responsibility for the safety and soundness of all insured institutions.<sup>60</sup> In granting deposit insurance, the FDIC must consider the factors in section 6 of the FDI Act;<sup>61</sup> these factors generally focus on the safety and soundness of the proposed institution and any risk it may pose to the DIF. The FDIC is also authorized to permit or deny various transactions by State nonmember banks, including merger and change in bank control transactions, based to a large extent on safety and soundness considerations and on its assessment of the risk to the DIF.<sup>62</sup>

The FDIC has the responsibility to consider filings based on statutory criteria and make decisions. Following the publication of the proposed rule, the FDIC approved two deposit insurance applications, by Square Financial and Nelnet, to create *de novo* industrial banks, the first such approvals since 2008. The FDIC determined that the applications satisfied the seven statutory factors under section 6 of the FDI Act, and the FDIC's approval of deposit insurance for these industrial banks fulfilled the Agency's statutory responsibility. As part of both approvals, the FDIC required the industrial banks and their parent companies to enter into CALMAs and Parent Company Agreements to protect the industrial bank and address potential risks to the DIF.

The FDIC invited comment on all aspects of the March 2020 proposal, including questions posed by the Agency. The comment period for the proposed rule ended on July 1, 2020.<sup>63</sup>

<sup>59</sup> “[T]he Corporation . . . shall have power . . . [t]o prescribe by its Board of Directors such rules and regulations as it may deem necessary to carry out the provisions of this chapter or of any other law which it has the responsibility of administering or enforcing (except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to any other regulatory agency).” 12 U.S.C. 1819(a)(Tenth).

<sup>60</sup> See 12 U.S.C. 1815, 1818(a).

<sup>61</sup> Such factors are the financial history and condition of the depository institution, the adequacy of the depository institution's capital structure, the future earnings prospects of the depository institution, the general character and fitness of the management of the depository institution, the risk presented by such depository institution to the DIF, the convenience and needs of the community to be served by such depository institution, and whether the depository institution's corporate powers are consistent with the purposes of the FDI Act. See 12 U.S.C. 1816.

<sup>62</sup> See 12 U.S.C. 1817(j), 1828(c), and 1828(d).

<sup>63</sup> Given the disruptions caused by the COVID-19 global pandemic, the FDIC announced on May 27,

<sup>55</sup> *Id.* at 13.

<sup>56</sup> The GAO did not recommend repeal of the exemption.

<sup>57</sup> 85 FR 17771 (Mar. 31, 2020).

<sup>58</sup> See proposed § 354.4(a)(1) through (8).

The FDIC received 29 comments from industry group/trade associations, insured depository institutions, consumer and public interest groups, State banking regulator(s), law firms, a member of Congress, academics, and other interested parties.<sup>64</sup> In addition, the FDIC received three letters related to the subject matter considered in the proposed rule prior to the formal comment period. The FDIC is now finalizing the proposed rule, with changes based on public comments, as described in detail below.

#### IV. Discussion of General Comments and Final Rule

##### A. General Comments

Many commenters were supportive of the FDIC's overall effort to provide certainty, clarity, and transparency to the supervisory framework for the parent companies and affiliates of industrial banks. A number of commenters were generally supportive of the industrial bank charter citing the benefits of charter choice, increased competition, and the provision of financial services. These commenters asserted the charter poses no increased risk to the DIF. In their view, the parent companies serve as an important source of strength and governance for the subsidiary industrial bank. They asserted that in times of stress, a diversified parent may be in a better position to provide capital support to a bank subsidiary than a BHC whose assets consist almost entirely of the bank subsidiary. These commenters also argued that an industrial bank benefits from its business relationship with the parent, for example, through marketing support and fewer start-up costs. State regulators stated that the joint supervisory approach to supervising industrial banks with the FDIC has been effective, and industrial banks with commercial parents do not present an outsized safety and soundness risk.

Comments submitted by bank trade associations, consumer groups, and academics were generally critical of the

2020, that it would extend the comment period from June 1, 2020, to July 1, 2020, to allow interested parties additional time to analyze the proposal and prepare comments.

<sup>64</sup> On March 15, 2020, bank trade groups, and consumer and civil rights groups sent a letter to the FDIC urging the agency not to approve deposit insurance applications submitted by industrial banks until the NPR is finalized. See <https://bpi.com/consumer-civil-rights-groups-industry-urge-fdic-halt-approval-of-industrial-bank-applications-close-ilc-loopholes-first/>. On July 29, 2020, some of the same groups sent a letter to Congress requesting a three-year moratorium on industrial bank licensing applications. See <https://bpi.com/banking-and-consumer-groups-call-on-congress-to-close-ilc-loophole/>.

proposed rule and expressed a range of concerns, which are discussed below.

##### 1. Banking and Commerce

Commenters' criticism of the industrial bank charter, and by extension the proposed rule, is focused, in part, on the mixing of banking and commerce through the commercial ownership of an industrial bank. The main argument is that commercial ownership of an industrial bank disregards the policy of separation of banking and commerce embodied in the BHCA<sup>65</sup> and raises risk to the DIF as a result of a lack of Federal consolidated supervision over the commercial parent company.

Although Federal banking regulation has historically advanced a policy of separating banking and commerce, there is an express Congressional exception of industrial banks from the BHCA's restrictions on commercial affiliations.<sup>66</sup> The CEBA exception does not limit eligible parent companies to those engaged in financial activities. The FDIC's responsibility is to implement the law as it exists today. Whether commercial firms should continue to be able to own industrial banks is a policy decision for Congress to make.

Some commenters requested that the FDIC impose a new moratorium on deposit insurance applications involving industrial banks to allow for legislative action. Certain commenters argued that a moratorium, or a delay in the rulemaking more generally, was important in light of the current economic stress and uncertainty caused by the COVID-19 pandemic. The purpose of this final rule is to ensure adequate oversight of industrial banks owned by financial and commercial companies. Additional moratoria or delays in processing and considering applications are outside the scope of this rulemaking and would be inconsistent with the express

<sup>65</sup> See Federal Reserve Bank of San Francisco, Economic Letter 1998-21, The Separation of Banking and Commerce (July 3, 1998), available at <https://www.frbsf.org/economic-research/publications/economic-letter/1998/july/separation-banking-commerce/>.

<sup>66</sup> The legislative history of the CEBA offers no explanation of why this exception was adopted. While the industrial bank exception was included in the Senate version of the Act, the House version omitted it. The Conference report does not shed much light:

INDUSTRIAL LOAN COMPANY EXEMPTION SECTION 2(C) (2) (H) OF THE BANK HOLDING COMPANY ACT

The Senate amendment exempts from the definition of "bank" certain industrial banks; industrial loan companies, or other similar institutions. The House recedes to the Senate.

Conference Report to accompany H.R. 27—Competitive Equality Banking Act of 1987 (July 31, 1987), at 121.

Congressional exception of industrial banks from the BHCA's restrictions on commercial affiliations and the FDIC's statutory obligations to receive and process applications related to industrial banks.

These commenters also argued that allowing commercial firms and industrial banks to combine could potentially lead to conflicts of interest in the lending process and undue concentrations of economic power—concerns they contend underlie the general prohibition against the mixing of commerce and banking in the BHCA. As noted above, the decision to allow commercial firms to own industrial banks was a decision made by Congress. Industrial banks are restricted from making favorable loans to their affiliates by sections 23A and 23B of the Federal Reserve Act, which quantitatively and qualitatively limit transactions between an industrial bank and its affiliates.<sup>67</sup> Furthermore, section 23B of the Federal Reserve Act requires that any transaction between a bank and its affiliates must be "on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to [the] bank or its subsidiary as those prevailing at the time for comparable transactions" with unaffiliated companies.<sup>68</sup> All covered transactions between an industrial bank and its affiliates must be on terms and conditions that are consistent with safe and sound banking practices.<sup>69</sup>

Commenters' competition concerns were based on the possibility that large commercial or technology firms will acquire industrial banks and lead to commercial and financial conglomerates with concentrated and excessive economic power. These commenters were concerned that the FDIC will not adequately consider the anti-trust implications of commercial and financial conglomerates. The FDIC recognizes that there is a possibility that large and complex companies may seek to acquire an industrial bank as emerging technologies and other trends are leading to changes in the provision of banking services. The FDIC has discretion to evaluate the competitive effects of such proposals when considering a deposit insurance application, specifically the statutory factors of the risk to the DIF and the convenience and needs of the community to be served, in order to ensure the market for the provision of

<sup>67</sup> 12 U.S.C. 371c(a)(1), 371c-1(a)(1); see also 12 U.S.C. 1828(j).

<sup>68</sup> 12 U.S.C. 371c-1(b).

<sup>69</sup> 12 U.S.C. 371c(a)(4).

banking services remains competitive and safe and sound.<sup>70</sup> Moreover, the FDIC must consider the anticompetitive effects of a transaction when it is evaluating a notice under the Change in Bank Control Act (CBCA) or an application under the Bank Merger Act.<sup>71</sup> Recognizing that the business models proposed by industrial banks are evolving (e.g., the increasing interplay of services between the bank and its nonfinancial affiliates), the FDIC is issuing this rule in order to help ensure the safety and soundness of industrial banks that become subsidiaries of Covered Companies.

## 2. Lack of Federal Consolidated Supervision

Many commenters that were critical of the proposed rule also argued that the potential future expansion of banks operating under the CEBA exception threatens the Federal safety net because the FDIC lacks the statutory tools to adequately examine and supervise industrial banks and their parents and affiliates. These commenters noted for instance the many ecommerce affiliate relationships of a large, overseas parent company. The FDIC sought comment on whether the commitments requiring examination and reporting included in the proposed rule were the best approach to gain transparency and identify any potential risk to the industrial banks. A number of commenters argued that the eight commitments in the FDIC's proposed rule "fail to achieve parity with the regime of consolidated supervision required for BHCs." Elements they viewed as lacking included consolidated capital and liquidity standards for the Covered Company, including both the industrial bank and all affiliated entities under common ownership, examination for compliance with the Volcker Rule requirements, sections 23A and 23B, and provisions in the Gramm-Leach-Bliley Act (GLBA)<sup>72</sup> on data safeguards and privacy of customer information. Such commenters also argued that the FDIC does not have the authority to conduct full-scope examinations across any and all affiliates, including the parent company, in their own right. Several commenters suggested that the FDIC ask Congress to transfer the supervision of parent companies of industrial banks to the FRB to conduct consolidated supervision.

As discussed in the proposed rule, the FDIC has both the authority and the capacity to effectively regulate industrial banks and their parent companies, and this rule strengthens the FDIC's supervision. The FDIC uses its supervisory authorities to mitigate the risks posed to insured depository institutions whose parent companies are not subject to consolidated supervision. In considering applications for deposit insurance and mergers, as well as change in control notices, the FDIC uses prudential conditions, as needed, to ensure sufficient autonomy and insulation of the insured depository institution from its parent and affiliates. The FDIC also requires CALMAs, which generally exceed the minimum capital requirements for traditional community banks, and other written agreements between the FDIC and controlling parties of industrial banks. These agreements are enforceable under sections 8 and 50 of the FDI Act. In addition, under section 38A of the FDI Act, the FDIC is required to impose a requirement on companies that directly or indirectly own or control an industrial bank to serve as a source of financial strength for that institution.<sup>73</sup> Subsection (d) of section 38A of the FDI Act also provides explicit statutory authority for the appropriate Federal banking agency to require reports from a controlling company to assess the ability of the company to comply with the source of strength requirement, and to enforce compliance by such company.<sup>74</sup> These prudential conditions and requirements will be embodied in written agreements consistent with the framework established by this final rule.

In addition, an important focus of the FDIC's examination and supervision program is evaluating and mitigating risk to insured depository institutions from affiliates. This includes examining the insured depository institution for compliance with laws and regulations, including affiliate transaction limits and capital maintenance.<sup>75</sup> The examination reviews envisioned under this final rule provide the basis and opportunity to more fully evaluate the institution's affiliate relationships. As noted above, most conflict situations affecting banks and their affiliates can be mitigated through the supervisory process and application of the restrictions in sections 23A and 23B of the Federal

Reserve Act and need not pose excessive risk to the bank or the banking system.

The rule also strengthens the FDIC supervisory framework in the area of contingency planning. This rule allows the FDIC to impose a contingency plan requirement, as needed, which will lead the FDIC, as well as the Covered Company and its subsidiary industrial bank, to a better understanding of the interdependencies, operational risks, and other circumstances or events that could create safety and soundness concerns for the insured industrial bank and attendant risk to the DIF. When imposed, this additional commitment will provide for recovery actions that address any financial or operational stress that may threaten the industrial bank.

Finally, the FDIC's oversight and enforcement power extends to the parent or affiliates of any industrial bank whose activities affect that bank, further protecting the industrial bank from risky activities of affiliates.<sup>76</sup>

The FDIC has not found that industrial banks pose unique safety and soundness concerns based on the activities of the parent organization. Industrial banks are subject to all of the same restrictions and requirements, regulatory oversight, and safety and soundness exams as any other kind of insured depository institution. As such, the risks posed are substantially similar to those of all other charter types. A number of commenters noted that two industrial banks failed during the recent financial crisis. While these failed institutions were owned by parent companies not subject to Federal consolidated supervision, the failures were not the result of factors related to the industrial bank charter, as further discussed below.

Certain commenters also observed that several large corporate owners of industrial banks experienced stress during the 2008–09 financial crisis. In some cases, the parent organizations ultimately filed bankruptcy, while others pursued strategies to resolve the stress, including through access to government programs intended to alleviate the effects of the crisis within the financial services sector. These programs included the FDIC's Temporary Liquidity Guarantee Program (TLGP) and the Troubled Asset Relief Program (TARP) administered by the Department of the Treasury. Desired access to these programs contributed to several companies pursuing conversions of an industrial bank to a commercial bank, which required approval of the

<sup>73</sup> 12 U.S.C. 1831o–1(b).

<sup>74</sup> See 12 U.S.C. 1831o–1(d).

<sup>75</sup> See *Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act* (Sept. 2016). The 2016 joint report evaluated the risks of bank activities and affiliations, as required by section 620 of the Dodd-Frank Act.

<sup>76</sup> See 12 U.S.C. 1820(b) and 1820(b)(4)(A).

<sup>70</sup> As part of its considerations, the FDIC may also seek the views of other Federal agencies.

<sup>71</sup> See 12 U.S.C. 1817(j)(7)(A), (B); 1828(c)(5).

<sup>72</sup> Financial Services Modernization Act of 1999, Public Law 106–102, 113 Stat. 1338 (1999).



parent company to become a BHC subject to regulation and supervision by the FRB.

However, it is important to note that each institution or company described in the comments was engaged in activities permissible for all Federal and State banks, BHCs, or financial holding companies, as evidenced by the ability to gain approval for the conversions to commercial banks and BHCs. Further, the types and degree of stress were also experienced by many other insured depository institutions and banking companies, some of which also sought participation in TLGP and/or TARP, failed, or pursued transactions to restructure the organization, merge, or raise capital to alleviate stress or avert failure. As such, the circumstances involving the companies highlighted in the comments were not dissimilar to those facing other banking companies, including companies subject to Federal consolidated supervision.

