Approved February 16, 1987
Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE.

The meeting was called to order by Sen. Neil H. Arasmith at
Chairperson

9:00 a.m./~~p.m.~~ on February 13, 1987 in room 529-S of the Capitol.

All members were present except:

Senators Gannon and Burke - Excused

Committee staff present:

Bill Wolff, Legislative Research
Myrta Anderson, Legislative Research
Bill Edds, Revisor of Statutes

Conferees appearing before the committee:

Jim Walter, Kansas Securities Commissioner
Steve Wassom, Kansas Securities Commissioner

The minutes of February 12 were approved.

The chairman called on Roger Walter of the Kansas Securities Commissioner's office to present two amendments on SB 66 which had not been ready at the time of the hearing. They deal with section (b) concerning registration of rates for registered offerings and section (d) concerning the retaining of language for the adoption of regulations for cheap stock. (See Attachment I.)

Sen. Kerr asked what effect the fee charge would have on the revenue. Steve Wassom of the Securities Commissioner's office said that he had analyzed the impact of the proposed rates. The impact on debt and equity securities is neutral. For mutual funds, there would be an increase of approximately $48,000. If this is projected through the end of this year, it would be $75,000. He continued that the rate structure has changed, and they have made an effort to simplify it by reducing from four rates to one rate. A renewal fee of $100 will be added for mutual funds. If you apply the rates to this current year, the overall impact is $150,000. He concluded that their objective was not to increase the revenue but to simplify the rates to put Kansas in line with other states.

Sen. Karr said this information was helpful but that more is needed. The chairman was in agreement and asked Mr. Wassom to submit some written information on this.

Sen. Werts asked what section of the law currently provides guidance for amending, extending, or exempting. Mr. Wassom said for amending the only current law is section (g) of 1259, and paragraph three under section (b) replaces that. Sen. Werts asked further how much time it takes for applications for exemption. Mr. Wassom said it depends on what kind it is, but the most routine take one half to one hour.

The chairman asked the Commissioner, Doug Mays, what his office planned to do with the extra money. Mr. Mays said it goes back to the general fund. Sen. Kerr explained further that only 20% goes to the general fund, and then sometimes it is recommended to lower the fees.

Attention was turned to SB 72 dealing with branch banking. Staff distributed the information as was requested on action taken by the economic development commission this summer, giving the committee an idea of the information they were dealing with at that time. (See Attachments II and III.)

The chairman told the committee there were several options they could take: (1) to do nothing, (2) to forget branching and go back to existing law, and expand it to two bank towns, (3) to limit it to countywide branching, or (4) to adopt the bill as written. The chairman passed out copies of letters he had received concerning branching from the FDIC and Charles Moyer of The First National Bank of Phillipsburg. (See Attachment IV.)

Sen. Karr mentioned the possibility of interstate banking. Sen. Kerr said this was

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

discussed by the task force but not in the form of a recommendation. The task force was presented very convincing evidence that there is a trend even in small communities to gain access to bigger markets. There may be cause to study interstate banking, but there is no recommendation for it in Kansas.

Sen. Kerr said he looks at this present bill as an extender of bank life of our small communities. He used the example of Coats, Kansas, where they could have had a bank now if this bill were in effect. The chairman said that he was concerned that should the concept of this bill be adopted, the acquisition of failing banks may stop because banks would rather buy a healthy bank. Sen. Werts said he feels failed banks will not be overlooked any more than they are now. If a well-managed bank were going to acquire a failed bank, it would buy only the good assets; the FDIC would take the bad debts so this bill would not affect the failed banks one way or another.

Sen. Strick expressed his concern that the acquiring bank would not have to hold it for two years as in SB 432 which leaves the possibility of a town being left without a bank if the acquiring bank decided to leave soon after the acquisition.

The chairman asked Sen. Werts if the banking industry has slowed down in the use of multibanking for acquisition. Sen. Werts said it is not accurate to say it has slowed down, but it did not explode into multibank acquisitions as had been speculated. A discussion of how many multibank holding companies are in existence now followed. Staff said there are fewer than sixty banks in holding companies and that the majority of multibank holding companies have only two banks.

Sen. Werts asked to responded to Sen. Strick's concern about the requirement of a purchasing bank to hold the acquired bank for two years. Sen. Werts said the residents of a community could buy the bank and operate it. Sen. Strick said that under SB 72 he thought the community could not buy the bank. Sen. Werts said there is nothing to prevent them from buying and operating the bank. The chairman pointed out that SB 72 does repeal all of the provisions of SB 432, and he doesn't know where that leaves the commissioner for establishing branches and dealing with failed banks. Sen. Gordon spoke of some towns in his district with failed banks and his concern of the effect of branches opening. Sen. Werts responded that the FDIC makes different deals with acquiring banks over which the state has no control.

Sen. Karr asked Sen. Kerr if any work was done by the task force on countywide branch banking. Sen. Kerr said not much. The feeling of the task force was that there wasn't any point of creating artificial barriers of that type. This has been done for some time, and perhaps that was worked to our detrement. He had a study that showed that 30% of banks that have less than 25 million dollars in assets are in trouble so he feels it behooves the legislature to allow the most buyers possible rather than limiting it.

The chairman noted that the committee needs to look at the bill with the point of view of, is the situation that much different as it was a few years ago? He told the committee to be ready for motions at the meeting on Monday, February 16.

Sen. Kerr wanted to point out to the committee why the task force got involved in this as a question of economic development as some have questioned this as an area that should have been considered by the task force. He said that in his mind this does concern economic development. Banks figure very predominantly in creating venture capital, but the bankers do not have the options they need because of limitations. He distributed copies of two pages from a study done by the Stanford Research Committee showing branch banking is a positive factor in economic development. (See Attachment V.)

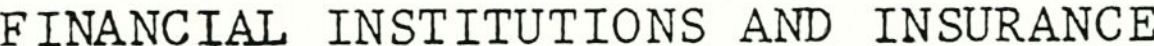
The chairman said that prior to next Monday he hopes to visit with the Senate leadership and asked Sen. Karr to visit with the minority leadership. He also plans to visit with the Governor's office as to what their position is on branch banking.

Sen. Reilly commented that the letter to the chairman from Mr. Moyer is excellent and has valid points. He asked the chairman to convey his feeling to Mr. Moyer.

