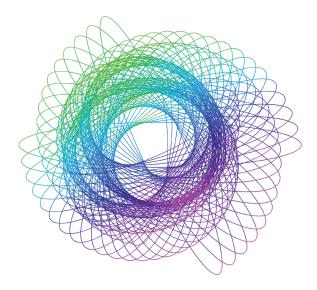
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FDIC - Industrial Loan Companies (ILC) Final Rule

Deloitte Center for Regulatory Strategy—December 2020

The purpose of the proposed rule is to codify existing practices utilized by the FDIC to supervise ILC and their parent companies, to mitigate undue risk to the DIF [Deposit Insurance Fund] that may otherwise be presented in the absence of Federal consolidated supervision of an ILC and its parent company, and to ensure that the parent company that owns or controls an ILC serves as a source of financial strength for the ILC, consistent with Section 38A of the FDI [Federal Deposit Insurance] Act. With the exception of the added reporting for systems for PII, the balance of the revisions, although modest, were in the ILC applicant's favor. The rule provides a clearer process regarding expectations and should make the approval process clearer in which to comply.

Key Changes

- 1. The final rule is largely consistent with the proposed rule, with the exception of a) Revises the commitment of each parent company to limit its representation on the ILC's board to less than 50 percent from no more than 25 percent b) Subsidiary ILC to obtain the FDIC's prior approval to add or replace a member of the board of directors, or to add or replace a senior executive officer of the ILC only for a period of three-year period as opposed to perpetual basis c) Additional reporting requirement on systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information
- 2. The rule rules applies to institutions prospectively
- 3. The FDIC defends the regulatory framework around ILCs drawing parallels to state non-member banks and making it clear they have the tools to govern / manage both non-financial and financial ILCs and affiliate relationships
- 4. Provides clarity to the approval process of what tools the FDIC has
- 5. The FDIC does not wade into the debate on non-financial ILCs, makes it clear that they will apply the law as it stands

6. April 1, 2021 Effective Date - While this is a fairly long time for an effective date, the FDIC has made it clear they will continue to be processing "pending" deposit insurance applications. This appears to mean that applications that have been received and are in pending status will be processed in a similar manner to past ILC application, such as Square and Nelnet. Additional clarity is needed regarding how applications submitted between 12/15/20 and 4/1/21 will be processed. It is likely they will still be processed, but not submitted to the FDIC Board for approval.

FDIC considers ILC Bank similar to other Charter Types

- The FDIC has not found that ILCs pose unique safety and soundness concerns based on the activities of the parent organization.
- ILCs are subject to all of the same restrictions and requirements, regulatory oversight, and safety and soundness exams as any other kind of insured depository institution. As such, the risks posed are substantially similar to those of all other charter types.
- At year-ends 2009 through 2011, ILCs maintained a median tier
 1 leverage capital (T1LC) ratio between 13.1 percent and 15.4
 percent, whereas, other insured institutions maintained a median
 T1LC ratio between 9.3 percent and 9.7 percent. The capital and
 earnings ratios for ILCs is reflective of the higher degree of risk
 inherent in their business models
- When compared to other insured institutions, ILCs typically maintain a lower volume of liquid assets and rely more heavily on non-core liabilities to fund longer- term earning assets. As a result, while still satisfactory, the liquidity posture for ILCs was considered slightly lower both during and subsequent to the 2008-09 financial crisis. In the FDIC's experience, asset quality has been comparable between ILCs and other insured institutions.

Themes	Potential Impact	Potential Impact Description
Minor Clarification: Timing Update and wording clarification	Low	The proposed rule would have divided the rule into two temporal states, on or before the effective date on the one hand, and after the effective date on the other hand. The final rule amends the dividing line so that the relevant timeframes would be before the effective date and on or after the effective date. FDIC has made it clear they will continue to be processing "pending" deposit insurance applications. This appears to mean that applications that have been received and are in pending status will be processed in a similar manner to past ILC application. Additional clarity is needed regarding how applications submitted between 12/15/20 and 4/1/21 will be processed. It is likely they will still be processed, but not submitted to the FDIC Board for approval. Minor wording clarifications have been made (e.g., explicit use of language to state applicability related to nonfinancial commercial firms)
Flexibility: Board— Independence Threshold flexibility	High	Limited the Covered Company's direct and indirect representation on the board of directors or board of managers, as the case may be, of each subsidiary ILC to less than 50 percent of the members (from no more than 25%) of such board of directors or board of manager. The revision aligns with ILC business models and support flexibility in including members with direct experience with bank operations.
Additional Reporting: Reporting Requirement	High	In response for covered companies that are not engaged in financial services that are not covered by GLBA, the rule added reporting on Systems for protecting the security confidentiality, and integrity of consumer and nonpublic personal information. This likely will have more of an impact on covered companies that are non-financial in nature and not covered by GLBA
Flexibility: Requirements removed related to additional commitment/ restrictions	High	Removed the requirement related to additional commitments required by a Covered Company or by an individual who is a controlling shareholder of a Covered Company. This was removed in response to concerns regarding the FDIC having the ability to have open-ended authority over covered companies or controlling shareholders and provides flexibility to the banks. Additionally, also removed requirement around imposing additional restrictions on the activities or operations of an ILC that is controlled by a Covered Company to avoid confusion that the FDIC would unilaterally impose additional commitments/restrictions.
Flexibility: Three Year Limitation on requirement of FDIC approval on add or replace a member of the board of directors/ senior executive officer	High	Revised to include a three-year limitation on the requirement of written approval to employ of 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 ILC to allow ILCs flexibility to appoint directors and officers in a timely manner. A three-year limitation was added representing the de novo period to allow ILCs the flexibility to appoint directors and officers in a timely manner since FDIC approval would not be needed outside of the three-year period.



