



**Testimony  
by  
David E. Hayes  
President/CEO of Security Bank  
Dyersburg, TN  
&  
Chairman  
Independent Community Bankers of America  
Washington, DC**

**H.R. 3505  
“Financial Services Regulatory Relief Act 2005”**

**United States House of Representatives  
Financial Services Committee, Subcommittee on  
Financial Institutions and Consumer Credit**

**October 18, 2005**



Mr. Chairman, Ranking member Sanders and members of the subcommittee, my name is David Hayes, Chairman of the Independent Community Bankers of America ("ICBA")<sup>1</sup> and President and CEO of Security Bank; a \$135 million community bank in Dyersburg, Tennessee. I am pleased to appear today on behalf of ICBA and its nearly 5,000 members to testify on H.R. 3505, the Financial Services Regulatory Relief Act of 2005, introduced by Reps. Jeb Hensarling and Dennis Moore. We endorse their initiative.

Earlier this year, ICBA testified before this subcommittee about community banks' need for relief from the severe regulatory burden that we face<sup>2</sup>. I will not repeat those comments today, except to say that reducing the regulatory burden remains a top concern of community bankers and that we strongly support this subcommittee's efforts to reduce it.

In summary, ICBA:

- Greatly appreciates the inclusion of several provisions from the Communities First Act (H.R. 2061) as part of H.R. 3505 and recommends adding additional CFA provisions.
- Strongly supports the Gillmor/Frank compromise on industrial loan companies as a first step toward closing the ILC loophole.
- Supports the subcommittee's effort to reduce the burden and enhance the effectiveness of Bank Secrecy Act compliance.
- Strongly opposes increasing credit union powers so long as they have an unfair tax and regulatory advantage over community banks.
- Urges the Congress to quickly enact hurricane relief legislation.

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<sup>1</sup> The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org).

<sup>2</sup> Testimony of Terry Jorde, President/CEO, CountryBank USA, Cando, ND, and Chairman-Elect Independent Community Bankers of America, May 19, 2005

## Communities First Act

ICBA greatly appreciates the fact that the bill before us (H.R. 3505) includes five provisions from Rep. Jim Ryun's Communities First Act (H.R. 2061). CFA includes a number of regulatory and tax relief items that would be very helpful to community banks and our consumer, small business, and local government customers who depend on us for financial support. By lifting the yoke of regulatory burden from our backs, and moving us closer to tax parity with tax-exempt credit unions, the CFA would allow community banks to focus our resources on serving our customers and communities.

CFA has gained tremendous bi-partisan support in the House, with 75 sponsors, and was introduced in the Senate as S. 1568 with three sponsors. A total of 43 state banking trade associations have also endorsed CFA. (List of endorsing associations attached.)

The following provisions from CFA are included in the Hensarling/Moore bill:

- **Streamlining Call Reports** (*Hensarling/Moore 606; CFA 204*). Calls on the agencies to reduce or eliminate the information required for reports of condition if the information is "no longer necessary or appropriate."
- **Flexible Exam Schedule for Community Banks** (*Hensarling/Moore 607; CFA 107*). Expands the eligibility for the 18-month exam cycle from banks under \$250 million in assets to banks up to \$1 billion.
- **Short Form for Call Reports** (*Hensarling/Moore 608; CFA 102*). Permits highly rated, well-capitalized banks with assets of \$1 billion or less to file a short form Call Report every other quarter.
- **Changes to Small BHC Policy Statement** (*Hensarling/Moore 616; CFA 104*). Requires the Federal Reserve to revise the Small Bank Holding Company Policy Statement on Assessment of Financial and Managerial Factors so that the policy applies to BHCs with assets of less than \$1 billion that are not engaged in any nonbanking activities involving significant leverage and do not have a significant amount of outstanding debt. (The current policy applies to BHCs with assets under \$150 million. Subsequent to introduction of CFA, the Federal Reserve proposed to increase the level to \$500 million.)

- **Exception to Annual Privacy Notice** (*Hensarling/Moore 617; CFA 203*). Exempts a bank from the annual privacy notice requirement if the bank does not share customer information other than as permitted by one of the exceptions in the Gramm-Leach-Bliley Act, does not share information with affiliates under the Fair Credit Reporting Act, and has not changed its policies.

These provisions will be very helpful to community banks and we are grateful that the committee has included them in its bill. In addition, we strongly urge the committee members to take another look at the Communities First Act to determine if there are additional provisions that can be added to H.R. 3505.

In particular, we urge you to include the following sections of the Communities First Act:

- **Consideration of Community Bank Impact.** Section 109 of the Communities First Act requires that before establishing or making any revision in any regulation, requirement, or guideline, the appropriate banking agency must take into account the effect on community banks and savings associations. The OCC has already adopted a formal policy along these lines and it is appropriate that the other agencies follow suit.
- **Truth-in-Lending Act Three-Day Right of Rescission.** Section 201 of the Communities First Act 1) directs the Federal Reserve to prescribe regulations authorizing customers who borrow from Federally insured depository institutions to waive the three-day right of rescission, 2) exempts a refinancing with a new lender from the three-day right of rescission where no new money is advanced, and 3) exempts home equity lines of credit from the three-day right of rescission.

The three-day right of rescission, while it may protect consumers from unscrupulous lenders, has imposed a major inconvenience for borrowers from legitimate lenders such as insured banks. It makes little sense to impose this waiting period on borrowers who are doing business with legitimate lenders, who are not borrowing new funds, or who are establishing home equity lines. When there is no new money lent, the delay simply makes the borrower wait for the lower interest rate or other benefit from the new loan. In the case of a line of credit, the borrower already has a built in right of rescission; they can wait three days (or three months, or longer) before drawing on the line.

- **Loans to Officers and Directors.** Section 108 of the Communities First Act allows banks with less than \$1 billion in total assets to make loans to directors and officers, in the aggregate, up to two times capital. The current asset size limit is \$100 million in deposits. This adjusts this limit to the growth in average bank assets, but it is not a tenfold increase. That is because a bank with \$1 billion in assets could have considerably less than that in deposit liabilities.

Section 205 would help all banks by increasing to \$250,000 the special regulatory lending limit on loans to executive officers for loans other than those for housing, education, and certain secured loans.<sup>3</sup> This limit was set at \$100,000 in 1978. If adjusted for inflation, the limit would be \$296,000 today. So this amendment simply makes an appropriate adjustment for inflation.

- **Management Interlocks.** We note that section 404 of the Hensarling/Moore bill would increase the size of banks eligible for an exemption from interlocking director prohibitions from \$20 million to \$100 million. Section 105 of the Communities First Act would increase the level to \$500 million. It has always been a challenge for the smallest institutions to find qualified directors. Now that directors' responsibilities have increased under the Sarbanes-Oxley Act and other requirements, this has become a challenge even for larger community banks. We hope the subcommittee will consider increasing the level in section 404 to \$500 million to address this problem.

## Industrial Loan Companies

As the subcommittee members know, Wal-Mart recently applied for an industrial loan company charter in Utah and for Federal deposit insurance. ICBA and the other members of the Sound Banking Coalition strongly oppose the Wal-Mart application. We believe that this proposal to mix banking and commerce poses a special threat to the FDIC, the nation's payments system, and the communities we serve. ICBA's letter to the FDIC and the coalition's letter are included as an Appendix to my testimony.