The meeting was adjourned.

SENATE COMMITTEE

ON



FINANCIAL INSTITUTIONS AND INSURANCE

OBSERVERS
(Please print)

DATE	NAME	ADDRESS	REPRESENTING
2/13/87	STEVE WASSOM	TOPEKA, KS.	KS. SECURITIES COMM.
"	Doug Mays	"	" " "
"	Roger N. Walter	TOPEKA, KS	KS. SECURITIES COMM.
"	Pete McGill	"	KIBA
"	LINDA McGILL	"	"
"	FRANK WILLIAMS	"	SE&L
	M. Hcavan	"	Cap-Journal
"	Sue Armstrong	"	Kansas Banking Dept.
"	Jim Maag	"	KBA
"	[illegible]	"	KBA
"	Gary Shomer	Wichita, Ks	French Financial Corp.
"	Jim McBride	Topeka	observer
"	Joel Wright	Topeka	KCUL
	Herb [illegible]	Topeka	Kansas Bankers Assoc.
	Chuck Stones	Topeka	KS Bankers Assoc
	Lynn VanAalst	Topeka	KLSI

SENATE BILL No. 66

By Legislative Commission on Kansas Economic Development

1-23

AN ACT concerning securities; relating to certain expenses; deposit of securities in escrow; amending K.S.A. 17-1259 and repealing the existing section.

Be it enacted by the Legislature of the State of Kansas:

Section 1. K.S.A. 17-1259 is hereby amended to read as follows: 17-1259. (a) When securities are registered by notification or by coordination or by qualification, they may be offered and sold ~~by-the-issuer,-any-other-person-on-whose-behalf they-are-registered~~ by a registered agent of the issuer or by any registered broker-dealer. Every registration shall remain effective ~~until-revoked-by-the-commissioner~~ for one year after its effective date unless the commissioner by rule or order extends the period of effectiveness or until terminated upon request of the registrant with the consent of the commissioner. No registration is effective while a stop order is in effect under K.S.A. 17-1260, and amendments thereto. So long as a registration remains effective, all outstanding securities of the same class shall be considered to be registered for the purpose of any nonissuer distribution. A registration statement relating to a security issued by a face-amount certificate company or a redeemable security issued by an open-end management company or unit investment trust, as those terms are defined in the invest-

ment company act of 1940, may be amended after its effective date so as to increase the securities specified therein as proposed to be offered. The commissioner may permit the omission of any document or item of information from any registration statement. ~~So long as the registration statement remains effective the registrant shall file reports semiannually for securities registered-by-qualification-and-annually-for-securities-registered by notification or coordination and such reports shall include-a-balance-sheet-and-a-profit-and-loss-statement-for-the issuer's-most-recent-fiscal-year-and-such-other-information-as the-commissioner-may-require.~~ Upon completion of a registered offering a registrant shall file a final report of sales.

(b) (1) Every person filing a registration statement shall pay a ~~filing-fee-computed-upon-the-aggregate-offering-price-of the-securities-sought-to-be-registered.--The-fee-shall-be-.1%-of the-amount-registered-up-to-$200,000,-plus-.05%-of-that-portion of-the-amount-registered-which-is-in-excess-of-$200,000-and-which does not exceed $300,000, plus .025% of that portion of the amount-registered-which-is-in-excess-of-$300,000-and-which-does not-exceed-$500,000,-plus-.0125%-of-that-portion-of-the-amount registered-which-is-in-excess-of-$500,000,-except-that-in-no-case shall-the-fee-be-less-than-$100-nor-more-than-$2,000-for-each such-registration-statement.--The-commissioner-may-prescribe-a maximum-amount-of-securities-to-be-registered-at-any-one-time-by a face-amount certificate company or an open-end management company-or-until-investment-trust,-as-those-terms-are-defined-in the-investment-company-act-of-1940~~ fee of .05% of the maximum

aggregate offering price at which the securities are to be offered in this state, but not less than $100 or more than $1500 for each year of effectiveness. If a registration statement is ~~denied or~~ voluntarily withdrawn prior to ~~the offering of any securities in this state,~~ being examined by the staff of the commissioner, the commissioner may refund 50% of the fee so paid.

(2) Every person filing an application to amend or extend an effective registration statement shall pay a fee of $100. If an application to amend increases the maximum aggregate offering price of securities to be offered in this state, an additional fee shall be paid based upon the increase in such price calculated in accordance with the rate and annual minimum and maximum fees specified in paragraph (1) of this section.

(3) The commissioner may by rule and regulation set a fee not to exceed $100 for an application or filing made in connection with any exemption from securities registration.

(c) The commissioner at the time of the granting of the authorization to sell securities as herein provided, may determine and fix the maximum amount~~,-which-shall-not-exceed-15%,~~ that may be paid as or in the way of commission, advertising expenses and all other expenses from the sale of such securities~~,-but-any profit-resulting-from-a-rise-in-the-market-value-of-securities subsequent-to-their-purchase-by-the-sale-of-securities~~.

(d) (1) Before any authorization to sell securities shall be issued by the commissioner as herein provided, all stock or securities of any kind issued, or to be issued~~in payment of~~

~~property,-patents,-formulae,-goodwill,-promotion-or-intangible assets-shall-be-deposited-by-the-person-to-whom-they-are-to-be issued or by the company or promoter issuing them, with the commissioner,-or-a-depository-approved-by-the-commissioner-in this-or-any-other-state,-to-be-held-in-escrow.--The-owners-of such-securities-shall-not-be-entitled-to-withdraw-such-securities from-escrow-until-the-company-shall-show-to-the-satisfaction-of the commissioner that it has had sufficient earnings, after taxes, to pay a dividend or dividends to all stockholders aggregating-at-least-6%,-but-such-dividend-or-dividends-need-not actually be paid. If such dividend or dividends have not actually-been-paid,-the-evidence-submitted-to-the-commissioner, to-show-that-the-company-has-had-such-sufficient-earnings,-shall be-in-permanent-documentary-form-or-transcribed-oral-testimony, or-both,-and-such-documents-and-transcribed-testimony-shall-be retained-as-part-of-the-permanent-files-of-the-commissioner.-Such earnings-shall-not-include-gains-from-sale-of-capital-assets-or the-sale-of-depreciable-property-or-real-or-personal-property used-in-trade-or-business-and-in-case-of-dissolution-or-insol- vency during the time such securities are held in escrow the owners-of-such-securities-shall-not-participate-in-the-assets until-after-the-owners-of-all-other-securities-shall-have-been paid-in-full.--No-assignment-or-transfer-of-such-securities-shall be-made-unless,-upon-application-therefor,-the-commissioner-shall find-that-such-assignment-or-transfer-would-be-in-keeping-with the-purpose-of-this-act-except-this-subsection-(d)(1)-shall-not apply-to-securities-entitled-to-registration-by-notification.--It~~

