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TESTIMONY OF
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COMMISSIONER OF FINANCIAL INSTITUTIONS
STATE OF UTAH
BEFORE THE
BANKING, HOUSING AND URBAN AFFAIRS
COMMITTEE
U.S. SENATE
OCTOBER 4, 2007

Good morning, Chairman Dodd, Ranking Member Shelby and members of the committee, thank you for the opportunity to share Utah's view on the regulation and supervision of industrial banks or as they are sometimes called Industrial Loan Companies.

I am Edward Leary, Commissioner of Financial Institutions for the State of Utah. I have been involved with banking for thirty-three years, first as a community banker, then fifteen years in bank examiner positions with the Utah Department and for the last fifteen years as its Commissioner. I am pleased to be here today to share my views on the supervision and regulation of industrial banks.

STATE CHARTER OPTION

As we all know, banking is integral to the fabric of economic life for all of us. Since the founding of this nation, states have chartered, regulated and supervised banking. The choice of charter remains a vital component of the check and balances of the dual banking system. State-chartered institutions in attempting to survive and meet the needs of their communities have fostered creativity and experimentation. The state-chartered institutions can innovate in a controlled environment that limits systemic risks. If a product, service, delivery mechanism or charter is fundamentally unsafe or unsound then those weaknesses may be exposed.

Today largely as a result of federal preemption the states are losing assets and state-chartered depository institutions are becoming a less viable and appealing charter.

The following numbers illustrate the dramatic shift in percentage of assets by chartering agency.

<u>Date</u>	<u>States</u>	<u>OCC</u>	<u>OTS</u>
12/31/1995	41%	45%	14%
12/31/2000	42%	46%	12%
12/31/2001	41%	46%	12%
12/31/2002	42%	46%	12%
12/31/2003	41%	47%	12%
12/31/2004	31%	55%	13%
12/31/2005	31%	55%	14%
12/31/2006	30%	57%	12%

Another foundation of the dual banking system is the ability to freely choose the supervisory structure under which the insured entity operates. This foundation contributes to a competition in excellence among financial institution regulators. It is therefore vital that there is more than one approach to the regulation and supervision of financial institutions.

In today's environment of decreasing assets in state-chartered institutions, industrial banks are experiencing asset growth. Why? Because of the innovations in customer service and delivery of financial products to targeted segments that consumers have responded to very well. Based upon Utah's history and experience in chartering and regulating industrial banks, my view and statement is that industrial banks are the embodiment of what is right and proper in the dual banking system.

The irony is that while many profess belief in the Dual Banking System and are staunch supporters of its merits in providing safe, sound banks with competitively priced financial services and products to consumers and businesses; today we are discussing restrictions and limitations on a state-chartered, federally insured banking industry that I believe embodies real innovation and creativity in the delivery of banking services.

A statement from the former Federal Reserve Chairman, Alan Greenspan, is an appropriate ending to this section.

"A system in which banks have choices, and in regulations that result from the give and take involving more than one agency, stands a better chance of avoiding the extremes of Supervision." (No Single Regulator for Banks, Wall Street Journal, December 15, 1993.)

WHAT THE PUBLIC POLICY DEBATE SHOULD BE

The fact that the committee is having this hearing today reflects the reality that Utah's chartering and regulating of the industrial banks has been commensurate to the risk. Utah, in partnership with the FDIC, has jointly created a supervisory model for industrial banks that has evolved and will likely continue to evolve, but through more than twenty years of everyday application, it has worked, in that no Utah industrial bank has failed.

My belief is that this committee should not consider rewriting banking laws to address the desires of particular industry groups or trade associations whose desire is to suppress competition.

Nor should Congress change, much less outlaw a proven, successful regulatory structure because some groups have concerns about a particular applicant.

Testifying before Congress on financial services reform in 1987, the FDIC's then-chairman L. William Seidman argued that the public interest would be best served by:

"... financial services industry that met four objectives: the financial system should be viable and competitive, the banking system should be operated in a safe and sound manner, customers should realize benefits from enhanced competition, and the system should be flexible enough to respond to technological change. Consistent with these objectives, the regulatory and supervisory structure of banking should be the simplest and least costly one available."

The question facing policy makers then was - and continues to be - whether these objectives can be met without restricting the ability of banks to choose the corporate structure that best suits their business needs. As Seidman noted:

“The pivotal question . . . is: Can a bank be insulated from those who might misuse or abuse it? Is it possible to create a supervisory wall around banks that insulates them and makes them safe and sound, even from their owners, affiliates and subsidiaries? If so, then the banking and commerce debate should focus on how affiliations should be regulated so that the public interest is met.” (FDIC Banking Review, January 2005, The Future of Banking in America, The Mixing of Banking and Commerce: Current Policy Issues, Volume 16, No. 3.)