The fact that the nation's largest and most aggressive retailer has applied for, essentially, a state banking charter, highlights the urgency of this issue. That is why ICBA strongly supports the Gillmor/Frank compromise that would limit the branching powers of new ILCs that are not owned by primarily financial companies. This would prohibit predominantly commercial firms from buying or establishing an industrial loan company and using the new branching authority to establish nationwide banking operations.

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<sup>3</sup> Executive officers would remain subject to the same limit on directors and principal shareholders, the loans-to-one-borrower limit, and to the requirement that loans to insiders not be on preferential terms

Parent companies of ILCs are not subject to the Bank Holding Company Act. Federal Reserve Governor Mark Olson testified before Congress that, "Allowing a commercial firm to operate a nationwide bank outside the supervisory framework established by Congress for the owners of insured banks raises significant safety and soundness concerns and creates an un-level competitive playing field." We agree.

A Government Accountability Office (GAO) report on ILCs released September 22, 2005 found that ILC parent companies are not adequately regulated and pose increased risks to the deposit insurance fund. GAO called on Congress to close the regulatory gap between ILCs and commercial banks, and urged Congress to consider the risks inherent in allowing ILCs to be owned by commercial firms.

GAO found that even though FDIC examines and supervises insured ILCs, "it has less extensive authority to supervise ILC holding companies than the consolidated supervisors of bank and thrift holding companies [i.e., the Federal Reserve and the OTS]." The report continued, "these ILCs may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company," adding that, "Congress should consider strengthening the regulatory oversight accorded to ILCs."

The financial risks faced by Wal-Mart are not similar to those faced by most banks and create unique problems due to its enormous size, scope, and complexity of its operations. This makes the need for holding company supervision even more urgent. The Bank Holding Company Act gives the Federal Reserve the authority to examine the bank holding company itself and any of its non-bank subsidiaries at any time, while the FDIC has only limited examination authority, and it is generally unable to examine affiliates of banks.

The Federal Reserve also has the authority to establish consolidated capital requirements to ensure that owners are a source of financial strength for the subsidiary bank. Corporate parents of ILCs are not subject to these capital requirements.

In addition, the Federal Reserve has broad enforcement authority and can issue cease and desist orders, impose civil penalties, and order a holding company to divest non-bank subsidiaries if it determines that ownership of the subsidiary poses a risk to the affiliated bank. The Federal Reserve is the only federal agency authorized to take such actions against bank holding companies.

GAO also raised concerns about mixing banking and commerce when ILCs are owned by commercial companies. The GAO said it finds “it unusual that a limited ILC exemption would be the primary means for mixing banking and commerce on a broader scale and sees merit in Congress taking a broader look at allowing ILCs or other entities to engage in this level of activity.”

The Wal-Mart application presents a prime example of the dangers of concentration of resources and impaired credit availability that flow from allowing a commercial company such as Wal-Mart to own a bank or ILC. And in Wal-Mart’s particular case, these dangers are amplified because of the company’s enormous size, market clout and role in destroying the vitality of many small town centers.

Will a competing local hardware or clothing store, a local pharmacy, or someone wishing to establish a new store, be able to obtain credit from the Wal-Mart bank, or want to share its confidential business plans with the Wal-Mart bank? The Wal-Mart bank would have no incentive -- in fact it would have a disincentive -- to lend to businesses that compete with its parent company.

Consumers and households likewise will be ill-served by a Wal-Mart bank. If the past is prologue, local banks, just like local retailers in towns where Wal-Mart has located, will face unfair competition. While the initial effect may be cheaper services at the Wal-Mart bank, the long-term effect will be reduced choices for consumers as the number of financial services providers shrinks

A Wal-Mart owned bank will not be able to look at other factors beyond a consumer’s credit score to understand the customer’s individual circumstances and cannot make the customer a loan based on a long-standing relationship and personal knowledge of the customer—something community banks do every day.

ICBA believes that the best way to deal with and eliminate the mixing of banking and commerce made possible by the ILC loophole is to close it by bringing ILCs under the Bank Holding Company Act. However, the Gillmor/Frank language is a reasonable first step that should be included in any proposal to relax branch restrictions or add other new powers for ILCs.

### **Bank Secrecy Act Compliance**

ICBA appreciates Congress’s oversight of the implementation of the Bank Secrecy Act and the efforts against terrorist financing and money laundering. We believe your efforts have helped swing the pendulum away from the “zero tolerance” policies that some examiners had adopted and that were driving legitimate businesses away from the nation’s banks.

Clearly, this is an area that requires sustained attention, since bankers across the country continue to identify BSA compliance as one of the most costly and burdensome issues they face. ICBA looks forward to continuing to work with Congress, Treasury, and the banking agencies to develop a reporting system that focuses on truly suspicious transactions, simplifies the system to eliminate reporting of routine transactions with no value for law enforcement, and properly balances costs and benefits.

Continuing their cooperation announced last year on matters of BSA compliance, Treasury and the bank regulatory agencies jointly issued an examination manual on June 30 and the agencies have conducted outreach meetings with industry on the new procedures. This is a very welcome approach to the problem. Section 702 of H.R. 3505 will further codify this cooperation in the area of monetary transaction recordkeeping and reporting, so we strongly endorse it.

Community bankers recognize the need to balance the needs of law enforcement with the need for effective BSA compliance. Section 701 represents another attempt to improve the exemption process for filing currency transaction reports (CTRs) to eliminate unnecessary costly reports of routine legal transactions. However, it is important to recognize that it is far easier for most community banks to file CTRs, rather than implement an exemption process. Similarly, for many larger banks, the process of filing the reports is fully automated, and many have decided that not using the exemption process is less burdensome, less confusing and less risky (especially because it eliminates risk of criticism by examiners).

In the current environment, bankers, especially community bankers, may continue to be reluctant to use the "seasoned customer" exemption. It is important to note that, despite Congressional mandates to reduce the number of unnecessary CTRs since 1994, efforts have been unsuccessful. While the ICBA believes the provisions of H. R. 3505 are a step in the right direction, the risks involved with implementing such exemptions might discourage community banks from using this option.

Therefore, ICBA favors a simple increase in the CTR filing threshold. An increase would adjust the threshold to take account of inflation (the filing threshold has been \$10,000 since it was set by statute in 1970) and reduce the number of filings for routine, legal transactions. Perhaps more important, it would be simple to apply.

Nonetheless, the specific measures in H.R. 3505 send a very valuable signal to Treasury, law enforcement, and the regulatory agencies that Congress is concerned about these issues and wishes to achieve a better balance. Thank you for your continuing efforts in this area.

## Credit Union Provisions

In our testimony earlier this year, we emphasized that – unlike the Communities First Act – the credit union industry bill (H.R. 2317) goes far beyond regulatory relief. The credit union bill is a powers enhancement proposal, while the Communities First Act includes no new powers for anyone. ICBA strongly opposes new powers for credit unions so long as they have an unfair tax and regulatory advantage over community banks.

CFA is strictly designed to lift the regulatory and tax burden for community banks and help level the playing field. In contrast, the credit union bill would, among other things substantially increase the ability of tax-exempt credit unions to make loans to businesses. Therefore, we are pleased that this provision and the one that would allow credit unions to reduce their capital are not included in H.R. 3505.