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~~shall be unlawful for any person in whose name any of the securities-deposited-in-escrow-were-issued;-to-sell;-contract-to sell;-or-offer-to-sell;-any-of-the-securities-until-after-they are-released-from-escrow.~~

~~(2)--Whenever-it-is-determined-that-a-security-which-has been-escrowed-with-the-Kansas-securities-commissioner;-pursuant to-subsection-(d)(1)-of-this-section-for-three-consecutive-years after voluntary dissolution or revocation of the corporate charter; the Kansas securities commissioner may destroy such stock.--The-securities-commissioner-shall-maintain-a-permanent record-of-all-stock-destroyed.--Such-record-shall-include:--(A) Name of issuer; (B) stock certificate number; (C) number of shares-represented-by-the-certificate;-(D)-name-of-the-owner-of the-stock-certificate;-and-(E)-CUSIP-number-if-applicable.~~ for consideration less than the public offering price or for consideration other than cash may be required to be deposited in escrow according to such conditions as the commissioner shall by rule and regulation provide.

(e) The commissioner shall keep a register showing the issuer, date of registration, amount in number of dollars, of the securities registered.

(f) Neither the commissioner nor any employee of the securities department shall be interested as an officer, director, or stockholder in securing any authorization to sell securities under the provisions of this act.

(g) ~~For application for an exemption; pursuant to subsection-(m)-of-K.S.A.-17-1261;-and-amendments-thereto;-or-for~~

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~~application-for-an-amendment-to-a-registration,-there-shall-be paid-to-the-commissioner-a-registration-fee-of-$10.--A-reregistration-shall-not-be-considered-to-be-an-amendment-of-a-registration-under-this-section.~~ Upon termination of a registration the filing of a final report as required by section (a) shall satisfy the filing requirements of K.S.A. 17-1261(m)(3), and amendments thereto.

Sec. 2. K.S.A. 17-1259 is hereby repealed.

Sec. 3. This act shall take effect and be in force from and after its publication in the statute book.

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must be able to react to global economic changes with Wall Street's ease and speed.

WORKING CAPITAL FINANCING

The Commission charged the Task Force to make bold recommendations. In no area of the Task Force's analysis and recommendations has the need for boldness been more clear than in the regulation of intrastate and interstate banking.

Intrastate Banking Regulation

Need and Mission

Status. Kansas bank statutes and regulations restricting intrastate banking limit the ability of Kansas banks to attract capital into the state and meet the rapidly changing needs of the Kansas economy.

Banks live on the spread between the cost of money and the income from loans and investments. The median size of Kansas' 616 banks is $17 million. For 1985, 168 banks had less than $10 million in deposits and an aggregate negative net income of $2.6 million. There are 353 one-bank towns in Kansas. Current statutes make it very difficult for local banks to generate enough loan and deposit activity to cover overhead and be profitable.

The FDIC is the single largest bank in Oklahoma. Kansas must avoid what Oklahoma has confirmed: failed banks and the FDIC destroy businesses. In Lacrosse, Kansas, many Main Street businesses failed when the town's two banks fell into FDIC's pick-and-choose hands. Presently, there are 167 problem banks in Kansas. Bank failures appear to follow demographics.

Of the top five deposit institutions in Kansas, four are Savings and Loans (S&Ls). Of the top ten, eight are. These S&Ls do not attend to Kansas' commercial and agricultural needs. Federal S&Ls, however, hold an unfair advantage: their statute makes no reference to the subject of branching and they are therefore free to engage in intrastate banking. The First National Bank of Manhattan, Kansas, recently spent $100,000 in legal fees in order to convert into a S&L.

Successful banks, such as the MidAmerica Bank in Roeland Park, are currently landlocked because they lack the legal ability to expand beyond their city location, to their natural market area. On the other side of the coin, a successful agribusiness in western Kansas recently called on dozens of state banks for a $7 million expansion loan. The banks were unable to carry the loan and the business turned to out-of-state bankers.

Kansas Banking Law restricts the tools available for: (1) successful banks to bail out troubled ones before they fall into the hands of the FDIC; (2) successful small town banks to expand services beyond their local area to their natural market area; (3) the banking industry to finance development throughout the state.

Recommendation. The Task Force recommends allowing intrastate banking through statewide branching by acquisition only. (This excludes existing de novo branches already approved.) The Task Force's recommendation does not change the current limits on bank asset concentration, which continue to protect small community banks from any unfair competition.

Task Force on Interstate Banking Regulation

Need and Mission

Status. Kansas' regulated banks are at a disadvantage against regional banks and nonbank banks. Within the limits of Federal regulation, many banks are positioning themselves throughout the nation. Thirty-seven states representing over 96 percent of U.S. bank assets have already passed interstate compact agreement legislation. Kansas banks are being "done unto" by global capital market forces and by federal regulations which do not allow banks to compete. Moreover, Kansas can easily be done unto by its neighboring states which become aggressive in their capital market policies, such as Oklahoma.

Models. States with regional reciprocal interstate banking statutes include Alabama, Connecticut, District of Columbia, Florida, Georgia, Idaho, Illinois, Indiana, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Nevada, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Virginia, and Washington.

Recommendation. The Task Force recommends forming a Task Force on Interstate Banking to study the effect of interstate banking in other states and to make recommendations which are in the best interest of the state's users of capital.

