October 10, 2024

<u>ELECTRONICALLY SUBMITTED</u>

Mr. James P. Sheesley
Assistant Executive Secretary
Attn: Comments—RIN 3064-AF88
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

RE: Comments of Nelnet, Inc., and Nelnet Bank Concerning Proposed Rule Captioned "Parent Companies of Industrial Banks and Industrial Loan Companies, RIN 3064-AF88

Dear Mr. Sheesley:

This letter contains the comments of Nelnet, Inc. ("Nelnet") and its subsidiary Nelnet Bank in response to the Federal Deposit Insurance Corporation's ("FDIC") Notice of Proposed Rulemaking titled "Parent Companies of Industrial Banks and Industrial Loan Companies," published in the *Federal Register* on August 12, 2024 (the "Proposed Rule").[1]

Nelnet is a public company whose financial health draws from a diverse array of subsidiaries, including: a payments company; a loan servicing company; a solar business; significant investments in the fiber-optic telecommunications and software industries; and, as noted in the text accompanying the Proposed Rule, Nelnet Bank, an industrial bank ("IB") chartered under the laws of the State of Utah. Nelnet Bank is one of only three IBs to receive deposit insurance from the FDIC in the last 16 years. In the short time it has been in operation, Nelnet Bank has saved 4,000 borrowers across all 50 states and Puerto Rico more than $50 million (an average of $13,000 per customer) over the life of their education loans by reducing their monthly payments with a refinance product and has originated approximately $55 million in private student loans and parent loans. By prioritizing

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[1] Parent Companies of Industrial Banks and Industrial Loan Companies, 89 Fed. Reg. 65,556 (proposed Aug. 12, 2024) (to be codified at 12 C.F.R. pt. 354) (hereinafter "Proposed Rule"), *available at* https://www.fdic.gov/sites/default/files/2024-03/pr20034a.pdf.

flexible repayment options, easy cosigning options, and no application or origination fees, Nelnet Bank stands as a reliable partner in making education accessible and attainable for all. The bank has also awarded more than $200,000 "Learn to Dream" scholarships to low-moderate income students in Utah attending community and technical college in its primary Community Reinvestment Act assessment area. Beyond scholarships and other community development investing, Nelnet Bank focuses on educating borrowers and customers by offering free financial literacy resources. Through its comprehensive approach to lending, community support, and financial education, Nelnet Bank is a true financial services partner in empowering students and families across the nation.

As a condition to granting Nelnet Bank's application, "the FDIC required [Nelnet Bank and its] parent compan[y] to enter into written agreements with the FDIC that contained provisions consistent with the requirements of part 354."[2] As a result of those agreements, and consistent with general principles of prudential bank management, today, Nelnet Bank:

- Maintains a 12% leverage ratio (compare to the generally applicable Community Bank Leverage Ratio of only 9%);[3]
- Is governed by an experienced board of directors—75% of whom are independent from Nelnet, Inc. (note that current Part 354 requires only a 50% threshold)—who ensure the bank is operated on a standalone basis;[4]
- Has developed and continues to refine, as needed and requested by the FDIC, a plan for the orderly wind-down of the bank, if circumstances warrant, that does not impair the Deposit Insurance Fund ("DIF");
- Meaningfully relies on its well-diversified parent company, Nelnet, as a source of financial strength, as required by the Dodd-Frank Act's amendments to the Federal Deposit Insurance Act; and
- Is subject, along with its parent company, to effectively the same quality and level of supervision as community banks and their holding companies, albeit pursuant to a different statutory scheme than the Bank Holding Company Act ("BHCA").

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[2] *Id.* at 65,558; *see* In re Nelnet Bank (In Organization), Order on Application for Federal Deposit Insurance, Fed. Deposit Ins. Corp., https://www.fdic.gov/sites/default/files/2024-03/pr20034a.pdf (Mar. 18, 2020).
[3] *See* 12 C.F.R. § 324.12(a)(1)(establishing community bank leverage ratio for qualifying community banking organizations).
[4] *See* 12 C.F.R. § 354.4(a)(6)(requiring only a 50% independent board).