There is one area where we believe credit unions very much need regulatory relief. Earlier this year, the National Credit Union Administration, attempted to undermine two Texas credit unions' ability to choose to convert to a mutual thrift charter. NCUA invalidated a vote by one credit union's members to convert solely because of the way the required disclosure was folded. Fortunately, after a Federal magistrate's decision against it, NCUA settled the case and permitted the credit union to convert. However, this was just the latest example of NCUA's efforts to unreasonably block credit union conversions. To prevent further abuse, ICBA strongly urges the subcommittee to vote for Rep. McHenry's bill (H.R. 3206) that would eliminate NCUA's ability to micromanage the conversion process.

## Hurricane Relief Recommendations

The recent Gulf Coast hurricanes, Katrina and Rita, have highlighted a need for regulatory relief targeted to financial institutions in those areas. ICBA testified last month in detail about our recommendations for relief by Congress and the agencies<sup>4</sup>. Several bills introduced in the House include items that were part of our recommendations. We recommend that Congress enact all of these bills as expeditiously as possible.

***Hurricane Check Cashing Relief Act of 2005 (H.R. 3909)*** introduced by Rep. Ginny Brown-Waite. The bill would provide up to \$2,000 in reimbursement to a financial institution that has cashed a check for someone from an area affected by Hurricanes Katrina and Rita if the check is un-collectable. This will help those

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<sup>4</sup> Testimony of C. R. (Rusty) Cloutier, President/CEO, MidSouth Bank in Lafayette, LA and Past Chairman of the Independent Community Bankers of America, September 14, 2005

customers who had to flee from the hurricanes without their identification and other personal papers or who later lost them during evacuation. Financial institutions will be more likely to cash checks for people in need because the bill offers compensation in cases where, even when making their best efforts, a check they cash is returned without payment.

The bill appropriately rewards those banks that, in the early days after the disaster, did the right thing and provided cash when ATMs were not working. At that time, cash was essential, but individuals' normal source of cash was unavailable.

***Hurricanes Katrina and Rita Flood Insurance Buy-In Act of 2005 (H.R. 3922)*** introduced by Rep. Gene Taylor. This bill would extend flood insurance coverage to properties that had not been in designated flood risk areas. It would require the property owner to pay 105 percent of premiums for the preceding 10 years and also require that the property be covered in the future. This will greatly assist communities damaged by these extraordinary storms to begin to rebuild while protecting additional properties from future losses.

***Hurricane Katrina Financial Services Relief Act of 2005 (H.R. 3945)*** introduced by Rep. Richard Baker. Key provisions of this bill would:

- Require the Federal Reserve to waive wire-transfer fees for affected banks;
- Authorize the federal banking agencies to exercise flexibility in enforcing capital requirements; and
- Exclude deposits of casualty insurance proceeds when calculating a bank's capital requirements.

The enhanced flexibility for banks' capital requirements is particularly important for the reconstruction of local communities. Without this flexibility, community banks most affected by hurricane losses would be less able to provide badly needed loans to businesses and consumers seeking to rebuild. As the bill recognizes, it makes great sense to allow well-managed banks to remain in operation even though their capital is temporarily reduced due to the effects of the hurricane on customers and deposits.

ICBA recommends that H.R. 3945 be broadened to include banks in areas affected by Hurricane Rita.

## **Conclusion**

ICBA very much appreciates this opportunity to again testify on the importance of regulatory relief. We are pleased that significant sections of Rep. Ryun's Communities First Act have been included in the Hensarling/Moore bill, and hope that other provisions can be added as the bill moves forward. We are also pleased that H.R. 3505 includes the Gillmor/Frank compromise on industrial loan companies. This is vital so long as these state-chartered banks can be purchased or established by commercial firms. Finally, we again urge the Congress to act quickly on legislation to provide relief to communities and community banks affected by the hurricanes along the Gulf Coast.

## **State Associations Endorsing the Communities First Act (8.12.05):**

- The Community Bankers Association of Alabama
- Arkansas Community Bankers
- California Independent Bankers
- Independent Bankers of Colorado
- Florida Bankers Association
- Community Bankers Association of Georgia
- Community Bankers Association of Illinois
- Community Bankers Association of Indiana
- Iowa Bankers Association
- Iowa Independent Bankers
- Community Bankers Association of Kansas
- Kansas Bankers Association
- Heartland Community Bankers Association
- Bluegrass Bankers Association (BBA) in Kentucky
- Community Bankers of Louisiana
- Maine Association of Community Banks
- Michigan Association of Community Bankers
- Minnesota Bankers Association
- Independent Community Bankers of Minnesota
- Missouri Bankers Association
- Missouri Independent Bankers Association
- Montana Bankers Association
- Montana Independent Bankers
- Nebraska Independent Community Bankers
- Community Bankers Association of New Hampshire
- Independent Community Bankers Association of New Mexico
- Independent Bankers Association of New York
- North Carolina Bankers Association
- Independent Community Banks of North Dakota
- North Dakota Bankers Association
- Community Bankers Association of Ohio
- Community Bankers Association of Oklahoma
- Oklahoma Bankers Association
- Oregon Bankers Association
- Pennsylvania Association of Community Bankers
- Independent Banks of South Carolina
- Independent Community Bankers of South Dakota
- Independent Bankers Division/ Tennessee Bankers Association
- Tennessee Bankers Association
- Independent Bankers Association of Texas
- Texas Bankers Association
- Virginia Association of Community Banks
- Washington Independent Community Bankers Association
- West Virginia Association of Community Bankers
- Community Bankers of Wisconsin
- Bankers Bank Council



August 18, 2005

Honorable Donald E. Powell  
Chairman  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, N.W.  
Washington, D.C. 20429

Mr. John F. Carter  
Regional Director  
Federal Deposit Insurance Corporation  
25 Jessie Street at Ecker Square, Suite 2300  
San Francisco, California 94105

**Re: Comments Regarding FDIC Application #20051977; Wal-Mart  
Application for Insurance and Industrial Bank Charter**

Dear Chairman Powell and Mr. Carter:

On behalf of its 5,000 members, the Independent Community Bankers of America<sup>5</sup> writes to comment on the Wal-Mart Stores, Inc. application for a Utah industrial bank or industrial loan company charter (ILC) and federal deposit insurance. ICBA opposes the application and urges the FDIC to deny the application. ICBA further requests the FDIC to conduct a public hearing on the application and the serious public policy issues it raises.

ICBA is a founding member of the Sound Banking Coalition, which is also filing a letter opposing the application and requesting a hearing. ICBA

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<sup>5</sup> *The Independent Community Bankers of America, the nation's voice for community banks, represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry.*

incorporates by reference herein the arguments and issues raised in the Sound Banking Coalition's letter. The Coalition also filed a letter dated August 10, 2005 objecting to Wal-Mart's omission of essential elements about the company's plans for the ILC from the public portion of its application. Lack of this essential information makes it impossible for the public to adequately assess the application or fully comment on it. Accordingly, the Coalition requested the FDIC to require that Wal-Mart disclose more information and to extend the comment period for an additional thirty days.

Although Wal-Mart professes a narrow business plan for the ILC, the application nonetheless presents very serious public policy issues regarding the appropriate structure of our financial and economic system. The application by the world's largest company—with \$290 billion in revenue, 3,600 U.S. retail stores, 1.25 million U.S. employees, and more than 100 million customers a week—presents issues involving the mixing of banking and commerce, impartial allocation of credit, economic concentration, banking supervision, extension of the federal safety net and losses to taxpayers and community disinvestment. For the reasons presented below, the ICBA urges the FDIC to deny the application.