The Task Force should report its findings and recommendations to the House, Senate and Joint Committees on Economic Development. The Interstate Banking Task Force should be composed of the highest quality people available; people who will look critically at the problems facing Kansas banks on one hand, and the problems facing borrowers on the other; people who will bring positive, aggressive solutions to those problems; have a statewide and a global vision; be highly regarded by their peers as leaders, but should not be formal representatives or paid professionals of interest groups or trade organizations.

economically provide individually. For example the Merrill Lynch Cash Management Account combines a margin account at a brokerage firm, a captive Merrill-Lynch money market fund, a Visa debit card and a service arrangement through Bank One of Ohio (Eisenbeis, 1983);

- "Broker-bankers" of which Sears-Roebuck is the premier retail example. Sears has been in insurance since 1931, has acquired the nation's fifth largest stock brokerage firm and the largest real estate brokerage firm, and now offers or plans to offer such financial services as an MMF invested in US securities, a debit card, a credit card, automatic teller machines in its retail stores, and secured and unsecured lending;

- "Non-bank banks", or limited service banks, are chartered commercial banks which either make commercial loans or accept demand deposits, but do not perform both functions. Such banks do not, therefore, meet the statutory definition of a bank, and can thus be acquired by any financial or non-financial company and strung together in interstate organizations to link brokerage, commercial, and industrial activities with interstate deposit taking (Eisenbeis, 1983).

The threat financial hybrids' pose to the survival of regulated banks is very real: Citicorp, the nation's biggest and most diversified banking company, ranks G.E. Credit, Sears, Roebuck & Company and American Express -- all nonbank banks -- as its three strongest competitors. G.E. Credit, which lends to the same middle-level companies as many commercial banks, has a return on equity above 20%, greater than any other major finance company or bank in the nation; only J.P. Morgan & Company can match its AAA credit rating.

6.1 The American Banking System

6.1.1 Dual Regulation

Essentially all banks in the United States were initially chartered by state governments to provide a stable source of capital for the development of real good markets within their states. The one exception to state-initiated chartering prior to the turn of the century are the federally chartered commercial banks. J. Cook, Secretary of the Treasury during the Civil War, created federally chartered commercial banks to finance primary industries that operated

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on an interstate basis. It is the the Office of the Comptroller of the Currency (OCC) which now supervises Cook's national banks.

Around the time of World War I, the Federal Reserve System was created to oversee the money supply through a system of federally chartered banks. The Federal Reserve Board supervises state-chartered banks that are members of the Federal Reserve System and also supervises bank holding companies. Following the bank crisis of 1933, three additional federal institutions were created to insure the safety of deposits in financial institutions and to stabilize the supply of funds to the housing and commercial sectors.

- The Federal Deposit Insurance Corporation (FDIC). The FDIC now supervises state-chartered banks that are insured by the FDIC but that are not members of the Federal Reserve System (state non-member banks); FDIC also supervises state-chartered savings banks insured by the FDIC, and FDIC-insured state branches of foreign banks.

- The Federal Home Loan Bank Board (FHLBB). The FHLBB supervises federal savings and loan associations, federal savings banks and, through the Federal Savings and Loan Insurance Corporation (FSLIC), state-chartered savings institutions whose accounts are insured by the FSLIC.

Today, virtually every bank and thrift institution in the U.S. is supervised by at least the FDIC, the OCC or the state banking commissioner and most institutions have at least two regulatory bodies to which it must answer, creating the American dual-regulatory banking system. Of the more than 14,000 commercial banks in the country, in excess of 10,000 are state chartered, virtually all of which are insured and regulated by the Federal Deposit Insurance Corporation (FDIC). The remainder are federally chartered, belong to the Federal Reserve System and must comply with federal policies. State chartered banks tend to be much smaller than nationally chartered ones; even though they are more numerous, they account for only 45 percent of all bank assets.

While state and federal regulators have their own respective sets of regulations, they share a common framework. Typically three dimensions of

commercial banks' activities are controlled: liability regulations specify the terms on which banks can accept deposits; asset regulations require a certain proportion of a bank's assets to be held in non-interest bearing reserve accounts as security, and restrict the types of loans that can be made, the maximum amounts, and the interest rates; and market structure regulations establish the process for authorization of charters for new banks, and for approval of branch locations.

On the face of it, asset regulation would seem to be far more important than liability regulation, since asset regulation directly affects who and what kinds of enterprises can use the assets. But the character and terms of a bank's uses of funds are strongly constrained by the character and terms of the bank's sources of funds. Sources of funds must match uses of funds both by length of term and by level of risk if the private financial intermediary is both soundly invested and financially sound.

6.1.2 U.S. Bank Structure

Among the nation's nearly 15,000 banks there are enormous differences in terms of both size and function. This Paper has so far concentrated on the relatively very small group of large banks. Though small in number, the 50 largest banks hold somewhat more than 40 percent of all bank assets in the U.S., and their fate is of crucial importance to the future of the overall American financial system. There are a host of other banks, however, which though minuscule in terms of assets, perform vital functions in the U.S. banking system. A rough classification of U.S. banks is:

- Money Center Banks: The money center banks are the ten largest banks in the U.S. These banks have assets of over $35 billion and are located in New York, San Francisco, Los Angeles, and, to a lesser extent, Chicago. Money center banks are primarily wholesale institutions serving multi-national clients and have large holdings of industrial and commercial loans.

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- Regional Banks: The regional banks are a larger group of banks with over $10 billion in assets serving the needs of larger corporations in a region. These banks are large enough to operate in national and international money markets and are able to influence regional flows of money. There are approximately 35 such banks in the U.S.

- Local or Retail Banks:
  1) Medium Size Banks - Banks with between $100 million and $10 billion in assets which largely serve the credit needs of states and large communities. These banks tend not to be connected to nation-wide or international markets. In Kansas, only 4% of the banks are medium size banks, some of which actually behave as regional banks for the Kansas banking system.

  2) Small Banks - The vast majority of banks, especially in Kansas have under $100 million in assets (in 1985 96% of Kansas banks had under $100 million in assets). These banks serve the needs of households and small businesses in their local communities through the supply of consumer credit and residen tial mortgages.

The U.S. banking structure is partly an outgrowth of the dual-regulatory system and partly an outgrowth of the economy in which they developed. Because until recently banks could not establish branches outside their own state and in many states, even branching within the state was severely restricted or prohibited, a very large number of small local banking establishments emerged to serve the country's deposit and borrowing needs. Meanwhile a small number of large national and multinational banks remained, descendents of J. Cook's national banks, to serve the needs of America's largest corporations. Shifts in real good markets and in the financial regulatory system are forcing shifts in the structure of the U.S. regulated financial system.

