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State Farm Insurance Company: The Unitary Thrift Holding Company Model for Integrated Financial Services

At the end of 2001, nearly 17,000 insurance agents made Bloomington, Illinois-based State Farm Mutual Automobile Insurance Company (State Farm) the country's largest insurer of homes and automobiles. These agents generated $25.6 billion in earned automobile premiums that year, insuring one out of every five cars in the United States. From 1939 until recently, however, State Farm agents have referred insurance customers seeking loans or a place to deposit funds to partner banks. State Farm and other insurance companies view an existing policyholder base as an opportunity to offer loans and other financial services products. Doing so would provide the insurance company with an additional source of revenue and simultaneously encourage or facilitate one-stop shopping for its policyholders. Consequently, by the end of 2001, nine of the top ten property-casualty insurers had developed financial services products.

The Office of Thrift Supervision (OTS) approved State Farm's application for permission to organize and acquire State Farm Financial Services, F.S.B. (State Farm Bank) on November

3. STATE FARM MUTUAL AUTO. INS. CO., supra note 1, at 26.
5. Veronica Agosta, State Farm to Cut Loan Tie to N.J.'s Valley National, AM. BANKER, Dec. 6, 2000, at 6. This loan-referral process took place through State Farm's Car Finance Program, in which agents would receive a fee for taking loan applications and forwarding them to one of State Farm's lending partners. Steve Cocheo, Like a new neighbor State Farm Bank is here, A.B.A. BANKING J. ONLINE (Sept. 1, 1999), 1999 WL 10893193. Approximately 165,000 loans were made through the Car Finance Program each year. Id.
As previously alluded to, the fact that the company was watching potential business slip away every time an agent had to refer a policyholder seeking an auto or home loan to a partner bank was likely a motivating factor in State Farm's decision to establish a thrift.\(^7\) Also, competitive pressures stemming from the recent integration of the banking and insurance industries required State Farm to form a thrift in order to prevent its customers from flocking to institutions that could provide both insurance and financial services products.\(^8\) Although the company's decision to make the thrift branchless created transactional problems, it has thus far allowed the thrift to avoid certain Community Reinvestment Act (CRA) requirements.\(^9\)

The overall purpose of this Note is to trace and analyze the evolution of State Farm Bank in light of the legal and competitive obstacles present at the time of its formation. Part I of this Note will examine the banking and insurance industries as well as the legal landscape at the time State Farm applied for the thrift and discuss how the state of the industry at that time served as a motivating factor in the company's decision to enter into the financial services arena.\(^10\) Part II of this Note will provide an introduction to State Farm's thrift and discuss the advantages and disadvantages that flow from a unitary thrift charter.\(^11\) Part III will examine State Farm's decision to establish a branchless bank in light of the CRA.\(^12\) Part IV will analyze the relationship between State Farm and its thrift subsidiary and examine specific issues that arise in large part merely because of the enormous size of the holding company.\(^13\)


\(^8\) See Agosta, supra note 5, at 6.

\(^9\) See infra notes 15-56 and accompanying text.

\(^10\) See infra notes 83-140 and accompanying text.

\(^11\) See infra notes 15-56 and accompanying text.

\(^12\) See infra notes 57-82 and accompanying text.

\(^13\) See infra notes 83-140 and accompanying text.

\(^14\) See infra notes 141-158 and accompanying text.
I. THE GRAMM-LEACH-BLILEY ACT AND THE INFUX OF INSURERS INTO THE BANKING WORLD

A. Insurers Feared Legislation Would Forbid Them From Establishing a Thrift

Creating the ability to retain business that flows from its policyholders' needs for auto and home mortgage loans did not appear to be the only motivation for State Farm to establish its thrift.\(^{15}\) At the same time State Farm applied to the OTS for a thrift acquisition, many insurance companies were doing the same in an attempt to take advantage of laws which allowed non-banking companies to own a single thrift as a unitary thrift holding company.\(^{16}\) In addition to State Farm, The Hartford Group, MetLife, Nationwide, Sun America, and others applied for thrift charters in 1997 and 1998.\(^{17}\) In May of 1997, only fourteen insurance companies owned thrifts,\(^{18}\) but from the beginning of 1997 until June 30, 2000, the OTS was inundated with thrift applications from forty-five insurance companies.\(^{19}\) This rush of insurance companies into the banking sector is attributed in large part to the fear that: 1) Congress would soon enact legislation prohibiting the formation of a unitary thrift holding company in this manner,\(^{20}\) and 2) such legislation would give banks entering the insurance industry an unfair competitive advantage over insurers.\(^{21}\)

