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UTAH INDUSTRIAL BANKS

Good morning. As always, it is a delight to attend the Utah Association of Financial Services Convention. Thank you for extending an invitation.

This morning I have an opportunity to state my thoughts on the condition of the Utah industrial banking industry. Naturally, my thoughts will be from my perspective as the chief state regulator of the industry.

STATE VISION

The department envisions Utah as a premier financial services center in the United States with growing importance internationally. I acknowledge that is an astonishingly audacious vision. The industrial banking industry is an integral component in realizing this goal. The enhancement and advancement of the Utah image should be the outcome. In keeping with that vision, we expect the best corporate conduct of all industrial banks chartered in Utah. We also expect the best performance of ourselves as a regulatory agency, it does not advance or enhance the state=s image if we do not succeed.

CORE VALUES

Over the years, I have articulated the core values of the Utah Department of Financial Institutions because I believe all else flows from these core values and if we are true to these core values we cannot stray too far from our intended course.

We are strong supporters of the Dual Banking System and especially the State Banking component of that system.

We strive for a state regulatory system that is a competition in excellence.

We regulate according to a conservative view of the law but in a fair manner.

We view our joint supervision of state nonmember banks - including all Industrial Banks - with the FDIC as a partnership,

The challenge I issued to all charter applicants and those currently operating in Utah is that if they are going to do it in Utah, DO IT RIGHT.

I enjoy reading the American Bankers Association News publication. In the July 5, 2005, Viewpoints section written by Virginia Dean were some comments that stuck with me. I would like to quote from a portion of what she wrote.

> *"Malcolm Galdwell is doing for people what Jane Goodall did for gorillas - examining behavioral peculiarities and making sense out of them. ... his conclusions are useful to any business interested in doing a better job. (He wrote a best seller) entitled 'Blink.' Blink is about the split-second decisions we make with surprising accuracy based on expertise so internalized it's almost part of our DNA. The tennis coach who instinctively knows when a player will double-fault before the ball is hit; an art historian who can spot a very good fake instantaneously.*
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> *But life experiences can cause blink-of-an-eye decision making too. So can fear. The fear of bad things happening on their watch is reason enough for an examiner or lawmaker to overreact to ensure that the boys-behaving-badly episodes at the Enrons and WorldComs won't be repeated in the banking universe.*
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> *Tightened rules can indeed make banks better, fairer, sounder. Taken to extremes, which is where zeal often travels, the law of unintended consequences kicks in. Credit can crunch, paper can clog the compliance gears, costs can increase and raise consumer costs, bank compliance officers can opt for a less stressful line of work like air traffic control at O'Hare or being shot out of a cannon in the circus.*
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> *The best regulators, lawmakers, and bankers - like good parents or teachers or coaches - inspire, guide, and bring about change in a positive, constructive way, not with a punitive, bad-dog! attitude. Doing the right thing - with your kids, your aging parents, your customers, or the employees in your care - is harder than it sounds. Sometimes we need to set aside our gut reactions, take a closer look and then decide.*

UTAH INDUSTRIAL BANKS

Attachment (1) Total Assets of Utah Industrial Banks as of June 30, 2005 and Applications approved or pending.

Attachment (2) The Comparative size of all states banking departments.

THE FEDERAL LAW EXEMPTION FOR INDUSTRIAL BANKS

In 1987, Congress passed the Competitive Equality Banking Act ("CEBA") which changed the definition of "bank" in the Bank Holding Company Act to **include** any institution having FDIC insurance. However, CEBA also carved out some important **<u>exceptions</u>** to the definition of the term "bank," including an exception for industrial banks. I want to emphasize the point; this exemption is NOT a LOOPHOLE but a SPECIFIC GRANT OF EXEMPTION in federal law.

In considering and passing the Gramm-Leach-Bailey Act of 1999, Congress did not repeal the exemption granted industrial banks in the1987 CEBA Act while they did remove the exemption for others.

The Bank Holding Company Act generally requires a company that controls a bank to register with the Board of Governors of the Federal Reserve as a bank holding company and to comply with capital, and **most importantly, activity restrictions which requires that all holding company activities are "banking related**." It is this holding company activity restrictions that prompts interest by national firms in industrial bank charters.

If as a recent newspaper article states there are *"lax laws"* concerning industrial banks, then it must be referring to lax federal laws because that is where the industrial bank exemption is contained.

The industrial bank exemption is not unique. The owners of a number of other financial institutions are also excluded from the Acts activity restrictions. It should be noted that most U.S. banks operate outside the holding company structure (and therefore the Federal Reserve Board's regulatory scrutiny) because they are not controlled by a holding company.

