

President's Message



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Wal-Mart Application Focuses Spotlight on Industrial Loan Companies

Wal-Mart has been in the spotlight in recent months for its application with the FDIC to obtain deposit insurance for an industrial loan corporation (ILC).

ILCs have been around for 100 years. For most of that time, they have been small, locally owned institutions with limited deposit-taking and lending powers. But that changed in 1987, when Congress passed an exception to federal banking law to allow any type of business to own an ILC. And since then, ILCs have been purchased by non-financial firms, including General Electric Co., Volkswagen A.G., General Motors Corp., Pitney Bowes Inc. and Target Corp.

So why are bankers and regulators concerned? Isn't the ILC supervised by the FDIC and the chartering states?

That's correct, but the corporation owning the ILC is not. To critics of the Wal-Mart application, this gap raises a number of concerns. Among them:

- Unintended extension of the federal banking safety net to commercial firms that own ILCs. Risks might be shifted to the federally insured ILC, yet the FDIC could not force the parent company to cover the losses of the ILC if it were to fail.

- The commercial firm may have business objectives that are not consistent with the safety and soundness of the insured ILC; and

- The commercial firm's market power might increase because of its ownership of the ILC.

If ILCs were small, the matter would not be receiving so much attention. But the more than 50 FDIC-insured ILCs are now among some of the nation's largest and more complex financial institutions, according to the Government Accountability Office. Assets topped \$140 billion in 2004. The Merrill Lynch ILC by itself has more than \$50 billion in deposits.

Wal-Mart argues that its ILC application is getting far more scrutiny than those already approved for GE, GM, Volkswagen and even its top competitor, Target. Wal-Mart has promised not to open retail branches in its stores and said the primary purpose of the new ILC would be to process credit- and debit-card transactions. By processing in-house the approximately 140 million electronic transactions its stores generate each month, Wal-Mart expects to realize considerable savings, which, as with all of its efficiencies, it would pass along to consumers.

But many bankers are not convinced; they fear that the wall separating banking from commerce will crumble. Retired Federal Reserve Chairman Alan Greenspan has agreed. Before leaving the Fed, Greenspan urged Congress to hold open, public discussions as to what is best to protect the safety and soundness of the banking system—and the taxpayers who ultimately pay for our mistakes. The new Fed chairman, Ben Bernanke, has agreed. In his first address to the House, Bernanke backed a measure that would put industrial loan companies under Fed oversight.

Public hearings planned by the FDIC will allow both proponents and opponents to present their views on this important matter. However it plays out, the issue of ILCs promises to be one of the more interesting banking issues of 2006.