Nelnet Bank is also subject to Regulation W and the amendments to FDIA Sections 23A and 23B made by the Dodd-Frank Act.[5] These characteristics are important for the FDIC to bear in mind because in light of them, and the relative novelty of the Part 354 regime that requires them, Nelnet cannot discern a reasonable basis for the Proposed Rule.

Part 354, a comprehensive set of IB-specific regulations that the FDIC created just three years ago, generally requires IBs and their parent companies to consent to a rigorous examination and oversight program similar to what is required of other commercial banks and their holding companies subject to consolidated supervision by the Board of Governors of the Federal Reserve System (the "FRB"). Nelnet and Nelnet Bank understood the concerns the FDIC raised in the course of its 2020-21 rulemaking and, having operated under the Part 354 regime for three years, can attest to the ways in which Part 354 has strengthened the financial performance of the bank, enhanced its capital planning (including for an orderly wind-down, if necessary), and further protected the Deposit Insurance Fund.[6] Nelnet Bank is also supervised by the Utah Department of Financial Services, which has significant experience in regulating IBs.

Part 354 appeared to be designed to increase regulatory parity between IB and other commercial banks, thus allowing banks of all kinds to contribute to a dynamic, diverse financial services ecosystem that is a hallmark of the U.S. economy. For years, critics of the IB model contended that the exclusion of IB parent companies from coverage under the BHCA yielded some kind of benefit to IBs due to an alleged regulatory arbitrage. Nelnet disputes that assertion; but even if it were true, the FDIC's institution of Part 354 effectively countered it. Part 354 is presently a comprehensive regulatory and supervisory scheme that closely mimics FRB-style consolidated supervision under the BHCA and allows IBs to thrive in the manner their chartering states and the long history of federal enabling legislation contemplate.[7]

Yet abruptly, now only three year later, the FDIC has proposed a rule that would effectively kill the IB model without *any* new statutory authority, *any* economic

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[5] *See* Dodd-Frank Wall Street Reform & Consumer Protection Act, Pub. L. 111-203 (2010), at §§ 608, 609.
[6] *See* Parent Companies of Industrial Banks and Industrial Loan Companies, 86 Fed. Reg. 10,703 (Feb. 23, 2021) (codified at 12 C.F.R. pt. 354).
[7] *See, e.g.*, Competitive Equality Banking Act of 1987, Pub. L. 100-86 (1987), at § 101(a)(1) (containing *express* exemption for a company to own and control an industrial bank without becoming a bank holding company).

study or data to demonstrate a problem, or *any* reasonable basis. It does so by creating—*out of thin air*—a series of regulatory presumptions against IBs that will in practice operate to deny them deposit insurance or the ability to effect a change in control at or of the bank. Prudent rulemaking, especially in the wake of the Supreme Court's holding in *Loper Bright*, should scrupulously detail the basis for the agency's action, especially when the issue the agency wishes to address is existential for an entire financial services community and its customers, and especially when Congress has recently considered *and declined to enact* the agency's preferred outcome.[8] It is perplexing why the FDIC, having recently taken steps to increase its regulatory program for IBs and their parent companies in Part 354, would now effectively jettison those efforts in favor of a regulatory scheme designed essentially to dismantle the very same industry.

The FDIC should withdraw the Proposed Rule. If the FDIC wishes to explore and develop economic data concerning the efficacy of Part 354, or the regulation of IBs generally, it either already has the tools to do so or it could ask for the public's assistance using a request for information, an advanced notice of proposed rulemaking, or some other means by which to examine its hypotheses. But it hasn't. Proposing an industry-killing regulation without any economic justification—especially at a time when the chairman of the FDIC has announced his resignation and just weeks before an important presidential election—violates the APA and the FDIA, and gives the unfortunate impression that its true basis is political, not prudential.

If the FDIC does not withdraw the Proposed Rule, it should at least withdraw its proposal to designate certain IBs as "shell or captive" because the basis upon which such designation purports to rest is at best speculative. It also contravenes the express findings of the FDIC just three years ago; it presents no data to demonstrate why those findings are suddenly false. Conspicuously absent is any data comparing the performance of "captive or shell" IBs to either non-captive IBs or to BHCA-covered commercial banks. Consider the following comparison of statements the FDIC made in 2021 versus those made in the Proposed Rule.