While not subject to federal reserve regulation as bank holding companies, industrial bank owners are subject to many of the same requirements as bank holding companies and as a result, safeguards exist to protect these depository institutions against abuses by the companies that control them or activities of affiliates that might jeopardize the safety and soundness of the institutions or endanger the deposit insurance system.

For example, restrictions on transactions with affiliates in Sections 23A and 23B of the Federal Reserve Act apply to industrial banks and their owners. These provisions, enforced by the Federal Reserve Board, limit the amount of affiliate loans and certain other transactions (including asset purchases) to 20 percent of a bank's capital, and require that such loans be made on an arm's length basis. Thus, an industrial bank may not lawfully extend significant amounts of credit to its holding company or affiliates or offer credit to them on preferential or non-market terms. All loans by industrial banks to their affiliates must be fully collateralized, in accordance with Section 23A requirements.

Because industrial bank parent companies are not restricted to activities "closely related to banking" some have argued, they represent a threat to the banking system. This argument has been articulated mostly by the Federal Reserve who currently does not have a regulatory role. The Federal Reserve has staked out the umbrella regulator role from the top down.

Regulatory scrutiny can also be accomplished from the bank up. At least, the case has not been made that it does not work. In fact, the track record of Utah industrial banks after 19 years of supervision from the state and FDIC is that there is no extraordinary risk in doing so.

Finally, if some bankers and their national association are opposed to industrial banks, one must ask why? They have stated they oppose industrial banks because they: (1) are not subject to federal reserve supervision, an interesting charge when I understand a significant portion of their own members are not subject to federal reserve jurisdiction because they do not have a holding company, (2) allow for the merging of banking and commercial entities, despite the fact that the owners of the vast majority of industrial bank assets are companies engaged exclusively or predominantly in financial services companies.

One would think that if these were meritorious arguments, the local commercial bankers and their association would be leading the charge against industrial banks. In Utah, if there were valid reasons for bankers to be concerned about industrial banks you would think that the Utah Bankers Association would be leading the charge. They are not - in fact - they support industrial banks and have extended membership to industrial banks, have industrial bank executives on their executive committee, and their current Chairman is Preston Jackson of Merrill Lynch Bank USA, an industrial banker.

In a letter dated April 18, 2003, addressed to all state banking association executives Utah Bankers Association President Howard Headlee, and then UBA Chairman Zions Bank President Scott Anderson stated the following:

> *"During recent debate on several important banking bills questions were raised about this (ILC) charter. Some of the comments during the debate have raised concerns that we think are unwarranted. After a significant review of the activities of these banks, the Utah Bankers Association has welcomed industrial banks into our Association. They are fully integrated in our activities and in many cases are important partners in our community.*
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> *Industrial banks are regulated and examined by the State of Utah and the FDIC in exactly the same way that other state-chartered banks are regulated and examined. Parent companies of ILC's are also subject to regulatory evaluation. ILC dealings with the non-bank parents and affiliates are strictly governed by Regulation W (implementing section 23 A and 23B of the Federal Reserve Act) and consequently are strictly at arms-length terms and conditions and at fair market pricing."*

INDUSTRIAL BANK SUPERVISION

As state-chartered FDIC insured institutions, Utah industrial banks are subject to the same banking laws and are regulated in the same manner as other depository institutions. They are supervised and examined both by the department that charters them and by the FDIC that insures the deposits. They are subject to the same safety and soundness, consumer protection, deposit insurance, Community Reinvestment Act, and other requirements as all other FDIC-insured banks.

No industrial bank is permitted to engage in any activity that is not permissible for other state-chartered commercial banks.

Industrial banks tend to specialize in specific banking activities such as credit card, home mortgage, automobile, agricultural, or small business lending.

The FDIC, as the relevant federal agency and steward of the deposit insurance fund, has repeatedly testified before Congress that industrial banks are no more threatening to the deposit insurance fund than commercial banks.

Recent newspaper articles quoting banking association and special interest lobbying spokespersons have stated that state and federal agencies do a lousy job of regulating industrial banks. They believe the Federal Reserve needs to be able to examine the finances of each industrial loan corporation's parent company. They go on to state an industrial bank controlled by a company in financial distress could be harmed or even fail. They worry that if the parent company needed money. They could use their bank as a personal piggy bank. An event that is unlikely given the requirements of Federal Reserve Regulations 23 A & B limiting parent or affiliate transactions.

In their statements, they refer to a worst case scenario of a holding company of an industrial bank filing bankruptcy or getting into financial difficulty. Utah has already had that occur without adverse repercussions to the deposit insurance fund.

