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Industrial Loan Companies/Banks and the Separation of Banking and Commerce: Legislative and Regulatory Perspectives

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Industrial Loan Companies/Banks and the Separation of Banking and Commerce: Legislative and Regulatory Perspectives

Summary

Industrial Loan Companies (ILCs) are state-chartered and state-regulated depository institutions. The Federal Deposit Insurance Corporation (FDIC) may insure them. Their owners include nonfinancial companies that cannot own (hold stock of) a bank under the Bank Holding Company Act (i.e., to be a bank or financial holding company). Their primary federal regulator is not the Federal Reserve, which regulates bank holding companies, but the FDIC. Although prominent large ILCs include subsidiaries of securities firms, their owners also include automotive and retailing companies. The ILC form reflects a persistent tendency to combine the financing of a business with its operations, standard in many countries, especially Germany and Japan, but in disfavor in America. ILCs, therefore, have developed against a long U.S. two-way tradition of the separation of banking and commerce: (1) Ownership interests that nonfinancial firms may have in banks are generally 25% or less. (2) Banks may generally hold only nominal amounts of corporate stock.

ILCs evoke two major policy concerns. First, should Congress grant ILCs powers that would allow them to be nationwide banks while in competition with community banks? Second, could the combination of state and FDIC regulation provide oversight comparable to that for nationwide banks, especially for bank holding companies? The interest shown by Wal-Mart in controlling an ILC with nationwide potential has heightened interest in these issues. The 108th Congress considered these issues in two bills that passed the House. H.R. 758 would have allowed ILCs to provide business checking accounts, while H.R. 1375 would have allowed ILCs to open branches nationwide. These measures could have transformed ILCs into a parallel banking system regulated primarily by a few states, growing into large institutions with commercial ownership.

In 2005, Wal-Mart announced that it was again applying for an ILC charter. (DaimlerChrysler did likewise later in the year). In the 109th Congress, H.R. 1224, allowing business checking accounts, passed the House on May 24, 2005. It would prevent ILCs owned by nonfinancial businesses from becoming more bank-like. H.R. 3882 independently seeks to make any company that controls an ILC become a financial holding company (as defined above). The House passed H.R. 3505, a regulatory relief measure, on March 8, 2006. This bill would restrict ILCs from opening interstate branches. H.R. 5746 was introduced July 10, 2006. It would give the FDIC the authority to regulate the owners of ILCs and prohibit some ILCs from branching into new states. On December 7, 2006, 107 Members of Congress asked the FDIC to continue a moratorium on deposit insurance applications by ILCs owned by commercial firms. The Members said this would provide time for the 110th Congress to act on the policy concerns.

This report analyzes the controversy by (1) providing an historical overview of the separation of banking and commerce; (2) examining the nature of ILCs and their regulation; and (3) identifying and analyzing the relevant legislation in Congress. This report will be updated as events warrant.

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Introduction

Industrial Loan Companies (ILCs) are state-chartered and state-regulated depository institutions whose deposits the Federal Deposit Insurance Corporation (FDIC) may insure. Congress specifically exempted them from being defined strictly as "banks" in statutes. Nonetheless, state banking codes may define them as industrial banks. Although they are subject to FDIC inspection and the same banking laws that apply to all FDIC-insured institutions, parent companies may own them without becoming bank holding companies or financial holding companies and, therefore, are not subject to supervision by the Federal Reserve (Fed). ILCs are now typically found in a few western states. In recent years large companies such as GMAC, Volkswagen, Target and Harley-Davidson have created or acquired ILCs to provide in-house financial services including financing customers' accounts. An additional 14 have applications pending for new ILCs or transfers of ownership.[1]

ILCs are arguably an institutional manifestation of a persistent tendency to combine the financing of a business with its operations. Entrepreneurs may view this combination as efficient, so that it emerges in this country periodically. Yet policymakers and, especially, the Fed have often opposed it. In America, industrial firms may have only noncontrolling interests in banks as defined in statutes, generally 25% or less of bank shares. The combination of banking and commerce, however, is found in many other nations with different financial systems. Germany and Japan are perhaps the most prominent nations mixing capital sources and uses directly.

