

attributes, it should be considered to be "incorporated" regardless of how it is labeled under State law.<sup>29</sup> Clearly, the actual nature of an entity is much more important than its label.

Within the confines of Federal law, and subject to safety and soundness, banks need to be able to take advantage of new forms of business organization in order to maintain maximum viability. Some of these new forms of business entities were never envisioned at the time that Congress passed the FDI Act almost 70 years ago. Part of the FDIC's duty in administering the FDI Act is to interpret it to carry out the purposes of the FDI Act in the modern world. Consistent with that duty, the FDIC believes that it is more reasonable to focus on the essential characteristics of a corporation that distinguish it from other forms of business entities rather than to focus on the presence or absence of a label.

Therefore, mindful of the need to maintain the viability of the nation's banking system, and consistent with the purposes of the FDI Act, the FDIC believes that the better approach, is to interpret the term "incorporated" to include those LLCs that have the four traditional corporate attributes.

As noted above, the attributes that are commonly identified as distinguishing a corporation from other forms of business organizations are: perpetual succession, centralized management, limited liability, and free transferability of interests.

#### *Perpetual Succession*

The first attribute, perpetual succession, is essential to the FDIC's efforts to promote public confidence in the nation's banking industry. An institution that automatically terminated, dissolved, or suspended operations upon the happening of some event would most likely have a substantial, adverse effect on public confidence. A depositor in such an institution would have no way of knowing from one day to the next whether the institution will continue in existence, and whether he or she will be able to retrieve his or her money when the need arises. Furthermore, such an automatic termination, dissolution, or suspension feature would have a significantly adverse effect on the FDIC's efforts to resolve failed

institutions. The FDIC is not only charged with promoting the safety and soundness of banking institutions, but is also charged with the duty of resolving failed institutions in an orderly, least costly manner. The FDIC would have no practical opportunity to plan and execute an orderly, least-costly resolution of an institution that, without any warning or advance notice, was terminated or dissolved or whose operations were suspended. Most likely it would not be possible to arrange for a healthy institution to purchase the assets and assume the deposit liabilities of the failed institution in order to continue to serve the affected community with the least disruption. Checks that were in transit at the time of the bank's failure, but that had not yet been paid, would be rejected. The disruption to the community could be substantial. The cost to the insurance fund of resolving such an institution could be significantly higher than necessary as a result, and the higher costs would tend to deplete the insurance fund more rapidly. Consequently, the FDIC believes that perpetual succession is an essential prerequisite for an insured depository institution, and that automatic termination/dissolution/suspension features are inconsistent with the FDIC's duties and the purposes of the FDI Act.

#### *Centralized Management*

Centralized management in the form of a board of directors provides the FDIC and other banking regulators with a discrete group of individuals who are authorized to act for, and represent, the institution in virtually all matters. The typical rights, liabilities, powers, and responsibilities of a board of directors are well-established. On the other hand, management of an institution directly and solely by all of its owners presents a variety of problems both from an operational standpoint and from an enforcement standpoint. First, if the authority to manage the bank is limited to the owners of the institution, management expertise would necessarily also be limited. The quality of the management of a bank is a key factor in a bank's success or failure. In order to provide the best chance for a bank to compete successfully and to operate profitably, a bank should be free to enlist the best qualified managers available to it. If there are too few owners, the group may not provide sufficient management experience and expertise. Too large of a group may also mean that even if adequate banking expertise is represented among the owners, it may be negated by a larger segment of the owners that lacks

adequate expertise. Second, management by a group that is too small could severely impair the bank's ability to respond to supervisory and regulatory direction. The volume and complexity of the demands of operating a bank might put too small of a group under excessive pressure and could result in management that is not responsive or, at least so slow as to imperil the bank's effectiveness. Too large of a group may make it unwieldy or excessively difficult to disseminate information, arrange meetings, ensure that all members have the opportunity to be heard, and get decisions in a timely manner. Finally, with a member-managed Bank-LLC, merely determining who represents the institution and the extent of his or her authority could represent a significant task for regulators. Consequently, centralized management is also an important attribute for purposes of the FDI Act.

#### *Limited Liability*

Limited liability, of course, encourages investment in the enterprise. Potential owners are more likely to invest in an enterprise when their liability is limited to the amount of their investment. Attracting and maintaining sufficient capital helps to ensure an adequate cushion to protect an institution during periods of economic stress. Since banks are subject to periods of economic stress just as other businesses are, the FDIC believes that the owners of banks should have limited liability to encourage the maintenance of adequate capital.

#### *Free Transferability of Ownership Interests*

The free transferability of ownership interests also tends to aid in attracting and maintaining adequate capital. Conversely, requiring the prior consent of the other owners in order to transfer an ownership interest may decrease the bank's ability to attract and maintain adequate capital. At worst, prior consent to a transfer limits the pool of available investors; at best, it delays interested, potential investors. While the FDIC currently insures approximately 700 mutual institutions (that issue no stock) and more than 1,700 closely-held institutions (some of which may have stock-transfer restrictions in the form of shareholder agreements), the FDIC has substantial experience with their structure, operations, and capital maintenance capabilities. The FDIC has no similar experience with institutions organized as LLCs, and that lack of similar experience argues for facilitating, rather than impairing, the maintenance of a capital cushion.

<sup>29</sup> This approach is not unprecedented. In *Morrissey v. Commissioner of Internal Revenue*, 296 U.S. 344, 359, 56 S.Ct. 289, 296 (1935) the Supreme Court held that a trust created for the purpose of carrying on a business that had continuity of life, centralized management, limited liability, and free transferability of interests is sufficiently analogous to a corporation to justify taxation as a corporation.