INTERVIEW BY BOB O'CONNOR
WITH
CATHY GHIGLIERI
FORMER TEXAS BANKING COMMISSIONER

NASFA hired Ms. Ghiglieri to analyze State Farm Bank. She is the former Texas Banking Commissioner and is currently the President of Ghiglieri & Company, a bank consulting firm in Austin, Texas that she founded in 1999. Ms. Ghiglieri spent 25 years as a bank regulator, including 18 years at the Office of the Comptroller of the Currency, the regulator of federally chartered national banks and federal thrifts. She is co-founder of The Bank Directors' College and co-author of *The Ultimate Guide for Bank Directors.* You can read more about her at www.ghiglieri.com .

Q. NASFA asked you to analyze State Farm Bank. How did you go about doing that since State Farm, the parent, is not a public company?

A. Even though State Farm is not a public company and no SEC 10K information is available, private banks can still be analyzed using Thrift Financial Reports ("TFRs"). These are quarterly reports submitted by federal and state-chartered savings and loan associations and savings banks, also called "thrifts," to the Office of Thrift Supervision ("OTS"). The OTS has just merged into a federal bank regulator called the Office of the Comptroller of the Currency ("OCC"), which was required under the Dodd-Frank Act. TFRs consist of balance sheet and income and expense information. Peer group information is also available for comparison purposes.

Q. What is the difference between a thrift and a bank?

A. The thrift charter was originally designed to promote home ownership and the focus for thrifts was historically on mortgage lending. Banks were able to offer a wider array of lending services with no requirement to have a certain percentage of their loan portfolio be in mortgage loans. Today, there are few differences between banks and thrifts, although the focus for thrifts remains on mortgage lending. Thrifts must meet what is called a Qualified Thrift Lender Test, which requires that 65% of the loan portfolio must consist of mortgages and consumer-related or small business loans. They can also make a small number of commercial loans.

Q. Why did State Farm form a bank and why did they decide on the thrift charter and not a bank charter?

A. To answer this question, it is important to understand the regulatory framework pertaining to banks that was in effect at the time State Farm Bank was chartered. State Farm Bank was chartered in early 1999 and at this time, the restrictions of Glass-Steagall Act were just being repealed. This law separated commercial banking from investment banking and was passed in response to the stock market crash of 1929. Also in 1999, the Bank Holding Company Act restricted the merger of banking and commerce activities. The restrictions of the Glass-Steagall Act and the Bank Holding Company Act were removed with the passage of Gramm-Leach-Bliley Act ("GLB") in late 1999, which allowed the merger of banking, insurance and securities activities. But prior to late 1999, banking activities were very restrictive in nature.

Thrift activities, on the other hand, were very expansive in nature. Prior to GLB, unitary thrift charters, or a holding company owning only one thrift, could engage in any legitimate business activities, as long as these activities were not a safety and soundness risk to the thrift. Banks could only engage in business activities that were closely associated to banking. Federal thrifts could also branch nationwide. Banks could not. Federal preemption allowed federal thrifts to operate under federal rules rather than having to comply with different state statutes, thereby making a nationwide branching system efficient.

Many commercial firms, such as State Farm, Travelers, Allstate and Merrill Lynch, obtained thrift charters because the charter allowed them to offer banking products to an already established market through an already established distribution channel. This was appealing to securities and insurance firms, which could not own banks because of the Glass-Steagall Act and the Bank Holding Company Act restrictions.

Q. Why can State Farm Bank call itself a "bank" if it is a thrift?

A. Since the 1980's when the image of the savings and loan industry was tarnished, thrifts have been allowed to call themselves "banks." However, there is a designation after the name to identify them as thrifts. For example, State Farm Bank "FSB" means "Federal Savings Bank," which is another kind of thrift.

In the United States, we have a dual banking system, which means that organizers of a bank or thrift can choose a federal or state charter. Federally-chartered banks are chartered by the OCC and are called "national banks." They must have the word "national" in their names or "NA" after their names. "NA" stands for "national association." Some examples of national banks are Bank of America NA and First National Bank of Chicago. State banks are chartered by state banking commissioners and have to follow naming rules of the individual states. In many states, there is no "state" designation required.

The dual system for thrifts has similar characteristics. As noted above, federal savings banks have "FSB" after their names to indicate they are federally chartered by the OCC. State savings banks have "SSB" after their names to indicate they are chartered by the individual state authorities.

Q. How does State Farm Bank differ from other banks?

A. State Farm Bank has no branches but instead relies on its insurance branch network to generate deposits and loans.

Q. What is the condition of State Farm Bank?

A. The overall condition of State Farm Bank is improving, especially compared to the last three years. The bank's condition has suffered because of asset quality problems, particularly in credit cards, home equity lines of credit and auto loans. The bank was unprofitable from 2007 through 2010 but has generated a small profit as of year-to-date June 30, 2011. The bank was able to maintain capital at "well-capitalized" levels set by the regulators because of $700 million in capital injections by the parent, State Farm.

Q. The full analysis of State Farm Bank is available to our members at the link below: