Wal-Mart's Industrial Loan Company: The Risk to Community Banks

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Wal-Mart's Industrial Loan Company: The Risk to Community Banks

I. INTRODUCTION

It has been a long day at work and Anthony is on his way home after receiving his paycheck. He realizes that he needs to pick up a few things such as some razors, orange juice, milk, and that new DVD. Fortunately for Anthony, there is a Wal-Mart on his way home from work. As he walks through the aisles, he browses the shelves to see what else he might need. He has been thinking about getting a new television and his DVD player has been acting up lately. The lawnmower needs new parts and the light bulbs in the garage have been out for a month. Wal-Mart sells all these items at the lowest price in town. How about a mortgage to go with those light bulbs? This could be a new product available at Wal-Mart if its application for an industrial loan company charter ("ILC") is approved.

On July 19, 2005, Wal-Mart filed an application with the Utah Department of Financial Institutions ("UDFI") and the Federal Deposit Insurance Corporation ("FDIC") to operate an ILC. In its application to the FDIC, Wal-Mart states that it is seeking only a narrow charter that would allow it to process the store's electronic checks and credit and debit transactions. This would allow the company to capture costs it currently pays to third-party financial institutions to perform these services. Wal-Mart's possible foray into the world of ILCs has caught the attention of many trade organizations such as the Independent

1. See infra notes 63-65 and accompanying text.
2. See infra notes 58-61 and accompanying text.
3. Karen L. Werner, Community Banks: Banking Coalition Seeks House Support for ILC Compromise After Wal-Mart Request, 85 BANKING REP. 230 (2005). An ILC is an FDIC-supervised financial institution that can be owned by a commercial firm that is not regulated by a federal banking agency. Id.
4. Id. It is a narrow charter because the Wal-Mart ILC would accept limited deposits from nonprofit and charitable organizations. Id. According to Wal-Mart, the company has no plans to operate branch banks under the charter and will not engage in lending of any type. Id.
5. Id.
Community Bankers of America, the United Food and Commercial Workers International Union, the National Grocers Association, and the National Association of Convenience Stores. These groups believe that if Wal-Mart charters an ILC, and the charter is later expanded to include full retail banking services, it would put many businesses at substantial risk, in particular small community banks. The approval of an ILC for Wal-Mart could significantly compromise the status of community banks and upset the historic separation in our economy between banking and commerce.

Part II of this Note briefly examines Wal-Mart’s Utah application and the conditions for approval by the UDFI along with the fears shared by community banks of an expanded charter. Part III examines Wal-Mart’s business model and possible risks to community banks if a Wal-Mart ILC follows this model. Part IV discusses the legislatively-mandated separation of banking and commerce and the policy reasons for that separation. Part V examines the risk a Wal-Mart ILC could pose to the Bank Insurance Fund (“BIF”), the FDIC’s role in supervising the Wal-Mart ILC, and the possibility of inadequate federal oversight because of the ILC loophole in the Bank Holding Company Act (“BHCA”). In Part VI, the Note concludes that a Wal-Mart ILC could negatively impact the community banking system and upset the balance between banking and commerce.

II. WAL-MART’S UTAH APPLICATION FOR AN ILC

As of December 31, 2004, there were twenty-nine chartered ILCs in Utah with $120 billion in total assets. In Utah, ILCs are able to make consumer and commercial loans and accept federally insured

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7. Werner, supra note 3.
8. Id.
9. See infra notes 14-45 and accompanying text.
10. See infra notes 46-109 and accompanying text.
11. See infra notes 110-52 and accompanying text.
12. See infra notes 153-82 and accompanying text.
13. See infra notes 183-95 and accompanying text.
deposits, but not demand deposits if they have total assets greater than $100 million. Companies with Utah ILCs include General Electric, Merrill Lynch, Unbundled Bitstream Services ("UBS AG"), Goldman Sachs, American Express, General Motors Acceptance Corporation, BMW, Volkswagen, Lehman Brothers, and Target Stores. Many of these companies use the ILC charters for credit card operations.

Wal-Mart also wants to charter an ILC for credit, debit and electronic check transactions, according to Denis Bouchard, Wal-Mart's director of payments services. Bouchard stated that "[t]he bank will serve as an acquirer of credit transactions in the Visa and MasterCard systems, and will be a sponsor for debit transactions in automated clearing house ("ACH") transactions." Wal-Mart processes about 140 million transactions a month, roughly $288 billion in sales for 2004. The company stands to save a substantial sum acquiring Visa and MasterCard credit and debit card transactions, and truncating checks at the cash register. Presently, Wal-Mart uses First Data to process millions of debit transactions at its stores. It is estimated that about sixty percent of the store's transactions, or about $172 billion a year, are Visa and MasterCard credit and debit card transactions. The transaction costs that would be saved from processing its own Visa and MasterCard credit and debit transactions are estimated to be around $650 million. These savings alone justify the economic benefit to Wal-Mart of an ILC charter.

