Sivon, Natter & Wechsler, P.C.
ATTORNEYS AT LAW
WASHINGTON, D.C.

The FDIC's Supervision of Industrial Banks

James Sivon*
May 2022

Introduction

Members of Congress, State and Federal banking regulators, trade groups, and consumer organizations have debated the regulation of industrial banks for over thirty years.[1] This debate revolves around two issues: the ownership of industrial banks by commercial companies and the ability of the Federal Deposit Insurance Corporation ("FDIC") to supervise industrial banks and their parent companies adequately.

This paper addresses the second issue: the FDIC's supervision of industrial banks and their parent companies. The paper has five sections. Section I is an executive summary. Section II provides background information on the origins, activities, and regulation of industrial banks. Section III describes the alternative approaches to supervision by the FDIC and the Federal Reserve Board (the "Board") and debate over the relative merits of those approaches to the supervision of industrial banks and their parent companies. Section IV is a detailed comparison of the supervisory powers of the FDIC and the Board. Section V is a conclusion.

I. Executive Summary

In the 1980's, Congress passed two laws that materially changed the regulatory framework for industrial banks. Federal deposit insurance was authorized for industrial banks, and the parent companies of industrial banks were expressly exempted from regulation by the Board as bank holding companies. With these changes, financial and commercial companies that owned industrial banks were able to offer banking products and services to consumers and businesses without changing their business models.

The subsequent growth in the number and total assets of industrial banks led to efforts by Members of Congress to limit access to industrial bank charters, especially by non-financial commercial companies. Such efforts continue today. As part of these efforts, it has been asserted that the FDIC's "bank-centric" approach to supervision is not equivalent to the Board's "consolidated" supervision of a bank holding company, and, as a result, industrial banks could pose undue risks to the FDIC's Deposit Insurance Fund (the "DIF").

This paper compares these two, alternative approaches to bank supervision. The comparison takes into consideration the supervisory powers of the FDIC in the Federal Deposit Insurance Act (the "FDI Act") and a regulation the FDIC issued in 2021 that imposes additional conditions on industrial banks and their parent companies. The

*James Sivon is the senior partner in the Washington, DC-based law firm of Sivon, Natter & Wechsler, P.C., which specializes in financial services law and policy.
[1] Industrial banks also are called "industrial loan companies" or "ILCs."

© 2022 James Sivon All rights reserved.

comparison shows that the FDIC's bank-centric approach to supervision is just as effective in addressing potential risks to the DIF as the Board's consolidated approach.

More specifically, the comparison shows that:

The FDIC's supervisory authority over industrial banks is broader than the Board's powers over banking subsidiaries of bank holding companies. As the primary federal regulator and insurer for industrial banks, the FDIC has the authority to conduct regular, on-site examinations of industrial banks, and to receive quarterly reports on the condition of industrial banks. In contrast, the Board must defer to examinations and reports prepared by, or for, other regulators unless a bank is a member of the Federal Reserve System. The FDIC also has the exclusive authority to grant and withdraw deposit insurance for industrial banks.

The FDIC's supervisory powers over the affiliates of an industrial bank, including a parent company, are comparable to the Board's. Like the Board, the FDIC requires the parent of an industrial bank to identify each of its subsidiaries and to provide information on the company's financial condition and risk controls. Like the Board, the FDIC may examine the parent and other affiliates of an industrial bank, and the FDIC's authority is supplemented by the FDIC's subpoena power and state examinations of the parents of industrial banks.

The FDIC imposes restrictions on transactions between an industrial bank and its affiliates that the Board does not impose on bank holding companies. Financial transactions between an industrial bank and its affiliates are subject to the same prudential limits as transactions between a bank and a bank holding company. The FDIC also requires prior review of any services an affiliate may provide to an industrial bank, and the FDIC limits management interlocks between an industrial bank and its parent to help maintain the independence of the industrial bank. The Board does not impose either of these restrictions on bank holding companies.

Since the enactment of the Dodd-Frank Act in 2010, the parent company of an industrial bank must serve as a source of financial strength for the bank, just as a bank holding company must serve as a source of financial strength for a subsidiary bank. The FDIC may use this requirement to order the parent company of an industrial bank to maintain capital and liquidity resources sufficient to support the operations of the bank and mitigate risks to the DIF. Additionally, the FDIC has the authority to bring an enforcement action against the parent of an industrial bank and any other affiliates of that bank that participate in the affairs of the bank.

Given the scope of these authorities, the debate over the adequacy of the FDIC's bank-centric approach to supervising industrial banks and their parent companies rings hollow and should not serve as a basis for restricting access to an industrial bank charter.

II. The Origins, Activities, and Regulation of Industrial Banks

Industrial banks originated in the early 1900's as state-chartered consumer loan companies. They were established to provide loans to low- and moderate-income industrial

© 2022 James Sivon All rights reserved.

workers who were unable to obtain credit from commercial banks. Today, industrial banks operate in the states of California, Hawaii, Minnesota, Nevada, and Utah. They offer a full range of consumer and commercial loans, but do not accept demand deposits (checking accounts). However, they may offer NOW accounts to customers, which are a functional equivalent of a checking account from a customer's perspective.[2]

Industrial banks are subject to supervision by the FDIC and their chartering state.[3] Industrial banks also are subject to the same laws applicable to all FDIC-insured banks, including the Bank Secrecy Act (anti-money laundering), the Community Reinvestment Act, federal consumer protection laws (e.g., the Truth in Lending Act, the Equal Credit Opportunity Act, the Real Estate Settlement Procedures Act), and the restrictions on transactions with affiliates contained in Sections 23A and 23B of the Federal Reserve Act.

