

FDIC proposes rules limiting integrated business models of IBs and their parent companies

Initial perspectives related to the Federal Deposit Insurance Corporation (FDIC) Notice of Proposed Rulemaking on Parent Companies of Industrial Banks and Industrial Loan Corporations (IBs)



With only 24 industrial banks in existence in the US and only three IB-approved FDIC applications since April 1, 2021¹ (when the previous Part 354 revision became final) the timing and sweeping nature of the proposed rulemaking on parent companies of IBs (proposed rulemaking) **seems geared to recent IB application experiences (including withdrawn FDIC applications) and the priorities of the outgoing FDIC chair.**



The proposal communicates **FDIC opposition to IB business models integrated with and dependent upon the IB parent company and affiliates.** The age-old issue of the mixing of **commerce and banking** appears to be a key driver of this proposal, rather than emerging topics like FinTechs or digital currencies, but the proposed rule would apply regardless of the type of business activity (financial, or not) of the parent organization. While Congress has not closed the "IB loophole" in the Bank Holding Company Act, the FDIC would appear to be getting there, as a practical matter, through its proposed restrictions and added scrutiny of IB applicants and their parent companies.



The proposed rulemaking generally applies to future IB applicants for FDIC insurance, as well as change in control and merger transactions. While the majority of IBs operating today are not in scope of the rulemaking² **these existing IBs and their parents should be aware that a change in control or merger that occurs at or above the level of the parent company, would subject the IB to the provisions in the proposed rule.** The proposed rulemaking:

- **Requires an IB business model that is viable on a stand-alone basis** that has franchise value independent of the Parent
- **Classifies an IB as a shell or captive institution** if it: (a) could not function independently of the Covered Company;³ (b) is significantly or materially reliant on the Covered Company or its affiliates; or (c) serves only as a funding channel for an existing Covered Company or affiliate business line
- States that a business plan for an IB where products/services are only available to customers of an affiliated company or narrow segment of the community **will weigh heavily against the applicant**



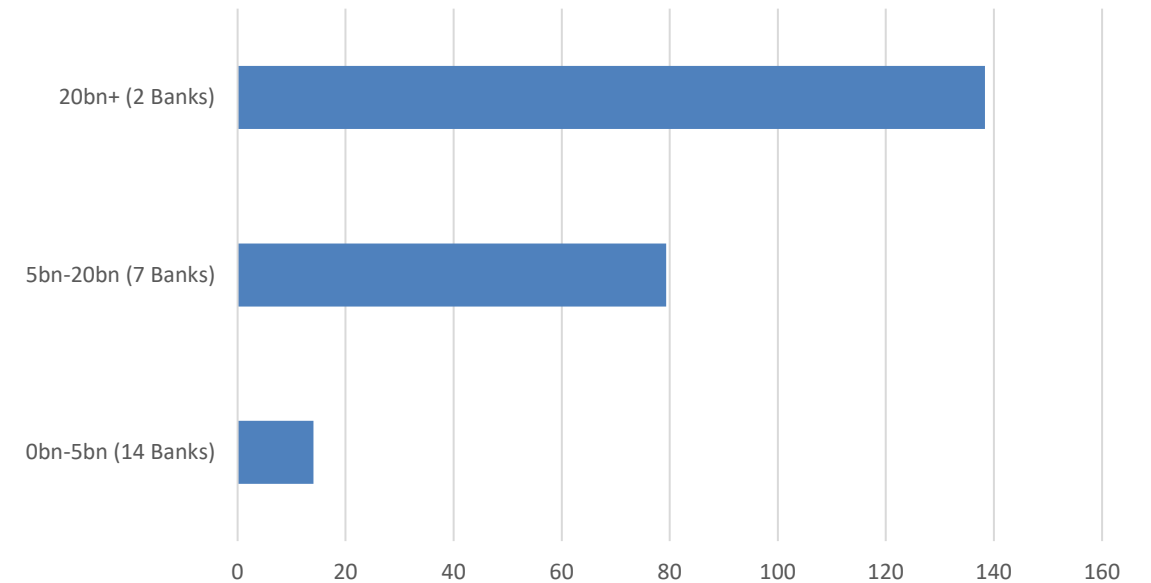
The headline is simple. No longer can future applicants, or existing IBs that meet the expanded change in control requirements have business models that rely on complementary activities with its parent or affiliate organization. A split board decision reflects the divergence of opinions on this subject that could get revisited again at some point in the future, making it difficult for commercial organizations to navigate how to execute a business strategy that could benefit from an IB, and have profound implications for those actively looking to apply for an IB charter.



The industry and other stakeholders may consider weighing in on this proposed rulemaking.

24 Industrial Banks Asset Size (in 'bn) by Asset Groups

Overview of IB population (totals in billions)



Asset Size in USD Bn (Count of number of banks in the asset group
(note out of 24 IBs one entity is not operational yet).