I urge this committee and Congress to focus on the adequacy of the current regulatory processes conducted by the State of Utah and the FDIC. In the absence of a demonstrated example of regulatory failure, there is no fundamental, underlying reason for a public policy change.

If, in the future, shortcomings are identified, an amendment may be considered without outlawing a class of banks that have operated for over a century without harming competitors, consumers or the deposit insurance system. Believe me, if I am still the Commissioner when a shortcoming in our regulatory process is identified, it will be corrected, long before any legislative body could take action. The states and the FDIC have developed prudential standards that are in place today.

UTAH INDUSTRIAL BANKS

As of June 30, 2007, all of the nation’s 59 operating industrial banks represented a very small .7% component of the 8,615 total insured banks and savings banks. Nationally, industrial banks also represented a very small \$226 billion of the \$12.2 trillion of the insured bank and savings bank total assets, or 1.8%.

Looking specifically at Utah industrial banks for the period ending June 30, 2007, Utah had 31 operating charters holding \$200.9 billion in total assets.(See Appendix -1) Thus, Utah holds 89% of all industrial bank assets. Utah industrial banks represent only 1.6 % of the insured bank and savings bank total assets, and 1.7% of total deposits with \$138 billion of the \$8.0 trillion in total insured bank and savings bank deposits. Currently, there are 30 operating industrial bank charters as MagnetBank converted to a commercial bank charter in August. The foregoing percentages were determined by the Utah Department of Financial Institutions based upon numbers derived from the FDIC database as of June 30, 2007.

A statement has been made that there has been a “stampede” to the industrial bank charter. An analysis of the number of charters over the last twenty years will show that there has been on average an increase of one charter per year. (See Appendix - 2)

As of June 30, 2007, the Utah Department's, non-determinative and non-binding analysis using the provisions of the House passed H. R. 698 is listed in Appendix - 3. The Utah Department's analysis based upon knowledge of the industrial bank holding companies is that 82% of Utah's industrial bank assets would be considered held by "*financial*" entities.

As of June 30, 2007, the Utah Department's, non-determinative and non-binding analysis using the provisions of the House passed H. R. 698 is listed in Appendix - 4. The Utah Department's analysis based upon knowledge of the industrial bank holding company is that 18% of Utah's industrial bank assets would be considered held by "*non-financial*" entities.

The increase in Utah industrial bank "*non-financial*" assets over the last six months is largely attributable to Utah and FDIC's approval of the General Motors application to sell a 51% interest in GMAC. GMAC held a Utah industrial bank, the GMAC Automotive Bank. The FDIC granted an exception to its six-month moratorium on industrial bank applications and approved the sale and subsequent merger, which resulted in \$23.5 billion in additional mortgage assets coming to the Utah industrial bank. The renamed GMAC Bank is considered a "*non-financial*" Utah industrial bank.

The Utah Department's analysis of those Utah industrial banks with a Federal Agency supervising the holding company is listed in Appendix - 5. The Utah Department's analysis is that seven entities holding 77% of all Utah industrial bank assets are currently subject to a Federal Holding Company Supervisor at the holding company level.

UTAH'S REGULATORY STRUCTURE & EXPERIENCE IN PARTNERSHIP WITH THE FDIC

Utah has been chartering industrial banks since the 1920s. In 1986, Utah law was changed to require Federal Deposit Insurance for all industrial banks.

Like most state banking departments, Utah regulates all types of state-chartered depository institutions, including banks, industrial banks and credit unions. The Utah department also has jurisdiction over many non-depository activities. The Utah department is entirely funded from assessments to the financial institutions we regulate through a restricted account that can only be appropriated to the department.

As state-chartered, FDIC insured institutions, industrial banks are currently operating in the states of Utah, California, Colorado, Hawaii, Indiana, Nevada and Minnesota. No state permits industrial banks to engage in activities that are not permissible for other state-chartered banks.

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 states that charter them and by the FDIC. They are subject to the same safety and

soundness, consumer protection, deposit insurance, Community Reinvestment Act, and other requirements as other FDIC-insured banks. However, special emphasis is placed on Federal Reserve Regulation W and Sections 23 A & B of the Federal Reserve Act, which closely regulates all parent and affiliate company transactions to ensure that there is a limit to the amount of “*covered transactions*” and an “*arms length*” basis for all transactions.

