

ALERTS

FDIC Approves Deposit Insurance for Two Industrial Bank Applicants and Proposes New Rules for Future Applicants

March 20, 2020

On March 18, 2020, the Federal Deposit Insurance Corporation (“FDIC”) announced it had approved deposit insurance applications for two industrial bank applicants — Square Inc. and Nelnet Inc. Those decisions represented the first time since 2008 that the FDIC had been willing to grant deposit insurance to an industrial bank applicant. Since deposit insurance is a prerequisite for obtaining an industrial bank charter, the FDIC’s moratorium — sometimes official, sometimes unofficial — had put the charter on ice for more than a decade.[1]

On March 17, 2020, the FDIC also issued for public comment a proposed rule that would impose certain conditions on industrial bank applicants going forward. These developments, which are discussed further below, indicate that the FDIC has changed its position with regard to approving deposit insurance applications for industrial bank applicants, and the once highly sought after industrial bank charter may begin to garner serious attention once again.

What Is the Value of the Industrial Bank Charter?

Under U.S. banking law, generally, an entity that is deemed to control a banking organization is subject to regulation by the Board of Governors of the Federal Reserve System (“Board”) as a bank holding company or a

savings and loan holding company. Such regulation is extensive and pervasive, including capital requirements, liquidity requirements, leverage limitations, “source of strength” obligations and activity restrictions.

However, there are exceptions to this general rule for entities that control “limited purpose banks,” such as industrial banks and special purpose national banks chartered by the Office of the Comptroller of the Currency (“OCC”) (which currently exist in two forms — trust banks and credit card banks).[2] While both existing types of special purpose national banks have very limited powers (as their names would indicate, a trust bank is largely limited to conducting fiduciary activities and a credit card bank is generally limited to consumer credit card lending), an industrial bank, in contrast, can engage in virtually all activities that a regular bank can engage in and, as such, was and is now again a potentially attractive bank charter.

What Are Industrial Banks?

Industrial banks (also sometimes referred to as “industrial loan companies”) have existed in the United States since 1910, originally created to provide loans to low and moderate-income industrial workers who had stable jobs but little access to bank credit. In the early years of the industry, a majority of the states offered some form of industrial bank charter. During the past decade, however, this number dropped to just seven states, and currently only six states still have active FDIC-insured industrial banks. Of those six, however, only Utah and Nevada offer charters that are able to fully benefit from the federal law treatment discussed above, which was enacted by Congress in 1987.[3]

Because the owners of industrial banks are not subject to most of the requirements imposed on bank holding companies and savings and loan holding companies, they may be owned by entities that would not be eligible to own a commercial bank or savings and loan association. In 1988, General Motors was the first such company to charter an industrial bank. Following General Motors, numerous other commercial companies, including manufacturers and retailers, obtained a charter.

Recently, the industrial bank charter has received a lot of attention from fintech companies, which may now consider revisiting such a charter as an option going forward.

As noted above, while the owners of OCC-chartered trust banks and credit card banks (and, perhaps in the future, fintech banks) receive the same federal law benefit as the owners of industrial banks, such charters are far more limited and, thus, less attractive to most potential applicants. In contrast to other limited purpose charters, the only significant limitation on the powers of an industrial bank is that it cannot offer “demand deposits” (such as traditional checking accounts) if the bank’s total assets exceed \$100 million. However, industrial banks may offer negotiable order of withdrawal (“NOW”) accounts, which function much like a traditional checking account, with the only difference being that the bank has the right to require at least seven days’ written notice of a withdrawal, though for competitive reasons banks nearly always automatically waive such right. Thus, in practice, an industrial bank can be virtually indistinguishable from a full-service bank. Moreover, like a full-service bank, an industrial bank enjoys federal preemption of interest rate limitations, allowing the industrial bank to export to out-of-state borrowers the interest rate permitted by the state in which it is located.

What Conditions Will the FDIC Impose on Industrial Bank Applicants?

In approving the Square and Nelnet applications, the FDIC required each to enter into a Capital and Liquidity Maintenance Agreement and a Parent Company Agreement. Through the former, the FDIC required each applicant to agree to (i) serve as a source of financial strength for its bank; (ii) ensure that the bank maintains sufficient capital and liquidity; and (iii) inject capital or liquidity if the bank’s capital or liquidity falls below a certain threshold. The latter agreement requires each applicant to consent to examination, reporting, recordkeeping and other provisions designed to provide safeguards to protect its bank and the Deposit Insurance Fund.

As noted above, the day before announcing its approval of the applications, the FDIC issued a proposed rule that would require 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 becoming, after the effective date of any final rule, a subsidiary of a company that is not subject to consolidated supervision by the Board. The proposed rule would require a covered parent company to enter into written agreements with the FDIC and the industrial bank to (i) address

the company's relationship with the industrial bank; (ii) require capital and liquidity support from the parent to the industrial bank; and (iii) establish appropriate recordkeeping and reporting requirements. Comments on the proposed rule are due 60 days from its publication in the Federal Register. We plan to issue an upcoming *Alert* with more details on the proposal.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] In 2006, the FDIC declared a self-imposed moratorium of the approval of applications for FDIC deposit insurance made by industrial banks, which expired in 2008. An additional moratorium was imposed by the Dodd-Frank Act in 2010, which expired in 2013. Since then, the FDIC has “slow-walked” applications, causing applicants to withdraw.

[2] While the OCC created a third type of special purpose national bank in 2018, a financial technology (“fintech”) bank, such a charter has never been issued, as the OCC’s authority to do so has been the subject of litigation. In October 2019, the district court for the Southern District of New York entered a final judgment in favor of the New York Department of Financial Services, who had filed a lawsuit challenging the OCC’s authority to offer fintech bank charters. In December 2019, the OCC filed its appeal and the case is still pending.

[3] In Nevada, industrial banks operate under a “limited purpose thrift company” charter.

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