Approved [signature] 2/23/88
Date

MINUTES OF THE HOUSE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS.

The meeting was called to order by Clyde D. Graeber at
Chairperson

3:30 ~~a.m.~~/p.m. on February 16, 1988 in room 527-S of the Capitol.

All members were present except: Clifford Campbell, Herman Dillon, Norman Justice and Susan Roenbaugh, Excused.

Committee staff present: Bill Wolff, Research Department
Myrta Anderson, Research Department
Bruce Kinzie, Revisor of Statutes
June Evans, Secretary

Conferees appearing before the committee: Jim Maag, Kansas Bankers Association
Ben Craig, KBA, Overland Park, Kansas
Jim Cooper, KBA, Garnet, Kansas
Doug Mays, Kansas Securities Commission
Larry W. Magill, Jr., Independent Insurance Agents of Kansas
Karen McClain, Kansas Association of Realtors
Janet J. Stubbs, Home Builders Association of KS

Chairman Graeber brought the meeting to order.

Bill Wolff, Legislative Research Department, gave an explanation of HB 2738, an act relating to banks and banking; concerning certain powers thereof; amending K.S.A. 1987 Supp. 9-1101, 9-1102 and 9-1112 and repealing the existing sections.

The legislation was requested by the Kansas Bankers Association and changes to K.S.A. 9-1101 are as follows: Subject to the prior approval of the state bank commissioner and the state banking board and subject to such rules and regulations as are adopted by the state bank commissioner pursuant to K.S.A. 9-1713, and amendments thereto, to promote safe and sound banking practices, a bank may establish or acquire a subsidiary which engages in securities activities and any aspect of the securities business, including but without limitation because of enumeration, (a) issuing, underwriting, selling or distributing stocks, bonds, debentures, notes, interests in any type of mutual funds and other securities, (b) organizing, sponsoring and operating mutual funds, (c) acting as a securities broker-dealer, and (d) acting as an investment adviser to any investment company.

Sec. 2. K.S.A. 1987 Supp. 9-1102 is amended to read as follows: 9-1102. (a) Any bank may own, purchase, improve, manage, lease, hold, encumber or convey real property and certain personal property subject to the following:

Lines 216 thru 245 are changed as follows: (2) Subject to such rules and regulations as are adopted by the state bank commissioner pursuant to K.S.A. 9-1713, and amendments thereto, to promote safe and sound banking practices, a bank may purchase, hold, encumber and convey or lease, as lessor or lesee, any interest in unimproved or improved real estate, and may construct, alter and manage improvements of any description on real estate in which it holds a substantial equity interest. The amount of a bank's total investment or ownership at all times in any one tract of real estate shall not exceed 15% of the bank's unimpaired capital stock, surplus and undivided profits. The powers granted in this section do not include, and a bank may not:

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.

(a) Manage any real estate in which the bank does not own substantial interest;

(b) engage in activities of selling, leasing or otherwise dealing in real estate as an agent or broker; or

(c) acquire any interest in agricultural land as defined in K.S.A. 17-5903, and amendments thereto, except in satisfaction of debts due it and as provided in subsection (b);

(3) a bank's total investment or ownership at all times in any one or more tracts of real estate shall not exceed 1/2 of its unimpaired capital stock, surplus, undivided profits and capital notes and debentures, and any such excess shall be removed from the bank's books unless approval is granted by the state bank commissioner. (This is the present statutory limitation; not new language.)

The following proponents testified for HB 2738:

Jim Maag, Kansas Bankers Association, testified the KBA requested HB 2142 last year but it was not acted on in 1987 and during the summer and fall the Association spent much time discussing this issue. It was decided to request this legislation (See Attachment #1).

The next person to testify for HB 2738 was Ben Craig, President, Kansas Bankers Association, stating this bill is essential if the community bank is to survive. There is much competition and the return on equity is not as good as in the past.

Jim Cooper, State Affairs Committee, Kansas Bankers Association, Garnett, was the next to testify for HB 2738 stating the banks need this bill to have the ability to effectively compete (See Attachment #2).