### **The Wal-Mart Application, Past Failed Attempts to Enter the Banking Business**

Wal-Mart's current business plan for the ILC is narrowly described as providing back office processing of credit card, debit card and electronic check transactions in Wal-Mart store.

While the application itself is narrowly drawn, Wal-Mart has had a well-publicized mission to get into the banking business despite the existing legal and regulatory barriers established on long-held public policy grounds to prevent the full blown mixing of banking and commerce in our nation. Wal-Mart's repeated past attempts to gain a foothold in banking and combine full-service banking with its retail operations on a nationwide basis give rise to skepticism about its current narrow business plan.

In 1998, Wal-Mart attempted to purchase a small unitary thrift institution in Broken Arrow, Oklahoma. The Congress shut down this back-door approach for a commercial firm to enter the banking business when it passed the Gramm-Leach-Bliley Act of 1999 and reaffirmed our nation's policy of separating banking and commerce by closing the "unitary thrift holding company" loophole and prohibiting commercial firms from owning or acquiring savings associations (as they are prohibited from owning banks).

Wal-Mart later sought to enter banking through an arrangement with Toronto-Dominion Bank USA to offer banking services in 100 Wal-Mart stores. This attempt was blocked by the Office of Thrift Supervision, which objected to Wal-Mart's plan to share profits with TD Bank and have its retail store employees perform banking transactions for TD Bank in their stores. OTS found such an arrangement would give Wal-Mart illegal control over TD Bank USA, circumventing the Gramm-Leach-Bliley Act prohibition on a commercial firm becoming a savings and loan holding company.

Lastly, Wal-Mart sought to purchase a small California industrial bank in 2002. In the face of Wal-Mart's application, the California legislature blocked the acquisition by passing a law prohibiting commercial firms from owning ILCs.

Despite any current non-legally binding pledges from Wal-Mart regarding its business plan for a Utah ILC—such as a “no branching” pledge—we see nothing to prevent Wal-Mart from chartering the ILC on a narrow business plan, and later seeking the approval of the Utah Department of Financial Institutions and the FDIC to expand its business and conduct full service banking in its stores. We also see nothing to prevent any conditions placed on the approval of a narrow charter by the Utah DFI being removed in the future upon application by the Wal-Mart ILC.

### **Conflict of Interest Inherent in Mixing of Banking and Commerce**

The linchpin of the financial and economic system of the United States is the principle of the separation of banking and commerce. This tradition has resulted in the most vibrant, successful and diversified economic and financial system in the world. 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.

The Wal-Mart application presents a prime example of the dangers of concentration of resources and impaired credit availability that flow from allowing a commercial company such as Wal-Mart to own a bank or ILC. And in Wal-Mart's particular case, these dangers are amplified because of the company's enormous size, market clout and role in destroying the vitality of many small town centers.

Numerous small towns and communities have experienced the devastating loss of locally-owned and operated retailers, and disinvestment after Wal-Mart establishes a store on the outskirts of town. The Wal-Mart store in essence becomes the new “downtown” once the town center has been depleted of viable competitors. Indeed Wal-Mart Supercenters house under one roof full-line grocery stores along with the 36 general merchandise departments of Wal-Mart (including clothing, health and beauty aids, household, electronics, toys, lawn and garden, jewelry, pharmacy, snack bar or restaurant and shoes), plus specialty shops such as a vision center, tire and lube services, photo processing, dry cleaner, beauty parlor, video rental, etc. Various retail outlets competing with Wal-Mart have charged it engages in predatory pricing practices to capture market share, then raises prices once competitors have been eliminated. See, e.g., “Is Wal-Mart Too Powerful?” *Business Week*, October 6, 2003; “When Wal-Mart Pulls Out, What’s Left?”, *New York Times*, March 5, 1995; “Store Shuts Doors on Texas Town; Economic Blow for Community,” *USA Today*, October 11, 1990; “Arrival of Discounter Tears Civic Fabric of Small-Town Life,” *Wall Street Journal*, April 14, 1987.

Because of this common history and experience of many communities, when evaluating the application the ICBA urges the FDIC to consider what will happen to credit availability and customer and community service when the Wal-Mart bank siphons deposits from locally-owned and operated community banks, impairing their ability to continue to support economic growth and development in their communities through lending, and driving them out of business.

Will a competing local hardware or clothing store, a local pharmacy, or someone wishing to establish a new store, be able to obtain credit from the Wal-Mart bank, or want to share its confidential business plans with the Wal-Mart bank? The Wal-Mart bank would have no incentive -- in fact it would have a disincentive -- to lend to businesses that compete with its parent company. Instead of making impartial credit decisions based on the creditworthiness of the borrower, the Wal-Mart bank would have incentive to deny credit, not on the merits, but because of a conflict of interest and its relationship with Wal-Mart.

Ownership by Wal-Mart would have a similar effect on the bank’s decision-making with regard to credit applications by Wal-Mart suppliers. Again, instead of making credit decisions on the merits of a borrower’s creditworthiness, the Wal-Mart bank would have an incentive to favor Wal-Mart’s suppliers and disfavor their competitors. In fact, Wal-Mart could require its suppliers to obtain their banking and credit services from the Wal-Mart bank if they want to do business with Wal-Mart.

## **Impact on Consumers, Community Disinvestment**

Consumers and households likewise will be ill-served by a Wal-Mart bank. If the past is prologue, local banks, just like local retailers in towns where Wal-Mart has located, will no longer be able to compete. While the initial effect may be cheaper services at the Wal-Mart bank, the long-term effect will be reduced choices for consumers as the number of financial services providers shrinks, and as the products become more commoditized.

A Wal-Mart owned bank will not be able to look at other factors beyond a consumer's credit score to understand the customer's individual circumstances and cannot make the customer a loan based on a long-standing relationship and personal knowledge of the customer—something community banks do every day.

Moreover, there is the danger that Wal-Mart will export deposits out of the local community. This has been the current pattern of the large retailer when it establishes itself in a local community. The retailer's deposits do not stay with local banks, but rather are transferred to the store's central headquarters. This pattern in the past has had a devastating effect on local communities as retail dollars spent in the community are exported elsewhere and do not remain in the community to support local lending and economic development.

### *Safety and Soundness Concerns, Holding Company Supervision*

The Wal-Mart application also illustrates that the affiliation of banks and nonbanking companies presents conflicts of interest and safety and soundness concerns. Federal Reserve Chairman Alan Greenspan has repeatedly argued that the mixing of banking and commerce presents safety and soundness concerns and poses the specter that the federal safety net protecting depositors of insured institutions will spread to non-depository affiliates, thereby introducing additional risks to the deposit insurance funds and the taxpayers.

Because of the ILC loophole in the Bank Holding Company Act, parent companies of ILCs, unlike other companies that own banks, are not regulated at the holding company level by the Federal Reserve. "Allowing a commercial firm to operate a nationwide bank outside the supervisory framework established by Congress for the owners of insured banks raises significant safety and soundness concerns and creates an unlevel competitive playing field," the Federal Reserve has testified. "Congress has established consolidated supervision as a fundamental component of bank supervision in the United States because consolidated supervision provides important protection to the insured banks that are part of a larger organization and to the federal safety net that supports those banks. Financial trouble in one part of an organization can spread rapidly to other parts. To protect an insured bank that is part of a larger organization, a supervisor needs to have the authority and tools to understand

the risks that exist within the parent organization and its affiliates and, if necessary, address any significant capital, managerial, or other deficiencies before they pose a danger to the bank.”