The 108th Congress considered legislation, detailed below, allowing ILCs to be like regular commercial banks. Similar legislation resurfaced in the 109th Congress, especially after the Government Accountability Office completed its study of these institutions, and Wal-Mart revived its attempts to control an ILC.

There are two policy issues concerning ILCs. First, if such measures become law, could ILCs become "alternative" nationwide banks, owned by commercial and industrial, and financial, businesses? That would contravene long-standing policy prohibiting nonfinancial companies from owning banks. Second, could state and federal (the FDIC rather than the Fed) supervisors regulate the resulting ILCs and their owners comparably to other banking institutions and their holding companies?

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[1] Testimony of Douglas H. Jones, acting general counsel, FDIC, in U.S. Congress, House Committee on Financial Services, July 12, 2006, p.19.

Some observers believe that, should ILCs be allowed to expand, a less-regulated banking system controlled by very large securities firms and nonfinancial businesses would emerge, contrary to long-standing laws. If so, deep-pocket companies could operate nationwide ILCs as extensions of their corporate treasuries, in competition with community banks. A three-thousand-or-more branch "Bank of Wal-Mart" could be the first of many such ILCs. Others note that existing ILCs are small players on the field of finance. They would continue to be regulated by states and the FDIC, maintaining their safety and soundness despite ownership by retailers, securities firms, and others.

This report addresses the controversy over expansion of ILCs by line of business and by branching across the nation as follows, providing:

(1) an historical overview of the U.S. separation of banking and commerce;
(2) information on ILCs and their regulation; and
(3) analysis of relevant legislation in Congress.

Banking and Commerce in American Economic Development

Overall, analysts think of banking as a source of funds, and all other activities, including commercial and industrial business, as a use of funds. Much of the history of banking in the United States revolves around the desire to avoid mixing the two. (In the rest of the world, such combinations are prevalent.) Problems have occurred when they have mixed, particularly when users of funds have treated a bank as a captive financier of business activities, or an adjunct to a corporate treasury. The potential for bank failure has been higher in such cases. The combination may heighten potentials for systemic risk, in which the failure of one major lender leads to failures of others, when regulatory oversight is not sufficiently strong.

Nineteenth Century

Following calamitous combinations of banking with commercial activities in the early 1800s, New York and Georgia led the way into having banks be purely lending and deposit-taking businesses in 1838. Chartered banks generally moved away from commercial activities. The National Banking System, which Congress created to finance the Civil War,[2] patterned itself on the limited New York banks.

Other state banking systems included banks with significant commercial activities. One notable example of state-level bank/industry combination was The Bank of California, which owned extensive gold and silver mining properties in Nevada. Unincorporated private banks, often partnerships, combined financing and investing activities under one roof later in the century. The Morgan and Rockefeller commercial/financial/banking empires were prominent among these aggregations. Their deposits financed investments in stocks, often controlling other firms.

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[2] 12 Stat. 665, significantly amended by the National Bank Act of 1864, 13 Stat. 99.

Early 20th Century

At the start of the 20th century, many incorporated commercial banks emulated private bank operations through "departments," while trust companies investing in corporate stock investments emerged. Deposits essentially funded both types of banks, allowing them large bases of assets. The spread of mixed commercial/investment banking lessened the distinction between financing an enterprise through credit and controlling it through ownership. Losses did occur, especially after the stock market collapse in 1929, when many banks believed to have had significant stock holdings could not meet depositor demands for their money. "Runs" to withdraw deposits caused the failure of many other banks, including those that had not suffered losses, because, although they had operated safely and were solvent, they lacked adequate funds on hand (liquidity) to pay depositors seeking withdrawals quickly. Many critics blamed the Great Depression that followed on "financiers," who abused banks in the service of nonbank business.