Doug Mays was the next to testify stating that he, as Securities Commissioner, is neutral and that the Securities Commission has no objection to this bill.

The following opponents appeared testifying against HB 2738:

Larry W. Magill, Jr., Executive Vice President, Independent Insurance Agents of Kansas stated the appropriate forum for this debate is the U.S. Congress (See Attachment #3).

Karen McClain, Director of Governmental Affairs, Kansas Association of Realtors, testified opposing HB 2738. It is felt this is the beginning of a serious threat to the real estate business and to the security of the Kansas banks and the availability for consumers loans across Kansas. One primary concern of the Kansas Association of Realtors is for the health of the state's financial system, upon which both our state's economy and the banking industry's survival depend (See Attachment #4).

The last person to testify against HB 2738 was Janet Stubbs, Executive Director, Home Builders Association of Kansas, Inc. If the bill is passed by this committee the Association suggests some amendments that are in Attachment #5 (See Attachment #5).

The Chairman closed the hearing on HB 2738 stating possible action might be taken on this bill on Thursday, February 18. Representative Shallenburger moved and Representative Gatlin seconded the approval of the minutes of February 11, 1988.

The meeting adjourned at 5:05 P.M.

PUBLIC TESTIMONY ON HB 2738

TO THE
HOUSE COMMITTEE ON
COMMERCIAL AND FINANCIAL
INSTITUTIONS

BY
KANSAS BANKERS ASSOCIATION

FEBRUARY 16, 1988

Atch 1

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

February 16, 1988

TO: House Committee on Commercial & Financial Institutions
FROM: Jim Maag, Director of Research
Kansas Bankers Association
RE: HB 2738 - Additional Powers for State-Chartered Banks

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear before the committee today in support of HB 2738. The bill would allow state-chartered banks to engage in a variety of securities services through a subsidiary and would also allow state banks to make real estate investments within certain capital limitations. The membership of the Kansas Bankers Association believes this bill can be an important first step toward giving banks greater ability to compete with other financial and non-financial institutions in today's market place.

The decision by the KBA to request introduction of this measure was not arrived at hurriedly. Committee members will recall that in the 1987 session we asked for the introduction of HB 2142 which would have allowed for a broad range of new powers and services for state-chartered banks. Since no hearings were held on the measure last session we spent considerable time during the interim discussing the issue with Kansas banks. Extensive surveys were done at our KBA Fall Conferences and discussions were held in KBA committees, boards and councils where there was unanimous support to pursue a products and services bill. Following further discussions with legislative leadership, the decision was made to narrow the legislation to the securities and real estate powers contained in HB 2738.

Banks today face ever-increasing competition from every direction. In addition to the traditional competition from S&Ls and credit unions, banks

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now see agents and brokers representing many non-financial institutions offering services which just a few short years ago were considered to be banking functions.

As examples of how the lines of authority between banking and non-banking entities have become blurred in recent years, I have attached to this testimony a sheet showing the affiliation between securities firms and FDIC-insured institutions and a chart showing comparisons of the products and services offered by banks vs. other institutions such as Sears, Merrill Lynch, American Express and the Ford Motor Company. Also attached are two recent newspaper articles concerning the largest S&L in Kansas - Franklin Savings - and the extent of their non-banking activities. It is very important to understand that banks' traditional competitors - the S&Ls - have had broad real estate investment powers for several years.

Yet legislative and regulatory attempts by the banking industry to gain authority to offer new services have met with strident resistance. As a result of this expanded competition and the inability to gain new powers, banks have seen their share of the market shrink throughout the 1980's - as the attached chart shows. This, in turn, will increasingly become a factor in the ability of banks to attract new capital.

The real estate and securities powers being requested in this bill are certainly not unique to Kansas. As the attached chart reveals, nearly one-half of the states allow their state-chartered banks to take equity positions in real estate and 14 states currently allow either securities underwriting or full service brokerage powers. Bank regulators, including the Conference of State Bank Supervisors (CSBS), the FDIC and the Comptroller of the Currency, have endorsed the need for legislation to give banks a broader range of products and services.