High Impact – Results in some process changes and additional effort required (Reporting)



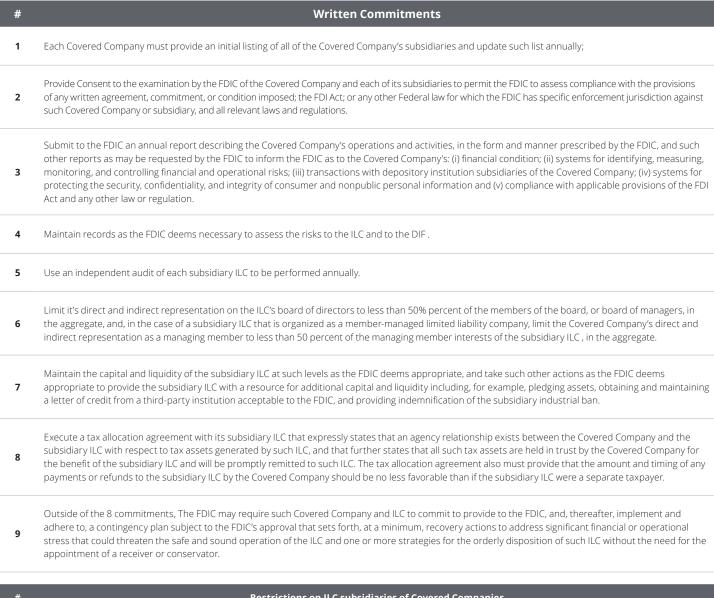
Medium Impact – Results in some process changes but no additional effort required (25% & 3-year)



Low Impact – Results in no direct impact and no additional effort (Effective date, FDIC authority)

Written Commitments

No ILC may become a subsidiary of a Covered Company unless the Covered Company enters into one or more written agreements with both the FDIC and the subsidiary ILC, which contain commitments by the Covered Company to comply with the requirements listed below.



Restrictions on ILC subsidiaries of Covered Companies

Without the FDIC's prior written approval, an ILC that is controlled by a Covered Company shall not: (a) Make a material change in its business plan after becoming a subsidiary of such Covered Company; (b) Add or replace a member of the board of directors, board of managers, or a managing member, as the case may be, of the subsidiary ILC during the first three years after becoming a subsidiary of such Covered Company; (c) Add or replace a senior executive officer during the first three years after becoming a subsidiary of such Covered Company; (d) 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 ILC; or (e) Enter into any contract for services material to the operations of the ILC (for example, loan servicing function) with such Covered Company or any subsidiary thereof.

For additional details on Banking Charter options and services related to applying, implementing and standing up digital banking operations, refer to: Business model strategy for financial services.

Appendix:

FDIC ILC Proposed Rule Changes

This link compares the FDIC's ILC Proposed and Final Rule, in regard to Parent Companies of ILCs and Industrial Loan Companies.

FDIC ILC Final - How it effects Procedures Manual Supplement for Non-Bank Applicant

Potential impact of revisions from the Proposed to Final rule related to Procedures Manual Supplement.

Sources

Fact Sheet: https://www.fdic.gov/news/fact-sheets/ilc-12-15-20.pdf?source=govdelivery&utm_medium=email&utm_source=govdelivery.

- 1. Statement by FDIC Chairman Jelena McWilliams on the Final Rule for Parent Companies of ILCs and Industrial Loan Companies at the FDIC Board Meeting: https://www.fdic.gov/news/speeches/spdec1520c.html?source=govdelivery&utm_medium=email&utm_source=govdelivery.
- 2. Statement by FDIC Board Member Martin J. Gruenberg on the Final Rule: Parent Companies of ILCs and Industrial Loan Companies at the FDIC Board Meeting: https://www.fdic.gov/news/speeches/spdec1520e.html?source=govdelivery&utm_medium=email&utm_source=govdelivery.
- 3. Final Rule: https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-b-fr.pdf?source=govdelivery&utm_medium=email&utm_source=govdelivery.
- 4. Press Release: https://www.fdic.gov/news/press-releases/2020/pr20137.html?source=govdelivery&utm_medium=email&utm_source=govdelivery

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