NATIONAL ASSOCIATION OF REALTORS®

The Voice for Real Estate®

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Thomas M. Stevens, CRB, CRS, GRI
President

October 10, 2006

Chairman Sheila C. Bair
c/o Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th St., NW
Washington, DC 20429

[transmitted by e-mail to comments@FDIC.gov]

Dear Chairman Bair:

On behalf of the more than 1.3 million members of the National Association of REALTORS® (NAR), I am pleased to respond to the 12 questions published on August 23, 2006[1], by the Federal Deposit Insurance Corporation (FDIC) in connection with Industrial Loan Companies and Industrial Banks.

The National Association of REALTORS®, "The Voice for Real Estate," is America's largest trade association, including NAR's five commercial real estate institutes and its societies and councils. REALTORS® are involved in all aspects of the residential and commercial real estate industries and belong to one or more of some 1,400 local associations or boards and 54 state and territory associations of REALTORS®.

Moratorium Extension

Before addressing the specific questions, I would first like to thank the FDIC Board of Directors for adopting a six-month moratorium on all ILC applications. The moratorium is scheduled to end on January 31, 2007. Among the FDIC's stated purposes for the moratorium is to "preserve the status quo" while the FDIC considers issues related to the ILC industry, including "whether statutory, regulatory, or policy changes should be made in the FDIC's oversight of ILCs in order to protect the Deposit Insurance Fund or important Congressional objectives."

[1] 71 Federal Register 49456 (August 23, 2006).

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NAR believes that the FDIC should prevent any additional commercial firms from becoming owners of ILCs until Congress fully considers whether to eliminate or tighten the existing ILC loophole. While a six month moratorium appears, at first blush, to be sufficient time for Congress to act, the reality is quite different. At the end of July, when FDIC imposed the moratorium, Congress had few remaining session days and most of those were already devoted to other issues, including considering appropriations bills for 2007. As you know, a new Congress (the 110th) will begin work in mid-to late January[2] and it will take considerable time for the Committees to decide whether and when to consider legislation, such as the "Industrial Bank Holding Company Act of 2006" (H.R. 5746, 109th Cong.), which will most likely be reintroduced next year by the current sponsors, Reps. Paul E. Gillmor and Barney Frank. Accordingly, we strongly urge you to extend the moratorium to the end of 2007.

NAR Responses to the FDIC's ILC Questions

1. Have developments in the ILC industry in recent years altered the relative risk profile of ILCs compared to other insured depository institutions? What specific effects have there been on the ILC industry, safety and soundness, risks to the Deposit Insurance Fund, and other insured depository institutions? What modifications, if any, to its supervisory programs or regulations should the FDIC consider in light of the evolution of the ILC industry?

NAR has no comment, other than to note that ILC assets have grown from $3.8 billion in 1987, when the ILC loophole was enacted to permit commercial firms to own ILCs, to more than $155 billion by March 31, 2006. The ILC exception to the national policy against mixing banking and commerce is no longer limited to an extremely small corner of the banking industry.

2. Do the risks posed by ILCs to safety and soundness or to the Deposit Insurance Fund differ based upon whether the owner is a financial entity or a commercial entity? If so, how and why? Should the FDIC apply its supervisory or regulatory authority differently based upon whether the owner is a financial entity or a commercial entity? If so, how should the FDIC determine when an entity is ``financial'' and in what way should it apply its authority differently?

Commercial ownership of an ILC, or any other types of insured depository institution, places both the institution and the Deposit Insurance Fund at greater risk than when the parent company is a financial institution. Since NAR believes that Congress should close the ILC loophole, it has no suggestions for adapting FDIC oversight depending on whether the parent company is a commercial or financial entity. NAR supports the "Industrial Bank Holding Company Act of 2006" (H.R. 5746) and would support comparable legislation in the 110th Congress. H.R. 5746 would only permit financial firms (those with no more than 15% of their revenues derived commercial activities) to own ILCs, but it would grandfather existing ILC ownership structures. The bill would also enhance regulation of ILC parent companies by the FDIC.

[2] In 2006, the first days of business for the U. S. Senate and the U.S. House of Representatives were January 18 and January 31, respectively.

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

No company is immune from improper actions of its employees. The SEC has opened an informal investigation of Home Depot's treatment of stock options, and Home Depot has announced it has made some adjustments.[3] And even Wal-Mart has been victimized by fraudulent actions of its dishonest Vice Chairman.[4] We cannot afford to open the door to actions that threaten the safety and soundness of the banking system.