Finally, I would direct the committee's attention to the recent Report of the Commission on the Future of Kansas Agriculture. That report notes the need to strengthen the financial institutions which serve agriculture and goes on to recommend that agricultural banks be allowed "to offer a full range of financial products and services . . . ."

Kansas banks are not asking that our competitors be restricted in their

activities. What we are asking for is the opportunity for "a fair fight" by allowing banks at least these additional powers in real estate and securities. We believe it will result in a sounder and stronger banking system for Kansas.

Your favorable consideration of HB 2738 will be greatly appreciated.

EXHIBIT 3

AFFILIATIONS BETWEEN SECURITIES FIRMS AND FEDERALLY INSURED DEPOSITORY INSTITUTIONS IN THE UNITED STATES

Securities firm	Insured Depository Institution*
American Express Company IDS Securities Corp. The Robinson-Humphrey Co., Inc. Shearson Lehman Brothers, Inc.	Advisory Bank & Trust Co. American Express Centurion Bank Boston Safe Deposit & Trust Co. Savings Bank Trust Co., NW
Bear, Stearns & Co. Inc.	Custodial Trust Company
Dean Witter Reynolds Inc.	Greenwood Trust Company Hurley State Bank
Drexel Burnham Lambert Incorp.	Commercial Trust Co. Harbor Trust Company
Dreyfus Corp.	Dreyfus Consumer Bank
Eaton Vance Distributors, Inc.	Investors Bank & Trust Co.
Federated Securities Corp.	Liberty Bank and Trust, NJ
The First Boston Corporation	Universal Trust Co.
First Investors Securities Corp.	First Financial Federal Savings and Loan Association
Franklin Distributors Inc.	Pacific Union Bank and Trust Co
Goldman, Sachs & Co.	Broad Street Bank and Trust Co.
E. F. Hutton & Company Inc.	E. F. Hutton Bank
The Illinois Co., Inc.	Land of Lincoln Savings & Loan
John Hancock Subsidiaries, Inc. Sutro & Co. Incorporated Tucker, Anthony & R.L. Day, Inc.	First Signature Bank & Trust Co
Kidder, Peabody & Co. Incorp.	Monogram Bank
Merrill Lynch & Co., Inc.	Merrill Lynch Bank & Trust Co.
Prudential-Bache Securities Inc.	Prudential Bank and Trust Co.
The Travelers Corporation Dillon, Read & Co. Inc. Securities Settlement Corporation	Massachusetts Co., Inc.

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* Deposits insured by the FDIC except First Financial Federal Savings & Loan Ass and Land of Lincoln Savings & Loan, whose deposits are insured by the FSLIC.

