

**Hearing Before The House Financial Services  
Subcommittee on Financial Institutions and Consumer Credit  
Entitled  
“ILCs—A Review of Charter, Ownership, and Supervision Issues”**

**Statement of the  
National Association of REALTORS<sup>®</sup>,  
July 12, 2006**

On behalf of more than 1.3 million members of the National Association of REALTORS<sup>®</sup> (NAR), I am pleased to submit our views to the House Financial Services Subcommittee on Financial Institutions and Consumer Credit for the hearing entitled, “ILCs—A Review of Charter, Ownership, and Supervision Issues.”

The National Association of REALTORS<sup>®</sup>, “The Voice for Real Estate,” is America’s largest trade association, including NAR’s five commercial real estate affiliates. REALTORS<sup>®</sup> are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,500 local associations or boards, and 54 state and territory associations of REALTORS<sup>®</sup>.

■ **NAR Opposes Commercial Firms Owning Banks**

NAR is extremely concerned about both Wal-Mart and Home Depot’s intention to acquire industrial loan companies (ILC) chartered by the state of Utah. NAR is on record as opposing Wal-Mart’s application for federal deposit insurance for Wal-Mart Bank and opposing Home Depot’s Notice of Change in Control related to its proposed acquisition of EnerBank USA. Our specific concerns regarding both the Wal-Mart and Home Depot applications are detailed further in this statement.

NAR believes that banks must be “honest brokers” of financial services and not be swayed into making credit and other business decisions based on their affiliation with commercial firms. When commercial firms are allowed to engage in banking, the bank functions under an inherent and irreconcilable conflict of interest. The bank’s commercial parent will be tempted to use the bank in a manner that furthers its own corporate objectives, which may be at odds with what is in the best interests of the bank subsidiary, customers, competitors, and our financial system.

REALTORS<sup>®</sup> are also concerned about the competitive impact of giving large commercial firms benefits that come with owning a federally insured bank. For example, if an ILC owned by a commercial firm provided loans on favorable terms to suppliers or customers of its parent, it would put other commercial firms at a disadvantage. Permitting commercial firms to acquire banks also provides them with access to the nation’s payments system, which increases risk incurred by other participants. We believe that mixing banking and commerce creates risks to the financial system because a bank owned by a commercial firm may not have the freedom to exercise the discipline needed to make independent credit judgments. For these reasons, NAR is encouraged that Congress is taking steps to address the issue of commercial firms owning ILCs and asks that the House Financial Services Committee consider legislative options to

tighten or eliminate the ILC loophole that permits commercial firms to own this type of federally insured state bank. Finally, considering the FDIC has a number of applications relating to ILCs that can be granted at any time, NAR urges Congress to send a clear signal to the Board of Directors of the FDIC to impose a moratorium on the approval of any commercial companies' applications for federal deposit insurance for ILCs.

### • **Wal-Mart Bank**

Wal-Mart's pending federal deposit insurance application marks the latest chapter in Wal-Mart's continuing effort to gain a foothold entry into the banking industry. If permitted to establish an affiliation, it is inevitable that Wal-Mart will attempt to expand this foothold. We believe that Wal-Mart's effort to obtain a federally-insured depository institution, if successful, will establish a dangerous precedent that will inevitably lead to an erosion of the national policy against mixing of banking and commerce and have serious consequences for the continued stability and growth of the nation's financial system. NAR has urged the FDIC to carefully consider the risks of permitting Wal-Mart to control an insured bank, even one whose powers are, at least initially, purported to be limited.

### *Conflict of Interest*

Wal-Mart has publicly stated that the company's sole motivation is to have the Bank act as a vehicle for providing Wal-Mart with direct access to the payment system to process electronic payments such as debit and credit card and Automated Clearing House (ACH) transactions. However, the publicly available portions of Wal-Mart's FDIC application expressly provide that "the Bank will also offer certificates of deposit." The statement is unqualified. As best as we can determine, Wal-Mart proposes no limitation in the application that precludes Wal-Mart from significantly expanding the bank's deposit taking activities at any time. Some of the significant risks raised in this statement will undoubtedly come to fruition if a Wal-Mart Bank is able to compete with other depository institutions in accepting deposits. Wal-Mart would divert the funds raised to investments in securities rather than to loans to residents and businesses in the communities in which it raised the funds. In effect, Wal-Mart Bank will deprive local banks and thrifts from funds that would be lent locally. These risks would be exacerbated if the Bank were to engage at some future time in lending activities. Moreover, we do not believe that requiring the bank to obtain the FDIC's approval before expanding its activities or inviting public comment if the bank seeks to expand its activities will adequately protect the public interest. Once the door is opened, it is exceedingly difficult to close it.