The major concern of opponents of the Wal-Mart ILC application is that there is nothing to prevent Wal-Mart from chartering an ILC based on a narrow business plan, and later seeking approval of

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17. Id.
18. Id.
19. Id.
20. Id.
21. Id.
23. Wal-Mart Drops the Other Shoe, supra note 16.
24. Id.
25. Id.
the UDFI and the FDIC to expand its business and conduct full service banking.\(^{26}\) Full service banking would include taking deposits and making consumer and business loans. According to Utah and federal law, once an ILC has been established and receives FDIC insurance, it is only restricted to the original business model for the first three years of the ILC’s existence.\(^{27}\) After the first three years, the ILC can file for an amendment to its charter and would be free to engage in all activities allowed by law.\(^{28}\) These activities would include the business of a commercial bank which is not considered a change in the general character or type of business requiring the prior written consent of the FDIC.\(^{29}\) Without this prior written consent, critics fear that Wal-Mart, which has tried to enter banking in the past, may take advantage of this amendment power at a future time to achieve this goal even if that is not Wal-Mart’s current expectation.\(^{30}\)

If a charter amendment is approved, Wal-Mart would be permitted to open branches in twenty-two states.\(^{31}\) Five states provide for ILC charters and seventeen additional states agreed to the “opt-in” provision under the Riegle-Neal Interstate Banking and Branching Act of 1994 (“Riegle-Neal”) to a reciprocal arrangement that allows banks

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28. Id. A Wal-Mart ILC would qualify as an industrial bank. See 12 C.F.R. § 333.1 (2005). Subsequently, an ILC shall not permit any change to be made in the general character or type of business exercised by it without the prior written consent of the FDIC. See 12 C.F.R. § 333.2.

29. See 12 C.F.R. § 333.101(a). The typical change which might require the prior written consent of the FDIC would be to exercise trust powers. Id. As long as the Wal-Mart ILC is in compliance with its original business plan with the FDIC for the first three years, it will only need to notify the FDIC of its change in the general character of business and will not need consent. See Gillmor, supra note 27.


chartered in each state to compete in all of them. Currently, there is federal legislation pending that would enable ILCs to branch into all fifty states without the consent of state officials.

A. Wal-Mart’s Prior Attempts to Enter Banking

Wal-Mart’s first attempt to enter banking was an effort to purchase a small thrift institution named Federal BankCenter in Broken Arrow, Oklahoma. Congress blocked this attempt in the Gramm-Leach-Bliley Act of 1999 ("GLBA") by closing the "unitary thrift holding company" loophole and reaffirming the nation’s policy of separating banking and commerce.

In 2001, Wal-Mart attempted to enter banking again through an agreement with Toronto-Dominion Bank USA ("TD Bank"), a subsidiary of Canada’s Toronto-Dominion Bank, to offer banking services in 100 Wal-Mart stores. The Office of Thrift Supervision ("OTS") thwarted this attempt when it objected to Wal-Mart’s plan to share profits with TD Bank and have its retail store employees perform banking transactions for TD Bank in its stores. The OTS found that this agreement would give Wal-Mart unauthorized control over TD

34. A unitary holding company is a holding company that owns only one (unitary) savings and loan and is exempt from limitations on the nature of the activities conducted by its subsidiaries. Id.
35. Davis, supra note 6.
36. Fine, supra note 26. The main purpose of the GLBA was to permit banks, insurance companies, securities firms, and other financial institutions to affiliate under common ownership and offer their customers a complete range of financial services. Pepper Hamilton, LLP, The Gramm-Leach-Bliley Act: What’s In It for the Insurance Industry, http://library.findlaw.com/1999/Nov/1/127845.html (last visited Jan. 24, 2006). However, it did maintain the separation of commercial firms from banking. See infra notes 130-40 and accompanying text.
37. Pepper Hamilton, supra note 36. The unitary thrift holding company loophole excluded holding companies that held a single savings association from the requirement that their other activities be limited to those closely related to banking. Id. Grandfathering was provided for insurance companies and others that were approved as thrift holding companies before, or pursuant to an application filed before, May 4, 1999 (a date carefully chosen to exclude an application from Wal-Mart). Id.
38. See infra notes 129-40 and accompanying text.
Bank, even though it had avoided the GLBA prohibition on a commercial firm owning a savings bank.\footnote{Id.}

In 2002, Wal-Mart attempted to purchase a small bankrupt $2.5 million industrial bank named Franklin Bank in California.\footnote{Wal-Mart Drops the Other Shoe, supra note 16.} The California legislature reacted swiftly by enacting a law preventing non-financial institutions from acquiring state-chartered industrial banks unless they are "engaged in the activities permitted for financial holding companies" as established in the GLBA.\footnote{California Closes Door on Wal-Mart Bank, ELECTRONIC PAYMENTS INT’L, Oct. 30, 2002, at 2.} This thwarted Wal-Mart’s bid to buy Franklin Bank, a move it said would help it to reduce debit card fees.\footnote{Id.} When California Governor Gray Davis signed the bill, he stated that he did so "in accordance with the federal prohibition against mixing banking and commerce, as intended by the GLBA.”\footnote{Id.}