[8] *See* Loper Bright Enterprises v. Raimondo, 603 U.S. ___ (2024) (overruling judicial "*Chevron*" deference to agencies' interpretation of statutes). Moreover, in 2022, the House Financial Services Committee considered H.R. 5912 (117th Cong.), a bill that would have placed new regulations on ILCs; there was bipartisan opposition to the bill, and it never advanced beyond the committee.

2021 Final Rule	2024 Proposed Rule
The circumstances experienced by industrial banks during the crisis were not dissimilar from the circumstances confronting other insured institutions and were not the result of factors related to the industrial bank charter. In general, the FDIC's supervision helped to isolate the insured industrial bank from the stress of the parent organization, which helped in managing the potential risk to the industrial bank and the DIF.	The FDIC's experience during the 2008–2009 Financial Crisis showed that business models involving an insured depository institution (IDI) inextricably tied to and reliant on the parent and/or its affiliates creates significant challenges and risks to the DIF, especially in circumstances where the parent organization experiences financial stress and/or declares bankruptcy.
Implementation of the rule positions the FDIC to better protect the industrial bank from activities of a parent organization that present heightened risk to the organization and the bank and to ensure that the parent company is a continuing source of financial strength.	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.
As to the specific threshold, the FDIC is revising the commitment in the final rule to establish a less than 50 percent threshold, which will maintain a sufficient number of independent directors [. . .] Nevertheless, the FDIC retains the authority, as appropriate, to require a higher threshold of director independence.	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 that would impact consideration of the relevant statutory factors.
The final rule preserves the FDIC's supervisory discretion to tailor the contents of any contingency plan to a specific Covered Company and its insured industrial bank subsidiary. While the contingency plan is one type of commitment that the FDIC would be able to require of Covered Companies and their industrial bank subsidiaries, there may be other commitments that the FDIC may determine to be appropriate given the business plan, capital levels, or organizational structure of a Covered Company or its subsidiary industrial bank. Additional commitments may be derived, for instance, from elements of the business model presented, including the nature and scope of activities conducted, the risk profile of the activities, and the complexity of operations. The proposed relationships and transactions with the parent organization that may impact the industrial bank also could be taken into consideration.	Where an industrial bank is significantly reliant on and interconnected with its parent organization to generate business on both sides of the balance sheet (e.g., for funding and for lending), as well as operational systems and support, financial difficulties at the parent organization could be transmitted to the dependent industrial bank. Such a captive model creates material concerns about the viability of the industrial bank's proposed business model on a standalone basis and the industrial bank's franchise value in the event the parent organization experiences financial difficulty or failure.

"Agencies are free to change their existing policies as long as they provide a reasoned explanation for the change."[9] But the contrast between the statements and conclusions the FDIC made in 2021 about IBs and their parent companies, and those made in the text accompanying the Proposed Rule, is not explained at all in the latter. In fact, as this textual comparison highlights, many of the concerns the FDIC notes in the current proposal were *specifically addressed* in the 2021 final rule. An agency must "articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made."[10] The bar may be relatively low, but the FDIC has not met it in the Proposed Rule. The Proposed Rule thus plainly violates the Administrative Procedure Act.

The Proposed Rule also violates the FDIA itself because the act does not authorize or even contemplate the creation of a subcategory of IBs designated as "shell or captive" entities. The FDIC has a particular statutory mission; its rulemakings and supervisory authorities must be specifically authorized in law. Nowhere in the FDIA or any other law does the FDIC find the power to create an IB caste system whereby some banks are singled out for unfavorable treatment. To the contrary, and as the FDIC noted in the 2021 final rule, the FDIC has broad *supervisory* and *enforcement* authorities that can be used on a case-by-case basis to deal with particular institutions as the circumstances may warrant. An *a priori* judgment that all IBs with the characteristics found in the Proposed Rule automatically pose heightened safety and soundness risks is overbroad and not permitted under the FDIC authorizing statutes.