Two laws enacted in the 1980's materially changed the federal regulation of industrial banks. In 1982, Congress amended the FDI Act to permit industrial banks to apply for FDIC deposit insurance, provided the banks were subject to regulation and supervision comparable to a commercial bank. Before that change, the FDIC had granted deposit insurance to industrial banks on a case-by-case basis.[4]

In 1987, Congress amended the definition of the term "bank" in the Bank Holding Company Act ("BHC Act") to exclude industrial banks that are chartered by certain states and meet certain operating conditions.[5] As a result of this amendment, the parent company of an industrial bank is not subject to the restrictions on activities imposed by the BHC Act or to supervision by the Board.[6] This change effectively enables any company, including a company engaged in non-financial commercial activities, to own an industrial bank.

The combination of these two laws made the industrial bank charter attractive to both financial and commercial companies. Between 1987 and 2006, the total assets held by industrial banks increased from $4.2 billion to $213 billion, and between 2000 and 2006, twenty-four industrial banks obtained insurance from the FDIC. As of January 2007, fifty-eight industrial banks were in operation, primarily in the states of Utah and California.[7]

---

[2] The limitation on the acceptance of demand deposits is based upon state laws that prevented industrial banks from accepting deposits. A NOW account gives an industrial bank the right to require at least 7 days' notice prior to the withdrawal of a deposit. In practice, an industrial bank may waive this right.
[3] As a state-chartered bank, an industrial bank may elect to be a member of the Federal Reserve System, which would make the Board, rather than the FDIC, the primary federal regulator for the industrial bank. Currently, no industrial bank is a member of the Federal Reserve System.
[4] Mindy West, *The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective*, FDIC Supervisory Insights, Summer 2004.
[5] The 1987 Competitive Equality Banking Act amended the definition of the term "bank" in the Bank Holding Company Act to exclude an industrial bank that: (1) is chartered in a state that required FDIC insurance on March 5, 1987; and (2) is subject to the following operating conditions: (i) it does not accept demand deposits; (ii) has less than $100 million in assets; or (iii) it has not been acquired by another company since August 10, 1987. The states that required an industrial bank to have FDIC insurance as of March 5, 1987, are California, Colorado, Hawaii, Minnesota, Nevada, and Utah. Colorado has since repealed its industrial bank statute, and there are no industrial banks operating in the state.
[6] Under the Bank Holding Company Act, the parent of a "bank" is classified as a "bank holding company" and may engage only in activities that are closely related to banking.
[7] Parent Companies of Industrial Banks and Industrial Loan Companies, 86 Fed. Reg. 10703, 10705 (Feb. 23, 2021).

© 2022 James Sivon All rights reserved.

Currently, there are twenty-five industrial banks in operation. This reduction in the number of industrial banks since 2007 is the result of many factors, including mergers, conversions, and voluntary liquidations.[8] It also reflects efforts to restrict access to industrial bank charters, which resulted in moratoriums imposed by the FDIC and the Congress on deposit insurance for industrial banks controlled by non-financial commercial companies.[9]

III. Same or Different: The Debate Over Supervision of Industrial Banks

The FDIC and the Board approach supervision from different directions. The FDIC applies a bank-centric or bank-up approach to supervising industrial banks and their affiliates, including the parent company.[10] This supervisory approach focuses on isolating the insured bank from potential risks posed by a parent company and other affiliates of the bank. It includes restricting transactions between an industrial bank and its affiliates and examining any affiliate of the industrial bank to determine the nature of the relationship between the affiliate and the industrial bank and its potential impact on the industrial bank. State banking authorities supplement the FDIC's supervision of industrial banks and their parent companies.[11]

In contrast, the Board follows a top-down or consolidated approach to supervising bank holding companies and their subsidiaries. The Board's approach is intended to give the Board an understanding of the organization's structure, activities, resources, and risks before they pose a danger to the bank holding company and its subsidiary depository institutions.[12] Consolidated supervision of bank holding companies supplements the authority the primary federal or state bank supervisor has over the company's subsidiary depository institutions. It includes the authority to examine and obtain reports from bank holding companies and each of their subsidiaries and to establish consolidated capital requirements for bank holding companies.

The alternative approaches to supervision by the FDIC and the Board share a common goal – protecting the insured bank and the DIF. Yet, in the years before the passage of the Dodd-Frank Act in 2010, there was an active debate over the merits of the two approaches. The Board, for example, asserted that the FDIC's approach to supervising industrial banks was not as comprehensive as the Board's supervision of bank holding

---

[8] *Id.*

[9] The FDIC self-imposed a moratorium on deposit insurance applications for commercially owned industrial banks between July 2006 and January 2008, and Congress imposed a statutory moratorium on such applications between 2010 and 2013 pursuant to Section 603(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

[10] Christine E. Blair, *The Future of Banking in America the Mixing of Banking and Commerce: Current Policy Issues*, FDIC Banking Review, Volume 16, No. 3 (2004).