A Utah industrial bank is required to maintain the minimum amount of capital required by its federal deposit insurer, but the Commissioner may require a greater amount of capital.

The department has and will continue to defend our regulation and supervision of the industrial bank industry. The department takes its supervisory role seriously. It is an active participant with the FDIC in all industrial bank examinations and targeted reviews wherever they are conducted in the country. 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.

Utah believes it is a full partner in regulating, supervising and examining this industry. As proof of that fact, Utah is one of the very few states in the country performing CRA/Compliance examinations. Utah conducts most of these examinations jointly with the FDIC. To solidify this relationship with the FDIC, Utah signed a written agreement in January of 2004.

Utah is participating with the FDIC in the Large Bank Supervision Program for four industrial banks: Merrill Lynch Bank USA, UBS Bank USA, American Express Centurion Bank and Morgan Stanley Bank. The supervision of these large banks is coordinated by a full-time relationship manager from the State as well as the FDIC.

A team of examiners and specialists from Utah and the FDIC conduct targeted reviews in areas such as: commercial and retail credit, capital markets, bank technology, asset management, and compliance and they track the quality and quantity of risk management procedures. This type of activity is no longer extraordinary.

The large bank program allows the State and FDIC to develop a more thorough knowledge of the bank than is possible through the traditional regime of periodic, discrete examinations. Over the four years Utah has been involved in this program, we have developed, tested, and refined this supervisory approach expressly to address the special financial and compliance challenges posed by bigger, more complex and to some degree globally positioned banks.

Today, our industrial banks operate nationally but they may have affiliates or relationships that operate overseas, as well as our neighboring countries to the north and to the south.

This expansion of our large industrial bank operations' across various legal entities and geographic boundaries puts an increased premium on coordinating our supervisory responsibilities with our federal regulatory counterparts and foreign regulators. Nationally, Utah participates as a full partner in their supervisory reviews. Utah shares the reports of examinations. In the large bank program, Utah shares information on proposed examination and supervisory activities for the coming year and coordinate the planning and execution of those programs.

Some industrial banks tend to specialize in specific banking activities such as credit card, home mortgage, automobile, agricultural, loans secured by brokerage accounts or small business lending. This specialization has resulted in critics challenging the safety and soundness of these institutions. However, the FDIC has stated that industrial banks are no more a threat to the deposit insurance fund than commercial banks.

The supervisory approach employed by Utah and the FDIC has been described as "*Bank-Centric*". Please review the John Douglas quote within the next section dealing with Banking & Commerce for a more detailed discussion of the "*Bank-Centric*" approach. This is not a new concept when examining a bank that is part of a holding company structure. Industrial banks based in Utah have been a "laboratory" for those insured institutions owned by commercial entities. The evolving supervisory approaches of Utah and the FDIC have helped fine-tune processes and procedures that insulate an insured depository institution from potential abuses and conflicts of interest by a non-federally supervised parent. Critical controls have been developed as the result of cooperation between Utah regulators and the FDIC.

ADDITIONAL PRUDENTIAL SAFEGUARDS APPLIED TO INDUSTRIAL BANKS

While the track record of Utah industrial banks after more than twenty years of dual supervision from the state and FDIC is excellent. Utah believes that this good record of safety and soundness is in part attributable to additional prudential safeguards applied to the industrial banks operating from Utah. Supervising industrial banks is an evolving regulatory dynamic as new issues arise and new lessons are learned, I suspect we will add new requirements.

This enhanced regulatory hand is most evident in approval Orders of de novo industrial banks. 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 potential problems.

Today, all Utah industrial bank approval Orders issued by the department 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. (Note that these director independence requirements were imposed long before the 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 industrial bank 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 industrial bank, maintain direct control of the industrial bank, and retain the industrial banks independence from the parent company.

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

EXAMINE THE FACTS IN A WORST CASE SCENARIO

In this discussion and others the worst case scenario that detractors have postulated is that of a holding company filing bankruptcy or getting into financial difficulty. The reality is that Utah and the FDIC have experienced both. While no regulator relishes stressful circumstances, we can state that we weathered the storm. Utah has had large corporate parents of industrial banks encounter financial difficulties, and in one instance the ultimate parent company filed for bankruptcy protection.