Federal Reserve Board Chairman Ben Bernanke has reaffirmed statements made by former Federal Reserve Chairman Alan Greenspan and other Federal Reserve Board Governors raising concerns about the industrial loan company loophole. This loophole is the last significant exception that permits a commercial firm to control a federally insured bank that is broadly engaged in lending and deposit taking activities. In a written statement provided in response to a question asked by Representative Brad Sherman at a February 15, 2006, House Financial Services Committee hearing, Chairman Bernanke explained that Congress should decide the extent to which mixing of banking and commerce should be permitted, if at all. He noted that—

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

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

[3] http://www.nytimes.com/2006/06/24/business/24option.html?ex=1308801600&en=c882d5848a9961ac&ei=5088&partner=rssnyt&emc=rss
[4] See http://walmart.nwanews.com/wm_story.php?paper=adg&storyid=144830.

bank's customer. This "guarantee" is backed up by a thorough, independent credit review of the merchant's credit.

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

We disagree with Wal-Mart's contention that the proposed Wal-Mart Bank would reduce risks to the payment system. The Wal-Mart Bank's safety and soundness would be almost exclusively dependent upon the financial fortunes of only one customer—Wal-Mart. Such dependence violates the cardinal principle of banking—spreading risk through diversification. Diversification, not concentration, leads to safety. The federal bank regulators understand this well in the context of monoline banks. When a bank's sole mission is to process payments for its commercial parent, the risk to the bank, the financial system, and the deposit insurance fund is greater. Public confidence in a bank whose fate is inextricably tied to its parent's performance erodes quickly when the public believes the bank's parent is troubled. If Enron or WorldCom had owned a bank, one could assume the bank would have joined its parent in failure, and the bank's losses would have spread throughout the financial system.

3. Do the risks posed by ILCs to safety and soundness or to the Deposit Insurance Fund differ based on whether the owner is subject to some form of consolidated Federal supervision? If so, how and why? Should the FDIC assess differently the potential risks associated with ILCs owned by companies that (i) are subject to some form of consolidated Federal supervision, (ii) are financial in nature but not currently subject to some form of consolidated Federal supervision, or (iii) cannot qualify for some form of consolidated Federal supervision? How and why should the consideration of these factors be affected?

NAR has no comment.

4. What features or aspects of a parent of an ILC (not already discussed in Questions 2 and 3) should affect the FDIC's evaluation of applications for deposit insurance or other notices or applications? What would be the basis for the FDIC to consider those features or aspects?

See our answers to Questions 2 and 5.

5. The FDIC must consider certain statutory factors when evaluating an application for deposit insurance (see 12 U.S.C. 1816), and certain largely similar statutory factors

when evaluating a change in control notice (see 12 U.S.C. 1817(j)(7)). Are these the only factors FDIC may consider in making such evaluations? Should the consideration of these factors be affected based on the nature of the ILC's proposed owner? Where an ILC is to be owned by a company that is not subject to some form of consolidated Federal supervision, how would the consideration of these factors be affected?

NAR has no comment on whether the statutory factors are an exclusive list. We do, however, believe that the FDIC should take into account the nature of the proposed owner of the ILC. The nature of the owner should definitely affect the FDIC's consideration of the statutory criteria, including the adequacy of the ILC's capital structure, its future earnings, the character and fitness of its management, and the convenience and needs of the community.

An application from a commercial entity may raise particular concerns about whether the depository institution will actually benefit the community. The FDIC should be especially careful in its review of applications from commercial firms to consider the convenience and needs of the community to be served. Where the business plan of an applicant is designed simply to reduce costs to the firm or promote more spending at its stores, it is fair to ask whether the explanations of how the public will benefit are primarily window dressing.

The Wal-Mart application, for example, raises serious questions about whether it is in the public interest. If Wal-Mart Bank becomes the main or only provider of financial services in a market,[5] it would place commercial competitors at a serious disadvantage in seeking financial services. The bank would have a strong incentive to base its credit decisions on whether the applicant competes with the bank's parent. Furthermore, Wal-Mart Bank could position itself to provide loans on favorable terms to the suppliers of Wal-Mart Stores, which would put commercial firms that are not affiliated with a bank at a competitive disadvantage. These factors are uniquely significant in the case of Wal-Mart considering that the opening of a Wal-Mart store has been the death knell of the small businesses in many small towns. These potential problems would, of course, be inconsistent with the public interest because they could have the effect of reducing or eliminating competition in smaller markets.