American Bankers Association
Office of the General Counsel
November, 1987

COMPARISON OF PRODUCTS AND ACTIVITIES OF FINANCIAL AND NON-FINANCIAL INSTITUTIONS

Products/ Powers	Nat. Bank	Bank Holding Company	Federal Savings Bank or Savings & Loan	Unitary Thrift Holding Company[19]	Multiple Thrift Holding Company	Fed. Credit Union	American Express	Bene-ficial Corp.	Dreyfus	Ford Motor Company	General Electric	Gulf & Western Company	Household Inter-national	ITT	Merrill Lynch	tial Bache	Sears
Demand Deposit	Y	N[6]	Y[13]	N[6]	N[6]	N	N[33]	Y[38]	Y[40,41]	Y[45]	N	Y[47]	Y[48]	Y[49]	N[50]	N	Y[55]
Savings Deposit	Y	N[6]	Y	N[6]	N[6]	Y	N[33]	Y[38]	Y[42]	Y[45]	N	Y[47]	Y[48]	Y[49]	Y[50]	Y[53]	Y[55]
Certif-icate of Deposit	Y	N[6]	Y	N[6]	N[6]	Y	Y	Y[38]	Y[42]	Y[45]	N	Y[47]	Y[48]	Y[49]	Y[51]	Y	Y[55,56]
Transaction Account (NOW/ATS etc.)	Y	N[6]	Y	N[6]	N[6]	Y[29]	Y[34]	Y[38]	Y[40,41]	Y[45]	N	Y[47]	Y[48]	Y[49]	Y[52]	Y53	Y[55]
Federal Insurance	Y	N[6,7]	Y	N[6,7]	N[6,7]	Y	N[35]	Y[38]	Y[43]	Y[45]	N	Y[47]	Y[48]	Y[49]	Y[43]	Y[43]	Y[43]
Commercial Loans	Y	Y	Y[14]	Y	Y	N[30]	Y	Y[39]	N	Y	Y	Y	Y	Y	Y	Y	Y
Consumer Loans	Y	Y	Y[15]	Y	Y	Y[31]	N	Y	Y[42]	Y	Y	Y	Y	Y	N[50]	N[54]	Y
Residential Mortgages	Y	Y	Y	Y	Y	Y[31]	Y	Y	Y[42]	Y	Y	Y	Y	Y	Y	N[54]	Y
Commercial Mortgages	Y	Y	Y[16]	Y	Y	N[30]	N	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y

roducts/ owers	Nat. Bank	Bank Holding Company	Federal Savings Bank or Savings & Loan	Unitary Thrift Holding Company	Multiple Thrift Holding Company	Fed. Credit Union	American Express	Bene-ficial Corp.	Dreyfus	Ford Motor Company	General Electric	Gulf & Western Company	Household Inter-national	ITT	Merrill Lynch	Pruden-tial Bache	Sears
argin oan	Y	Y	N[17]	Y	N[23]	Y[31]	Y	N	Y	N	Y	N	Y	N	Y	N[54]	Y
redit ards	Y	Y	Y	Y	Y	Y[31]	Y	Y	Y	Y	N	Y	Y	Y	N[50]	Y	Y
redit elated nsurance gent	Y	Y	Y[18]	Y	Y	Y	Y	Y	N[44]	Y	Y	Y	Y	Y	Y	Y	Y
eneral nsurance gent	N[1]	N[8]	Y[18]	Y	Y	Y[32]	Y	Y	N[44]	Y	Y	Y	Y	Y	Y	Y	Y
nsurance der- riter	N	N[8]	N	Y	N[24]	N	Y	Y	N[44]	Y	Y	Y	Y	Y	Y	Y	Y
tock okerage	Y[2]	Y[2]	Y[18]	Y	Y[25]	N	Y	N	N	N	Y[46]	N	N	N	Y	Y	Y
iscount ock oker	Y	Y	Y[18]	Y	Y	Y	N	N	N	N	N	N	N	N	N	Y	N
nvestment dvisor	Y	Y	Y[18]	Y	Y	N	Y	N	Y	N	Y	N	N	N	Y	Y	Y
nvestment n Corporate ecurities	N	Y[9]	Y[19]	Y	Y[26]	N	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y

Products/ Powers	Nat. Bank	Bank Holding Company	Federal Savings Bank or Savings & Loan	Unitary Thrift Holding Company	Multiple Thrift Holding Company	Fed. Credit Union	American Express	Bene- ficial Corp.	Dreyfus	Ford Motor Company	General Electric	Gulf & Western Company	Household Inter- national	ITT	Merrill Lynch	Pruden- tial Bache	Sears
Organ./Oper. of a Mutual Fund	N	Y[10]	N	Y	N[27]	N	Y	N	Y	N	Y	N	N	N	Y	Y	Y
Real Estate Broker	N[3]	N[11]	N[20]	Y	N[27]	N	Y[36]	N	N	N	Y	N	N	N	Y	N	Y
Real Estate Development	N	N	Y[18]	Y	Y	N	Y	N	N	N	N	N	N	N	Y	Y	Y
Real Estate Appraisal For Others	N	Y	Y	Y	N[27]	N	N	N	N	N	N	N	N	N	Y	N	Y
Data Processing Service For Others	Y[4]	Y[12]	Y[21]	Y	Y[28]	Y[32]	N	N	N	N	Y	N	Y	N	N	N	Y
Travel Agency	N	N	N	Y	N[27]	N	Y	N	N	N	N	N	N	N	N	N	N
Leasing Personal Property	Y[5]	Y	Y	Y	Y	Y[32]	Y[37]	Y	N	Y	Y	Y	Y	Y	Y	N	N
Retail Sales	N	N	N	Y	N	N	Y	Y	N	Y	Y	Y	Y	Y	N	N	Y
Manu- facturing	N	N	N	Y	N	N	N	N	N	Y	Y	Y	Y	Y	N	N	N

