

July 30, 2024

**MEMORANDUM TO:** The Board of Directors

**FROM:** Doreen R. Eberley, Director  
Division of Risk Management Supervision

Mark Pearce, Director  
Division of Depositor and Consumer Protection

**SUBJECT:** Proposed Rule to Amend Part 354, Parent Companies of Industrial Banks and Industrial Loan Companies

### Recommendation

Staff recommends that the Board of Directors (Board) adopt the attached proposed rule and authorize its publication in the Federal Register with a 60-day comment period. The proposed rule would amend part 354 of the FDIC Rules and Regulations (part 354), which governs parent companies of industrial banks and industrial loan companies. Part 354 requires certain conditions and written commitments in specific situations that would result in an insured industrial bank or industrial loan company (industrial bank) becoming a subsidiary of a company that is not subject to consolidated supervision by the Federal Reserve Board (FRB), referred to herein as a Covered Company.<sup>1</sup> The proposed amendments would revise the scope of part 354 to: (1) include conversions involving a proposed industrial bank under section 5 of the Home Owners' Loan Act (HOLA) or other transactions as determined by the FDIC; (2) ensure that a parent company of an industrial bank would be subject to part 354 if there is a change of control at the parent company or a merger in which the parent company is the resultant entity; and (3) provide the FDIC the regulatory authority to apply part 354 to other situations where an industrial bank would become a subsidiary of a company that is not subject to Federal consolidated supervision. Additionally, the proposed amendments would clarify the relationship between written commitments and the FDIC's evaluation of the statutory factors applicable to an industrial bank filing; set forth additional criteria that the FDIC would consider when assessing the risks presented to an industrial bank by its parent organization and evaluating the industrial bank's ability to function independently of the parent organization. The proposal would clarify and enhance the supervisory framework that the FDIC formalized in part 354 to supervise industrial banks, mitigate risk to the Deposit Insurance Fund (DIF), and provide necessary transparency for market participants.

Concur:

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Harrel Pettway, General Counsel

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<sup>1</sup> Section 2(c) of the Bank Holding Company Act (BHCA) provides certain exceptions to the definition of "bank" that allow a company to own or control an industrial bank without becoming a bank holding company (BHC) under the BHCA. The exceptions allow both financial and commercial companies to own and control industrial banks. *See* 12 U.S.C. 1841(c)(H). Congress expressly adopted the exceptions as part of the Competitive Equality Banking Act of 1987 (CEBA). Pub. L. 100-86, 101 Stat. 552 (Aug. 10, 1987). As a result, parent companies of industrial banks are not subject to the BHCA's activities restrictions or FRB supervision and regulation.

## Background

On February 23, 2021, the FDIC finalized a rule governing parent companies of industrial banks, codified at 12 CFR part 354.<sup>2</sup> The rule requires industrial banks and their parent organizations to comply with certain conditions and written commitments 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 that is not subject to Federal consolidated supervision. The rule also requires that before any industrial bank may become a subsidiary of such company, the company and the industrial bank must enter into one or more written agreements with the FDIC. The rule additionally requires the FDIC's prior written approval for certain actions proposed by the industrial bank, such as making a material change to its business plan. Part 354 also includes an optional contingency plan requirement that the FDIC may impose depending on the filer's business plan and other factors. The rule applies to any industrial bank that becomes a subsidiary of a Covered Company on or after April 1, 2021.

Because industrial banks are insured State nonmember banks,<sup>3</sup> they are subject to the FDIC Rules and Regulations, as well as other provisions of law, including restrictions under the Federal Reserve Act governing transactions with affiliates,<sup>4</sup> anti-tying provisions of the BHCA,<sup>5</sup> and insider lending regulations.<sup>6</sup> Industrial banks are also subject to regular safety and soundness and compliance examinations. Pursuant to section 10(b)(4) of the Federal Deposit Insurance Act (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>7</sup> The FDIC also has the authority under section 38A of the FDI Act to require companies that directly or indirectly own or control an industrial bank to serve as a source of financial strength for that institution and to require reports from a controlling company to assess its ability to comply with the source of strength requirement.<sup>8</sup>

As of June 27, 2024, there were 23 industrial banks<sup>9</sup> with \$232 billion in aggregate total assets. A significant number of the industrial banks support the commercial or specialty finance operations of their parent company. Generally, the industrial banks are funded through

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<sup>2</sup> 86 FR 10703 (Feb. 23, 2021).