[11] *See* Testimony of G. Edward Leary, Commissioner of Financial Institutions, State of Utah, before the Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Servicers, U.S. House of Representatives, July 12, 2006. ("The evolving supervisory approaches of Utah and the FDIC have helped finetune processes and procedures that insulate an insured depository institution from potential abuses and conflicts of interest by a non-federally supervised parent. Critical controls have been developed as the result of cooperation between Utah regulators and the FDIC.").

[12] Federal Reserve Board, SR Letter 08-9, "Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations" (Oct. 16, 2008).

© 2022 James Sivon All rights reserved.

companies, and that this difference created competitive disparities and placed industrial banks and the DIF at risk.[13]

Additionally, a report on the supervision of industrial banks prepared by the U.S. Government Accountability Office ("GAO") recommended that Congress "consider" subjecting industrial banks and their affiliates to consolidated supervision.[14] GAO made this recommendation even though it found that "from an operations standpoint, [industrial banks] do not appear to have a greater risk of failure than other types of insured depository institutions."[15] In support of this recommendation, GAO cited the scope of FDIC's authority to examine the parent and other affiliates of an industrial bank. That authority is based upon "relationships" between the bank and its parent and other affiliates. In response to the 2005 GAO Report, the Chairman of the FDIC, Donald E. Powell, called bank-centric supervision a "proven model" for protecting the DIF, and he stated that GAO mischaracterized the scope of the FDIC's authority to examine the parent and other affiliates of an industrial bank. That examination authority, he noted, "is not dependent upon any particular kind of relationship, nor it is limited to discrete actions between [an industrial bank] and its affiliate."[16]

The 2005 GAO Report also based its recommendation for consolidated supervision on the absence of any express authority for FDIC to impose a capital requirement on the parent of an industrial bank. This issue, however, was addressed five years later in the Dodd-Frank Act.[17] Section 616 of the Dodd-Frank Act amended the FDI Act to require any company that controls an industrial bank to serve as a source of financial strength for the industrial bank.[18] The source of strength amendment empowers the FDIC to require the parent company of an industrial bank to have sufficient financial resources, including

---

[13] *See* Testimony of Scott Alvarez, General Counsel, Federal Reserve Board, before the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate, October 4, 2007.
[14] U.S. Gov't Accountability Off., GAO-05-621, Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority (Sept. 2005), hereinafter, the "2005 GAO Report."
[15] *Id.* at 8-9.
[16] *Id.* at Appendix III.
[17] Congressman Barney Frank (D-MA) originally proposed the source of strength provision in 2007 as part of a bill that addressed the FDIC's authority to supervise industrial banks and their parent companies. That bill, H.R. 698, which was co-sponsored by Congressman Paul Gillmor (R-OH), also would have limited the ownership of industrial banks by commercial firms by prohibiting any company from establishing or acquiring an industrial bank if the company derived more than 15 percent of its revenue, on a consolidated basis, from non-financial activities. The bill was approved by the House of Representatives by a vote of 371-16, but not enacted into law. A similar bill was introduced in the Senate in 2007 by Senator Sherrod Brown (D-OH), S. 1356. The co-sponsors of that bill included Senator John Thune (R-SD), Senator Bernie Sanders (I-VT), Senator Jon Tester (D-MT), and Senator Barack Obama (D-IL).
[18] Section 603 of the Dodd-Frank Act also imposed a three-year moratorium on the approval of deposit insurance and change in control applications that would result in the ownership of an industrial bank by a commercial company and directed the GAO to study the exemption for industrial banks (and other institutions) contained in the Bank Holding Company Act. That GAO report provided data on industrial banks, explained how they are supervised, and surveyed both regulators and industry participants on the likely effects of removing the exemption in the Bank Holding Company Act, but did not make any recommendations regarding the supervision of industrial banks. *See* U.S. Gov't Accountability Off., GAO-12-160, Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions (Jan. 2012).

© 2022 James Sivon All rights reserved.

capital, to support the industrial bank. This requirement supplemented the FDIC's pre-existing authority to require the parent of an industrial bank to enter into a capital and liquidity maintenance agreement ("CALMA") to support a subsidiary industrial bank. Such agreements contractually obligate the bank's parent to ensure that the bank maintains sufficient capital and liquidity and to inject capital or liquidity if the bank's capital or liquidity falls below a certain threshold.

Moreover, as a practical matter, the parents of industrial banks hold more capital than bank holding companies. In a 2012 report, the GAO found that between 2006 and 2010, the average equity-to-total-assets ratio for the parents of industrial banks was approximately 30 percent. In comparison, the average equity-to-total-assets ratio for bank holding companies during that period was approximately 10 percent.[19]

In 2020, in response to the continued interest in industrial bank charters by both financial and commercial firms, the FDIC proposed a regulation (the "Industrial Bank Rule") that addressed the supervision of industrial banks and their parent companies.[20] In the Industrial Bank Rule, the FDIC proposed to codify practices used by the agency in supervising industrial banks and their parent companies.[21] The FDIC finalized the Industrial Bank Rule in February 2021, and it became effective April 1, 2021.[22]

The Industrial Bank Rule applies to newly formed industrial banks that apply for deposit insurance from the FDIC as well as existing industrial banks that submit merger or change in control applications to the FDIC. The centerpiece of the Industrial Bank Rule is a requirement that an industrial bank and its parent company make written commitments to ensure the safe and sound operation of the industrial bank and mitigate risks to the DIF.