### III. Risks to Community Banks

#### A. Wal-Mart’s Business Model

Wal-Mart’s business model of extraordinary price-cutting has made it difficult for community businesses to compete against it in the marketplace.\footnote{Id.} This model began when Sam Walton and his brother opened the first Wal-Mart store in 1962.\footnote{Id.} Instead of charging just a little less than his competitors, Walton slashed prices as much as he could while still making a profit.\footnote{Id.} Most other retailers would take the price breaks from manufacturers and add them to their bottom line, while leaving the retail prices untouched.\footnote{Id.} Walton, however, passed these savings on to his customers, assuming he would make up the difference in sales volume.\footnote{Id.} In addition, Wal-Mart built its own

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41. Id.
42. Wal-Mart Drops the Other Shoe, supra note 16.
44. Id.
45. Id.
47. Id.
48. Id.
49. Id.
50. Id.
infrastructure and distribution network. In contrast, other retailers depended on wholesalers to procure, warehouse, and distribute manufactured products. Through its business model, Wal-Mart was able to eliminate some inefficiencies of distribution by not relying upon wholesalers, and pass these savings on to its customers. Wal-Mart also cuts costs by demanding the best prices possible from its suppliers, a move which some contend forces manufacturing jobs overseas in search of cheaper labor. Wal-Mart’s salary structure comprises another effort to cut costs. The average full-time hourly wage for a Wal-Mart employee is $9.98, while the average full-time hourly wage in most urban areas is $10.38. In an effort to continually lower prices, Wal-Mart has shifted most of its purchasing power overseas, where there is generally less government regulation and cheaper labor. In 2004, Wal-Mart reportedly purchased $7.5 billion in goods directly and another $7.5 billion indirectly from China. In 2005, Wal-Mart plans to increase purchasing of Malaysian products by twenty percent. Wal-Mart is now the world’s largest company with $290 billion in revenue, 3,600 U.S. retail stores, 1.25 million U.S. employees, 59

51. Sam Hornblower, Is Wal-Mart Good for America?: Always Low Prices, PBS, http://www.pbs.org/wgbh/pages/frontline/shows/walmart/secrets/pricing.html (last visited Jan. 24, 2006). Wal-Mart was one of the earliest retailers to take advantage of the bar code to increase efficiency at the checkout counter. Id. Wal-Mart developed technology that transmitted point of sale information in real time to manufacturers. Id. This lowered Wal-Mart’s inventory costs and eliminated the need for warehousing. Id. Instead manufacturers would deliver just in time. Id.

52. Id.

53. Id.

54. Goldman & Cleeland, supra note 46.


59. Fine, supra note 26. This is nearly twice as much as General Electric Co. and almost eight times as much as Microsoft Corp. Goldman & Cleeland, supra note 46.

60. Fine, supra note 26.

61. Id. Wal-Mart employs an additional 330,000 employees internationally. Wal-Mart at a Glance, supra note 55.
and more than 100 million customers per week.\textsuperscript{62} Wal-Mart accounts for eight percent of U.S. retail sales, excluding automobiles.\textsuperscript{63} Wal-Mart is the nation’s largest seller of groceries,\textsuperscript{64} toys, furniture, jewelry, dog food, and countless other consumer products.\textsuperscript{65} Wal-Mart achieved its status as this retail behemoth by unflinchingly sticking to its goal of providing its customers the lowest prices possible, at least until local competition is diminished.\textsuperscript{66}

B. How Wal-Mart’s Business Model Could Impact the Communities Served by Community Banks if its ILC Charter is Expanded to Include Full Retail Services

Wal-Mart has shown a pattern of entering local communities and using competitive pricing and other techniques to reduce local competition.\textsuperscript{67} Once local competition has diminished or has been eliminated altogether, Wal-Mart often raises its prices or sometimes shuts down its stores in order to open larger regional stores.\textsuperscript{68} An Iowa State University study revealed that after Wal-Mart’s expansion into Iowa, 555 grocery stores, 298 hardware stores, 293 building suppliers, and 116 pharmacies closed.\textsuperscript{69} Further studies indicate that for every Wal-Mart “Supercenter” opened, two local groceries will close.\textsuperscript{70}

A Wal-Mart ILC could have a similar negative effect on local community banks if a Wal-Mart ILC charter is amended to include full retail banking services.\textsuperscript{71} Community banks are an essential component of their communities.\textsuperscript{72} There would be little economic growth and

\begin{itemize}
  \item Fine, \textit{supra} note 26.
  \item \textit{Wal-Mart at a Glance, supra} note 55.
  \item Goldman & Cleeland, \textit{supra} note 46.
  \item \textit{Id}.
  \item \textit{Id}.
  \item \textit{Sound Banking Coalition, supra} note 56.
  \item \textit{Id}.
  \item \textit{Id}.
\end{itemize}
development without community banks because the local deposits primarily fund consumer and business loans made to members of the community. Further, community bankers know the needs of the localities because they must spend significant amounts of time on community development. As such, community banks lend their expertise to local causes that improve their communities. A Wal-Mart ILC, with lending and investment opportunities available in the many communities in which it operates nationwide, may not be as dedicated to the improvement of the local community as a community bank operating only within that community. Highlighting this problem is the fact that Wal-Mart's ILC application has sought to avoid responsibility under the Community Reinvestment Act ("CRA").