In reaction, the Glass-Steagall Act[3] divided banking and industry (including securities operations and their corporate investments) into separate businesses after 1933. The Morgan, Rockefeller, and other complex business combinations with financial firms were split into separate banking and "nonbanking" parts. Glass-Steagall prohibited most banks from holding significant amounts of stock in commercial businesses. The new securities firms, no longer able to invest for their own account based on deposit funding, became transactional financial businesses focusing on commissions and fees. Subsequent attempts to mix sources and uses of funds through corporate combinations generally involved "affiliates."[4]

Holding Companies

Subsequent bank participation in commercial operations turned to the holding company form that seemingly maintained a certain separation while gaining some efficiencies. This form of an unregulated state-chartered corporation with potentially unlimited authorities could control ("hold" the stock of) regulated banks and any number of unregulated financial and nonfinancial businesses. The archetype of this diversification was the giant Transamerica Corporation. Transamerica owned The Bank of America, other large banks in several western states, large insurance companies, real estate and oil development operations, a fish packer, a metal fabricator, ocean shipping, and taxicab operations. Provisions addressing companies holding bank stock in the 1933 Act did not prevent its rise.

Repeated Federal Reserve (Fed) efforts to restrain Transamerica culminated in the Bank Holding Company Act of 1956 (BHCA).[5] This act removed multi-bank holding companies from commercial ownership and activities and interstate

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[3] 48 Stat. 162, §§20, 21, 26, 32.

[4] An analysis of such structures appears in CRS Report RS21680, *Affiliates in Banking, Finance, and Commerce: Development and Regulatory Background*, by William D. Jackson.

[5] 70 Stat. 133.

expansion. The Fed became the supervisor of multi-bank holding companies, and quickly limited their commercial ties and interstate operations.

Large businesses continued to find it advantageous to own just a single bank. A "one-bank" holding company could own only one bank, which nonfinancial businesses could then control without restraint. By 1970, more than 700 of these companies had emerged. In that year, major amendments to the BHCA[6] limited such combinations. The amended BHCA's definition of a bank applied only to institutions that both accepted demand deposits (checking accounts) and made commercial loans.

The 1956 statute specified that "control" of banks occurred when a single "company" such as a nonfinancial business or investment enterprise owned 25% or more stock ownership of voting shares in banks, with significant exceptions; this figure still critically defines the span of prohibited "control" of a bank by a nonfinancial company. The Change in Bank Control Act of 1978[7] extended the 25% value to unincorporated firms, individuals, etc.

Nonbank Banks

Shortly afterwards, limited-service "nonbank banks" (NBBs) arose. NBBs (1) accepted either demand or other deposits, or (2) made commercial loans, but, critically, not both. Corporate buyers would purchase or create a bank with a national or state charter and divest either its business loans or its deposits payable on demand. Thus, their banking operations fell outside the BHCA's redefinition in 1970. Yet, the FDIC insured their deposits.

The Office of the Comptroller of the Currency, which charters national banks, chartered the first such institution in 1982. This agency soon became flooded with applications. Because NBBs fell outside the strict legal definition of a bank, they, their parent corporations, and related companies, were not subject to BHCA activity and interstate banking restrictions. Most apparently accepted deposits but made no commercial loans. Prominent NBBs thus became known as "credit card banks." Others apparently functioned as extensions of corporate treasuries and invested largely in money market instruments. This "nonbank bank loophole" allowed financial conglomerates such as Merrill Lynch, Shearson/American Express, and Prudential; and industrial companies such as General Electric, Textron, Gulf and Western, Sears Roebuck, Archer-Daniels-Midland, J.C. Penney, and Control Data, to offer FDIC-insured banking services.

[6] 84 Stat. 1760.

[7] 92 Stat. 3683.

Competitive Equality Banking Act of 1987

With strong Fed backing, the Competitive Equality Banking Act of 1987 (CEBA)[8] prohibited new NBBs, reasserting both Fed control and interstate banking restrictions. CEBA more stringently defined "banks" under the BHCA to include institutions insured by the FDIC, with certain exceptions. CEBA broadly defined the terms "demand deposit" and "commercial loan" to cover many variations. Thus, it stopped prospective owners of NBBs from creating more institutions combining banking and commerce across state lines. (A decade later, the Economic Growth and Regulatory Paperwork Act of 1996[9] relaxed some of its numerical restraints.)