6.2 The Primacy of the Global Consumer

A major concern of the regulated banking industry has been the extraordinary growth of first, money market funds (MMFs) and now mutual funds (MFs). These unregulated institutions have been able to attract consumer deposits on an

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interstate basis by offering high yields on small investments with excellent liquidity (Carron, 1982) -- a very competitive alternative to local banks.

Ironically, money market funds exist because of an innovation created by regulated banks. In the early 1950's the overwhelming majority of banks' funds came from demand deposits. As long as demand deposits dominated bank sources of funds, interest rates were not a determinant of competition among banks. Rather they competed on the level of services they could provide to customers.

During the second half of the 1970's interest rates began rising to such an extant that holding demand deposits in a noninterest-bearing form became expensive. Banks were forced by the market to examine the liability side of their balance sheet and to begin competing for interest-bearing deposits to maintain their share of funds. Simultaneous with the surge in interest rates, exchange controls between the major countries of the world were abolished making it progressively more difficult to isolate interest-rate developments abroad from the deposit-rate structure at home. To compound the banking systems problems, the energy crisis hit.

Walter Wriston, CEO of Citicorp, in 1959 created the Certificate of Deposit (CD) to broaden the basis upon which banks competed. (Wriston insightfully redefined Citicorp as an investment institution rather than simply a bank in the process.) The CD, generally issued by wholesale banks, is a deposit greater than $100,000 left with the bank for a short, specified period of time, usually ninety days. The certificate, evidence of the deposit, may be traded in the secondary markets. For the borrower it has flexibility. For the bank it is a means to create a liability that is more attractive to depositors and a more dependable source of funding than a simple deposit.

Financial institutions in the U.S. and abroad looked to fund long-term debt with short-term variable rate borrowing and to lend at rates that would

move with general interest rates whenever possible. The dollar volume of CD's thus rose quickly. Thrift institutions, hard hit by the rise in interest rates, created their own version of the CD, the NOW Account.

During the late 1970s and early 1980s the nonbank banks responded to CDs and NOW accounts with a vengeance. Money Market Funds were created and generated a significant drain on banks' funds, especially small to medium size banks. The first MMF began operation in 1972; ten years later, MMF assets were $180 billion or about 25% of the entire thrift industry (Bankers' Monthly, 2/15/82). Some MMF dollars did flow back to the regulated banks, but at an even higher cost and generally not to local financial institutions.

Bank obligations do make up approximately 40 percent of money market investments, but the odds are high that the CDs of the overwhelming majority of Kansas banks are not among them. MMFs, most of which are based in New York, Boston and other financial centers, concentrate their investments in negotiable CDs of large money center banks, including CDs of foreign branches of U.S. banks and domestic branches of foreign banks. With few exceptions, most MMFs are prohibited by their bylaws from buying CDs of banks with assets of less than $1 billion. Thus, most local banks in Kansas have lost low cost core deposits to MMFs.

With the continuing decontrol of bank liabilities, banks have been able to recapture deposits from MMFs through the introduction of money market deposit accounts (MMDAs), but at a high premium market rate thus increasing the cost of the banks' loans. The introduction of MMDAs has had the additional impact of siphoning funds from lower paying "core" deposit accounts within the banks themselves, pushing bank loan rates even further.

More recently, as inflation has slowed and interest rates have dropped, money market funds have decreased in importance but have been replaced by mutual

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funds of which the fastest growing now are American Overseas Funds investing in the Pacific Rim and Europe. Mutual funds represent another remarkable change in the way people invest; that is, less in direct stock investment and bank certificate of deposits, whose yields have dropped to 7 or 8 percent, and more in double-digit earning mutual funds. Mutual fund industry sales doubled between 1984 and 1985, up to $89.3 billion.

Small banks in Kansas must pay deposit rates, therefore, determined by the actions of money center banks and nonregulated global financial institutions because local depositors have constant access to potentially more profitable investments. The rates Kansas banks charge on loans, in turn, are determined by globally determined rates on deposits.

This competition for high cost deposits is a reality of national liability deregulation now. The issue for Kansas banks is not only cost; it is the ability to attract money at all. The issue for local businesses is service as changes in the banking industry threaten to lead to loss of direct consumer contacts.

6.3 The Deregulation of Regulated Markets

Large regulated banks have been deserted by U.S. corporations under the momentum of securitization; financing Third World expansion has proven to be a business whose returns do not justify the risk taken by banks; and the industries that are on banks' books are looking increasingly sour. Besides the myriad of increasingly negative customer outlooks, the present market configuration means that competitors -- nonregulated financial institutions -- compete across state lines with regulated banking institutions. State regulators can not stop their passage through state borders: every small rural bank in Kansas

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is vulnerable to a Fidelity Management Mutual Fund 800 number and a Sears Roebuck Financial Service Center just around the corner.

The regulated banking industry's obvious response, given limited local customer forecasts, is to begin looking in every other state's backyard for the best opportunities just to keep pace with nonregulated competitors, even though nationwide interstate banking is still officially restricted by the Federal government. Each of these opportunities to enter new markets have been pursued by the large money center and regional banks, putting them in an advantageous position with respect to all other regulated banks when nationwide interstate banking is legally allowed.

6.3.1 The Interstate Race: Citicorp takes on First Bank of Elk

The 1927 McFadden Act forbids banks to open offices outside their home state except in a state that authorizes such interstate penetration. The McFadden Act as well as the Douglas Amendment to the Bank Holding Company Act have served as commercial banks' primary legal constriction against geographic expansion since the Great Depression. In the rush of 1930's anti-trust legislation, the McFadden Act, the Bank Holding Company Act and Glass-Steagall were all enacted to preserve the deposits of "little old ladies in gym shoes" against the vagaries of greedy Wall Street investors playing with others' money.

Though the legislation was a well-intended attempt to create market stability, the legislation also created capital market concentration. Market forces have found so many means to circumvent the laws that, with the exception of retail deposit taking, the McFadden Act and the Douglas Amendment are all but perfunctory. A Federal Reserve Bank of Atlanta study found that in 1983 there were over 7,800 out-of-state offices of banking organizations.

In fact, the executive branch of the federal government has been slowly loosening interstate banking restrictions wherever it can. Meanwhile, the

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Congress, which has long resisted any form of interstate banking legislation, is gradually giving way to market forces because of the unsustainable pressure on federal insurers such as FSLIC and FDIC.

