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Waging War With Wal-Mart: A Cry For Change Threatens the Future of Industrial Loan Corporations

Zachariah J. Lloyd*

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WAGING WAR WITH WAL-MART: A CRY FOR CHANGE THREATENS THE FUTURE OF INDUSTRIAL LOAN CORPORATIONS

Zachariah J. Lloyd[*]

I. INTRODUCTION

Wal-Mart, America's behemoth one-stop-shop, boasts astronomical statistics: two million employees worldwide; $374.5 billion in sales for the fiscal year ending January 31, 2008; more than 4,100 locations in the United States alone, spanning approximately 600 million square feet of retail space; and more than 176 million customers per year.[1] Despite these staggering figures, "[f]ew efforts illustrate the breadth of Wal-Mart's ambitions . . . as much as a nearly decade-long drive to establish its own bank."[2]

After a firestorm of criticism from banking industry officials[3] and

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[*] Mr. Lloyd is an associate in the securities and commercial litigation group at Perkins Coie LLP. He obtained his J.D. with high honors, Order of the Coif, from the S.J. Quinney College of Law at the University of Utah in 2008; B.A. (English Theory) from the University of Utah. The Author thanks Clemens Mueller-Landau, Joseph Loosle and Matthew Pierce, as well as the staff of the Utah Law Review, for their invaluable efforts in bringing this article to fruition. The Author also wishes to thank Professor Christian A. Johnson for his research assistance and academic insight. Ultimately, however, none of this would have been possible without the love and encouragement from the Author's wife, M.E., and the inspiration of his two daughters, Layla and Alix; to them, the Author is eternally indebted.

1. Wal-Mart, Inc., Corporate Facts, http://www.walmartfacts.com/FactSheets/3142007_Corporate_Facts.pdf [hereinafter Corporate Facts] (last visited Oct. 26, 2008); Wal-Mart Stores, Inc., 2008 Annual Report (Form 10-K), http://walmartstores.com/sites/AnnualReport/2008/docs/wal_mart_annual_report_2008.pdf, at 2-4 [hereinafter Annual Report].

2. Eric Dash, *Wal-Mart Abandons Bank Plans*, N.Y. TIMES, Mar. 17, 2007, at C1, *available at* http://www.nytimes.com/2007/03/17/business/17bank.html.

3. *See* Letter from Camden R. Fine, President and CEO, Indep. Cmty. Bankers of Am., to Donald E. Powell, Chairman, Fed. Deposit Ins. Corp. (Aug. 18, 2005), at 1,

consumer watchdog groups,[4] legislative threats from lawmakers,[5] and an extended moratorium freezing all Industrial Loan Corporation ("ILC")[6] applications by the Federal Deposit Insurance Corporation ("FDIC"),[7] Wal-Mart withdrew its most recent attempt to secure a bank charter – an ILC[8] – on March 16, 2007.[9] Despite its lack of success, this attempt by the world's largest retailer to enter the world of banking stoked anew the flames of controversy surrounding America's age-old public policy: to keep banking and commercial entities separate. Specifically, it highlighted the surge in ILCs and the subsequent brick-by-brick dismantling of the wall dividing the banking and commercial worlds.[10]

Although ILCs have existed with relatively little fanfare for decades (and several blue chips already control ILCs of their own),[11] Wal-Mart's ILC application created unprecedented opposition; drastic calls for legislative action came from nearly every arena to prevent Wal-Mart and other giant retailers from controlling a banking institution. The purpose of this Article, therefore, is to chronicle the development of the ILC industry and to analyze whether the separation of banking and com-

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available at http://www.icba.org/files/ICBASites/PDFs/ltr081805.pdf.

4. *See* Dash, *supra* note 2.

5. *Id.*

6. As of March 17, 2004, Utah law was amended to rename the industry from Industrial Loan Corporations (ILCs) to Industrial Banks. UTAH CODE ANN. § 7-8-21 (2006). This article will use the term "ILC" to refer to both Industrial Loan Corporations and Utah Industrial Banks.

7. Fed. Deposit Ins. Corp., FDIC Board of Directors order executed by FDIC Executive Secretary Robert E. Feldman, FDIC Notice No. 6714-01-P, Moratorium on Certain Industrial Loan Company Applications and Notices (July 2006) pt. IV, *available at* http://www.fdic.gov/news/news/press/2006/pr06073a.html (imposing a six-month moratorium, effective through January 31, 2007, on FDIC action "to (i) accept, approve, or deny any application for deposit insurance submitted to the FDIC by, or on behalf of, any proposed or existing ILC, or (ii) accept, disapprove, or issue a letter of intent not to disapprove, any change in bank control notice submitted to the FDIC with respect to any ILC").

8. *See id.* at pt. I (noting that "[w]hile ILCs are 'banks' under the FDI Act, [12 U.S.C. § 1813(a)(2)], they generally are not 'banks' under the Bank Holding Company Act (BHCA) [12 U.S.C. § 1841(c)(2)(H)]").

9. *See* Dash, *supra* note 2, at C1.

10. Karen L. Werner, *Community Banks: Banking Coalition Seeks House Support For ILC Compromise After Wal-Mart Request*, 85 BANKING REP. 230 (2005).

11. *See infra* Part II.A.1(b).

merce is a justifiable basis for opposing ILCs. Part II will address the history of the ILC from its creation to its emergence as the banking entity of choice for some of the Nation's largest financial and commercial companies; Wal-Mart's role in advancing the controversy; and the regulatory and legislative responses to large commercial entities seeking to control ILCs. Part III will address the separation of banking and commerce as it relates to ILCs. It will also set forth three different solutions available to Congress, and will discuss the impact that the implementation of proposed legislation will have on the ILC industry as a whole, and on the State of Utah in particular. This Article concludes that in the absence of any risk peculiar to commercially-affiliated ILCs, and in light of the regulatory success of the FDIC and Utah Department of Financial Institutions ("Utah DFI"), a wall of separation should not be erected between ILCs and commercial holding companies. Rather, ILCs should continue to receive charters, so long as there is sufficient regulatory supervision to manage the risks inherent in their holding structure.

II. THE CONTROVERSY

A. ILC Overview: From Creation to Expansion to Explosion

1. ILC Growth and Development

According to a report by the Government Accountability Office ("GAO Report"), ILCs are "state-charted financial institutions that emerged in the twentieth century to provide consumer credit to low and moderate income workers who were generally unable to obtain consumer loans from commercial banks."[12] Although most ILC deposits were not insured by the FDIC until the passage of the Garn-St. Germain Act of 1982,[13] these financial institutions raised capital by issuing investment certificates and taking deposits. The ILCs then used these

12. GOV. ACCOUNTABILITY OFFICE, NO. 05-621, INDUSTRIAL LOAN CORPORATIONS: RECENT ASSET GROWTH AND COMMERCIAL INTEREST HIGHLIGHT DIFFERENCES IN REGULATORY AUTHORITY 1, *available at* http://www.gao.gov/new.items/d05621.pdf [hereinafter GAO REPORT].

13. Pub. L. No. 97-320, 96 Stat. 1469 (1982) (codified as amended in scattered sections of 12 U.S.C.).

funds to make unsecured, high interest loans to consumers.[14] In the last ten years, however, an increased interest in owning ILCs by commercial entities has caused the ILC industry to experience "significant asset growth."[15]

(a) ILC Statutory Creation and Advantages

Like other "non-bank" banks that neither accepted demand deposits nor made commercial loans,[16] ILCs were originally exempted from the Bank Holding Company Act of 1956 ("BHC Act")[17], which prohibited bank holding companies from engaging in insurance, securities underwriting, or commercial business.[18] As a result, many banking institutions participated in only one of the permissible activities – accepting demand deposits *or* making commercial loans – to avoid classification and regulation as a "bank" under the BHC Act. In response to the growing number of such "non-bank" banks, the Board of Governors of the Federal Reserve System ("Federal Reserve Board") enacted the Competitive Equality Banking Act ("CEBA"), redefining the term "bank" under the BHC Act to include any FDIC-insured bank.[19] The CEBA strengthened the BHC Act's supervisory reach by subjecting all non-excepted FDIC-insured banks to consolidated supervision[20] and by bringing them within the scope of the BHC Act's limitations on bank holding companies.[21]

Except for a limited number of qualifying institutions, entities that own or control insured depository institutions generally may engage, directly or through subsidiaries, only in activities that are financial in nature.[22] With respect to ILCs, however, the CEBA excepted from the BHC Act four types of ILCs because they did not fall within the definition of "bank":

14. Raymond Natter, *The Industrial Loan Corporation Controversy*, FIN. SERVICES INST. July 2005 ¶ 3.
15. GAO REPORT, *supra* note 12, at 1, 15.
16. Natter, *supra* note 14.
17. 12 U.S.C. §§ 1841, 1843 (2006).
18. *Id.*
19. *Id.* at ¶ 4.
20. *Id.*
21. *Id.*
22. 12 U.S.C. §§ 1843, 1467a(c) (2006). Grandfathered unitary thrift holding companies are not subject to these activities restrictions. Limited purpose credit card banks are also exempt from the BHC Act. *Id.* § 1841(c)(2)(F).

(i) an ILC that does not accept demand deposits which the depositor may withdraw by check or similar means for payment to third parties;
(ii) an ILC that has less than $100 million in total assets;
(iii) an ILC that has not undergone a change in control after the date of enactment of the CEBA (i.e., August 10, 1987); and
(iv) an ILC that does not, directly or through an affiliate, engage in any activity in which it was not lawfully engaged as of March 5, 1987.[23]

Notably, exceptions (i) through (iii) do not require the ILC to have been in existence as of a certain date. Thus, a new ILC may be chartered in any state that permits such entities and may avoid being subject to the BHC Act, provided it meets one of these three exceptions.[24] Therefore, on one hand these exceptions for ILCs arguably create special supervisory risks, because an ILC's parent company and non-banking affiliate might not be subject to supervision on a *consolidated* basis by a federal agency such as the Federal Reserve Board, the Office of the Comptroller of the Currency, the Office of Thrift Supervision ("OTS"), or the National Credit Union Association.[25]

ILCs are now "the only federally-insured depository institutions with the authority to offer a broad range of banking products and services in a holding company structure exempt from the [BHC Act]."[26] Thus, neither the holding company nor its subsidiaries are restricted in any way as to the services or products they may offer. FDIC insurance permits ILCs to generate funds through deposits, which are often the most cost-effective way to acquire funding.[27] Additionally, ILCs share with FDIC-insured institutions the ability to "export" their home state's usury laws – laws regarding interest and finance charges – regardless of where their customers reside.[28]

Yet another advantage of ILCs is their ability to become an originator of "Visa or MasterCard credit, debit, charge, and business cards."[29]

23. Natter, *supra* note 14, ¶ 5 (citing 12 U.S.C. § 1841(c)(2)(H)(i)(I-III), (ii) (2006)).

24. *Id.* ¶ 8.