In amending the BHCA, this law significantly exempted industrial loan companies or industrial banks, from being defined as banks. In language still in effect in 2006, CEBA legislated that the term "bank" in the BHCA does not generally refer to ILCs, if (1) their chartering state then required them to obtain FDIC insurance, or was considering such a requirement; (2) they do not accept demand deposits; (3) they do not incur payments system overdrafts leading to Fed credit on behalf of affiliated companies; (4) they do not offer checking accounts for commercial customers if they grow to $100 million in assets; and (5) they do not become acquired by new owners after March 1987.[10] CEBA affected about 50 ILCs, and now governs a handful more.

Savings and Loan Associations

Created as housing finance lenders when banks could not or would not lend on the security of residential real estate, these associations specialized in consumer mortgage financing and deposit-taking. Policymakers did not perceive these "thrift" institutions as "banks" for many years. A holding company act, put into much of its present form in 1968,[11] eventually came to govern them, too. The Change in Savings and Loan Control Act of 1978[12] statutorily made their ownership standards the same as for bank ownership. Nevertheless, for many years their holding company law contained no activity restrictions on companies owning just a single ("unitary") thrift institution. They included Ford, National Steel, Sears, and, again, Transamerica.

By the early 1980s, thrift institutions suffered large losses. Their mortgage revenues, particularly on mortgages made in earlier years and carrying low fixed rates, could not match the high rates then needed to attract and keep deposits. Remediation efforts included regulatory liberalization of ownership with reduced capital in 1982, which allowed new owners to contribute stock, land, real estate, etc. as "in-kind capital." Lawmakers authorized thrifts to make direct investments via the

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[8] 101 Stat. 552.

[9] 110 Stat. 3009, Title II, §2304.

[10] 12 U.S.C. §1841(c)(2)(H).

[11] 82 Stat. 5.

[12] 92 Stat. 3687.

Garn-St Germain Depository Institutions Act of 1982,[13] and in states having permissive laws such as California, Florida, and Texas. Thrifts owned casinos, fast-food franchises, ski resorts, and windmill farms, among other direct investments.

Although such commercial activities were only one of many elements of the financial plight of thrifts, they became viewed as highly visible sources of trouble. In 1985, regulatory tightening restricted direct investments of thrifts without special federal permission to 10% of assets. Systemic disintegration of insolvent thrifts led to strong and costly remedies in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989,[14] followed by the Federal Deposit Insurance Corporation Improvement Act of 1991.[15] Both measures, among their many safety and soundness provisions, severely limited commercial investments for the remaining thrifts, and the latter did so for banks as well. Direct investments came under FDIC veto power in the 1991 legislation, limiting the ability of states to authorize activities and stockholdings for their chartered banks and similar depository institutions.

Gramm-Leach-Bliley Act

This legislation (GLBA)[16] liberalized the BHCA in 1999 to provide new corporate forms for owning banks. Such financial holding companies (FHCs), or securities-based investment bank holding companies, may own commercial banks, securities houses, insurance companies, and other financial companies. As specially empowered bank holding companies, FHCs may own more diversified financial businesses than bank holding companies previously could. The Fed regulates FHCs under the BHCA, while the Securities and Exchange Commission regulates investment bank holding companies. Inside both, banks "held" are subject to all federal and state banking laws, including ownership rules. Commercial firms cannot be, or own, these holding companies. FHCs cannot have nonfinancial affiliates, with a few exceptions such as "merchant banking"[17] and insurance company investments. A critical GLBA percentage is 85%, which is the proportion of total revenue of a company allowed be a FHC and similar that must be financial.[18]

This law ended the ability of "unitary thrift holding companies" noted above to engage in bank-like activities while being owned by nonfinancial businesses. GLBA also ended some of CEBA's 1987 restrictions on remaining NBBs. GLBA did not disturb the exemption of ILCs and their owners from Fed supervision.

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[13] 96 Stat. 1469.

[14] 103 Stat. 183.

[15] 105 Stat. 2236.

[16] 113 Stat. 1338.