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15. See infra notes 20-21 and accompanying text.
21. Faucette, supra note 19, at 640-41. Insurers alleged that this unfair
B. Banks Qualify as Financial Holding Companies and Enter the Insurance Industry

Under the Bank Holding Company Act\textsuperscript{22} (BHCA), a bank holding company (BHC), which is defined as "any company which has control over any bank or over any company that is or becomes a bank holding company,"\textsuperscript{23} may only engage in non-banking activities if they are "closely related to banking."\textsuperscript{24} The Code of Federal Regulations specifically lists seven types of insurance agency and underwriting activities that are deemed to be "closely related to banking;"\textsuperscript{25} however, the general sale and underwriting of property and casualty insurance is not included. In addition to a grandfather provision, the "closely related to banking" insurance activities listed in the Code of Federal Regulations are essentially limited to the insuring of extensions of credit by the BHC, and the supervision on behalf of insurance underwriters of retail insurance agents who sell insurance on the real and personal property used in the operations of the BHC, or who sell group insurance protecting employees of the BHC.\textsuperscript{26}

However, the Gramm-Leach-Bliley Act (GLBA), which was signed into law by President Clinton on November 12, 1999,\textsuperscript{27} now allows a parent company that qualifies as a financial holding company (FHC) to own an affiliate that both sells and underwrites insurance.\textsuperscript{28} In order to qualify as an FHC, a BHC must be well-managed, well-capitalized, and have received at least a competitive advantage would arise both because federal deposit insurance provides banks with a lower cost of capital and insurance underwriting is capital intensive, and because tax considerations and regulatory restrictions make it easier to deploy this capital downstream to a subsidiary. \textit{Id.}

\textsuperscript{23} \textit{Id.} § 1841(a)(1).
\textsuperscript{24} \textit{Id.} § 1843(c)(8).
\textsuperscript{25} \textit{See} List of permissible non-banking activities, 12 C.F.R. § 225.28(b)(11) (2002).
\textsuperscript{26} \textit{See id.} An exception exists that allows a BHC to engage in any insurance agency activity in a place with a population not greater than 5,000 in which the BHC has a lending office. \textit{Id.} § 225.28(b)(11)(iii)(A).
\textsuperscript{27} Faucette, supra note 19, at 629.
“satisfactory” CRA rating for all of its depository institution subsidiaries. The BHC must then declare that it wishes to engage in activities not permissible for a BHC and certify that it meets the above requirements in order to become an FHC. Once established as an FHC, the company is free to engage in any activity that is financial in nature. Insurance sales and underwriting are statutorily defined as financial in nature. Both CitiGroup in its acquisition of Travelers Insurance and Charles Schwab in its acquisition of U.S. Trust Corp. elected to become financial holding companies pursuant to this authority.

C. The Effect of GLBA on the Insurance Industry

GLBA closed the opportunity for commercial entities to own a unitary thrift, but grandfathered all unitary thrift holding companies that existed (such as State Farm), or had applications pending, on or before May 4, 1999. However, the fear of insurers that they would no longer be able to enter into the banking world was never realized. Although GLBA closed the ability of commercial entities to establish themselves as a unitary thrift holding company, it still allows an insurance company to acquire bank subsidiaries by first establishing itself as a financial holding company (FHC). Furthermore, the statute expressly states that “insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of

29. See 12 U.S.C. § 1843(l); see infra notes 98-107 and accompanying text.
31. Dunham Jr. et al., supra note 17, at 393.
34. 12 U.S.C §1467a(c)(9) (2000). This is the provision that prevented Wal-Mart from establishing a thrift and from offering banking operations in its stores. Jerry W. Markham, Banking Regulation: Its History and Future, 4 N.C. BANKING INST. 221, 263-64 (2000).
36. See id. § 1467a(c)(9).
37. See id. § 1467a(c)(9)(A), § 1843(k).
the foregoing, in any State" are activities considered to be financial in nature. Thus, insurance sellers and underwriters can continue to acquire bank subsidiaries as long as all the other activities of the insurance holding company are financial, not commercial, in nature. Notwithstanding the fact that they must now register as FHCs, the major significance of GLBA with respect to insurance companies is the fact that it has created the potential for increased competition by providing an avenue for banks to enter into the insurance industry.