The 1982 Garn-St Germain Act enabled nonbank banks and industrial banks to purchase federal deposit insurance, creating a new avenue for interstate expansion. It also permitted out-of-state bank holding companies to acquire failed banks if they had assets of more than $500 million and to acquire failed thrift institutions across state borders without any size restraint. The "Regulators Bill" which expands the provisions of Garn-St. Germain, allows acquisitions of failed and failing banks with assets of $250 million or more. Garn's most recent proposal, as a response to the growing problems of oil banks in the southwest, is to expand federal regulators authority to arrange interstate acquisitions of failing banks.

In anticipation of unrestricted nationwide interstate banking, regulated financial institutions such as Citicorp, Chase Manhattan and Irving Bank are quickly positioning themselves in a variety of ways in markets throughout the country within the limits of McFadden. Banks have traditionally done so by entering other states using grandfather banking offices, as nonbanks banks, Edge Act Corporations or limited service banks, rather than offering full services that would categorize them as commercial banks.

Banks also operate in interstate markets through a wide range of services that do not require their physical presence: corporate finance, loan participations, correspondent banking, cash management, credit cards and Automatic Teller Machine networks. While federally authorized interstate banking can be protested legitimately on the grounds that it could lead to a potential drain on local deposits, the fact is that a vast configuration of legal interstate financial activities are in place already and can not be eliminated.

While the Executive branch and Congress have been struggling over deregulation, states have begun responding forcefully to market momentum both to maintain the competitiveness of their financial institutions and as an economic development strategy. More than thirty five states have formally enacted legislation permitting some form of entry into their state markets by outside banking organizations. State deregulatory legislation has taken on as many forms as the nearly forty states that have deregulated but the laws can be broken down into roughly three types: reciprocal laws, non-reciprocal laws with limitations on activities of subsidiaries, and laws without restrictions.

Regional reciprocal laws are the most popular form of state-level interstate banking legislation, restricting entry to banking organizations from specified states. Often these laws attempt to exclude large banks from states like New York and California. Several of the regional pacts, of which there are currently seven, have trigger dates for nationwide banking.

States with Regional Reciprocal Interstate Banking Statutes

Alabama	Louisiana	Pennsylvania
Connecticut	Maine	Rhode Island
District of Columbia	Massachusetts	South Carolina
Florida	Michigan	Tennessee
Georgia	Nevada	Utah
Idaho	New York	Virginia
Illinois	North Carolina	Washington
Indiana	Ohio	
Kentucky		

A few states have passed non-reciprocal laws with limitations on activities of subsidiaries. This generally authorizes out-of-state bank holding companies to acquire a single newly established bank limited to a single office within the state, restrict activities of the acquiring banks holding company and of its acquired bank, and provide that the acquired bank must be operated in a manner that is not likely to compete with existing banks by attracting customers

from the general public. States with such legislation include Delaware, Maryland, Nebraska, Nevada, South Dakota and Virginia.

Finally, non-reciprocal laws are those that permit acquisitions largely without restrictions and bans on nonbank banks. Generally capital-poor states have enacted non-reciprocal laws including Alaska, Arizona and Maine, which permit virtually unlimited entry by out-of-state bank holding companies. Additionally, Oregon permits non-reciprocal acquisitions by banks or bank holding companies from eight states.

Perhaps the most significant state to open its borders is California. A state banking bill would allow California banks to fortify themselves through regional mergers and in 1990 would open California to banks from reciprocating states -- including New York. For most East coast banks California represents the most profitable location for their funds. Colossal bicoastal deals are not unthinkable, but it is more likely that the major east coast banks will try to acquire California's vulnerable, smaller banks and thrifts with $2-4 billion asset ranges and good deposit-gathering branch systems (eastern banks already have west coast loan-production offices and millions of credit-card holders). California, on the other hand, can be expected to undertake a similar strategy on the east coast.

The result of regional pacts is regional banks -- the $4 billion to $20 billion wholesale type. Several small to medium size banks merge to form a $20 billion bank better able to withstand the pressures of global, nonregulated markets. Regional size banks have been the most rapidly growing in number over the last ten years. A few regional banks have merged to form money center banks, but it is not easy to be a money center bank in 1986. Money center banks must work within extraordinarily tight spreads and be enormously efficient to remain competitive with nonregulated global rivals. The most rapidly growing

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category of banks for the next decade is likely, therefore, to remain regional banks.

It is not all together easy, on the other hand, to be a regional bank in 1986. Though regional banks are able to influence regional capital markets, they are also heavily influenced by the regional economy because they typically wholesale financial services to smaller, local banks and lend money directly to major regional industries. When major sectors of the economy decline, as oil and agriculture have in states like Texas, Oklahoma and Louisiana, regional banks typically suffer. The federal government, out of desperation to maintain the nation's financial stability, has taken control of the Oklahoma banking system and has come quite close to doing likewise in Louisiana.

6.3.2 Recommendations for Kansans Considering Interstate Deregulation

Though Kansas does not have banks that qualify as regional banks by asset size, it has banking institutions which are in every other respect regional banks that strongly influence the flows of capital within the state's banking system. Kansas is fortunate; the Kansas economy, unlike Louisiana or Oklahoma, has not become as singularly dependent on any one sector of the economy. While small, rural Kansas banks have had greater difficulty diversifying out of agriculture and related industries, Kansas's largest banks have so far weathered structural changes in the economy quite well and at present only one of the ten largest banks in Kansas is in financial distress.

Many small, rural Kansas banks are, however, in financial distress. Nearly 36% of Kansas banks below $10 million in assets operated in the red during 1985. These same size banks held 93% of agribusiness loans in the state and thirteen have so far failed in 1986. Though they are too small to cause concern in the FDIC or FSLIC, they are important sources of financing to their communities. It is crucial that Kansas public and private sector actors control

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those capital market forces within the state's power -- Kansas must not allow itself to be done unto. Though it is not likely that it would be "done unto" by federal regulators the way Oklahoma has been, it is now being "done unto" by global capital market forces and by federal regulations which do not help small, rural banks to compete. Moreover, Kansas can easily be done unto by its neighboring states that become aggressive in their capital market policies and become an economic island. If Kansas adapts policies that are in the best interest of the state's users of capital -- which is the reason the public sector regulates capital markets in the first place -- it can maintain control over its banking and thrift institutions.