[17] See CRS Report RS21134, *Merchant Banking: Mixing Banking and Commerce Under the Gramm-Leach-Bliley Act*, by Gary Shorter.

[18] 113 Stat. 1348.

Industrial Loan Companies

ILCs (known as industrial banks in California and Utah and thrift companies in Nevada) can engage in most banking activities under specific state law. Under federal law these institutions cannot now accept demand deposits (i.e., business checking accounts, whether bearing interest or not). They are vestiges of an early-20th-century mode of finance, in which state-chartered loan companies served the borrowing needs of "industrial" workers that banks would not provide. Many later merged with commercial banks; 12 states still have industrial bank-charter options.

The FDIC began to insure the deposits of a few ILCs in 1958. After collapses of state ILC insurance funds in Utah and California, the Garn-St Germain Depository Institutions Act of 1982[19] encouraged the FDIC to cover deposits of ILCs operating safely.[20] It insured commercially owned ILCs commencing in 1988.

FDIC-insured ILCs are found mostly in Utah, California, and Nevada. The FDIC has insured 58 of these entities in seven states, which thus are potentially the basis for an alternative banking system. Insured ILCs have about $130 billion in assets:[21] less than 1.5%of total assets of all FDIC-insured institutions.[22] (Another 900 or more "Industrial Loan Corporations" exist, but are very small, lacking FDIC insurance[23] and sometimes even state banking agency regulation. They are not part of the current congressional interest in ILCs.)

Under their state charters, ILCs are not greatly limited in the types of business they may conduct. ILC activities vary from being community-oriented consumer and small business lenders, to specialty lenders, to auxiliaries of their owners' corporate treasuries, to financiers of their parents' large-dollar products. ILCs and, especially their parent owners, need not always carry as much capital as banks and their holding companies. These characteristics have attracted several large owners. ILCs in Utah include subsidiaries of American Express, BMW, Citigroup, General Electric, General Motors, Merrill Lynch, Morgan Stanley, Pitney-Bowes, Sears, UBS, Volkswagen and Volvo. Wal-Mart's attempt to buy an industrial bank in California in 2002 set off protests from community banks and labor groups. California soon enacted legislation to prohibit nonfinancial companies from obtaining an ILC charter. Colorado has barred nonfinancial firms from owning its ILCs. Utah thus is the favored location for enhanced ILCs. For example, in 2003, it chartered Medallion

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[19] 96 Stat. 1469, §703.

[20] ILCs must meet Federal Deposit Insurance Act insurability criteria: financial condition and history, capital adequacy, earnings prospects, character of management, community convenience and needs, and corporate powers consistent with law. 12 U.S.C. §1816.

[21] Rob Blackwell, "Wal-Mart After ILC Again," *American Banker Online*, Mar. 8, 2005.

[22] Office of Inspector General, Federal Deposit Insurance Corporation, *The Division of Supervision and Consumer Protection's Approach for Supervising Limited-Charter Depository Institutions*, Evaluation Report, Sept. 30, 2004.

[23] Conference of State Bank Supervisors, *A Profile of State-Chartered Banking* (Washington: 2002), pp. 16-18.

Bank, which received FDIC coverage, to finance taxicabs. It has chartered ILCs with total assets of $106 billion: 62% of FDIC-insured ILC deposits.[24]

Insured ILCs are subject to state banking supervision, FDIC oversight as state banks, and most other major federal banking laws governing consumer compliance, community reinvestment, and transactions with insiders and related parties. Nonetheless, their owners do not fall under the definition of a bank holding company subject to Fed scrutiny. The Fed allows bank holding companies to own, control, operate, and provide services to ILCs, but, as noted above, may not require ILC owners to become bank holding companies.[25] Opponents of ILCs view the Fed's holding company regulation, reaching to ownership, as "safer" than the FDIC's governance of institutions but not their owners. Yet owners of ILCs face similar restrictions against irregular self-dealings.