D. Banks in the Insurance Industry Have Competitive Advantages Over Insurers That Require Insurers to Respond by Offering Financial Services Products

Once a BHC qualifies as an FHC, it has many advantages over traditional insurance agencies in the sale of insurance products. For example, surveys have shown that banks are both physically and psychologically closer to customers than are insurance agents. Accordingly, these customers have greater trust for their banks. Assertions have been made that numerous bank-branch locations have more frequent contact with customers than insurance agents. State Farm, with well over 16,000 agents nationwide, is likely one of few insurance companies that can claim that its agents' offices are as physically close to customers as bank branches are. Bank of America, for example, has just 4,500 branches nationwide. Although in today's world of ATMs and Internet shopping, one can question the importance of contact with customers, it is true that the structure of State Farm Bank provides little agent-client contact once an account has been

38. Id. § 1843(k)(4)(B).
39. See id. § 1843(k); see also id. § 1467a(c)(9)(A).
40. Faucette, supra note 19, at 648.
42. Id. at 138.
43. Id.
44. Id.
established.\textsuperscript{46} However, since the majority of State Farm Bank customers are insured by the company when they open an account with or receive a loan from the thrift,\textsuperscript{47} the agent and the customer may have already established a trusting relationship.

Banks might also have an advantage in the insurance arena because banking products, as opposed to insurance products, are the starting point of customer needs.\textsuperscript{48} For example, a customer will first seek a mortgage loan at a bank, but will subsequently need homeowners' insurance, a product that an FHC can now offer.\textsuperscript{49} In other words, since the bank is a requisite first stop in purchasing a home or a car, if it now offers to insure that purchase, customers have no need to go to an unaffiliated insurance agency. By acquiring thrifts and offering loans, insurance companies are clearly attempting to combat this disadvantage so they can also be viewed by consumers as the initial stop.

In sum, the legislation passed in 1999 and the subsequent ability of the banking sector to enter the insurance industry motivated insurance companies such as State Farm to enter the thrift industry for purposes other than merely to attract banking business from existing customers.\textsuperscript{50} Acquiring a thrift was a necessary protective measure for insurance companies in order to prevent current policyholders from taking their insurance to a subsidiary of the bank where that policyholder receives his or her financial services products.\textsuperscript{51}

A survey of State Farm policyholders indicated that 68% wanted State Farm to offer banking services.\textsuperscript{52} State Farm Bank's original business plan foresaw the bank operating in just three

\textsuperscript{46} See infra notes 85-94 and accompanying text.
\textsuperscript{47} See Lee Ann Gjertsen, Core Hurting, State Farm's Banking, AM. BANKER, Mar. 14, 2002, at 1, 10 (stating that as of March, 2002, 93-95% of State Farm Bank's customers were existing State Farm policyholders).
\textsuperscript{48} See White, supra note 41, at 138.
\textsuperscript{49} See id.
\textsuperscript{50} See supra notes 165-49 and accompanying text.
\textsuperscript{51} See Faucette, supra note 19, at 649.
\textsuperscript{52} State Farm Opens Bank in Kansas, BEST'S INS. NEWS, Sep. 7, 2001, 2001 WL 24724811. A survey conducted by a New York research firm revealed that while 45% of consumers surveyed had no concerns about consolidating their financial accounts to one institution, only 18% worried that the institution might fail. Jeremy Quittner, Insurers Look to Policyholders as Bank Customers, AM. BANKER, Oct. 16, 2001, at 10A.
states after its first three years. Instead, it was servicing customers in forty-eight states in two and a half years. State Farm sped up the bank's rollout partially because of increased competitive pressures as more financial institutions were entering the insurance industry. "It's kind of an offensive and a defensive," State Farm Bank President and Chief Executive Officer (CEO) Stan Ommen said.

II. STATE FARM BANK, A UNITARY THRIFT SUBSIDIARY OF STATE FARM INSURANCE

A. State Farm Bank's Chronology and Structure

After waiting approximately fourteen months for approval from the OTS, State Farm Bank started operating in May of 1999 in Central Illinois and St. Louis. In March of 2000, it began Internet operations. In 2001, State Farm cancelled its referral alliance with all nine of its banking partners. By the beginning of 2002, the company had approximately 14,000 agents trained and selling bank products in each of the forty-eight states in which it operates. By the end of 2002, State Farm Bank had over $4.5

53. Gjertsen, supra note 47, at 1.
54. Id.
55. Id. at 10.
56. Id.
59. Id.
61. Gjertsen, supra note 47, at 1. The original business plan called for State Farm Bank to be operating in only three states by mid-2002. See id. State Farm agents offer banking products such as savings and checking accounts, car loans, home mortgage and equity loans, a State Farm credit card, an ATM card, certificates of deposit (CDs) and money market accounts. Quittner, supra note 52, at 13A. The credit card is a VISA® card. See State Farm Insurance, Credit Cards, at http://www.statefarm.com/bank/credit.htm (last visited Feb. 15, 2003).
billion in assets,62 a large increase from the $1.3 billion in assets at the end of 2001.63