6.3.3 The Intrastate Race: I'm O.K, You're O.K.

Another major trend in the structure of the regulated financial services industry is the consolidation of small banks into top size small banks or medium size banks with about $100-150 million in assets. This consolidation can be attributed to the dramatic increase in the number of bank failures over the last two years. Between 1971 and 1980 a total of 79 insured commercial banks were closed. In contrast, 79 banks failed in 1984 and over 100 in 1985, most of which were small and rural banks. By 1984 FDIC had 817 problem banks and this number had increased to 1,196 by the beginning of this year, about 40% of which were small agricultural banks.

Because federal deregulation and structural trends in real good and capital markets show no sign of shifting direction, most economists are predicting greater consolidation in the future. Golembe Associates, a bank consulting firm, has projected a potential 30-50 percent decline in the number of commercial banks in the U.S. Another study which surveyed bank CEOs predicted that the total number of banks would drop 36% by 1990 (Bank Administration Institute, 1983).

Most every state has responded in some way to consolidation within the financial services industry. Only one state, Mississippi, does not provide for statewide banking either through branches or multi-bank holding companies. But even Mississippi allows statewide banking in emergency situations for the takeover of failing banks.

6.3.4 Recommendations for Kansans Considering Intrastate Deregulation

Intrastate banking issues remain in Kansas, such as the chartering and regulation of commercial banks and thrift institutions. The debates over many intrastate issues are virtually meaningless unless they are undertaken with full recognition of financial market developments outside Kansas borders -- borders to which global financial actors, nonbank banks and even regulated money center banks are practically blind. Intrastate discussions which do not recognize the extent to which global capital markets are daily influencing the state economy are essentially distractions from the real issues all local depository institutions in the state must face.

Those real issues were summarized in the balance sheets of Chapter 1. We conclude with thosee balance sheets because they are what every Kansan -- bankers, business people and individuals -- look at every day. Whether Kansans know it or not, they are daily living global capital markets.

We recommend expanding intrastate branching by acquisition to increase the operating efficiency of Kansas banks. Of the 613 banks in Kansas, 353 are the sole banks in their communities. The structural capital market changes surveyed in this Paper mean that the vast majority of these local banks' deposit bases are too low to cover their overhead. For instance, it may be far more efficient to have one loan officer per county rather than one loan officer per bank given the volume of loans. Such consolidation would mean greater efficiency on the asset side of the balance sheet. It should be noted that state legislation can

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not dictate acquistion priority, geographically or otherwise, to the federal regulators; the federal regulators have demonstrated that they will pick the highest bidder regardless.

THE FIRST NATIONAL BANK

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PHILLIPSBURG, KANSAS

CHARLES I. MOYER
EXEC. VICE PRESIDENT
AND TRUST OFFICER

PHONE: 913-543-6511

January 31, 1987

Mr. Neil Arasmith
59 Sunset Dr.
Phillipsburg, KS 67661

Dear Neil:

I received a copy of the Senate Bill 72, proposing Statewide Branch Banking, and have studied it quite thoroughly. I am told that your Committee on Financial Services and Insurance will hold hearings on the Bill next Tuesday and Wednesday. I would like to present some of my views to you. Neil, you know what a business that is owned and managed out of town does for a community; one has but to look at a few nonresident businesses in our community of Phillipsburg and determine how they support our chamber or commerce, local businesses and promote new industry. Resident businesses are the builders of a community; supporting new industry and growth with their time, talent and hard-earned dollars. Neil, you have been in business in western rural Kansas, as have others on your Committee, and I am sure you have observed the benefits of resident business over nonresident businesses in a community. The proponents of branch banking have many facts and figures to present in an attempt to draw you away from the basic ideas of that great philosophy that has been the root of rural Kansas, as well as America itself. That philosophy upholds, promotes job development, private innovation, stronger tax base, better service to the consumer than any other society has been privileged to have, just to name a few.

The Kansas Independent Bankers proposed a Bill to your Committee in 1986 (Senate Bill 432) which was passed by the Legislature in 1986. This Bill provided the people of rural Kansas in areas with problem banks, the opportunity to have banking service in their communities. I feel this was a good Bill for the people of Kansas, as well as the banking industry. The proponents profess that statewide branch banking will allow banks to better service business and industry. They don't say anything about the people of Kansas; the rural communities of Kansas. These same proponents don't seem to realize where the majority of retail deposits are produced. The banking laws of 1930 prohibited concentration of credit because of what happened in 1929. The banking laws of 1930 were designed to serve the people of America, provide a strong financial base, while preventing the reoçcurrence of the catastrophe of 1929.

The old adage that "money talks" is very, very prevalent in the theory behind branch banking. City Corp, the largest bank in America by two times the next in line, is the major proponent of branch banking thrust at the present time. They need our retail deposit base to help cover loan losses

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of Third World and Latin American Countries. These losses would break the nine larger banks in the United States if they were regulated the same as smaller independent banks. Sending our deposits to large money centers, whether it be state, or national, cannot support the needs of our rural communities. Let's keep the support of our government where it is needed; IN OUR RURAL COMMUNITIES.

The proponents are also trying to sell the need for Branch Banking through economic initiative (or economic development whichever you might wish to call it) that the state of Kansas is promoting. I am for economic development in Kansas. Our bank will support venture capital through the economic development program for Kansas, but I cannot believe that a person from the academic world comes out from the eastern part of the United States and tells the Kansas people what is good for them in banking. If you want people from the academic world telling us what is good for us, then let's get someone from the academic world who is an opponent of branch banking and give them the equal opportunity to discuss the adverse effects of branch banking. I don't think you and I need someone to tell us what is good or bad for us from the academic world. We know this, and I think most Kansans know it. So maybe we should start listening to some of the depositors of Kansas instead of a few bankers.

Statewide, or any form of branch banking, historically reduces the number of banks doing business within a state and drives capital from the rural areas to larger urban centers, lending to concentration of credit and weakening of the competitive spirit.

Sincerely,

Charles I. Moyer
Executive Vice President
and Trust Officer

CIM:aw

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FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

February 4, 1987

Dear Senator Arasmith:

I was advised by Regional Director Thacker that your committee is considering legislation to authorize statewide branch banking in Kansas this week (SB 72).