As we have stated, NAR believes that banks must be "honest brokers" of financial services and not be swayed into making credit and other business decisions based on their affiliation with commercial firms. This is one of the key reasons banks are not permitted to engage in commercial activities. And when commercial firms are allowed to engage in banking, the bank also functions under an inherent and irreconcilable conflict of interest. While there are existing restrictions on transactions between a bank and its affiliates, as evidenced by the Home Depot proposal, we think that the bank's commercial parent will inevitably use the bank to further the corporate objectives of the company, which may be at odds with what is in the best interests of the bank subsidiary, customers, competitors, and our financial system. If the parent is in the midst of a financial crisis, ethical and legal behavior by senior management cannot always be assumed. No company is immune from improper actions of its employees. Indeed, even Wal-

Mart has been victimized by fraudulent actions of its dishonest Vice Chairman.<sup>2</sup> We cannot afford to open the door to actions that threaten the safety and soundness of the banking system.

If the Wal-Mart Bank were to expand its business plan into retail banking, it is reasonable to expect that it would use the enormous financial resources of its parent, Wal-Mart Stores, to seek to become the dominant, or even sole, player in banking in its rural markets. That is precisely what has already happened in many small retail markets around the country. If Wal-Mart Bank becomes the main or only provider of financial services in a market, it would place commercial competitors at a serious disadvantage in seeking financial services. The bank would have a strong incentive to base its credit decisions on whether the applicant competes with the bank's parent. Furthermore, Wal-Mart Bank could position itself to provide loans on favorable terms to the suppliers of Wal-Mart Stores, which would put commercial firms that are not affiliated with a bank at a competitive disadvantage. These factors are uniquely significant in the case of Wal-Mart considering that the opening of a Wal-Mart store has been the death knell of the small businesses in many small towns.

### ***Risk to the Stability of the Financial System***

Federal Reserve Board Chairman Ben Bernanke has recently reaffirmed statements made by former Federal Reserve Chairman Alan Greenspan and other Federal Reserve Board Governors raising concerns about the industrial loan company loophole. This loophole is the last significant exception that permits a commercial firm to control a federally insured bank that is broadly engaged in lending and deposit taking activities. In a written statement provided in response to a question asked by Representative Brad Sherman at the February 15<sup>th</sup> House Financial Services Committee hearing, Chairman Bernanke explained that Congress should decide the extent to which mixing of banking and commerce should be permitted, if at all. He noted that—

[T]he Board has encouraged Congress to review the exemption in current law that allows a commercial firm to acquire an FDIC-insured industrial bank (ILC) chartered in certain states without regard to the limits Congress has established to maintain the separation of banking and commerce. Continued exploitation of the ILC exception threatens to remove this important policy decision from the hands of Congress.

We believe Chairman Bernanke's statement supports NAR's recommendation that the FDIC should not approve the Wal-Mart application until Congress has an opportunity to consider the appropriateness of existing law and vote on whether to sunset existing authority, as it did in 1999 when the Gramm-Leach-Bliley Act slammed the door on commercial firms acquiring thrifts.

A recent report of the U.S. Government Accountability Office questions the risk to the Bank Insurance Fund presented by nonfinancial companies of insured industrial loan companies.<sup>3</sup> The GAO concluded that although the FDIC has supervisory authority over an insured ILC, it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of bank and thrift holding companies. Therefore, according to the GAO, from a regulatory standpoint, ILCs controlled by commercial companies and supervised by the FDIC may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company. Restructuring the supervisory framework for ILCs along the lines of the Federal Reserve Board's comprehensive umbrella supervisory authority over bank holding companies is not the solution because it will simply leave the door open to a continued mixing of banking and commerce. Because of the overriding policy reasons not to permit mixing banking

and commerce, the solution is to close the ILC loophole once and for all.

One of the most important risks raised by the application is that providing Wal-Mart with direct access to the payments system would enable Wal-Mart to spread the risk of the company's commercial operations to other participants in the payment system. Today, banks serve as trusted intermediaries when making or collecting payments on behalf of customers. Banks typically will require corporate customers to meet certain credit standards before the bank will agree to act as the customers' "window" to the payment system. In effect, the bank guarantees to other banks participating in the payments system that it will make good on obligations arising from payments the bank makes on behalf of its customers. For example, if a bank originates an ACH debit on behalf of a merchant, the bank guarantees the receiving bank that it will reimburse the receiving bank if the ACH debit was not authorized by the receiving bank's customer. This "guarantee" is backed up by a thorough, independent credit review of the merchant's credit.