Agents’ offices are not, however, established as bank branches, so when a customer wishes to purchase a financial services product from an agent, the agent refers the customer to a central processing office.64 For every successful referral, an agent receives a commission.65 Customers can access their accounts via either the Internet or telephone.66

B. The Necessity of Meeting the Qualified Thrift Lender Test

By establishing itself as a unitary thrift holding company, State Farm is free from any restrictions on its non-banking or non-financial activities and may continue to underwrite and sell all types of insurance.67 With respect to the activities of the subsidiary itself, however, a federal thrift charter such as State Farm’s is more restrictive than a bank charter because of the limitations on the investment and lending powers of federal thrifts.68 A unitary thrift subsidiary is required by the Home Owners’ Loan Act (HOLA)69 to meet the qualified thrift lender (QTL) test.70 In order to meet this test, State Farm Bank’s qualified thrift investments, which are defined to include mortgage and home equity loans, as well as

62. Kathy McKinney, State Farm battled losses; Insurer made cuts as income dropped, PANTAGRAPH (Bloomington, IL), Jan. 1, 2003, 2003 WL 5339744 [hereinafter McKinney, State Farm battled losses]. This $4.5 billion in assets places State Farm Bank among the top 5% of all banks based on net asset size. Kathy McKinney, Lending a hand; Vice president looks to make products more accessible, PANTAGRAPH (Bloomington, IL), Dec. 30, 2002, 2002 WL 5110584 [hereinafter McKinney, Lending a hand].

63. See STATE FARM MUTUAL AUTO. INS. CO., supra note 1, at 29.

64. See David Reich-Hale, State Farm Hopes Banking Clients Are There, AM. BANKER, Oct. 20, 2000 at 1, 3.

65. See Gjertsen, supra note 47, at 10. State Farm does not expect its agents to completely support their income based on bank products; the compensation scheme for these bank products is designed to merely support the income agents receive through the sale of insurance products. See id.

66. Quittner, supra note 52, at 10A.

67. See Dunham, Jr. et al., supra note 17, at 388.


70. Id. § 1467a(m).
loans made through credit cards,71 must equal or exceed 65% of its portfolio assets on a monthly average basis in nine out of every twelve months.72 Auto loans are not mentioned in the definition of "qualified thrift investments," and the statute specifically excludes any investment not mentioned in this definition.73

If any unitary thrift subsidiary of an insurer were to fail the QTL test, in order to keep its thrift, the insurer would be required to register as a bank holding company (BHC) within one year and would be subject to the resulting restrictions on its activities.74 Since a BHC cannot underwrite insurance, the insurer would be practically forced to sell the thrift so that it would not have to stop selling insurance.75 Since, as previously mentioned, State Farm is the nation's leading insurer of automobiles, one could assume that the QTL test is a concern for the company.76 Presumably, if State Farm Bank feared that its qualified thrift investments would fall below this 65% mark, it could sell its automobile loans, thereby increasing the percentage of home mortgage, equity, and credit card loans that constitute its assets.

There is, however, a potential change relating to the QTL test that would be a huge benefit to State Farm.77 Section 208 of H.R. 3951, The Financial Services Regulatory Relief Act of 2002, would redefine "qualified thrift investments" to include automobile loans for QTL test purposes.78 If such a provision were to become law, State Farm could meet the 65% threshold

71. Id. § 1467a(m)(4)(C).
72. Id. § 1467a(m)(1)(B).
73. Id. § 1467a(m)(4)(C).
74. Id. § 1467a(m)(3)(C). These activities are listed under the Bank Holding Company Act of 1956. Id. §§ 1841-1850.
75. Dunham Jr. et al., supra note 17, at 389.
76. See Agosta, supra note 5, at 6 (stating that "auto lending is contingent upon strong auto sales").
78. Id. Democrats on the House Financial Services subcommittee unsuccessfully attempted to strike down this provision in May. Michelle Heller, Regulatory Relief Bill Clears House Subcommittee, AM. BANKER, May 9, 2002, at 3. Republicans on the subcommittee justified the provision on the grounds that it is necessary to "enhance the lending power of thrifts in uncertain economic times." Id. (quoting Rep. Eric Cantor, R-Va.).
established by the QTL test by taking into account home mortgage, home equity, credit card, and automobile loans, as opposed to having automobile loans count against this threshold.\textsuperscript{79} The bill, sponsored by Shelley Moore Capito, a Republican from West Virginia, passed the House Financial Services Committee in June 2002.\textsuperscript{80} However, the House did not vote on the bill in 2002 because it stalled as a result of differences over another provision.\textsuperscript{81} There was no companion bill introduced in the Senate, but Republicans in both the House and the Senate have indicated that regulatory relief measures will be pursued, and a similar bill is likely to be re-introduced during the 108th Congress.\textsuperscript{82}

