Opening Statement by
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before
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The Structure and Role of Commercial Affiliations
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Good morning. Chairman Powell, Vice-Chairman Reich, other panel members and attendees, it is an honor to participate in this FDIC Symposium and addressing this timely topic in today's financial services environment.

My background in banking began as a community banker and then 15 years in bank examiner positions with the Utah Department of Financial Institutions and for the last 11 years as the Department's Commissioner.

CORE VALUES

What I hope to present today is the perspective of the Utah regulator, our experience, how we regulate and what the industry is doing. Let me begin by outlining some of our core values.

We are strong supporters of the Dual Banking System and especially the State Banking component of that system. As such, we are strong supporters of community banks which constitute the majority of the institutions subject to our jurisdiction.

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

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

We work toward regulatory consistency between the states, between the states and the federal regulatory agencies and among all depository industries.

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, and

Personally, based upon my Naval Reserve Officer background, my attitude is that nothing untoward is going to happen on my watch.

STATE CHARTER OPTION

As we all know, banking is integral to the fabric of economic life for all of us. Since the
foundering of this nation, states have chartered, regulated and supervised banking. Today largely as a result of the states' success in performing that role, the state charter remains a viable option for banks. The state charter allows for innovation in a locally controlled environment, limiting systemic risks. If a product, service, delivery mechanism or charter is fundamentally unsafe or unsound then those weaknesses may be exposed.

I believe I was invited to participate in this symposium because of Utah’s history and experience in chartering and regulating Industrial Loan Corporations (ILCs) or Industrial Banks. In my view, ILCs are the embodiment of what is right and proper in the Dual Banking System.

My association, the Conference of State Bank Supervisors issued a statement on April 24, 2003, that stated in part:

“In the welter of concerns that have been raised about ILCs, CSBS reaffirms the longstanding principles that are the bedrock of state banking.

Within the dual banking system, the state banking system contributes creativity, experimentation, diversity and choice, all of which enhance local economic development, competition and flexibility. ILCs are an excellent example of the spirit of creativity and experimentation embodied by the state banking system.

We believe that preventing the federalization of the state banking system avoids unduly burdensome regulation and encourages competition.

Any diminution of or constraint upon any state charter potentially endangers all state charters and the state banking system.

Congress has addressed ILCs in previous legislation and has allowed them to exist, where they are authorized by states, for more than 100 years. If Congress revisits the issue, CSBS's stance will be that no state charter should be placed in a position of weakness vis-à-vis federal charters.

The vast majority of existing ILCs are financial companies that have options other than the ILC charter, including federal options.

ILCs are subject to the same banking laws and regulations as other depository institutions. They are supervised and examined by the states that charter them as well as by the FDIC. “

Our host FDIC Chairman Powell recently stated, “Banking is regulated for good reason . . . The purpose of our bank regulatory system is to make sure the public retains its confidence in insured banks and thrifts . . . But we must be watchful . . . Against the possibility that the regulatory system itself does not impair the vital process of innovation and change that which is the lifeblood of the American marketplace.”
ILC INDUSTRY

Based upon numbers available to me as of March 31, 2003, Utah chartered and regulates 24 of
the 50 FDIC insured Industrial Banks in the country with approximately $97 of the total $113
billion in industry assets which represents only approximately 1.4% of insured deposits.

Across the country there are four broad categories of ILCs:

1. Community focused institutions,
2. Speciality lending programs, (leasing)
3. Institutions affiliated with organizations whose activities are predominately financial in
   nature, and
4. Institutions that directly support the parent organization (BMW, Volvo, VW, Fry
   Electronics).

Of the 24 Utah ILC Charters:

21 - are or have a parent company listed on the NYSE.
14 - have transaction account authority (2 grandfathered DDA authority).
12 - have some type of credit card product.
11 - have an affiliate insured institutions.
  9 - have been in business less than three years.
  2 - are subsidiaries of financial holding companies

UTAH’S REGULATORY STRUCTURE & EXPERIENCE

Utah has been chartering ILCs since the 1920s. In 1986, Utah law was changed to require
Federal Deposit Insurance for all ILCs. In my view, since that date there has been a partnership
with the FDIC in supervising this industry.

Like most state banking departments, we regulate all state-chartered depository institutions,
including banks, savings banks, industrial banks and credit unions. We also have jurisdiction
over many non-depository activities in Utah. We are entirely funded from assessments to the
financial institutions we regulate through a restricted account that can only be appropriated to the
department.
Utah’s vision of the industry was to advance and enhance the image of Utah and the state charter.
We envisioned ourselves as a financial services center. We expect the best of all ILCs chartered
in Utah.