The background and outcome were well described by the FDIC in the January 2005, *FDIC Banking Review, The Mixing of Banking and Commerce: Current Policy Issues*,

“The bankruptcy of the corporate owner of an ILC - Conseco Inc - but not of the ILC itself illustrates how the bank-up approach can effectively protect the insured entity without there being a BHC-like regulation of the parent organization. Conseco Inc. was originally incorporated in 1979 as Security National of Indiana Corp. After several years of raising capital, it began selling insurance in 1982. Security National of Indiana changed its name to Conseco Inc. in 1984, after its 1983 merger with Consolidated National Life Insurance Company. Conseco Inc. expanded its operations throughout the 1980s and 1990s by acquiring other insurance operations in the life, health, and property and casualty areas. Conseco Inc. was primarily an insurance company until its 1998 acquisition of Green Tree Financial Services. A diversified financial company, Green Tree Financial Services was one of the largest manufactured-housing lenders in the United States. Upon acquisition, it was renamed Conseco Finance Corporation. Included in the acquisition were two insured depository charters held by Green Tree Financial Services - a small credit-card bank chartered in South Dakota and an ILC chartered in Utah. Both of these institutions were primarily involved in

issuing and servicing private-label credit cards, although the ILC also made some home improvement loans. The ILC - Green Tree Capital Bank - was chartered in 1997 and changed its name to Conseco Bank in 1998 after the acquisition. Conseco Bank was operated profitably in every year except the year of its inception, and grew its equity capital from its initial \$10 million in 1997 to just over \$300 million in 2003. Over the same period, its assets ballooned from \$10 million to \$3 billion”.

“Conseco Bank was supervised by both the Utah Department of Financial Institutions and the FDIC. Despite the financial troubles of its parent and the parent's subsequent bankruptcy (filed on December 18, 2002), Conseco Bank's corporate firewalls and the regulatory supervision provided by Utah and the FDIC proved adequate in ensuring the bank's safety and soundness. In fact, \$323 million of the \$1.04 billion dollars received in the bankruptcy sale of Conseco Finance was in payment for the insured ILC - Conseco Bank, renamed Mill Creek Bank -which was purchased by GE Capital. As a testament to the Conseco Bank's financial health at the time of sale, the \$323 million was equal to the book value of the bank at year-end 2002. Thus, the case of Conseco serves as an example of the ability of the bank-up approach to ensure that the safety and soundness of the bank is preserved.”

In another case, TYCO, a large parent company of a Utah industrial bank called CIT Online Bank encountered financial difficulties and decided to spin the industrial bank group off in an initial public offering which was approved and completed. In spite of TYCO's financial difficulties, the Utah industrial bank continues operations today as CIT Bank.

BANKING & COMMERCE

In discussing industrial banks one often reads of the need to “*restore the traditional separation of banking and commerce*” that industrial banks exist because of a “*loophole*” in the Bank Holding Company Act.

Those that state there is and should be a separation of banking and commerce believe that this is a fundamental principle incorporated by the passage of the Glass-Steagall Act in 1933 while others believe that if there ever was a separation between banking and commerce it was eviscerated with the passage of the Gramm-Leach-Bliley Act of 1999.

The proponents of the former argument subscribe to the conclusion that great “*evils*” result when banking and commerce are mixed. That somehow these great “*evils*” are compounded by the fact that Congress left this gaping hole through an oversight and this “*loophole*” may be exploited by commercial companies that will endanger the safety and soundness of our financial services sector and the deposit insurance funds.

Utah believes that the written testimony submitted by John L. Douglas, a former General Counsel of the FDIC, before the Subcommittee on Financial Institutions and Consumer Credit in July 12, 2006, states well our views on the primary issue of mixing banking and commerce and we incorporate a part of his testimony as ours.

“These first two assertions are simply historically inaccurate, and ignore the fact that throughout our history there have long been affiliations between banks and commercial firms. Indeed many of these have been expressly blessed by Congress. We should be clear on this point. Such affiliations have always existed. Congress has chosen to limit certain of them from time to time, by the Bank Holding Company Act, the Competitive Equality Banking Act, the Federal Deposit Insurance Corporation Improvement Act and the Gramm-Leach-Bliley Act each address and bless, and regulate commercial affiliations with banks.”

He states in his footnote number 1 on the Glass-Steagall Act that,

“The Glass-Steagall Act separated to a limited degree investment and commercial banking. The separation was never absolute; indeed, it was substantially eroded by regulatory interpretations by the Federal Reserve in the 1980's and 1990's. Whatever separation remained was essentially eviscerated by the adoption of the Gramm-Leach-Bliley Act in 1999.”