From 1985 through early 2004, 21 ILCs failed. Collapsed ILCs were mainly small finance-company-mode companies taking on risky customers. Pacific Thrift and Loan and Southern Pacific Bank were the largest, and most recent, failed ILCs. Collectively, failed ILCs were less than 1% of insured banking firms that collapsed. The riskiest ILCs could not obtain FDIC insurance in the early 1980s, so that the agency expended no federal funds on their liquidations, in contrast to the savings and loan experience.[26] In the other direction, the collapse in 2002 of a prominent owner of an ILC, Conseco, for business reasons unrelated to the ILC, did not adversely affect its insured ILC. GE Capital bought the ILC at its book value, so that no losses resulted.[27]

Today, federal and state regulators expect ILCs to be run in a safe and well-capitalized manner, with defined business plans and relationships to their parent owner firms. As primary federal regulator, the FDIC has authority to examine the affairs of any affiliate of any depository institution, including its parent company, to decide the effect of the relationship between the institution and affiliates.[28] **Table 1** presents the business models and some examples of owners of insured ILCs.

Debate over measures granting ILCs banking powers, without requiring that their owners be bank holding companies, involves interrelated questions. They involve competitive balance, the nature and effectiveness of regulation, and safety and soundness issues. Comparisons of ILCs and banks involve value judgments as to the safety and competitiveness of banking institutions, federalism, and relations between ownership and behavior. The following summarizes the contending positions over ILC authorities.

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[24] Blackwell, "Wal-Mart After ILC Again."

[25] 12 C.F.R. §225.28.

[26] Mindy West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," *FDIC Supervisory Insights*, vol. 1, summer 2004, p. 5-13.

[27] Christine Blair, "The Mixing of Banking and Commerce: Current Policy Issues," *FDIC Banking Review*, vol. 16, no. 4, 2004, p. 114.

[28] Federal Deposit Insurance Act §10(b)(4), 12 U.S.C. §1820.

Arguments for ILC Expansion

The FDIC notes that ILCs are subject to its examinations, compliance with banking laws, and supervisory restrictions. In this view, there are no safety and soundness reasons for requiring constraints on this charter type beyond those imposed on other FDIC-insured charter types. The Conference of State Bank Supervisors, and the Financial Services Roundtable believe in the potential for competitive flexibility of ILCs, with their state charters forming just another part of the "dual banking system" of federal and state banking charters.

The Utah ILC regulator has testified that it has the experience and capacity to regulate the ILCs. G. Edward Leary, Utah's commissioner of financial institutions, testified that the industrial banks are "well capitalized, safe and sound institutions."[29]

Merrill Lynch, Morgan Stanley, Goldman Sachs, UBS Warburg, and Wal-Mart have publicly supported the ILC expansion effort. (Merrill's ILC already controls about half of ILC assets.)

Table 1. Summary of ILC Business Models

Business Model Description	Number	Total Assets, $Billion (percent)	Example ILCs
Community-focused, stand-alone.	6	$0.8 (1%)	Golden Security Bank; Tustin Community Bank.
In businesses with activities predominantly: (a) financial, ILC has community focus; (b) financial, ILC supports a specialty function within the firm; (c) within the financial services sector.	(a)15 (b)16 (c) 3	$127.7 (94%)	Finance Factors, LTD; Merrill Lynch Bank USA; American Express Centurion Bank; USAA Savings Bank (United States Automobile Association); Associates Capital Bank (Citigroup); Trust Industrial Bank.
In businesses not necessarily financial in nature.	7	$4.2 (3%)	GE Capital Financial; GMAC Commercial Mortgage Bank; Exante Bank (United Health).
Directly support parent business commercial activities.	9	$2.6 (2%)	BMW Bank of North America; Volkswagen Bank USA; Pitney Bowes Bank.
Totals	56	$135.4	—

Source: Adapted by CRS from Office of Inspector General, Federal Deposit Insurance Corporation. *The Division of Supervision and Consumer Protection's Approach for Supervising Limited-Charter Depository Institutions, Evaluation Report*, Sept. 30, 2004, pp. 34, 37.

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[29] Testimony of G. Edward Leary, Utah commissioner of financial institutions, in U.S. Congress, House Committee on Financial Services, July 12, 2006, p.19.

