Good morning. As always, it is a delight to attend your Convention. Thank you for extending an invitation to speak. This is a great honor for me.

THANK YOU FOR YOUR SUPPORT

First, I wish to express my thanks to each of you individually and your industry for support in passing HB 430, The Department of Financial Institutions Pay Plan, sponsored by Representative Jeff Alexander and Senator Bill Hickman during the last Legislative session. The successful passage of the bill establishes a process designed to alleviate a concern we have with retention of state bank examiners. The bill requires market comparability surveys with federal agencies to establish pay scales for our state examiners. The bill also addressed my salary level and established a formula range over other department employees that the Governor shall use.

Even though, the first market comparability survey has not been completed, the bill has already proved successful in that two examiners offered employment by the FDIC, choose not leave largely based upon our salaries being more competitive with the FDIC’s and reasoned hope for increases in the future.

Second, I want to thank your industry for taking the longer view and supporting the Department’s fee increase bill during the last legislative session. Our objective is to be responsible stewards of your funds. I would hope that the two fee decreases over that last few years before this fee increase request demonstrates our sincerity. We report quarterly to the Financial Institutions Board, of which David Poulsen of American Express Centurion Bank is a member. We report on all expenditures pursuant to Legislative appropriations. I especially want to thank Preston Jackson, who personally appeared at both committee hearings and stated that even though his bank would pay a significant increase in fees if the bill passed, he supported the bill because it kept a strong regulatory presence in Utah.
INDUSTRIAL BANK PROFILE

Utah Profile

I have passed out a summary of the June 30, 2006 call report listing total assets and applications pending of Utah industrial banks.

Application Processing

Utah has previously approved three applications that appear to be caught in the FDIC Moratorium, as extensions of those approvals Orders become necessary, we will address them.

We will continue processing the three applications accepted as complete. The industry Supervisor will write the required findings and recommendation, then the applicant will be notified in writing that the process will be suspended until the end of the FDIC Moratorium at which time, we would expect to complete an update and review of the application for an approval Order, if appropriate.

The decision to suspend is largely based upon the reality that the applicant must meet certain conditions enumerated in the approval Order to activate the charter. One of those conditions is obtaining federal deposit insurance, which is not possible during the period of the FDIC Moratorium. If the FDIC amends or indicates that deposit insurance is available to a particular applicant, the decision to suspend may be revisited.

National Profile

I thank the FDIC for the industrial bank profile that follows. Industrial banks comprise a relatively small share of the banking industry—numbering less than one percent of the total 8,790 insured depository institutions and 1.4 percent of the assets. There were 61 insured industrial banks, with 33 operating from Utah and 15 operating from California. Industrial banks also operate in Colorado, Hawaii, Indiana, Minnesota and Nevada.

The industrial bank charter has generated a significant amount of public interest in recent years as various entities have explored the feasibility and business opportunities of including an industrial bank as part of their operations.
Industrial banks are owned by a diverse group of financial and commercial firms. Of the 61 existing industrial banks, 43 are either independently owned or affiliated with a parent company whose business is primarily financial in nature. These 43 comprise approximately 90 percent of the industry's assets and deposits. The remaining 18 are associated with parent companies that can be considered non-financial. They account for approximately ten percent of industrial bank assets and deposits.

In particular, it is important to emphasize that while the industrial bank industry has grown significantly in recent years, this growth has overwhelmingly occurred in industrial banks with financial parent organizations.

Today, the assets in industrial banks are approximately $155 billion. This reflects growth from $4.2 billion in 1987. The four largest industrial banks owned by financial services firms accounted for 63 percent of this growth. Excluding these four industrial banks, all other industrial banks grew by approximately $56 billion over the period 1987 through the first quarter of 2006.