25. GAO REPORT, *supra* note 12, at 10.

26. George Sutton, *Industrial Banks*, 56 CONSUMER FIN. L.Q. REP. 178, 179 pt. III.A (2002).

27. *Id.* at 180 pt. III.B.

28. *Id.* at 180 pt. III.E.

29. *Id.* at 180 pt. III.F.

Each ILC is chartered and regulated by the state banking commissioner in the state in which the institution is based. As will be addressed below, virtually all ILCs established in recent years have been chartered and regulated by the State of Utah.[30]

(b) Major Participants in the ILC Market

In the time since the CEBA's passing, ILCs have emerged from relative obscurity and have grown into an industry with over $212.8 billion in assets.[31] Today, "the typical [ILC] is owned by a parent corporation with well established multistate operations."[32] Most ILCs offer "specific financial products and services to established customers of the parent."[33] Thus, the ILC allows the parent company to "leverage existing customer relationships" and drive more sales "through established distribution channels."[34] ILCs offer a versatile depository charter for companies that are not permitted to, or that choose not to, become subject to the BHC Act.[35]

An overview of the ILC industry revealed that of the sixty-one existing industrial banks as of August 2006, forty-three were either independently owned or affiliated with a parent company whose primary business purpose is financial in nature.[36] Further, these forty-three charters comprised approximately ninety percent of the industry's assets and deposits.[37] The other eighteen charters were "associated with parent companies that can be considered non-financial . . . [and] account for approximately ten percent of . . . assets and deposits."[38]

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30. *Id.* at 179 pt. II.

31. *See* H.R. REP. NO. 110–155, at 10 (2007). In 1987, the largest ILC had total assets of $410 million. *Id.* By 2006, the largest ILC had total assets of $67 billion with $54 billion in deposits, "making it among the twenty largest [FDIC] insured banks in terms of deposits." *Id.*

32. Sutton, *supra* note 26, at 179 pt. II.

33. *Id.*

34. *Id.*

35. *See supra* notes 26-30 and accompanying text.

36. G. Edward Leary, Remarks of the Utah Commissioner of Financial Institutions before Utah Association of Financial Services, 3 (Aug. 25, 2006), *available at* http://www.dfi.utah.gov/PDFiles/IB%20Speech%202006.pdf [hereinafter Leary Remarks].

37. *Id.*

38. *Id.*

Active ILCs that are not independently owned[39] can be categorized into three distinct business groups. The first group comprises the majority of the active ILCs; they are owned and operated by large and "complex financial institutions with extensive access to the capital markets."[40] These ILCs – such as American Express Centurion Bank ($23.4 billion) and UBS Bank USA ($23.1 billion) – use the ILC entity to service their brokerage accounts and make securities-backed loans.[41] The second group, comprised of commercial and retail corporations such as GMAC Automotive Bank ($23.5 billion), Target Corporation ($15.3 million), and GE Capital Financial ($2.2 billion),[42] utilize the ILC as a "financial arm of larger corporate organization[s]" in order to enhance their retail operations.[43] The third group, including BMW ($2.4 billion) and Volkswagen ($288 million),[44] employs the ILC to "directly support the holding company organizations' commercial activities."[45]

The variety of ILC business models highlights the ILC's flexible utility. Generally, only three particular assets are needed to enter the financial services market – capital, information technology, and distribution. It is logical, therefore, that most commercial entities with these assets in hand would gravitate toward the opportunities afforded by the ILC. As Ross & Sutton observed, "[e]ach company tends to market specialized [financial] products to [its] national and international markets."[46] These products may include "general consumer credit cards, business credit cards, [and] affinity group and private label cards [as

39. The GAO REPORT notes that there are a few ILCs which are "community-focused, stand-alone institutions such as Golden Security Bank and Tustin Community Bank." GAO REPORT, *supra* note 12, at 18. In contrast to most ILCs, these function much more like traditional community banking institutions. *Id.*

40. *Id.*

41. These figures were current as of June 30, 2007. *Industrial Loan Companies: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 110th Cong., 16, attachment 1 (Oct. 4, 2007) (statement of FDIC Chief Operating Officer John F. Bovenzi) [hereinafter Bovenzi Attachment]. For current Utah ILC Asset Statistics from the FDIC, *see* http://www2.fdic.gov/idasp/index.asp (follow link for "Find Institutions" and search by "Institution Name") (last visited Oct. 28, 2008).

42. *Id.*

43. GAO REPORT, *supra* note 12, at 18.

44. Bovenzi Attachment, *supra* note 41.

45. *Id.*

46. Yan M. Ross & George Sutton, *Utah Industrial Loan Corporations: A Fresh Look Backward and Forward*, 48 CONSUMER FIN. L.Q. REP. 7, 8 (1994).

well as] . . . small consumer loans, commercial loans . . . , home equity loans, and auto loans."[47]

(c) Utah's Emergence as the ILC Industry Leader

As of June 30, 1993, the State of Utah regulated fourteen active ILCs with just over $1.0 billion in assets.[48] By year-end 2004, twenty-nine ILCs were chartered in Utah with assets totaling more than $115.0 billion.[49] These twenty-nine ILCs represented eighty-two percent of the ILC industry's total assets.[50]

Utah's emergence as the ILC industry leader is attributable to three primary factors. First, Utah has desirable usury law.[51] Because an ILC enjoys the same authority as other FDIC-insured institutions to export the interest rate laws of its home state to every other state in which it does business, the usury laws of the ILC's home state are vital.[52] As Sutton analyzed, "[w]ith minor exceptions, the Utah Consumer Credit Code (Title 70C of the Utah Code) does not impose caps on interest rates, finance charges, or other fees that a lender and borrower can specify in a credit contract."[53]

Second, Utah's laws are generally business- and institutionally-friendly. Utah businessmen and legislators have collaborated to be on the forefront of deregulation of the financial industry, passing laws and regulations that foster business and financial development.[54] As a result, Utah has a regulatory framework that benefits both the state and its financial institutions. Utah's state regulators continue to work to enable further improvement and expansion of financial industries while maintaining proper safety and soundness as directed by the FDIC.[55]

Third, Utah is a preferred operations site. Salt Lake City is significantly less expensive than other urban areas in terms of operation costs, yet approximately eighty percent of the state's population lives within

47. *Id.*
48. *Id.* at 8.
49. GAO REPORT, *supra* note 12, at 19.
50. *Id.*
51. *Id.*
52. *Id.* at 21.
53. Sutton, *supra* note 26, at 180.
54. *Id.*
55. *Id.*

forty miles of the city.[56] Additionally, Utah's "education and literacy levels are among the highest in the nation" and "productivity levels in the Utah facilities of many national and international companies are among the highest in those organizations."[57] These factors demonstrate why almost all ILCs established in the last decade have been chartered in Utah.[58]

2. *Regulatory Framework*

Under the BHC Act, the Federal Reserve Board (the "Fed") "generally supervises bank holding companies and has established a consolidated supervisory framework for assessing the risks to a depository institution that could arise because of their affiliation with other entities in a holding company structure."[59] The ILC exemption from the BHC Act, however, removes these institutions from the Fed's consolidated supervisory framework. This exemption makes up one facet of the great controversy surrounding the continuing existence of ILCs.[60]

(a) The FDIC

Exemption from the BHC Act does not remove an ILC from all federal regulation. According to the GAO Report, "[The] FDIC is the primary federal supervisor of state-chartered institutions that do not join the Federal Reserve system, including ILCs."[61] The FDIC has the same broad supervisory, regulatory, and enforcement authority over ILCs as it has over other non-member, insured state banks under its jurisdiction.[62] As the GAO Report noted, the "FDIC's supervisory authority over the

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56. *Id.*

57. *Id.* at 180-81.

58. *See id*.

59. GAO REPORT, *supra* note 12, at 1.

60. *Id.*

61. *Id.* at 11. "As of December 31, 2004, 3 of the top 16 largest insured institutions supervised by the FDIC were ILCs." *Id.* Further, it should be noted that ILCs may choose whether to be regulated by the FDIC or Federal Reserve Board; no ILCs in Utah have selected the Federal Reserve Board to be its primary regulator. *See* Sutton, *supra* note 26, at 179.

62. *See* 12 U.S.C. § 1820(b)(2) (2006). *See also* Mindy West, *The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective*, SUPERVISORY INSIGHTS (Div. of Supervision & Consumer Prot. of the Fed. Deposit Ins. Corp.), Summer 2004, at 9-10 (detailing the effectiveness of FDIC supervision of ILCs and the modifications that it has adopted to improve supervision).

holding companies and affiliates of ILCs is more limited than the authority that consolidated supervisors have over the holding companies and affiliates of banks and thrifts."[63] Further, "[ILCs] are subject to the same regulations and regulatory standards as any FDIC-insured commercial bank."[64]

Nevertheless, many banking industry leaders and lawmakers are critical of the ILC exemption from the BHC Act because they believe the FDIC does not have the same coercive power to regulate as the consolidated regulators (the Fed or OTS).[65] While a consolidated supervisor is generally able to examine the holding company and any non-bank subsidiary – notwithstanding any relationship the subsidiary has with the affiliated insured bank – the "FDIC's authority to examine an affiliate of an insured depository institution is limited to examinations necessary to disclose fully the relationship between the institution and any affiliate and the effect of the relationship on the institution."[66]

However, the Federal Deposit Insurance Act bolsters the express examination power with a statutory grant to the FDIC to "exercise by its Board of Directors, or duly authorized officers or agents, all powers . . . necessary to carry out the powers so granted."[67] Additionally, in view of the Supreme Court's broad interpretation of "incidental powers" in the banking context,[68] the FDIC has plenary powers that historically have resulted in supervisory results comparable to those of the consolidated supervisors.[69] As Part II will argue, however, more so than

63. GAO REPORT, *supra* note 12, at 6.

64. Sutton, *supra* note 26, at 179.

65. *See* GAO REPORT, *supra* note 12, at 5-7 (expressing skepticism as to the FDIC's ability to supervise effectively a large and complex ILC holding company, especially in a time of financial stress); Fine, *supra* note 3, at 5 ("While the FDIC would have the authority and tools to address safety and soundness problems confined to the Wal-Mart ILC, it lacks the essential tools the [BHC Act] gives the Federal Reserve [Board] to oversee and supervise bank holding companies and ensure the safe operation of the overall enterprise.").

66. GAO REPORT, *supra* note 12, at 5-7; *see also* 12 U.S.C. § 1820(b)(4)(A) (2006) (setting forth the FDIC's examination authority of affiliates).

67. 12 U.S.C. § 1819(a) (2006).