III. STATE FARM BANK'S BUSINESS MODEL: A NATIONWIDE BRANCHLESS BANK

A. The Advantages and Disadvantages of Operating a Branchless Bank

Had State Farm wished to establish nationwide branches either at agents' offices or in separate buildings, it likely would have had little problem doing so. Since 1992, thrifts that meet the QTL test have had the ability to establish nationwide branching,\textsuperscript{83} and the OTS has granted many requests from thrifts to open branches in multiple states.\textsuperscript{84} State Farm's decision not to establish thrift branches has created practical problems.\textsuperscript{85} Agents cannot underwrite loans or accept deposits; instead, customers must mail loan applications to a central processing office,\textsuperscript{86} and must either

\textsuperscript{79} See 12 U.S.C. §§ 1467a(m)(4)(C), 14767a(m)(1)(B); H.R. 3951.
\textsuperscript{82} See id.
\textsuperscript{84} Id.
\textsuperscript{85} See Reich-Hale, supra note 64, at 3.
\textsuperscript{86} Harrison, supra note 57, at 13.
mail, direct deposit, or wire transfer any deposit. It is surely reasonable for a customer to fear the loss of a check in the mail or to prefer that deposits be credited much quicker than the two or three days it would take via mail. The limitation on the ability to make deposits led State Farm Bank President and CEO Stan Ommen to admit that the bank’s structure makes it difficult to offer certain types of accounts, such as small business accounts in which credit for deposits is desired quickly.

In early 2001, State Farm established a loan processing center in the St. Louis suburb of Creve Coeur, Missouri to avoid having to outsource loan processing. The loan center was also, at least in part, another consequence of the decision to open a branchless thrift. The center serves as a support mechanism for agents who need help explaining loan products. One could also argue that a system in which a centralized staff receives all loan applications and makes all decisions at one location is more efficient than a decentralized system in which employees at geographically dispersed branches make decisions on loan applications because supervision in the former system would be much less complicated.

Additionally, customers have difficulty in withdrawing funds as a result of State Farm’s decision not to open nationwide branches. Instead of establishing its own system of ATMs, State Farm decided to participate in other ATM networks and to reimburse customers up to $1.50 for the first five ATM transactions per month at other institutions’ ATMs. But, if a surcharge exceeds $1.50 or if the customer makes more than five transactions in one month, he or she is responsible for the difference between the amount State Farm agrees to cover and the actual surcharges the customer pays. Apparently, the company

87. Reich-Hale, supra note 64, at 3.
88. See id.
90. See id. at 9.
91. Id. at 1.
92. See Reich-Hale, supra note 64, at 3.
93. See id.
94. See id.
must have determined that this system was less expensive and more convenient to customers than creating its own nationwide system.

However, there may be a less apparent reason why State Farm decided not to establish branches or its own ATMs.95 Undoubtedly, one advantage of not establishing branches is the cost savings that would otherwise be required to build, open and manage the branches. Also, because its headquarters are located in Bloomington, Illinois, and it did not create branches in all forty-eight states in which State Farm agents are located, State Farm Bank’s CRA96 assessment area is solely the Bloomington-Normal (Illinois) Metropolitan Statistical Area (MSA).97

The purpose of the CRA is to help meet the credit needs of low- and moderate-income neighborhoods, while at the same time maintaining safe and sound lending practices.98 The Act “requires the OTS to assess a saving association’s record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods.”99 The OTS then assigns each savings association one of four ratings: “outstanding,” “satisfactory,” “needs to improve,” or “substantial noncompliance.”100 Of the 1,244 institutions evaluated between July of 1997 and June of 2000, only fifty-three (4%) received a rating below “satisfactory.”101 As part of its evaluation, the OTS also conducts a lending test,102 an investment test,103 and a service

95. See infra notes 108-112 and accompanying text.
99. Id.
100. 12 C.F.R. § 563e.28(a).
102. 12 C.F.R. § 563e.22 (2002).
103. Id. § 563e.23.
test on large institutions and gives a rating for each test of either “outstanding,” “high satisfactory,” “low satisfactory,” “needs to improve,” or “substantial noncompliance.” By making it impossible for an institution to receive a “satisfactory” overall rating if it receives a “needs to improve” or “substantial noncompliance” rating in the lending test, the CRA implies that lending is the primary means by which a savings association can meet its community’s lending needs. In determining a lending test rating, the OTS will evaluate an institution’s lending performance by considering, among other things, the number and amount of loans made in the assessment area, the income level of borrowers, and the “use of innovative or flexible lending practices to address the credit needs of low- or moderate-income individuals or geographies in a safe and sound manner.”