### 3. Consumer Protection Risks

Commenters opposed to the proposed rule also argued that the growth in industrial banks poses broader consumer protection risks. They asserted that the parent companies of industrial banks are not subject to Federal financial privacy and information security requirements and the absence of these requirements creates risk for customers of the industrial banks, whether or not they also obtain products and services from the parent companies or nonfinancial affiliates. BHCs and SLHCs are limited in their use of consumer financial data for commercial purposes. These commenters asserted that industrial bank parent companies should be subject to the same restrictions.

While there is no general Federal regime covering how nonpublic personal information held in the U.S. may be disclosed or how it must be secured, financial institutions, including industrial banks, are subject to Title V of the GLBA.<sup>77</sup> The GLBA and its implementing regulations, cited by some commenters, impose a range of privacy obligations on financial

institutions, including industrial banks, that exceed those imposed on most other business types. Specifically, the GLBA and implementing rules (1) impose limitations on information sharing between financial institutions and nonaffiliated third parties and require disclosure of information sharing policies and practices to consumers and customers, and (2) require financial institutions to develop, implement, and maintain comprehensive information security programs.<sup>78</sup> However, businesses that are not subject to the GLBA are not free from all privacy and data protection requirements. There are other Federal laws that address privacy and data protection that may apply to a Covered Company and its affiliates as well as financial institutions. As one example, the Fair Credit Reporting Act (FCRA) establishes standards for collection and permissible purposes for dissemination of data by consumer reporting agencies and obligations on furnishers of information. As another example, section 5 of the Federal Trade Commission Act (FTC Act) provides broad authority to the FTC to pursue unfair and deceptive trade acts and practices against most businesses arising from privacy and data protection practices.<sup>79</sup> Further, the Dodd-Frank Act granted the Consumer Financial Protection Bureau (CFPB) broad authority to enforce unfair, deceptive, and abusive acts and practices related to consumer financial products and services that may cover the activities of a Covered Company and its affiliates.<sup>80</sup> Adding to the complexity at the Federal level, States have enacted laws governing the collection, use, protection, and disclosure of personal information. Many States have consumer protection and privacy laws as well as laws similar to the FTC Act that prohibit unfair or deceptive business practices.<sup>81</sup>

<sup>78</sup> See, e.g., 12 CFR part 332, Privacy of Consumer Financial Information.

<sup>79</sup> The FTC is empowered to seek injunctive relief and voluntary consent decrees that can result in FTC oversight of a company for a period of up to 20 years and may carry financial penalties for future violations. The Federal banking agencies enforce section 5 as to financial institutions under their supervision.

<sup>80</sup> The CFPB has been active in the privacy area and recently issued an advanced notice of proposed rulemaking (ANPR) seeking input on the financial records access right granted by section 1033 of the Dodd-Frank Act pertaining to consumer information in the control or possession of consumer financial services providers. 85 FR 71003 (Nov. 6, 2020).

<sup>81</sup> For example, the California Consumer Privacy Act of 2018 serves as an omnibus law governing privacy rights. It was recently amended and expanded by the California Privacy Rights Act. 2020

In the absence of a single, comprehensive Federal law regulating privacy and the collection use, processing, disclosure, security, and disposal of personal information, the FDIC will continue to supervise and examine industrial banks and enforce compliance with the GLBA and all other Federal consumer protection laws and regulations. In addition, and in response to the concerns expressed by commenters that a Covered Company and affiliates that are not engaged in financial services would not be covered by the GLBA, the FDIC is including in the final rule 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, as part of the Covered Company's commitment to submit an annual report to the FDIC. This reporting will provide the FDIC with a better understanding across all of a Covered Company's financial and nonfinancial affiliates and activities and provide the means to monitor for potential consumer protection risks.

The FDIC will evaluate privacy and data protection issues presented by a deposit insurance application, a change in control notice, or a merger application involving an industrial bank on a case-by-case basis. When appropriate, the FDIC may consider imposing heightened requirements specific to industrial banks and Covered Companies regarding the use of consumer financial data for commercial purposes. Decisions will be based on the size and complexity of the 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.

Certain commenters expressed concerns about industrial bank and nonbank partnerships that the commenters believe have led to increased predatory lending.<sup>82</sup> A major

Cal. Legis. Serv. Prop. 24 (2020). The Massachusetts Data Security Regulation includes State-level general data protection security requirements. 201 Mass. Code Regs. 17.00 *et seq.* The Act to Protect the Privacy of Online Consumer Information enacted by the Maine legislature is another example of a State law governing the privacy of consumer information. 35-A M.R.S. section 9301. These examples underscore the fact that although a uniform Federal law has not been enacted, privacy is increasingly in the forefront of the public and legislators alike.

<sup>82</sup> The concern appears to arise from perceived abuses of longstanding statutory authority rather than the proposed rule. Congress enacted section 27 of the FDI Act, 12 U.S.C. 1831d, in 1980, permitting State banks to charge interest at the rate permitted by the law of the State where the bank is located,

<sup>77</sup> Subtitle A of Title V of the GLBA, captioned "Disclosure of Nonpublic Personal Information," limits the instances in which a financial institution may disclose nonpublic personal information about a consumer to nonaffiliated third parties, and requires a financial institution to disclose certain information sharing practices. "Nonpublic personal information" is defined to mean any personally identifiable financial information that is provided by the consumer to the financial institution; results from any transaction with the consumer or service performed for the consumer; or is otherwise obtained by the financial institution, but which is not "publicly available information." See 15 U.S.C. 6801-09.

component of the FDIC's mission is to ensure that financial institutions treat consumers and depositors fairly, and operate in compliance with Federal consumer protection, anti-discrimination, and community reinvestment laws. The FDIC addresses the problem of predatory lending by taking supervisory action, by encouraging and assisting banks to serve all sectors of their community, and by providing consumers with information to help make informed financial decisions.

#### 4. Justification for the Proposed Rule

Several commenters raised concerns that the FDIC offered insufficient justification for the proposed rule. In particular, commenters argued that the proposed rule did not set out a sufficient factual, legal, or policy basis for proposed rule, and that there was insufficient discussion of the risks, public policy concerns, and statutory public interest factors concerning industrial banks.

The Administrative Procedure Act (APA)<sup>83</sup> requires a notice of proposed rulemaking to provide sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully.<sup>84</sup>

The proposed rule set out a clear description of the basis for the proposed rule. The NPR discussed the history of industrial banks in the U.S., both generally and in the context of controversies over the past two decades. The NPR acknowledged the arguments raised by critics, reviewing the potential risks inherent in approving and supervising industrial banks. These include concerns over the mixing of banking and commerce as well as the risk to the DIF posed by the lack of Federal consolidated supervision of parent companies. The NPR also set out the justification for the proposed rule, including the need to codify and clarify supervisory expectations for industrial banks and the importance of imposing commitments on parent companies to ensure the parent company can serve as a source of strength for its subsidiary industrial bank. The NPR provided sufficient discussion of the factual,

even if that rate exceeds the rate permitted by the law of the borrower's State. Federal court precedents reviewing this authority have upheld this practice for decades. Section 27 also permits States to opt out of its coverage by adopting a law, or certifying that the voters of the State have voted in favor of a provision which states explicitly that the State does not want section 27 to apply with respect to loans made in such State.

<sup>83</sup> 5 U.S.C. 551 *et seq.*

<sup>84</sup> 5 U.S.C. 553(b); *see, e.g., National Lifeline Association v. F.C.C.*, 921 F.3d 1105, 1115 (D.C. Cir. 2019).

legal, and policy considerations for the proposed rule, such that interested parties were able to—and did—submit a variety of comments on a number of issues raised in and by the proposed rule.

A few commenters argued that the NPR did not adequately discuss the FDIC's decision to allow industrial bank applications in the wake of both the temporary moratorium the FDIC put into place from 2006 to 2008 and the subsequent 2010 to 2013 moratorium Congress enacted through the Dodd-Frank Act. To reverse the industrial bank moratorium without additional details, these commenters suggest, is arbitrary and capricious and violates the APA.

As the Supreme Court has noted, "Agencies are free to change their existing policies as long as they provide a reasoned explanation for the change."<sup>85</sup> The explanation need not prove that "the reasons for the new policy are better than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency believes it to be better, which the conscious change of course adequately indicates."<sup>86</sup> Specifically, "the 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."<sup>87</sup>

The NPR provided a reasoned discussion of the decision to move forward with the proposed rule, as discussed above. Furthermore, the NPR also explained why it was proceeding now when it chose not to do so with the 2007 rulemaking. The NPR noted that the FDIC's decision not to go forward with the 2007 proposal was rooted in a number of factors. More specifically, while the FDIC considered the comments received on the 2007 rulemaking, industry conditions and other factors had the effect of reducing organizer interest in establishing new industrial banks. Most notably, interest in organizing new institutions of all charter types, including industrial banks, diminished given the deteriorating economic and market conditions identified as early as mid-2007. In part, this diminished interest reflected the market uncertainty, restricted liquidity, reduced availability of capital, and difficult interest rate environment experienced by all

<sup>85</sup> *Encino Motorcars, LLC v. Navarro*, 136 S.Ct. 2117, 2126 (2016).

<sup>86</sup> *F.C.C. v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009).

<sup>87</sup> *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

institutions across the banking industry. In addition, interest in industrial bank charters was affected by changes in certain State laws that limited the ability to form or acquire industrial banks, and was reflected in the number of industrial banks seeking conversions to commercial bank charters. The factors, collectively, argued against moving forward with a final rule, as did the opportunity to closely monitor the performance of industrial banks during a period of significant stress.<sup>88</sup>

Overall, the performance and condition of industrial banks during the most recent banking crises was generally consistent with other FDIC-insured institutions based on assigned supervisory ratings, which consider each institution's unique business model, complexity, and risk profile. From the beginning of 2009 through 2011, on average, industrial banks were assigned composite and component ratings similar to other charter types with regard to safety and soundness, consumer protection, and the CRA. Further, the portfolio of industrial banks reflected similar proportions of institutions that were composite rated 3, 4, or 5<sup>89</sup> during the crisis, as well as a similar rate of failure as the portfolio of traditional community banks.

Looking more specifically at financial performance, and notwithstanding their general focus on nontraditional business models, industrial banks have experienced, by most key measures of performance and condition, comparable results to other insured institutions. Industrial banks tend to maintain higher levels of capital and generate higher earnings. At year-ends 2009 through 2011, industrial banks maintained a median tier 1 leverage capital (T1LC) ratio between 13.1 percent and 15.4 percent, whereas, other insured institutions maintained a median T1LC ratio between 9.3 percent and 9.7 percent. As of June 30, 2020, the median T1LC ratio for industrial banks was 14.6

<sup>88</sup> As noted above in section II.H of this Supplementary Information section, after 2013, the moratorium imposed by Congress in the Dodd-Frank Act expired by its terms and was not renewed.

<sup>89</sup> Each financial institution is assigned composite and component ratings for safety and soundness under the Uniform Financial Institutions Rating System (UFIRS). Under the UFIRS, composite ratings are based on an evaluation and rating of six essential components of an institution's financial condition and operations: Adequacy of capital, the quality of assets, the capability of management, the quality and level of earnings, the adequacy of liquidity, and the sensitivity to market risk. Evaluations of the components take into consideration the institution's size and sophistication, the nature and complexity of its activities, and its risk profile.

percent as compared to 10.3 percent for other insured institutions.<sup>90</sup>

Similarly, industrial banks reported a median return on average assets (ROAA) ratio of between 0.6 percent and 2.5 percent at year-ends 2009 through 2011, versus a median ROAA ratio of between 0.4 percent and 0.7 percent for other insured institutions. The median ROAA ratio for industrial banks and other insured institutions as of June 30, 2020, were 1.1 percent and 0.9 percent, respectively.<sup>91</sup>

The capital and earnings ratios for industrial banks is reflective of the higher degree of risk inherent in their business models. The specialty nature of most industrial bank business models, particularly when compared to traditional community banks (which constitute a large proportion of all other insured institutions), have contributed to the maintenance of higher levels of capital and earnings, generally. Additionally, since the mid-2000s, approved filings for industrial banks have largely included CALMAs that required higher capital requirements than other insured institutions.

Further, industrial banks have been assigned examination ratings for the capital and earnings components that, on average, were very similar to those of other insured institutions. This generally indicates that industrial banks have implemented and maintained appropriate risk management practices that, given financial condition and performance, have adequately compensated for the risks inherent in the business models.

When compared to other insured institutions, industrial banks typically maintain a lower volume of liquid assets and rely more heavily on non-core liabilities to fund longer-term earning assets. As a result, while still satisfactory, the liquidity posture for industrial banks was considered slightly lower both during and subsequent to the 2008–09 financial crisis. In the FDIC's experience, asset quality has been comparable between industrial banks and other insured institutions, indicating both a manageable volume of past due loans or other problem assets, as well as satisfactory risk management practices. In addition, management practices for industrial banks also have been in line with that of other insured institutions, both during and after the financial crisis.

Despite the above, it is important to note that some industrial banks experienced stress during the 2008–09 financial crisis. The circumstances

experienced by industrial banks during the crisis were not dissimilar from the circumstances confronting other insured institutions and were not the result of factors related to the industrial bank charter. In general, the FDIC's supervision helped to isolate the insured industrial bank from the stress of the parent organization, which helped in managing the potential risk to the industrial bank and the DIF.

Nevertheless, as discussed above, several commenters noted the participation of industrial banks or their parent organizations in various government programs established during the crisis. There were six industrial banks (or their parent companies) among the more than 110 companies that accessed the debt guarantee program component of the TLGP, including several owned by parent companies organized as thrift holding companies. However, it is important to note that establishment of the TLGP was prompted by the unexpected and precipitous market conditions brought on by the related housing, financial, and banking crises that occurred over the period of 2007 through 2011.<sup>92</sup> These conditions impacted even the largest banking companies in the U.S. and abroad.<sup>93</sup>

Some comments noted the crisis-era conversions of industrial banks and their parent organizations to commercial banks and BHCs. Of the conversions noted by commenters, the majority involved industrial banks that were fundamentally sound, based on the most recent examinations prior to the conversions. The same held with respect to the respective parent companies, one of which converted from a thrift holding company to a bank holding company during the crisis. In each case, the FRB determined that

<sup>92</sup> As has been noted in *Crisis and Response*, the housing bubble that developed during the early 2000s burst in 2007, bringing the financial system "relatively quickly to the brink of collapse" and resulted in the worst economic dislocation in decades. Large losses in economic output and large declines in economic indicators were evident, including with respect to steep declines in employment and household wealth, among other indicators. The related banking crisis was also severe, with almost 500 institutions failing during the period of 2008 through 2013. In addition, between March 2008 and December 2009, the number of problem banks rose from 90 to over 700, and ultimately peaked at almost 900 in early 2011. This level constituted nearly 12 percent of all FDIC-insured institutions. See note 49.

<sup>93</sup> Some of the industrial banks that were owned by thrift holding companies had sister financial institutions that were also FDIC-insured. Ownership of an industrial bank was not the driving force that caused or allowed these entities to issue guaranteed debt through the TLGP. Rather, the companies could have accessed the program simply by virtue of being a thrift holding company or owning an FDIC-insured institution.

approval of the BHC applications was warranted, based on evaluation of the relevant statutory factors and regulatory requirements. Given these circumstances, the conversions and participation in crisis-related programs reflected responses to the broader conditions in all segments of the economy, including the financial sector.