In connection with an application for deposit insurance or a change in control or merger application, the Industrial Bank Rule requires an industrial bank's parent company[23] to agree to the following:

---

[19] U.S. Gov't Accountability Off., GAO-12-160, Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions 24 (Jan. 2012).

[20] Parent Companies of Industrial Banks and Industrial Loan Companies, 85 Fed. Reg. 17771 (March 31, 2020). The FDIC also had proposed a regulation in early 2007 to address the supervision of industrial banks owned by financial companies that were not supervised by the Board or the Office of Thrift Supervision, but that proposed regulation was never finalized. *See* Industrial Bank Subsidiaries of Financial Companies, 72 Fed. Reg. 5217 (Feb. 5, 2007).

[21] In 2020, shortly before the release of the proposed Industrial Bank Rule, the FDIC approved two applications for deposit insurance for two industrial banks, Nelnet Bank and Square Financial Services. Those approval orders are illustrative of the types of conditions the FDIC imposed on industrial banks and their parent companies prior to the promulgation of the Industrial Bank Rule. *See* FDIC Order Approving Application for Deposit Insurance for Square Financial Services, Inc., March 17, 2020, and FDIC Order Approving Application for Deposit Insurance for Nelnet Bank, March 17, 2020.

[22] 12 C.F.R. pt. 354; 86 Fed. Reg. 10703 (Feb. 23, 2021).

[23] The FDIC also may require an individual who is the controlling shareholder of a parent company to join in these commitments. For example, in its approval of the deposit insurance application filed by Square Financial Services, Inc. the FDIC required that Jack Dorsey, as the controlling shareholder of Square, Inc., enter into a Capital and Liquidity Maintenance Agreement and a Parent Company Agreement.

© 2022 James Sivon All rights reserved.

- Submit to the FDIC an initial list of all the company's subsidiaries and update that list annually;

- Consent to FDIC examination of the company and each of its subsidiaries to permit the FDIC to assess compliance with the provisions of any written agreement, commitment, or condition imposed; the FDI Act; or any other Federal law for which the FDIC has specific enforcement jurisdiction against the company or subsidiary; and all other relevant laws and regulations;

- Submit to the FDIC an annual report describing the company's operations and activities, including the company's: (1) financial condition; (2) systems for identifying, measuring, monitoring, and controlling financial and operational risks; (3) transactions with depository institution subsidiaries of the Covered Company; and (4) compliance with applicable provisions of the FDI Act and any other law or regulation;

- Maintain such records as the FDIC may deem necessary to assess the risks to the subsidiary industrial bank or to the DIF;

- Cause an independent audit of each industrial bank subsidiary to be performed annually;

- Limit the company's direct or indirect representation on the industrial bank's Board of Directors to less than 50% of the members of such Board of Directors;

- Maintain the capital and liquidity of the subsidiary industrial bank at such levels as the FDIC deems appropriate, and take such other actions as the FDIC deems appropriate to provide the industrial bank with a resource for additional capital and liquidity; and

- Execute a tax allocation agreement with its subsidiary industrial bank that expressly states that an agency relationship exists between the company and the industrial bank with respect to tax assets generated by such industrial bank, and that all such tax assets are held in trust by the company for the benefit of the industrial bank and will be promptly remitted to such industrial bank.

Additionally, under the Industrial Bank Rule, the FDIC may require the parent company and the industrial bank to establish and implement a contingency plan that sets forth, at a minimum, recovery actions to address significant financial or operational stress that could threaten the safe and sound operation of the industrial bank and one or more strategies for the orderly disposition of such industrial bank without the need for the appointment of a receiver or conservator.

The FDIC's reliance on written commitments in the Industrial Bank Rule is not unusual. Commitments made in connection with an application are used routinely by the federal banking agencies, including the Board. Two sections of the FDI Act give the agency

© 2022 James Sivon All rights reserved.

the authority to enforce these commitments, Sections 8 and 50.[24] The FDI Act also gives the FDIC the authority to issue regulations that ensure the safety and soundness of industrial banks and to protect the DIF.[25] Furthermore, federal courts have recognized that the determination of what constitutes safety and soundness is a matter committed to the expertise of banking regulators.[26]

IV. Comparing the FDIC's Supervision of Industrial Banks to the Board's Consolidated Supervision of Bank Holding Companies

The issuance of the Industrial Bank Rule did not end the debate over the regulation of industrial banks. Members of Congress, banking trade groups, and consumer organizations continue to express concerns over the FDIC's ability to supervise industrial banks and their parent companies.[27] A comparison of the supervisory approaches of the FDIC and the Board shows that these concerns are unwarranted.

The following comparison takes into consideration the full array of powers available to the FDIC. Those powers are the provisions of the Industrial Bank Rule as well as the FDIC's other supervisory powers under the FDI Act, including the source of strength amendment made by the Dodd-Frank Act. The comparison first explains the Board's supervisory powers and then explains the FDIC's supervisory powers. Appendix A summarizes the comparison.