68. *See* NationsBank of N.C. v. Variable Annuity Life Ins. Co., 513 U.S. 251, 257-58 (1995) (construing "business of banking" language of the National Bank Act broadly to permit the Office of the Comptroller of the Currency to decide that small banks could sell annuities).

69. *See generally* West, *supra* note 62 at 11-13 (discussing a recent FDIC staff

these statutory and judicial enhancements, the FDIC's regulatory track record offers convincing proof of the adequacy and sustainability of the FDIC's supervisory powers.[70]

(b) Utah Department of Financial Institutions

Each ILC is chartered and regulated by the state banking commissioner in the state where the institution is based.[71] All ILCs in Utah are chartered and regulated by the Utah Department of Financial Institutions ("Utah DFI").[72] The Utah DFI has robust, plenary authority over both its ILCs and the companies that control them under Utah Code Title 7.[73] Its Commissioner also has broad supervisory, regulatory and enforcement authority over Utah ILCs that parallels the FDIC's authority. The Utah DFI's supervisory authority includes the right to examine the ILC and to take enforcement and remedial actions against the ILC and its affiliates.[74] Its enforcement powers include: the right to issue cease and desist orders;[75] remove officers and directors;[76] take possession of the institution;[77] and enforce supervisory acquisitions and mergers.[78] The Utah DFI's regulatory power also brings ILCs within the scope of "the same laws and regulations, as well as standards for safe and sound lending practices," as other Utah commercial banks.[79]

The Utah ILC application process closely mirrors that of the FDIC;

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study setting forth the FDIC's excellent track record supervising ILCs and noting that of the twenty-one ILCs that have failed, none was either a Utah ILC or owned by a commercial entity).

70. *See infra* Part II.C.1.

71. *See* UTAH DEP'T OF FIN. INSTS., WHAT IS A UTAH INDUSTRIAL BANK?, http://www.dfi.utah.gov/whatisIB.htm (last visited Oct. 28, 2008).

72. *Id.*

73. *See* UTAH CODE ANN. § 7-1-201 (2008) (providing that Department of Financial Institutions is responsible for "the execution of the laws of this state relating to all financial institutions and other persons subject to this title, and relating to the businesses they conduct"); *see also* Leary Remarks, *supra* note 36, at 5-6 (setting forth the Utah DFI's examination procedures).

74. UTAH CODE ANN. §§ 7-1-314, -510 (2008).

75. *Id.* § 7-1-307.

76. *Id.* § 7-1-308.

77. *Id.* § 7-1-510.

78. *Id.* § 7-1-313, -314.

79. GAO REPORT, *supra* note 12, at 24. The GAO Report also notes that California, the other state with any significant concentration of ILC assets, has similarly subjected its ILCs to the same standards and regulatory limitations as its commercial banks. *Id.*

an ILC applicant may thus file the FDIC application in lieu of filing the application for the ILC charter with the State of Utah.[80] The Utah DFI considers various factors when determining whether to approve applications for ILC charters. The weight accorded to each factor depends on the business model of each ILC applicant.[81] Some of these factors include:

- The character, reputation and financial standing of the organizer(s).
- Whether the organizers have the capital resources to support an ILC.
- The establishment of a Utah organization in which autonomous decision making authority and responsibilities reside with the board and management such that they are in control of the ILC's activities and direction.
- Utah-based management that has knowledge, expertise and experience in operating a depository institution in a regulated environment.
- Management that is independent of the parent; however, goals and policies attributed to the parent may be carried out by the ILC if defined in the ILC's business plan.
- A bona fide business plan and defined purpose for the existence of the ILC, including deposit taking as an integral component, with at least three years of pro forma projections and supporting data.[82]

Imposition of these factors by the regulator is meant to ensure that each ILC has sufficient autonomy, is insulated from the parent company, and is "held accountable for ensuring that all bank operations and business functions are performed in compliance with banking regulations and in a safe and sound manner."[83]

In addition to the initial review conducted before the approval of a depository charter – and as with all depository institutions – ILCs are subject to safety and soundness examinations by the Utah DFI and the

80. *See* UTAH DEP'T OF FIN. INSTS., *supra* note 71.
81. *See id.*
82. *Id.*
83. West, *supra* note 62, at 9.

FDIC.[84] These annual examinations are usually conducted jointly by the two regulators.[85] The Utah DFI has over forty-two field examiners who are experienced in conducting regular examinations of holding companies, and it plans "to provide further training and increase [its] number [of examiners] so that [it] can conduct, independently, if need be, holding company inspections of all financial institution holding companies registered in Utah."[86] Propelled by this regulatory framework and the exceptions under the BHC Act, ILCs have grown out of relative obscurity to include among their ranks one of the twenty largest FDIC-insured banks.[87]

B. Wal-Mart's Efforts to own a Bank

Sam Walton opened his first discount store in 1962.[88] Over the ensuing forty-six fiscal years, Wal-Mart's corporate footprint permeated communities in every state and thirteen countries worldwide to include 1,589 discount stores, 2,794 Supercenters, 713 Sam's Clubs, and 134 Neighborhood Markets.[89] Its 1.4 million American employees make it the nation's largest employer and it sits atop the Fortune 500.[90] Yet, despite its remarkable growth and repeated efforts, Wal-Mart has been unable to accomplish a primary objective – to acquire its own banking institution.

1. Past Attempts

Wal-Mart commenced its quest to own a bank in June 1999 when it

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84. UTAH DEP'T OF FIN. INSTS., *supra* note 71.

85. *Id.*

86. Leary Remarks, *supra* note 36, at 6. Additionally, Commissioner Leary stated that "Utah is participating with the FDIC in the Large Bank Supervision Program for four [ILCs]" and "[t]he supervision of these large banks is coordinated by a full-time relationship manager for [Utah] as well as the FDIC." *Id.* These examiners instigate a bank-specific regulatory and supervisory plan that usually "involves three targeted reviews that roll-up to an annual Examination Report that is reviewed with [both ILC] management and the board." *Id.*

87. *See* H.R. REP. NO. 110-155, at 10 (2007).

88. *See* Wal-Mart Stores History, http://walmartstores.com/AboutUs/297.aspx (last visited Oct. 28, 2008).

89. Annual Report, *supra* note 1, at 53.

90. Corporate Facts, *supra* note 1; Christopher Tkaczyk, *Fortune 500: The Top 50,* FORTUNE, Apr. 30, 2007, at 210, *available at* http://money.cnn.com/galleries/2007/fortune/0704/gallery.500top50.fortune/index.html.

applied to purchase a small thrift in Broken Arrow, Oklahoma named the Federal Bank Center.[91] The Gramm-Leach-Bliley Act[92] ("Gramm-Leach"), passed by Congress in November 1999, "blocked this attempt . . . by closing the 'unitary thrift holding company' loophole[93] and reaffirming the nation's policy of separating banking and commerce."[94] This was the first of many times during the course of Wal-Mart's quest that its efforts to own a bank would be stymied by national legislative opposition.

Wal-Mart's next attempt to acquire a bank was made in 2001 through a strategic alliance with Toronto-Dominion Bank USA ("TD Bank") allowing TD Bank to offer its banking services in approximately 100 Wal-Mart stores.[95] Wal-Mart's plan to share in the bank's profits, however, and to have its associates perform transactions within those banks, led to the merger's rejection by OTS because it would "give Wal-Mart unauthorized control over TD Bank."[96]

Undaunted, Wal-Mart turned its attention to the ILC structure by attempting to acquire a small, bankrupt California ILC named Franklin Bank in 2002.[97] This time the California legislature stepped in by passing legislation that prevented "non-financial institutions from acquiring state-chartered [ILCs] unless they are 'engaged in the activities permitted for financial holding companies' as established by [Gramm-Leach]."[98] California governor Gray Davis stated that he signed the pro-

91. *See* Bloomberg News, *Wal-Mart Wants To Buy Savings And Loan*, N.Y. TIMES, June 30, 1999, at C31; Kevin Nolan, *Wal-Mart's Industrial Loan Company: The Risk to Community Banks*, 10 N.C. BANKING INST. 187, 191 (2006).

92. Pub. L. No. 160-102, 113 Stat.1338 (Nov. 12, 1999) (codified at 12 U.S.C. § 1811).

93. Nolan, *supra* note 91, at 191 n.37. Interestingly, Congress grandfathered in exempted thrifts approved before May 4, 1999, a date carefully chosen to exclude an application from Wal-Mart. *Id.* at 191.

94. *Id.* A unitary thrift holding company was a holding company owned by a commercial company that owned only one savings and loan or thrift institution and was thereby exempt from limitations on the nature of the activities conducted by its commercial subsidiaries. *Id.* at 200.

95. *Id.* at 191 (citing Rob Blackwell, *Wal-Mart, TD Venture Hits Regulatory Wall,* AM. BANKER, Nov. 5, 2001, at 1).

96. *Id.* at 191-92.

97. *Id.* at 192 (citing *Wal-Mart Drops the Other Shoe*, ELECTRONIC PAYMENTS WK., July 26, 2005).

98. *Id.*; 2002 Cal. Stat. 1162.

hibitive legislation "in accordance with the federal prohibition against mixing banking and commerce, as intended by [Gramm-Leach]."[99]

2. The Utah ILC Application

March 16, 2007 marked the end of the most recent chapter of Wal-Mart's historic mission to acquire its own bank.[100] The nearly eighteen-month effort to charter a Utah ILC, which began in July 2005,[101] came to a close when Wal-Mart withdrew its application amidst swelling controversy and the extension of an FDIC moratorium[102] on all ILC applications for FDIC insurance by non-financial institution applicants.[103]

According to Wal-Mart's application, its major purpose in acquiring a Utah-chartered ILC was to process credit, debit and electronic check transactions.[104] Denis Bouchard, Wal-Mart's director of payments services, said "the bank will serve as an acquirer of credit transactions in the Visa and MasterCard systems, and will be a sponsor for debit transactions in ACH [Automated Clearing House] transactions."[105] Presently, Wal-Mart uses First Data to process an estimated sixty percent of its millions of annual transactions, totaling approximately $172 billion per year.[106] Savings on transactional costs would be an estimated $650 million annually.[107] Thus, Wal-Mart's staunch desire to charter an ILC is certainly understandable.

However, the biggest fear of banking industry leaders and lawmakers who opposed Wal-Mart's application was not that Wal-Mart would charter an ILC in order to more cost-efficiently process credit transactions, but rather that it likely would have expanded its business

99. Letter from Gray Davis, Governor, to Members of the C.A. State Assembly (Sept. 30, 2002) (on file with author), *available at* 2002 Cal. ALS 1162 (LEXIS).

100. *See* Dash, *supra* note 2.

101. *Wal-Mart Drops the Other Shoe*, ELECTRONIC PAYMENTS WK., July 26, 2005.

102. *See infra* note 132.

103. *See infra* Part II.C.1.