Sources

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Moody's Banking and Finance Manual (1987)

Moody's Industrial Manual (1987)

E. Compton, The New World of Commercial Banking (1987)

C. Pavel and H. Rosenblum, Financial Darwinism: Nonbanks and Banks - Are Surviving (Federal Reserve Bank of Chicago, 1985)

Notes

Y represents activities generally permitted with respect to financial institutions and presently being engaged in with respect to non-financial institutions. N represents activities generally prohibited with respect to financial institutions and not presently being engaged in with respect to non-financial institutions.

1. National banks located in cities of 5,000 or less population may act as an agent for fire, life or other insurance.

2. Decisions by the Comptroller of the Currency and the Board of Governors of the Federal Reserve System permit national banks and bank holding companies, respectively, to provide both discount brokerage services and investment advisory services, thus approaching full service stock brokerage. See, Decision of the Comptroller of the Currency concerning the Application of American National Bank of Austin, Texas to Establish an Operating Subsidiary to Provide Investment Advice, [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶99,732 (Sept. 2, 1983). An action challenging this decision is currently pending. Securities Industry Association v. Comptroller of the Currency, No. 83-3581 (D.D.C. filed Dec. 1, 1983); Securities Industry Association v. Board of Governors of the Federal Reserve System, 821 F.2d 810 (D.C. Cir.) (Natwest), petition for cert. filed, (U.S. Oct. 5, 1987) (No. 87-562).

3. National banks located in cities of 5,000 or less population may act as an agent or broker in procuring loans on real estate.

4. The extent to which national banks may provide data processing services to others is not clear. Compare: National Retailers Corp. v. Valley National Bank, 604 F.2d 32 (9th Cir. 1979) and 12 C.F.R. §7.3500.

5. National banks may lease personal property when the lease is equivalent to a secured lending arrangement. The 1987 Competitive Equality Banking Act (CEBA), P.L.100-86, also grants national banks additional authority to engage in operating leases (Title I,§108).

6. These services may, of course, be offered by a depository subsidiary of the holding company.

7. State institutions may apply for federal insurance coverage.

8. Insurance activities of bank holding companies under federal law are set forth in 12 C.F.R. §225.25(b)(8). Revised provisions were adopted on October 31, 1986 to reflect amendments to the Bank Holding Company Act made by the Garn-St. Germain Depository Institutions Act of 1982. Bank holding companies are generally permitted to sell credit-related life, accident and health insurance, and involuntary unemployment insurance; to sell property insurance on collateral securing loans for $10,000 or less ($25,000 for manufactured homes) through finance company subsidiaries; to act as general insurance agents in towns under 5,000 population or where the bank holding company has less than $50 million in assets; and to continue to sell (and to expand in certain instances) insurance agency activities authorized on or before May 1, 1982. These revisions are currently being challenged in Independent Insurance Agents of America Inc. v. Board of Governors of the Federal Reserve System, Nos. 86-1572, 86-1573 and 86-1576 (D.C. Cir. filed, Oct. 27, 1987).

9. A bank holding company may invest in less than 5% of the voting shares of any corporation without prior regulatory approval, and may invest without limit in other corporations engaged in activities closely related to banking.

10. A bank holding company may sponsor, organize and manage a closed-end investment company.

11. A bank holding company may act as the intermediary for the financing of commercial property by arranging for the transfer of title, control, and risk of the real estate project to one or more investors.