Mr. Douglas also stated in footnote number 3 that,

“I will not repeat the arguments that have been presented before Congress many times in the past on the first two assertions. As to the “historic” separation of banking and commerce, I will merely note that it wasn’t until 1956 that activity restrictions were place on multi-bank holding companies and that those restrictions weren’t extended to single bank holding companies until 1970. Further, it wasn’t until 1999 that activity restrictions were imposed on unitary savings and loan holding companies. As for the “unintended loophole,” Congress has extensively considered industrial loan banks on numerous occasions, most extensively as part of the Competitive Equality Banking Act in 1987, and again as part of the Gramm-Leach-Bliley Act in 1999.”

He then goes on to address his key points which are germane for our discussion.

“Another assertion that has recently been made is that the unregulated owners of industrial banks would wreck havoc on our financial system given the lack of “comprehensive supervision” of the corporate owners of such institutions. This last proposition ignores the existing legal framework governing all financial institutions, including industrial loan banks, and ignores the substantial power and authority (and indeed belittles the capacity) of the FDIC to supervise, examine and enforce laws, rules and regulations that are intended to assure safety and soundness, as well as prevent abuses that might possibly arise from affiliations between banks and commercial affiliates.

“It is this last assertion that I particularly wish to address, that somehow the lack of comprehensive supervision poses a threat to our financial system. I make four major points in response:

“First, industrial loan banks are subject to the same comprehensive framework of supervision and examination as “normal” commercial banks. They have no special powers or authorities; they are exempt from no statute or regulation. They must abide by the requirements of: Sections 23A and B, limiting and controlling transactions with affiliates; Regulation O, governing loans to officers, directors or their related interests; capital requirements; the Prompt Corrective Action safeguards instituted by Congress in the early 1990's that assure maintenance of adequate capital and impose an ever-increasing level of supervisory control if institutions fail to do so; and all of the other laws, rules and regulations that promote safe and sound banking in this country.

“Second, the FDIC has been given full and ample authority to supervise and regulate these institutions, and can exercise the full range of enforcement authorities granted by Congress. I was a participant in the political process that led to Congress' rewrite of those provisions in 1989, as part of FIRREA, and I personally can attest to the scope of the cease and desist, removal and prohibition, civil money penalty and withdrawal of deposit insurance powers. Given the magnitude of the 1980's financial debacle and the great concerns in Congress that it never happen again, we at the FDIC at that time worked closely with members of this Committee and others in Congress with the clear intention to give the FDIC and the other bank regulators all of the supervisory and enforcement powers they would ever need to protect the banking system. We wanted to be sure that no future banking failures would be the result of a lack of FDIC authority and tools to address threats to a bank's safety-and-soundness, including threats that might arise from its nonbanking affiliates.

“Importantly, all of these enforcement powers apply with full force to an industrial loan bank, as well as to any officer, director, controlling shareholder or “any other person . . . who participates in the conduct of the affairs of an insured depository institution.” There is no question that to the extent that either the corporate owner of an industrial loan bank or any affiliate of that owner engages in any violation of law, rule or regulation applicable to the industrial loan bank, or has engaged, is engaging or is about to engage in an unsafe or unsound practice relating to the industrial loan bank, the FDIC can bring the full range of enforcement authorities to bear. These remedies can include not only requiring that impermissible or inappropriate activities cease immediately, but also requiring that the condition be remedied and restitution made. Civil money penalties up to one million dollars per day can be imposed, and individuals can be removed from their positions and precluded from having any involvement not only with the industrial loan bank but with any insured depository institution. The FDIC can also restrict the activities of the industrial loan bank or any affiliate participating in its affairs, can withdraw the deposit insurance of the industrial

loan bank and take any other action it “deems appropriate” in the event of a violation of law, rule or regulation, including in my opinion even forcing the divestiture of the industrial loan bank by its owner.

“Third, I can attest from experience that the FDIC regularly and vigorously exercises these powers. The FDIC routinely requires an independent, fully functioning board of directors designed to assure that the industrial loan bank stands on its own and is not merely an arm of its corporate owner. The industrial loan bank must have adequate capital, operate in a safe and sound fashion, avoid unsafe and unsound practices, have comprehensive policies, controls and procedures, and an effective internal audit program. The FDIC rigorously examines the institution and closely scrutinizes transactions and relationships between the industrial loan bank and its affiliates. It conditions approvals to assure compliance with carefully crafted commitments designed to assure the safe and sound operations of the industrial loan bank. It forcefully uses its enforcement powers, and is not shy about inquiring about any action, transaction or relationship that might potentially affect the insured institution.