While the enactment in 1986 of SB 432 has been of some assistance in handling failing banks, additional flexibility is needed.

Fourteen banks failed in Kansas in 1986, and two others avoided failure with FDIC financial assistance. Seven of the failed banks were sold as branches, four were sold as de novo banks, and three resulted in a pay-off to depositors. Two of the pay-offs occurred in two-bank towns where sale as a branch was precluded by SB 432, and bidder interest in a de novo charter was dampened by the significant start-up costs coupled with concern for future profitability.

We believe that the provisions of SB 432 which prohibit branch banking in communities with more than one bank, prefer de novo charters, and give priority to the closest geographical bidder, have unfavorable effects on the Kansas economy and the Federal Deposit Insurance Fund. We, therefore, applaud your reassessment of these issues and encourage a system which not only provides maximum flexibility in handling failed banks, but also offers opportunities to resolve troubled situations before failure becomes imminent.

Charles Thacker and his staff in Kansas City are available to work with you in addressing these issues. You have my best wishes that your efforts result in a system which is beneficial to the people of Kansas.

Sincerely,

L. Wm. Seidman

L. William Seidman
Chairman

The Honorable Neil Arasmith, Chairman
Committee on Financial Institutions
and Insurance
The State Senate
State Capitol
Topeka, Kansas 66612

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- *Venture Capital Funds Per Capita*— Venture capital companies are an increasingly important source of capital to entrepreneurs. Further, many venture capital companies explicitly give preference to local firms because they can monitor the behavior of high-risk start-ups more closely.

State Initiatives for Capital Formation
State initiatives to increase capital formation can reduce the cost or increase the availability of capital, particularly to new firms. Banks may lend new enterprises less than required because of banking laws that limit the number of high-risk loans. States can reduce this problem by allowing lending to higher-risk firms (at an appropriate risk-adjusted rate) or by other state initiatives for capital formation.

Direct subsidy of business by states through tax incentives is not included in our set of indicators; subsidization is a zero sum game, with one state "buying" business at the expense of another. The state activities we have chosen increase the efficiency of capital markets, resulting in more economic growth, not redistribution of existing economic activity.

State Regulation of Capital Markets
This category includes five indicators:

- *Absence of Interest Rate Ceilings*— State regulations can reduce the availability of capital to entrepreneurs by imposing interest ceilings on business loans and by restricting the availability of funds to high-risk start-up companies. Thus, we have chosen the absence of interest rate ceilings as an indicator of capital availability.
- *Allow Branch Banking*— Smaller business and start-up firms are likely to get financial capital locally. States that allow branch banking are likely to have more local bank competition and thus lower interest rates.
- *State Equity or Venture Capital Funds*— Some states have been investing directly or indirectly in companies in exchange for an ownership interest.
- *State Loan Guarantee Loan Program*— Some states guarantee private-sector loans to facilitate business expansions that entail unusual but reasonable levels of risk.
- *Business Incubators*— State-supported incubators provide a number of benefits to new businesses: below-market rents; on-site business assistance; assistance in obtaining financing; and, in some cases, employee training and placement. In addition, locating new businesses together allows them to share common costs and benefit from each other's experiences.

Directions for Further Study
In addition to the capital availability indicators used in our report, there are other measures that would provide additional insights if data on them can be compiled through subsequent research. For example, data on financial reserves and some information on levels of innovation are readily available, but data on actual lending practices are much more difficult to aggregate. Also, corporate investment capacity does not necessarily correspond with attitudes regarding investment, particularly with respect to certain industries and geographic areas. Measures that provide correlations between these two variables would be very useful.

Direct subsidy of business by states through tax incentives is not included in our set of indicators; subsidization is a zero sum game, with one state "buying" business at the expense of another.

CAPITAL AVAILABILITY INDICATORS

Region	State	Total Equity Capital in Commercial Banks (000's $ per Capita) (a)	Size of Venture Capital Funds ($ per Capita) (b)	No Interest Rate Ceiling (c*)	Allow Branch Banking (d*)	State Equity and Venture Capital Funds (e*)	State Loan Guarantee Program (f*)	State Sponsored Business Incubators (g*)
UNITED STATES	Average	606.4	39.2	0.8	0.8	0.3	0.4	0.2
NEW ENGLAND	Average	398.7	133.8	0.8	1.0	0.5	1.0	0.5
	Connecticut	351.6	103.5	1	1**	1	1	1
	Maine	256.5	0.0	1	1**	1	1	0
	Massachusetts	443.7	202.7	1	1**	1	1	1
	New Hampshire	343.5	0.0	1	1	0	1	0
	Rhode Island	508.7	183.6	0	1**	0	1	0
	Vermont	394.2	0.0	1	1**	0	1	1
MID ATLANTIC	Average	987.7	58.3	1.0	1.0	0.3	0.7	0.7
	New Jersey	377.2	11.8	1	1**	0	1	0
	New York	1,525.4	110.6	1	1**	1	1	1
	Pennsylvania	574.3	9.8	1	1	0	0	1
MIDWEST	Average	578.6	21.7	1.0	0.8	1.0	0.5	0.5
	Illinois	838.1	62.1	1	0	1	0	1
	Indiana	502.5	0.0	1	1	1	1	0
	Michigan	430.8	2.7	1	1	1	1	0
	Minnesota	684.9	18.0	1	1	1	0	1
	Ohio	452.7	13.5	1	1	1	1	1
	Wisconsin	516.2	7.4	1	1	1	0	0
WEST NORTH CENTRAL	Average	733.0	7.0	1.0	0.5	0.2	0.2	0.0
	Iowa	756.1	17.9	1	1	0	0	0
	Kansas	723.2	17.9	1	0	1	0	0
	Missouri	629.4	4.0	1	0	0	0	0
	Nebraska	772.5	0.0	1	1	0	0	0
	North Dakota	753.6	0.0	1	0	0	1	0
	South Dakota	1,297.4	0.0	1	1**	0	0	0
EAST SOUTH CENTRAL	Average	466.4	1.4	0.5	1.0	0.0	0.3	0.3
	Alabama	457.2	0.0	1	1**	0	0	0
	Kentucky	543.3	2.0	1	1	0	1	0
	Mississippi	416.8	1.2	0	1	0	0	1
	Tennessee	440.7		0	1	0	0	0

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