Wal-Mart’s enormous size make these considerations and the risk posed to the Bank Insurance Fund and taxpayers in the event Wal-Mart experiences financial difficulties more acute.

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 Bank Holding Company Act gives the Federal Reserve to oversee and supervise bank holding companies and ensure the safe operation of the overall enterprise. For example, the Federal Reserve’s supervisory authority over bank holding companies includes: general examination authority, consolidated umbrella supervision, capital requirements and enforcement authority for unsafe and unsound activities at the parent company or affiliate. This lack of safeguards at the holding company level puts the Wal-Mart bank, the Bank Insurance Fund, and taxpayers at jeopardy for trouble at its parent company.

## **Conclusion**

For the reasons stated herein and in the Sound Banking Coalition’s August 17, 2005 letter, the ICBA urges the FDIC to reject Wal-Mart’s application for federal deposit insurance for a Wal-Mart ILC. The application presents serious public policy issues inherent in the mixing of banking and commerce and in the ILC loophole and warrants a public hearing to allow adequate public comment. The issues presented—conflicts of interest, economic concentration, lack of impartial credit decisions, inadequate holding company supervision, and inappropriate extension of the federal safety net—are amplified by Wal-Mart’s size and market clout. The threat of community disinvestment is particularly acute in this case because of Wal-Mart’s track record and destructive impact in hundreds of communities across the United States. Our nation’s long-standing principle of separation of banking and commerce, reaffirmed in the Gramm-Leach-Bliley Act, is the underpinning for our stable and highly successful economic and financial system, and should not be allowed to be skirted by the world’s largest commercial company.

Sincerely,

A handwritten signature in cursive script that reads "Camden R. Fine". The signature is written in black ink and is positioned below the word "Sincerely,".

Camden R. Fine  
President and CEO

August 17, 2005

Mr. John F. Carter  
Regional Director  
Federal Deposit Insurance Corporation  
25 Jessie Street at Ecker Square  
San Francisco, California 94105

**Re: Initial Comments and Request for Public Hearings Regarding FDIC  
Application # 20051977 – Wal-Mart Application for Insurance and  
Industrial Bank Charter**

Dear Mr. Carter:

The undersigned members of the Sound Banking Coalition – the Independent Community Bankers of America, the National Association of Convenience Stores, the National Grocers Association, and the United Food and Commercial Workers International Union – submit this letter in opposition to Wal-Mart's application for a Utah industrial bank<sup>6</sup> charter and FDIC insurance, and to request a public hearing on the matter. As noted in our August 10 letter, Wal-Mart failed to provide crucial information regarding its proposed bank in the publicly available application. Public release of this information is needed to allow for full, meaningful comment. Therefore, this letter serves as preliminary comments and the Coalition reserves the right to submit additional comments following the public release of necessary information. In addition, the fundamental issues raised by this application by the largest commercial company in the United States to acquire a bank charter are so numerous and complex that the FDIC must hold public hearings in order to get a full airing of these issues.

Although Wal-Mart has narrowly drafted its Application to make it appear that it would use an industrial bank charter primarily to process internal transactions, Wal-Mart does not foreclose the possibility that it would eventually seek to branch and enter retail banking. To the contrary, we believe that a careful examination of Wal-Mart's application and past efforts to obtain a bank reveal that this application is a first step toward an expansion into retail banking.

Wal-Mart's application raises difficult policy issues. The mixing of banking and commerce that would occur if Wal-Mart owned a bank as well as the lack of consolidated supervision of the bank by the Federal Reserve Board threaten some of the basic underpinnings of banking regulation in the United States. These threats are particularly acute here given that Wal-Mart is the largest commercial company in the United States.

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<sup>6</sup> Industrial banks are alternatively referred to as Industrial Loan Companies or ILCs in these comments.

The Federal Reserve and Chairman Alan Greenspan have repeatedly raised questions about the lack of regulation of industrial banks and the need for holding company level regulation of these banks by the Federal Reserve. The risks of industrial banks were summed up well by Federal Reserve Governor Mark Olson when he testified: "Allowing a commercial firm to operate a nationwide bank outside the supervisory framework established by Congress for the owners of insured banks raises significant safety and soundness concerns and creates an unlevel competitive playing field." Like the Federal Reserve, a number of public interest groups including the Consumer Federation of America, National Consumer Law Center, ACORN, Consumers Union, National Association of Consumer Advocates, National Community Reinvestment Coalition, and the U.S. Public Interest Research Group have raised concerns about the public policy implications of the industrial bank loophole in the Bank Holding Company Act.<sup>7</sup>

As a general matter, we believe that Wal-Mart's application should be denied because the very possibility that Wal-Mart will enter into retail banking poses an enormous, unjustifiable threat to taxpayers, consumers, small communities, small businesses, FDIC insurance, and the soundness of our banking system itself. As an industrial bank, Wal-Mart could establish banks in its retail stores, causing competitive problems for local bankers in much the same way that it has for local retailers. This would leave Wal-Mart as the only banking option in many small communities and force small businesses to hand their deposits over to, and apply for loans from, their biggest competitor. Further, as an industrial bank, Wal-Mart would not be subject to the consolidated supervision and many of the restrictions applicable to other owners of insured banks. This could make it impossible to detect financial troubles before they have an opportunity to affect the federal insurance safety net.

In addition to these policy considerations, Wal-Mart's application should be denied because Wal-Mart fails to meet the criteria that the FDIC must consider in reviewing insurance applications under Section 6 of the Federal Deposit Insurance Act. Wal-Mart fails to meet these criteria for the following reasons: (1) a Wal-Mart industrial bank would present a grave risk to the Bank Insurance Fund, (2) the application makes it possible for Wal-Mart to enter into retail banking in the future, which would have a destructive impact local communities, (3) legal and ethics issues pose a threat to Wal-Mart's financial condition and future earnings; and (4) there are serious questions about Wal-Mart meeting FDIC standards for management character and fitness.

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<sup>7</sup> See Testimony of Travis Plunkett, Legislative Director, Consumer Federation of America and Carolyn Carter, Of Counsel, National Consumer Law Center, before the Senate Committee on Banking, Housing and Urban Affairs, hearing titled "Current Proposals Considered for Regulatory Relief Legislation," June 21, 2005.

## **(1) A Wal-Mart Bank Would Pose an Enormous Threat to the Bank Insurance Fund and the Banking System Itself**

The sheer size of Wal-Mart presents a grave risk to the Bank Insurance Fund. Because of Wal-Mart's size and volume of business, the losses that the FDIC would endure if the bank or the parent company experienced financial problems could be very large.

Commenting on the impact Wal-Mart's size and influence already has on dependent suppliers, Tom Rubel, CEO of consultant Retail Forward Inc. predicted that "If [Wal-Mart] ever stumbles, we've got a potential national security problem on our hands. They touch almost everything....If they ever really went into a tailspin, the dislocation would be significant and traumatic."<sup>8</sup> A company this large should not be permitted to place our banking system and the Bank Insurance Fund at a similar risk.