The CRA is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods. Enacted by the Congress in 1977, the CRA requires each depository institution's record to be evaluated periodically to ensure that the institution helps meet the credit needs of its entire community. CRA examinations are

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73. Id.
75. Scharpen, supra note 72. Community bankers often serve as school board members, city council members, county commissioners, etc. See Elder, supra note 74.
76. Id.
77. Id.
78. Fine, supra note 26. Proponents of Wal-Mart would argue that the reason that Wal-Mart avoids responsibility under the Community Reinvestment Act is because the Wal-Mart ILC has no plans to offer full retail services and will use the ILC for strictly processing debit and credit card transactions. See supra notes 18-25 and accompanying text.
82. Community Reinvestment Act, supra 80. Subsequently, that record is taken into account in considering an institution's application for charters or for approval of bank mergers, acquisitions, and branch openings. Id.
conducted by the federal agencies that are responsible for supervising depository institutions.\textsuperscript{83}

The CRA provides a framework in which depository institutions and community organizations work together to promote the availability of credit and other banking services to underserved communities.\textsuperscript{84} As a result of this legislation, banks and thrifts have adopted more flexible credit underwriting standards and made substantial commitments to increase lending to underserved segments of local communities.\textsuperscript{85} Further, not only does the CRA encourage community-wide lending practices, the law makes it clear that an institution's CRA activities should be undertaken in a safe and sound manner.\textsuperscript{86}

Critics of the Wal-Mart's ILC request for an exemption from the CRA contend that this would give the Wal-Mart ILC the ability to take deposits from local communities without having to reinvest in these same communities.\textsuperscript{87} The Association of Community Organizations for Reform Now ("ACORN"), one of the nation's largest community organizations representing low- and moderate-income families, and the newly organized Florida-based Wal-Mart Alliance for Reform Now ("WARN"), are two of the main critics of Wal-Mart's request for an exemption from the CRA.\textsuperscript{88} ACORN, for example, argues that most local businesses use local banks, which in turn recycle a large portion of their deposits back into the communities where they operate through loans and investments.\textsuperscript{89} A Wal-Mart ILC, however, would not be required to recycle these deposits back into the local communities if the application is approved in its current state.\textsuperscript{90} On the other hand, Wal-Mart contends that since it is only applying for a narrow charter and is only using its ILC for "back office" transactions, not deposits, it should not be subject to the requirements of the CRA.\textsuperscript{91}

\textsuperscript{83} These agencies are the FRB, FDIC, the Office of the Comptroller of the Currency and the OTS. Federal Financial Institutions Examination Council: Community Reinvestment Act, http://www.ffiec.gov/cra/history.htm (last visited Jan. 24, 2006).
\textsuperscript{84} Id.
\textsuperscript{85} Id.
\textsuperscript{86} Id.
\textsuperscript{88} Id.
\textsuperscript{89} Id.
\textsuperscript{90} Id
\textsuperscript{91} Id.
Another possible effect of an expanded Wal-Mart ILC is that it may bring competition to communities and consumers. At first the Wal-Mart ILC could offer lower loan rates and fees than the local community banks, thereby giving more options to consumers. Using its retail business model, the Wal-Mart ILC would make up the lower rates and fees with the sheer volume of the loans that it could potentially process. With already thin profit margins, this could drive most of the local community banks out of business.

C. Why Wal-Mart Might Not Expand its Narrow ILC Charter

The basis of the community bankers' fears is that at some point the Wal-Mart ILC will seek to expand its charter to include full retail banking services. According to Jane Thompson, the President of Wal-Mart Financial Services, however, Wal-Mart has no desire to establish branches or engage in lending, and the ILC is a bank that no consumer will ever see. To bolster this argument, Thompson points out that Wal-Mart is actively encouraging community banks to open more branches in its stores. Wal-Mart currently has arrangements with more than 300 banks, which operate more than 1,100 branches in Wal-Mart stores across the country. In the next three years, Wal-Mart plans to have 1,400 branches in its stores. Wal-Mart’s leases with these banks are typically 15-year agreements, which give its bank partners an opportunity to end the lease at the 5-, 10-, and 15-year marks. Wal-Mart has no option to terminate the leases and is