<sup>3</sup> See 21 U.S.C. 1813(a)(2) ("The term 'State bank' means ... any industrial bank ...."). Historically, industrial banks have elected not to become members of the Federal Reserve System.

<sup>4</sup> See 12 U.S.C. 1828(j)(1)(A); 12 CFR part 223.

<sup>5</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(h)(1).

<sup>6</sup> See 12 CFR 337.3.

<sup>7</sup> 12 U.S.C. 1820(b)(4)(A).

<sup>8</sup> 12 U.S.C. 1831o-1(b). 12 U.S.C. 1831o-1(d).

<sup>9</sup> Of the 23 industrial banks, 15 were chartered in Utah, three in Nevada, three in California, one in Hawaii, and one in Minnesota. Under the CEBA, these states were permitted to grandfather existing industrial banks and charter new industrial banks. Colorado was also grandfathered, but it has no active industrial banks and has since repealed its industrial bank statute. Two newly established industrial banks (Nelnet Bank, Draper, Utah, and Square Financial Services, Inc., Salt Lake City, Utah) became FDIC-insured in November 2020 and March 2021, respectively. On June 20, 2024, the FDIC Board approved an industrial bank deposit insurance application for Thrivent Bank; the bank has not yet commenced operations.

non-core sources, and offer limited deposit products, a full range of commercial and consumer loans, and other banking services. For the most part, the existing industrial banks are seasoned in nature (all but two were established between 1984 and 2006), at least satisfactorily rated with a composite risk management rating of 1 or 2, and fared similarly to other types of financial institutions during previous banking crises.<sup>10</sup> Additionally, because part 354 was based upon the FDIC's historic supervisory practices, written agreements are in place for five industrial banks: two are subject to capital maintenance agreements, one is subject to a capital and liquidity maintenance agreement (CALMA), and two are subject to both CALMAs and parent company agreements.<sup>11</sup>

Since the issuance of part 354, the FDIC has received a limited number of filings for prospective industrial banks. These filings have contemplated specialty or limited purpose business models, including those where the operations of the proposed industrial bank would be closely connected to, or reliant on, the operations of the parent company or its affiliates. Some of the existing industrial banks rely to a significant extent on their parent companies or affiliates for business generation, operational aspects, and/or a variety of corporate support services. While many of the industrial banks are closely integrated with their parent organizations, they typically maintain adequate capital, have sufficient liquidity, and reflect satisfactory risk profiles. However, certain recent industrial bank proposals involving shell or captive structures failed to include a business model that is viable on a stand-alone basis, and have presented managerial, financial, and overall safety and soundness concerns. The FDIC is also concerned about whether proposals involving a business model where there is a significant degree of dependence on the parent company or affiliates, particularly with respect to the primary business functions of the proposed institution, would appropriately serve the convenience and needs of the community.

### **Statutory Authority**

The FDIC has authority to issue rules to carry out the provisions of the FDI Act,<sup>12</sup> including rules to ensure the safety and soundness of industrial banks and to protect the DIF. As deposit insurer, the FDIC has been provided the authority to grant deposit insurance to a proposed institution. In granting deposit insurance for any insured depository institution (IDI), including an industrial bank, the FDIC must assess the safety and soundness of the proposed institution, the convenience and needs of the community to be served, and the risk posed to the DIF.<sup>13</sup> The FDIC may also approve or deny a merger application from a State nonmember bank, issue a non-objection or an objection to a change in bank control notice by a State

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<sup>10</sup> During the 2008-09 financial crisis, several parent companies pursued conversions of an industrial bank to a commercial bank, which required approval of the parent company to become a BHC subject to regulation and supervision by the FRB. The conversions allowed the respective companies to access programs such as the FDIC's Temporary Liquidity Guarantee Program and the Troubled Asset Relief Program administered by the Department of the Treasury.