Bank Examinations and Reports on a Bank's Condition

Board: The Board has the authority to examine and receive reports from a banking subsidiary of a bank holding company.[28] However, the Board's use of these powers is qualified. The Board must rely "to the fullest extent possible" on reports and examinations conducted by other Federal and State regulators and must avoid duplications of reports and examinations "to the fullest extent possible." This limitation does not apply to state banks that are members of the Federal Reserve System for which the Board is the primary federal regulator. However, as of December 31, 2021, less than 20 percent of the state-chartered banks insured by the FDIC were members of the Federal Reserve System.[29]

---

[24] 12 U.S.C. § 1818 (Section 8) and 12 U.S.C. § 1831aa (Section 50).
[25] 12 U.S.C. § 1820(g).
[26] *See* Groos National Bank v. Comptroller of the Currency, 573 F2d 998 (5th Cir. 1978) and First National Bank of Lamarque v. Smith, 610 F.2d 1258, 1265 (5th Cir. 1980).
[27] *See* H.R. 5912, The Close the ILC Loophole Act, introduced by Rep. Garcia (D-IL) on November 9, 2021. *See also* letter to Rep. Garcia from John Ryan, President, Conference of State Bank Supervisors, November 15, 2021 ("State regulators believe the joint supervisory approach to overseeing ILCs with the FDIC has been effective in ensuring that ILCs with commercial parents do not present an outsized safety and soundness risk."), and letter to Representatives Maxine Waters and Patrick Henry, April 5, 2022, from banking trade associations and consumer organizations ("ILCs operate under a special exemption in federal law that permits any type of organization — including a large technology company or commercial firm — to control a full-service FDIC-insured bank without being subject to the same oversight and prudential standards or limitations on the mixing of banking and commerce that Congress has established for the U.S. financial system.")
[28] 12 U.S.C. § 1844(c).
[29] As of December 31, 2021, there were 3484 state-chartered banks insured by the FDIC, 2816 were state non-member banks and 668 were state member banks. *See* FDIC Quarter Banking Profile, Fourth Quarter 2021, Table III-C.

© 2022 James Sivon All rights reserved.

FDIC: As the primary federal regulator for an industrial bank, the FDIC is required to conduct a full-scope, on-site examination of an industrial bank on an annual basis.[30] The FDIC must coordinate examinations with other Federal and State agencies and may agree to alternative annual examinations with a state banking authority if the FDIC determines that the State examination would be comparable. An industrial bank also must submit reports to the FDIC on its financial condition.[31]

Examinations of a Parent Company and Affiliates

Board: The Board has the authority to examine a bank holding company and its non-banking subsidiaries.[32] However, like the Board's power to examine the banking subsidiary of a bank holding company, the Board must rely "to the fullest extent possible" on examinations of non-banking subsidiaries conducted by other Federal and State regulators.

The BHC Act specifies the scope of the examinations conducted by the Board. The Act provides that the Board may examine: (1) the "nature" of the operations and financial condition of the bank holding company and the subsidiary; and (2) the financial, operational, and other risks within the bank holding company system that may pose a threat to (i) the safety and soundness of the bank holding company or of any depository institution subsidiary of the bank holding company; or (ii) the stability of the financial system of the United States.

FDIC: The FDIC has the statutory authority to examine any non-banking affiliate of an industrial bank, including a parent company, and, unlike the Board, the FDIC is not required to defer to other regulators in conducting such examinations.[33] The FDI Act provides that such examinations disclose fully the "relationship" between the industrial bank and any such affiliate, and the effect of such "relationship" on the industrial bank.[34] As noted above, the FDIC has interpreted this authority broadly. In its response to the 2005 GAO Report, the FDIC stated that "the authority is not dependent upon any particular kind of relationship, nor it is limited to discrete actions between [an industrial bank] and its affiliate."[35]

Additionally, the FDIC's statutory authority to examine relationships between an industrial bank and its affiliates is supplemented by: (1) the FDIC's authority to use its statutory subpoena and investigative powers to obtain information from any affiliate of an industrial bank, including the parent of an industrial bank;[36] (2) the Industrial Bank Rule, which requires the parent of an industrial bank and its subsidiaries to submit to FDIC

[30] 12 U.S.C. § 1820(d). Smaller banks may be examined on an 18-month cycle.
[31] 12 U.S.C. § 1817(a).
[32] 12 U.S.C. § 1844(c). Section 26 of the FDI Act, as added by the Dodd-Frank Act (12 U.S.C. §1831c), also gives the Board the authority to examine nonbank subsidiaries of depository institution holding companies, other than subsidiaries that are functionally regulated (e.g., broker/dealers, insurance companies, and investment companies).
[33] 12 U.S.C. §§ 1820(b)(4)(A) and 1831v(b).
[34] 12 U.S.C. § 1820(b)(4)(A).
[35] The 2005 GAO Report, Appendix III.
[36] 12 U.S.C. §§ 1818(n) and 1820(c).