Arguments Against ILC Expansion

Fed officials opposing ILC expansion argue that ILCs and, especially, their owners are not subject to the same level supervision as commercial banks and their holding companies, and, in this line of thought, would pose a risk to the financial system if they became prominent. The Fed notes that owners of ILCs, especially large commercial firms, avoid regulations that apply to holding company owners of full service insured banks. Community banks feel threatened by potential competition from Wal-Mart and other deep-pocket owners of in-house ILCs with nationwide banking powers, just as small merchants and labor groups feel threatened by entry of Wal-Mart into their communities. The Independent Community Bankers of America opposes ILC expansion, as does the United Food and Commercial Workers union. Some consumer groups feel that ILCs threaten the FDIC insurance fund, and, therefore taxpayers, by mixing banking with commerce.[30]

108th Congress Legislative Debate

H.R. 758 (Representative Kelly) would have permitted banks to pay interest on business checking accounts, which is the essence of their relationship with commercial customers, particularly small businesses. The measure would have also allowed ILCs to offer checking accounts to corporate customers and pay interest on them. Industry observers know the latter provision as the Royce Amendment (after its sponsor), adopted in a markup, March 13, 2003. The committee defeated two amendments of opposite, restrictive, intent. The House passed the result by voice vote on April 1, 2003. The Senate did not take it up.

H.R. 1375 (Representative Capito) would have relieved depository institutions, including ILCs, from some perceived burdens of their regulation. This measure would, among many other things, have given banks and ILCs authority to use start-up ("de novo") branches to cross state lines by opening newly created branches through its amending of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.[31] In its Financial Services Committee markup, an amendment seeking to disallow ILCs from branching across state lines without permission of the states entered, was defeated. The committee approved H.R. 1375 on May 20, 2003. A compromise (by Representatives Frank and Gillmor) was incorporated into the manager's amendment, which the House passed on March 18, 2004. It would have limited ILCs' crossing a state line without acquiring an existing bank, unless the ILCs were more than 85% financial in nature, or had FDIC insurance before October 2003. The Senate did not take that measure up either.

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[30] Ibid.

[31] 108 Stat. 2238 §102.

109th Congress Activity

Wal-Mart's latest strategy to own an ILC envisioned its opening in Utah in 2006, while pledging to limit its operations to credit and debit card activities and not opening branches in stores.[32] DaimlerChrysler, the world's fifth-largest car maker, announced in November 2005 that it is seeking to open a new Utah ILC subsidiary by early in 2006.[33] The FDIC held two days of hearings in Arlington, Virginia, on April 10 and 11, 2006, concerning the Wal-Mart ILC application. Hearings were, also, held on April 25, 2006, in Overland, Kansas.[34] Home Depot requested permission to acquire an existing ILC, EnerBank USA, on May 12, 2006. The FDIC has not announced a decision on either application. Other pending applications include those from Blue Cross/Blue Shield and Berkshire Hathaway.

H.R. 1224 (Representative Kelly), the Business Checking Freedom Act, passed the House on May 24, 2005, by 424-1. Many ILCs would have been excluded from its provisions that would have allowed banks to pay interest on corporate accounts. The ILC provision repeats a compromise struck by Representatives Frank and Gillmor in the 108th Congress. This legislation would have disqualified ILCs from the new power to pay interest on the accounts if a firm that controlled them derived at least 15% of its annual gross revenues from activities that were not "financial in nature or incidental to a financial activity" in at least three of the last four calendar quarters. Some ILCs would have qualified, including those that became an insured depository institution before October 1, 2003, or those that had approved applications by that date. The 85% test originated with the Gramm-Leach-Bliley Act noted above.

In September 2005, the Government Accountability Office released a report on ILCs.[35] This document seemingly questioned whether ILCs are a proper vehicle for mixing banking and commerce and thus, the desirability of their current regulatory climate. Representative Leach, citing this study, introduced a freestanding measure to change ILC regulation.[36] H.R. 3882, the Financial Safety and Equity Act of 2005, provides that any company that controls an industrial loan company, industrial bank, or similar institution shall become a financial holding company (as defined above).