92. Scharpen, supra note 72.
93. Id.
95. Id. Statistics show that the typical community bank needs to spend three to five cents more than its large bank counterparts to generate operating revenue. Id.
96. Id.
97. See supra notes 27-33 and accompanying text.
99. Id. at 2.
100. Id. at 3.
101. Id.
102. Id.
committed for the full 15 years if the bank chooses to remain in the store.103 Currently, Wal-Mart is committed until the year 2023 on some of these leases.104 According to Thompson, Wal-Mart has never broken a lease with a tenant or a bank and this historical record should support the claim that Wal-Mart is not interested in banking.105

In addition to existing partnerships with in-store banks, there would be other hurdles in operating a retail bank. First, even if a Wal-Mart ILC was in every store, Wal-Mart would not have good branch density since most stores are generally located on the periphery of major population centers.106 Second, once Wal-Mart started collecting deposits it would need to find something to do with them.107 Since it would not make economical sense for Wal-Mart to plow deposits into asset-backed securities or some other investment vehicle, Wal-Mart most likely would have to develop a nationwide loan origination system.108 This would require Wal-Mart to become a bureaucratic banking organization which would be a daunting task by any standard.109

IV. RISKS TO BUSINESSES – THE HISTORICAL SEPARATION OF BANKING AND COMMERCE

A principal underlying banking regulation in the United States is that banking and commerce should remain separate.110 This separation traces its roots back to medieval Europe.111 The primary risk from mixing banking with commerce was that banks could enter ventures that were too risky or dominate certain trades.112 Also, British merchants worried that a bank’s monopoly in giving bank notes would give banks

103. Id.
104. Garver, supra note 98, at 3.
105. Id.
106. Id. Branch density refers to the amount of satellite banking deposit locations of a single bank in a given area. Id.
107. Id. at 4.
108. Id.
109. Id.
112. Id.
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a competitive edge in commercial markets.\textsuperscript{113} This separation has not previously prevented the U.S. economy from becoming the most vibrant and diverse economic and financial system in the world.\textsuperscript{114} The separation of banking and commerce allows for fewer conflicts of interest, less undue concentration of resources, and the impartial allocation of credit,\textsuperscript{115} all of which are vital to economic growth.\textsuperscript{116}

The wall between banking and commerce is built on various federal laws such as the National Bank Act of 1864 ("NBA"), the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"), and the BHCA, as well as state banking laws.\textsuperscript{117} The NBA limits the powers of national banks and their subsidiaries to "all such incidental powers as shall be necessary to carry on the business of banking."\textsuperscript{118} The phrase "business of banking" has been the main point of contention in interpreting the statute by the courts and the Comptroller of the Currency.\textsuperscript{119} This phrase has come to be interpreted that banks may engage in businesses similar to traditional banking services but not other commercial activities.\textsuperscript{120}

State banking statutes typically mirror the limits of non-banking activities applicable to national banks.\textsuperscript{121} However, over the years, some states have authorized activities beyond those allowed by national banks.\textsuperscript{122} In an effort to stem the tide, Congress passed FDICIA.\textsuperscript{123} FDICIA prohibits state-chartered banks from engaging in any activities

\begin{thebibliography}{99}
\item \textsuperscript{113} Id.
\item \textsuperscript{114} Fine, supra note 26.
\item \textsuperscript{115} Id. It is feared that Wal-Mart would favor its suppliers and disfavor their competitors. Id.
\item \textsuperscript{116} Fine, supra note 26.
\item \textsuperscript{117} See John R. Walter, Banking and Commerce: Tear Down This Wall?, ECON. Q., Mar. 22, 2003, at 7.
\item \textsuperscript{118} Id.
\item \textsuperscript{120} Walter, supra note 117, at 8.
\item \textsuperscript{121} Id.
\item \textsuperscript{122} Id.
\item \textsuperscript{123} Id.
\end{thebibliography}
deemed impermissible for national banks unless the FDIC rules that such activities pose no threat to the BIF.\textsuperscript{124}

The separation of banking and commerce is also reinforced by the BHCA.\textsuperscript{125} The BHCA restricts bank holding companies\textsuperscript{126} ("BHCs") so they can no longer "manage or control non-banking assets unrelated to the banking business."\textsuperscript{127} The only exception to this restriction is if the non-banking activity is determined to be so closely related to banking that is considered to be incident to banking.\textsuperscript{128}

Further strengthening the American separation of banking and commerce was the GLBA’s closure in 1999 of the so-called "unitary thrift holding company" loophole.\textsuperscript{129} This loophole allowed commercial companies to start or buy one thrift institution without being subject to any restrictions on the other activities conducted within the holding company.\textsuperscript{130} Further clarifying the separation between banking and commerce, GLBA also repealed the 66-year old Glass-Steagall Act\textsuperscript{131} and expanded the activities of qualifying bank-holding companies to include activities that are "financial in nature," "incidental to a financial activity," or "complementary to a financial activity."\textsuperscript{132} After the GLBA, it became permissible for banks to be affiliated with securities firms and insurance companies on the theory that all are involved in "financial activities" and not in "commerce."\textsuperscript{133}