Wal-Mart faces particular risks that other banks, not to mention many other commercial enterprises do not. Prominent examples of these risks include financial risks due to foreign currency fluctuations and fluctuations in oil prices. For example, Wal-Mart is exposed to substantial risk when there are fluctuations in the yuan. More than seventy percent of goods sold by Wal-Mart are made in China.<sup>9</sup> Xu Jun, Wal-Mart China's director of external affairs, has pointed out that China is Wal-Mart's most important supplier in the world and noted, "If Wal-Mart were an individual economy, it would rank as China's eighth-biggest trading partner, ahead of Russia, Australia and Canada."<sup>10</sup> More than 5,000 Chinese enterprises have established steady supply alliances with Wal-Mart.<sup>11</sup>

The commercial ties between Wal-Mart and China pose particular risks because China is loosening its artificial control of the valuation of its currency. On July 21, 2005, the Chinese government dropped the yuan-dollar peg and lifted the value of the currency by more than two percent. The revaluation raised the price of Chinese goods, pressuring profit margins on an enormous proportion of the products sold in Wal-Mart. While this first step in floating the yuan resulted in a relatively modest increase of the currency, economists have estimated that China's currency policy has kept the yuan undervalued by as much as forty percent.<sup>12</sup> AG Edwards advised its clients regarding the float of the yuan: "We believe that China's decision. . .will have an immediate impact for U.S. retailers sourcing product out of China. U.S. retailers cost of goods sold will increase and, of course, their gross margins will decrease."<sup>13</sup> A sudden jump in the valuation of the yuan could have devastating consequences for Wal-Mart and, if Wal-Mart becomes as dominant in the financial services sector as it has been in other segments of the economy, a decision made in Beijing regarding the valuation of its currency could put a Wal-Mart bank and, by extension, the Bank Insurance Fund at risk.

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<sup>8</sup> Business Week, *Is Wal-Mart Too Powerful?*, Oct. 6, 2003, available at [http://www.businessweek.com/magazine/content/03\\_40/b3852001\\_mz001.htm](http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm)

<sup>9</sup> Jiang Jingjing, *Wal-Mart's China inventory to hit US\$18b this year*, China Business Daily, November 29, 2004, available at [http://www2.chinadaily.com.cn/english/doc/2004-11/29/content\\_395728.htm](http://www2.chinadaily.com.cn/english/doc/2004-11/29/content_395728.htm).

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> Dow Jones, *Retail Stocks Lower in 'minor' China Revaluation*, July 21, 2005.

<sup>13</sup> *Id.*

Wal-Mart also faces risks from rising oil prices. Wal-Mart's stock price has fallen in reaction to recent news about oil prices and the August 16 statement by CEO H. Lee Scott, Jr. that, "I worry about the effect of higher oil prices . . . I anticipate challenges as the year progresses." These risks include increases in the costs Wal-Mart must pay to transport the large volume of goods it sells as well as the risk that as consumers spend additional funds on fuel they will have less to spend at Wal-Mart. As Mr. Scott said in the August 16 call, "Our customer continues to be impacted by higher gas prices, and it is difficult to improve our expense leverage in the current environment." These financial risks faced by Wal-Mart are not similar to those faced by most banks and create unique problems due to the size and scope of Wal-Mart's worldwide supply network and operation.

These risks are particularly significant because Wal-Mart, as an industrial bank, would not be subject to Federal Reserve oversight. This leaves insufficient safeguards to ensure that this massive company will not endanger the Bank Insurance Fund. Although a Wal-Mart bank would be subject to oversight by the FDIC, the FDIC does not have the same powers to regulate the entirety of a holding company's operations as does the Federal Reserve. The Bank Holding Company Act (BHCA) provides the Federal Reserve with the authority to examine the bank holding company itself and any of its non-bank subsidiaries at any time, while the FDIC has only limited examination authority, and is unable to examine affiliates of banks unless necessary to disclose the direct relationship between the bank and affiliate and the effect of the relationship on the bank.<sup>14</sup> The Federal Reserve is also entitled to establish consolidated capital requirements to ensure that bank holding companies are a source of financial strength for the subsidiary bank. Corporate parents of ILC's are not subject to these capital requirements. Finally, the Federal Reserve has broad enforcement authority under the BHCA, and can issue cease and desist orders, impose civil penalties, and order a holding company to divest non-bank subsidiaries if it determines that ownership of the subsidiary presents a risk to the financial safety, soundness, or stability of an affiliated bank and is inconsistent with sound banking principles or the purposes of the BHCA.<sup>15</sup> The Federal Reserve is the only federal agency authorized to take such actions against bank holding companies.

The safeguards provided by Federal Reserve regulation would be necessary to protect the Bank Insurance Fund against the potential risks presented by a Wal-Mart bank. Without these safeguards, it may be impossible for problems to be identified and managed in time to prevent deficiencies and damage to the federal safety net. A Wal-Mart bank is simply a risk that United States tax payers should not be forced to take.

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<sup>14</sup> Letter to Senator Tim Johnson from Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, June 25, 2003, at 4.

<sup>15</sup> *Id.* at 5.

## (2) A Wal-Mart Bank Would Have a Destructive Impact on Local Communities

Although Wal-Mart claims that it will simply use the industrial bank charter to process credit card, debit card, and electronic check transactions from its retail locations, Wal-Mart has not denied that it will pursue retail banking in the future. When asked whether shoppers could someday shop for mortgages at Wal-Mart, financial services director Tom McLean refused to say that Wal-Mart would not offer these types of retail banking services replying instead, “We continue to look for what makes sense to the customer.”<sup>16</sup> Certain statements in the filing also indicate that Wal-Mart’s application is really an attempt to get its foot into the door of retail banking. For example, it states that it will offer short-term certificates of deposit to nonprofit and educational organizations, as well as “individual investors generated through deposit brokers.” There is no detail about who these investors will be, and no guarantee that the bank will not offer them additional banking services.

Further, the application is only the most recent in a series of unsuccessful attempts by Wal-Mart to enter the financial services industry. In 1999, Wal-Mart tried to purchase a small savings and loan company in Oklahoma, but was stopped by provisions of the Gramm-Leach-Bliley Act.<sup>17</sup> In 2001, it attempted to partner with the Canadian Toronto-Dominion Bank, but its application was rejected as deficient by the Office of Thrift Supervision.<sup>18</sup> The application with Toronto-Dominion was explicit in noting Wal-Mart’s plan to offer retail banking services in its retail stores. In fact, one of the deficiencies in the application was that the plan contemplated having retail cashiers function as bank tellers.

Most recently, in 2002, Wal-Mart filed an application to acquire an industrial bank in California. The effort met with resistance from those concerned about the mixing of banking and commerce, and was ultimately blocked by the California legislature.<sup>19</sup> While right now Wal-Mart is publicly stating that it seeks only to save the costs of a third party processor for retail transactions, its current application is merely a continuation of its past efforts to enter into retail banking.

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<sup>16</sup> Becky Yerak and Josh Noel, *Wal-Mart Plan Has Bankers on Edge*, Chicago Tribune, July 20, 2005, available at <http://www.chicagotribune.com/business/chi-0507200160jul20,1,3606468.story?coll=business-utl>

<sup>17</sup> Jenifer K. Nii, *Wal-Mart is Planning to Open a Bank in Utah*, Desertnews.com, July 19, 2005, at <http://deseretnews.com/dn/view/0,1249,600149522,00.html>

<sup>18</sup> Christopher Leonard, *Retailer Seeking Banking Inroads*, Arkansas Democrat Gazette, July 20, 2005.

