Introduction:

Good morning. Chairman Powell, Vice-Chairman Reich, Senator Bennett, Congressman Leach and other honorable guests, it is a pleasure for me to participate on this panel this morning.

Objective:

My task, as it has been explained to me, is to give you a glimpse into what life is like inside an industrial loan corporation, otherwise known as an industrial bank.

What I would like you to take away from this presentation is the notion that working in and managing an industrial bank is just like working in and managing any other similar sized insured depository institution with a similar product mix. I would like you also to gain an appreciation for the fact that engaging in business with a parent or affiliate organization is very closely regulated, scrutinized, and controlled and is, in fact, generally more challenging and cumbersome than dealing with third parties.

Historical Evolution:

Industrial banks have existed for more than one hundred years. They evolved from Morris Plan Banks, which were consumer lending institutions organized at a time when commercial banks generally did not make consumer loans or offer deposit accounts. The word “industrial” stems from their original mission of providing credit to industrial workers, not to the industries themselves. Once located in 16 states, industrial banks are chartered in just 5 states today, namely California, Colorado, Nevada, Minnesota, and Utah.

Industrial banks engage in most of the same consumer and commercial lending and deposit taking activities as other banks. There are some limitations such as not being able to accept demand deposits if they have total assets greater than $100 million. Industrial banks are insured by the FDIC and are jointly regulated by the FDIC and the state under which they are chartered. For the most part, Utah industrial banks engage in banking activities that are national in scope but their operations are usually conducted from a single location.

Utah industrial banks grew in popularity in the late 80’s and early 90’s. Their relative attractiveness stemmed from Utah’s lower costs of operation, an abundant skilled labor force, a simple and clear Consumer Credit Code, lack of an anti-usury law, and a generally business-friendly legislature.
In the early 90s, some corporations not experienced in the ownership and operation of insured depository institutions acquired Utah industrial bank charters and commenced engaging in banking business. For a very brief time, these banking institutions were managed remotely, with policy and operational decisions dictated from home office and with primary banking records maintained outside of Utah.

In short order, the FDIC and State of Utah cracked down on these institutions and issued Memoranda of Understanding to each of them, outlining the strict requirements that must be followed if they expected to continue in operation. The message was clear: if they expected to operate a bank under the state and FDIC jurisdiction, the bank would have to meet the same standards as any other FDIC-insured bank. It would have to look, feel, and in every way behave like any other well managed bank. Primary banking records needed to be on site and readily available to examiners. The board of directors had to be active, have respectable credentials, and be independent of the parent. Management had to be resident in Utah and have qualifications commensurate with their responsibilities. The affairs and fortunes of the bank had to be independent from those of the parent. And, the banks had to comply with all the same state and federal regulations that were applicable to any other bank. These early owners of industrial banks promptly “got religion”. They re-established their industrial banks as they should have been established in the first place. Among other things, this involved hiring qualified and experienced bank officers to manage the banks. I think without exception, the CEOs of the industrial banks operating today were all hired after long and successful careers in other banks or as regulators. The qualifications of the current group of industrial bank CEOs compare favorably with any other group of banks.

**AECB Today**

I was hired to head American Express Centurion Bank in 1990 after an 18 year career at Citibank. I set out to hire a team of experienced bankers who had successful careers in well-performing, well-rated financial institutions. As a team we have now seen American Express Centurion Bank grow from under $300 million in assets to its present size of over $18 Billion in assets. Centurion Bank is headquartered in Utah but has customers in all 50 states and US trust territories. It is primarily a consumer credit card bank with an impressive array of proprietary and co-branded credit and charge cards. It also boasts a substantial small business loan portfolio, a vibrant and well rated internet banking channel, and a growing range of other consumer lending and deposit products.

**Interactions with Affiliates**

Much of Centurion Bank’s back office work is outsourced to other entities, some to affiliates and some to third parties. In the case of outsourcing to affiliates, the bank is strictly governed by Sections 23A and 23B of the Federal Reserve Act, both recently interpreted by the new Regulation W. That means when the bank engages in any activity with its parent or any affiliate, it documents the transaction with meticulous contracts and service level agreements. Furthermore, pains must be taken to document and
demonstrate that such interactions are undertaken at arm’s length and at fair market pricing. For example, when outsourcing to an affiliate, a typical approach is to first solicit bids from two or more unaffiliated companies to establish market pricing. In the case where the third party’s bid, and its perceived competency, is superior to that of the affiliate, the work goes to the unaffiliated third party. Managing inter-affiliate dealings is no minor house-keeping matter. And the rules governing industrial banks are no lighter than those governing other FDIC-insured institutions.

Bear in mind, Section 23 A also governs overdrafts, or deposits with, or any other extension of credit, to an affiliate. Such transactions are strictly limited. As you can well imagine, these particular requirements, and the scrutiny they receive by the regulators, in my mind, make the common argument of the dangers of “mixing banking with commerce” a non-starter.