The process breaks down, however, when the merchant's bank is a captive of the merchant, for the bank cannot exercise independent credit judgment. It must do what its parent, in this case, Wal-Mart, tells it to do. There is nothing that can prevent Wal-Mart from compelling its bank to initiate wire transfers or ACH debits and credits and transferring risk of loss to the banking system. Given its relatively limited resources (capital of merely \$150 million after three years), and the billions of dollars of payments Wal-Mart expects to process through the bank, Wal-Mart Bank's failure to exercise independent credit judgment will mean that Wal-Mart's credit risk will be transferred to the payment system from the banks with which it now does business and that apply controls on the amount of payments they process for Wal-Mart. As a result, banks participating in the payment system will be forced to absorb the risk of a default by Wal-Mart Stores. Such an involuntary transfer of credit risk is unacceptable and is another negative aspect of the Wal-Mart application.

If the Wal-Mart Stores parent of a Wal-Mart Bank were ever to find itself under financial pressure, it would be tempting for it to abuse its bank in a manner that enables it to resolve the problem. As we know from the collapse of Enron, WorldCom, and others in the last few years, circumstances sometimes spin out of the control of management and not all of those involved act within the law. If Enron or WorldCom had owned and abused its relationship with a federally insured depository institution, the impact on our economy would have been far worse. It is not reasonable to assume that if Wal-Mart found itself in a crisis, it would be entirely forthcoming about what is happening in communicating with its shareholders, the SEC, the FDIC or Federal Reserve Board, the Utah bank supervisor, or any other regulator. By the time these parties learned of the true condition of the enterprise, it could very well be too late to save the Bank or minimize harm to the rest of the financial system.

Accordingly, the National Association of REALTORS<sup>®</sup> opposes the Wal-Mart Bank deposit insurance application because it does not meet the statutory standards for approval and because the issue is of such significance that we believe Congress should decide as to whether it is appropriate to permit the mixing of banking and commerce such these circumstances.

#### • **Home Depot Bank**

Home Depot's proposed business plan is a perfect example of why banking and commerce should not be

mixed. Home Depot's plan calls for channeling credit primarily to home improvement contractors that are their customers. This plan will have an anti-competitive effect and adversely affect Home Depot's competitors and other banks.

### ***Risk to the Stability of the Financial System and Conflict of Interest***

As we have already stated, NAR believes that when banking and commerce mix, the inevitable results are conflicts of interest, harm to the competitive landscape, and risks to the financial system. Will a bank that is owned by a commercial company treat its customers that are suppliers and customers of its [commercial] parent the same as other bank customers who prefer to do business with a competitor of the parent? The answer, of course, is that it won't. The commercial parent will not want the bank to treat them the same; a bank owned by a commercial company will always want to make available as much credit as possible to the customers and suppliers of its parent so they do not shop or bank with competitors. Such a business strategy will pose significant risks to the financial system arise because a bank owned by a commercial firm may not have the freedom to exercise the discipline needed to make truly independent credit judgments.

Unlike Wal-Mart's stated purpose of wanting to use its ILC only for processing debit and credit card transactions, the Home Depot proposal has a significant and potentially more troubling twist. On May 9, 2006, Home Depot announced its agreement to purchase EnerBank to expand its "business and relationships" with home improvement contractors.<sup>4</sup> Home Depot's news release states,

"[t]his acquisition gives us the opportunity to offer our services to The Home Depot's large contractor customer base . . . . This growth opportunity and the resources of The Home Depot will also strengthen the high level of service we offer to our existing contractors and program sponsors."<sup>5</sup>

When the contractor and the homeowner are negotiating a contract, the contractor will "tell the client to phone EnerBank" which will approve the loan. The EnerBank loan to the homeowner "starts" when the homeowner is satisfied that a contractor has completed the home improvement project and when the homeowner endorses an EnerBank check to the contractor. Home Depot's [FDIC filed] Notice states:

The Home Depot believes that EnerBank's ability to help contractors be more successful will strengthen The Home Depot's affinity relationship with its contractor customers, and as a result, they will be more likely to purchase their materials from The Home Depot.<sup>6</sup>

This Home Depot business plan creates an inherent conflict of interest because Home Depot will have an incentive to encourage EnerBank to provide financial services to home improvement contractors that are Home Depot customers and not to other contractors, because that will help increase sales by Home Depot. An unlevel competitive playing field is a significant risk because EnerBank may be pressured to provide loans on favorable terms to prospective borrowers who use contractors with whom Home Depot has established relationships as a means of generating additional business for Home Depot. As a wholly-owned subsidiary of Home Depot, on which it presumably will be dependent for a substantial portion of its funding, the EnerBank will have a built-in bias towards favoring applicants who do business with contractors who are customers of its parent. The Home Depot plan, therefore, has the potential to expose EnerBank to substantial risk of losses because of this inherent bias and conflict of interest.