Mill Creek Bank whose ultimate parent company Conseco, filed for bankruptcy protection. In the bankruptcy proceeding, Mill Creek Bank entered into an asset purchase and assumption of liability agreement with GE Capital Consumer Card Company, a depository institution. A $300 million plus premium was paid to Conseco in that agreement for the industrial bank.

In another case, TYCO, the ultimate parent company encountered financial difficulties and decided to spin the industrial bank group off in an initial public offering which was approved and readily completed. CIT, industrial bank continues operations today.

DEFENDING UTAH'S SUPERVISION OF INDUSTRIAL BANKS

The department has been forced to defend our chartering and supervision of the industrial banking industry. Over the years, the growth and changes in the Utah industrial bank industry has been dramatic. The vast majority of Utah industrial banks have operated safely and soundly. In fact, it is their success and the growth of the industry which has energized detractors.

There are members of Congress who are displeased because of their philosophical opposition to "merging banking and commerce" and the fact that Utah has been able to capitalize upon this industry and make it an advantage for Utah over other states.

In the last three years, I have delivered speeches, participated in panel discussions and answered questions on industrial banks before many groups. The department has and will continue to defend (in partnership with the FDIC) our regulation and supervision of industrial banks.

The department takes its supervisory role seriously. We are an active participant with the FDIC in all industrial bank examinations and targeted reviews wherever they are conducted in the country. Examiners are going regularly to New York, Chicago, Princeton, New Jersey, Phoenix, Jacksonville and Stamford, Conn. to conduct examinations.

Our examiners are participating in large loan exams (reviewing loans and lines-of credit in the $100's of millions), capital market examinations, trust exams, information system exams, consumer compliance and community reinvestment exams and bank secrecy act and anti-money laundering exams. We believe we are full partners with FDIC examiners.

The department does not serve the state of Utah well, if we are lax in our supervision of this industry. While the industrial banks are on the fore-front of banking structure we are not abdicating our supervisory role. We seek the best in banking performance and expect the same from ourselves as regulators.

GOVERNMENT ACCOUNTABILITY OFFICE REVIEW

In the middle of last year's Congressional debate the former Chairman of the House Banking Committee Rep. Jim Leach of Iowa , who is opposed to the industrial banking industry on grounds that: (1) the industry mixes banking and commerce, (2) the states are incompetent to regulate such an industry and (3) if Iowa cannot take advantage of the industry then no state should have them, asked the investigative arm of Congress the Government Accountability Office (GAO) to study the issues relating to industrial banks.

In conducting that review GAO representatives have been professional. They have called us often. They have come to Utah and met with myself and other department personnel. They met with representatives of the industry and others. They went to California and Nevada and visited regulators there. They have met with the federal regulators and lobbyists in Washington, D.C. In the winter, GAO indicated they were getting close to a final report and thought a panel discussion would help them flush-out the remaining issues.

So on February 11, 2005, I flew to Washington and participated in the GAO panel discussion. Others on the panel included the Federal Reserve and FDIC regulators, a law school professor, a former professor and current "think-tank" members and a well known banking observer and an staff person from the Independent Community Bankers of America. It was an interesting 4 hour open debate moderated by GAO officials.

GAO is still completing its review, I expect it will be made public sometime soon. I am of the opinion, that GAO has done a professional review but I do not know if certain members of Congress or the Federal Reserve will allow anything other than an adverse report to be published. I will reserve judgment until the report is issued.

WAL-MART'S INDUSTRIAL BANK APPLICATION

I know I cannot conclude these remarks without commenting on the industry flashpoint. On July 18, 2005, the department received an application from Wal-Mart for a Utah industrial bank charter. We have NOT yet accepted the application as complete. When we accept the application as complete, a 30 day public comment period will commence. Because the FDIC has already accepted the application and commenced a comment period, we will accept all comments received until the expiration of our 30 day comment period.

Since Wal-Mart has chosen to apply for a Utah industrial bank charter it will undergo the same regulatory process and its business plans would be analyzed and reviewed based upon the same criteria as all other applicants. As you all know this is a lengthy process with many potential pitfalls.

SUMMARY

Industrial banks are important to Utah, in fact, an integral component of realizing the vision of Utah as a financial services center.

Industrial banks are well capitalized, safe and sound institutions.

Industrial banks are subject to the same regulations and are examined in the same manner as other banks.

Utah has been successfully regulating FDIC insured industrial banks for 19 years.

Utah has established a record of safe and sound institutions with prudential safeguards in place that have prevented parent companies from exercising undue influence over the insured entity.

An essential component of our regulation is the requirement for on-site management from bank-experienced people.

We view our joint supervision of state nonmember banks - including all industrial banks - with the FDIC as a partnership,

We want companies in Utah that are passionate about doing it right.

Thank You.