INDUSTRIAL BANK SUPERVISION AND REGULATION

More than seventy-five years ago, in the throes of the Great Depression, Congress and the bank regulators appeared to adopt the goal that all bank failures should be eliminated. To achieve that goal, they established the Federal Deposit Insurance Corporation and strict limits on bank powers. They also limited bank activities and established tighter examination policies. By discouraging banks from taking appropriate risks to fulfill their fundamental role as financial intermediaries, this well-intentioned, single minded-focus on preventing bank failures probably proved counterproductive. While failures were nearly eliminated, at least for a period of time, the cost was reduced innovation. Banks may have lost their competitive edge, as well as many of their customers.

Since then, I hope that Congress and bank regulators have come to recognize that the supervisory process must support a competitive banking industry, which takes appropriate risks in a safe and sound manner. Bank supervision works best when it helps banks identify risks. There is much discussion in supervision today about encouraging banks to develop advanced tools and techniques to manage those risks, for themselves and for their customers.
In that light, industrial banks have a good safety and soundness record. The FDIC has testified that its examination experience with industrial banks has been similar to the larger population of insured institutions, and the causes and patterns displayed by problem industrial banks have been like those of other institutions. As noted in the GAO's 2005 report on Industrial banks, "from an operations standpoint [industrial banks] do not appear to have a greater risk of failure than other types of depository institutions."

CONGRESSIONAL REVIEW OF THE INDUSTRY

On July 12, 2006, I had the honor to represent the State of Utah and testify before the Financial Institutions and Consumer Credit Subcommittee of the House Committee on Financial Services. The hearing examined the industrial bank charter, ownership, and supervision issues.

The first panel comprised the General Counsels of the Federal Reserve and FDIC, Senior Audit Manager for the GAO and me. It lasted for more than 2.5 hours. My quick summary of the panel would be that we all shared in the heat. I hope I held my own and did well in representing the State and the Department or as those of you who remember Ken Goddard in my office would tell me each time I went out the door, “Please, don’t embarrass us.” I can hope that I did not embarrass you.

The second panel consisted of representatives from the private sector including George Sutton, who did a very good job.

I will restate the main themes of my testimony in my remarks today.

NATIONAL CONFERENCE OF STATE LEGISLATURES SPEECH

On August 15, 2006, I also represented the State of Utah and testified before the Financial Services Committee of the National Conference of State Legislatures (NCSL), an association of all state legislatures. The purpose of the hearing was to review industrial banks, how they operate and are regulated. George Sutton was also there representing the industry and the General Counsel, of the Virginia Bankers Association represented the opposing view on the industry.
Again many of the same issues were discussed as in the Congressional hearing. This time, I spent more time discussing the potential ramifications of the action of a number of states that have passed laws prohibiting interstate branching of industrial banks. Again, I will restate the main themes during my remarks today.

**FDIC MORATORIUM**

On July 28, 2006, the FDIC Board unanimously voted to place a moratorium on all industrial bank de novo or change of control applications until January 31, 2007. The stated purposed according to their Press Release was that, “The FDIC put the moratorium in place to provide time to assess developments in the ILC industry, to determine if any emerging safety and soundness or policy issues exist involving ILCs, and to evaluate whether statutory, regulatory or policy changes need to be made in the oversight of these charters. The moratorium also allows the agency time to further evaluate the various issues, facts and arguments raised in connection with the ILC industry, and to assess whether statutory or regulatory changes or revised standards and procedures for ILC applications and supervision are needed to protect the deposit insurance fund.”

Pursuant to that notice on August 17, 2006, the FDIC put out twelve questions for a forty-five day public comment period.

I highly recommend that each of you take this opportunity to become personally engaged in the issues pertaining to your industry. I urge each industrial bank President to write a letter either in combination with others or individually. I believe it is critical that you state your views and counter the public misperceptions that potentially adversely affect your charter. It is my observation that you would be writing your comments for two audiences, the first, the FDIC in direct response to their request for public input and second, to Congress. So let your views be known.

**UTAH’S REGULATORY STRUCTURE & EXPERIENCE IN PARTNERSHIP WITH THE FDIC**

As a direct result of your support of the Department Fee Increase bill you will see that the department is able to maintain the quality of our regulation and supervision
of your industry. We will continue our tradition of performing safety and soundness examinations, speciality examinations and in providing quality training to our examiners.

