

IN FOCUS

Next Fed Applicant? List Could Be Long One

Why auto, insurance firms may follow Goldman footsteps

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By [Steven Sloan](#)

WASHINGTON — What was a move of desperation for Goldman Sachs Group Inc. and Morgan Stanley could become a strategy for a broad array of institutions hoping to weather the economic turmoil.

With liquidity at a premium and confidence in corporate America dwindling, insurance companies, automakers, and small investment houses could apply to the Federal Reserve Board to become bank holding companies, observers said.

The status would provide several advantages, including access to more stable funding through the discount window and — in a kind of reverse regulatory arbitrage — a perception of stronger oversight from the Fed, which could soothe anxious investors.

"Reputationally, the advantages of becoming a bank have increased in the past few weeks," said Georges Ugeux, the chairman and chief executive of Galileo Global Advisors LLC, a small New York investment firm. "Becoming a bank and being regulated by the Fed is certainly now a better place."

At the end of last year the Fed supervised 459 bank holding companies with assets of more than \$1 billion. (The central bank said it oversaw 4,611 bank holding companies with less than \$1 billion.)

The most likely converts include insurance companies. Some, such as State Farm Insurance Co. and Allstate Insurance Co., already own thrifts, clearing the first hurdle for forming a bank holding company: owning a depository institution. But until now they have avoided Fed oversight and have been subject to regulation from the Office of Thrift Supervision.

"They could easily convert," said Marc Franson, a partner in the banking department of Chapman & Cutler LLP in Chicago. "They are the next logical step. ... They're the other arm of financial services."

Observers said that since the Gramm-Leach-Bliley Act of 1999 eliminated barriers between banking, insurance, and securities firms, conversion to a bank holding company would be relatively straightforward for an insurance company.

"When you look at Gramm-Leach-Bliley, it allowed the convergence of financial services and insurance activities," Mr. Franson said. "You wouldn't have to go to Congress. The legal framework is already there. ... It's sort of seeing it come to fruition."

Another much talked about, though more complicated, sector for potential converts is the auto industry. Automakers have been smarting for years under the weight of expensive pension plans, pricier supplies, and foreign competition. The credit crunch has dried up liquidity for car loans, further denting demand for some products.

Some observers said the automakers could argue that the credit crunch is justification for a status change.

"If you look at what's going on with GM, Ford, and Chrysler, they would argue that the problem is credit with buyers," said Steve Dunlevie, a partner at Womble Carlyle Sandridge & Rice PLLC in Atlanta. "The

real impetus is to gain access, immediate access, to the traditional discount window, whereby they could borrow and use the same collateral as banks."

Mr. Ugeux of Galileo Global Advisors said automakers should at least consider becoming bank holding companies.

"It's clear that the amount of financing happening at the moment outside the regulated world is shrinking," he said. "Whether its GMAC or Ford Credit, they are going to have to look at what is their best incarnation for the future."

Some sources have indicated a change in the largest automakers' status could come in weeks. But so far automakers remain mum about such a plan.

Toni Simonetti, a spokeswoman for GMAC Financial Services, said her company, which already owns an industrial loan company, is not planning to seek bank holding company status. But she acknowledged it is looking for liquidity anywhere it can get it. The company is "certainly looking for a variety of ways to fund our business."

Some sources said even holding company status would be unlikely to solve the auto industry's fundamental problem.

"The problems in those industries are not related to lending, where becoming a bank holding company would be perceived by the market as a cure," Mr. Welge said. "They have a lot of long-term liabilities, but those liabilities weren't incurred. They're not the type of things banking regulation would help."

Another question mark is whether General Electric Co. should consider a conversion. It reported a third-quarter earnings decline Friday as a result of decreased income from GE Capital, its financial arm.

"GE Capital has always told the world it is doing banking without the regulatory model," Mr. Ugeux said. "That might not work for their long term future."

On Friday, GE said its finance unit "is not immune from the current environment," but in the third quarter it "continued to outperform our financial services peers."

Bert Ely, an independent analyst in Alexandria, Va., said GE might consider splitting off GE Capital and turning it into a financial holding company, a distinction for institutions with the best capital and management. "But this is where you run into the bugaboo of mixing banking and commerce."

Still, if the Fed opened the door to new institutions, it could become harder to determine where the banking system — and the risk inherent in it — begins and ends.

"Everything is theoretically on the table," Mr. Ely said. "You could finance the whole damn economy through the Fed, if you want."

Other investment banks are already following the lead of Goldman Sachs and Morgan Stanley.

Raymond James Financial Inc., a small investment bank, confirmed last month that it would convert its thrift holding company to a bank holding company, though it said the decision was made before the financial crisis toppled Wall Street.

Observers say other small investment firms are sure to follow suit, now that their larger brethren have essentially declared the investment banking model — with its trade-off of high risks and huge profits — unworkable.

"To the extent your business is heavily depending on trading and the evaluation of trading with you, the more likely you'll see advantages in the perceived discipline" of bank holding companies, said Robert Davis, the American Bankers Association's executive vice president for government relations.

Observers differed on how willing the remaining investment firms would be to convert. The smaller ones may not feel the same pressure as Goldman Sachs, Morgan Stanley, and Merrill Lynch & Co. Inc., which sold itself to Bank of America Corp.

"For big investment banks like Goldman and Morgan Stanley, being regulated by the Fed makes a lot of sense," said Peter Heyward, a partner at Venable LLP. "It builds confidence. Other, smaller investment banks may not feel the same need to get that."

Moreover, Mr. Heyward said, commercial and investment banks have become increasingly similar in recent years. Traditional banks "can engage in all kinds of securities activities."

John Welge, a partner at Bryan Cave LLP in St. Louis, said that leaves investment banks with just the downside of commercial banking. "What they lose is the high-risk, high-reward business, because they're now more regulated and have various ratios to comply with," he said.

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