The GLBA established two new corporate vehicles for the conduct of financial service activities, the financial holding company

\begin{footnotesize}
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\item \textsuperscript{124} See 12 U.S.C. § 1831(a) (2000).
\item \textsuperscript{125} Id.
\item \textsuperscript{126} BHC means any company that has control over any "bank" which is defined within the statute. Id.
\item \textsuperscript{127} Id. Nonbanking assets are assets in the bank's possession which are acquired for non-payment of loan dues. Id.
\item \textsuperscript{128} See 12 U.S.C. § 1843(c)(8) (2000). This restriction first applied only to BHCs that held multiple banks, but was made applicable to BHCs that held one bank by the 1970 amendment to the BHCA. Id.
\item \textsuperscript{129} Walter, supra note 117, at 9.
\item \textsuperscript{130} Id. (i.e. savings bank or savings and loan association).
\item \textsuperscript{131} 12 U.S.C. § 377 (2000).
\item \textsuperscript{132} See 12 U.S.C. § 1843(k)(4) (2000) (listing activities financial in nature); 12 U.S.C. § 1843(k)(7 ) (stating procedure to have the FRB and the Treasury Department undertake a rulemaking to find an additional activity permissible).
\end{itemize}
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("FHC") and the financial subsidiary.\textsuperscript{134} Under GLBA, FHCs are authorized to engage in activities that are financial in nature such as: securities underwriting and dealing; insurance agency and underwriting activities; and merchant banking activities.\textsuperscript{135} Also, FHCs may engage in any other activity that the Federal Reserve Board ("FRB") determines to be financial in nature or incidental to a financial activity after consultation with the Secretary of the Treasury.\textsuperscript{136} Furthermore, a FHC may engage in any non-financial activity that the FRB determines is complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system.\textsuperscript{137}

The GLBA also established the concept of functional regulation of subsidiaries of financial holding companies, and established the FRB as the umbrella supervisor.\textsuperscript{138} As the umbrella supervisor of all BHCs, including FHCs, the FRB has the authority to require reports from, and examine any BHC, including a FHC, and any subsidiary.\textsuperscript{139} Mostly, the FRB must rely on audited financial statements, reports submitted to functional regulators, and reports of examination prepared by the subsidiary’s functional regulator.\textsuperscript{140}

In the case of a Wal-Mart ILC, it would not be subject to the supervision of the FRB under GLBA because only the unitary thrift holding company loophole was closed in the GLBA.\textsuperscript{141} ILCs are not considered "banks" under the BHCA, so their corporate owners are not regulated as BHCs or FHCs\textsuperscript{142} under federal regulation, which leaves

\begin{footnotesize}
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\item \textsuperscript{136} See 12 U.S.C. § 1843(k)(2) & (3) (2000).
\item \textsuperscript{138} Gramm-Leach-Bliley, supra note 134.
\item \textsuperscript{139} See 12 U.S.C. § 1844(c)(1) & (2) (2000); Id.
\item \textsuperscript{140} See 12 U.S.C. § 1844(c)(1) & (2) (2000).
\end{itemize}
\end{footnotesize}
these institutions less regulated than other depository institutions. This seems to be inconsistent with the provision of the GLBA that closed the unitary thrift holding company loophole to prevent commercial firms from entering banking by purchasing unitary thrifts. The GLBA and BHCA were enacted to provide safeguards to consumers and the economy for depository institutions by subjecting them to adequate federal regulation. ILCs were not previously covered by these laws because ILCs in the past were small depository institutions. However, in recent years, the assets of ILCs have grown tremendously. Since 1987, the total assets of the ILC industry have grown 3500% from $3.8 billion to over $140 billion in 2004. Furthermore, six ILCs are among the 180 largest financial institutions. The size of ILCs combined with their abilities to participate in activities similar to banks under the BHCA now make supervision of ILCs more of a priority than when the BHCA and GLBA were enacted. A Wal-Mart ILC could become a large ILC. This possibility makes a Wal-Mart ILC a depository institution that may need to be regulated under the BHCA.

V. RISK TO BANK INSURANCE FUND

An ILC is a state-chartered institution. ILC charters are available under the laws of California, Colorado, Hawaii, Indiana, Minnesota, Nevada, and Utah. An ILC does not qualify as a "bank"

143. See id.
144. Id.
145. Id.
147. Id.
148. Id.
149. Id.
150. Id.
151. See infra note 152 and accompanying text.
152. Industrial Loan Corporations, supra note 146.
under the BHCA\textsuperscript{154} if it satisfies one of the following conditions: (1) the institution does not accept demand deposits, (2) the institution's total assets are less than $100 million, or (3) control of the institution has not been acquired by any company after August 10, 1987.\textsuperscript{155} Ownership of an ILC will not subject the corporate parent to the limitations on other businesses of being "closely related to banking" or "financial in nature."\textsuperscript{156} If a Wal-Mart ILC were to avoid classification as a "bank," then it could avoid some of the important regulatory supervision that other banking entities are required to follow. Further, a Wal-Mart ILC could pose a potential risk to the BIF if it were to become insolvent.\textsuperscript{157}

A. FDIC's Supervisory Authority over ILCs

Since ILCs fall outside the scope of the BHCA, they are not subject to the oversight of the FRB.\textsuperscript{158} Consequently, the FDIC and state bank regulators are the primary regulators of ILCs.\textsuperscript{159} A Wal-Mart ILC would be subject to the FDIC's examination procedures, which include "an assessment of the ILC's corporate structure and how the ILC interacts with its affiliates including a review of intercompany transactions and interdependencies, as well as an evaluation of any

\textsuperscript{154} Id.

\textsuperscript{155} See 12 U.S.C. § 1841 (c)(2)(h) (2000). Since most ILCs do not want to qualify as banks but still would like to have assets greater than a $100 million, they do not offer demand deposits. See INDUSTRIAL LOAN CORPORATIONS, supra note 146. Instead many ILCs offer negotiable order of withdrawal ("NOW") accounts. Id. NOW accounts are deposit accounts that give an ILC the right to require at least seven days written notice prior to withdrawal. See 12 C.F.R. § 204.2(b)(3) (2005). "An account holder can withdraw funds by writing a negotiable order of withdrawal payable to a third party." TeachMeFinance.com, http://teachmefinance.com/Financial_Terms/negotiable_order_of_withdrawal_account.html (last visited Jan. 24, 2006). These NOW accounts are similar in many respects to demand deposits and may be offered by ILCs that are not subject to regulation under the BHCA. See INDUSTRIAL LOAN CORPORATIONS, supra note 146. The availability of NOW accounts would allow a Wal-Mart ILC to avoid the $100 million deposit limit. See 12 U.S.C. § 1841. Under the Federal Deposit Insurance Act, NOW accounts may be offered to individuals and nonprofit organizations. See 12 U.S.C. § 1832 (2000). However, there is pending legislation that would allow ILCs and other depository institutions the authority to offer interest-bearing NOW accounts to businesses which would greatly expand the transactions that a Wal-Mart ILC with full retail bank services would be able to offer. See H.R. 1224, 109th Cong. (2005); see also INDUSTRIAL LOAN CORPORATIONS, supra note 146.

\textsuperscript{156} See A Historical Perspective, supra note 153.

\textsuperscript{157} See infra notes 176-82 and accompanying text.

\textsuperscript{158} See supra notes 153-55 and accompanying text.

\textsuperscript{159} A Historical Perspective, supra note 153.
financial risks that may be inherent in the relationship. The FDIC examiners also have the power to review the current business plan submitted with the ILC application and any documents involving shared employees or management of the applicant. The FDIC also has the authority under § 10(b) of the FDICIA to examine any affiliate of the institution, including the parent company. The purpose of this authority is to determine the relationship between the ILC and its parent and the effect of such a relationship on the ILC. While this regulatory authority may appear sufficient on its face, it may not be sufficient to contain any problems posed by an unstable Wal-Mart ILC.

B. The Federal Reserve's Authority Under the BHCA

The FDIC's authority appears to be adequate until it is compared to the power of the FRB under the BHCA. The BHCA provides the FRB with the authority to examine the BHC itself and any of its non-banking subsidiaries at any time. On the other hand, the FDIC employs a supervisory approach that primarily focuses on isolating the ILC from potential risks posed by the holding company, rather than assessing these potential risks systematically across the consolidated holding company structure. Also, the FDIC has only limited examination authority and is unable to examine affiliates of banks or ILCs unless necessary to disclose the direct relationship between the bank and affiliate and the effect of the relationship on the bank. If a relationship does not exist, any reputation or other risk presented by an affiliate that could impact the institution may not be

160. Id.
161. Shared employees are employees that would work for Wal-Mart and the Wal-Mart ILC. Id.
162. A Historical Perspective, supra note 153.
164. A Historical Perspective, supra note 153.
165. See infra notes 166-75 and accompanying text.
166. See infra notes 167-75 and accompanying text.
168. INDUSTRIAL LOAN CORPORATIONS, supra note 146.
169. See id.
detected.\textsuperscript{170} In addition, the FRB is entitled to establish consolidated capital requirements to ensure that BHCs are a source of financial strength for the subsidiary bank.\textsuperscript{171} Parent companies of ILCs are not subject to these capital requirements.\textsuperscript{172} Also, the FRB has broad enforcement authority under the BHCA.\textsuperscript{173} With this enforcement authority, the FRB can issue cease and desist orders, impose civil money penalties and order a BHC to divest non-bank subsidiaries if it determines that ownership of the subsidiary presents a risk to the financial safety, soundness or stability of an affiliated bank or is inconsistent with sound banking principles or the purposes of the BHCA.\textsuperscript{174} The FRB, not the FDIC, is the only agency that has the authority to take such actions against BHCs.\textsuperscript{175}