<sup>19</sup> Mark Anderson, *Wal-Mart Will Look Elsewhere to Buy Bank*, Sacramento Business Journal, Oct. 2, 2002.

Granting Wal-Mart an industrial bank charter would allow it to branch into more than 20 states under current law – and that number could easily grow. Wal-Mart’s entrance into banking would have such a destructive impact on local communities and businesses throughout Utah and the United States that the mere possibility that it would use an industrial bank charter for this purpose should be enough reason to deny the application. Wal-Mart’s retail business has frequently been criticized for having a destructive impact on local communities and businesses. It has a pattern of entering local communities and using predatory pricing and other techniques to run all local competition out of business. Once local competition is destroyed, Wal-Mart is free to raise its prices, or even shut down its stores to open larger regional stores. There is no reason to believe that a Wal-Mart bank would not engage in the same practices and have the same effects on local banks.

A study conducted by Iowa State University revealed that, following Wal-Mart’s expansion in the state, 555 grocery stores, 298 hardware stores, 293 building suppliers, 161 variety shops, 158 women’s apparel stores, 293 building suppliers, and 116 pharmacies closed.<sup>20</sup> When Wal-Mart opened three Sam’s Club (Sam’s) stores in Oklahoma, local gas stations were initially pleased due to the business generated by traffic traveling to and from the stores. Wal-Mart quickly usurped the opportunity by providing gas below wholesale prices at its own stores, and caused local gas stations to lose a large volume of sales. A federal judge in the Western District of Oklahoma enjoined and restrained Sam’s from selling motor fuel below cost as defined by the Oklahoma Unfair Sales Act, and the Tenth Circuit affirmed.<sup>21</sup> According to the Tenth Circuit, the evidence showed that “because of the volume of Sam’s gasoline sales and its below-cost pricing, competition was lessened in Oklahoma City [in much of the] area surrounding Sam’s stores.”<sup>22</sup>

Wal-Mart has repeated this pattern – aggressively harming local businesses and competition – many times. The grocery business is a prime example. Studies by Retail Forward, a market research firm, indicate that for every one Wal-Mart “Supercenter” opened, two local groceries will close.<sup>23</sup> The following is an explanation of the devastating effect that this can have on communities:

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<sup>20</sup> Stone, *Competing with Discount Mass Merchandisers*, at

[http://www.econ.iastate.edu/faculty/stone/1995\\_IA\\_WM\\_study.pdf](http://www.econ.iastate.edu/faculty/stone/1995_IA_WM_study.pdf)

<sup>21</sup> See *Star Fuel Marts, LLC, v. Sam’s East, Inc.*, 362 F.3d 639, 643 (10th Cir. 2004).

<sup>22</sup> *Id.* at 649.

<sup>23</sup> Business Week, *Is Wal-Mart Too Powerful?*, Oct. 6. 2003, available at [http://www.businessweek.com/magazine/content/03\\_40/b3852001\\_mz001.htm](http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm).

“As the number of supermarkets shrinks, more shoppers will have to travel farther from home and will find their buying increasingly restricted to merchandise that Wal-Mart chooses to sell -- a growing percentage of which may be the retailer’s private-label goods. Meanwhile, the failure of hundreds of stores will cost their owners dearly and put thousands out of work, only some of whom will find jobs at Wal-Mart, most likely at lower pay.”<sup>24</sup>

Indeed, some estimate that for every one job created by Wal-Mart, two are lost. Wal-Mart has also driven many American jobs overseas. Relentlessly seeking lower prices, the company has shifted much of its purchasing power overseas, where cheap labor and minimal government regulation result in cheaper goods. Gary Gereffi, a Duke University professor who studies global supply chains, has stated that Wal-Mart is one of the “key forces” propelling global outsourcing because it controls so much of the purchasing power of the U.S. economy.<sup>25</sup> In 2004, Wal-Mart reportedly purchased \$9 billion-worth of goods directly and another \$9 billion indirectly from China.<sup>26</sup> In 2005, Wal-Mart plans to purchase more than \$2 billion in goods from India,<sup>27</sup> and to increase purchasing of Malaysian products by 20 percent.<sup>28</sup>

The adverse effect that Wal-Mart has had on local businesses, workers, and communities in the retail industry should not be permitted to repeat itself in the banking industry. An industrial bank charter would give Wal-Mart the opportunity to destroy local banks much as it has destroyed other local businesses such as grocers, pharmacists, and florists. If competitor banks are destroyed, surviving local businesses would be forced to go to their biggest competitor for deposits and loans, providing Wal-Mart with an even greater competitive advantage and creating a nightmare scenario which is a key reason for the longstanding U.S. policy prohibiting the mixture of banking and commerce. A Wal-Mart bank also will not help the local community in Salt Lake City. Wal-Mart has indicated in its application that it will outsource many of the bank’s functions (although it has failed to reveal where or to whom). Wal-Mart’s application states that it will outsource its general ledger and accounting system and implies that it will outsource its information systems. Not only will this deprive the local community of jobs, the lack of information about how and where this outsourcing will occur raises troubling questions about the bank’s operations and oversight. The application also pointedly says only that Wal-Mart “does not have any plans to relocate the main office within the first three years of its operations.”

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<sup>24</sup> *Id.*

<sup>25</sup> Interview by Frontline with Gary Gereffi, Professor, Duke University (Sept. 9 2004), available at <http://www.pbs.org/wgbh/pages/frontline/shows/walmart/interviews/gereffi.html>.

<sup>26</sup> The Economist, *Wal-Mart: How Big Can it Grow?*, April 15, 2004, available at [http://www.economist.com/business/displayStory.cfm?story\\_id=2593089](http://www.economist.com/business/displayStory.cfm?story_id=2593089).

<sup>27</sup> India Business Insight, *Government to Set Up Panel to Help Wal-Mart Source Goods*, June 3, 2004.

<sup>28</sup> Namnews, *Malaysia: Wal-Mart To Increase Malaysia Sourcing By 20%*, Aug. 5, 2005, at <http://www.kamcity.com/namnews/asp/newsarticle.asp?newsid=23489>.

For these reasons, a Wal-Mart bank would have an adverse impact on local communities – including banks, other local businesses, their workers, and their customers. This appears likely to be true in Salt Lake City and Utah as well as the rest of the country. Therefore, if the convenience and needs of the community are to be considered, the Wal-Mart application must be denied.

### **(3) Wal-Mart’s Legal and Ethical Problems Present Serious Risks to its Financial Condition and Future Earning Potential**

Wal-Mart is one of the most often sued companies in history. Wal-Mart was reportedly sued 4,851 times in 2000 — or nearly once every two hours, every day of the year.<sup>29</sup> Wal-Mart continues to be besieged by litigation. These lawsuits create enormous potential liabilities that could eventually lead the company, and, if it acquires one, its bank to fail.

For example, an employment discrimination class action is currently pending in which the plaintiffs, over 1.5 million current and former female employees, could be entitled to as much as \$10 billion in back pay, punitive damages, and raises. The case may lead to a very expensive judgment or settlement. In addition, Wal-Mart recently has entered into an \$11 million settlement agreement over a federal investigation of its labor practices and been fined \$3.1 million for violations of the Clean Water Act. These troubles could also scare away investors, require expensive fixes, and lead to a decrease in profits and stock prices.