Under the CRA, the assessment area must consist of one or more MSAs “or one or more contiguous political subdivisions, such as counties, cities, or towns, in which the savings association has its main office, branches, and deposit-taking ATMs.” The CRA requirement that a financial institution be directly involved in lending to low- and moderate-income level areas “can impose substantial costs” and “may result in the inefficient use of resources.” Furthermore, lending to low- and moderate-income level households poses a greater risk of default by the borrower. Thus, one can see why a national thrift such as State Farm would want to limit its assessment area. Since State Farm Bank has no branches or deposit-taking ATMs, and its main office is in McLean County, Illinois, its assessment area is comprised of McLean

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104. Id. § 563e.24.
105. See Office of Thrift Supervision, supra note 98.
107. Id. at 37,604.
109. See id. § 563e.11(b).
110. Christopher A. Richardson, The Community Reinvestment Act and the Economics of Regulatory Policy, 29 Fordham Urb. L.J. 1607, 1624 (2002), WL 29 FDMULJ 1607. A major factor that leads to these increased costs is the higher information costs necessary to assess risk in low- and moderate-income areas. See id. at 1614.
County, which the U.S. Census Bureau estimated that as of July 1, 2001, had a population of 151,878.

B. The Results of State Farm Bank’s First Community Reinvestment Act Examination

State Farm Bank’s first CRA examination took place in February of 2000, when the bank had assets of only $161 million and only State Farm agents in Illinois and Missouri were performing lending operations and deposit services. The bank received a satisfactory overall rating in this examination. The bank received a “low satisfactory” ranking in each of the lending, investment, and service tests. With respect to the lending test, the OTS implied that although the bank’s lending ratio to low- and moderate-income borrowers was reasonable and about average, the low satisfactory rating was a result of the low percentage of mortgage loans. This occurred because the bank’s mortgage lending operation was in the start-up mode. The OTS stated that the bank’s 15% of loans in low- and moderate-income areas was “marginally acceptable.” Furthermore, the OTS implied that the “low satisfactory” rating in the service test was a result of there being no traditional branch network. A second examination was scheduled for September 2002.

111. Office of Thrift Supervision, supra note 97, at 5.
113. Office of Thrift Supervision, supra note 97, at 4.
114. Id. at 2.
115. Id. at 7, 13.
116. See id. at 7.
117. Id.
118. Id. at 10.
119. Id. at 13-14.
Even at the time of the first CRA examination, when it was operating in only two states,\textsuperscript{121} 79\% of the bank's mortgage lending activity occurred outside of its CRA assessment area.\textsuperscript{122} In the first CRA examination, only for performance context purposes,\textsuperscript{123} the OTS did an analysis of consumer and mortgage loan lending activity outside the assessment area\textsuperscript{124} because it realized that a large percentage of the bank's loans would occur outside its assessment area.\textsuperscript{125} It found the bank's consumer lending activity in low- and moderate-income areas to be relatively low and attributed it to the fact that the bank had a very high consumer lending volume at the time.\textsuperscript{126} The OTS also noted that State Farm's insurance agents are located in middle- to upper-income areas, making it difficult for the bank to generate consumer loan volume in low-income areas.\textsuperscript{127} However, the OTS found that the combined approximately 43\% of consumer loans to low- and moderate-income individuals outside the assessment area was considered good.\textsuperscript{128} The OTS also stated that the 22\% of total loans going to low- and moderate-income areas was reasonable,\textsuperscript{129} and the 39\% of mortgage loans going to low- and moderate-income individuals outside the assessment area was "relatively strong."\textsuperscript{130}

C. Potential Change in the CRA Examination Process

The Department of the Treasury is not completely content with the OTS's assessment of non-traditional thrifts,\textsuperscript{131} such as