“Fourth, the experience of the FDIC with respect to industrial loan banks, similar to the experience of the OTS with respect to diversified owners of savings associations, belies any fundamental concerns over threats to the banking system or our economy that might arise from commercial ownership. There have only been two failures of FDIC-insured industrial loan banks owned by holding companies. These holding companies were not commercial (i.e., a non-financial) enterprises. These two failures cost the FDIC roughly \$100 million. Both failed not as a result of any self dealing, conflicts of interest or impropriety by their corporate owners; rather, they failed the “old fashioned way” by poor risk diversification, imprudent lending and poor controls. These two failures stand in sharp contrast to the hundreds of bank failures that operated in holding company structures, many of which cost the FDIC billions of dollars. The list is long and sobering - Continental Illinois, First Republic, First City, MCorp, Bank of New England, and so on - all of which were subject to the much-vaunted “consolidated supervision” by the Federal Reserve as the holding company regulator that offered as cure for something that hasn’t proven to be a problem.

*“And we should be very clear about a fundamental point. **Throughout our history to now, there have always been, and federal law has always allowed, affiliations between “banking” and “commerce.”** In our modern era, these relationships have been carefully considered, and accompanied by a statutory and regulatory framework assuring that our regulatory authorities have ample power to protect against abuses and problems.*

“Moreover, both consumers and our economy have unquestionably benefitted from the hundreds of banking-commerce affiliations that have long existed, and continue to exist. Congress should consider very carefully the full implications of any change in law that could choke off these affiliations and deny our financial

system the flexibility and innovation that it always has had in the past. It would indeed be unwise to roll back the clock by taking steps to limit healthy and beneficial competition under the guise of advancing an idea that may have an attractive rhetorical resonance, but in fact is simply irrelevant to the issue at hand.”

The industrial bank experience, like the experience of credit card banks, non-bank banks and other institutions with commercial parents, shows that fears about banking and commerce are unfounded. The history of industrial banks is a testament that the regulatory model has maintained the safety and soundness of these institutions. The track record demonstrates that banks can be safely operated as parts of diversified holding companies.

HOLDING COMPANY SUPERVISION

The bank holding company model works well for companies whose principal business is limited to banking - it was devised at a time when bank holding companies were permitted to do nothing else. The existing industrial bank supervisory process works well. Utah believes it is the “*superior*” model for holding companies whose principal business may not be banking.

What has received very little coverage in the current debate is the fact that industrial bank oversight by the states and the FDIC is supplemented by holding company oversight by federal financial regulators other than the Federal Reserve. The Office of Thrift Supervision (OTS) and Securities and Exchange Commission (SEC) have regulatory oversight over many holding companies with Utah industrial bank subsidiaries.

As previously stated, the OTS has supervisory responsibilities at five Utah industrial bank holding companies whose industrial banks collectively constitute 58% of all Utah industrial bank assets. The OTS has holding company jurisdiction because of affiliated federal savings banks to the Utah industrial banks.

The SEC has Consolidated Supervisory responsibility over Goldman Sachs Bank’s holding company whose industrial bank holds approximately 7% of total Utah industrial bank assets. The SEC has dual consolidated supervision authority with the OTS over three additional Utah industrial banks in total representing 53% of Utah assets.

The Federal Reserve has holding company supervision of UBS Bank’s parent company (which holds approximately 11% of total Utah industrial bank assets) because UBS’s parent filed as a Financial Holding Company with the Federal Reserve.

The federal agency oversight listed above constitutes approximately 77% of all Utah industrial bank assets as of June 30, 2007. This is not a parallel regulatory structure when federal agencies have holding company authority over 77% of all Utah industrial bank assets.

While not included in the federal agency oversight totals above, consideration should be given to three additional Utah industrial banks: Advanta Bank with \$2.0 billion in total assets, Target Bank with \$15 million, and World Financial Capital Bank with \$177 million in total assets, all of which have sister national banks chartered by the Office of the Comptroller of the Currency (OCC).

Again, trying to keep this discussion in perspective, the entire industrial bank industry, even with its growth during the last twenty years, represents only approximately 1.8% of U. S. banking assets.

The parent companies of the vast majority of Utah industrial bank assets are engaged exclusively or predominantly in financial services activities. These include: Advanta, American Express, Merrill Lynch, Morgan Stanley and UBS. Other industrial banks are owned by diversified companies, such as General Electric and GMAC which engage in both financial and non-financial activities. Some are controlled by companies primarily engaged in commercial or industrial activities, such as BMW and Volkswagen. However, both BMW and Volkswagen have extensive banking operations in Europe.