<sup>11</sup> Previously 10 other industrial banks (that have since merged, converted, or voluntarily liquidated) were also subject to CALMAs and/or parent company agreements. The FDIC began imposing additional prudential requirements in Orders granting Federal deposit insurance in March 2004. The FDIC described its imposition of additional prudential requirements in [FDIC: The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective – Summer 2004 Vol. 1, Issue 1.](#)

<sup>12</sup> See FDI Act §§ 9(a) and 10(g), 12 U.S.C. 1819(a)(Tenth) and 1820(g).

<sup>13</sup> See FDI Act §§ 5, 6, and 8, 12 U.S.C. 1815, 1816, and 1818.

nonmember bank, or approve a Federal savings association's conversion to a State nonmember bank based, in part, on evaluating safety and soundness, and other applicable risk factors.<sup>14</sup> In addition, as it relates to industrial banks that would be subject to part 354, the FDIC requires that Covered Companies serve as a source of financial strength for the industrial bank.<sup>15</sup>

Consistent with this authority, its role as deposit insurer, and as the appropriate Federal banking agency for industrial banks,<sup>16</sup> the FDIC possesses the necessary authority to adopt the proposed amendments to part 354. Further, the appropriateness of adopting the proposed amendments to part 354 is supported by the risks identified in recent filings, including those regarding ownership and control structures, parent company and affiliate relationships, and business models. The proposed amendments to part 354 will enhance the FDIC's supervisory processes and contribute to protecting the DIF.

## **The Proposed Rule**

### *1. Revisions to the Scope of Part 354*

#### A. Amending the definition of "Covered Company" to expressly include filings made pursuant to section 5(i)(5) of the HOLA

Part 354 applies to Covered Companies and industrial banks controlled by a Covered Company. "Covered Company" is defined in part 354 to mean "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." The effect of this definition, together with the scope provisions of section 354.1, is that industrial banks organized on or after April 1, 2021, are subject to part 354, while those organized prior to April 1, 2021, (legacy institutions) are not subject to part 354 unless a Covered Company comes to control such an industrial bank through one of the three enumerated routes. As a result, a company that controls an industrial bank that has converted from a Federal savings association charter would not be a Covered Company.

The FDIC has received a limited number of filings where the parent company would control an industrial bank as a result of a conversion pursuant to section 5(i)(5) of the HOLA.<sup>17</sup> Section 5(i)(5) allows a Federal savings association to convert to a State bank with the approval of the appropriate State bank supervisor and the appropriate Federal banking agency if the resulting State bank will meet all financial, management, and capital requirements applicable to the resulting national or State bank.<sup>18</sup> Such proposed conversions from a Federal savings association to an industrial bank, although infrequent, raise similar issues to those raised by the filings currently triggering application of part 354, namely that such conversions also would result in an industrial bank becoming a subsidiary of a company that is not subject to Federal

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<sup>14</sup> See FDI Act §§ 7(j) and 18(c), 12 U.S.C. 1817(j) and 1828(c); 12 U.S.C. 1464(i)(5).

<sup>15</sup> See 12 U.S.C. 1831o-1.

<sup>16</sup> See 12 U.S.C. 1813(q). Industrial banks may become members of the Federal Reserve System, but typically do not. All existing industrial banks are state nonmember banks, for which the appropriate Federal banking agency is the FDIC.

<sup>17</sup> 12 U.S.C. 1464(i)(5).

<sup>18</sup> 12 U.S.C. 1464(i)(5)(A), (B).

consolidated supervision. As a result, FDIC staff has determined that such conversions, if approved, should be subject to the provisions of part 354, as if part 354 applied.