Finally, industrial banks did not experience a disproportionate rate of failures when compared to other types of institutions, and there have not been any industrial bank failures since 2010.<sup>94</sup>

This experience with supervision in the industrial banking space informs the present rulemaking. The heightened source of strength requirements, along with other regulatory requirements included in the final rule, are examples of how the FDIC is applying lessons learned in this rulemaking process.

Some commenters also questioned why the proposed rule applies to industrial banks that would be owned by financial and commercial companies, when the FDIC's 2007 rulemaking was limited to financial companies and the FDIC's extended moratorium applied only to commercial companies. As the FDIC discussed in the proposed rule, commenters on the 2007 rulemaking observed that the FDIC lacked authority to draw a distinction between financial and nonfinancial industrial bank owners absent a change in law. The FDIC agrees that the CEBA exception does not distinguish between commercial and financial parent companies of industrial banks in excluding them from the definition of "bank." As discussed above, the FDIC's supervisory experience has shown that a distinction based on the activities of the parent company is not warranted in this final rule.

Most crucial, though, is the fact that the most recent of the moratoriums commenters reference expired in 2013. In the ensuing years, Congress has declined to act with regard to industrial banks. The FDIC, as all agencies, is charged with enacting the laws as they exist today. Therefore, given that the rule is permissible under the statute, that it is sufficiently supported by the reasoning presented in the NPR and this Supplementary Information section, and that there is a clear connection between the facts at hand and the choice to proceed, the rule is a permissible change in policy.

The FDIC believes that the final rule, which is largely consistent with the

<sup>94</sup> As noted above, Security Savings Bank, Henderson, Nevada, failed in February 2009, and Advanta Bank Corporation, Draper, Utah, failed in March 2010.

<sup>90</sup> FDIC Call Report Data, June 30, 2020.

<sup>91</sup> *Id.*

proposed rule, is an appropriate response to safety and soundness issues surrounding financial and commercial ownership of industrial banks under existing law. Specific suggestions from commenters on the regulation itself are described below in the appropriate sections of this preamble on the specific sections of the rule.

### B. Description of the Final Rule

#### 1. Section 354.1—Scope

This section of the proposed rule described the industrial banks and parent companies that would be subject to the rule. The proposed rule applied to industrial banks that, after the effective date, become subsidiaries of companies that are Covered Companies, as such term is defined in § 354.2. Industrial bank subsidiaries of companies that are subject to Federal consolidated supervision by the FRB would not have been covered by the proposed rule. An industrial bank that, on or before the effective date, is a subsidiary of a company that is not subject to Federal consolidated supervision by the FRB (a grandfathered industrial bank) generally would not have been covered by the proposed rule.<sup>95</sup> A grandfathered industrial bank could become subject to the proposed rule following a grant of deposit insurance, change in control, or merger occurring on or after the effective date in which the resulting institution is an industrial bank that is a subsidiary of a Covered Company. Thus, a grandfathered industrial bank would have been subject to the proposed rule, as would its parent company that is not subject to Federal consolidated supervision, if such a parent company acquired control of the grandfathered industrial bank pursuant to a grant of deposit insurance after the effective date, a change in bank control transaction that closes after the effective date, or if the grandfathered industrial bank is the surviving institution in a merger transaction that closes after the effective date. Industrial banks that are not subsidiaries of a company, for example, those wholly owned by one or more individuals, would not have been subject to the proposed rule.

The FDIC specifically sought comment on whether to apply the rule prospectively or to all industrial banks

that, as of the effective date, are a subsidiary of a parent company that is not subject to Federal consolidated supervision by the FRB. A number of commenters expressed the view that the rule, if adopted, should apply only prospectively; that is, to industrial banks that become a subsidiary of a parent company that is a Covered Company as of the effective date of the rule, noting that existing industrial banks and their parents are subject to most of the standards of the proposed rule. Three commenters requested that the rule apply to a parent company and its subsidiary industrial bank if the parent company became a Covered Company after either the date of FDIC's notice announcing the FDIC board meeting at which the proposed rule was considered or the date of the FDIC board meeting, rather than the effective date.

Some commenters supported the retroactive application of the proposed rule to all industrial banks that, as of the effective date, are a subsidiary of a parent that is not subject to Federal consolidated supervision. These commenters asserted that otherwise existing industrial banks would enjoy a regulatory advantage over new industrial banks. They also argued that retroactive application would enhance the FDIC's ability to perform its supervisory responsibilities. However, other commenters expressed concerns that applying the rule retroactively would violate the APA as parent companies of existing industrial banks had no opportunity to consider these requirements in their decision to establish or acquire an industrial bank. These commenters also argued that existing industrial banks have a record of sound operations under the existing supervisory framework.

In addition, one commenter recommended that the final rule apply to grandfathered industrial banks that undergo certain *other* changes, such as when the industrial bank parent company acquires a subsidiary engaged in nonfinancial activities, or the industrial bank parent company engages in new nonfinancial activities. The final rule operates prospectively on the basis of a filing that would result in an industrial bank becoming a subsidiary of a company not subject to consolidated Federal supervision. In contrast, the suggested triggers, as described, would be applied to existing industrial banks and their parent companies, would not be related to a filing, and would not necessarily result in any impact to the industrial bank. Should such an impact be identified, the FDIC would rely on its supervisory or enforcement authority as the

appropriate means to ensure the safe and sound operation of the industrial bank. Further, the commenter's suggestion would be difficult to administer because the recommended triggers for applicability of the rule—engaging in “nonfinancial” activities—historically has proven difficult to define and measure. Accordingly, the final rule does not adopt the commenter's recommendation. However, the FDIC will continue to apply all appropriate supervisory and enforcement authorities to existing industrial banks and their parent organizations, as appropriate, to ensure the continued safety and soundness of the industrial bank.

The FDIC also sought comment on whether the rule should apply to industrial banks that do not have a parent company or to industrial banks that are controlled by an individual rather than a company. Several commenters asserted that it was not necessary to apply the requirements of the proposed rule to industrial banks without parent companies (or that are controlled by an individual rather than a company), in part because industrial banks themselves are subject to the same regulatory treatment as State nonmember banks. By contrast, several commenters asserted the requirements should be applied to such industrial banks and/or also to an individual that controls an industrial bank. The FDIC believes that industrial banks that are owned by individuals or do not have a parent company generally do not present the same potential risks as industrial banks owned by companies. Industrial banks that are controlled by a parent company, whether engaged in commercial or financial activities, that are not subject to Federal consolidated supervision present the risks that are addressed by the safeguards in this final rule. In addition, applying the rule to industrial banks that have a parent company and requiring that the parent company provide capital support is consistent with the statutory requirements of section 38A of the FDI Act.

After considering these comments regarding the scope of the proposed rule, the final rule will apply only prospectively as of the effective date of the rule, to industrial banks that become subsidiaries of companies that are Covered Companies.<sup>96</sup> The FDIC must

<sup>95</sup> Although generally not subject to the rule, grandfathered industrial banks and their parent companies that are not subject to Federal consolidated supervision by the FRB will remain subject to FDIC supervision, including but not limited to examinations and capital requirements. See also the discussion of the reservation of authority in section IV.B.6. of this Supplementary Information.

<sup>96</sup> The proposed rule divided the rule into two temporal states, on or before the effective date on the one hand, and after the effective date on the other hand. The final rule amends the dividing line so that the relevant timeframes would be before the effective date and on or after the effective date. This change was made because the effective date is

consider the requirements of the APA and the Riegle Community Development and Regulatory Improvement Act (RCDRIA) in determining the effective date of new regulations, and both of these statutory schemes generally provide for an effective date that follows the date on which the regulations are published in final form. Thus, the final rule will be effective on April 1, 2021.<sup>97</sup>

The FDIC also sought comment on whether an individual that controls the parent company of an industrial bank should be responsible for the maintenance of the industrial bank's capital and liquidity at or above FDIC-specified levels and for causing the parent company to comply with the written agreements, commitments, and restrictions imposed on the industrial bank. The FDIC also asked whether an individual who is the dominant shareholder of a Covered Company should be required to commit to the maintenance of appropriate capital and liquidity levels. As discussed below, § 354.3(b) of the proposed rule provided that the FDIC may condition a grant of deposit insurance, issuance of a non-objection to a change in control, or approval of a merger on an individual who is a controlling shareholder of a Covered Company joining as a party to the written agreements required under the rule. In such cases where the FDIC would require the controlling shareholder to join as a party, the controlling shareholder would be required to cause the Covered Company to fulfill its obligations under the written agreements through the voting of shares, or otherwise. These obligations include, among other things, maintaining each subsidiary industrial bank's capital and liquidity at such levels as the FDIC deems necessary for the safe and sound operation of the industrial bank (commitment (7)).

Several commenters criticized the controlling shareholder requirement. Some commenters argued that an individual who controls or owns a parent company should not be held personally liable for maintaining the industrial bank's capital or liquidity. These commenters expressed concern that such a requirement would make it more difficult to attract shareholders and capital. As noted above, in cases

commonly understood to be the date upon which a rule is effective, not the day before a rule would take effect.

<sup>97</sup> During the period before the effective date of the final rule, the FDIC will consider pending deposit insurance applications, change in control notices, and merger applications for industrial banks on a case-by-case basis and impose conditions and requirements as appropriate and that are consistent with current practice.

where the FDIC would require a person that controls a Covered Company to join as a party, such person would be required to vote their shares or take such other appropriate actions to cause the Covered Company to fulfill its obligations under the written agreements. The obligation to maintain the subsidiary industrial bank's capital and liquidity rests with the Covered Company.

Other commenters noted that the parent company already commits in the CALMA to provide support and were concerned that requiring the parent company's shareholders to also provide a guarantee of support will drive away investors. These commenters, however, were not opposed to a requirement for the controlling shareholder to commit to vote his or her shares to comply with the CALMA. One commenter noted that the Office of the Comptroller of the Currency (OCC) may impose certain commitments on the controlling shareholder related to the ownership of shares and how the controlling shareholder exercises shareholder rights.

Several commenters supported the approach of imposing certain conditions at the level of the Covered Company's controlling shareholder as necessary to ensure the safety and soundness of the subsidiary industrial bank. Some commenters asserted that the FDIC should require the dominant shareholders of a parent company to maintain appropriate levels of capital and liquidity. Another commenter argued that the choice of ownership structure should not relieve an individual from source of strength and other obligations.

The FDIC believes that in order to ensure that a Covered Company serves as a continuing source of financial strength to the subsidiary industrial bank, the FDIC may exercise its supervisory discretion to require a controlling, or dominant, shareholder of a Covered Company to join as a party to the written agreements required under the rule. An individual with controlling ownership has a direct and effective means by which to influence the major decisions of the Covered Company by voting shares or by exercising an influence as a member of the Covered Company's board of directors.

Accordingly, the FDIC is finalizing this requirement in § 354.3(b) as proposed. As discussed in the proposed rule, in such cases where FDIC would require the controlling shareholder to join as a party, the controlling shareholder would be required to cause the Covered Company to fulfill its obligations under the written agreements through voting

shares, or otherwise, including to maintain the capital and liquidity levels of the subsidiary industrial bank at or above FDIC-specified levels. The FDIC intends to make such a determination on a case-by-case basis and will consider the business plan, capital structure, risk profile, and business activities of the Covered Company.

## 2. Section 354.2—Definitions

This section of the proposed rule listed the definitions that applied to part 354. Terms that were not defined in the proposed rule that are defined in section 3 of the FDI Act had the meanings given in section 3 of the FDI Act.<sup>98</sup>

The term "control" was defined to mean the power, directly or indirectly, to direct the management or policies of a company or to vote 25 percent or more of any class of voting securities of a company and specifically would have included the rebuttable presumption of control at 12 CFR 303.82(b)(1) and the presumptions of acting in concert at 12 CFR 303.82(b)(2)<sup>99</sup> in the same manner and to the same extent as if they applied to an acquisition of securities of a company instead of a "covered institution." These definitions are nearly the same as the definitions of "control" in the CBCA<sup>100</sup> and the FDIC's regulations implementing the CBCA<sup>101</sup> except that they would have broadened the term to apply to control of a company and not solely insured depository institutions so that the definition can accurately describe the relationship between the parent company of an industrial bank and any of its nonbank subsidiaries, which also would be affiliates of the industrial bank.

Two commenters suggested that the rule should incorporate the definition of control used in the BHCA and its implementing regulations. One trade group commenter argued that such an approach would lead to consistency in the treatment of parent companies of insured depository institutions. An industrial bank commenter suggested that aligning the proposed rule's definition of control with the BHCA and the FRB's regulatory framework<sup>102</sup> would create a more uniform system that would make it easier for investors

<sup>98</sup> 12 U.S.C. 1813.

<sup>99</sup> The proposed rule erroneously referred to the presumptions set forth at 12 CFR 303.83(b)(1) and (2). The final rule corrects that technical error to correctly refer to § 303.82(b)(1) and (2).

<sup>100</sup> 12 U.S.C. 1817(j)(8)(B).

<sup>101</sup> 12 CFR 303.80 through 303.88.

<sup>102</sup> 85 FR 12398 (Mar. 2, 2020); see also Regulation Y—Frequently Asked Questions, available at <https://www.federalreserve.gov/supervisionreg/reg-y-faqs.htm>.

to balance their investment decisions with the regulatory implications of certain levels of investment.

The FDIC has considered these comments and has decided to retain the definition used in the proposed rule. First, the definition of control proposed in the NPR is consistent with the definition of control that the FDIC uses in other contexts, namely changes in bank control. The FDIC in 2015 amended its filing requirements and processing procedures for notices filed under the CBCA with respect to proposed acquisitions of State nonmember banks and certain parent companies thereof.<sup>103</sup> Among other things, the FDIC's CBCA implementing regulations adopted the best practices of the related regulations of the OCC and FRB, rendering more consistent the CBCA implementing regulations of the Federal banking agencies.

Second, the FDIC is not the Federal banking agency responsible for implementing and interpreting the BHCA and has not developed precedent for the implementation of the BHCA. In adopting the CBCA implementing regulations, the FDIC noted that it found the logic of the FRB's interpretations regarding control under the BHCA useful in analyzing fact patterns under the CBCA, but did not adopt the FRB's interpretations, preferring instead to review each case based on the facts and circumstances presented.<sup>104</sup>

The term "Covered Company" meant any company that is not subject to Federal consolidated supervision by the FRB and that, directly or indirectly, controls an industrial bank (i) as a result of a change in bank control under section 7(j) of the FDI Act,<sup>105</sup> (ii) as a result of a merger transaction pursuant to section 18(c) of the FDI Act,<sup>106</sup> or (iii) that is granted deposit insurance under section 6 of the FDI Act,<sup>107</sup> in each case after the effective date of the rule.

Under these provisions, a company would control an industrial bank if the company would have the power, directly or indirectly, (i) to vote 25 percent or more of any class of voting shares of any industrial bank or any company that controls the industrial bank (*i.e.*, a parent company), or (ii) to direct the management or policies of any industrial bank or any parent company. In addition, the FDIC presumes that a company would have the power to direct the management or

policies of any industrial bank or any parent company if the company will, directly or indirectly, own, control, or hold with power to vote at least 10 percent of any class of voting securities of any industrial bank or any parent company, and either the industrial bank's shares or the parent company's shares are registered under section 12 of the Securities Exchange Act of 1934, or no other person (including a company) will own, control, or hold with power to vote a greater percentage of any class of voting securities. If two or more companies, not acting in concert, will each have the same percentage, each such company will have control. As noted above, control of an industrial bank can be indirect. For example, company A may control company B, which in turn may control company C which may control an industrial bank. Company A and company B would each have indirect control of the industrial bank, and company C would have direct control. As a result, the industrial bank would be a subsidiary of companies A, B, and C.