The cases cited above are just a small, recent sampling of the lawsuits that have been brought against Wal-Mart. The potential liabilities stemming from present and future lawsuits create huge financial risks for the company. In May of 2005, a group of institutional investors holding more than \$545 million worth of Wal-Mart stock voiced concern about an apparent breakdown in the company’s legal and regulatory controls. The group, which includes William C. Thompson Jr., the comptroller of New York City, stated that they were “deeply concerned about contingent liabilities and negative effects on the company’s stock price and reputation,” and urged the company to establish a special committee of independent directors to review and report on the company’s legal and regulatory controls.<sup>30</sup>

The shareholders warned the company that “recent reports of legal and regulatory non-compliance raise serious concerns about the adequacy of the company’s controls,” and that “the frequency of the reports suggests that non-compliance with internal standards, as well as with laws and regulation, may be far too commonplace at Wal-Mart.”<sup>31</sup> The letter cited raids of 60 Wal-Mart stores in 21 states by U.S. federal agents that resulted in

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<sup>29</sup> Richard Willing, *Lawsuits a Volume Business at Wal-Mart*, USA Today, Aug. 13, 2001, available at <http://www.nfsi.org/walmart/Lawsuits%20a%20volume%20business%20at%20Wal-Mart.htm> (last visited Aug. 2, 2005).

<sup>30</sup> Letter from William C. Thompson, Jr., Comptroller, The City of New York, *et. al.*, to Roland A. Hernandez, Chair, Audit Committee of the Board of Directors, Wal-Mart Stores, Inc. 1 (May 25, 2005) available at [http://www.comptroller.nyc.gov/press/2005\\_releases/PR05-06-067.shtm](http://www.comptroller.nyc.gov/press/2005_releases/PR05-06-067.shtm).

<sup>31</sup> *Id.*

the arrest of 250 illegal immigrant workers and the \$11 million settlement mentioned above, and a 2005 settlement with the U.S. Department of Labor involving more than 24 violations of child labor laws in three states.

The shareholders also voiced concern about a recent corporate scandal. Former Wal-Mart Vice Chairman Thomas Coughlin reportedly was forced to resign from Wal-Mart's board after an internal investigation alleged that he abused his expense account and used fraudulent invoices to obtain reimbursements. Coughlin allegedly informed co-workers that the funds were actually a "round-about way" of compensating him for out-of-pocket expenses he made to wage an anti-union campaign involving bribes.<sup>32</sup> The shareholder letter also noted that the employee who reported Coughlin's suspect transactions was subsequently fired. If it is discovered that Wal-Mart executives have been misusing company funds to finance illegal anti-union activities, this could lead to further litigation, reduce investor confidence in the company, and have serious financial consequences. Wal-Mart's increasingly negative public image has led to countless organized challenges from citizens and local governments seeking to keep Wal-Mart out of their communities.<sup>33</sup> These efforts could also pose a threat to Wal-Mart's future growth and overall financial health.

Wal-Mart's pattern of legal and regulatory non-compliance is particularly concerning because, as an Industrial bank, it would not be regulated by the Federal Reserve as are other bank holding companies. Therefore, the potential financial impact of Wal-Mart's frequent legal and regulatory violations and resulting liabilities may not be detected in time to prevent financial problems before they endanger the bank and the Bank Insurance Fund. As Wal-Mart shareholders have themselves cautioned, "the risks associated with a compliance breakdown are especially onerous for Wal-Mart and its shareholders in light of the company's large size and market capitalization."<sup>34</sup>

#### **(4) Concerns about Wal-Mart Meeting FDIC Standards for Management Character and Fitness**

One of the criteria by which the FDIC must evaluate this application is the general character and fitness of management. We sincerely hope that any unproven claims against Wal-Mart are false, and that past violations will not be repeated, but Wal-Mart's existing track record of legal and ethical violations is too much to ignore. Under these circumstances, we do not believe that Wal-Mart's management should be extended the authority and responsibility that comes with an industrial bank charter and FDIC

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<sup>32</sup> James Bandler & Ann Zimmerman, *Petty Cash: A Wal-Mart Legend's Trail of Deceit*, Wall Street Journal, Apr. 8, 2005, available at <http://mindfully.org/Industry/2005/Wal-Mart-Coughlin8apr05.htm>.

<sup>33</sup> See, e.g., Julie Edgar, *Township May Shut Door on Wal-Mart*, Detroit Free Press, July 27, 2005; Laura Counts, *'Super' Grocery Outlets Banned in Oakland; Lawmakers Vote to Turn Away Wal-Mart and Target*, Alameda Times-Star, Oct. 23, 2003; *Wal-Mart Hits Big Apple Pothole*, CNNMoney.com, Feb. 24, 2005; Russell Max Simon, *Wal-Mart Battle Comes to Santa Fe*, Albuquerque Journal, April 24, 2004, at Journal North Pg. 1; Donal O'Connor, *City Urged to Say No to Wal-Mart; Crowd Cheers as Speakers Blast U.S. Retail Giant*, Stratford Beacon Herald, June 21, 2005, at News Pg. 1.

<sup>34</sup> Letter from William C. Thompson, Jr. at 2.

insurance, particularly in light of the fact that Wal-Mart will not be subject to consolidated supervision by the Federal Reserve.

The reports of violations of labor and environmental laws, alleged discrimination in employment and sales practices, and negative impacts on communities raise questions about the character of Wal-Mart's management. The picture these allegations paint is just what Wal-Mart's shareholders found – that breaking laws and regulations is “far too commonplace” at Wal-Mart.

Many of Wal-Mart's shareholders have expressed concern regarding the ethical lapses of the company's management. With respect to the scandal over Coughlin's alleged misuse of company funds, a shareholder group stated that the incident merely “bolstered the public perception of a culture of non-compliance and disregard for ethical standards within the ranks of Wal-Mart management.”<sup>35</sup> In light of Wal-Mart's practices and legal problems, the FDIC cannot assure itself that Wal-Mart's management will instill a culture of compliance and ethical practices at its bank that will protect its customers and the public.

\* \* \*

Wal-Mart's application for an industrial bank is troubling on many fronts and should be rejected. It does not meet the basic legal requirements upon which the FDIC judges such applications and it would open so broadly the ILC loophole in the BHCA that the long-time separation of banking and commerce would no longer be a recognizable principle. Concerned taxpayers, consumers, small businesses and bankers should be entitled to present facts concerning the destructive impact that a Wal-Mart industrial bank would have on the convenience and needs of their communities, and further facts must be presented to elaborate on the financial history and condition of the institution, its future earning prospects, the adequacy of its capital structure, the character and fitness of its management, and the risk that the depository institution will present to the deposit insurance fund. Written submissions during the comment period are insufficient to make an adequate presentation of these issues and facts to the FDIC, making a public hearing necessary. The need for a public hearing is particularly pressing due to Wal-Mart's failure, as noted in our August 10 letter, to disclose crucial information about its proposed bank in the public application.

Respectfully,

Sincerely,

Vice President, Congressional Relations  
Affairs Director  
Independent Community  
Bankers of America

Senior Vice President  
Government Relations  
National Association of Convenience Store

Senior Vice President  
and General Counsel  
National Grocers Association

Legislative and Political  
United Food and Commercial  
Workers International Union

cc: Alan Whitchurch, Incorporator

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<sup>35</sup> *Id.*