DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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FDIC RELEASES PROPOSED ILC RULEMAKING; APPROVES SQUARE AND NELNET

The FDIC is seeking comments on a proposed rule that would require certain conditions and commitments for each deposit insurance application approval, merger application approval and non-objection to a change in control application that would result in an insured industrial bank or industrial loan company (ILC) (together "industrial banks") becoming a subsidiary of a parent company that is not subject to consolidated supervision by the Federal Reserve Board (FRB). Generally, the proposal seeks to codify current supervisory processes used for ILCs not subject to FRB supervision. Comments will be accepted on the rule until 60 days after the date of publication in the Federal Register.

The stated goals for the rule are: (i) to ensure that the parent of a covered industrial bank approved for deposit insurance would serve as the source of strength for the industrial bank and (ii) to provide transparency to future applicants and the broader public as to what the FDIC requires of parent companies of covered industrial banks.

The Rule would prohibit any industrial bank from becoming a subsidiary of a covered company unless the covered company enters into one or more written agreements with the FDIC and its subsidiary industrial bank. In such agreements, the covered company would make certain required commitments to the FDIC and the industrial bank. The proposed commitments include the following:

(1) Furnish to the FDIC an initial listing, with annual updates, of all subsidiaries;

(2) Consent to FDIC examination to monitor compliance with written agreements, commitments, conditions and certain provisions of law;

(3) Submit to the FDIC an annual report and such other reports as the FDIC may request;

(4) Maintain such records as the FDIC deems necessary to assess risk to the industrial bank and to the Deposit Insurance Fund;

(5) Cause an independent annual audit of each subsidiary industrial bank;

(6) Limit representation on the industrial bank's board of directors to 25 percent of the members of the board, or if the bank is organized as a limited liability company and is managed by a board of managers, to 25 percent of the members of the board of managers, or if the bank is organized as a limited liability company and is managed by its members, to 25 percent of managing member interests;

(7) Commit to maintain capital and liquidity as the FDIC deems necessary for the safe and sound operation of the industrial bank; and

(8) Enter into a tax allocation agreement that expressly recognizes an agency relationship between the parent and the industrial bank with respect to tax assets generated by the bank.

The rule would also implement restrictions on industrial banks, including obtaining the FDIC's prior approval to (i) make a material change in its business plan; (ii) add or replace a member of the board of directors or board of managers or a managing member; (iii) add or replace a senior executive officer; (iv) employ a senior executive officer who is associated in any manner with an affiliate of the industrial bank or (v) enter into any contract for material services with the covered company or a subsidiary thereof.

After releasing the Proposed Rulemaking, regulators approved two industrial banks: Square and Nelnet. Square's bank, expected to launch in 2021, will be governed by the FDIC and the Utah Department of Financial Services. Square Financial Services, Inc., the name of the bank, will offer small-business loans to those merchants. Nelnet is a student-loan servicer based in Nebraska.

Additionally, e-commerce company Rakuten (a shopping platform focusing on consumer rebates) withdrew its application for an industrial bank but plans to re-file with the FDIC in the coming months. ❑

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