Industrial banks are required by law to operate in a safe and sound manner, and that means that we have to have strong internal control processes that protect the bank and the deposit insurance funds. This framework is tested over and over through internal and external audits and through the examination process, with two sets of regulators involved. If there has ever been a misperception that industrial banks operate in a world with only a light veneer of “bank-like” requirements, I hope by now you understand that this is not the case.

Corporate Governance

A great deal of my time at the Bank is spent on corporate governance issues, which is not surprising, since the centerpiece of risk management really comes down to promoting and refining the overall governance process.

American Express Centurion Bank has a board of directors comprised of nine members, only two of which are employees of the bank or its parent. It is a diverse board including two women, three ethnic minorities, and our directors possess an impressive array of professional qualifications. The board includes a former Chairman of the Federal Deposit Insurance Corporation, three former bank CEOs, an executive and director of Neighborhood Housing Services of America, a former general counsel of the FDIC, and an entrepreneurial real estate developer. The board meets 8 times per year and routinely demonstrates its independence and authority.

The bank operates with the usual oversight committees, including an Executive Committee of the Board, an Audit Committee comprised only of independent board members, Credit Policy Committee, Asset and Liability Committee, a Risk Assessment Committee, a Compliance Committee and a Community Reinvestment Committee. The directors and officers of the bank and all its affiliates are all subject to Regulation O. The bank engages in a robust FDICIA review process annually which is attested to by our Chief Financial Officer and by me.
Centurion bank has adopted all appropriate aspects of Sarbanes-Oxley Act with regard to corporate governance. We are also busy implementing all the know-your-customer and other security provisions of the USA Patriot Act and all the customer privacy provisions of the Graham-Leach-Bliley Act.

In the area of CRA, Centurion Bank is a recognized leader in its designated lending areas and has consistently maintained an Outstanding CRA rating under the lending, investment and services tests. The bank has a group of 5 full time employees that are devoted exclusively to community development and developing and implementing the Bank’s CRA programs.

Centurion Bank is subject to routine examination by examiners from the state of Utah and the FDIC. Because of its size, Centurion is in the large bank category and consequently undergoes a year-around Safety and Soundness examination. Other routine regulatory examinations include Bank Secrecy Act, Compliance and CRA Examinations, and Information Systems Examinations. In conjunction with the Safety & Soundness examination we provide current information regarding the financial health and performance of our parent. Examiners from both the state and the FDIC routinely visit and examine the performance of our parent company and related affiliates.

My executive team includes a Chief Operations Officer, and Chief Credit Officer, a Chief Compliance Officer, a Chief Technology Officer, a Chief Financial Officer, CRA Officer, and a Human Resources Officer.

On a national level, our bank actively participates as members of the American Bankers Association (I personally serve on the ABA’s government relations committee), the American Bankers Council, BAI, the Conference of State Bank Supervisors, and as one of 15 bank members of NACHA’s Direct Financial Institution Committee. In May, at its annual Compliance Conference, the American Bankers Association and its National and Graduate Compliance Schools presented a special award to American Express in recognition of outstanding support of the schools. As a bank, we have conscientiously recruited highly competent compliance officers and throughout the bank we have promoted continuing education in banking and regulatory compliance. Locally, along with other Utah industrial banks, we belong to the Utah Bankers Association, the Utah Association of Financial Services, and the Better Business Bureau.

Conclusion

I believe that much of what I have related to you about American Express Centurion Bank today could be said of any of the other 23 Utah industrial banks.

As can be gathered from the foregoing, we are a bank led by a group of dedicated leaders who are intent on doing things right. We strive for the highest ratings in all bank examinations. We strive to provide premium value and exceptional service to our many valued customers. I am intensely proud to lead a banking organization that shares one of the world’s most respected service brands.
I hope that this brief presentation today has given you the idea that life in a so-called industrial bank is really no different from life in any other well run banking organization. On the one hand, industrial banks are subject to the same banking laws and are regulated in the same manner as other insured depository institutions. They are subject to the same general safety and soundness, consumer protection, deposit insurance, Community Reinvestment Act, and other requirements that apply to other FDIC-insured depository institutions. On the other hand, industrial banks seek the proverbial “level playing field” and wish to enjoy all the same opportunities as any other bank. I know there are a lot of very intelligent people with opinions on both sides of this issue. However, my own opinion, after many years of being up-close and personal, in both traditional banks and industrial banks is that in today’s modern and competitive world of banking, there is not sufficient basis for industrial banks to be discriminated against in any federal banking legislation. Such discrimination would only serve to limit competition, and when competition is limited, it is the consumer who ultimately suffers.

Thank you very much.