

Testimony at State Farm Oral Arguments at the Office of Thrift Supervision, U.S. Department of the Treasury, Central Region Office, Chicago, Illinois, June 3, 1998

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The Woodstock Institute is a 25 year-old non-profit that promotes access to safe and sound capital and credit in lower-income and minority communities. The Institute engages its mission through applied research, public education and technical assistance. The Institute performed some of the initial studies of redlining in the early 1970s, promoted the passage of the Home Mortgage Disclosure Act and the Community Reinvestment Act, and has worked since for their effective implementation. I am also speaking as a Board member of the National Community Reinvestment Coalition which has over 600 member organizations committed to community reinvestment and to the proper implementation of the CRA. I would add that I could take our visitors to any number of neighborhoods in Chicago where new infill single- unit housing, rehabbed apartment buildings, revitalized retail strips, and active industry exist because of the CRA..

I welcome this occasion to argue that the OTS should not accept the current application of the State Farm Mutual Automobile Company for permission to organize a de novo federal savings bank:

The State Farm application is one of several such applications that will establish a critical precedent for the terms under which insurance companies enter the banking business; and yet that application, in our opinion, seriously violates the letter and intent of the CRA and its regulations.

As you know, on March 5 of this year, the OTS ruled Woodstock Institute's protest of the proposed merger "substantial" as it did that of my colleagues here today, and suggested that the Company and the community groups enter into discussions about the substance of the protests. That happened in one meeting in Washington and several exchanges of letters. We fully acknowledge State Farm's willingness to enter into those discussions. Those discussions, however, while adding some detail to State Farm's intentions did not, in our view, significantly address the substance of our initial arguments.

The most serious problem in the State Farm application is, in our view, the proposed delineation of the new bank's CRA assessment area. The CRA asserts that regulated financial institutions have a continuing and affirmative obligation to meet the credit needs of their communities including low- and moderate-income areas. It further provides that those institutions establish a service area to delineate the communities in which they have that obligation.

It is clear from the State Farm application that after some initial testing of products, they will “roll-out” the proposed FSB to three states, Illinois, Missouri, and Arizona. It is also clear that they intend to offer SBA backed small business loans in New York and New Jersey. After a few years, the Company intends to offer its banking services nationwide.

I would add that the names of these five states were not contained in the information provided to community groups when they first requested copies of the State Farm application. We obtained those names only later when we protested their absence from the information we had been given. We do not see how community groups can fully comment on the CRA intentions of a new bank without that vital information, and would request that OTS, in future, provide it as a matter of course.

So initially, the proposed FSB will operate in five states, with the rest of the nation to follow quickly. And yet the State Farm application describes the proposed FSB’s assessment area to be the Bloomington-Normal MSA in Central Illinois, and no other area. That designation makes no sense and can only be justified by the most capricious reading of the statute and its regulations.

We note all the bank regulators efforts to recognize changing realities in the banking industry by stretching interpretations of the statute and the regulations. This is done in the name of promoting “bank modernization.” And yet when the needs and convenience of the average household are at stake, it appears that even a reasonable, common sense and indeed common language application of the current law in the light of contemporary realities is too much to ask.

State Farm says that it will conduct its banking business through its insurance agents, and presumably through telephone transactions for those customers who are recruited through regional and national advertising. It adds that because of this “wholesale” delivery system it will have a lower cost structure than the traditional savings institution, giving it flexibility to price products and services in a competitive manner. It says explicitly that it does not intend to operate any retail branches. The use of the word wholesale is misleading. The proposed FSB will have a physical presence in the communities in which it operates namely its insurance agents and their offices. So, for example, in the city of Chicago, the telephone book lists 124 non-duplicative addresses and numbers for State Farm agents.

State Farm is reinventing the notion of a branch by using existing insurance agents. Of course, it does not call them branches because under former banking practice they were not. But under this proposed banking practice they are clearly akin to a branch: they are where you come or where you call to do that banking business you choose not to do through an ATM. But the new practices are not just about the location of the agents’ offices. State Farm talks about direct access to customers through advertising. This is yet another reinvention of a bank presence, namely an electronic presence which is the way those customers will be in touch with their bank. The notion of a traditional branch and the notion of traditional presence have been changed through the use of insurance

agents and through the use of technology. There are, of course, other examples of this reinvention as in Internet banks.

How then should the CRA assessment area be applied. Note first that if the OTS approves this application it will be de facto approving the use of insurance agents as bank staff. I'm not sure that is specifically permitted in any current banking regulation. But the OTS if it so acted, would presumably be acting in light of "contemporary realities." Why should "contemporary realities" be applied to the use of insurance agents as bank staff and not to their location and their offices as bank branches or premises?

But consider again the electronic bank which this proposed FSB will, in part, become. The new reality is that banks will increasingly do significant business in communities in which they have no traditional physical presence. (There is plenty of evidence, incidentally from data about small business lending and the distribution of checking accounts that this reality is not in the interests of low- and moderate-income households.) Hence brick and mortar are no longer the only manifestation of a bank presence. The new manifestation of a bank presence is merely the existence of a bank customer recruited and served through and other than through a bank presence but still himself or herself located in the physical reality of a community. Let us admit that a bank presence would exist for CRA purposes not everywhere there was a single customer, but where there was a significant group of customers. This last logic is fully in accord with the State Farm business plan which describes a geographically progressive roll-out. You build a base of customers and move on.

Now the new CRA regulations, recent though they are, were not terribly prescient. They require that the assessment area consist of geographies in which the savings associations have their main offices, branches and deposit taking ATMs; i.e. where they do business. They did not, in fact, foresee the even immediate future of banking. To pretend that the State Farm presence is only the area around their headquarters is a massive falsehood, constructed only to permit State Farm to avoid its responsibilities under the law.

I would add that the Regulation goes on to say that the assessment area include the geographies in which the savings association has originated or purchased a substantial portion of its loans. The most literal interpretation of this sub-section would embrace MSAs wherever they were located where the proposed FSB did such a portion of its loans.

I urge the OTS to recognize the reality of the State Farm proposed delivery system, the irrelevance of where its only brick and mortar building is located, and reject this application because of the entirely inadequate and, I would venture, illegal assessment area.

My colleagues have raised a number of additional points and I would like to touch on just one more raised in our letter of March 26, 1998. Bank staff person in the past only sold bank products. Those were all the products staff had to offer. So if they were operating in lower-income communities they were offering at least some bank products to low- and

moderate-income individuals. But the State Farm proposed FSB will operate through people whose current mission is the sale of insurance products. They could easily offer those products to low- and moderate-income people without offering bank products. In that case the FSB would not be serving low- and moderate income people or low- and moderate income communities and would hence be in violation of the CRA. State Farm could have offered in its application clear directives and incentives for insurance agents to so offer bank products. In the parts of the plan we have been permitted to see there are no such directives or incentives. Absent those guidelines, State Farm has no systematic way of ensuring the FSB's compliance with the CRA mandate that a regulated financial institution serve all of its community including low- and moderate-income geographies. We submit that the application should be so modified.