104. *See* Josh Gerstein, *AFL-CIO Opposes Wal-Mart Plan To Set Up Bank*, THE N.Y. SUN, Aug. 15, 2005, at A1 (stating that Wal-mart's ILC would be limited to handling electronic payments and issuing short-term certificates of deposit to individual investors and nonprofit organizations).

105. *See Wal-Mart Drops the Other Shoe*, *supra* note 101.

106. *Id.*

107. *Id.*

model once the initial three-year period following its charter by the FDIC expired.[108]

According to federal and Utah law, once an ILC has been established and receives FDIC insurance, it is only restricted to its original business plan for the first three years of the ILC's existence.[109] After three years, an ILC may seek approval for an amendment to its original charter from the FDIC and Utah DFI to expand its business and conduct full-service banking.[110] Thus, it is possible that a Wal-Mart ILC would eventually be able to expand its charter beyond merely processing credit transactions to engage in any practice of a commercial bank permitted by law.[111]

If approved, an amendment to Wal-Mart's ILC charter would allow Wal-Mart to immediately open branches in twenty-two states.[112] As one author summarized, "[f]ive 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" that authorized reciprocal arrangements.[113] Thus, banks chartered in one state are permitted to branch into all other "opt-in" states without obtaining any additional consent by state officials.[114] This relatively easy transition from being a limited ILC to having the ability to branch into nearly half of the states

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108. *See* Fine, *supra* note 3, at 2-3 (highlighting Wal-Mart's repeated efforts to enter the banking industry as evidence that the likelihood of expansion of its ILC charter is quite high).

109. Press Release, Paul E. Gillmor, Congressman, Ohio's Fifth Cong. Dist., Congressman Gillmor Requests a Full Investigation of the Wal-Mart Bank Application (Sept. 23, 2005), http://www.walmartwatch.com/img/documents/20050923_Gillmor_letter_to_FDIC_Chairman_Powell.doc [hereinafter Gillmor Release].

110. 12 C.F.R. § 333.101(a) (2007). The typical change, which might require the prior written consent of the FDIC, would be to exercise trust powers. *Id.* § 333.101(b). Yet, an ILC may engage in any practice permitted by law after three years without the FDIC's prior consent if such a change would not be considered a change in the general character or type of business of the ILC. Gillmor Release, *supra* note 109.

111. Gillmor Release, *supra* note 109. So 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* 12 C.F.R. 333.101(a) (2007).

112. *Wal-Mart and Financial Services: Supercentre Banking*, ECONOMIST, Sept. 3, 2005, at 2; Gillmor Release, *supra* note 109.

113. Nolan, *supra* note 91, at 190; *see* 12 U.S.C. 36(g) (2006).

114. Nolan, *supra* note 91, at 190-91.

explains why community banks nationwide were intensely opposed to the prospect of a Wal-Mart banking institution.[115]

3. Bank Branching and Wal-Mart's Expansive Ambitions

Before Wal-Mart eventually abandoned its efforts to charter the Utah ILC, it stated in a comment to the first FDIC moratorium on all ILC applications that it would be willing to accept a charter approved by the FDIC that included a ban on branching.[116] According to Jane Thompson, the President of Wal-Mart Financial Services, Wal-Mart had no desire to establish branches or engage in lending, and the ILC was "not a bank a consumer [would] ever see."[117] In addition, Thompson pointed out that Wal-Mart actively encourages community banks to open branches in its stores.[118]

Against the backdrop of these comments, however, two critical historical trends surrounding Wal-Mart's development deserve mentioning. First, Wal-Mart already has a long history of branching out into markets in which it previously stated it had no interest.[119] Second, as critics of its ILC charter and business model argue, once Wal-Mart enters into new markets it uses "predatory pricing and other techniques to run all local competition out of business."[120] Camden Fine, President of the Independent Community Bankers of America ("ICBA"), noted

115. *See Wal-Mart's Utah ILC Application Running into Flack*, ELECTRONICS PAYMENTS WK., Nov. 1, 2005; *see also* Werner, *supra* note 10, at 230 (documenting efforts by a collation of banks to urge Congress to not allow a Wal-Mart bank).

116. Comment Submitted by Wal-Mart Stores, Inc. to FDIC Request for Comment, 71 Fed. Reg. 49456 (Aug. 23, 2006). The FDIC has developed conditions that may be imposed when approving deposit insurance applications for institutions that will be owned by or significantly involved in transactions with commercial or financial companies. *See* West, *supra* note 62, at 10 (citing a list of conditions the FDIC has applied in the past).

117. Rob Garver, *Wal-Mart's Financial Vision In Retail: Focus on Unbanked, Partnerships, Home Grown ATMs*, AM. BANKER, Oct. 5. 2005, at 5.

118. *Id.* As of the date of its Utah ILC application, Wal-Mart had arrangements with more than 300 banks operating more than 1,100 branches in Wal-Mart stores across the country. *Id*.

119. Shaheen Pasha, *Wal-Mart Bank Faces Tough Opposition*, CNNMONEY.COM, Jan. 4, 2006, http://money.cnn.com/2006/01/04/news/companies/walmart_bank/index.htm.

120. Letter from Sound Banking Coalition to John F. Carter, Reg'l Dir., Fed. Deposit Insur. Corp., at 5-6 (Aug. 17, 2005) *available at* http://www.icba.org/files/ICBASites/PDFs/sbc081705.pdf.

this checkered past: "Fifteen years ago, Wal-Mart said it had no designs on the grocery business and 20 years ago, they said they had no designs on the hardware business but now they dominate both businesses."[121]

Evidence of this repetitive cycle surfaced on June 20, 2007 when, only months after withdrawing its ILC application and denying intentions of branching banks, Wal-Mart announced plans to open 1,000 "financial-service centers" by 2009.[122] In a partnership with Visa, General Electric Co.'s ILC, and the Green Dot automated-teller network, customers at 450 Wal-Mart MoneyCenters would be able to cash checks, pay bills, and use a prepaid Wal-Mart-brand Visa nationwide.[123] Thus, ICBA President Fine declared, "Wal-Mart wants in to the financial-services business and they're going to try every way conceivable to do that."[124] Further, Steve Verdier, an ICBA lobbyist affirmed, "[i]t looks like they're building the infrastructure for a nationwide network of bank branches."[125] Thus, contrary to its recent statements, it seems Wal-Mart may indeed have intentions of expanding its broad array of in-store departments[126] to include many banking and financial services.

Typically, after Wal-Mart expands into another sector of the market and reduces local competition – or does away with it entirely – Wal-Mart frequently increases its own prices.[127] The rippling effects of these two historical trends are far-reaching. An Iowa State University study revealed that after Wal-Mart's expansion into Iowa, 555 grocery stores, 298 hardware stores, 293 building materials stores, and 116 drug stores closed their doors.[128] Other studies indicate that "for every Wal-Mart

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121. Pasha, *supra* note 119.

122. Lauren Colman-Lochner, *Wal-Mart Will Open 1,000 Financial Centers by 2009*, BLOOMBERG, June 20, 2007, http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a3P.tll8xX1w.

123. *Id.*

124. Telephone Interview with Camden R. Fine, President, Indep. Cmty. Bankers Ass'n, in Salt Lake City, Utah (June 21, 2007).

125. Colman-Lochner, *supra* note 122.

126. Wal-Mart is currently the largest grocery retailer in the United States, as well as "the nation's No. 1 retailer of recorded music, DVDs, toys, [and] pet food." Mary Deibel, Q & A about Wal-Mart's bid to branch into banking, DESERET MORNING NEWS, May 15, 2006, *available at* http://findarticles.com/p/articles/mi_qn4188/is_/ai_n16365538.

127. Nolan, *supra* note 91, at 194.

128. DR. KENNETH E. STONE, COMPETING WITH THE DISCOUNT MASS MERCHANDISERS, 23 tbl. 2 (Jan. 16, 2004), *available at* http://www.econ.iastate.edu/

'Supercenter' opened, two local groceries will close."[129] Therefore, as Nolan concludes, a Wal-Mart ILC could similarly harm the community banking industry "[i]f a Wal-Mart ILC charter is amended to include full retail banking services" in each of its Supercenters nationwide.[130]

C. Fallout from Wal-Mart's Application

1. The FDIC Moratoria

In the first six months following the July 2005 submission of Wal-Mart's ILC application, the FDIC received approximately 1,700 letters in total, with the majority vehemently opposing Wal-Mart's ILC application.[131] By the end of 2006, that number had increased to over 13,800 comment letters.[132] As the letters poured in, members of the House Committee on Financial Services requested that the FDIC "defer any decision on the application for federal deposit insurance filed by Wal-Mart Bank until the [FDIC] Board has its full complement of directors," because of the importance of the application.[133]

By the time one year had elapsed following Wal-Mart's application, the ILC controversy was in full bloom. On July 28, 2006, the FDIC issued a moratorium on all states currently chartering ILCs to block any additional applicants from receiving ILC charters, which effectively bought some time for the FDIC to assess the risks posed by ILCs to the FDIC insurance fund and the banking industry.[134] The FDIC posited

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faculty/stone/1995_IA_WM_Study.pdf.

129. Nolan, *supra* note 91, at 194.

130. *Id.* at 195; *see also* Anthony Bianco & Wendy Zellner, *Is Wal-Mart Too Powerful?*, BUS. WK., Oct. 6, 2003, at 100, *available at* http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm.

131. Pasha, *supra* note 119, at 1.

132. Moratorium on Certain Industrial Bank Applications and Notes, 72 Fed. Reg. 5290, 5291-92 (Feb. 5, 2007).

> Approximately 12,485 comments were generated by what appears to be organized campaigns either supporting or opposing the proposed industrial bank to be owned by Wal-Mart or the proposed acquisition of Enerbank, also an [ILC], by The Home Depot. Of this total, approximately 82 percent generally were opposed to the ownership of [ILCs] by Wal-Mart or other commercial companies.

Id. at 5292.

133. Press Release, H. Comm. on Fin. Servs., 25 Financial Services Committee Members Urge FDIC to Wait on Wal-Mart Application (Dec. 16, 2005), *available at* https://financialservices.house.gov/pr12162005.html.