© 2022 James Sivon All rights reserved.

examinations to assess compliance with the provisions of the Industrial Bank Rule and applicable law;[37] and (3) examinations of parent companies by State banking authorities.[38]

Reports on Parent Company and Affiliates

Board: The Board may require reports from a bank holding company and each subsidiary about its financial condition, systems for monitoring and controlling financial and operating risks, transactions with banking subsidiaries, and compliance with applicable law.[39] Again, this authority is qualified by a requirement that the Board rely "to the fullest extent possible" on reports prepared by other Federal and State regulators.

FDIC: The Industrial Bank Rule requires the parent of an industrial bank to identify each of the company's subsidiaries, and to file an annual report that provides information not only on its financial condition, systems for monitoring and controlling financial and operating risks, transactions with banking subsidiaries, and compliance with applicable law, but also on its systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information.[40] Additionally, the Industrial Bank Rule requires the parent of an industrial bank to maintain such other records as the FDIC may deem necessary to assess the risks to the subsidiary industrial bank or to the Deposit Insurance Fund.[41] In exercising these authorities, the FDIC, like the Board, must rely upon reports prepared for other Federal or State regulators.[42]

Transactions with Affiliates

Board: The Board has the authority to monitor and enforce compliance with the restrictions on transactions between a bank and its affiliates imposed by Sections 23A and 23B of the Federal Reserve Act.[43] However, since the Board must defer to reports and examinations by other Federal and State regulators, it is likely that another regulator would detect and enforce such violations, unless the bank is a state bank that is a member of the Federal Reserve System.

FDIC: As the primary federal regulator for an industrial bank, the FDIC also has the authority to monitor and enforce compliance with the affiliate transaction restrictions imposed by Sections 23A and 23B of the Federal Reserve Act.[44] Additionally, since enactment of the Dodd-Frank Act, the FDIC shares responsibility with the Board for granting exemptions to the 23A and 23B restrictions for state-chartered banks.[45]

---

[37] 12 C.F.R. § 354.4(a)(2).
[38] For example, Utah subjects the parent company of an industrial bank to examination by the state's Department of Financial Institutions. *See* Section 7-1-501 of the Utah Code.
[39] 12 U.S.C. § 1844(c).
[40] 12 C.F.R. §§ 354.4(a)(1), (a)(3).
[41] 12 C.F.R. § 354.4(a)(4).
[42] 12 U.S.C. § 1831v(a).
[43] Section 23A of the Federal Reserve Act (12 U.S.C. § 371c) imposes quantitative limits credit and other transactions between a bank and its affiliates. Section 23B of the Federal Reserve Act (12 U.S.C. § 371c-1) requires that transactions between a bank and its affiliates be on market terms.
[44] 12 U.S.C. § 1828(j).
[45] Prior to the passage of the Dodd-Frank Act, the Board had unilateral authority to grant, by regulation or order, exemptions to the affiliate transaction restrictions imposed by Sections 23A and 23B. In response to

© 2022 James Sivon All rights reserved.

Capital Requirements

Board: The Board is authorized to issue regulations and orders imposing capital requirements on bank holding companies but may not impose a capital requirement on a functionally regulated subsidiary (e.g., a broker/dealer, investment company, or insurance company) that is subject to a capital requirement by another regulator.[46]

FDIC: Since the enactment of the Dodd-Frank Act the FDIC has had explicit statutory authority to require the parent of an industrial bank to serve as a source of financial strength for an industrial bank.[47] This authority permits the FDIC to order the parent of an industrial bank to maintain capital and liquidity resources sufficient to support the operations of the bank and mitigate risks to the DIF. The FDIC also has used its authority under Sections 8 and 50 of the FDI Act to require CALMAs from the parties that control industrial banks. For example, in its approval of Square Financial Inc.'s industrial bank application, the FDIC required the bank's parent company (Square, Inc.) and the controlling shareholder of that company to execute a CALMA.

Additionally, the Industrial Bank Rule requires the parent company to commit to maintain the capital and liquidity of a subsidiary industrial bank at such levels as the FDIC deems appropriate, and to take such other actions as the FDIC deems appropriate to provide the subsidiary industrial bank with a resource for additional capital and liquidity.[48] In the case of parent company located outside the United, the FDIC may require the company to hold capital and liquidity resources in the United States to support the subsidiary industrial bank.[49]

Parent Company's Source of Strength Requirement

Board: Bank holding companies are subject to a statutory requirement to serve as a source of financial strength for subsidiary banks.[50] The Board also has the authority to require reports from a controlling company for the purposes of assessing the ability of the company to comply with the source of strength requirement and enforcing compliance with the requirement. However, the Board may not require a functionally regulated subsidiary of a bank holding company (i.e., a broker/dealer, insurance company, or registered investment advisor) to provide financial support to a bank affiliate if the regulator for the functionally regulated subsidiary objects.[51] In that event, the Board may order the bank holding company to divest its subsidiary bank.

FDIC: As noted above, the FDIC also has the authority to require a parent of an industrial bank to as a serve source of financial strength for the industrial bank.[52] Like the

---

criticism of the Board's use of this authority, Congress gave the FDIC joint authority over exemptions involving State chartered banks in section 608 of the Dodd-Frank Act.

[46] Section 171 of the Dodd-Frank Act (12 U.S.C. § 5371) and Section 5(c)(3) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(3)).

[47] 12 U.S.C. § 1831o-1.