The speciality exams that we are conducting include: trust, information technology (IT), capital markets, CRA/Compliance and holding company inspections.

Utah remains one of the very few states performing CRA/Compliance examinations. We conduct most of these examinations jointly with the FDIC.

The fee increase also allows us to hire five more examiners bringing our total number of field examiners to forty-two. While we have a cadre of experienced holding company examiners and have been conducting these inspections regularly. It is our intention to provide further training and increase their number so that they can conduct, independently, if need be, holding company inspections of all financial institution holding companies registered in Utah. We will be expanding our capacity in this area and by the end of this year you should start experiencing more holding company inspections during 2007 and beyond.

Utah is participating with the FDIC in the Large Bank Supervision Program for four industrial banks: The supervision of these large banks is coordinated by a full-time relationship manager for the State as well as the FDIC. These examiners coordinate the implementation of the supervisory plan for each bank. This plan generally involves three targeted reviews that roll-up to an annual Examination Report that is reviewed with management and the board.

A team of examiners and specialists from the state and 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. I think it is noteworthy that in June of this year, fifteen examiners from our Department completed a three week targeted review in Chicago as part of a loan review and analysis of wholly-owned subsidiaries for one of the large industrial banks. This is no longer extraordinary for the Department, we are doing this kind of examination routinely.

The large bank program allows the State and FDIC to develop a more thorough knowledge of the bank than is possible through the traditional one time periodic, discrete examination.
Utah has and will continue to defend (in partnership with the FDIC) our regulation and supervision of the industrial bank industry. The Department takes its supervisory role seriously.

SUPERVISION OF INDUSTRIAL BANK PARENT COMPANIES

What has received very little to no coverage in the current discussion about industrial banks is that there is federal agency oversight of the industrial bank parent companies comprising 90% of Utah assets. The Federal Reserve already has jurisdiction over 15% of Utah industrial bank assets. An additional 75% of Utah industrial bank assets are subject to oversight of the Office of Thrift Supervision (OTS) and the Securities and Exchange Commission (SEC).

Many other large industrial banks have Federal Savings Bank affiliates and therefore their parent companies are also subject to the jurisdiction of the OTS.

Additionally, in a Consolidated Supervised Entity (CSE) environment the holding companies of a number of securities firms are subject to the jurisdiction of the SEC.

It should be noted that the important fact of other federal agency oversight of industrial bank parents was given scant attention in the GAO’s report on industrial banks. The GAO report also did not uncover a single example of the regulatory failure, or a problem that could have been averted with a different form of holding company oversight.

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.

Handout on Seven steps to reviewing Reg. 23 A & B Compliance.

OTS Supervision of Conglomerates
Savings and loan holding companies are required to register with the OTS, submit reports about the operations of the holding company and its subsidiaries, and are subject to examination by the OTS. Examiners “have the power to make such examinations of the affairs of all affiliates of such savings associations as shall be necessary to disclose fully the relations between such savings associations and their affiliates.”

In 2003, the OTS issued a Regulatory Bulletin addressing the supervision of “large and complex enterprises” that control thrifts. It requires examiners of conglomerates that include thrifts to conduct a “comprehensive assessment from the perspective of the consolidated regulator at the parent, top-tier, organization within the conglomerate.”

In a letter to the House Committee submitted as part of the record on the Industrial Bank Congressional Hearing held on July 12, 2006, John Reich, Director of the OTS stated,

“Some have suggested that industrial bank’s and their holding companies are unregulated and the industrial bank’s in holding company structures pose potential risks arising out of the relationship, transaction and activities between the industrial bank and its parent holding company. In fact, there is a regulatory structure already in place in which a number of industrial bank holding companies are currently subject to holding company oversight.

In any instance where an industrial bank and a savings association are affiliated in a corporate structure, the holding company is a savings and loan holding company subject to regulation by the OTS. In such cases, the state is the primary regulator of the industrial bank, the FDIC is the appropriate federal banking agency for the industrial bank, and the OTS is the appropriate federal banking agency for the industrial bank holding company, as well as the affiliate savings association.