One commenter observed that the Supplementary Information for the proposed rule characterized BHCs and SLHCs as generally prohibited from engaging in commercial activities.<sup>108</sup> This commenter noted that grandfathered unitary SLHCs are permitted to engage in certain "grandfathered" activities, which may include commercial activities and requested that the FDIC clarify its position with respect to grandfathered unitary SLHCs. The FDIC recognizes that certain grandfathered unitary SLHCs may be able to engage in commercial activities. Further, as the FDIC intends to apply the final rule prospectively, a grandfathered unitary SLHC that is subject to Federal consolidated supervision would not be subject to the final rule.

In response to question 5 in the NPR, commenters were split on whether to require a Covered Company to form an intermediate holding company from which to conduct its financial activities.

One commenter suggested that there would be limited benefit to requiring a Covered Company that conducts activities other than financial activities to conduct some or all of its financial activities (including ownership and control of an industrial bank) through an intermediate holding company, observing that any potential benefit could be significantly outweighed by the complexity and cost of implementing an intermediate holding company structure, and may only serve

to organizationally distance the bank from the primary source of strength, most commonly the top tier parent company. Another commenter strongly opposed the possible requirement, arguing that in many cases it would not make sense to create a corporate structure in service of an industrial bank that is a small part of the overall activities or assets of a Covered Company.

Another commenter argued that complex diversified Covered Companies that conduct nonfinancial activities must be required to structure their financial activities under an intermediate holding company so that the intermediate holding company may be subjected to enhanced supervision.

The final rule will not require a Covered Company that conducts activities other than financial activities to conduct some or all of its financial activities (including ownership and control of an industrial bank) through an intermediate holding company.<sup>109</sup> The FDIC believes that such a structure is not required to adequately supervise industrial banks and their parent companies.

The final rule includes the definition of Covered Company as proposed with one revision: The proposed rule defined a Covered Company as a company that is not subject to Federal consolidated supervision by the FRB and that controls an industrial bank as a result of the non-objection to a change in bank control, or approval of a merger transaction or deposit insurance *after* the effective date. The final rule applies where such a non-objection or approval occurs *on or after* the effective date. This revision is not a change in FDIC policy, but rather a recognition that the effective date is commonly understood to be the date upon which a rule is effective.<sup>110</sup>

The FDIC received no comment on a number of definitions: The terms "FDI Act," "filing," "FRB," "industrial bank," and "senior executive officer." The final rule adopts these terms as proposed.

In the NPR, the FDIC requested comment on whether the rule should include other types of nonbank banks, in addition to industrial banks. One commenter stated that all bank and financial service companies, including industrial banks and other institutions that have been excluded from the BHCA definition of bank (such as credit card

<sup>103</sup> 80 FR 65889 (Oct. 28, 2015). The FDIC received no comments on its approach.

<sup>104</sup> 80 FR 65889, 65893.

<sup>105</sup> 12 U.S.C. 1817(j).

<sup>106</sup> 12 U.S.C. 1828(c).

<sup>107</sup> 12 U.S.C. 1816.

<sup>108</sup> See 85 FR at 17772-73.

<sup>109</sup> The FDIC may consider requiring an intermediate holding company in the case of a Covered Company that is not located in the United States and presents unique circumstances.

<sup>110</sup> See also *supra* note 96.

and limited purpose trust banks) should be subject to a level playing field, including subjecting the parent company to Federal consolidated supervision. Another commenter stated that it was not necessary to include credit card banks and trust companies in the scope of the rule because they are limited purpose institutions. Another commenter suggested that the rule may be appropriate for other kinds of banks whose owners are not subject to the BHCA, but cautioned that there may be unique issues related to those charters that should be considered before extending the rule to such institutions.

The FDIC has decided not to extend the scope of the final rule at this time to other types of banking institutions that have parent companies not subject to Federal consolidated supervision. These other types of institutions (credit card banks and limited purpose trust companies) operate under a limited purpose charter, which narrows the range of services they may offer. As a result, the FDIC's experience indicates these charter types have generally not presented the broad issues as presented by industrial banks.

Commenters also suggested additional terms for which definitions would be useful. The FDIC believes that the final rule is sufficiently clear that such additional definitions were not determined to be necessary, although section IV.B.5. of this Supplementary Information section provides examples of what will and will not be considered a "material change" to a business plan requiring prior FDIC approval.

### 3. Section 354.3—Written Agreement

This section of the proposed rule prohibited any industrial bank from becoming a subsidiary of a Covered Company unless the Covered Company enters into one or more written agreements with the FDIC and its subsidiary industrial bank. In such agreements, the Covered Company would make certain required commitments to the FDIC and the industrial bank, including those listed in paragraphs (a)(1) through (8) of § 354.4, the restrictions in § 354.5, and such other provisions as the FDIC may deem appropriate in the particular circumstances. When two or more Covered Companies will control (as the term "control" is defined in § 354.2), directly or indirectly, the industrial bank, each such Covered Company would be required to execute such written agreement(s). This circumstance could occur, for example, (i) when two or more Covered Companies will each have the power to vote 10 percent or more of the voting stock of an industrial

bank or of a company that controls an industrial bank, the stock of which is registered under section 12 of the Securities Exchange Act of 1934, or (ii) when one Covered Company will control another Covered Company that directly controls an industrial bank. Section 354.3(a) of the final rule is unchanged from the proposal.

As discussed above, proposed § 354.3(b) allowed the FDIC, in its sole discretion, to require, as a condition to the approval of or non-objection to a filing, that a controlling shareholder of a Covered Company join as a party to any written agreement required in § 354.3. In such cases, the controlling shareholder would be required to cause the Covered Company to fulfill its obligations under the written agreement, through the voting of shares, or otherwise.

In addition to the written agreements, commitments, and restrictions of the final rule, the FDIC will condition an approval of an application or a non-objection to a notice on one or more actions or inactions of the applicant or notificant, as deemed appropriate by the FDIC.<sup>111</sup> The FDIC may enforce conditions imposed in writing in connection with any action on any application, notice, or other request by an industrial bank or a company that controls an industrial bank,<sup>112</sup> so it is not necessary to include provisions regarding conditions in the proposed rule.

### 4. Section 354.4—Required Commitments and Provisions of Written Agreement

The FDIC historically has included conditions in deposit insurance approval orders for industrial banks that are intended to create a sufficient supervisory structure with respect to a Covered Company. The commitments that the FDIC has required industrial banks and their parent companies to undertake in written agreements have varied on a case-by-case basis, depending on the facts and circumstances and the particular concerns the FDIC has identified during the review of the application materials.

Section 354.4 of the proposed rule required each party to a written agreement to comply with paragraphs (a)(1) through (8). These required commitments are intended to provide the safeguards and protections that the FDIC believes are prudent to impose to

maintain the safety and soundness of industrial banks that are controlled by Covered Companies. These required commitments and other provisions are intended to establish a level of information reporting and parent company obligations similar to that which would be in place if the Covered Company were subject to Federal consolidated supervision. 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. The FDIC proposed to include these required commitments in the rule to provide transparency to current and potential industrial banks, the companies that control them, and the general public.

In order to provide the FDIC with more timely and more complete information about the activities, financial performance and condition, operations, prospects, and risk profile of each Covered Company and its subsidiaries, the proposed rule required that each Covered Company furnish to the FDIC an initial listing, with annual updates, of all of the Covered Company's subsidiaries (commitment (1)); consent to the FDIC's examination of the Covered Company and each of its subsidiaries to monitor compliance with any written agreements, commitments, conditions, and certain provisions of law (commitment (2)); submit to the FDIC an annual report on the Covered Company and its subsidiaries, and such other reports as the FDIC may request (commitment (3)); maintain such records as the FDIC deems necessary to assess the risks to the industrial bank and to the DIF (commitment (4)); and cause an independent audit of each subsidiary industrial bank to be performed annually (commitment (5)).

In the NPR, the FDIC sought comment on whether the proposed commitments requiring examination and reporting serve the supervisory purpose of transparency and identifying any potential risks to the industrial bank and whether there was a better approach for supervising a Covered Company. As discussed above in section IV.A.2. of this Supplementary Information section, a number of commenters were generally critical of the proposed commitments as being inadequate and failing to achieve parity with the regime of consolidated supervision required for BHCs. The FDIC believes that the examination reviews envisioned under the final rule enhance the existing supervisory practices and allow for a more robust evaluation of the industrial bank's affiliate relationships. In addition, the FDIC believes the enhanced reporting

<sup>111</sup> See 12 CFR 303.11(a) ("The FDIC may approve, conditionally approve, deny, or not object to a filing after appropriate review and consideration of the record.") See 12 CFR 303.2(bb) for a list of standard conditions.

<sup>112</sup> 12 U.S.C. 1818(b); 1831aa(a).

requirements in the final rule are consistent with section 38A(d) of the FDI Act, which provides explicit statutory authority for the FDIC to require reports from a controlling company of an industrial bank to assess the ability of the company to comply with the source of strength requirement, and to enforce compliance by such company.<sup>113</sup> The final rule adopts these commitments as proposed, other than as described below. Implementation of the rule positions the FDIC to better protect the industrial bank from activities of a parent organization that present heightened risk to the organization and the bank and to ensure that the parent company is a continuing source of financial strength.<sup>114</sup>

In response to the concerns expressed by commenters that a Covered Company that is not engaged in financial services would not be covered by the GLBA, the FDIC is revising the commitment in the final rule that a Covered Company submit an annual report to the FDIC (commitment (3)) to include 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. This reporting will provide the FDIC appropriate information across all of a Covered Company's financial and nonfinancial activities to monitor for potential consumer protection risks.

The FDIC also sought comment on whether the commitment and requirements of the rule are appropriately tailored in light of the GLBA's restrictions on the extent to which a Federal banking agency may regulate and supervise a functionally regulated affiliate of an insured depository institution.

Most commenters supported the reporting<sup>115</sup> and examination requirements that enable the FDIC to monitor and evaluate financial and other conditions in the parent

organization that are relevant to the industrial bank. One commenter supported carving out functionally regulated entities from the scope of the required commitments in § 354.4 to be consistent with "jurisdictional boundaries" contemplated by the GLBA. While functionally regulated financial firms do not raise the types of concerns that commercial firms do with respect to industrial banks, different regulatory supervisors will have different supervisory approaches and will be focused, by design, on the aspects of a business that concern that regulator.<sup>116</sup> The FDIC serves as the regulator for the industrial bank and exercises oversight of the parent company to the extent necessary to ensure the safety and soundness of the industrial bank subsidiary and to protect the DIF. Through examination and reporting, the FDIC will be able to gauge and monitor the operational risks an industrial bank affiliate, whether functionally regulated or unregulated, presents to the industrial bank. The FDIC may take action to prevent or redress an unsafe or unsound practice if action to address that risk when limited to the industrial bank would not effectively protect against the risk.

The FDIC sought comment on whether a Covered Company should be required to disclose to the FDIC certain additional affiliates or portfolio companies of the Covered Company because these affiliates could engage in transactions with, or otherwise impact, the subsidiary industrial bank. One trade association commenter opposed any further extension of the reporting requirement as being burdensome. A number of commenters acknowledged the FDIC's authority to understand affiliate relationships and their impact on the industrial bank, but suggested that the reporting be tailored by including a materiality threshold. Otherwise, these commenters believed the reporting would be burdensome while potentially providing information with no real relevance to the industrial bank.

Other commenters argued that the final rule should require a Covered Company to disclose its affiliates and portfolio companies that could engage in transactions with, or otherwise impact, the subsidiary industrial bank in order to provide the FDIC a complete and transparent picture of the business model. These commenters observed that related entities may impact the financial

condition and results of operations of the Covered Company, which may negatively impact its ability to serve as a source of strength for the industrial bank.

The FDIC believes that the relationship of a bank with its affiliated organizations is important to the analysis of the condition of the bank itself. Because of commonality of ownership or management that may exist, transactions with affiliates may not be subject to the same sort of objective analysis that exists in transactions between independent parties. Also, affiliates offer an opportunity to engage in types of business activities that are prohibited to the bank itself yet those activities may affect the condition of the bank. In recognition of the importance of these relationships, the FDIC has been granted authority, under certain conditions to examine affiliates in connection with its examination of a bank to disclose the relationship between the bank and a given affiliate, as well as the effect of that relationship on the bank.<sup>117</sup> The FDIC also has been granted authority to bring enforcement actions against insured State nonmember banks and their institution-affiliated parties.<sup>118</sup> As discussed above in section IV.A.2., industrial banks are subject to these same examination and enforcement authorities as other banks, as well as sections 23A and 23B of the Federal Reserve Act and Regulation W, which govern transactions with affiliates. In addition, section 38A of the FDI Act provides authority for the FDIC to require reports from a company that controls an industrial bank to assess the ability of the company to comply with the source of strength requirement, and to enforce compliance by such company.<sup>119</sup> Section 38A of the FDI Act therefore provides an additional supervisory tool to the FDIC in regulating Covered Companies, including their subsidiaries.

In supervising industrial banks, the FDIC considers each industrial bank's purpose and placement within the organizational structure and tailors reporting and other requirements accordingly. Requiring the disclosure of the Covered Companies' subsidiaries along with the other reporting tools available to the FDIC as discussed above are sufficient and will appropriately cover those affiliates of the industrial bank of most concern to the FDIC. Accordingly, the FDIC is adopting § 354.4(a)(1) as proposed.

<sup>113</sup> See 12 U.S.C. 1831o-1(d).

<sup>114</sup> See 12 U.S.C. 1820(b) and 1820(b)(4)(A).

<sup>115</sup> If the Covered Company is required to submit reports to the Securities and Exchange Commission (SEC), the requirement to submit an annual report may be satisfied through submission of SEC Form 10-K (or equivalent), along with the company's annual audit report and management letter (with management responses), provided that the combination of reports addresses each requirement as stated in the rule. In some cases, it may be necessary or appropriate to also submit evaluations of the Covered Company's internal operations, along with management responses, satisfying the Statement on Standards for Attestation Engagements (SSAE) Number 18, *Report on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting*, as issued or amended by the Auditing Standards Board, or similar reports or evaluations.

<sup>116</sup> For example, in a situation where a parent company issues securities, the SEC's role and expertise lies in supervising the parent company as an issuer of securities, not in the role of a parent company of an industrial bank.

<sup>117</sup> 12 U.S.C. 1820(b)(4).

<sup>118</sup> 12 U.S.C. 1813(u) and 1818.

<sup>119</sup> See 12 U.S.C. 1831o-1(d).



In order to limit the extent of each Covered Company's influence over a subsidiary industrial bank, the proposed rule required each Covered Company to commit to limit its representation on the industrial bank's board of directors to 25 percent of the members of the board, or if the bank is organized as a limited liability company and is managed by a board of managers, to 25 percent of the members of the board of managers, or if the bank is organized as a limited liability company and is managed by its members, to 25 percent of managing member interests (commitment (6)). For example, if company A, which has 15 percent representation on the subsidiary industrial bank's board, controls company B, then the companies' representation would be aggregated and limited to no more than 25 percent. Thus, company B's representation would be limited to no more than 10 percent.