[48] 12 C.F.R. § 354.4(a)(7).

[49] 86 Fed. Reg. 10723 (Feb. 23, 2021), note 129.

[50] 12 U.S.C. § 1831o-1.

[51] 12 U.S.C. §1844(g).

[52] 12 U.S.C. § 1831o-1.

© 2022 James Sivon All rights reserved.

Board, the FDIC may require reports from a parent company to assess the ability of the company to comply with the requirement and to enforce compliance with the requirement. Also, like the Board, the FDIC may not require a functionally regulated subsidiary of a parent company to provide financial support to an affiliated industrial bank but may require the divestiture of an industrial bank if the bank is significantly undercapitalized.[53]

Deposit Insurance

FDIC: The FDIC has the exclusive authority to grant deposit insurance coverage for any bank, including an industrial bank.[54] In granting deposit insurance, the FDIC must consider several factors including: (1) the financial condition of the bank; (2) the capital adequacy of the bank; (3) the earning potential of the bank; and (4) the fitness of management.

The FDIC also has the exclusive authority to exercise the ultimate penalty on an industrial bank, the termination of deposit insurance.[55] Since industrial banks must have deposit insurance, the termination of deposit insurance results in the closure of the bank. The FDIC may use this power if it finds that: (1) the industrial bank is engaging in unsafe or unsound practices; (2) the industrial bank is in an unsafe or unsound condition to continue to operate as an insured institution; or (3) the directors of the industrial bank have violated any applicable law, regulation, or condition imposed in writing by the FDIC in connection with the approval of an application.

Services Provided by an Affiliate to the Bank

Board: Board regulations permit a bank holding company to acquire or establish a company that provides services to an affiliated bank without any prior notice or review by the Board or a regional Federal Reserve Bank.[56]

FDIC: The Industrial Bank Rule requires an industrial bank to receive the prior approval of the FDIC before it can enter a contract for any material service from a parent company or any subsidiary of the parent company.[57]

Privacy and Information Security

Board: Banks and bank holding companies are subject to limitations on information sharing with nonaffiliated third parties and must disclose information sharing policies and practices to consumers and customers. They also must develop, implement, and maintain comprehensive information security programs.[58]

FDIC: Industrial banks and financial parents of industrial banks (e.g., insurance companies and securities firms) are subject to the same privacy and information security

[53] 12 U.S.C. §§ 1831v(a) and 1831o.
[54] 12 U.S.C. §§ 1815 and 1816.
[55] 12 U.S.C. § 1818.
[56] 12 C.F.R. § 225.22(b).
[57] 12 C.F.R. § 354.5(e).
[58] 15 U.S.C. § 6801 et. seq.

© 2022 James Sivon All rights reserved.

requirements that are applicable to bank holding companies and their banking subsidiaries. While the FDIC does not have authority over the privacy and information security practices of non-financial commercial parents of industrial banks, other regulators have such powers. For example, Section 5 of the Federal Trade Commission Act gives the FTC broad authority to pursue unfair and deceptive trade acts and practices against most businesses arising from privacy and data protection practices.

Independence of Bank Management

Board: The Board does not impose limits on the number of representatives a bank holding company may have on the board of a subsidiary bank. As a result, it is not uncommon for the board of directors of a bank holding company and the board of directors of a subsidiary bank to be composed of the same individuals, a majority of which are not independent.

FDIC: The Industrial Bank Rule includes personnel restrictions that curb the ability of the parent of an industrial bank to influence the operations of the industrial bank. The Industrial Bank Rule requires the parent of an industrial bank to limit its direct and indirect representation on the board of directors of each subsidiary industrial bank to less than 50 percent of the members of the industrial bank's board of directors.[59]

Additionally, under the Industrial Bank Rule, an industrial bank controlled by another company must obtain the prior approval of the FDIC to: (1) add or replace a member of the board of directors of the industrial bank during the first three years after becoming a subsidiary of the company; (2) add or replace a senior executive officer during the first three years after becoming a subsidiary of the company; and (3) employ a senior executive officer who is, or during the past three years has been, associated in any manner (*e.g.,* as a director, officer, employee, agent, owner, partner, or consultant) with an affiliate of the industrial bank.[60]

Resolution/Recovery/Contingency Planning

Board: Bank holding companies with more than $250 billion in assets and each subsidiary bank with more than $100 billion in assets are required to develop resolution plans for the organization's rapid and orderly resolution in the event of material financial distress or failure.[61] The nation's largest bank holding companies also must engage in recovery planning to ensure the ongoing resiliency of a firm's consolidated operations as well as its core business lines, critical operations, banking offices, and other material entities.[62]

[59] 12 C.F.R. § 354.4(a)(6).
[60] 12 C.F.R. §§ 354.5(b), (c), and (d).
[61] 12 C.F.R. pt. 381 (bank holding companies) and 12 C.F.R. § 360.10 (banks). While the FDIC has authority to require resolution plans from insured depository institution with $50 billion or more in assets, it currently is applying that requirement to insured depository institutions with $100 billion or more in assets.
[62] Federal Reserve Board, SR Letter 14-8, Consolidated Recovery Planning for Certain Large Domestic Bank Holding Companies.

© 2022 James Sivon All rights reserved.