134. Moratorium on Certain Industrial Loan Company Applications and Notices, 71

twelve questions designed to evaluate the following four issues:

(i) industry developments;
(ii) the various issues, facts, and arguments raised with respect to the ILC industry;
(iii) whether there are emerging safety and soundness issues or policy issues involving ILCs or other risks to the insurance fund; and
(iv) whether statutory, regulatory, or policy changes should be made in the FDIC's oversight of ILCs in order to protect the deposit insurance fund or important Congressional objectives.[135]

At the conclusion of the six-month moratorium, the FDIC's much-anticipated decision came in the form of yet another moratorium: a one-year extension, except this time the stay on applications applied solely to those submitted by commercial companies, such as Wal-mart.[136] The FDIC explained in a statement, "the original moratorium demonstrated that the growth of the ILC industry, the trend toward commercial company ownership of ILCs and the nature of some ILC business models have raised significant questions about the risks to the deposit insurance fund."[137] In addition, the FDIC announced a proposed regulation that would create a framework for the FDIC to make decisions on the ILCs owned by financial parents.[138] Ultimately, according to the FDIC, the moratorium would "provide Congress with an opportunity to address the issue legislatively[,] while the FDIC consider[ed] how best to respond to any safety and soundness issues surrounding commercial ownership under existing law."[139]

2. *Congressional Actions*

Since the passing of Gramm-Leach in 1999, which closed the BHC

Fed. Reg. 43482, 43483 (Aug. 1, 2006).

135. *Id.*

136. Press Release, Fed. Deposit Insur. Corp., FDIC Extends Moratorium on ILC Applications by Commercial Companies for One Year; Will Move Forward on Applications from Financial Companies (Jan. 31, 2007), *available at* http://www.fdic.gov/news/news/press/2007/pr07007.html.

137. *Id.*

138. *Id.*

139. *Id.*

Act loophole for unitary thrift holding companies, critics have wondered why Congress chose to expressly reaffirm the separation of banking and commerce while still excluding ILCs from BHC Act supervision.[140] The Gillmor-Frank Amendment, sponsored by Barney Frank (D-MA) and Paul Gillmor (R-OH) in 2005, is representative of the type of changes to the ILC industry Congress has considered over the past decade.[141] The amendment provided that the benefits of the ILC exception from consolidated supervision would not extend to any ILC owned by a parent company that receives fifteen percent or more of its annual gross revenues from non-financial activities.[142] However, although the amendment passed the House, it was never enacted into law.

While the Gillmor-Frank Amendment failed to gain traction in the Senate, the Wal-Mart ILC application had clearly catapulted the ILC controversy back into the financial-sector's spotlight and Congress took aim ILCs once again with the Industrial Bank Holding Company Act of 2006.[143] While this particular bill did not make it out of committee before the end of Congress's term, a nearly identical version of the bill emerged at the commencement of the next congressional session as the Industrial Bank Holding Company Act of 2007 ("House Bill 698").[144] This legislation would require an ILC holding company to register and file certain reports with the FDIC within 180 days after becoming an ILC holding company.[145] House Bill 698 would also prohibit such a

140. *See* Peter E. Heyward & Ronald R. Glancz, *GAO Report Contributes to the Industrial Loan Company Debate*, *in* ALI-ABA COURSE OF STUDY 274 (2006), *available at* SL015 ALI-ABA 271, 274 (Westlaw).

141. The language of the Gillmor/Frank Amendment passed the House of Representatives twice, in the Business Checking Freedom Act of 2005 and the Financial Services Regulatory Relief Act of 2005. *See* Business Checking Freedom Act of 2005, H.R. 1224, 109th Cong. (1st Sess. 2005); Financial Services Regulatory Relief Act of 2005, H.R. 3505, 109th Cong. (1st Sess. 2005).

142. *See, e.g.*, H.R. 1224 § 2(b)(3)(B).

143. H.R. 5746, 109th Cong. (2d Sess. 2006) (amending the Federal Deposit Insurance Act to establish industrial bank holding company regulation).

144. H.R. 698, 110th Cong. (1st Sess. 2007). Congressman Gillmor and Financial Services Committee Chairman Barney Frank introduced H.R. 698 on January 29, 2007 to help restore the wall between banking and commerce and stem the expansion of the ILC charter. Press Release, House Comm. On Fin. Servs., Financial Services Committee Overwhelmingly Passes Industrial Bank Holding Company Act (May 2, 2007), *available at* http://www.house.gov/apps/list/press/financialsvcs_dem/press050207.shtml. Similar legislation was introduced in the Senate. *See* S. 1356 110th Cong. (1st Sess. 2007).

145. H.R. 698 § 51(c).

holding company from being controlled by a commercial firm and grandfathers in certain institutions to exempt them from its requirements.[146] Under House Bill 698, a company would be considered "commercial" if it derives 15 percent or more of its gross revenue, on a consolidated basis, from non-financial activities.[147] The House of Representatives Report discussing the bill ("House Report") concluded, however, that "[t]hose commercial companies that already own [ILCs] . . . will be exempt from this prohibition under one of two grandfather provisions."[148] House Bill 698 will be addressed further in Part III.B.

Other legislative proposals that Congress has considered over the past few years have taken an expansive rather than restrictive view of the ILC industry. The GAO Report notes that recent "legislative proposals would remove the current prohibition on paying interest on demand deposits and, separately, authorize insured depository institutions, including most ILCs, to offer interest-bearing business NOW accounts."[149] Opponents of ILCs argue this expansion of ILC powers "could further blur the distinction between ILCs and traditional banks."[150] The GAO Report also highlights another legislative proposal that "would allow banks and most ILCs (those included in a grandfathered provision) to branch into other states through establishing new branches – known as de novo branching – by removing states' authority to prevent them from doing so."[151] Federal Reserve Board officials have said that these provisions could yet again "increase the attractiveness of owning an ILC."[152] This attractiveness would likely further expand the ILC industry.

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146. H.R. 698 § 51(f)(3).

147. H.R. 698 § 51(f)(2).

148. H.R. REP. NO. 110-155 at 9 (2007).

149. GAO REPORT, *supra* note 12, at 76; *see* H.R. 1224, 109th Cong. §§ 2, 3 (1st Sess. 2005).

150. GAO REPORT, *supra* note 12, at 76.

151. *Id.* at 76; *see* H.R. 1375, 108th Cong. § 401(b) (2d Sess. 2004). In response to Wal-Mart's ILC application and the threat of ILCs having the ability to engage in de novo branching, several states enacted legislation prohibiting an ILC chartered under the law of another state from establishing an office on the premises or property of the ILC's affiliate if that affiliate engages in "commercial" activities. *See, e.g.*, VA. CODE ANN. § 6.1-232.2 (Supp. 2007) (repealed effective Feb. 5, 2007, Acts 2007, c.1, cl. 2).

152. GAO REPORT, *supra* note 12, at 76.

III. POSSIBLE SOLUTIONS

In the wealth of comments submitted in response to the FDIC moratoria, countless interest groups, corporations, and law and policy makers have offered their respective remedies to the ILC controversy. Many have suggested that the FDIC reject ILC applications from commercial entities by considering the competitive effects, potential conflicts of interest, or any other policy concerns.[153] Yet, ultimately, this policy decision falls on the shoulders of Congress, not the FDIC Board of Directors.[154]

The GAO Report offered three alternative courses of action that Congress could pursue in order to address the ILC controversy.[155] First, the report suggested that Congress could eliminate "the current exclusion for ILCs and their holding companies from consolidated supervision."[156] Second, Congress could grant the "FDIC similar examination and enforcement authority as a consolidated supervisor."[157] Third, Congress could leave "the oversight responsibility of small, less complex ILCs with the FDIC, and trans[fer] oversight of large, more complex ILCs to a consolidated supervisor."[158] However, as demonstrated by the legislative action (or lack thereof) discussed above in Part

153. *See* Fine, *supra* note 3, at 4-5; *see Industrial Loan Companies: Hearing on H.R. 698 before H. Comm. on Financial Services*, 110th Cong. at 2 (1st Sess. 2007) (statement of James P. Ghilglieri Jr., Chairman, Indep. Cmty. Bankers Ass'n).

154. Statement of John C. Dugan, Comptroller of the Currency, Regarding the ILC Moratorium Extension at the Meeting of the Fed. Deposit Insur. Corp. Bd. of Dirs. (Jan. 31, 2007), *available at* http://www.occ.treas.gov/ftp/release/2007-9a.pdf. The Federal Deposit Insurance Act, 12 U.S.C. §§ 1815 *et seq.*, sets forth the seven factors the FDIC may consider in determining whether to extend insurance to a particular institution. These Factors include: (1) the financial history and condition of the depository institution; (2) the adequacy of the institution's capital structure; (3) the future earnings prospects of the institution; (4) the general character and fitness of the management of the institution; (5) the risk presented by the institution to the Deposit Insurance Fund; (6) the convenience and needs of the community to be served by the institution; and (7) whether the institution's corporate powers are consistent with the purposes of the FDI Act. 12 U.S.C. § 1816 (2006). These factors expressly mention nothing as to commercial affiliation. Thus, the only factor where the commercial nature of an applying entity might plausibly be considered is the risk presented by the institution to the Bank Insurance Fund.

155. GAO REPORT, *supra* note 12, at 81.

156. *Id.*

157. *Id.*

158. *Id.*

II.C.2, it appears that Congress is either unable or unwilling to plausibly consider implementation of these alternatives.

The most drastic legislative reform to the ILC industry would undoubtedly be the complete elimination of the ILC exception from the BHC Act and consolidated supervision. Yet, with many of America's largest and most prolific corporations already owning ILCs[159] – including commercial giants General Electric and General Motors, as well as financial services leaders such as Morgan Stanley – complete elimination of the ILC industry is now likely to be out of legislative reach. Further, it is also unlikely that ILC supervision would shift between the FDIC and one of the other consolidated regulators such as the Federal Reserve Board based only on the relative size of the ILC. The legislative trail leads toward a compromise between the complete elimination of the ILC exception to the BHC Act, on the one hand, and unrestricted commercial affiliation, on the other.

Congress must decide not only the fate and future of ILCs owned by commercial entities, but also the proper regulatory structure, including both the level of supervision and the federal or state regulatory entity that can best administer that supervision. These decisions, however, will ultimately depend on the weight given to the long-standing public policy requiring the separation of banking and commerce.

Part III.A will address the viability of the argument that ILCs affiliated with commercial entities pose special risks to themselves as institutions and the banking industry as a whole. Part III.B will then focus on the effects of proposed legislation – House Bill 698 and any similar bills that may be on the horizon – on the ILC industry as a whole and in Utah, in particular.

A. Separation of Banking and Commerce: Does Commercial Affiliation as Currently Permitted by the ILC Holding Structure Create a Measurable Risk to the Banking Industry or Institution Itself?

The chief criticism of the ILC exception to the BHC Act and consolidated supervision is that America is committed to a long-standing policy – a form of legislative *stare decisis*[160] – of erecting a wall to

159. *See supra* notes 41-45 and accompanying text.