Moreover, the FDIC's use of the word "heightened" is vague because it does not answer—*compared to what?* If the argument is that an IB poses greater risk to the DIF because its parent company "may be vulnerable to any financial distress or operational disruptions," the FDIC should have analyzed and presented data showing the risk to the DIF posed by banks owned and controlled by BHCA-covered companies. Many BHCA-covered companies are themselves akin to a shell, existing primarily for the purpose of retaining capital and serving as a source of strength to their bank subsidiary. Many such bank holding companies derive their capital from dividends paid up to them from the bank. However, the recent experience, for example, of the failures of Heartland Bank or Republic First Bank demonstrate that bank holding companies are scarcely more reliable than a diversified company like Nelnet to serve as a source of strength for their subsidiary banks. Contrary to presenting "heightened" risk to the DIF, a diversified *operating company* parent is

[9] Encino Motorcars, LLC v. Navarro, 136 S.Ct. 2117, 2126 (2016).
[10] Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

less likely to experience exogenous shock and a sudden erosion of capital than a bank holding company that exists solely to hold assets.

Even if a “shell or captive” IB were to present a heightened risk to the DIF compared to non-IB commercial banks, the FDIC has not explained why the tools available under existing Part 354, which were created three years ago specifically *to* manage such risks, are suddenly insufficient for the task for which they were designed. One possible reason for this lack of explanation could be that at least for Nelnet Bank, the requirements of Part 354, in concert with Regulation W and other laws, have worked well to mitigate against the FDIC’s theoretical concerns announced in the Proposed Rule text. Any heightened risk that may be present with respect to an IB is and should be handled through a capital and liquidity maintenance agreement, as contemplated by Part 354 (and is in effect at Nelnet and Nelnet Bank), not a cascade of ill-conceived regulatory presumptions.

But regardless of whether Part 354 is an appropriate “remedy” to the hypothetical concerns the FDIC raises, the creation of a rebuttable presumption that a captive or shell IB *fails a statutory factor* under the FDIA is an entirely irrelevant response to such concern. (We note that the public is not told which statutory factor is likely to implicated, and thus cannot meaningfully comment on it.) If an IB “could not function independently of the parent company” or serves “only as a funding channel for an existing parent company or affiliate business line,” as set forth in proposed §354.6(c)(1), why or how would a presumption against permitting, say, a change in control of the IB or parent company change that? Or, if somehow it would, why would Part 354 be inadequate to address the FDIC’s concern, if the concern were an increased risk to the DIF?

The FDIC should abandon its proposed shell/presumption mechanism because it does nothing to remedy the concerns it raises about increased risk to the DIF. But if it does not, the FDIC should clarify, at a minimum, that the operation of the shell/presumption schematic in proposed §354.6(c)(1) applies only to applications for deposit insurance from *de novo* institutions. This is perhaps contemplated in (c)(1)(iii) because the FDIC uses the word “would,” implying the future tense (*i.e.*, to an entity that does not yet exist), but the use of the word “transactions” in (c)(3) could refer to a broader set of applications than just for deposit insurance. A carveout from the shell/presumption scheme for existing IBs and parent companies would be consistent with the FDIC’s stated concern of ensuring that IBs meet the “convenience and needs of the community” because existing IBs already have met this statutory factor when they applied for and received deposit insurance. A simple change in control does not weigh against this statutory factor, and a change in business plan deserves no more scrutiny under this factor for an IB than it does for a community bank wishing to change its business plan.

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As a matter of both law and prudence, the FDIC should abandon the Proposed Rule. The Proposed Rule would effectively eliminate the viability of the IB charter even while Congress has repeatedly, expressly supported it. The Proposed Rule complains that IBs are too connected to their parent companies while stipulating that this is precisely why many IBs are chartered in the first place (a fact that was as true in 2021 as it is today). It expressly discriminates against innovation in considering whether IBs should receive deposit insurance. And with a whipsaw effect, it upends and contradicts thoughtful regulation implemented just three years ago without any data or empirical evidence of why the present statutory scheme is not working. Nelnet respects the hard work of the FDIC's staff, but the public is entitled to a better rulemaking record than is contained in the Proposed Rule.

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Thank you for your consideration of these comments. We would be happy to discuss them with you.

Sincerely,

[redacted]

Timothy A. Tewes
President
Nelnet, Inc.

[redacted]

Andrea Moss
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