Consequently, FDIC staff proposes to amend the definition of “Covered Company” to expressly include filings made pursuant to section 5(i)(5) of the HOLA. This revision would provide interested parties with clarity and transparency regarding the FDIC’s practices.

B. Change in control or merger involving the parent company of an industrial bank

The FDIC is proposing a second amendment to the definition of “Covered Company” to include companies that control an industrial bank organized before April 1, 2021, if, on or after the effective date of the amendment to the definition of “Covered Company,” there is a change in control at the parent company or there is a merger transaction in which the parent company is the resultant entity. Currently, industrial banks and their parent companies would not be subject to part 354 unless the parent company controls the industrial bank *as a result of* one of three triggering events enumerated in the “Covered Company” definition, in each case after the effective date of part 354. A gap results where there is a change in control or merger that occurs at or above the level of the parent company that results in a change in the person that controls the parent company but does not result in a change in the relationship between the industrial bank and its parent company. Similarly, if the parent company were a party to a merger in which it is the resultant entity, then new management with a new plan for the industrial bank could be installed. The parent company would continue to control the industrial bank, but not *as a result of* one of the trigger events, thus failing to make the parent company a Covered Company subject to part 354.

The FDIC has an interest in being able to review changes that impact the parent company’s control of the industrial bank. The proposed amendment would ensure that a parent company subject to such a change of control, or a parent company subject to a merger in which it is the resultant entity would be subject to part 354.

C. Applying Part 354 to any other situation where an industrial bank would become a subsidiary of a company that is not subject to Federal consolidated supervision

Finally, FDIC staff proposes an amendment that would provide the FDIC the regulatory authority to apply part 354 to any other situation (*i.e.*, transaction or matter) where an industrial bank would become a subsidiary of a company that is not subject to Federal consolidated supervision. FDIC staff also proposes to allow a company the opportunity to present its views in writing if the company does not agree with the FDIC’s determination to apply part 354 to a particular situation.

2. *Clarifying the Role of Written Commitments in Resolving Statutory Factors*

In considering recent industrial bank filings, FDIC staff has become concerned that applicants may be misinterpreting part 354 and the effects of the written commitments required under the rule as they relate to the FDIC’s assessment of the applicable statutory factors. Part 354 permits the FDIC to condition the approval of an application or non-objection to a notice on the Covered Company and industrial bank entering into written agreements and making required

commitments. CALMAs and parent company agreements are intended to protect the industrial bank and mitigate potential risks to the DIF, as well as to provide a means for the FDIC to pursue a formal enforcement action under sections 8 and 50 of the FDI Act if a party fails to comply with the agreements. However, such agreements do not replace any statutory factor applicable to the filing and will not necessarily lead to the favorable resolution of any statutory factor where the facts and circumstances are otherwise unfavorable. If a filing presents material concerns and fundamental weaknesses with respect to any statutory factor, the written agreements will not compensate for such weaknesses for purposes of resolving the statutory factor.

Consequently, FDIC staff proposes to amend section 354.4 to clarify the FDIC's implementation of part 354 to expressly address and make clear, consistent with long-standing applications processing policy,<sup>19</sup> that written agreements will be taken into account as part of the FDIC's consideration of the underlying filing, but do not replace any statutory factor applicable to the filing and will not necessarily lead to the favorable resolution of any statutory factor where the facts and circumstances are otherwise unfavorable. This position applies to the required commitments and provisions within any written agreements, the industrial bank subsidiary restrictions that are also included within part 354, and any other conditions that may be imposed as part of the FDIC's approval of, or non-objection to, a filing.

As noted in the preamble to the proposed rule, upon taking action on a filing, or if a proponent withdraws their filing during the review process, the FDIC Board of Directors may release a statement addressing the Board's views regarding the transaction if such a statement is considered to be in the public interest for purposes of creating transparency for the public and future applicants.