Of course, there are numerous other requirements under banking law that the FDIC must consider. For example, an additional concern about the Home Depot proposal to acquire EnerBank arises in connection with the application of Section 23A of the Federal Reserve Act, 12 U.S.C. 371c, and Federal Reserve Regulation W, 12 C.F.R. Part 223, which limit "transactions with affiliates." EnerBank, of course, is subject to the restrictions of Section 23A and Regulation W.[6] Loans made by EnerBank to customers of home improvement contractors that are customers of Home Depot will be transactions that will be subject to Section 23A and Regulation W because the proceeds of the transaction are used for the benefit of, or transferred to, Home Depot. The Notice suggests that restrictions on transactions with affiliates are addressed by the proposed policy that prohibits contractors from purchasing material with an EnerBank check in Home Depot stores.[7] The fact that Home Depot may benefit from, and perhaps receive the loan proceeds from, contractors indicates that Home Depot's business plan is

[5] See our answer to Question 9 for a discussion of this risk.
[6] 12 U.S.C. 1828(j).
[7] Notice at page 10.

based upon a miscomprehension of banking law. NAR has recommended that the FDIC consult with the Federal Reserve, the agency with rulemaking and interpretive authority for Section 23A[8], regarding this matter. We have also asked the Federal Reserve to review the TWA issues raised by the Home Depot proposal and to ask the FDIC to suspend consideration of the proposed acquisition until the Federal Reserve has completed its review.

6. Should the FDIC routinely place certain restrictions or requirements on all or certain categories of ILCs that would not necessarily be imposed on other institutions (for example, on the institution's growth, ability to establish branches and other offices, ability to implement changes in the business plan, or capital maintenance obligations)? If so, which restrictions or requirements should be imposed and why? Should the FDIC routinely place different restrictions or requirements on ILCs based on whether they are owned by commercial companies or companies not subject to some form of consolidated Federal supervision? If such conditions are believed appropriate, should the FDIC seek to establish the underlying requirements and restrictions through a regulation rather than relying upon conditions imposed in the order approving deposit insurance?

NAR does not support conditioning the approval of ILC applications from commercial firms because it believes that Congress should close, or significantly tighten, the existing ILC loophole permitting commercial firms to own ILCs. But if the FDIC nevertheless approves the Wal-Mart or other applications from commercial firms, NAR urges it to restrict all approvals to just the activities identified in the applicants' submitted business plans. Any changes to the business plans, such as expansion into retail or credit card banking, should be processed as if the proposed changes were new applications to establish or acquire an ILC, not to broaden the activities of an existing ILC.

7. Can there be conditions or regulations imposed on deposit insurance applications or changes of control of ILCs that are adequate to protect an ILC from any risks to safety and soundness or to the Deposit Insurance Fund that exist if an ILC is owned by a financial company or a commercial company? In the interest of safety and soundness, should the FDIC consider limiting ownership of ILCs to financial companies?

NAR believes that Congress should close, or significantly tighten, the existing ILC loophole permitting commercial firms to own ILCs. We believe that the inherent conflicts of interest that arise when a commercial firm owns an ILC are impossible to correct by imposing conditions. The temptation to use the ILC for the commercial purposes of its parents will be great and, when abuses occur, they will be significant. See our answer to Question 8 for a more detailed discussion.

8. Is there a greater likelihood that conflicts of interest or tying between an ILC, its parent, and affiliates will occur if the ILC parent is a commercial company or a company not subject to some form of consolidated Federal supervision? If so, please describe those conflicts of interest or tying and indicate whether or to what extent such conflicts of interest or tying are controllable under current laws and regulations. What regulatory or supervisory steps can reduce or eliminate such risks? Does the FDIC have authority to

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[8] 12 U.S.C. 371c(f).

address such risks in acting on applications and notices? What additional regulatory or supervisory authority would help reduce or eliminate such risks?

Will a bank that is owned by a commercial company treat its customers that are suppliers and customers of its commercial parent the same as other bank customers who prefer to do business with a competitor of the parent? The answer, of course, is that it will not. The commercial parent will not want the bank to treat them the same. A bank owned by a commercial company will always want to make available as much credit as possible to the customers and suppliers of its parent so they do not shop or bank with competitors. Such a business strategy will pose significant risks to the financial system because a bank owned by a commercial firm may not have the freedom to exercise the discipline needed to make truly independent credit judgments.

Home Depot's proposed business plan is a perfect example of why banking and commerce should not be mixed. Home Depot's plan calls for channeling credit primarily to home improvement contractors that are their customers. This plan will have an anti-competitive effect and adversely affect Home Depot's competitors and other banks.