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\textsuperscript{121} Office of Thrift Supervision, supra note 97, at 2.
\textsuperscript{122} See id. at 4.
\textsuperscript{123} See id. at 9.
\textsuperscript{124} See infra notes 131-135 and accompanying text.
\textsuperscript{125} See Office of Thrift Supervision, supra note 97, at 12.
\textsuperscript{126} See id. at 10.
\textsuperscript{127} Id.
\textsuperscript{128} Id. at 12.
\textsuperscript{129} Id. at 9.
\textsuperscript{130} Id. at 11.
\textsuperscript{131} The Department of the Treasury defined non-traditional thrifts as "those thrifts that have their primary office in one local community but conduct their business in a broader, regional, or national area. They may not even have typical branch offices." Office of Inspector General, supra note 101, at 26.
\end{flushleft}
State Farm Bank, many of whom by definition do all or a large portion of their business via the Internet, particularly in areas outside their traditional (or designated) assessment areas. The Department of the Treasury had two primary complaints. First, inconsistency in procedure was demonstrated in a sample taken by the Department of the Treasury in which the OTS evaluated only half of the non-traditional thrifts outside their respective designated assessment areas. Second, the OTS gave additional favorable consideration to a strong lending record in low- and moderate-income areas outside a thrift's designated assessment area, but did not give unfavorable consideration for a weak lending record in those areas. Therefore, at the end of 2001 the Department of Treasury recommended that the OTS give examiners further guidance with respect to examining non-traditional thrifts.

D. Public Relations and Moral Obligations

The Department of the Treasury is not the only one concerned with low- and moderate-income lending by non-traditional thrifts such as State Farm Bank. Five community organizations filed protests against State Farm's application for a charter. These protests were probably a direct result of the fact that State Farm's low- and moderate-income lending would not be supervised in the vast majority of communities in which it operates. At the time of chartering, State Farm committed to originate $195 million in loans to low- and moderate-income

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132. See id. at 27-28.
133. Id. at 28.
134. Id.
135. Id.
136. Id. In its 2002 review of the CRA regulations, the Federal Financial Institutions Examination Council (FFIEC) is focusing on, among other things, the assessment area examination problems caused by non-traditional thrifts. Letter from Ellen Siedman, Director, Office of Thrift Supervision, to Benny W. Lee, Regional Inspector General for Audit, U.S. Department of Treasury, (Nov. 28, 2001), reprinted in Office of the Inspector General, supra note 101 app. 3, at 41.
borrowers during its first three years in what was initially planned to be just three rollout states. After this period, the bank originally agreed to an annual goal of CRA-related loan activities in an amount equal to either 5% of assets or the amount of deposits the bank generates from low- and moderate-income individuals, whichever is greater.

Although now that the thrift has over $4.5 billion in assets, and this $195 million promise has surely been exceeded anyway, one could assume that these initial agreements were made at least partially because of State Farm's desire to avoid a public relations nightmare in which the media and community organizations accuse the "Good Neighbor" of attempting to avoid community obligations. State Farm is clearly attempting to balance its interest in making the low-risk loans it desires against its legal obligations to meet CRA standards and moral obligations to the communities in which its agents operate.

IV. ADVANTAGES AND DISADVANTAGES RESULTING FROM STATE FARM BEING THE COUNTRY'S LARGEST HOME AND AUTO INSURER

The size of State Farm's agency force may have been a primary factor behind the OTS's decision to require State Farm Bank to hire a full-time compliance officer. The OTS rarely makes such a requirement a necessary condition for an insurance company to charter a federal thrift. For example, the OTS did not even require an insurer as large as Allstate to meet this condition when approving its application to obtain a thrift.

138. Office of Thrift Supervision, supra note 97, at 5.
139. Id. This means that for 2002, State Farm would attempt to put $225 million into CRA related loan activities. See McKinney, State Farm battled losses, supra note 62 (stating that State Farm Bank had $4.5 billion in assets at the end of 2002).
140. See supra note 62 and accompanying text.
141. See Office of Thrift Supervision, supra note 7, at 2-3.
143. Allstate is the nation's number two auto and home insurer. Tammy Williamson, Insurers now looking to cover banking needs: State Farm plans to have service in all states this year, CHICAGO SUN TIMES, May 14, 2001, 2001 WL 7230690.
Thirty days before beginning operations, State Farm was required to present the OTS with a program for training and monitoring agents to assure that the agents did not violate anti-tying restrictions. State Farm and State Farm Bank must comply with the anti-tying restrictions of 12 U.S.C. §§ 1464(q) and 1467a(n). These provisions prevent State Farm or any other institution from "tying" by prohibiting the sale of insurance to be contingent upon the purchase of a loan, or vice versa.

The pure size of State Farm provides its bank with advantages as well. With so many agents and existing customers, even if only a small percentage of existing insurance customers acquire banking products, the bank will still be able to build a large amount of assets. Also, in 2001, State Farm suffered a $5.6 billion underwriting loss from the company's auto insurance business and a $3.7 billion underwriting loss from its homeowners' business. The net loss from all sources in 2001 was $5.0 billion, and through the first nine months of 2002 the company had operating losses of $4.9 billion. The overall net worth of State Farm and its subsidiaries dropped by $5.7 billion, or 13%, in 2001. These losses were at least one factor in State Farm's decision in early to mid-2002 to stop writing homeowners insurance in over seventeen states and limit new policies in six others. However, the bank has not appeared to have suffered any consequences as a result of its parent company's poor

(last visited Feb. 15, 2003).