The House Financial Services Committee unanimously approved H.R. 3505, the Financial Services Regulatory Relief Act of 2005 (Representative Hensarling), on November 16, 2005. The bill would have placed new restrictions against subsidiaries

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[32] Blackwell, "Wal-Mart After ILC Again."

[33] Chris Noon, "Schrempp's DaimlerChrysler Sees Money In A Bank," at website [http://www.forbes.com/2005/11/16/daimlerchrysler-bank-finance-cx_cn_1116autofacescan11.html?partner=msn].

[34] Transcripts and written statements are available at [http://www.fdic.gov/regulations/laws/walmart/publichearings/hearings_transcripts.html].

[35] *Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority,* GAO-05-621, Sept. 15, 2005, at [http://www.gao.gov/htext/d05621.html].

[36] R. Christian Bruce, "GAO Urges Congressional Review of ILCs; Bill by Rep. Leach Would Close Loophole," *Daily Report for Executives*, Sept. 23, 2005 , p. A-1.

of commercial firms, such as ILCs, opening branches on an interstate basis. Under the language of Representatives Frank and Gillmor noted above, commercial firms are defined as deriving at least 15% of revenues from activities that were not financial in nature. It was designed to discourage companies such as Wal-Mart from offering retail banking services. The bill passed the House on March 8, 2006, by a vote of 415-2.

H.R. 5746 (Representatives Gillmor and Frank), the Industrial Bank Holding Company Act of 2006, was introduced on July 10, 2006, and referred to the House Committee on Financial Services. It would have required corporations owning ILCs to register with the FDIC and be subject to FDIC regulation. It would also have limited the ability of certain ILCs to branch into certain states, which would have lessened the attraction to a retailer such as Target or Home Depot of owning an ILC.

The House Committee on Financial Services held oversight hearings on July 12, 2006, to review charter, ownership, and supervision issues concerning ILCs. At that time, there were 14 applications before the FDIC for new ILC charters or for transfers of ILC charters. Of these 14, 11 had been filed after the Wal-Mart application.

110th Congress Update

H.R. 698, the Industrial Bank Holding Company Act of 2007, which would prevent nonfinancial companies (called commercial companies in the bill) from creating or acquiring new ILCs, was introduced on January 29, 2007, and referred to the House Committee on Financial Services. The bill would create a new type of entity, industrial bank holding companies, similar to bank holding companies. The bill would prohibit commercial companies from becoming industrial bank holding companies. The bill would exempt ILCs that became insured depositories before October 1, 2003, and that have not had a change of control since September 31, 2003. It would, also, exempt commercial firms that became industrial bank holding companies by acquiring an ILC before January 29, 2007, and on or after October 1, 2003, as long as industrial bank holding company did not acquire control of any other depository institution or have a change in control after January 28, 2007.

The House Financial Services Committee favorably reported the bill on May 16, 2007, and the House approved the bill on May 21, 2007. The Senate referred the bill to the Committee on Banking, Housing, and Urban Affairs.

A companion bill, S. 1356, was introduced in the Senate by Senator Sherrod Brown on May 10, 2007. It was referred to the Committee on Banking, Housing, and Urban Affairs.

The FDIC continued its moratorium on applications from commercial companies for one year on January 31, 2007. The FDIC later announced that it would seek authority over industrial bank holding companies similar to the Fed's authority over bank holding companies.[37] The FDIC has continued to approve applications from financial companies that wish to own an ILC.

Wal-Mart withdrew its application to operate an ILC, on March 17, 2007.[38] On January 24, 2008, Home Depot announced that it would withdraw its application to purchase an ILC. Other applications by commercial companies remain on hold. The FDIC moratorium was not extended and expired on January 31, 2008. Shortly afterwards, Ford Motor Company applied for a charter on an ILC.

[37] Joe Adler, "FDIC Asking For Fed-Like ILC Authority," *American Banker*, Mar. 23, 2007, p. 1.

[38] Sheila C. Bair, "Statement of FDIC Chairman Sheila C. Bair on the Decision of Wal-Mart to Withdraw Bank Application," available at [http://www.fdic.gov/news/news/press/2007/pr07023.html].