12. Data processing services provided to others is limited to processing banking, financial and economic data.

13. Only when offered to customers with whom a business or commercial loan relationship exists or for collecting customer bill payments.

14. Commercial loans are limited to 10% of assets.

15. Consumer loans are limited to 30% of assets.

16. Loans on nonresidential real estate cannot exceed 40% of assets.

17. Loans may be secured by government backed securities.

18. These services may be performed through a service corporation. See, 12 C.F.R. §545.74(c) (1987).

19. A federal association may invest in highly rated commercial paper and other corporate debt securities, including convertible bonds. They may also invest in shares of open-end mutual funds which are restricted in their investments to those permitted a federal association directly. See, 12 C.F.R. §§545.75 and 545.76 (1987).

20. A service corporation may provide brokerage services with respect to property owned by a parent federal association. See, 12 C.F.R. §545.74(c)(3) (1987).

21. A federal association may offer data processing services with respect to financial or economic data, or information related to the thrift industry. Customers must be other depository institutions (including the parent or subsidiary of either) or established customers of the federal association. See, 12 C.F.R. §545.138 (1987).

22. Under the provisions contained in Title I§104 of CEBA, exemption from the nonbanking restrictions of the Savings and Loan Holding Company Act will only remain available if the subsidiary thrift meets the qualified thrift lender test (i.e., the thrift must devote at least 60% of its assets to housing and related activities). A unitary S&L holding company formed before March 5, 1987 may retain its thrift, even if that thrift does not meet the test, subject to certain restrictions. (Among other things the restrictions prohibit the acquisition of additional banks or thrifts and state that the subsidiary may not engage in nonbanking activities which it did not engage in on the grandfather date.)

23. Not permitted, unless authorized by state law for a state chartered thrift subsidiary.

24. Multiple holding companies may underwrite credit related insurance written in connection with an extension of credit made by an insured institution.

25. Section 106 of CEBA places a moratorium on further affiliations of insured thrift institutions with organizations principally engaged in certain securities activities (i.e. applies sections 20 and 32 of the Banking Act of 1933 to insured thrift institutions). This moratorium is not applicable to relationships established before March 5, 1987 and is set to expire March 1, 1988.

26. To the extent permitted by federal or state law to insured thrift subsidiaries.

27. Unless permitted by state law for an insured thrift subsidiary.

28. Data processing services may be provided to other financial institutions.

29. Share draft accounts.

30. Commercial loans may be made to businesses which are members of the credit union, but only for amounts up to the amount of shares held. Federal credit unions may make loans to other credit unions or join in participation loans.

31. Loans are restricted to members of the credit union.

32. Through a service corporation.

33. American Express engages in international banking operations, but does not domestically accept demand deposits or savings deposits.

34. American Express, through Shearson, offers an "FMA" account which is similar to Merrill Lynch's "CMA Account." See note 49.

35. American Express, through Shearson, brokers customers' funds into insured certificates of deposits. The FDIC and FHLBB's regulations attempting to restrict this practice of brokering deposits were struck down in FAIC Securities, Inc. v. United States, 768 F.2d 352 (D.C. Cir. 1985)

36. Commercial customers only.

37. Through its subsidiary Shearson.

38. Through Beneficial National Bank (USA) a nonbank bank located in Delaware. The bank does not make commercial loans.

39. Beneficial National Bank based in Wilmington, Delaware, "conducts a full service commercial banking operation, with emphasis on commercial lending in its local and regional market."

40. Dreyfus owns the Dreyfus Consumer Bank of East Orange, New Jersey. This bank is federally insured and offers demand and savings deposits. It does not make commercial loans.

41. Dreyfus offers a "High Yield Checking Service" which permits automatic transfers between money market mutual funds and investors checking accounts at banks.

42. Through Dreyfus Consumer Bank.

43. To the extent that the bank or thrift subsidiary is federally insured and to the extent that brokered funds are placed in certificates sold by federally insured institutions.