160. BLACK'S LAW DICTIONARY 1443 (8th ed. 2004) (defining *stare decisis* as "[t]he doctrine of precedent, under which it is necessary for a court to follow earlier judicial decisions when the same points arise again in litigation.").

separate banking and commerce. Indeed, Fine has referred to this metaphorical wall as the "linchpin of the financial and economic system of the United States."[161] Fine further argues that the "walls separating banking and commerce prevent conflicts of interest and undue concentration of resources, and ensure the impartial allocation of credit so vital to economic growth and development and to a safe and sound financial system."[162] Yet, just how impenetrable is this wall? Is it erected between banking and all commercial entities, or are there particular types of commercial institutions that generate a greater need for a distinct division and heightened fortifications? Or, is the separation of banking and commerce merely a protectionist partition behind which bankers, seeking to thwart unwanted competition, retreat to relatively unquestioned safety from unwanted expansion into the banking industry?

Proponents of the wall posit three central justifications.[163] First, allowing the banking and commerce spheres to mix might, in effect, "lead to an extension of the federal safety net to commercial affiliates and make insured banks susceptible to the reputational, operational and financial risks of their commercial affiliates."[164] Second, banks affiliated with commercial firms may be "less willing to provide credit to the competitors of their commercial affiliates or may provide credit to their commercial affiliates at preferential rates or on favorable terms."[165] Third, allowing industrial or financial conglomeration between comercial and banking entities could result in excessive concentration of resources, with large companies wielding too much power.[166]

What all three arguments lack, however, is any empirical support evincing statistically-significant, industry-specific risks posed to both the banking industry and the deposit insurance fund by ILCs generally or by commercially-owned ILCs specifically.

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161. Fine, *supra* note 3, at 3.
162. *Id.*
163. *See* GAO REPORT, *supra* note 12, at 71; *Industrial Loan Companies: Hearing on H.R. 698 before H. Comm. on Financial Services*, 110th Cong. at 3 (1st Sess. 2007) (statement of Donald L. Kohn, Vice Chairman of the Bd. of Governors of the U.S. Fed. Res. System).
164. Kohn, *supra* note 163, at 7.
165. *Id.*
166. *Id.*

1. *Increased Exposure to Reputational, Operational, and Financial Risks of ILC Affiliates*

John C. Dugan, Comptroller of the Currency and member of the board of directors of the FDIC, said in a statement regarding the FDIC's extension of the first ILC moratorium that "the record before us simply does not establish that commercial affiliations present an undue risk to the [deposit insurance] fund," and that "the comments [that the board of directors of the FDIC] received during the last six months have provided virtually no empirical evidence to support the proposition that commercially owned ILCs are more risky than non-commercially owned ILCs."[167] He acknowledged that when reviewing ILC applications the FDIC "may take into account potential or hypothetical risk," but also stated that "the very best evidence of risk in this area is the FDIC's own [twenty]-year experience in supervising ILCs owned by commercial companies."[168]

Further, in a report created for the FDIC documenting the twenty-one ILC failures over the past two decades, no data indicated that any ILC failed because of commercial affiliation.[169] Similarly, the GAO Report noted that "from an operations standpoint, ILCs do not appear to have a greater risk of failure than other types of insured depository institutions."[170] As one industry analyst noted, failures of ILCs have not stemmed from commercial affiliations or the regulatory structure under which ILCs operate, but rather "from faulty strategic or tactical decisions."[171] Thus, like all other failed banks, the ILC failures resulted from bad management, not risky affiliation.

The 2002 bankruptcy of Conseco, Inc ("Conseco") is an excellent example.[172] Conseco was primarily an insurance company until it acquired Green Tree Financial Services ("Green Tree") in 1998; the acquisition included Green Tree's Utah ILC, which was later renamed

167. Dugan, *supra* note 154, at 3-4.
168. *Id.* at 3.
169. West, *supra* note 62, at 6-8.
170. GAO REPORT, *supra* note 12, at 24.
171. Christine E. Blair, *The Future of Banking in America*, *The Mixing of Banking and Commerce: Current Policy Issues*, 16 FDIC BANKING REV. 97, 114 (2004), *available at* http://www.fdic.gov/bank/analytical/banking/2005jan/article3.pdf.
172. Bloomberg News, *Conseco Makes Chapter 11 Filing*, N.Y. TIMES, Dec. 18, 2002, at C4.

Conseco Bank.[173] Despite its parent's financial troubles and impending insolvency, "Conseco Bank's corporate firewalls and the regulatory supervision provided by Utah and the FDIC proved adequate."[174] The ILC was sold to GE Capital for its book value as part of the Conseco bankruptcy sale of assets.[175] The Conseco Bank example illustrates the effectiveness of the FDIC's regulatory supervision and demonstrates that ILCs can be steered clear of the financial troubles of their parent companies.

ILC critics believe that "[t]he potential transfer of risks among insured banks and uninsured commercial affiliates could result in inappropriate risk-taking, misallocation of resources, and uneven competitive playing fields in other industries."[176] Yet, while these critics continue to cite the potential risks resulting from commercial affiliation, these risks simply have not materialized over the twenty-year history of FDIC supervision.[177] Conversely, as one author notes, evidence suggests that with adequate safeguards – corporate firewalls and regulatory supervision – "the careful mixing of banking and commerce can yield benefits without excessive risk."[178] Further refuting the threat of systemic risk and unfair competition posed by ILCs is the fact that "[a]t year-end 2002, [ILCs] held just over $120 billion in assets. This represent[ed] only 1.4 percent of the total assets held in all [FDIC] insured institutions."[179] Thus, in terms of total market share and leverage, ILCs pose very little threat to the banking industry when considered as a whole.

As the remarks of former FDIC Chairman Donald Powell

173. Jeff Bailey, *Conseco Agrees to Acquire Green Tree – Exchange of Stock Valued At About $6.44 Billion; Cross-Selling Plays Role*, WALL ST. J., Apr. 8, 1998, at A2.

174. Blair, *supra* note 171, at 114.

175. Bloomberg News, *Company News; Federal Judge Approves Sale of Conseco Finance*, N.Y. Times, Mar. 15, 2003, at C4 ("A Conseco lawyer said the total value of the deal was $1.37 billion."); Blair, *supra* note 171, at 114 (noting that $323 million of the total amount received in the bankruptcy sale was for the ILC).

176. GAO REPORT, *supra* note 12, at 72.

177. *See, e.g.*, FED. DEPOSIT INSUR. CORP., MANDATE FOR CHANGE: RESTRUCTURING THE BANKING INDUSTRY (1987); Blair, *supra* note 171, at 115; Rose Marie Kushmeider, *The U.S. Federal Financial Regulatory System: Restructuring Federal Bank Regulation*, FDIC BANKING REV., 2005, at 1.

178. Blair, *supra* note 171, at 117.

179. Donald E. Powell, Chairman, Fed. Deposit Insur. Corp., Remarks Before the Conf. of State Bank Supervisors, The ILC Debate: Regulatory and Supervisory Issues (May 23, 2003), *available at* http://www.fdic.gov/news/news/press/2003/pr5203.html.

accurately highlight, "[the] risk posed by any depository institution depends on the appropriateness of the institution's business plan and model, management's competency to run the bank, the quality of the institution's risk-management processes and, of course, the institution's level of capital."[180] These are risk characteristics of every insured institution, not unique to commercially-affiliated ILCs. Further, "[t]he FDIC believes the ILC charter, *per se*, poses no greater safety and soundness risk than other charter types."[181]

2. *Distortion of Credit Allocation by Commercially-Affiliated ILCs*

The second rationale behind the separation of banking and commerce – e.g., greater potential for conflicts of interest and favoritism of affiliates – also appears to be founded on a protectionist ground. A conflict of interest exists "whenever an entity that serves more than one interest is in a position to favor one of those interests over the other(s)."[182] For example, an ILC "affiliated with a commercial firm may choose to deny loans to the affiliate's competitors, may choose to lend preferentially to its commercial affiliate(s), or may illegally tie loans to purchases of the affiliate's [goods or services]."[183]

Notably, however, the FDIC has cited no conflict of interest that is unique to bank-commercial affiliations.[184] Sections 23A[185] and 23B[186] of the Federal Reserve Act apply to all FDIC-insured institutions and, among other things, restrict the amount and terms under which banks can lend to their affiliates. Section 23B requires transactions between affiliates to be at arm's length and on market terms, and must serve "to prohibit certain tying arrangements."[187] ILCs, like other supervised banking institutions, are thus restricted in the type and terms of credit they can extend to affiliates and must deal with them at arm's length.

These regulatory restrictions, when combined with entity-internal firewalls, demonstrate that the "principal potential conflicts [of interest]

180. *Id.* at 3.
181. *Id.*
182. Blair, *supra* note 171, at 102.
183. *Id.*
184. *See id.* at 103-04.
185. 12 U.S.C. § 371c (2008).
186. 12 U.S.C. § 371c-1.
187. Blair, *supra* note 171, at 103.

that are offered as a rationale for separating banking and commerce seem unlikely to pose significant risks to the safety and soundness of the bank or to the federal safety net."[188] As former FDIC Chairman Powell noted, "the firewalls and systems of governance safeguarding ILCs from misuse by their parent companies are, in many cases, more stringent than what exists in many affiliates of bank holding companies."[189] Powell further stated that "[d]epending on the purpose and placement of the [ILC] within the organizational structure, mandated safeguards include: on-site management rather than management from distant corporate headquarters, independent boards of directors, strict guidelines to ensure arms-length transactions with the parent and other affiliates, and so on."[190] Lastly, and most importantly, "[r]efusing to lend to the competitors of its nonbank affiliates or granting credit to its affiliates . . . on favorable terms" runs counter to market forces because it "serves only to reduce bank income."[191]

3. *Excessive Concentration of Resources from Conglomeration Between Banking and Commercial Entities*

Given Wal-Mart's corporate statistics, it is easy to see why many ILC critics are intensely concerned with concentration of resources and Wal-Mart's ability to first enter, then dominate, yet another market. Indeed, the conglomeration argument packs a fair punch, especially when combined with critics' contentions under the conflict of interest argument addressed above. When the BHC Act was enacted, the concern was that the growth of unregulated bank holding companies could lead to "undue concentration of control in banking activities."[192] The BHC Act's mission was two-fold: "preventing bank monopoly power from proliferating into nonbanking businesses, and discouraging the growth of large entities."[193]

However, once again, in today's competitive banking market, this threat has failed to materialize. "Conglomerate integration – the combination of banks and nonbanks under a holding company" is unlikely to

188. *Id.* at 104.
189. Powell, *supra* note 179, at 3.
190. *Id.*
191. Blair, *supra* note 171, at 105.
192. *Id.* at 104 (quoting Stephen K. Halpert, *The Separation of Banking and Commerce Reconsidered*, 13 J. Corp. L. 481, 500 (1988)).
193. *Id.*

result in monopoly rents because "markets for bank loans are competitive." It is therefore difficult for a bank to extend market power to non-banking lines of business.[194] Moreover, "attempts by the bank to engage in predatory pricing," (a practice in which Wal-Mart has been accused of engaging in other markets[195]) by cross-subsidizing the operations of its affiliates would work only if there were considerable barriers to entry into the banking market.[196] In fact, however, although consolidation in banking has increased over the past decade, interstate banking and competitive markets for small or community banks continue to make it unlikely that monopoly power will spread from banking to non-banking business.