On May 9, 2006, Home Depot announced its agreement to purchase EnerBank to expand its "business and relationships" with home improvement contractors.[9] Home Depot's news release states:

> "[t]his acquisition gives us the opportunity to offer our services to The Home Depot's large contractor customer base . . . . This growth opportunity and the resources of The Home Depot will also strengthen the high level of service we offer to our existing contractors and program sponsors."[10]

When the contractor and the homeowner are negotiating a contract, the contractor will "tell the client to phone EnerBank"[11] which will approve the loan. The EnerBank loan to the homeowner "starts" when the homeowner is satisfied that a contractor has completed the home improvement project and when the homeowner endorses an EnerBank check to the contractor. Home Depot's Notice filed with the FDIC states:

> The Home Depot believes that EnerBank's ability to help contractors be more successful will strengthen The Home Depot's affinity relationship with its contractor customers, and as a result, they will be more likely to purchase their materials from The Home Depot.[12]

This Home Depot business plan creates an inherent conflict of interest because Home Depot will have an incentive to encourage EnerBank to provide financial services to home improvement contractors that are Home Depot customers and not to other contractors, because that will help increase sales by Home Depot. An unlevel competitive playing field is a

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[9] News Release, *The Home Depot to Acquire EnerBank USA*, http://ir.homedepot.com/ReleaseDetail.cfm?ReleaseID=195724.
[10] *Id.*
[11] *Id.*
[12] Interagency Notice of Change in Control filed by Home Depot on May 8, 2006, page 10.

significant risk because EnerBank may be pressured to provide loans on favorable terms to prospective borrowers who use contractors with whom Home Depot has established relationships as a means of generating additional business for Home Depot. As a wholly-owned subsidiary of Home Depot, on which it presumably will be dependent for a substantial portion of its funding, the EnerBank will have a built-in bias towards favoring applicants who do business with contractors who are customers of its parent. The Home Depot plan, therefore, has the potential to expose EnerBank to substantial risk of losses because of this inherent bias and conflict of interest.

9. Do ILCs owned by commercial entities have a competitive advantage over other insured depository institutions? If so, what factors account for that advantage? To what extent can or should the FDIC consider this competitive environment in acting on applications and notices? Can those elements be addressed through supervisory processes or regulatory authority? If so, how?

Commercial ownership of an ILC could give the ILC a significant competitive advantage over other insured depository institutions. For example, if the Wal-Mart Bank were to expand its business plan into retail banking, it is reasonable to expect that it would use the enormous financial resources of its parent, Wal-Mart Stores, to seek to become the dominant, or even sole, player in banking in its rural markets. That is precisely what has already happened in many small retail markets around the country.

If Wal-Mart Bank becomes the main or only provider of financial services in a market, it would place commercial competitors at a serious disadvantage in seeking financial services. The bank would have a strong incentive to base its credit decisions on whether the applicant competes with the bank's parent. Furthermore, Wal-Mart Bank could position itself to provide loans on favorable terms to the suppliers of Wal-Mart Stores, which would put commercial firms that are not affiliated with a bank at a competitive disadvantage. These factors are uniquely significant in the case of Wal-Mart considering that the opening of a Wal-Mart store has been the death knell of the small businesses in many small towns.

10. Are there potential public benefits when a bank is affiliated with a commercial concern? Could those benefits include, for example, providing greater access to banking services for consumers? To what extent can or should the FDIC consider those benefits if they exist?

For the reasons explained in our answers to other questions—inherent conflicts of interest, damage to the competitive landscape, and risk to the financial system—the ILC loophole should be closed or tightened, not broadened as a way to meet consumer needs. There are many other ways to meet the needs of those in need of banking services, including requiring banks to offer affordably priced or free "life-line" checking and savings accounts, permitting credit unions to accept as members any low- and moderate-income persons in their areas of operation, and educating consumers about the benefits of banking.

11. In addition to the information requested by the above questions, are there other issues or facts that the FDIC should consider that might assist the FDIC in determining

whether statutory, regulatory, or policy changes should be made in the FDIC's oversight of ILCs?

NAR believes Congress should eliminate or significantly tighten the ILC loophole and that the FDIC should extend the moratorium to give Congress more time to act.

12. Given that Congress has expressly excepted owners of ILCs from consolidated bank holding company regulation under the Bank Holding Company Act, what are the limits on the FDIC's authority to impose such regulation absent further Congressional action?

NAR has no comment.

Thank you for the opportunity to comment on this important public policy issue. If you have any questions or would like additional information, please contact Jeff Lischer, Manager, Financial Services, 202-383-1117 or jlischer@realtors.org.

Sincerely yours,

Thomas M. Stevens, CRB, CRS, GRI
2006 President, National Association of REALTORS®

cc: The Honorable Barney Frank
The Honorable Paul E. Gillmor