The FDIC sought comment on whether this threshold is appropriate. Three commenters argued against any limitation of a Covered Company's representation on the board of a subsidiary industrial bank. These commenters noted the burden in identifying independent director candidates and obtaining the prior approval for candidates associated with a Covered Company. In addition, these commenters argued that the restriction would limit the coordination necessary and appropriate among entities within an organization. One commenter expressed the concern that there could be a negative effect on the remaining directors if an independent director leaves a board. That is, the potential need to eliminate a director associated with a Covered Company in order to comply with the rule on a continuing basis.

One commenter asserted that there may be conflicts between the rule limitation and unspecified State law, while another noted the lack of comparable limitations on other legal structures, creating a distinct difference between Covered Companies and other operating entities. A number of commenters also suggested that relying on the simple majority of independent directors, as has been applied in other instances, has not led to issues or concerns regarding the subsidiary industrial bank.

To address the concerns regarding the limitation, commenters suggested either raising the threshold from 25 percent to one-third, or requiring that a simple majority be independent. While acknowledging the need for some degree of director independence to limit the potential influence from Covered

Companies, these commenters noted that the higher threshold may enhance coordination between the industrial bank and Covered Companies. By extension, the increased coordination would enable the Covered Companies to have a better understanding of the industrial bank's obligations. One comment also noted that the FDIC would retain its full enforcement authority should circumstances require action.

The FDIC understands the challenges involved in the selection of directors of insured institutions. However, the prior approval requirement should not substantially interfere in a well-qualified candidate's ability to assume the responsibilities of the position in a timely manner, and thereby to achieve the noted benefits of appropriate coordination between the industrial bank and the Covered Company. As to the possibility that an independent director's departure from a board may result in temporary non-compliance with the established threshold, the FDIC's construction and use of written agreements provides sufficient mechanisms by which compliance can be timely achieved without the extreme consequence of removing other directors or requiring FDIC actions to enforce the commitment.

As to the specific threshold, the FDIC is revising the commitment in the final rule to establish a less than 50 percent threshold, which will maintain a sufficient number of independent directors while addressing a number of the commenters' concerns. In making this change, the FDIC considered the potential numeric challenges that could confront industrial banks whose boards are comprised of a comparatively small number of directors. In addition, the change enables Covered Companies and industrial banks to select director candidates believed to be most qualified to direct and oversee the institution. As such, the change enables Covered Companies and industrial banks to exercise some additional flexibility when selecting directors. Nevertheless, the FDIC retains the authority, as appropriate, to require a higher threshold of director independence.

Finally, one comment requested clarification as to whether officers of the industrial bank would be included within the limitation. In short, if an officer in question is associated with a Covered Company, the individual would be counted against the limitation.

In order to ensure that a subsidiary industrial bank has available to it the resources necessary to maintain sufficient capital and liquidity, the proposed rule required each party to a

written agreement to commit to maintain each subsidiary industrial bank's capital and liquidity at such levels as the FDIC deems necessary for the safe and sound operation of the industrial bank, and to take such other actions as the FDIC finds appropriate to provide each subsidiary industrial bank with the resources for additional capital or liquidity (commitment (7)). As discussed above, the FDIC is finalizing § 354.3(b) as proposed, which provides that the FDIC may require the controlling or dominant shareholder of a Covered Company to join as a party to the written agreements required under the rule, including commitment (7). The final rule includes commitment (7) as proposed.

Lastly, the proposed rule required that each Covered Company and its subsidiary industrial bank(s) enter into a tax allocation agreement that expressly recognizes an agency relationship between the Covered Company and the subsidiary industrial bank with respect to tax assets generated by such industrial bank, and that further states that all such tax assets are held in trust by the Covered Company for the benefit of the subsidiary industrial bank and promptly remitted to such industrial bank (commitment (8)). As proposed, a tax allocation agreement would have also provided that the amount and timing of any payments or refunds to the subsidiary industrial bank by the Covered Company should be no less favorable than if the subsidiary industrial bank were a separate taxpayer.

One commenter questioned the FDIC's statutory authority to impose such a requirement. The FDIC has the power to issue rules to carry out the provisions of the FDI Act,<sup>120</sup> including rules to ensure the safety and soundness of industrial banks and to protect the DIF. As the FDIC discussed in the proposed rule, companies and their subsidiaries, including insured depository institutions and their parent companies, will often file a consolidated income tax return. A 1998 interagency policy statement issued by the Federal banking agencies and the U.S. Department of the Treasury, and an addendum thereto<sup>121</sup> (collectively,

<sup>120</sup> “[T]he Corporation . . . shall have power . . . [t]o prescribe by its Board of Directors such rules and regulations as it may deem necessary to carry out the provisions of this chapter or of any other law which it has the responsibility of administering or enforcing (except to the extent that authority to issue such rules and regulations has been expressly and exclusively granted to any other regulatory agency).” 12 U.S.C. 1819(a)(Tenth).

<sup>121</sup> See Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure, 63

Policy Statement), acknowledges this practice, noting that a consolidated group may prepare and file Federal and State income tax returns as a group so long as the interests of any insured depository institution subsidiaries are not prejudiced. Given the potential harm to insured subsidiary institutions, the Policy Statement encourages parent companies and their insured depository institution subsidiaries to enter into written, comprehensive tax allocation agreements, and notes that inconsistent practices regarding tax obligations may be viewed as an unsafe and unsound practice prompting either informal or formal corrective action. The final rule, consistent with the proposed rule, similarly seeks to avoid potential harm to a subsidiary industrial bank by requiring such a written tax allocation agreement. The final rule includes commitment (8) as proposed.

In addition to the eight commitments discussed above, § 354.4(b) of the proposed rule permitted the FDIC to condition the approval of an application or non-objection to a notice on the Covered Company and industrial bank committing to adopt, maintain, and implement an FDIC-approved contingency plan that presents one or more actions to address potential significant financial or operational stress that could threaten the safe and sound operation of the insured industrial bank. The plan also would reflect strategies for the orderly disposition of the industrial bank without the need for the appointment of a receiver or conservator. Such disposition could include, for example, sale of the industrial bank to, or merger with, a third party.

The FDIC received two comments on the contingency plan requirement. One commenter stated that the FDIC should consider size, complexity, interdependencies, and other relevant factors in requiring, reviewing, and approving a contingency plan—similar to the “living will” requirements under section 165(d) of the Dodd-Frank Act where the FRB has tiered certain requirements based upon an institution’s asset size. This commenter also suggested that the FDIC formalize

these considerations in the final rule. The other commenter stated that, while dissolution requirements may be appropriate for large complex institutions that pose a risk to the DIF, smaller banks do not pose the same risks nor require the same level of complex planning. According to this commenter, the cost of contingency planning would outweigh its benefit for smaller institutions. This commenter also stated that, at a minimum, any contingency planning requirement should be no more stringent than the requirement for other FDIC-insured institutions of the same size.

As discussed in the NPR, a contingency plan commitment would only be required in certain circumstances based upon the facts and circumstances presented, and after taking into consideration size, complexity, interdependencies, and other relevant factors. The final rule preserves the FDIC’s supervisory discretion to tailor the contents of any contingency plan to a specific Covered Company and its insured industrial bank subsidiary. This ability to tailor the requirements of a contingency plan serves to minimize the burdens of developing and implementing such a plan. It should also be noted that contingency plans are not the same as resolution plans under section 165(d) of the Dodd-Frank Act or § 360.10 of the FDIC’s Rules and Regulations, and the contents of a contingency plan (if required) would be far less complex. A contingency plan is an explanation of the steps the industrial bank and Covered Company could take to mitigate the impacts of financial and operational stress outside of the receivership process. Finally, the FDIC believes that a contingency plan, when required, may help the FDIC, the Covered Company, and its industrial bank subsidiary to better understand the relevant interdependencies, operational risks, and other circumstances or events that could create safety and soundness concerns and attendant risk to the DIF. Accordingly, the FDIC is finalizing this requirement as proposed.

While the contingency plan is one type of commitment that the FDIC would be able to require of Covered Companies and their industrial bank subsidiaries, there may be other commitments that the FDIC may determine to be appropriate given the business plan, capital levels, or organizational structure of a Covered Company or its subsidiary industrial bank. Section 354.4(c) of the proposed rule 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 in § 354.4(a) or (b) in order to ensure the safety and soundness of the industrial bank and reduce potential risk to the DIF.

Several commenters specifically addressed § 354.4(c).<sup>122</sup> One commenter raised concerns that the rule would be applied to Covered Companies or controlling shareholders of existing industrial banks. As discussed above, because the rule is constructed to apply prospectively, parties will become subject to the rule only as the result of (1) the formation of an industrial bank on or after the effective date of the final rule, or (2) a merger transaction or change in control on or after the effective date of the final rule, assuming the institution retains its industrial bank charter.

A second commenter raised concerns that § 354.4(c) vests open-ended authority in the FDIC to change, at any time and for any reason, the obligations of a Covered Company or controlling shareholder. The commenter further suggested that agreements should be negotiated at the outset. Another commenter also suggested that the FDIC should rely on its enforcement authority rather than including additional commitments in the written agreements.

In response to commenters’ concerns about the application of this section, the FDIC is removing § 354.4(c) to avoid confusion that the FDIC would unilaterally impose additional commitments (or restrictions). Notwithstanding this deletion, the FDIC retains its general supervision, examination, and enforcement authorities (as reserved by § 354.6) to take any actions beyond the scope of the final rule, including actions to ensure the safe and sound operation of any insured depository institution, including an industrial bank, and further to ensure that a parent of an industrial bank acts as a source of financial strength to that insured institution. For example, the FDIC may require additional, unique commitments from a Covered Company or a controlling shareholder of a Covered Company when the FDIC determines it is necessary to address specific elements of a filing or circumstances related to the filer. Additional commitments may be derived, for instance, from elements of the business model presented, including the nature and scope of activities conducted, the risk profile of the activities, and the complexity of operations. The proposed relationships

FR 64757 (Nov. 23, 1998); Addendum to the Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure, 79 FR 35228 (June 19, 2014). The 2014 Addendum to the Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure also clarifies that all tax allocation agreements are subject to the requirements of section 23B of the Federal Reserve Act, and tax allocation agreements that do not clearly acknowledge that an agency relationship exists may be subject to additional requirements under section 23A of the Federal Reserve Act.

<sup>122</sup> These commenters raised the same or similar concerns with respect to § 354.5(b), which the FDIC also is deleting in the final rule.

and transactions with the parent organization that may impact the industrial bank also could be taken into consideration.

The FDIC also sought comment on whether the rule should include a commitment that the parent company will maintain its own capital at some defined level on a consolidated basis. A number of commenters argued that creating consolidated capital requirements for the parent company would ensure that it is able to serve as a source of strength for its subsidiary industrial bank. Some commenters argued that such capital standards should be comparable to those imposed on BHCs of similar size and systemic significance. These commenters also argued that the absence of a consolidated capital standard for the parent company creates a lower standard of supervision than is imposed by the BHCA. One commenter recommended that such requirements should be greater than the requirements applicable to other FDIC-insured depository institutions due to the enhanced risk of the Covered Company on the industrial bank and the DIF.

By contrast, several commenters argued that applying a capital standard on the parent company itself is not encompassed within the FDIC's statutory mandate to preserve the safety and soundness of insured depository institutions. Other commenters observed that for many industrial bank parent companies, measures of tangible equity are not often the most pertinent indicator of the financial health of the company or its ability to serve as a source of strength. These commenters argued that given the diversity of industrial bank parent company operations, a more tailored approach would be appropriate.

The FDIC does not believe that the final rule should impose capital requirement commitments on Covered Companies because a one-size-fits all regulatory approach to capital requirements would not be appropriate, given the idiosyncratic business models and operations of such parent companies. The FDIC believes that the final rule and its supervisory framework adequately ensure that a parent company of an industrial bank has the ability to serve as a source of strength.

##### 5. Section 354.5—Restrictions on Industrial Bank Subsidiaries of Covered Companies

Section 354.5 of the proposed rule required the FDIC's prior written approval before an industrial bank that is a subsidiary of a Covered Company may take certain actions. These

restrictions, like the required commitments discussed above, are generally intended to provide the safeguards and protections that the FDIC believes would be prudent to impose with respect to maintaining the safety and soundness of industrial banks that become controlled by companies that are not subject to Federal consolidated supervision. Accordingly, the proposed rule required prior FDIC approval for the subsidiary industrial bank to take any of five actions set forth in § 354.5(a).

In order to ensure that the industrial bank does not immediately after becoming a subsidiary of a Covered Company engage in high-risk or other inappropriate activities, the subsidiary industrial bank would have been required to obtain the FDIC's prior approval to make a material change in its business plan after becoming a subsidiary of a Covered Company (paragraph (a)(1)). In order to limit the influence of the parent Covered Company, the subsidiary industrial bank would have been required to obtain the FDIC's prior approval to add or replace a member of the board of directors or board of managers or a managing member, as the case may be (paragraph (a)(2)); add or replace a senior executive officer (paragraph (a)(3)); employ a senior executive officer who is associated in any manner with an affiliate of the industrial bank, such as a director, officer, employee, agent, owner, partner, or consultant of the Covered Company or a subsidiary thereof (paragraph (a)(4)); or enter into any contract for material services with the Covered Company or a subsidiary thereof (paragraph (a)(5)). Pursuant to proposed § 354.5(b), the FDIC would have been able to, on a case-by-case basis, impose additional restrictions on the Covered Company or its controlling shareholder if circumstances warrant. The FDIC is adopting revisions to the restrictions in § 354.5(a)(2), (3), and (4) and removing § 354.5(b), as discussed below.

The FDIC sought comment on whether these restrictions should be time-limited. A number of commenters generally argued that the restrictions should only apply during the industrial bank's *de novo* period (*i.e.*, the first three-years of operation). Some commenters suggested that the FDIC should or could apply ongoing restrictions (beyond the *de novo* period) when special circumstances exist. One commenter proposed that the FDIC implement a process to allow an industrial bank to request a waiver of the requirements at the conclusion of the *de novo* period. Two commenters recommended limiting the restrictions

to the *de novo* period except for paragraph (a)(4) covering employment of a senior executive officer who is also currently associated with an affiliate of the industrial bank. Most of these commenters were concerned that the ongoing restrictions in these sections created greater burdens on industrial banks than required of non-industrial banks.

By contrast, other commenters argued that these restrictions should be perpetual in duration and viewed them as important safeguards on the actions of a Covered Company with respect to an industrial bank subsidiary. One commenter argued that given the unique and significant risks posed by industrial banks and their parent companies, the restrictions should not be limited to any number of years after an industrial bank becomes a subsidiary of a Covered Company.