145. Office of Thrift Supervision, supra note 7. Nowhere in Allstate's approval order was it stated that Allstate would have to present the OTS with a similar monitoring plan. See Office of Thrift Supervision, supra note 144.
146. Office of Thrift Supervision, supra note 7.
147. See Williamson, supra note 143.
148. See Gjertsen, supra note 47, at 10.
149. Id.
150. STATE FARM MUTUAL AUTO. INS. CO., supra note 1, at 27-28. The homeowners insurance losses were primarily attributable not to the September 11 terrorist attacks but to unusually high claims from storms and claims from Texas killer mold. Gjertsen, supra note 47, at 10.
151. STATE FARM MUTUAL AUTO. INS. CO., supra note 1, at 26. This loss compares with a net gain of $400 million in 2000. Id.
152. McKinney, supra note 62.
153. See STATE FARM MUTUAL AUTO. INS. CO., supra note 1, at 26.
performance in 2001.\textsuperscript{155} State Farm Bank President and CEO Stan Ommen said the losses will not force the company to pull back expenditures made towards its thrift,\textsuperscript{156} and it is likely that State Farm had already committed money to the bank before incurring its losses in 2001.\textsuperscript{157} In fact, the diversification that comes along with entering a new field of products and services may help offset insurance underwriting losses like those incurred by State Farm last year.\textsuperscript{158}

V. CONCLUSION

State Farm Bank, a branchless thrift acquired by the largest auto and homeowners’ insurer in the country, is in only its fourth year of operation.\textsuperscript{159} Yet, in this short time it has become a $4.5 billion institution offering banking products such as home mortgage and equity loans, automobile loans, checking and savings accounts, and credit cards to customers in every state in which its parent company has insurance agents.\textsuperscript{160} State Farm entered the banking industry at the same time as most of the country’s other large insurance companies.\textsuperscript{161} This invasion was most likely a result of the fear that future legislation would prevent insurers from owning thrifts, and, at the same time, would allow banks to enter into the insurance industry and attempt to steal policyholders away from insurance companies and towards institutions that could simultaneously provide its customers with both his or her insurance and financial services needs.\textsuperscript{162}

Although many insurers established thrifts, State Farm’s size and its decision to establish a branchless bank created unique opportunities, (such as the ability to become a nationwide thrift so quickly), as well as dilemmas for its thrift.\textsuperscript{163} The difficulty of

\textsuperscript{155} See Gjertsen, supra note 47, at 10.
\textsuperscript{156} Id.
\textsuperscript{157} Id.
\textsuperscript{158} Id.
\textsuperscript{159} See supra notes 57-61 and accompanying text.
\textsuperscript{160} See supra notes 61-66 and accompanying text.
\textsuperscript{161} See supra notes 16-19 and accompanying text.
\textsuperscript{162} See supra notes 20-21 and accompanying text.
\textsuperscript{163} See supra notes 141-158 and accompanying text.
depositing and withdrawing funds may turn some potential customers away from establishing a checking or savings account, thus limiting the thrift's customer base.\textsuperscript{164} However, State Farm apparently decided that these problems are outweighed by the costs of not having to build and maintain branches and the administrative and financial advantages of avoiding nationwide CRA regulations.\textsuperscript{165} Because of the size of its holding company, State Farm Bank in particular will be a good test case in determining whether a primarily Internet bank without brick and mortar branches can be effective and efficient.

Potential changes to current legislation and supervisory procedures, if they come into fruition, could prove to be both beneficial and detrimental to State Farm Bank.\textsuperscript{166} A provision included in a regulatory relief bill that should be re-introduced to Congress could eliminate the QTL test as a concern for State Farm Bank.\textsuperscript{167} On the other hand, growing governmental and societal discontent towards, and an examination into, the current format for determining the CRA assessment area could result in State Farm Bank being forced to meet minimum lending requirements with respect to low- and moderate-income level households in an enormously broader area than is currently required.\textsuperscript{168} If these examinations and societal pressures do lead to such CRA changes, it is possible that the decision not to establish branches may have caused more trouble than it was worth.

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\textsuperscript{164} See supra notes 85-94 and accompanying text.
\textsuperscript{165} See supra notes 95-136 and accompanying text.
\textsuperscript{166} See supra notes 77-82 and 131-136 and accompanying text.
\textsuperscript{167} See supra notes 77-82 and accompanying text.
\textsuperscript{168} See supra notes 131-139 and accompanying text.