### 3. *Shell and Captive Industrial Bank Business Models*

Shell and captive bank business models create potentially significant supervisory concerns for industrial banks. The level of concern with these business models is inherently heightened due to the substantial reliance on the parent company or its affiliates, particularly with respect to the primary business operations of the industrial bank. This may include total or nearly exclusive reliance on the parent organization for sourcing business, conducting key operational elements (*e.g.*, underwriting, administering, or servicing customer accounts or relationships), and obtaining a wide range of critical business support services.

In shell or captive structures, the industrial bank's operations and condition may be vulnerable to any financial distress or operational disruptions at the parent company or any affiliates that provide key services to the industrial bank. The heavily integrated relationship between the industrial bank and the parent organization results in significant concentration risks that are typically not present in traditional community bank operating structures. Further, the

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<sup>19</sup> See, *e.g.*, Applications Procedures Manual (APM), Applications Overview, 1.1, <https://www.fdic.gov/regulations/applications/resources/apps-proc-manual/index.html>; APM, Standard and Non-Standard Conditions, 1.11; and Deposit Insurance Applications Procedures Manual Supplement – Applications from Non-Bank and Non-Community Bank Applicants <https://www.fdic.gov/regulations/applications/depositinsurance/procmanual-supplement.pdf>.

industrial bank generally has limited or no ability to operate independently from the parent organization and, as discussed below, lacks franchise value on a standalone basis.

The existing part 354 addresses some of the concerns mentioned above by requiring any Covered Company to enter into written agreements including specific provisions and commitments intended to ensure that the Covered Company supports the industrial bank and its ability to operate in a safe and sound manner. However, as noted above, the written agreements are not a means to favorably resolve the statutory factors or circumstances that would result in an otherwise unfavorable finding on a filing. In addition, where the primary business purpose and operations of the industrial bank are highly dependent upon the parent company, such agreements may have limited value if the parent company experiences operational or financial difficulties. Similarly, the managerial restrictions of part 354 intended to ensure the independence of the industrial bank's management may not be effective where the business purpose of the industrial bank is to support the parent company's operations because there may be direct or indirect organizational influences on business decisions from outside the industrial bank.

The proposed amendments to part 354 would incorporate additional considerations that the FDIC will undertake to determine the degree of risk presented to the industrial bank from the Covered Company and its affiliates. These considerations address the business purpose for establishing or acquiring control of the industrial bank, intercompany relationships, the regulatory and consumer compliance history and supervisory record of each relevant entity, the novelty of the Covered Company's primary businesses (including any new or innovative processes), accessibility of information, and any plans or processes that mitigate risks presented by the Covered Company.<sup>20</sup> Expanding part 354 to include these considerations provides increased transparency regarding how the FDIC evaluates potential risks and concerns presented in an industrial bank filing.

In addition, the proposed amendments to part 354 include considerations aimed at identifying shell or captive structures and presumptions the FDIC will apply as a consequence of such identification. The FDIC will review each filing covered by the rule on a case-by-case basis, on the facts and circumstances presented within the context of the applicable statutory factors to determine the degree to which the industrial bank will have an independent board and management team, a business model that is viable on a standalone basis, and franchise value that is independent of the parent company and its affiliates. The characteristics of the industrial bank and its parent organization presented in the filing will inform the FDIC's findings with respect to the statutory factors, including, for example, risk to the Deposit Insurance Fund and the impact on meeting the convenience and needs of the community.

The proposed amendments would provide that an industrial bank will be presumed to be a shell or captive institution if it: (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. The FDIC will presume that the shell or captive nature of an industrial bank will weigh heavily against favorably resolving one or more of the applicable statutory factors. However, the FDIC will

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<sup>20</sup> See proposed 12 CFR 354.6.

allow any person seeking to rebut such a presumption an opportunity to present its views in writing.

