

# Rules and Regulations

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## FEDERAL DEPOSIT INSURANCE CORPORATION

### 12 CFR Part 303

RIN 3064-AC53

### Insurance of State Banks Chartered as Limited Liability Companies

**AGENCY:** Federal Deposit Insurance Corporation.

**ACTION:** Final rule.

**SUMMARY:** The Federal Deposit Insurance Corporation (FDIC) has adopted a final rule regarding whether and under what circumstances the FDIC will grant deposit insurance to a State bank chartered as a limited liability company (LLC). Pursuant to section 5 of the Federal Deposit Insurance Act (FDI Act) the FDIC may grant deposit insurance only to certain depository institutions. One of the statutory requirements for a State bank to be eligible for Federal deposit insurance is that it must be "incorporated under the laws of any State." In the recent past the FDIC received two inquiries regarding whether a State bank that is chartered as an LLC (a "Bank-LLC") could be considered to be "incorporated" for purposes of that requirement. The final rule provides that a bank that is chartered as an LLC under State law would be considered to be "incorporated" under State law if it possesses the four traditional, corporate characteristics of perpetual succession, centralized management, limited liability and free transferability of interests.

**DATES:** *Effective date:* March 17, 2003.

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#### SUPPLEMENTARY INFORMATION:

##### I. Background

Generally, the FDIC may grant deposit insurance only to depository institutions that are engaged in the business of receiving deposits other than trust funds.<sup>1</sup> The term "depository institution" is defined in the Federal Deposit Insurance Act (FDI Act) to mean any bank or savings association.<sup>2</sup> The term "bank" is also defined in the FDI Act to include any State bank,<sup>3</sup> and "State bank" means:

Any bank, banking association, trust company, savings bank, industrial bank \* \* \* or other banking institution which—

(A) Is engaged in the business of receiving deposits other than trust funds \* \* \* and

(B) Is incorporated under the laws of any State or which is operating under the Code of Law for the District of Columbia (except a national bank), Including any cooperative bank or other unincorporated bank the deposits of which were insured by the Corporation on the day before August 9, 1989.<sup>4</sup>

Recently, two banks expressed an interest in obtaining Federal deposit insurance for a State bank that would be chartered as an LLC.<sup>5</sup> The proponents have argued specifically that the term "incorporated" should not be interpreted to preclude an LLC from becoming an insured depository institution. The phrase "incorporated under the laws of any State" first appeared in the definition of "State bank" with the Banking Act of 1935,<sup>6</sup> but the FDI Act provides no definition of the term "incorporated." Furthermore, there is no legislative

<sup>1</sup> See 12 U.S.C. 1815.

<sup>2</sup> See 12 U.S.C. 1813(c)(1).

<sup>3</sup> See 12 U.S.C. 1813(a)(1).

<sup>4</sup> 12 U.S.C. 1813(a)(2).

<sup>5</sup> Currently, State law in 5 States expressly permits LLCs to engage in the business of banking; the law in 14 other States would not. An informal survey of these 14 States indicated that there appears to be no particular reason for this prohibition. Representatives of two of the States thought that one reason could be that the corporate form lends itself to regulation and supervision. Representatives of two other States mentioned that legislation was being drafted or proposed to remove the prohibition.

<sup>6</sup> See Banking Act of 1935, Pub. L. No. 74-305, sec. 101, 49 Stat. 684.

history nor judicial guidance regarding its meaning as used in the FDI Act. Consequently, it is not clear how the term "incorporated" should be interpreted in the context of the FDI Act, and specifically, whether an LLC could be considered to be "incorporated" for purposes of determining eligibility for Federal deposit insurance.

##### II. The Nature of Corporations

At common law there were generally three types of business entities: proprietorships, partnerships, and corporations. A proprietorship is an individual carrying on a business for profit. A partnership is generally an association of two or more persons to carry on as co-owners a business for profit.<sup>7</sup> Proprietorships and partnerships had no existence separate and apart from their owners. Corporations, on the other hand, were created and existed by virtue of a grant of authority from the sovereign. Although there appears to be no universally accepted definition of "corporation," most definitions of the term are pervaded by the notion of "an 'artificial legal creation,' the continuance of which does not depend on that of the component persons, and the being or existence of which is owed to an act of state."<sup>8</sup> One of the earliest judicial definitions reflecting that notion is that enunciated in the 1819 case of *Trustees of Dartmouth College v. Woodward*.<sup>9</sup> In *Dartmouth College*, Chief Justice Marshall stated that [A] corporation is an artificial being, \* \* \* existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it \* \* \* Among the most important are immortality and \* \* \* individuality; properties, by which a perpetual succession of many persons are considered as the same, and may act as a single individual.<sup>10</sup>

##### Attributes of a Corporation

The lack of any universal agreement as to the characteristics of a corporation

<sup>7</sup> See Unif. Partnership Act, sec. 101(6) (1997), 6 U.L.A. 61 (Supp. 2002).

<sup>8</sup> 1 William Meade Fletcher *et al.*, Fletcher's Cyclopaedia of the Law of Private Corporations § 4 (perm. ed., rev. vol. 2001).

<sup>9</sup> *Trustees of Dartmouth College v. Woodward*, 17 U.S. (4 Wheat.) 518 (1819).

<sup>10</sup> *Id.* at 636.