*** Includes 24 approved IBs and aggregate asset size data as of June 30, 2024**

Source: FDIC Reports of Condition



On July 30, 2024, the FDIC approved a notice of proposed rulemaking to amend Part 354 of the FDIC Rules and Regulations governing parent companies of IBs, which revises part 354 to clarify and enhance the agency's framework to supervise industrial banks, mitigate risks to the Deposit Insurance Fund, and provide necessary transparency for market participants.⁴ Here are some key insights and considerations that banks should be aware of.

5 summary insights

Changed the regulatory expectations of the IB: FDIC proposes a new set of business model considerations (e.g., Franchise Value) that have not previously been part of the formal regulatory expectations. It further discourages applications that deploy a shell or captive institution model, which is defined as an IB that: (a) could not function independently of the Covered Company; (b) is significantly or materially reliant on the Covered Company or its affiliates; or (c) serves only as a funding channel for an existing Covered Company or affiliate business line. This definition may apply to several institutions today and may present challenges for future applicants seeking an IB charter to obtain approval.

More emphasis on compliance with statutory factors: FDIC emphasized applicants should clearly demonstrate in their business plan and application how they are complying with the statutory factors and should refrain from leveraging written agreements/capital and liquidity maintenance agreements (CALMAs) to resolve statutory factors or circumstances on which the FDIC would otherwise make an unfavorable finding.

Greater focus on independence from parent: FDIC is further examining applicants that are overly reliant on parent or affiliate support. This includes relying on the parent organization for sourcing business and conducting key operational elements and critical business support, as well as overreliance on CALMAs and parent company agreements.

Narrow Business models will be scrutinized: The FDIC is interpreting a narrow business model reliant on parent capabilities to be simply a way to have the public subsidize the existing business model with federal deposit insurance, rather than serve the convenience and needs of the community or have a focused business model that is profitable and sustainable.

Recovery and Resolution Planning: FDIC has emphasized that IB overreliance on its parent for its operations, as well as financial requirements, presents challenges for the IB to liquidate during a crisis (i.e., the IB is structured to be valuable only when it is tied to the parent).

5 considerations to evaluate

- 1 Expect more denials and quicker processing of applications:** The proposed amendments to scope, role of written commitments in resolving statutory factors, and shell bank business models are intended to define why the FDIC has denied certain applications. The FDIC criteria may also discourage at least some potential future applications from being submitted in the first place, and then experiencing a protracted (multi-year) and ultimately unsuccessful FDIC application review process. Applicants should likely wait to begin the IB application process until rule is final and the FDIC Board is stabilized, following the upcoming election, to better understand the level of acceptability for their application.
- 2 Evaluate the degree of risk from parent / affiliates:** Applicants will need to determine the degree of risk presented to the IB from its parent and affiliate (and the level of reliance). The application and business plan should clearly address the business purpose for establishing or acquiring control of the IB, intercompany relationships, the regulatory and consumer compliance history and supervisory record of each relevant entity, the novelty of the parent's primary business (including any new or innovative processes), accessibility of information, and any plans or processes that mitigate risks presented. Overreliance on the parent and risks posed by the parent will pose challenges in the application process.
- 3 Demonstrate IB can operate on stand-alone basis:** The FDIC will expect applicants to demonstrate that the proposed IB can operate on a stand-alone basis and have limited reliance on parent company for customers or operational support. Applicants should be able to demonstrate the proposed IB has an independent board of directors, management team, and sustainable financial structure with appropriate capital and liquidity in place.
- 4 Demonstrate how IB will benefit the broader community:** Applicants must consider the convenience and needs of the community to be served when filing a deposit insurance or merger application. Applicants should consider the customer base that the applicant intends to serve with its deposit and credit products and the market need filled through those products and how they benefit the community. The FDIC has emphasized that business models that aim to serve a target customer base that represents a narrow segment of the community will be scrutinized.
- 5 Recovery and Resolution Planning:** Applicants will need to show the viability and operations of the IB are able to function independently should ongoing support from the parent organization be disrupted. An applicant's contingency plans may include one or more strategies for the orderly disposition or dissolution of the IB without the need for the appointment of a receiver or conservator.

Endnotes

¹ Federal Deposit Insurance Corporation (FDIC), "[Consolidated Reports of Condition and Income](#)," accessed August 2, 2024.

² IBs were established before April 1, 2021 under companies not subject to Federal Reserve supervision, that are or became controlled by companies subject to Federal Reserve supervision, or operate standalone, are out of scope for the provisions of the proposed rulemaking.

³ "Covered Company" is defined in part 354 to mean "any company that is not subject to Federal consolidated supervision by the Federal Reserve 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.

⁴ FDIC "[FDIC Board Approves Proposed Rule to Amend the Agency's Regulations Governing Parent Companies of Industrial Banks and Industrial Loan Companies](#)," press release, July 30, 2024.

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