### ***Conflict with Transactions with Affiliates (TWA) Rule***

An additional concern raised by the proposal arises in connection with the application of Section 23A of the Federal Reserve Act, 12 U.S.C. 371c, and Federal Reserve Regulation W, 12 C.F.R.

Part 223, which limit “transactions with affiliates.” EnerBank, of course, is subject to the restrictions of Section 23A and Regulation W<sup>7</sup>. Loans made by EnerBank to customers of home improvement contractors that are customers of Home Depot will be transactions that will be subject to Section 23A and Regulation W because the proceeds of the transaction are used for the benefit of, or transferred to, Home Depot. The Notice suggests that restrictions on transactions with affiliates are addressed by the proposed policy that prohibits contractors from purchasing material with an EnerBank check in Home Depot stores. The fact that Home Depot may benefit from, and perhaps receive the loan proceeds from, contractors indicates that Home Depot’s business plan is based upon a miscomprehension of banking law. NAR has recommend that the FDIC consult with the Federal Reserve, the agency with rulemaking and interpretive authority for Section 23A<sup>8</sup>, regarding this matter. We have also asked the Federal Reserve to review the TWA issues raised by the Home Depot proposal and to ask the FDIC to suspend consideration of the proposed acquisition until the Federal Reserve has completed its review.

NAR believes the business plan of The Home Depot is flawed and accordingly, we oppose its Interagency Notice of Change in Control. As NAR has consistently stated over the years, we believe Congress should decide whether it is appropriate to permit the mixing of banking and commerce in circumstances such as these, not the regulators.

#### ■ **Other Initiatives to Permit Banks into Commerce Should Also Be Blocked**

At the same time that numerous banking organizations and bank trade associations are strenuously opposing the Wal-Mart and Home Depot’s application on the basis that permitting commercial firms to own banks will result in an impermissible mixing of banking and commerce, they are themselves seeking to expand permissible bank activities into real estate brokerage, management, and real estate development—activities which by their very nature are commercial. NAR believes that the various government agencies involved should reverse any trend in this direction.

In 2001, for example, the Federal Reserve Board and the Department of the Treasury published a proposed rule that would permit financial holding companies and financial subsidiaries of national banks to engage in real estate management and brokerage. NAR believes that these activities are commercial, and apparently Congress agrees, since it has blocked the agencies from issuing a final rule. More recently, the Office of the Comptroller of the Currency (OCC) has issued several rulings that, in our view, go beyond the statutory authority banks have to own real estate to accommodate their businesses. We think that permitting banks to develop and own luxury hotels and develop residential condominiums for immediate sale in order to make the remainder of a project economically feasible stretches the law to the breaking point. As in the case of the Wal-Mart deposit insurance application and the Home Depot Notice, we believe that Congress should resolve the irreconcilable clash of commercial and banking industries over these related issues, not regulatory agencies.

#### ■ **Conclusion**

The National Association of REALTORS® commends Chairman Bachus and Representative Maloney for

holding today's hearing on ILCs. NAR asks Congress to send a clear signal to the FDIC to delay action on all pending commercial companies' applications for federal deposit insurance for ILCs and processing Change in Control Notices for acquisition of ILCs. NAR further asks Congress to carefully consider whether to tighten or eliminate the loophole altogether. NAR stands ready to work with you on legislation that reinforces our national policy against mixing of banking and commerce to ensure continued stability and growth of the nation's financial system.

<sup>1</sup> Federal Deposit Insurance Corporation (FDIC) Public Hearings Regarding the Deposit Insurance Application of Wal-Mart Bank, testimony of Testimony of Thomas M. Stevens, CRB, CRS, GRI, President, National Association of REALTORS<sup>®</sup> (April 11, 2006) and Letter to John F. Carter, Regional Director, Federal Deposit Insurance Corporation Regional Office on the Home Depot Notice of Change in Control related to its proposed acquisition of EnerBank USA (June 5, 2006).

<sup>2</sup> See [http://walmart.nwanews.com/wm\\_story.php?paper=adg&storyid=144830](http://walmart.nwanews.com/wm_story.php?paper=adg&storyid=144830).

<sup>3</sup> "Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority," GAO-05-621 (September 2005)

<sup>4</sup> News Release, *The Home Depot to Acquire EnerBank USA*, <http://ir.homedepot.com/ReleaseDetail.cfm?ReleaseID=195724>.

<sup>5</sup> *Id.*

<sup>6</sup> Interagency Notice of Change in Control filed by Home Depot on May 8, 2006, page 10.

<sup>7</sup> 12 U.S.C. 1828(j).

<sup>8</sup> for Section 23A 12 U.S.C. 371c(f).