The FDIC previously has imposed restrictions similar to those contained in § 354.5 in prior actions on filings involving industrial banks. The agency's experience indicates that there are advantages and disadvantages to imposing such restrictions on a perpetual basis, just as there are advantages and disadvantages to imposing the restrictions on a time-limited basis. The relative advantages and disadvantages vary depending on the nature of the particular restriction. Nevertheless, certain items are believed so directly related to the industrial bank's ongoing safe and sound operation that a perpetual restriction is warranted. As such, the FDIC is adopting the restrictions regarding material changes to business plans, entering into contracts for material services with a Covered Company or its subsidiaries, and employing a senior executive officer that is associated with an affiliate of the industrial bank as proposed, with one exception noted below.

However, having considered commenters' suggestions regarding the restrictions on the appointment of directors (paragraph (a)(2)) and senior executive officers (paragraph (a)(3)), the FDIC is modifying the final rule to apply a three-year period to filings approved by the FDIC for an industrial bank that is a subsidiary of a Covered Company. This modification provides flexibility for industrial banks to timely appoint directors and officers. The FDIC's supervisory efforts and enforcement authorities remain fully accessible if an industrial bank's director or officer selection raises concerns. Further, consistent with § 354.6 of the final rule, the FDIC may impose additional restrictions if appropriate to a particular

filing. Thus, as circumstances warrant, the FDIC may extend the three-year period or impose the restriction on a perpetual basis.

In light of the changes to paragraphs (a)(2) and (3) above, the FDIC is also adopting a revision to the restriction on employment of a senior executive officer who is currently associated with an affiliate of the industrial bank (paragraph (a)(4)). The restriction is modified in the final rule to cover a senior executive officer who is or was during the past three years associated with an affiliate of the industrial bank to prevent evasion of the restriction. As noted above, this restriction is not otherwise modified with respect to its perpetual duration.

As discussed above, proposed § 354.5(b) has been removed to align with the change the FDIC made to § 354.4(c).

Several commenters requested that the FDIC clarify what is meant by a “material change” to the industrial bank’s business plan that requires the FDIC’s written approval prior to effecting such change. Because business plan changes or deviations may alter the facts and circumstances that supported the FDIC’s action on a filing in which the business plan condition was imposed, the following generally have been determined to constitute a material change in or deviation from an institution’s business plan:

- Increases in financial statement categories or subcategories (such as types of loans, funding, revenue, or capital) of 25 percent or more;
- Introduction of distinctly new or different business strategies or objectives, including products or services, target markets, delivery channels, or business development strategies;
- Changes to the institution’s financial strategies, or the acquisition of assets, an operating entity, or the assumption of deposits or other liabilities; or
- Changes in organizational relationships such that the manner in which the institution implements or carries out its business strategies or objectives is impacted.

#### 6. Section 354.6—Reservation of Authority

The FDIC proposed to clarify that it retains the authority to take supervisory or enforcement actions, including actions to address unsafe or unsound practices, or violations of law.

The FDIC has broad supervision, examination and enforcement powers and authorities granted to it by the FDI

Act and other laws.<sup>123</sup> The reservation of authority in § 354.6 clarifies that, notwithstanding the final rule, the FDIC retains the authority to exercise those powers, as it would for any insured depository institution where it is the appropriate Federal banking agency, which includes industrial banks. While the final rule establishes certain commitments and restrictions with respect to industrial banks and Covered Companies, § 354.6 recognizes that the FDIC could require industrial banks and their parent companies that are not subject to Federal consolidated supervision by the FRB to enter into written agreements, provide additional commitments, or abide by additional restrictions if necessary to maintain the safety and soundness of the industrial bank. Additionally, the FDIC’s powers and authorities may be applied to require written commitments and/or to impose restrictions in the context of a particular industrial bank and its parent to mitigate risk and ensure the safe and sound operation of the insured depository institution, even if not in connection with a filing pursuant to this part.

The FDIC received only one comment that addressed the proposed reservation of authority, noting that the FDIC’s use of its discretion in applying the restrictions on industrial banks contained in § 354.5, together with a reservation of its examination authority, would allow for a practical implementation of the FDIC’s powers. The FDIC is adopting § 354.6 as proposed. During the period before the effective date of the final rule, the FDIC will consider pending deposit insurance applications, change in control notices, and merger applications for industrial banks on a case-by-case basis and impose conditions and requirements as appropriate and that are consistent with current practice and the FDIC’s general examination, supervision, and enforcement authorities.

#### 7. Responses to Additional Questions

In addition to the questions discussed above, the FDIC sought responses to several additional questions. In response to the FDIC’s question whether there were additional categories of information that the FDIC should consider in evaluating an industrial bank’s ability to meet the convenience and needs of the community to be served, some commenters opposed to the rule expressed concern that the CRA requires modernization or is otherwise inadequate to ensure industrial banks are properly serving the credit needs of

the communities in which the industrial bank operates. Two community group commenters went further indicating that the FDIC should not move forward with this rule until CRA assessment area procedures are updated.

In January of 2020, the FDIC joined the OCC in issuing a CRA proposal to modernize CRA regulations.<sup>124</sup> On May 20, 2020, the OCC issued its CRA final rule.<sup>125</sup> The FDIC did not move forward with a final rule following the proposal and continues to enforce its existing CRA regulation.<sup>126</sup> More recently, on September 21, 2020, the FRB issued an ANPR to solicit public input regarding modernizing the FRB’s CRA regulatory and supervisory framework.<sup>127</sup> Modernizing CRA regulations applicable to FDIC-supervised institutions is an important endeavor, and the FDIC is considering further rulemaking in this area, which may include seeking additional public input and engaging with the other prudential regulators. For the time being, however, the FDIC will continue to operate under the existing CRA regulations, which contain provisions including public participation in strategic plans and consideration for community development activity in insured institutions’ broader State-wide and regional areas.

However, the statutory factor addressing convenience and needs of the community to be served is broader than the CRA. In assessing the statutory factor convenience and needs of the community to be served, the essential considerations are the deposit and credit needs of the community to be served, the nature and extent of the opportunity available to the applicant in that location, and the willingness and ability of the applicant to serve those financial needs.<sup>128</sup> The markets to be served and the economic and competitive conditions within the markets are important to these considerations. The applicant’s CRA Plan is an important part of the FDIC’s evaluation of the convenience and needs to be served, but it is not the only consideration. The FDIC believes the benefits to finalizing this rule are significant, and formalizing and strengthening FDIC’s existing supervisory processes and policies that

<sup>124</sup> 85 FR 1204.

<sup>125</sup> 85 FR 34734.

<sup>126</sup> State savings associations will be examined by the FDIC under the CRA regulations of the OCC, 12 CFR part 25 and 12 CFR part 195, as may be amended from time to time.

<sup>127</sup> 85 FR 66410.

<sup>128</sup> See Statement of Policy on Applications for Deposit Insurance, 63 FR 44756 (Nov. 20, 1998), amended by 67 FR 79276 (Dec. 27, 2002).

<sup>123</sup> See *supra* notes 59–62 and accompanying text.

apply to parent companies of industrial banks that are not subject to Federal consolidated supervision should proceed even in the absence of a unified interagency rule on CRA.

The FDIC also sought comment on the FDIC's approach to foreign ownership of industrial banks. Some commenters argued that foreign ownership of industrial banks should not be permitted, or if permitted, should be heavily regulated. A commenter argued that the FDIC would not be well positioned to foresee the risks that a might arise for a foreign Covered Company in its home market. Another commenter asserted that the proposed supervisory approach fell short of the FRB's consolidated supervision framework, leaving the FDIC with limited examination authority and therefore unable to adequately monitor foreign companies whose risks might be spread across multiple entities. Another commenter opposed foreign ownership of industrial banks, but suggested that if such arrangements were permitted, further commitments such as a high net stable funding ratio and a prefunded orderly liquidation fund should be required of foreign Covered Companies.

On the other hand, a number of commenters indicated that there was no need to build in additional restrictions specific to foreign Covered Companies. These commenters noted that the FDIC already has robust supervisory authority to address unsafe and unsound conditions impacting insured depository institutions, and that the FDIC's practice of securing additional commitments from foreign parent companies of industrial banks has been effective. Other commenters also argued for flexibility, indicating that determining what additional commitments would be necessary in such instances is a fact-specific inquiry and should be based on the parent company's ability to be a source of strength for the industrial bank.

The final rule does not contain any specific requirements for foreign Covered Companies beyond those to which U.S.-based Covered Companies are subject. The FDIC's supervisory experience with foreign parent companies of industrial banks has shown that retaining the flexibility to secure additional commitments from such entities as needed is an effective approach. Such commitments would be in addition to the substantial requirements a Covered Company is subject to in the written agreements with the FDIC required by the final rule, including examination and reporting requirements, capital maintenance of the industrial bank, and contingency

planning. These commitments allow the FDIC to ensure that a Covered Company can and will serve as a source of strength for its industrial bank, and along with the added flexibility to require additional commitments as needed, they are sufficient to address both domestic and foreign Covered Companies.<sup>129</sup>

#### V. Expected Effects

As previously discussed, the final rule requires or imposes certain conditions, commitments, and restrictions for each deposit insurance application approval, non-objection to a change in control notice, and merger application approval that would result in an industrial bank becoming, pursuant to the rule, a subsidiary of a Covered Company. The final rule requires such Covered Company to enter into one or more written agreements with the FDIC and the industrial bank subsidiary.

##### A. Overview of Industrial Banks

As of June 30, 2020, the FDIC supervised 3,270 insured depository institutions, with combined assets of \$3.84 trillion. Of these, 23 institutions were industrial banks, comprising 0.7 percent of all FDIC-supervised institutions. The industrial banks hold combined assets of \$169 billion, comprising 4.54 percent of the combined assets of FDIC-supervised institutions.<sup>130</sup> The majority of industrial banks are headquartered in Utah and Nevada, and hold nearly all of the combined assets of industrial banks. As of June 30, 2020, 14 industrial banks were headquartered in Utah, four in Nevada, three in California, one in Hawaii, and one in Minnesota.

The final rule applies prospectively to deposit insurance, change in control, and merger transactions resulting in an industrial bank that is controlled by a Covered Company. It is difficult to estimate the number of potential Covered Companies that will seek to establish or acquire an industrial bank, as such an estimate depends on considerations that affect Covered Companies' decisions. These considerations, and how they affect decision making, are difficult for the FDIC to forecast, estimate, or model, as the considerations include external parties' evaluations of potential business strategies for the industrial bank as well as future financial conditions, rates of return on capital, and innovations in the provision of

financial services, among others. However, during the period of 2017 through 2019, the FDIC received nine industrial bank deposit insurance applications and one change in control application.<sup>131</sup> Consistent with the Paperwork Reduction Act (PRA)<sup>132</sup> estimates presented elsewhere in this rule, for this analysis the FDIC is estimating the final rule applies to four filings per year seeking to establish or acquire an industrial bank.

The final rule could indirectly affect subsidiaries of Covered Companies. Such Covered Companies operate through a variety of structures that include a range of subsidiaries and affiliates. Further, the final rule includes the FDIC's reservation of authority to require any industrial bank and its parent company, if not otherwise subject to part 354, to enter into written agreements, provide commitments, or abide by restrictions, as appropriate. Therefore, it is difficult to estimate the number of subsidiaries and affiliates of prospective Covered Companies, based on information currently available to the FDIC. However, based on the FDIC's experience as the primary Federal regulator of industrial banks,<sup>133</sup> the FDIC believes that the number of subsidiaries of the prospective Covered Companies affected by the final rule is likely to be small.

##### B. Analysis of the Commitments

Under the final rule, prospective Covered Companies are required to agree to the eight commitments, and may be required to agree to additional commitments under certain circumstances, which in summary include commitments by the Covered Company to:

- Furnish an initial listing, with annual updates, of the Covered Company's subsidiaries.
- Consent to the examination of the Covered Company and its subsidiaries.
- Submit an annual report on the Covered Company and its subsidiaries, and such other reports as requested.
- Maintain such records as deemed necessary.
- Cause an independent annual audit of each industrial bank.
- Limit the Covered Company's representation on the industrial bank's board of directors or managers (board),

<sup>131</sup> During the same period, the FDIC did not receive any merger applications involving industrial banks.

<sup>132</sup> 44 U.S.C. 3501 *et seq.*

<sup>133</sup> Historically, industrial banks have elected not to become members of the Federal Reserve System. The FDIC is the primary Federal regulator for State nonmember banks and the insurer for all insured depository institutions.

<sup>129</sup> The FDIC may require, in the case of a Covered Company located outside the United States, United States-based capital and liquidity support of the subsidiary industrial bank.

<sup>130</sup> FDIC Call Report Data, June 30, 2020.

as the case may be, to less than 50 percent.

- Maintain the industrial bank’s capital and liquidity at such levels as deemed appropriate and take such other action to provide the industrial bank with a resource for additional capital or liquidity.

- Enter into a tax allocation agreement.

- Depending on the facts and circumstances, provide, adopt, and implement a contingency plan that sets forth strategies for recovery actions and

the orderly disposition of the industrial bank without the need for a receiver or conservator.

The FDIC historically has imposed prudential conditions similar to the commitments listed above in connection with approving or not objecting to certain industrial bank filings. These conditions generally relate to the board and senior management, the business plan, operating policies, financial records, affiliate relationships, and other conditions on a case-by-case basis,

depending on the facts and circumstances identified during the review of the respective filings.<sup>134</sup>

The table below presents the FDIC’s analysis of the estimated costs to institutions that would be affected by the final rule of each required commitment. In each case, the FDIC used a total hourly compensation estimate of \$94.15 per hour.<sup>135</sup> The FDIC received no comments regarding the estimated burden of the rule as proposed.

Proposed commitment	Estimated annual compliance hours	Estimated annual compliance costs
Lists of Subsidiaries .....	4	\$376.60
Consent to the FDIC Examination .....	100	9,415.00
Annual and Such Other Reports as the FDIC may Request .....	10	941.50
Maintain Such Records as the FDIC Deems Necessary .....	10	941.50
Independent Audit <sup>1</sup> .....	100	9,415.00
Limit Membership on Board <sup>2</sup> .....	0	0.00
Maintain Capital and Liquidity .....	12	1,129.80
Tax Allocation Agreement <sup>3</sup> .....	0	0.00
<b>Total .....</b>	<b>236</b>	<b>22,219.40</b>

<sup>1</sup> The disclosure requirement and time to fulfill it are due to satisfying regulatory inquiries about the audit, and do not include the cost of the audit itself because Covered Companies already conduct audits for other purposes.

<sup>2</sup> Determinations regarding board membership are considered in the normal course of business.

<sup>3</sup> Tax allocation agreements are normal and customary among affiliated corporate entities.

The final rule also authorizes the FDIC to require additional commitments, including a contingency plan that sets forth strategies for recovery actions and the orderly disposition of the industrial bank without the appointment of a receiver or conservator. The additional contingency plan commitment would be required only in certain circumstances, based on the facts and circumstances presented and taking into consideration the size, complexity, interdependencies, and other factors relevant to the industrial bank and Covered Company.

It is difficult to estimate the recordkeeping, reporting, and disclosure costs associated with the contingency plan aspect of the final rule because such an estimate would depend on the organizational structure and activities of potential future Covered Companies.

The FDIC currently lacks such detailed information on potential future Covered Companies. While the contingency plan commitment is meaningfully different from resolution plan requirements for large banks, and while industrial banks that might need to develop such contingency plans are meaningfully different from large banks subject to resolution planning requirements, the FDIC considered prior analyses regarding resolution planning requirements imposed on certain institutions to inform its analysis.