The notion that only a bank holding company framework provides rigorous holding company oversight is mistaken. The OTS has long exercised broad and effective oversight of complex holding company structures that own savings association. OTS currently supervises 481 thrift holding companies with aggregate assets of $7.5 trillion.”
SEC Consolidated Supervision

Industrial bank owners that do business in the European Union (“EU”) countries (such as the broker-dealer and investment bank owners of industrial banks), are subject to the European Union Directive for Financial Conglomerates. This requires financial services holding companies to be regulated under a supervisory framework that is the “functional equivalent” of EU consolidated supervision. (Consolidated supervision under the EU model requires review at the holding company level of internal controls, capital adequacy, intra-group transactions and risk concentration) Responding, in part, to this requirement, the U.S. SEC has proposed a rule that would allow US broker-dealers that are part of a holding company to elect to be supervised at the holding company level by the SEC. Commission supervision would include examination of unregulated holding companies and affiliates.

SEC Chairman Christopher Cox in a letter dated October 26, 2005, addressed to Rep. Royce also included in the Congressional Hearing record, answered in the affirmative to each of the following questions:

“Does the Commission’s oversight regime for CSE allow it examine the entity’s risk management, internal controls, computers systems, or other operations on an enterprise-wide basis to identify systemic risks? Can the Commission take action with respect to activities that jeopardize the financial stability of the holding company? Does the Commission’s oversight of these entities permit the Commission to examine holding company affiliates that may not have business relationships with the industrial bank affiliate? Are consolidated supervised entities subject to capital standards?”

The OTS and SEC consolidated supervision regimes for certain industrial bank holding companies further minimizes the concerns that have been expressed about the ability of industrial bank supervisors themselves to address risks that might emanate from the institutions’ holding companies or affiliates.

UTAH SUPERVISION OF INDUSTRIAL BANK HOLDING COMPANIES
Utah industrial bank owners, like the banks they control, are subject to state regulation. For example, pursuant to Section 7-8-16 of the Utah Code, owners of
industrial loan banks must register with the Department and provide statements of financial condition.

The Utah Commissioner is authorized by law to examine the books and records of financial institution holding companies, compel the furnishing of reports necessary to supervise the holding company’s bank subsidiary, and take any other action that is necessary to protect the bank, its depositors, its customers or taxpayers. The reality is that Utah should be and thanks to industry support will be taking a much closer look at all holding companies. The industry support of the Fee Increase Bill demonstrates the sincerity of the industry’s desire to support quality regulation.

**BANKING & COMMERCE**

To me, the “separation of banking and commerce” is a debatable notion, not a reality. There have always been ways for commercial interests to affiliate with banks, and the ability of regulators to prevent abuses continues to evolve and strengthen.

Conversely, as the experience of the conventional banking industry shows, the wall separating banking and commerce is elastic.

It was not that long ago that the securities and insurance industries cited separated banking and commerce before Congress as a principle to keep banks from entering those lines of business.

When Congress passed the Gramm-Leach-Bliley Act, it essentially said the previously commercial activities of securities and insurance were now financial and changed the test for bank activities from “closely related to banking” to those “of a financial nature” thereby, allowing banks to enter the securities and insurance industries.

The elasticity of the test is demonstrated by the debate over whether real-estate brokerage is a financial activity.

Federal Reserve Governor Mark W. Olson in a speech delivered on March 13, 2006 to the Institute of International Bankers in Washington, D.C. posed the question, Are Banks Still Special?
“By 1999, ... Congress (felt) that federal action was appropriate, and the Gramm-Leach-Bliley Act was passed. Congress had learned from the securities and insurance experiences of foreign banks, both the high points and the low points. . . . However, the U.S. banking industry had also developed improved ways to manage risk, and banking supervision had become more effective. In addition, the improved analytical capacity offered by new technology, better coordination among domestic and international bank supervisors, a healthy track record for U.S. banks, and the growth of consolidated home-country supervision across the world helped U.S. banks and their affiliates to further expand their commercial activities.”