Since my appointment as Commissioner in 1992, Utah ILCs have grown little in numbers from
17 then to 24 currently. But there has been a tremendous growth in total assets from $1.5 billion
to $97 billion today. Two ILCs represented here today have developed their business plans and
grown their banks over the last 15 years to the point where they are national leaders.

David has stated the regulatory history of the industry in Utah. Since the companies found "religion" there has been an attitude of regulatory compliance.

While all ILCs are subject to all the same rules and regulations as commercial banks, special emphasis is taken on Section 23 A & B. Our examiners as well as FDIC examiners do a thorough review at every examination of all parent and affiliate company transactions.

Besides all normal jurisdiction and enforcement authorities over ILCs, pursuant to Section 7-8-16 of the Utah Code, each ILC holding company must register with the department and is subject to the department's jurisdiction. Also, according to Section 7-1-501 of the Utah Code each ILC holding company is subject to examination and enforcement authority of the department.

What activities are ILCs engaged in?

Credit cards - both consumer and commercial, small business, private label, travel and entertainment, fuel purchasing
Consumer lending - vehicle, mortgages, home improvement, loans secured by brokerage accounts
Commercial lending - equipment financing, equipment leasing, heavy truck financing, SBA loans, USDA Guaranteed loans, and
Commercial Escrow Services

ADDITIONAL PRUDENTIAL SAFEGUARDS APPLIED TO ILCs

The question may be posed, Can a bank regulated at the bank level be insulated and isolated from parent company improprieties? The Federal Reserve has staked out the umbrella regulator role from the top down. I submit that regulatory scrutiny can also be accomplished from the bank up. At least in my mind, the case has not been made that it does not work. In fact the track record of Utah ILCs after 18 years of dual supervision from the state and FDIC is that there is no extraordinary risk in doing so. However, I would be the first to add that the industry requires additional prudential safeguards. Supervising ILCs is an evolving regulatory dynamic as new issues arise and new lessons are learned, I suspect we will add new requirements.

This heavy regulatory hand is most evident in approval Orders of de novo ILCs. The Order is where the majority of prudential safeguards are issued and remain in effect for the life of the institution. These Orders reflect generally higher capital standards and more regulatory attention to previously noted problems.

Today, all Utah ILC approval Orders contain the following:

*The board of directors shall be comprised of a majority of outside-unaffiliated directors, and*
those unaffiliated directors shall not serve on the board of any other FDIC insured depository institution. I should note that these director independence requirements were imposed long before Sarbanes Oxley Act of 2002.

There shall be no change in the executive officers or in the board of directors as submitted in the application without the prior approval of the Commissioner for a period of three (3) years after the ILC commences operations.

Requires at a minimum an onsite President, the Chief Financial Officer, and the Chief Credit Officer with sufficient support staff with the knowledge, ability, and expertise to successfully manage the risks of the ILC, maintain direct control of the ILC, and retain the ILC’s independence from the parent company.

The board of directors meetings will be held no less than monthly for at least the first twenty-four (24) months after commencing operations.

As the state regulator, board and management independence and autonomy remains our primary concern.

What I tell the institution is this: What do the regulators want? We want autonomous management, not window dressing. This is fundamental to all other considerations. Regulators can tell after working in the institution if management is really in control. We want a management team that is autonomous from the larger corporation; that acts at all times in the best interest of the bank; that demands accurate, reliable accounting records on-site upon which to base their decisions; that retains the credit underwriting policy and decision-making authority; that ensures all transactions with the parent corporation or affiliates passes the strictest arms-length scrutiny and that has sufficient personnel and resources to carry-out management decisions and audit for compliance with those decisions. We want a board of directors comprising competent people of integrity. The board members must be active and provide direction and supervision to management.

The ILC shall operate within the parameters of the three-year pro-forma business plan submitted with the application and any significant deviation from the plan must have the prior written approval from the Commissioner.

Within 30 days of receiving all required regulatory approval to operate as an insured Utah ILC, the ILCs holding company shall register with the department by filing a registration statement as required by Utah law.

**MISCONCEPTIONS REGARDING ILCs**

I want to address some of the misconceptions regarding ILCs that have been published.
ILCs are not regulated

The statement is erroneous and offensive to the states and the FDIC. Those that make that representation are either uninformed or intentionally misstating the truth. ILCs are regulated! They are dual regulated by both the State and the FDIC. Both States and the FDIC have the same examination and enforcement authority over ILCs as they do over commercial banks.

ILCs have the same safety and soundness laws and regulations.
ILCs must adhere to the same consumer compliance laws and regulations.
ILCs must adhere to the same restrictions on transactions with affiliates and anti-tying restrictions.
ILCs have the same if not higher capital standards.

Pursuant to FDI Act Section 10(b)(4) examination authority of the FDIC extends to affiliates, including parent. This authority, according to our host Chairman Powell, allows the FDIC to manage the relationships between ILCs and their parents “with little or no risk to the deposit insurance funds - and no subsidy transferred to the nonbank parent.”