Based in part on the FDIC’s experience implementing and managing the resolution planning requirements of § 360.10, the FDIC estimates that Covered Companies and their industrial banks subject to the contingency plan commitment could incur \$326,000 in recordkeeping, reporting, and disclosure

compliance costs annually. To put the estimated cost of this commitment into context, the pre-tax net income of the median industrial bank in 2019 was \$64,515,000.<sup>136</sup> But, because the FDIC would have the supervisory discretion to tailor the contents of any contingency plan to a given Covered Company and its industrial bank, and because of the unique circumstances of the respective Covered Companies and industrial banks, the compliance costs incurred by Covered Companies would vary on a case-by-case basis, and could be lower.

The final rule incorporates an additional element as part of the reporting commitment to address Covered Companies’ systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information. However, the rule is constructed to

<sup>134</sup> See FDIC Deposit Insurance Application Procedures Manual Supplement, Applications from Non-Bank and Non-Community Bank Applicants, FIL–8–2020 (Feb. 10, 2020).

<sup>135</sup> Subject matter experts in the FDIC’s Division of Risk Management Supervision estimated that time devoted to complying with the commitments is broken down as follows: 25 percent (Executives and Managers), 15 percent (Legal), 15 percent (Compliance Officers), 15 percent (Financial Analysts), 15 percent (IT Specialists), and 15 percent (Clerical). The Standard Occupational Classification System occupations and codes used by the FDIC are: Executives and Managers (Management Occupations, 110000), Lawyers (Lawyers, Judges, and Related Workers, 231000),

Compliance Officers (Compliance Officers, 131041), Financial Analysts (Financial Analysts, 132051), IT Specialists (Computer and Mathematical Occupations, 150000), and Clerical (Office and Administrative Support Occupations, 430000). To estimate the weighted average hourly compensation cost of these employees, the 75th percentile hourly wages reported by the Bureau of Labor Statistics (BLS) National Industry-Specific Occupational Employment and Wage Estimates as used for the relevant occupations in the Depository Credit Intermediation sector, as of May 2018. The 75th-percentile wage for lawyers is not reported, as it exceeds \$100 per hour, so \$100 per hour is used. The hourly wage rates reported do not include non-monetary compensation. According to the

September 2019 Employer Cost of Employee Compensation data, compensation rates for health and other benefits are 33.8 percent of total compensation. To account for non-monetary compensation, the hourly wage rates reported by BLS are adjusted by that percentage. The hourly wage is adjusted by 2.28 percent based on changes in the Consumer Price Index for Urban Consumers from May 2018 to September 2019 to account for inflation and ensure that the wage information is contemporaneous with the non-monetary compensation statistic. Finally, the benefit-and-inflation-adjusted wages for each occupation are weighted by the percentages listed above to arrive at a weighted hourly compensation rate of \$94.15.

<sup>136</sup> FDIC Call Report Data, December 31, 2019.

enable affected parties to comply with the various commitments by relying on established and ongoing reports and records, to the extent possible. As such, while recognizing the difficulty in estimating the costs associated with this additional element due to the unique circumstances of each affected party, the FDIC believes the enhanced commitment should have no material impact on the estimated overall burden.

As illustrated by the preceding analysis, the final rule could pose as much as \$348,000 in additional recordkeeping, reporting, and disclosure compliance costs for each Covered Company that seeks to establish or acquire an industrial bank.<sup>137</sup> Covered Companies would also be likely to incur some regulatory costs associated with making the necessary changes to internal systems and processes. For context, the estimated \$348,000 recordkeeping, reporting, and disclosure costs only comprise 0.8 percent of the median noninterest expense for the 23 existing industrial banks.<sup>138</sup>

The FDIC believes that the final rule would benefit the public by providing transparency for market participants and other interested parties. Additionally, the FDIC believes that the final rule would benefit the public by formalizing a framework by which the FDIC would supervise industrial banks and mitigate risk to the DIF that may otherwise be presented.

It is difficult to estimate whether the final rule would serve as an incentive or disincentive for affected parties. Decisions to establish or acquire an industrial bank depend on many considerations that the FDIC cannot accurately forecast, estimate, or model, such as future financial conditions, rates of return on capital, and innovations in the provision of financial services. The final rule would enhance transparency in the FDIC's evaluation of filings, which could increase the number of applications received. However, such transparency could also serve to limit the number of applications received.

The FDIC analyzed historical trends in filings that would be subject to the final rule. Based on that analysis, and consistent with the FDIC's PRA analysis, the FDIC assumes four applications: Three deposit insurance applications, and one change in bank control notice per year, on average. Between 2000 and 2009, the FDIC received as many as 12 and as few as

two deposit insurance applications from entities seeking to organize an industrial bank; between 2017 and 2019, the FDIC received as many as four and as few as two such applications. Therefore, the FDIC believes it is reasonable to assume an annual deposit insurance application volume of four for the purpose of this analysis. In addition, the FDIC has received three change in bank control notices relating to industrial banks since 2010; therefore, the FDIC believes it is reasonable to assume an annual volume of one for the purpose of this analysis.

### C. Safety and Soundness of Affected Banks

The FDIC believes the final rule is consistent with supervisory approaches the FDIC has used to insulate industrial banks from risks posed by their parent companies, and that these supervisory approaches have been effective. For example, as previously noted, only two small industrial banks failed during the crisis. The FDIC believes the final rule would provide a prudentially sound framework for reaching decisions on industrial bank filings that the FDIC receives from time to time.

### D. Broad Effects on the Banking Industry

To the extent that the final rule results in higher numbers of industrial banks, the increase could lead to increased competition for depositors and borrowers. The increased competition could result in one or more of: Higher yields on deposit products, lower interest rates on loan products, reduced fees, less restrictive underwriting standards, greater account opening bonuses for new customers, and other benefits. To the extent that the final rule does not result in a higher number of industrial banks, this would not be expected to lead to increased competition for depositors and borrowers.

### E. Expected Effects on Consumers

To the degree the final rule results in an increase in the number of industrial banks, consumers could benefit from increased competition within the banking industry. These benefits could take the form of higher rates on deposit accounts, improved access to credit with better terms or lower rates, and lower fees for banking services. To the extent that the proposed rule does not result in a higher number of industrial banks, this would not be expected to lead to potential benefits from increased competition within the banking industry. Finally, in response to comments the final rule includes a commitment for a Covered Company to

inform the FDIC about the Covered Company's systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information. This aspect of the final rule is expected to benefit consumers by helping to mitigate potential consumer protection risks.

### F. Expected Effects on the Economy

The final rule's effects on the economy are likely to be modest, in line with its potential effects on the banking industry and consumers. If the final rule results in a modest increase in the number of industrial banks or improvement in the provision of banking products and services, the effects on the economy are likely to be modest.

## VI. Regulatory Analysis

### A. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) generally requires an agency, in connection with a final rule, to prepare and make available for public comment a final regulatory flexibility analysis that describes the impact of a final rule on small entities.<sup>139</sup> However, a final regulatory flexibility analysis is not required if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.<sup>140</sup> The Small Business Administration (SBA) has defined "small entities" to include banking organizations with total assets of less than or equal to \$600 million.<sup>141</sup>

Generally, the FDIC considers a significant effect to be a quantified effect in excess of 5 percent of total annual salaries and benefits per institution, or 2.5 percent of total noninterest expenses. The FDIC has considered the potential impact of the final rule on small entities in accordance with the RFA. Based on its analysis and for the reasons stated below, the FDIC believes that this final rule will not have a significant economic impact on a substantial number of small entities.

<sup>139</sup> 5 U.S.C. 601 *et seq.*

<sup>140</sup> 5 U.S.C. 605(b).

<sup>141</sup> The SBA defines a small banking organization as having \$600 million or less in assets, where an organization's "assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year." See 13 CFR 121.201 (as amended, effective Aug. 19, 2019). In its determination, the SBA "counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit." 13 CFR 121.103. Following these regulations, the FDIC uses a covered entity's affiliated and acquired assets, averaged over the preceding four quarters, to determine whether the covered entity is "small" for the purposes of RFA.

<sup>137</sup> \$22,219.40 for all Covered Companies that seek to establish or acquire an industrial bank, and an additional \$326,000 for those institutions required to adopt, implement, and adhere to a contingency plan.

<sup>138</sup> FDIC Call Report Data, December 31, 2019.

As of June 30, 2020, the FDIC supervises 3,270 institutions, of which 2,492 are defined as small institutions by the terms of the RFA.<sup>142</sup> Of these 3,270 institutions, 23 are industrial banks.

As previously discussed, a currently chartered industrial bank would be subject to the final rule, as would its parent company that is not subject to Federal consolidated supervision, if such a parent company acquired control of the grandfathered industrial bank pursuant to a change in bank control transaction that closes after the effective date of the final rule, or if the grandfathered industrial bank is the surviving institution in a merger transaction that closes after the effective date of the final rule.

Of the 23 existing industrial banks, eight reported total assets less than \$600 million, indicating that they could be small entities. However, to determine whether an institution is “small” for the purposes of the RFA, the SBA requires consideration of the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates.<sup>143</sup> The FDIC conducted an analysis to determine whether each industrial bank’s parent company was “small,” according to the SBA size standards applicable to each particular parent company.<sup>144</sup> Of the eight industrial banks that reported total assets less than \$600 million, the FDIC was able to determine that three of these potentially small industrial banks were owned by holding companies which were not small for purposes of the RFA. However, the FDIC currently lacks information necessary to determine whether the remaining five industrial banks are small. Therefore, of the 23 existing industrial banks, 18 are not small entities for purposes of the RFA, but no more than five, or about 22 percent, may be small entities.

Additionally, the FDIC has received three change in control notices relating to industrial banks since 2010. Of those three, only one was from an industrial bank that could possibly be small for purposes of the RFA.

Therefore, given that no more than five of the 23 existing industrial banks are small entities for the purposes of the RFA, and that no more than one change in control notice received by the FDIC

since 2010 may be from a small entity, the FDIC believes the aspects of the final rule relating to change in control notices or merger applications involving industrial banks is not likely to affect a substantial number of small entities among existing industrial banks.

As previously discussed, the final rule applies to industrial banks that, as of the effective date, become subsidiaries of companies that are Covered Companies, as such term is defined in § 354.2. It is difficult for the FDIC to estimate the volume of future applications from entities who seek to own and operate an insured industrial bank, or whether those entities would be considered “small” according to the terms of RFA, with the information currently available to the FDIC. Such estimates would require detailed information on the particular business models of institutions, prevailing economic and financial conditions, the decisions of senior management, and the demand for financial services, among other things. However, the FDIC reviewed the firms with industrial bank applications pending before the FDIC as of December 31, 2019. Each publically traded applicant had a market capitalization of at least \$1 billion as of March 6, 2020.

Each applicant operates either nationally within the United States, or operates worldwide, and none appear likely to be small for purposes of the RFA. Therefore, the FDIC believes that the aspects of the final rule relating to entities who seek to own and operate an insured industrial bank is not likely to affect a substantial number of small entities among existing industrial banks.

Therefore, based on the preceding information, the FDIC certifies that the final rule does not significantly affect a substantial number of small entities.

#### *B. Paperwork Reduction Act*

In accordance with the requirements of the PRA,<sup>145</sup> the FDIC may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number.

As discussed above, the final rule imposes PRA reporting and recordkeeping requirements for each industrial bank subject to the rule and its Covered Company. In particular, each industrial bank, and each Covered

Company that directly or indirectly controls the industrial bank, must (i) agree to furnish the FDIC an initial listing, with annual updates, of all of the Covered Company’s subsidiaries; (ii) submit to the FDIC an annual report on the Covered Company and its subsidiaries, and such other reports as the FDIC may request;<sup>146</sup> (iii) maintain such records as the FDIC deems necessary to assess the risks to the industrial bank and to the DIF; and (iv) in the event that the FDIC has concerns about a complex organizational structure or based on other circumstances presented by a particular filing, the FDIC may condition the approval of an application or the non-objection to a notice—in each case that would result in an industrial bank being controlled, directly or indirectly, by a Covered Company—on the Covered Company and industrial bank committing to providing to the FDIC, and thereafter adopting and implementing, a contingency plan that sets forth, at a minimum, one or more strategies for recovery actions and the orderly disposition of such industrial bank, without the need for the appointment of a receiver or conservator.

The FDIC submitted its request to OMB for review and approval under section 3507(d) of the PRA (44 U.S.C. 3507(d)) and § 1320.11 of OMB’s implementing regulations (5 CFR part 1320) at the proposed rule stage. OMB filed a comment assigning the FDIC OMB control number 3064–0213 and indicated that OMB would re-review the PRA submission once the proposed rule was finalized. The FDIC did not receive any comments on the PRA. In addition, as stated above, because the final rule has been constructed to enable affected parties to comply with the various reporting commitments by relying on established and ongoing reports and records, the FDIC believes that the enhanced reporting commitment should have no effect on the PRA burden listed at the proposed rule stage.

#### Information Collection

*Title:* Industrial Banks and Industrial Loan Companies.

*OMB Number:* 3064–0213.

*Affected Public:* Prospective parent companies of industrial banks and industrial loan companies.

<sup>142</sup> FDIC Call Report Data, September 30, 2019. In order to determine whether an entity is “small” for purposes of the Regulatory Flexibility Act, the FDIC uses its “affiliated and acquired assets” as described in the immediately preceding footnote. The latest available bank and thrift holding company reports, which the FDIC uses to determine

an entity’s “affiliated and acquired assets,” are as of September 30, 2019.

<sup>143</sup> 12 CFR 121.103.

<sup>144</sup> For example, if a particular industrial bank’s parent company was a motorcycle manufacturer, then the size standards applicable to motorcycle manufacturers were used.

<sup>145</sup> 44 U.S.C. 3501 *et seq.*

<sup>146</sup> The final rule requires additional reporting by Covered Companies regarding systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information as part of the annual report.



SUMMARY OF ANNUAL BURDEN AND INTERNAL COST

	Type of burden	Obligation to respond	Estimated number of respondents	Estimated frequency of responses	Estimated time per response	Frequency of response	Total annual estimated burden (hours)
Initial listing of all of the Covered Company's subsidiaries.	Reporting .....	Mandatory .....	4	1.00	4	One Time .....	16
Annual update of listing of all of the Covered Company's subsidiaries.	Reporting .....	Mandatory .....	4	1.00	4	Annual .....	16
Annual report on the Covered Company and its subsidiaries, and such other reports as the FDIC may request.	Reporting .....	Mandatory .....	4	1.00	10	Annual .....	40
Maintain records to assess the risks to the industrial bank and to the DIF.	Recordkeeping .....	Mandatory .....	4	1.00	10	Annual .....	40
Contingency Plan .....	Reporting .....	Mandatory .....	1	1.00	345	On Occasion	345
<b>Total Hourly Burden .....</b>							<b>457</b>

C. Plain Language

Section 722 of the GLBA<sup>147</sup> requires each Federal banking agency to use plain language in all of its proposed and final rules published after January 1, 2000. The FDIC sought to present the final rule in a simple and straightforward manner and did not receive any comments on the use of plain language in the proposed rule.