While not subject to regulation as bank holding companies, industrial bank owners are subject to many of the same requirements as bank holding companies. As a result, safeguards already 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 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. A recent Federal Reserve clarification requested by the FDIC on the ARCUS Financial Bank application is that the holding company activities are "*complimentary to banking*" and permissible for a Financial Holding Company.

Utah law establishes, besides all other jurisdiction and enforcement authorities over industrial banks, that pursuant to Section 7-8-16 each industrial bank 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 industrial bank holding company is subject to examination and enforcement authority of the Department.

Utah struggles to understand why Congress would want to keep out well-capitalized innovative entrants to the market? While the banking system is becoming concentrated in the hands of a few large institutions with huge market power and system risk, I

understand that the five largest banks are trillion dollar entities. These entities control a third of industry assets and deposits, and a fourth of all bank branches.

SUMMARY

Utah has been successfully regulating FDIC insured industrial banks for twenty 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.

Utah's industrial banks are well capitalized, safe and sound institutions.

Utah's industrial banks are subject to the same regulations and are examined in the same manner as other banks.

Utah and FDIC examiners have adapted as the industrial banks 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 partner, the FDIC.

In this discussion, the reality check is that the entire industrial loan industry, even with its growth of the last twenty years, is only approximately 1.8% of banking assets.

31 IBs as of 6-30-07	6/30/2007 Total Assets	Federal Holding Company Supervisor	Financial or Non-financial
ADVANTA BANK CORP	2,011,368		Financial
ALLEGIANCE DIRECT BANK	45,257		Financial
AMERICAN EXPRESS CENTURION BANK	23,419,480	OTS	Financial
BMW BANK OF NORTH AMERICA	2,365,047		Non-financial
CAPMARK BANK (gmaccm)	6,616,762		Non-financial
CELTIC BANK	119,536		Financial
CIT BANK	4,065,554		Financial
ENERBANK	150,131		Non-financial
ESCROW BANK USA	33,563		Non-financial
EXANTE BANK, INC.	524,824		Financial
FIRST ELECTRONIC BANK	14,001		Non-financial
GE CAPITAL FINANCIAL INC	2,217,336	OTS	Non-financial
GMAC BANK	23,450,998		Non-financial
GOLDMAN SACHS BANK USA	15,028,045	SEC	Financial
LCA BANK CORPORATION	24,882		Financial
LEHMAN BROTHERS COMMERCIAL BANK	3,431,671	OTS/SEC	Financial
MAGNET BANK, INC.	504,147		Financial
MEDALLION BANK	323,075		Financial
MERRICK BANK	1,118,990		Financial
MERRILL LYNCH BANK USA	60,879,265	OTS/SEC	Financial
MORGAN STANLEY BANK	27,391,000	OTS/SEC	Financial
REPUBLIC BANK INC	482,419		Financial
SALLIE MAE BANK	807,283		Financial
TARGET BANK	15,321		Non-financial
THE PITNEY BOWES BANK INC	664,309		Non-financial
TRANSPORTATION ALLIANCE BK	507,002		Non-financial
UBS BANK USA	23,090,817	Federal Reserve	Financial
VOLKSWAGEN BANK USA	288,023		Non-financial
WEBBANK	22,493		Financial
WORLD FINANCIAL CAPITAL BANK	177,424		Financial
WRIGHT EXPRESS FINANCIAL SERVICES	<u>1,108,181</u>		Financial
TOTAL UTAH INDUSTRIAL BANK ASSETS	200,898,204		
percentage of total ILC assets nationwide (59 banks)	89.0%		
percentage of total insured banks/S&Ls (8,615 banks)	1.6%		

(Numbers in 000s)

<u>FDIC INSURED ILC/IBS By Year</u>	<u>Charters Operating</u>	<u>Total Assets</u>
Beginning December 31, 1986	19	474,066,764
1987	10	429,625,000
1988	13	555,030,000
1989	15	835,036,000
1990	15	1,551,042,000
1991	15	1,360,393,000
1992	15	1,001,663,000
1993	13	1,198,808,000
1994	12	1,845,190,000
1995	13	2,993,882,000
1996	13	13,489,138,000
1997	16	15,373,706,000
1998	18	17,738,307,000
1999	20	29,670,874,000
2000	23	74,576,488,000
2001	23	98,304,191,000
2002	24	103,383,111,000
2003	27	110,422,054,000
2004	29	115,044,017,000
2005	32	123,428,502,000
2006	32	186,195,692,000
June 30, 2007	31	200,898,204,000