44. Dreyfus insurance subsidiary is presently dormant.

45. Ford owns First Nationwide Financial Corporation which is a holding company for First Nationwide Bank, a federally chartered stock savings bank. First Nationwide has branches in New York, California, Florida and Hawaii.

46. General Electric owns 80% of the investment banking firm of Kidder-Peabody.

47. Gulf & Western owns Associates National Bank and Heritage Federal Savings and Loan, both of which are located in California.

48. Available through either Valley National Bank or Household Federal Savings and Loan Association in California.

49. Available through its subsidiary Newport Balboa Savings and Loan Association located in California.

50. Through a cooperative agreement with Banc One of Ohio, Merrill Lynch customers may access the value of assets in margin accounts and the redemption value of certain shares either by check or credit card. Merrill Lynch has also established a state chartered FDIC insured bank in New Jersey.

51. Merrill Lynch acts as a broker by placing customers' funds in large certificates of deposit offered by insured banks and thrifts. As to the validity of the FDIC and FSLIC regulations attempting to limit this practice see note 32.

52. Merrill Lynch offers a "Cash Management Account (CMA)" in which funds are automatically transferred from a free credit balance to a money market mutual fund, and are accessible by check or credit card through an arrangement with Banc One.

53. Through Prudential Bank and Trust, Prudentual's nonbank bank.

54. Under consideration.

55. Through Allstate Savings and Loan subsidiary.

56. Brokered certificates of deposit offered through Dean Witter Reynolds.

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Franklin creates market for rarely traded stock

By LOLA BUTCHER

In an unusual transaction for a private company, Franklin Savings Association has made its stock available to the public. The company's goal is to create a market for Franklin stock so that employees who own the stock can easily sell it if they wish.

Based in Ottawa, Kan., Franklin is considered one of the largest — and one of the fastest-growing — savings and loan associations in the nation. As of March 31, the thrift boasted $9.1 billion in assets, up from just $214 million in 1981.

The company is private, with 95 percent of the company's stock owned by Franklin Savings Corp., a holding company of which Ernest and Barbara Fleischer are majority shareholders.

Earlier this year, however, Franklin executives issued a nine-for-one stock split to create more shares of the stock and thereby increase its liquidity. Since that time, about 3.5 percent — or about 2.1 million shares — of Franklin stock has been available for public trading. Although the company has about 550 shareholders, at least half of those are employees of either Franklin Savings or one of its subsidiaries.

Previously, the stock changed hands only when a seller happened to find a buyer in a private transaction.

The purpose of all this, said executive vice president Jerry Mayne, is to create a market for the stock so that Franklin employees who own the stock could sell it if they want to. Before the split, the only shares being traded were fetching more than $100; after the split, shares began trading in the $9.50 to $10.50 range.

"We're interested in there being a market for the stock for our employees who own it," Mayne said.

The only market-maker for the stock is Stern Brothers & Co., a Kansas City brokerage firm that Franklin Savings purchased last year. Mayne said he would like to have other market-makers. However, with such a small float of the stock, that might be unlikely.

Market makers maintain an inventory of a stock, must be prepared to buy or sell 100- shares at any time, and must announce bid and ask prices.

Stern Brothers is one of 12 subsidiaries that have been purchased or formed by Franklin Savings in the last few years. Others include a consulting entity, a real estate entity and three insurance subsidiaries. Additionally, Franklin is negotiating to purchase a major investment banking operation in Houston, a small bank in Pleasanton, Kan., and a savings and loan association in Coffeyville, Kan.

In an exhaustive research report, Stern Brothers' analysts Scott Stephenson and John Korschot point out a much-publicized basic about Frankin Savings: "First, and most importantly, Franklin is not the 'plain vanilla' type of savings and loan."

Rather, its growth has been propelled almost entirely by the purchase of mortgage-backed government securities such as those issued by Ginnie Mae and Freddie Mac. Those securities make up about 86 percent of Franklin's loan portfolio.

