

The FDIC's Final Rule on Applications by Industrial Banks: A Formalized Road Map for FinTechs Considering a National Banking Platform

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This advisory discusses the Federal Deposit Insurance Corporation's new Final Rule, which imposes obligations on parent companies of industrial banks, and what fintech companies should consider when evaluating an industrial bank charter to deliver their products nationwide.

On December 15, the Federal Deposit Insurance Corporation (FDIC) released its final rule (the Final Rule) regarding the obligations and commitments the FDIC may impose upon parent companies of industrial loan banks or industrial banks (IBs).¹ While codifying policies previously used by the FDIC in its evaluation of deposit insurance applications by de novo IBs in some instances, the Final Rule also provides an important set of considerations for fintech companies and their parents that are evaluating an IB charter as a means to deliver innovative financial products nationwide on a single, uniform platform.

BACKGROUND

IBs are state-chartered institutions² that possess FDIC insurance. In order to obtain a charter as an IB, an entity must satisfy all of the chartering requirements of the state from which the IB charter is sought, have the FDIC approve the applicant's application for deposit insurance, and meet one of the following requirements: (1) not accept demand deposits; (2) have total assets of less than \$100 million; or (3) have been acquired prior to August 10, 1987.

Because IBs are exempt from the definition of "bank" as set forth in the Bank Holding Company Act (BHCA)³, the parent companies of IBs are not "bank holding companies" as defined in the BHCA and are not subject to the BHCA's activities restrictions or Federal Reserve Board (FRB) regulation and supervision; as such, although commercial and financial companies are prohibited from holding "bank" subsidiaries, these entities are not statutorily prohibited from chartering and controlling an IB subsidiary. IBs, however, are subject to the full panoply of the FDIC's banking laws and regulations, including restrictions on transactions with affiliates (Federal Reserve Act Sections 23A and 23B, as set forth in Regulation W), anti-tying regulations, and insider lending regulations. IBs are also subject to regular supervision and examination by both the applicable state banking department and the FDIC as the entity's primary federal regulator.

Once granted a banking charter by the applicable state and deposit insurance by the FDIC, IBs generally have the same commercial and consumer lending authority as commercial banks that are subsidiaries of bank holding companies.

¹ The Final Rule's components are triggered when an IB: (i) submits an application seeking to obtain deposit insurance, (ii) submits a change in control notice, or (iii) proposes to become a subsidiary of a company that is not subject to consolidated Federal Reserve supervision (each, a "Triggering Event").

² The only states that currently charter IBs are California, Hawaii, Minnesota, Nevada, and Utah. Most existing IBs have Utah or Nevada charters.

³ The term "bank" is defined in the BHCA at 12 USC § 1841(c)(2)(H).

FINAL RULE

In determining that the FDIC must ensure that the regulatory obligations it will impose on IBs and the entities that control them are clear and delineated, the Final Rule requires that a “covered company”⁴ (i.e., an entity that controls an IB) must enter into written agreements with the IB and the FDIC that satisfy all of the following requirements before an IB is allowed to become a subsidiary of a covered company:

- 1) submit to the FDIC an initial listing of all of the covered company’s subsidiaries and update such list annually;
- 2) consent from the covered company to an examination by the FDIC (including an examination of the covered company’s subsidiaries) to assess compliance with any agreements and applicable laws;
- 3) submit an annual report describing the covered company’s operations containing information required by the FDIC;
- 4) maintain records the FDIC deems necessary to assess risks to the IB and the Deposit Insurance Fund;
- 5) obtain an independent audit of each IB subsidiary annually;
- 6) comply with limits regarding direct and indirect board representation;
- 7) maintain the capital and liquidity of the IB at such levels in accordance with FDIC directives; and
- 8) provide a tax allocation agreement with the IB that states the agency relationship that exists between the covered company and the IB with respect to tax assets generated by the IB.

The Final Rule also provides that these same requirements will be imposed on IB applications related to a Triggering Event,⁵ where the IB is a subsidiary of a controlling company. Additionally, the Final Rule provides that the FDIC may require that the covered company commit to an FDIC-approved contingency plan in connection with the disposition of the IB without the need for the appointment of a receiver or conservator.

Once operational, the Final Rule requires that FDIC prior written approval will be necessary when an IB that is controlled by a covered company: (1) makes a material change in its business plan; (2) adds or replaces a member of the board of directors or board of managers; (3) adds or replaces a senior executive officer during the first three years after becoming a subsidiary of a covered company; (4) employs a senior executive officer who is or has been associated with an affiliate of the IB⁶; or (5) enters into a contract for material services provided by the covered company or one of its subsidiaries.

A PENDING FINTECH CHARTERING STAMPEDE?

As we head into 2021, there are two forces competing in the market to deliver consumer financial products and services in a way that is efficient, scalable and streamlined: the first force is the tug that banks feel to become more nimble in the use of electronic platforms to market to and service customers. Customer acquisition models premised on in-branch cross-selling and targeted pre-screened mailings are vestiges of a “banking past” that do not reflect the electronic efficiency fintechs have perfected. The second force is the tug that fintech companies feel to obtain a platform to offer their products and services pursuant to a single, unified regulatory framework rather than a

⁴ A “covered company” is defined as “any company that is subject to Federal consolidated supervision by the Federal Reserve Board that controls an industrial bank (i) as a result of a change in bank control pursuant to section 7(j) of the FDI Act; (ii) as a result of a merger transaction pursuant to section 18(c) of the FDI Act; or (iii) that is granted deposit insurance pursuant to section 6 of the FDI Act, in each case on or after April 1, 2021.”

⁵ Note that these requirements do not apply to IBs chartered before April 1, 2021 or to IBs that are not subsidiaries of a parent company.

⁶ There is a three-year limitation on this requirement.

disjointed (and expensive) state-by-state model of delivery or, alternatively, in partnership with a bank, where the economics do not often reflect the “value” the fintech provides to the bank’s origination yields.

The Final Rule creates the necessary “lanes” in which fintechs (and their parents) can evaluate the desirability of an IB charter to offer their products and services on a national basis using the technology, algorithms, and marketing savvy they have honed. While the requirements related to operating pursuant to an IB charter may cause some fintechs to wait for the possibility of a special purpose, national bank charter from the Office of the Comptroller of the Currency, other fintechs will certainly use the Final Rule’s requirements as part of an internal analysis to determine whether an IB charter provides it with an opportunity to leverage customer acquisition and scoring “know how” on a national scale with a bank charter that allows interest rate exportation. The new year is likely to bring an increased number of pre-filing meetings with state banking regulators and the FDIC, as fintechs and their parents make these assessments.

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