20 "FINANCIAL"		Federal	Financial
31 IBs as of 6-30-07	6/30/2007	Holding Company	or
	Total Assets	Supervisor	Non-financial
ADVANTA BANK CORP	2,011,368		Financial
ALLEGIANCE DIRECT BANK	45,257		Financial
AMERICAN EXPRESS CENTURION B	23,419,480	OTS	Financial
CELTIC BANK	119,536		Financial
CIT BANK	4,065,554		Financial
EXANTE BANK, INC.	524,824		Financial
GOLDMAN SACHS BANK - USA	15,028,045	SEC	Financial
LCA BANK CORPORATION(1-26-06)	24,882		Financial
LEHMAN BROTHERS COMMERCIAL BANK	3,431,671	OTS/SEC	Financial
MAGNET BANK, INC.	504,147		Financial
MEDALLION BANK	323,075		Financial
MERRICK BANK	1,118,990		Financial
MERRILL LYNCH BANK USA	60,879,265	OTS/SEC	Financial
MORGAN STANLEY BANK	27,391,000	OTS/SEC	Financial
REPUBLIC BANK INC	482,419		Financial
SALLIE MAE BANK	807,283		Financial
UBS BANK USA	23,090,817	Federal Reserve	Financial
WEBBANK	22,493		Financial
WORLD FINANCIAL CAPITAL BANK	177,424		Financial
WRIGHT EXPRESS FINANCIAL SERVICES	<u>1,108,181</u>		Financial
TOTAL "FINANCIAL" INDUSTRIAL BANKS	164,575,711		
percentage of total Utah Industrial Banks (31 banks)	81.9%		
percentage of total ILC assets nationwide (59 banks)	72.9%		
percentage of total insured banks/S&Ls (8,615 banks)	1.3%		

(Numbers in 000s)

11 "NON-FINANCIAL"		Federal	Financial
31 IBs as of 6-30-2007	6/30/2007	Holding Company	or
	Total Assets	Supervisor	Non-financial
BMW BANK OF NORTH AMERICA	2,365,047		Non-financial
CAPMARK BANK (gmaccm)	6,616,762		Non-financial
ENERBANK	150,131		Non-financial
ESCROW BANK USA	33,563		Non-financial
FIRST ELECTRONIC BANK	14,001		Non-financial
GE CAPITAL FINANCIAL INC	2,217,336	OTS	Non-financial
GMAC BANK	23,450,998		Non-financial
TARGET BANK	15,321		Non-financial
THE PITNEY BOWES BANK INC	664,309		Non-financial
TRANSPORTATION ALLIANCE BK	507,002		Non-financial
VOLKSWAGEN BANK USA	<u>288,023</u>		Non-financial
TOTAL "NON-FINANCIAL" INDUSTRIAL BANKS	36,322,493		
percentage of total Utah Industrial Banks (31 banks)	18.1%		
percentage of total ILC assets nationwide (59 banks)	16.1%		
percentage of total insured banks/S&Ls (8,615 banks)	0.3%		

(Numbers in 000s)

7 UTAH INDUSTRIAL BANKS WITH OTS, FRB OR SEC HOLDING CO. SUPERVISION 31 IBs as of 6-30-07	6/30/2007 Total Assets	Federal Holding Company Supervisor	Financial or Non-financial
UBS BANK USA	23,090,817	Federal Reserve	Financial
AMERICAN EXPRESS CENTURION BANK	23,419,480	OTS	Financial
GE CAPITAL FINANCIAL INC	2,217,336	OTS	Non-financial
GOLDMAN SACHS BANK - USA	15,028,045	SEC	Financial
LEHMAN BROTHERS COMMERCIAL BANK	3,431,671	OTS/SEC	Financial
MERRILL LYNCH BANK USA	60,879,265	OTS/SEC	Financial
MORGAN STANLEY BANK	<u>27,391,000</u>	OTS/SEC	Financial
TOTAL "OTS FRB SEC" INDUSTRIAL BANKS	155,457,614		
percentage of total Utah Industrial Banks (31 banks)	77.4%		
percentage of total ILC assets nationwide (59 banks)	68.9%		
percentage of total insured banks/S&Ls (8,615 banks)	1.3%		

(Numbers in 000s)