“The response of Congress was essentially threefold. First, it moved the separation wall between banking and commerce to reflect what had already occurred in the marketplace: Gramm-Leach-Bliley also addressed the broader question of what types of businesses could own or affiliate with banks by allowing companies to own banking, securities, and insurance entities within a structure known as a financial holding company. Second, Congress provided a way for banks to gain new-product authority when the new products were determined to be financial in nature, incidental to banking, or complimentary to existing banking authority. Third, by clearly separating the federally insured entity--either banks or thrifts--from the newer and potentially higher-risk new-product authorities, Gramm-Leach-Bliley reaffirmed as a matter of public policy that banks continue to be regarded as special. But the act offers a clear acknowledgment that the separation of banking and commerce is not a bright line but is instead a negotiated compromise--one that will continue to move as markets change and products are refined. The guiding consideration in this compromise will be the protection of the federal deposit insurance fund.”

His conclusion to this speech was,

“But banks must also compete in the marketplace. Consequently, we can expect over time to see adjustments in both the direct activities of banks and in the line separating banking and commerce. History is, in some sense, about the drawing, re-evaluation, and re-drawing of lines. As a matter of public policy, changes will trail rather than lead the marketplace, and any changes must be informed by a careful study of both the role we want banks to play in our economy and the needs of the marketplace.”
So we are back to the question of what is the role of innovation in banking? Is banking so special that it should be protected from competition? Can laws or regulations, even when well intentioned, foil banks remaining competitive?

The bottom line is that banks must remain competitive and innovations that have historically been undertaken first by state charters be allowed to continue in order to strengthen the industry.

Let me conclude this section with a quote from former Federal Reserve Chairman Greenspan.

“A system in which banks have choices, and in regulations that result from the give and take involving more than one agency, stand a better chance of avoiding the extremes of Supervision.”


**INTERSTATE BRANCHING**

Since the 1994 passage of the Riegle-Neal Interstate Branching Act, some states have recognized the need for banks to be able to branch interstate without state restrictions. Thus far 22 states have adopted laws allowing for reciprocity whereby banks in those unfettered states may open new branches without having to buy a charter or a branch. The reciprocity provisions are to the effect that if your state allows my banks to branch de novo into your state, then I will allow your banks to branch de novo into my state. The fact that so many states saw this need allowed federal regulators to propose that all interstate branching restrictions be dropped, which is a provisions in the House version of the Financial Services Regulatory Relief Act. We all know that there is a restrictive provision in the bill adversely affecting industrial banks owned by commercial entities.

Today the federal savings bank charter can branch interstate without limit. The national bank charter has been able to take advantage of OCC rulings and may branch interstate, which leaves the state banking charter as the restricted charter.
Largely as result of a very large retail firm filing an industrial bank application, nine states have filed bills in their state legislatures that would preclude an industrial bank from branching into their state. The nine states are: Illinois, Iowa, Maryland, Michigan, Missouri, Oklahoma, Pennsylvania, Virginia, Wisconsin. I believe five of the states have passed and the Governor has signed those bills into law. They are Iowa, Oklahoma, Maryland, Missouri and Virginia.

Pursuant to an Inter-agency General Counsel letter dated July 28, 2006, the ramification of that action is that those states that had previously passed an interstate branching reciprocity provision, would not only prohibit industrial bank branches, but all bank branches as the The Riegle-Neal Interstate Banking and Branching Efficiency Act, does not allow states to differentiate between types of banks. The point is that in attempting to block an industrial bank branch they may be invalidating their reciprocity provisions for all banks. I understand that may be the case in Maryland, Oklahoma and Virginia which had previously passed reciprocity provisions.

WHAT THE PUBLIC POLICY DEBATE SHOULD BE

My statement to both Congress and the NCSL was 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 twenty years of everyday application, it has worked, in that no FDIC insured Utah industrial bank has failed.

Congress or state legislatures 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 or state legislatures 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,
“A ... 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 policymakers was then - 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.)

In the absence of a demonstrated example of regulatory failure, there is no fundamental, underlying reason for a public policy change.