The proposed amendments to part 354 address concerns regarding the ability of industrial bank proposals to satisfy the convenience and needs statutory factor. For some industrial bank proposals involving shell or captive structures, the primary deposit and credit products are both highly dependent upon the parent company and would target the customers of the parent company. Additionally, business models that are not generally available to the members of the community absent purchasing a product by an affiliated entity raise serious questions as to whether the general community is sufficiently served to merit the grant of deposit insurance. Where a proposal for an industrial bank is presumed to be a shell or captive institution under the presumptions in proposed §354.6(c)(1), if the target market is such that the institution’s products are only available to customers of an affiliated company or a narrow segment of the community, this will weigh heavily against favorably resolving the convenience and needs statutory factor where it is a factor for consideration in the filing before the FDIC.

Finally, the proposed amendments to part 354 address the risks that shell and captive business models may present to the DIF. Addressing these risks will facilitate the FDIC’s accomplishment of its statutory mandates, including as the receiver for a failed insured depository institution (IDI). The FDIC’s experience in resolving failed IDIs, including during the 2008-2009 Financial Crisis, shows that the franchise value of an IDI has implications for the resolution options that may be available to the FDIC.

#### **Proposed Amendments to Part 354**

Staff proposes the following amendments to part 354:

<b>CFR Citation</b>	
354.2	<b>Definition of “Covered Company.”</b> Amend to include filings made pursuant to section 5(i)(5) of the HOLA; amend to scope in an existing parent company of an industrial bank if there is a change in control at the parent company or merger in which the parent company is the resultant entity; also amend to include any other type of situation where an industrial bank would become a subsidiary of a company that is not subject to Federal consolidated supervision, after an opportunity for the company to present its views in writing.
354.4(a)	<b>Required commitments and provisions of written agreement.</b> Conforming revision to include approval of conversions, and each determination of Covered Company status.
354.4(c)	<b>Written agreements.</b> Adds a provision that as applicable for each type of filing, the FDIC must evaluate the appropriate statutory factors pursuant to applicable law. The required commitments, written agreement provisions, and industrial bank subsidiary restrictions do not replace any statutory factor applicable to an underlying filing and will not necessarily lead to the favorable resolution of any statutory factor where the facts and circumstances are otherwise unfavorable.



CFR Citation	
354.6(a), (b)	<b>Additional Considerations.</b> Adds additional considerations that the FDIC will assess to determine the degree of risk presented to the industrial bank from the Covered Company and its affiliates. These considerations address the business purpose for establishing or acquiring control of the industrial bank, intercompany relationships, the regulatory and consumer compliance history and supervisory record of each relevant entity, the novelty of the Covered Company’s primary business (including any new or innovative processes), accessibility of information, and any plans or processes that mitigate risks presented by the Covered Company.
354.6(c)(1)	<b>Rebuttable presumption of shell or captive character of industrial bank.</b> Adds considerations aimed at identifying shell or captive structures, and sets out a rebuttable presumption of being deemed a shell or captive industrial bank. An industrial bank will be presumed to be a shell or captive institution if it: (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.
354.6(c)(2)	Creates a rebuttable presumption that the shell or captive nature of an industrial bank involved in a filing weighs heavily against favorably resolving one or more applicable statutory factors.
354.6(c)(3)	The presumptions may be rebutted in writing and FDIC will suspend consideration of any related filings, time periods shall toll, and transactions shall not be consummated during such time.

## Conclusion

The FDIC’s existing framework of supervision, coupled with part 354 in its revised form as proposed,<sup>21</sup> is expected to continue to protect industrial banks and the DIF from potential risks related to parent company and affiliate relationships. The proposal would also provide interested parties with clarity and transparency regarding the FDIC’s practices when making determinations on certain filings involving industrial banks.

Staff recommends that the Board adopt the attached proposed rule and authorize its publication in the *Federal Register* with a 60-day comment period.

## Staff Contacts

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<sup>21</sup> Part 354 applies prospectively to Covered Companies and is not applicable for existing industrial banks, absent any new filing or transaction related to the industrial bank that would be subject to the rule.