FDIC: The Industrial Bank Rule gives the FDIC the discretionary authority to require the parent of an industrial bank and its subsidiary industrial bank to develop and submit a "contingency" plan that combines the elements of resolution and recovery planning.[63] The contingency plan must identify actions to address significant financial or operational stress that could threaten the safe and sound operation of the industrial bank and one or more strategies for the orderly disposition of such industrial bank without the need for the appointment of a receiver or conservator. The FDIC has stated that contingency planning permits the FDIC, as well as the parent of an industrial bank, to have a better understanding of the interdependencies, operational risks, and other circumstances or events that could create safety and soundness concerns for the insured industrial bank and attendant risk to the DIF. Additionally, like other banks with $100 billion or more in total assets, an industrial bank with $100 billion or more in total assets must develop a resolution plan for the orderly resolution of the bank in the event of the bank's failure.[64]

Enforcement Powers over Parent Companies and Affiliates

Board: The Board has the authority to pursue civil and criminal actions against individuals and companies that violate the provisions of the BHC Act.[65] This includes a bank holding company and any of its subsidiaries. The Board also may bring an enforcement action (e.g., cease and desist, civil money penalties) against an "institution-affiliated party" that engages in unsafe or unsound practices or violates a law, regulation, order, or agreement. An "institution-affiliated party" includes a controlling stockholder of a bank (i.e., a bank holding company).[66]

Additionally, the Board has the authority to compel the divestiture of a nonbank subsidiary of a bank holding company, or the subsidiary bank, if a nonbank subsidiary poses a serious risk to the subsidiary bank or is engaged in activities that are inconsistent with sound banking principles.[67]

FDIC: Like the Board, the FDIC may bring an enforcement action against an "institution-affiliated party," including the parent of the industrial bank, if the parent company engages in unsafe or unsound practices or violations of law, regulation, orders, or agreements.[68] The FDIC also may bring enforcement actions against affiliates of the industrial bank if they are participating in the affairs of the bank.

Under the FDI Act's prompt corrective action provisions, if an industrial bank becomes significantly undercapitalized, the FDIC may compel the parent company to divest a nonbanking subsidiary that is in danger of becoming insolvent and poses a significant risk to the industrial bank and may compel the parent company to divest the industrial bank if the divestiture would improve the financial condition of the industrial bank.[69]

[63] 12 C.F.R. § 354.4(b).
[64] 12 C.F.R. § 360.10.
[65] 12 U.S.C. § 1847.
[66] 12 U.S.C. § 1818.
[67] 12 U.S.C. § 1844(e).
[68] 12 U.S.C. § 1818.
[69] 12 U.S.C. § 1831o.

© 2022 James Sivon All rights reserved.

Additionally, the Industrial Bank Rule provides that the FDIC, at its sole discretion, may require an individual who is a controlling shareholder of the parent of an industrial bank to sign the commitment authorizing the agency to pursue an enforcement action against the individual for violations of the commitments required by the Industrial Bank Rule.[70]

V. Conclusion

The foregoing comparison of the FDIC's supervision of industrial banks and their parent companies to the Board's supervision of bank holding companies shows that the FDIC bank-centric approach to supervision is as effective in addressing risks to an industrial bank and the DIF as the Board's consolidated approach to supervision. The powers granted to the FDIC in the FDI Act combined with the provisions in the Industrial Bank Rule give the FDIC more than sufficient authority to understand the operations and activities of an industrial bank and its affiliates, including its parent company, and to mitigate any potential risks posed by those operations and activities. Moreover, the FDIC's capacity to implement these supervisory powers is fully within the control of the agency. The operations of the FDIC are supported by fees imposed on insured banks rather than Congressional appropriations. As a result, the FDIC has the flexibility to adjust fees to cover expenses, including personnel costs associated with the supervision of industrial banks and their parent companies.

[70] 12 C.F.R. § 354.3(b).

© 2022 James Sivon All rights reserved.

Appendix A
Comparison of the Supervisory Powers of the Board and FDIC

	Board	FDIC
Authority to Examine the Bank and Obtain Reports from the Bank	Yes	Yes
Authority to Examine Parent Company and other Affiliates of the Bank	Yes	Yes
Authority to Obtain Reports on Parents and Affiliates	Yes	Yes
Authority to Monitor and Restrict Transactions with Parent and Affiliates	Yes.	Yes.
Authority to Impose Capital Requirements on Parent Company and Affiliates	Yes, by regulation	Yes, by order
Authority to Require Parent Company to Serve as a Source of Strength for Subsidiary Bank	Yes	Yes
Authority to Grant and Withdraw Deposit Insurance for the Bank	No	Yes
Prior Approval Required for Affiliates to Provide Services to the Bank	No	Yes
Authority over Privacy and Security Practices of Bank and Parent Company	Yes	Yes, if parent is a financial company
Limits on Personnel Interlocks Between Parent Company and the Bank	No	Yes
Authority to Require Resolution/Recovery/Contingency Planning	Yes	Yes
Authority to Bring Enforcement Actions Against Parent Company	Yes	Yes
Authority to Bring Enforcement Actions Against Affiliates, other than the Parent Company	Yes	Yes, if affiliate participates in the affairs of the bank

© 2022 James Sivon All rights reserved.