C. Wal-Mart ILC’s Risk to the Bank Insurance Fund

In the case of a Wal-Mart ILC, supervisory oversight is critical due to the sheer size of Wal-Mart and the subsequent risk a Wal-Mart ILC may pose to the BIF.\textsuperscript{176} The losses that the FDIC would be responsible for if the Wal-Mart ILC experienced financial problems could be significant.\textsuperscript{177} If a loan office at a significant number of Wal-Mart ILCs made poor credit decisions on loans which later defaulted, it could create a significant hardship for the BIF.\textsuperscript{178} Mark G. Field, the President and Chairman of Farmers Bank of Liberty in Illinois, summarizes the fear well by stating “[i]magine what an Enron Bank or WorldCom Bank would have done to the FDIC insurance funds.... For that reason, Wal-Mart’s application should be denied.”\textsuperscript{179} A simple

\textsuperscript{170} Id. at 6.  
\textsuperscript{171} Greenspan, supra note 167.  
\textsuperscript{172} Id.  
\textsuperscript{173} Id.  
\textsuperscript{174} Id.  
\textsuperscript{175} Id.  
\textsuperscript{176} Sound Banking Coalition, supra note 56. The Bank Insurance Fund is a fund held by the FDIC as deposit insurance for banks excluding thrifts. See 12 U.S.C. § 1814 (2000).  
\textsuperscript{177} Id.  
\textsuperscript{178} Letter from John G. Schmid, Executive Vice President, Grant County State Bank, to John F. Carter, Regional Director, Federal Deposit Insurance Corporation (Sept. 23, 2005), available at http://www.fdic.gov/regulations/laws/walmart/commentletters/Grant%20County_State%20_Bank_September_29.pdf.  
\textsuperscript{179} Luke Mullins, Extension – And 14 ILC Comments Become 700, AM. BANKER, Sept. 27, 2005 at 1.
example will illustrate the risk that a Wal-Mart ILC could pose to the BIF. If one of Wal-Mart’s subsidiaries or Wal-Mart itself made poor credit decisions and sustained large losses, it is possible that Wal-Mart could sell these loans to the Wal-Mart ILC knowing that the ILC is federally insured. The Wal-Mart ILC could become insolvent but the depositors of the ILCs would be insured, permitting Wal-Mart to continue operations after shifting these losses to the government. The insolvency of a Wal-Mart ILC could mean significant losses and could have a significant negative effect on our national economy.

VI. CONCLUSION

Although it may be convenient for Anthony if he could purchase his dog food and obtain a mortgage from the same place, sanctioning one-stop shopping at a Wal-Mart and a Wal-Mart ILC requires careful consideration. Wal-Mart’s enormous size would allow it to establish an ILC in many communities across the country. That fact coupled with Wal-Mart’s business model means a Wal-Mart ILC would likely charge lower rates and fees on loans than local community banks. This could put great pressure on these local banks and may force many of them to close. With less competition, a Wal-Mart ILC could later raise its loan interest rates and fees and local retailers may be forced to go to their biggest competitor for loans. Also, a Wal-Mart ILC may not make impartial credit decisions and could favor its suppliers over suppliers of its competitors, which would further diminish healthy competition. Furthermore, a Wal-Mart ILC could take the deposits from the local community and re-invest them elsewhere which could deprive communities of much needed capital.

180. See Schmid, supra note 178.
181. See id.
182. See supra notes 176-81 and accompanying text.
183. See supra notes 59-65 and accompanying text.
184. See supra notes 46-58 and accompanying text.
185. See supra notes 92-96 and accompanying text.
186. Fine, supra note 26, at 4.
188. Fine, supra note 26, at 4.
189. See supra notes 87-91 and accompanying text.
The separation of banking and commerce has been a fundamental principle of our economy\textsuperscript{190} that provides for impartial allocation of credit with fewer conflicts of interest, and prevents undue concentration of resources, which is vital to economic growth.\textsuperscript{191} Congress has reaffirmed this separation with the GLBA, which prevented commercial firms from owning a single savings and loan association,\textsuperscript{192} and a Wal-Mart ILC could upset this delicate balance.

In addition, a loophole in the BHCA does not subject ILCs to the FRB's supervision.\textsuperscript{193} This is problematic because the FDIC may not have enough supervisory authority to control Wal-Mart if it gets into financial danger and seeks to use the Wal-Mart ILC to rectify any severe financial difficulty.\textsuperscript{194} Without rigorous supervision, the size of a Wal-Mart financial crisis could have a significant impact on the United States economy.\textsuperscript{195}

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\textsuperscript{190} Cocheo, \textit{supra} note 110.
\textsuperscript{191} Fine, \textit{supra} note 26, at 3.
\textsuperscript{192} \textit{Id.} at 6.
\textsuperscript{193} \textit{See supra} notes 153-55 and accompanying text.
\textsuperscript{194} \textit{See supra} notes 158-65 and accompanying text.
\textsuperscript{195} \textit{See supra} notes 176-82 and accompanying text.