I have already stated the Department's authority over ILC Holding Companies.

Additionally, the Federal Reserve does not have exclusive holding company authority. The Office of Thrift Supervision also has holding company authority.

ILCs pose a threat to banking system

I use two quotes from our host Chairman Powell. He answered the question so well,

“Overall, it is the FDIC’s view that ILC charters pose no greater safety and soundness risk than other charter types.”

“For troubled ILCs, several common issues have generally been evident, each reflecting faulty strategic or tactical decisions rather than issues of permissible activities, commercial affiliations, or the regulatory regime over the larger corporate organization.”

ILCs represent an inappropriate mixing of banking and commerce.

Again, quoting from Chairman Powell,

“We (the FDIC) do not believe that the potential for conflicts of interest is any greater for ILCs than for other FDIC insured institutions operating in a holding company structure.”
Why is the ILC charter appealing to national and international firms? Because in this closely watched and debated issue of merging “Commerce and Banking" the ILC charter is one of the few charter options remaining to those companies that do not want to cease all non-banking related activities at the parent company level.

ILCs enjoy a specific exemption to the definition of a “bank" under the Bank Holding Company Act granted in the Competitive Equality Banking Act of 1987. I want to emphasize the point. This is NOT a LOOPHOLE but a SPECIFIC GRANT OF EXEMPTION in federal law.

It should also be noted that the Gramm-Leach-Bliley Act of 1999 did not repeal the exemption granted ILCs in the1987 CEBA Act.

While I remain committed in my support of the Utah ILC charter and industry, that commitment should not be viewed as an endorsement for companies that want to conduct business in Utah in a reckless or wanton fashion. The Utah ILC industry is a controlled environment. If companies are not willing to play by the rules, my advice to them is Don't Come.

Finally, if some bankers and their association are opposed to ILCs based upon this merging of banking and commerce argument one would think that the local bankers and their association would be leading the charge. In Utah, if there were valid reasons for bankers to be concerned about ILCs you would think that the Utah Bankers Association would be leading the charge opposing ILCs. They are not - in fact - they support ILCs and have extended membership to ILCs, have ILC executives on their executive committee, and in two years an ILC President will become Chairman of the Utah Bankers Association.

CURRENT CONGRESSIONAL LEGISLATION

The ILC issue has been raised as part of the Congressional debate on two banking related bills before Congress. The ILCs did not come to Congress and ask for these enhanced banking powers, my understanding is that the banking associations and the federal regulators asked for them. In my view, all the ILCs are saying is, do not discriminate against them. If Congress is considering giving these new enhanced powers for all other financial institutions, let's have parity.

I find it truly ironic that H.R. 1375, Financial Services Regulatory Relief Act of 2003 is being viewed by some as a vehicle to restrict and roll-back powers currently available to FDIC insured depository institutions like the Industrial Banks.

THE COUNTRY’S LARGEST RETAILER (If needed)
Let me address an underlying issue. The country’s largest retailer does not have a Utah ILC charter and has not applied for a Utah ILC charter.

If bankers are concerned about a retailer using an ILC charter to branch interstate, yes they may and since Utah is a reciprocity state, ILCs currently may branch into 16 states. That is the correct answer but reality is that accomplishing that requires multiple regulatory approvals and with only four branches operating for all Utah ILCs, I would submit that is not the pattern of operation.

The country's largest retailer could have applied for an ILC charter for the last 17 years and has not done so. If the country's largest national retailer wanted to establish branches in those 16 states, it could have done so for the last three years but again has not.

If the country's largest retailer ever chooses to apply for an ILC charter in Utah they would go through the same regulatory process and their business plans would be analyzed and reviewed based upon the same criteria as all other applicants.

In my experience, over the years we have conducted many pre-application meetings with potentially interested parties and have only received a few applications. Many interest parties come with a business plan, they are convinced will work and many walk away never to return with the inadequacies of their business plans manifested to them. From the regulators perspective, there is an overriding consideration that future applicants would be well advised to remember and that is that business plans must make economic sense in a regulated environment for an insured institution.

**SUMMARY**

Utah has been successfully regulating FDIC insured ILCs for 18 years. We have 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.

We view our brand of regulation as tough but fair. An essential component of our brand of regulation is to require on-site management from bank-experienced people.

In my experience, regulating ILCs is different from regulating community banks only in the velocity of changes that may occur at the ILC.

Utah examiners, as well as, FDIC examiners have adapted as the ILCs have evolved. For us, keeping up with new products, new financial instruments and new delivery mechanisms has been a regulatory challenge, but a challenge we have met with the shared resources of our regulatory partners both states and FDIC.

Thank You.