

**HELP PROTECT GROCERS, LOCAL ECONOMIES
AND STATES FROM UNSOUND BANKING ARRANGEMENTS
OPPOSE ILC EXPANSION**

November 21, 2005

In 1987, Congress created a loophole in the federal banking laws that said some banks—specifically, industrial loan companies (ILCs)—were not banks at all for purposes of federal law. This loophole cut against a fundamental principle of U.S. banking law that has been emphasized by most states and the U.S. Congress—the separation of banking activities from commercial businesses. ILCs are FDIC insured financial institutions that can be owned by non-financial companies not subject to the supervision of the Federal Reserve. When the loophole was created it was not particularly significant because ILCs were very small, local institutions. Now, however, ILCs have grown to the point that deposits reach into the billions of dollars and several large corporations hold ILCs. In July, 2005, Wal-Mart, in an attempt to capitalize on this loophole, applied for a Utah ILC charter.

More than twenty states now allow for de novo bank branching—which permits banks chartered in one state to operate branches within another state. Consequently, if Wal-Mart is granted an ILC charter in Utah, it will be able to open up branch banks in nearly half of the country.

ILCs Threaten the Banking System

- **ILCs are not subject to Federal Reserve supervision.** The expansion by ILCs is taking place without regulation by the Federal Reserve at the holding company level. Such supervision has been a mainstay of banking regulation for other U.S. banks.
- **Expanding of banks without federal regulation is especially unwise in the post-Enron era.** Events have proven that even large, seemingly sound companies can be at risk. Allowing ILCs to grow unchecked without ensuring sound regulation will place the banking system at great risk.

The ILC Loophole is a Risk We Cannot Afford

- **Wal-Mart is attempting to exploit this loophole in applying for a Utah ILC charter.** ILCs were originally formed for the purpose of providing loans to industrial workers who did not have the collateral necessary to obtain credit. They have evolved from these humble origins into multibillion dollar institutions which commercial companies are **attempting to exploit so they don't have to play by the rules of our nation's banking laws.**
- **Federal Reserve Board Governor Mark Olson testified in opposition to expanded branching for ILCs and stated, "Allowing a commercial firm to operate a nationwide bank outside the supervisory framework established by Congress for the**

owners of insured banks raises significant safety and soundness concerns and creates an unlevel competitive playing field."

- **Banks face more stringent regulation than commercial businesses.** Banks and bank holding companies are very strictly regulated. Bank examiners closely analyze their books and banks must meet tough rules on the amount of capital reserves and other precautions they take. Commercial businesses would not come close to meeting these many stringent regulatory requirements.
- **Recent scandals show the potential risks.** We have seen the potential problems faced by commercial businesses as Enron, Tyco, Adelphia and others which have been decimated by accounting scandals. All of these commercial businesses looked financially strong and reported good results to investors. Now we know the truth about them.
- **We all would have paid if these commercial companies had owned banks.** The losses of these companies have been difficult for employees, investors, creditors and the economy, but what if they had owned banks? What would happen to people and small businesses who had entrusted their money to the bank? The answer is that some of them would lose their money, but by and large the rest of us would pay off the banks' account-holders. FDIC insurance would pay it but, as with the savings and loan crisis of the 1980s, taxpayers could be on the hook.
- **Wal-Mart faces enormous exposures to financial risks.** Unlike most banks, Wal-Mart faces enormous exposure to fluctuations in foreign currencies—namely the Yuan. Over 70% of the goods sold by Wal-Mart are produced in China. A sudden jump in the valuation of the Yuan could have devastating impacts on Wal-Mart, and by extension, our national banking system. Wal-Mart also faces enormous exposure to oil prices both in terms of direct fuel costs for transporting the goods sold in its stores as well as the risk that customers spending more on fuel will spend less in its retail outlets.

A Wal-Mart ILC Would Endanger Local Businesses and Community Banks

- **A Wal-Mart bank would devastate local businesses.** Community banks which are subject to Federal Reserve restrictions would be at a competitive disadvantage to a Wal-Mart bank as it would not be supervised and subject to the same restrictions set by the Fed. The playing field is not level for community banks so long as ILCs are not subject to Federal Reserve supervision. Community banks will go out of business and local business who compete with Wal-Mart will be forced to visit a Wal-Mart bank for loans. Small businesses may be required to share sensitive business information with Wal-Mart to obtain loan approval. A Wal-Mart bank may not be making lending decisions on the soundness of the borrower, but on competitive grounds further jeopardizing the banking system.
- **Losing community banks would drive up costs to customers and hurt small businesses.** There are about 8,300 community banks with nearly 37,000 locations

throughout the United States. According to the Federal Reserve, large banks' ATM surcharges and foreign fees exceed those of small banks. The Federal Reserve has also found that large, multi-office banks tend to lend a smaller proportion of their funds to small businesses. Allowing banks owned by large, commercial enterprises to compete with community banks on an unlevel playing field would threaten their viability. Without the vital access to capital that community banks provide, small businesses will be severely harmed.

- **Some communities could lose their banks.** Once the community banks are run off, the commercially owned banks could easily abandon convenient locations and altogether stop serving some smaller communities forcing local businesses to bank with Wal-Mart.