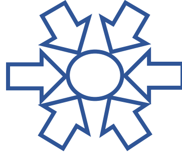

Financial Services Management

ILC Charters

Cite

FDIC, Notice of Proposed Rulemaking, Parent Companies of Industrial Banks and Industrial Loan Companies

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Impact Assessment

- On its own, the NPR would affect very few firms.
- Issues on which comment is sought could expand impact to all existing shell/captive ILCs and/or even all ILCs.
- More stringent conditions governing inter-connection with ILC parents could limit or even block the benefits anticipated from or now enjoyed by ILCs that fund parent firms or otherwise provide banking services to them.
- Doing so would reinforce barriers between banking and commerce applicable to traditionally-chartered IDIs.

Overview

A divided FDIC board has approved a proposal retracting key sections of the agency's 2020 rule meant to open the way to new ILC charters.[1] Strongly opposed at the time by now-Chair Gruenberg, the proposal subjects parent companies applying to establish what the NPR calls "captive" or "shell" ILCs to more stringent review when applying for a charter that are likely to lead to denial in most cases. The NPR also expands the scope of FDIC review when it comes to Change-in-Bank-Control Act (CBCA) notices to charter conversions and certain other actions. The analysis presented in the proposal along with questions on which it seeks comment suggest the agency could go considerably farther to rein in ILCs, although most additional actions would require new rulemakings.

Impact

The preamble to this proposal reiterates longstanding FDIC concerns about ILCs that were partially discounted in the 2020 final rule. Shared by banking organizations,

[1] See **ILC15**, *Financial Services Management*, December 21, 2020.

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these fears include the risks that arise when an IDI is affiliated with a commercial entity or other non-BHC that may lead not only to parent-company risks that the BHCs rules and Fed supervision seek to avert, but also to unique conflicts of interest and risks where IDIs depend for their franchise value on an unregulated parent and/or for critical services – i.e., charters the FDIC considers to be captive to their parent companies or shells for affording the parent with desired services such as less-costly funding. The FDIC is particularly concerned that these risks would sharply increase resolution costs.

These concerns underlie not only proposed, prospective ILC-charter restrictions, but also FDIC review when there are control changes of the parent company. These reflect the concerns evident in two recent FDIC proposals: one setting a new, stringent policy for bank-merger approvals[2] and another when passive investors acquire controlling interests in an IDI.[3] However, the NPR does not apply any restrictions broader than those aimed specifically at new applicants for captive or shell ILCs.

Nothing in this NPR affects a key concern of some at the FDIC and many bankers: the ability of ILCs to offer like-kind services to banks that are under significant restrictions on the products and services their parent companies may provide and the prudential rules that govern these parents. While ILCs may be under like-kind safety-and-soundness rules for other state nonmember banks – a point the FDIC emphasizes in this NPR – the parent company's business latitude and lower costs give it a considerable edge when compared to other companies that own IDIs.

Although dissenting FDIC directors pressed for a broader policy, the new FDIC proposal does not revisit these issues, deciding for example not to resurrect the earlier request for comment on whether ILCs should be housed in intermediate holding companies to shield them from the parent companies as required for larger FBOs.[4] However, the FDIC's final 2020 rule retained the agency's discretion to require this; if the final rule is adopted and retained after the election, then these IHCs may become more common.

However, the NPR states that the FDIC is generally satisfied with the conduct of existing ILCs even when these meet the new and proposed criteria as shell or captive firms. Several now have outstanding enforcement actions, but the FDIC is confident that rules applicable to all state nonmember banks and its supervisory authority suffice. Why this would not also be true of new ILCs chartered much as current captive or shell companies is not made clear. Perhaps troubled by this issue as well as requests for a broader policy, the NPR (see below) seeks views on broad questions that could open some or all existing ILCs to new restrictions that, if key concerns in the NPR are addressed, could adversely affect their franchise value and give more traditional IDIs a competitive edge.

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2 See **MERGER15**, *Financial Services Management*, March 27, 2024.

3 See **TAKEOVER11**, *Financial Services Management*, August 7, 2024.

4 See **ILC14**, *Financial Services Management*, April 13, 2020.

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What's Next

The FDIC voted 3-2 to approve this proposal on July 30. Comments are due by October 11. The proposal would apply its standards not only to new charters, but also to ILCs established after the current rule became effective in April of 2021. There appears to be only one such ILC.

Analysis

A. Scope

This proposal applies to industrial banks and ILCs in the same manner, with this analysis continuing to refer to these entities as ILCs. The proposal does not govern limited purpose trust companies and credit card banks even though parent companies are not necessarily BHCs.

ILCs chartered by parent companies by S&Ls will also come under this standard unless the parent company is an S&LHC under the Fed, making it considerably more difficult for any remaining S&Ls to charter or retain an ILC. This was very common during times when ownership standards for S&Ls differed significantly from those for banks, but has become much less pertinent after 2008.

B. Control Considerations

The FDIC says it reviews each ILC application on its statutory merits, but goes on to say that applications designed to circumvent another federal banking agency will generally be rejected. This would make it much harder for an IDI parent to shutter its BHC and retain its ability to gather insured deposits and access the payment system.

The proposal also covers any ILC where the parent company experiences a change of control or merger where the parent company survives on or after the final rule's effective date.

C. Source of Strength

The FDIC will generally reject ILC applications in situations where an ILC is a "shell" or "captive" of its parent company – i.e., where it depends on the parent for liquidity or other key resources, could not function independently, or only funds the parent company or its affiliates. The proposal bases this judgment on the view that the statutory requirement to assess an applicant's ability to serve the "convenience and needs" of the community is not solely a CRA evaluation. Shells and captives by definition do not serve the "community" as a whole. The NPR also raises the safety-and-soundness issues noted above. However, these applications will not be unilaterally rejected, with the agency giving applicants a chance to make their case, perhaps via a public hearing.

D. Written Commitments

The preamble notes that some ILCs appear to believe that written commitments to the FDIC substitute for adherence also to statutory application-approval requirements. The proposal thus states that written agreements will be considered,

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but do not replace FDIC consideration also of statutory factors that may lead to denial.

E. Supervisory Considerations

The proposal reiterates and strengthens the FDIC's expectation that shell or captive ILCs meet current requirements regarding independent directors, and stand-alone financial strength and business models. The FDIC is also adding a rebuttal presumption that certain characteristics will cause an ILC to be considered shall or captive that would weigh "heavily" against application approval. The FDIC will also consider how inter-connected the ILC would be with the parent, whether the parent company engages in novel activities, transparency, and consumer compliance, and proposed risk-mitigation actions. The NPR also lays out how an applicant could contest a determination that it is a shell or captive.

F. Convenience and Needs

Being a shell or captive serving only the parent is, as noted, now a consideration the FDIC consider in application approvals. A finding to this effect along with CRA review will also weigh heavily in favor of disapproval. The NPR lays out how a captive or shell ILC could show that serving only its parent still meets community needs (e.g., by increasing competition). Written agreements resolving these concerns are possible.

G. Questions

These include:

- other risks that warrant bringing some or all existing ILCs under new source-of-support and prudential standards;
- the need for additional application-approval considerations;
- resolution considerations germane to the filings required in this proposal (and perhaps others related to existing ILCs);
- the need for differences in how supervisors look at shell/captive ILCs when it comes to safety-and-soundness and consumer protection (with this question again appearing to pertain to all ILCs);
- the need for a new ILC supervisory framework; and
- the approach proposed for judging convenience and needs.

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