In sum, the arguments raised in support of the so-called policy[197] requiring the separation of banking and commerce ultimately lack factual corroboration. As the GAO Report candidly concedes, "generally the magnitudes of these risks [of mixing banking and commerce] are uncertain and may depend, in part, upon existing regulatory safeguards and how effectively banking regulators monitor and enforce these safeguards."[198] The issue lies, therefore, not within the industry but rather in the ability of regulation to ensure the safety and soundness of the institutions.

4. *Conclusion – Mixing of Banking and Commerce May Be Beneficial*

This banking and commerce debate is not new; neither is the related policy question facing lawmakers. Twenty years ago the FDIC's then-Chairman L. William Seidman testified before Congress: "The pivotal question . . . is: Can a bank be insulated from those who might misuse it or abuse it? Is it possible to create a supervisory wall around banks that

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194. *Id.*

195. *See* Fine, *supra* note 3, at 3.

196. Blair, *supra* note 171, at 105.

197. The separation of banking and commerce has merely been a function of the demands of the marketplace, level of technology, and the state of development of organization and business structures and that significant linkages between banking and commerce have existed and continue to exist despite regulation or prohibition. *See* Leary Remarks, *supra* note 36, at 10 (noting that "[a]s the experience of the conventional banking industry shows, the wall separating banking and commerce is elastic" and has moved and changed over time).

198. GAO REPORT, *supra* note 12, at 71.

insulates them and makes them safe and sound, even from their owners, affiliates and subsidiaries?"[199] If this analysis is correct, then the debate should focus on how affiliations should be regulated so that the public interest is met, i.e. to achieve the greatest possible good for the greatest possible number of individuals. Regardless where one stands on how to best serve the "public interest"[200], certainly the public interest can be determined only by considering both sides of the debate with respect to the ILC controversy.

Industry observers have stated that there are many potential benefits from mixed banking and commerce. First, cost efficiencies can result from economies of scale (when increasing the scale of operations lowers the average cost of production) or from economies of scope (when costs of production are lowered by the production of products that share inputs).[201] Though these advantages may be difficult to support with concrete empirical data, they are evidenced by the heightened interest commercial entities have shown in owning banking institutions in recent years. Second, "informational efficiencies" and product synergies may result from affiliation.[202] For example, a bank with an equity position in a start-up company can use the position to acquire "information about, and the ability to exercise control over, the commercial firm."[203] Third, banking and commerce affiliation could also enhance the global competitiveness of U.S. banks because "many other countries do not place similar restrictions on the affiliation of banks with commercial entities."[204] For evidence of these potential benefits, one need only look to the exponential growth of the ILC industry over the past decade. Moreover, ILC industry advocates note that these potential savings and revenues may then be "passed on to consumers through lower prices for banking or commercial services."[205] Thus, it is the consumer who ultimately reaps the benefit of the commercial affiliation.

In the media, these potential upsides to mixing banking and commerce go virtually unnoticed. Nevertheless, they are essential to the

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199. Leary Remarks, *supra* note 36, at 14.

200. BLACK'S LAW DICTIONARY 1625 (8th ed. 2004) (defining public welfare as "[s]ociety's well-being in matters of health, safety, order, morality, economics, and politics").

201. Blair, *supra* note 171, at 101; *see also* GAO REPORT, *supra* note 12, at 73.

202. Blair, *supra* note 171, at 101-02.

203. *Id.* at 101.

204. *Id.* at 102.

205. GAO REPORT, *supra* note 12, at 73.

debate. When the benefits of ILC commercial affiliation are weighed against the opposition's dearth of evidence of increased risk from commercial affiliation, the conclusion seems clear: mixed banking and commerce as permitted by the ILC structure is neither a risk to the banking industry nor against public policy or the public interest. Thus, the issue should not be whether ILCs create a greater risk to the safety and soundness of the banking industry. Rather, the question should be that same question the FDIC asks with every deposit insurance applicant: can the risk of a particular ILC applicant be effectively managed by properly authorized regulators?[206] Such a question should be answered on a case by case basis, as the FDIC and Utah DFI have successfully done for the past two decades.[207] Deference should be given to regulators with experience and a long history of effective supervision.

When asked to comment on Wal-Mart's Utah ILC application, Sheldon Woods, President of the Association of Financial Services (the association representing ILCs), declined to comment on the application itself, but stated that "if the FDIC and the state of Utah can't effectively manage the risk associated with any [ILC applicant], then that is where the question lies. . . . If that risk cannot be effectively managed, then [the Association of Financial Services's] position would be [that] we support the regulatory environment and [the particular ILC application] should not be approved."[208]

In the view of this author, Woods offers the best analysis to date. If the FDIC were to conclude that the risks posed by a Wal-Mart ILC to both the banking institution and to the industry could not be effectively managed through FDIC and Utah DFI supervision, then that individual application should not be approved. Congruently, an entire industry with a proven and stable regulatory track record[209] should not be eliminated because the risk posed by one commercially-affiliated ILC cannot be effectively managed by the FDIC and Utah DFI.

A decision to mix or to not mix banking and commerce by

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206. *See* Blair, *supra* note 171, at 116-17. Blair's extensive analysis of the ILC industry concludes with a question: "Does the mixing of banking and commerce constitute good public policy? The evidence suggests that the answer is a qualified yes: with adequate safeguards in place, the careful mixing of banking and commerce can yield benefits without excessive risk." *Id.* at 117.

207. *See supra* note 177 and accompanying text.

208. *Industry Outlook: Banking & Finance*, UTAH BUS., Mar. 2007, at 67, 72.

209. *See supra* Parts II.A.2(a), (b).

eliminating the ILC exception to the BHC Act should likewise not be a knee-jerk reaction. It should not be made in response to national hostility or animosity toward Wal-Mart[210] or a one-sided protectionist reaction to appease lobbyists[211] and constituents without actually weighing the issues and the impacts. Ultimately, this is a public policy question that must be made by Congress and should result in whatever action is best for the public interest.

The remainder of this Note is dedicated to the analysis of the formally proposed legislative amendments to the ILC exception from the BHC Act (and any similar proposed legislation that may be on the horizon) and the impact this legislation would have on the industry and Utah in particular.

B. House Bill 698: The Industrial Bank Holding Company Act of 2007

On May 21, 2007, the House of Representatives voted by a margin of over ninety-six percent to pass House Bill 698.[212] A look at the bill's provisions reveals Congressional support for restricting the escalating growth of commercially-affiliated ILCs.

House Bill 698 was a compromise on the issue of mixed banking and commerce, but it still would have banned future ILCs from being held by holding companies that are "commercial" in nature.[213] In addition, it would have established the FDIC as the consolidated supervisor of ILCs by granting it power equivalent to that of the Federal Reserve Board.[214] Finally, House Bill 698 would have placed restrictions on grandfathered-in commercially-affiliated ILCs, prohibiting participation in activities in which they did not partake in before January 28, 2007 and barring the acquisition or establishment of any new banking branch.[215] Each of these three provisions will be addressed

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210. *See, e.g.*, *Is Wal-Mart Good For America?: One, Two, Three, Four . . . We Don't Want Your Superstore*, PBS.org, Nov. 16, 2004, http://www.pbs.org/wgbh/pages/frontline/shows/walmart/transform/protest.html; Bianco & Zellner, *supra* note 130; Wake-UpWal-Mart.com, *The Real Facts About Wal-Mart*, http://www.wakeupwalmart.com/facts/ (last visited Oct. 28, 2008).

211. *See* Fine, *supra* note 3, at 1.

212. H.R. Rep. No. 110-698, at 10 (2007); 153 CONG. REC. H5513 (daily ed. May 21, 2007). The vote consisted of 371 ayes and only sixteen nays, amongst whom all three Utah Congressmen were numbered. *Id.*

213. H.R. 698 § 51(c)(2).

214. *See* H.R. REP. NO. 110-155, at 9 (2007).

215. H.R. 698 § 51(c)(4).

individually.

1. The "Commercial Bucket"

House Bill 698 aimed to restrict ILC charters to holding companies deriving fifteen percent of gross, consolidated revenues from "non-financial" activities.[216] Thus, despite the lack of evidence of any excess risk created by ILC commercial affiliation, Congress appears to be intent on continuing what it reaffirmed in 1999 under Gramm-Leach,[217] by closing yet another door to the melding of banking and commerce.

Only seven states charter entities identified as [ILCs] by the FDIC: Utah, California, Colorado, Minnesota, Hawaii, Indiana, and Nevada.[218] Of these seven states, Utah, Nevada, and Hawaii are the only states still chartering new ILCs controlled by commercial companies; Indiana no longer charters any new ILCs and "Minnesota, California, and Colorado no longer permit commercial companies to acquire or establish [ILCs]."[219] Further, Hawaii has not chartered any new ILCs in over fifteen years.[220] Thus, only Utah and Nevada would have been impacted by this aspect of House Bill 698.[221]

(a) Impact on the ILC Industry and Utah

Any future legislation similar to House Bill 698 will immediately impact those commercial entities that either (i) did not get their ILC applications approved for FDIC deposit insurance before the grandfathering provisions of the legislation take effect, or (ii) had plans to file an ILC application with the FDIC but had not done so before the law's enactment. Among those companies with ILC applications pending

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216. *See* H.R. REP. NO. 110-155, at 9.
217. *See supra* notes 92-94 and accompanying text.
218. H.R. REP. NO. 110-155, at 9.
219. *Id.* at 9-10.
220. *See id.* at 10.
221. Aside from the extensive discussion on Utah's ILC industry, it should also be noted that Nevada, home to Harley Davidson's Eaglemark Savings Bank and Toyota's Financial Savings Bank, has a growing ILC industry despite the relatively limited percentage of total ILC assets, and will likely be adversely impacted by House Bill 698. Valerie Miller, *Industrial Strength: ILC Banks Under Microscope*, LAS VEGAS BUS. PRESS, Apr. 24, 2006, at 2, *available at* http://www.lvbusinesspress.com/articles/2006/04/24/news/news03.txt.

before the FDIC when the first moratorium was enacted in July 2006 – and which will most likely be banned by any "commercial bucket" – are: Wal-Mart; The Home Depot; Ford Motor Company; Berkshire Hathaway; DaimlerChrysler Corp.; Ceridian Corp.; CapitalSource, Inc.; Marlin Business Services Corp.; Cargill Financial Services; BlueCross/Blue Shield; Security National Master Holding Co.; Compu-Credit; WESCOM Credit Union; and Cerberus.[222] These corporations – unlike some of their competitors, such as automakers General Motors, BMW and Toyota – are therefore unable to yield the additional level of profits that would result from conducting the entire transaction (from design to manufacturing to selling to financing) under the same corporate umbrella.