D. Riegle Community Development and Regulatory Improvement Act of 1994

Pursuant to section 302(a) of the RCDRIA,<sup>148</sup> in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency must consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on affected depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, section 302(b) of RCDRIA requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form.<sup>149</sup> The FDIC considered the administrative burdens and benefits of the final rule in determining its effective date and administrative compliance requirements. As such, the final rule will be effective on April 1, 2021.

E. Congressional Review Act

For purposes of the Congressional Review Act, OMB makes a determination as to whether a final rule constitutes a “major” rule.<sup>150</sup> If a rule is deemed a “major rule” by the OMB, the Congressional Review Act generally provides that the rule may not take effect until at least 60 days following its publication.<sup>151</sup>

The Congressional Review Act defines a “major rule” as any rule that the Administrator of the Office of Information and Regulatory Affairs of the OMB finds has resulted in or is likely to result in (1) an annual effect on the economy of \$100,000,000 or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies or geographic regions, or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets.<sup>152</sup>

The FDIC will submit the final rule and other appropriate reports to Congress and the Government Accountability Office for review.

List of Subjects in 12 CFR Part 354

Bank deposit insurance, Banks, banking, Finance, Holding companies, Industrial banks, Industrial loan company, Insurance, Parent company, Reporting and recordkeeping requirements, Savings associations.

12 CFR Chapter III

Authority and Issuance

For the reasons stated in the preamble, the Federal Deposit Insurance Corporation amends title 12 of the Code

of Federal Regulations by adding part 354 to read as follows:

PART 354—INDUSTRIAL BANKS

Sec.

- 354.1 Scope.
- 354.2 Definitions.
- 354.3 Written agreement.
- 354.4 Required commitments and provisions of written agreement.
- 354.5 Restrictions on industrial bank subsidiaries of Covered Companies.
- 354.6 Reservation of authority.

**Authority:** 12 U.S.C. 1811, 1815, 1816, 1817, 1818, 1819(a) (Seventh) and (Tenth), 1820(g), 1831o–1, 3108, 3207.

§ 354.1 Scope.

(a) In addition to the applicable filing procedures of part 303 of this chapter, this part establishes certain requirements for filings involving an industrial bank or a Covered Company.

(b) The requirements of this part do not apply to an industrial bank that is organized as a subsidiary of a company that is not subject to Federal consolidated supervision by the Federal Reserve Board (FRB) before April 1, 2021. In addition, this part does not apply to:

- (1) Any industrial bank that is or becomes controlled by a company that is subject to Federal consolidated supervision by the FRB; and
- (2) Any industrial bank that is not or will not become a subsidiary of a company.

§ 354.2 Definitions.

Unless defined in this section, terms shall have the meaning given to them in section 3 of the FDI Act.

*Control* means the power, directly or indirectly, to direct the management or policies of a company or to vote 25 percent or more of any class of voting securities of a company, and includes the rebuttable presumptions of control at § 303.82(b)(1) of this chapter and of acting in concert at § 303.82(b)(2) of this chapter. For purposes of this part, the

<sup>147</sup> 12 U.S.C. 4809.

<sup>148</sup> 12 U.S.C. 4802(a).

<sup>149</sup> 12 U.S.C. 4802(b).

<sup>150</sup> 5 U.S.C. 801 *et seq.*

<sup>151</sup> 5 U.S.C. 801(a)(3).

<sup>152</sup> 5 U.S.C. 804(2).

presumptions set forth in § 303.82(b)(1) and (2) of this chapter shall apply with respect to any company in the same manner and to the same extent as if they applied to an acquisition of securities of the company.

*Covered Company* means any company that is not subject to Federal consolidated supervision by the FRB and that controls an industrial bank:

- (1) As a result of a change in bank control pursuant to section 7(j) of the FDI Act;
- (2) As a result of a merger transaction pursuant to section 18(c) of the FDI Act; or
- (3) That is granted deposit insurance by the FDIC pursuant to section 6 of the FDI Act, in each case on or after April 1, 2021.

*FDI Act* means the Federal Deposit Insurance Act, 12 U.S.C. 1811, *et seq.*

*Filing* has the meaning given to it in § 303.2(s) of this chapter.

*FRB* means the Board of Governors of the Federal Reserve System and each Federal Reserve Bank.

*Industrial bank* means any insured State bank that is an industrial bank, industrial loan company, or other similar institution that is excluded from the definition of the term “bank” in section 2(c)(2)(H) of the Bank Holding Company Act, 12 U.S.C. 1841(c)(2)(H).

*Senior executive officer* has the meaning given it in § 303.101(b) of this chapter.

#### § 354.3 Written agreement.

(a) No industrial bank may become a subsidiary of a Covered Company unless the Covered Company enters into one or more written agreements with both the Federal Deposit Insurance Corporation (FDIC) and the subsidiary industrial bank, which contain commitments by the Covered Company to comply with each of paragraphs (a)(1) through (8) in § 354.4 and such other written agreements, commitments, or restrictions as the FDIC deems appropriate, including, but not limited to, the provisions of §§ 354.4 and 354.5.

(b) The FDIC may, at its sole discretion, condition a grant of deposit insurance, issuance of a non-objection to a change in control, or approval of a merger on an individual who is a controlling shareholder of a Covered Company joining as a party to any written agreement required by paragraph (a) of this section.

#### § 354.4 Required commitments and provisions of written agreement.

(a) The commitments required to be made in the written agreements referenced in § 354.3 are set forth in paragraphs (a)(1) through (8) of this

section. In addition, with respect to an industrial bank subject to this part, the FDIC will condition each grant of deposit insurance, each issuance of a non-objection to a change in control, and each approval of a merger on compliance with paragraphs (a)(1) through (8) of this section by the parties to the written agreement. As required, each Covered Company must:

- (1) Submit to the FDIC an initial listing of all of the Covered Company's subsidiaries and update such list annually;
- (2) Consent to the examination by the FDIC of the Covered Company and each of its subsidiaries to permit the FDIC to assess compliance with the provisions of any written agreement, commitment, or condition imposed; the FDI Act; or any other Federal law for which the FDIC has specific enforcement jurisdiction against such Covered Company or subsidiary, and all relevant laws and regulations;
- (3) Submit to the FDIC an annual report describing the Covered Company's operations and activities, in the form and manner prescribed by the FDIC, and such other reports as may be requested by the FDIC to inform the FDIC as to the Covered Company's:
  - (i) Financial condition;
  - (ii) Systems for identifying, measuring, monitoring, and controlling financial and operational risks;
  - (iii) Transactions with depository institution subsidiaries of the Covered Company;
  - (iv) Systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information; and
  - (v) Compliance with applicable provisions of the FDI Act and any other law or regulation;

(4) Maintain such records as the FDIC may deem necessary to assess the risks to the subsidiary industrial bank or to the Deposit Insurance Fund;

(5) Cause an independent audit of each subsidiary industrial bank to be performed annually;

(6) Limit the Covered Company's direct and indirect representation on the board of directors or board of managers, as the case may be, of each subsidiary industrial bank to less than 50 percent of the members of such board of directors or board of managers, in the aggregate, and, in the case of a subsidiary industrial bank that is organized as a member-managed limited liability company, limit the Covered Company's direct and indirect representation as a managing member to less than 50 percent of the managing member interests of the subsidiary industrial bank, in the aggregate;

(7) Maintain the capital and liquidity of the subsidiary industrial bank at such levels as the FDIC deems appropriate, and take such other actions as the FDIC deems appropriate to provide the subsidiary industrial bank with a resource for additional capital and liquidity including, for example, pledging assets, obtaining and maintaining a letter of credit from a third-party institution acceptable to the FDIC, and providing indemnification of the subsidiary industrial bank; and

(8) Execute a tax allocation agreement with its subsidiary industrial bank that expressly states that an agency relationship exists between the Covered Company and the subsidiary industrial bank with respect to tax assets generated by such industrial bank, and that further states that all such tax assets are held in trust by the Covered Company for the benefit of the subsidiary industrial bank and will be promptly remitted to such industrial bank. The tax allocation agreement also must provide that the amount and timing of any payments or refunds to the subsidiary industrial bank by the Covered Company should be no less favorable than if the subsidiary industrial bank were a separate taxpayer.

(b) The FDIC may require such Covered Company and industrial bank to commit to provide to the FDIC, and, thereafter, implement and adhere to, a contingency plan subject to the FDIC's approval that sets forth, at a minimum, recovery actions to address significant financial or operational stress that could threaten the safe and sound operation of the industrial bank and one or more strategies for the orderly disposition of such industrial bank without the need for the appointment of a receiver or conservator.

#### § 354.5 Restrictions on industrial bank subsidiaries of Covered Companies.

Without the FDIC's prior written approval, an industrial bank that is controlled by a Covered Company shall not:

- (a) Make a material change in its business plan after becoming a subsidiary of such Covered Company;
- (b) Add or replace a member of the board of directors, board of managers, or a managing member, as the case may be, of the subsidiary industrial bank during the first three years after becoming a subsidiary of such Covered Company;
- (c) Add or replace a senior executive officer during the first three years after becoming a subsidiary of such Covered Company;
- (d) Employ a senior executive officer who is, or during the past three years has been, associated in any manner (*e.g.*,

as a director, officer, employee, agent, owner, partner, or consultant) with an affiliate of the industrial bank; or

(e) Enter into any contract for services material to the operations of the industrial bank (for example, loan servicing function) with such Covered Company or any subsidiary thereof.

#### § 354.6 Reservation of authority.

Nothing in this part limits the authority of the FDIC under any other provision of law or regulation to take supervisory or enforcement actions, including actions to address unsafe or unsound practices or conditions, or violations of law.

Federal Deposit Insurance Corporation.

By order of the Board of Directors.

Dated at Washington, DC, on December 15, 2020.

**James P. Sheesley,**

*Assistant Executive Secretary.*

[FR Doc. 2020-28473 Filed 2-22-21; 8:45 am]

**BILLING CODE 6714-01-P**

## NATIONAL CREDIT UNION ADMINISTRATION

### 12 CFR Part 704

RIN 3133-AF13

#### Corporate Credit Unions

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Final rule.

**SUMMARY:** The NCUA Board (Board) is issuing a final rule that amends the NCUA's corporate credit union regulation. The final rule updates the definitions in this regulation and makes clear that corporate credit unions may purchase subordinated debt instruments issued by natural person credit unions. The final rule also specifies the capital treatment of these instruments for corporate credit unions that purchase them.

**DATES:** The final rule is effective January 1, 2022.

#### FOR FURTHER INFORMATION CONTACT:

*Policy and Analysis:* Robert Dean, National Supervision Analyst, Office of National Examinations and Supervision, (703) 518-6652; *Legal:* Rachel Ackmann, Senior Staff Attorney, Office of General Counsel, (703) 548-2601; or by mail at National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314.

#### SUPPLEMENTARY INFORMATION:

## I. Introduction

### a. Legal Authority and Background

The Board is issuing this rule pursuant to its authority under the Federal Credit Union Act (FCU Act).<sup>1</sup> Under the FCU Act, the NCUA is the chartering and supervisory authority for Federal credit unions (FCUs) and the federal supervisory authority for federally insured credit unions (FICUs). The FCU Act grants the NCUA a broad mandate to issue regulations governing both FCUs and FICUs. Section 120 of the FCU Act is a general grant of regulatory authority and authorizes the Board to prescribe regulations for the administration of the FCU Act.<sup>2</sup> Section 209 of the FCU Act is a plenary grant of regulatory authority to the NCUA to issue regulations necessary or appropriate to carry out its role as share insurer for all FICUs.<sup>3</sup> The FCU Act also includes an express grant of authority for the Board to subject federally chartered central, or corporate, credit unions to such rules, regulations, and orders as the Board deems appropriate.<sup>4</sup>

Part 704 of the NCUA's regulations implements the requirements of the FCU Act regarding corporate credit unions.<sup>5</sup> In 2010, the Board comprehensively revised the regulations governing corporate credit unions to provide longer-term structural enhancements to the corporate system in response to the financial crisis of 2007-2009.<sup>6</sup> The provisions of the 2010 rule successfully stabilized the corporate system and improved corporate credit unions' ability to function and provide services to natural person credit unions. Since 2010, and as part of the Board's continuous reevaluation of its regulation of corporate credit unions, the Board has amended part 704 on several occasions.<sup>7</sup> In 2017, the Board amended corporate credit union capital standards to change the calculation of capital after a consolidation and to set a retained earnings ratio target in meeting prompt corrective action (commonly referred to as PCA) standards.<sup>8</sup> In October 2020, the Board issued a final rule to amend several provisions relating to corporate credit union investments in credit union service organizations (CUSOs) and other provisions relating to corporate credit

union governance and technical matters, as discussed in the following sections.

### b. February 2020 Proposed Rule on Part 704

On February 20, 2020, the Board approved a notice of proposed rulemaking to update, clarify, and simplify several provisions of part 704 (proposed rule).<sup>9</sup> The proposed rule provided for a 60-day comment period, which the Board later extended by 60 days because of COVID-19.<sup>10</sup> The comment period ended on July 27, 2020.

### c. October 2020 Final Rule on Part 704

The NCUA received 35 comment letters on the proposed rule. Comments were received from credit unions, both corporate and natural persons, credit union leagues and trade associations, individuals, corporate CUSOs, and an association of state credit union supervisors. In October 2020, the Board issued a final rule that: (1) Permits a corporate credit union to make a minimal investment in a CUSO without the CUSO being classified as a corporate CUSO and subject to heightened NCUA oversight; (2) expands the categories of senior staff positions at member credit unions eligible to serve on a corporate credit union's board; (3) removes the experience and independence requirement for a corporate credit union's enterprise risk management expert; (4) clarifies the definition of a collateralized debt obligation; and (5) simplifies the requirement for net interest income modeling.<sup>11</sup>

The October 2020 final rule deferred final action on the provisions in the proposed rule that addressed the permissibility and capital treatment for corporate credit union purchases of subordinated debt instruments under the Board's January 2020 proposed rule on subordinated debt.<sup>12</sup> In the October 2020 final rule, the Board discussed the comments on this part of the proposed rule and noted that the commenters that addressed these provisions all supported them. The Board did not adopt the provisions at that time because it had not yet finalized the January 2020 proposed rule on subordinated debt.

### d. Final Rule on Subordinated Debt

The Board has now adopted the January 2020 proposed rule on subordinated debt as final.<sup>13</sup> These

<sup>1</sup> 12 U.S.C. 1751 *et seq.*

<sup>2</sup> 12 U.S.C. 1766(a).

<sup>3</sup> 12 U.S.C. 1789.

<sup>4</sup> 12 U.S.C. 1766(a).

<sup>5</sup> 12 CFR part 704.

<sup>6</sup> 75 FR 64786 (Oct. 20, 2010).

<sup>7</sup> *See e.g.*, 80 FR 25932 (May 6, 2015), 80 FR 57283 (Sept. 23, 2015), and 82 FR 55497 (Nov. 22, 2017).

<sup>8</sup> 82 FR 55497 (Nov. 22, 2017).

<sup>9</sup> 85 FR 17288 (Mar. 27, 2020).

<sup>10</sup> 85 FR 20431 (Apr. 13, 2020).

<sup>11</sup> 85 FR 71817 (Nov. 12, 2020).

<sup>12</sup> 85 FR 13982 (Mar. 10, 2020).

<sup>13</sup> *See*, <https://www.ncua.gov/files/agenda-items/AG20201217Item5b.pdf>.