ILCs controlled by financial holding companies, however, hold over ninety percent of ILC assets and deposits.[223] Furthermore, while much has been said about the disproportionate concentration of resources and monopolistic market control by commercial companies controlling an ILC, ILCs in general are home to only 1.4 percent of all FDIC-insured assets.[224] The combination of these two statistics reveals that ILCs controlled by non-financial holding companies, i.e. commercial entities, make up only one tenth of 1.4 percent of the total market for banking assets, or 0.14 percent. The impact of any "commercial bucket" in future legislation mirroring House Bill 698, therefore, will not be as significant for the ILC industry as a whole and the states that charter them as it is for the commercial companies themselves.

The "commercial bucket" of House Bill 698 would have restricted charters in the state of Utah that were never granted by the FDIC in the first place due to the moratoria.[225] Going forward, however, aside from the foregone jobs that would have developed in Utah as commercial companies received charters, the biggest impact of any future passage of legislation similar to House Bill 698 will likely befall those communities that benefit from the Community Reinvestment Act ("CRA").[226] Darryle Rude, Supervisor of Industrial Banks for the Utah DFI, summarized "[t]he CRA is intended to encourage depository institutions

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222. *See Ford Joins Record ILC Parade*, ICBA WASH. WKLY. REP., June 30, 2006, *available at* http://www.icba.org/publications/NewsletterDetailWWR.cfm?ItemNumber=22727&sn.ItemNumber=13783#n150712.

223. *See* H.R. REP. NO. 110-155; Sutton, *supra* note 26.

224. *See* Powell, *supra* note 179, at 2.

225. *See infra* Part III.B.2(a).

226. 12 U.S.C. § 2901 (2006).

to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods" by requiring banks to contribute to their respective communities by either creating lending programs for low-income individuals or investing in municipal bonds, housing projects, or educational developments.[227] ILCs are not exempt from the CRA and Utah is one of the few remaining states that continues to examine its banks for CRA compliance.[228] Thus, Utah ILCs substantially contribute to their communities through the CRA. Any future limitations on the growth of the ILC industry will impact Utah's communities as well as its economy.[229]

2. *The FDIC as Consolidated Supervisor*

House Bill 698 would have granted the FDIC additional supervisory powers equivalent to those of the Federal Reserve[230] and established the FDIC as the consolidated supervisor of ILC holding companies not already subject to consolidated regulation by another federal regulator.[231] Such supervisory authority would have empowered the FDIC to require either a regulatory agency or a holding company that controls an ILC to provide any information necessary to: (1) assess the risk to the ILC, or (2) determine its condition.[232] In tandem, the GAO Report "advocates that ILCs and their holding companies be regulated in a similar manner as other insured depository institutions and their holding companies."[233] Therefore, House Bill 698 would have implemented policy that the Federal Reserve Board and other industry observers championed as necessary to ensure that the FDIC, once it became the consolidated regulator of ILCs, could supervise its banking institutions adequately.[234]

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227. Nolan, *supra* note 91, at 195; 12 C.F.R. § 563e.11(b) (2007).

228. Telephone Interview with Darryle Rude, Supervisor of Indus. Banks, Utah DFI, in Salt Lake City, Utah (June 21, 2007). The Utah DFI conducts its CRA compliance reviews between every three to five years. *Id.*

229. *Id.*

230. H.R. REP. NO. 110-155, at 11.

231. H.R. 698 § 2(b); H.R. REP. NO. 110-155, at 9, 14.

232. H.R. 698 § 2(b); H.R. REP. NO. 110-155, at 17-18.

233. GAO REPORT, *supra* note 12, at 10.

234. *See id.* at 9.

(a) Impact on the ILC Industry and Utah

The FDIC has repeatedly emphasized, and other industry analysts have chronicled, the FDIC's proven supervisory track record indicating that the FDIC already possesses adequate supervisory power to regulate the risks of ILCs.[235] Consequently, it is unclear what additional effects or restrictions House Bill 698's proposed additional regulatory powers would have placed on ILCs. In response to criticisms of the FDIC's oversight of parent companies of ILCs, Powell stated that the FDIC can and does "visit the parent companies – and other affiliated entities, for that matter – to look over issues or operations that could impact the insured institution. Congress has given [the FDIC] the power to protect the integrity of those relationships. [The FDIC has] exercised that power . . . ."[236] Thus, if the FDIC has already supervised ILC holding companies and their non-banking affiliates, it is unlikely that this provision of House Bill 698 would have had any significant impact on the ILC industry. Moreover, because of the Utah DFI's preexisting regulatory relationship with the FDIC, it is unlikely that its local examination procedures and operations will be significantly altered by a parallel provision in any future legislation.

3. Activity and Branching Limitations

The activity and branching limitations under House Bill 698 would have applied to commercially-affiliated ILCs grandfathered in under the legislation.[237] First, these restrictions prevented a grandfathered-in commercial ILC from engaging in any activities in which it was not engaged as of January 28, 2007.[238] Second, a commercial ILC would not have been permitted to "acquire, establish, or operate any branch, deposit production office, loan production office, automated teller machine, or remote service unit in any State other than the home State of the [ILC]" unless the ILC had branched into that state prior to January 28, 2007.[239] Third, House Bill 698 would have authorized a federal supervisor to order a holding company or a non-bank subsidiary to terminate an activity or its ownership of the non-bank subsidiary if the activity or

235. *See supra* Part II.A.2(a).
236. Powell, *supra* note 179.
237. H.R. 698 § 51(f).
238. *Id.*
239. *Id.*

ownership of the subsidiary represents a serious risk to the depository institution.[240]

(a) Impact on the ILC Industry and Utah

These activity and branching limitations were a direct protection of community banks and were designed to prevent further expansion by ILCs – either through branching or marketing new products – into markets where, in Congress's opinion, their presence is undesired. Powell has quite accurately and succinctly stated, however, that "fear of competition should not be the compelling argument in formulating good public policy."[241] Further, as the Utah DFI noted, placing restrictions on the activities of commercial ILCs "is unnecessary, anti-competitive, not in the best interest of consumers, and stifles innovation in the market place."[242]

The possible effects of any similar activity and branching limitations in the future are important for both commercial ILCs and their customers. Some of the major advantages to ILC ownership are the economies of scale and scope.[243] The ability to offer a broader range of banking products and services to preexisting clients allows both the ILC holding company and the consumer to reap the savings benefits of convenience and efficiency. Activity restrictions, on the contrary, prevent marketplace ingenuity and diminish incentives for ILCs to develop improved products that better suit the needs of their consumers, especially as technology changes the future marketplace. These restrictions, if passed in a future bill, will essentially freeze commercial ILCs while the rest of the banking industry moves forward and adapts its products and services to technological and economic advances.

Additionally, the affiliates of a commercial ILC could also be restricted in the activities in which they are permitted to engage, or the ILC's holding company could run the risk of divestment if the activity jeopardizes the safety and soundness of the banking institution.[244]

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240. *Id.*

241. Powell, *supra* note 179, at 4.

242. UTAH DEP'T OF FIN. INSTS., RESPONSE TO THE FDIC'S DECISION ON ITS MORATORIUM ON INDUSTRIAL LOAN CO. APPLICATIONS (Jan. 31, 2007), http://168.177.228.15/newsrelease01%2D2007.htm.

243. *See supra* note 203 and accompanying text.

244. H.R. 698 § 2(b).

While this type of activity limitation is precisely what the BHC Act proscribes for bank holding companies,[245] such a restriction on ILC holding companies and their affiliates could significantly impact an ILC holding company of whose business banking is only a minor portion. Further, activity limitations also run counter to overall holding company stability derived from broad diversification amongst subsidiaries.

IV. CONCLUSION

In the disastrous wake of the unprecedented string of corporate scandals and subsequent insolvencies culminated by the collapse of Enron in December 2001, Congress swiftly passed the Sarbanes-Oxley Act of 2002 ("SOX").[246] In hindsight, the "hastily enacted and far-reaching legislation and subsequent regulations, which carry major ramifications for business, productivity, and competitiveness" may ultimately carry costs which far outweigh their purported benefits.[247] Not unlike SOX, House Bill 698 and any potential offspring proposed in Congress in the future would appear to follow the same reactionary legislative vein in response to the massive outcry to Wal-Mart's ILC application: too much response for too small a problem.[248] Although it is presently politically *au courant* to oppose all things Wal-Mart,[249] the passage of House Bill 698 would have ultimately paralyzed the future growth of an industry that provides specialized and evolving financial products that are in demand by consumers in the marketplace.

Nevertheless, House Bill 698 cleared only one of several legislative hurdles by being passed by the House. Senator Bob Bennett (R-UT)[250], a senior member of the Senate Committee on Banking, Housing, and

245. *See supra* notes 17-18 and accompanying text.

246. *See* Beverly Earle & Gerald E. Madek, *The New World of Risk For Corporate Attorneys and Their Board Posts – Sarbanes-Oxley: An Assessment of Impact and a Prescription For Action*, 2 BERKELEY BUS. L.J. 185, 189 (2005).

247. *Id.* A study has shown "that for companies with under $1 billion dollars in revenue the costs of sustaining as a public company increased 130% through fiscal year 2003." *Id.* at 218. Further, "the survey showed that these costs appear to be continuing and may even be increasing." *Id.*

248. It is interesting to note that SOX was enacted without amendment by a vote of 423-3 in the House and 99-0 in the Senate. *Id.* at 189. House Bill 698 passed the House with similar approval by a margin of 371 to sixteen. *See supra* note 214.

249. *See supra* note 212.

250. Senator Bob Bennett, http://www.senate.gov/~bennett/.

Urban Affairs,[251] among others, will likely lead a charge aimed at toning down the unnecessarily over-reactive legislative impact of any future legislation paralleling House Bill 698. By giving more deference to the supervisory success of the FDIC, the historic stability of commercially-affiliated ILCs and the benefits conferred upon consumers through the controlled mixing of banking and commerce, Congress will more accurately distinguish between hostility directed at Wal-Mart and the actual supervisory concerns and unmanaged risks created by ILCs generally and commercial ILCs specifically. In the absence of any risk peculiar to commercially-affiliated ILCs, and in light of the regulatory success of the FDIC and Utah DFI, a wall of separation should not be erected between ILCs and commercial holding companies. Rather, ILCs should continue to receive FDIC insurance provided there is a sufficient regulatory framework to manage the risks inherent in the commerce and banking affiliation.

251. *See* S. Comm. on Banking, Hous., & Urban Affairs Home Page, http://banking.senate.gov/public/index.cfm?fuseaction=information.membership (last visited June 23, 2007).