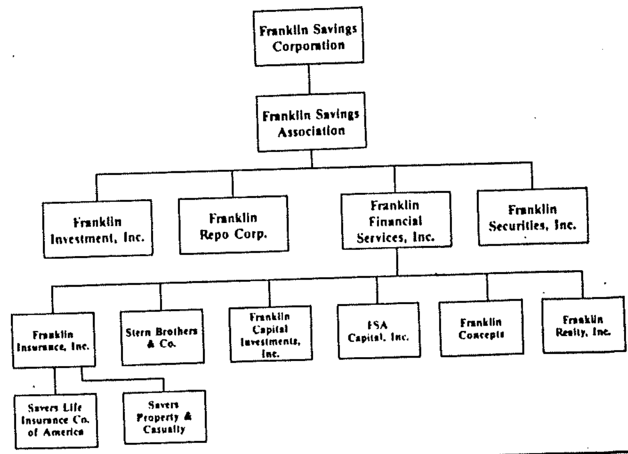
Earlier this year, Franklin executives issued a nine-for-one stock split to create more shares of the stock and thereby increase its liquidity.

The company's strategy is to acquire assets with low credit risk — the Freddie Macs and Ginnie Maes, for example — and hedge its interest rate risk through matching the duration of assets to liabilities. The biggest risk associated with this operating strategy, the analysts say, is that homeowners may want to refinance their mortgages during periods when interest rates are falling — which can upset the duration matching of Franklin's assets to liabilities.

Franklin executives, working with advisers at Smith Breeden Associates and using prepayment estimates of the government agencies that issue the certificates, predict what they think the prepayment rates will be. Earlier this year, Franklin said in a lawsuit that a faster-than-expected prepayment rate in early 1986 had cost it money, although it declined to reveal the extent of the cost. The suit against Federal Mortgage Acceptance Corp. seeks to have a federal judge order the agency to reveal how it makes its prepayment estimates.

In the fiscal year that ended June 30, 1986, Franklin tallied net income of $112.3 million, up from $37.4 million a year earlier. For the six months that ended Dec. 31, 1986, the company reported net income of $9.5 million, down from $16.5 million for the same period a year ago.

Franklin Savings' growing family of subsidiaries



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New York, and Tokyo, he said, are emerging as a single round-the-clock global market, with the same major banks and securities firms competing alongside each other in all three centers.

"The rapid acceleration of this development — and the changes taking place in the institutional structure of each of these centers — makes it essential that we achieve a meaningful degree of convergence in key aspects of financial, regulatory, and supervisory policies applicable to these markets," Mr. Corrigan stated. The approvals, he said, reflected Fed expectations that naming Japanese-owned firms as primary dealers should encourage greater access of U.S. financial institutions in the Japanese market.

While the Fed declines to disclose which firms have applied for primary dealer status, it is known that the Nikko Securities Company International Inc. and Yamaichi International (America) Inc. also have applied. But in his letter, Mr. Corrigan stated that there are "no other firms which meet all of our criteria as new primary dealers at this time."

The New York Fed said it planned no further additions to the dealer list for six months. This is to permit an "orderly adjustment to this significant expansion and change" in the ranks of primary dealers. The agency also unveiled plans to establish an informal "international capital markets advisory committee" composed of U.S. and foreign banks and securities firms to consult with the New York Fed on international capital market matters. ■

Kansas Thrift Buys Securities Firm

By ANDREA BENNETT
Midwest Bureau

CHICAGO — In an unusual transaction, a large savings and loan in Kansas has purchased an investment banking firm there.

Franklin Savings Association, Ottawa, Kan., completed the acquisition of Stern Brothers & Co., a privately held Kansas City, Mo., firm specializing in municipal finance, said Clay Coburn, executive vice president of Stern Brothers. The purchase price was not made public.

Stern Brothers, which was founded in 1917, is a full-service investment banking firm whose primary business is municipal bonds. According to Mr. Coburn, the firm is primarily controlled by two members of the Stern family, who wanted to liquidate it for tax purposes.

As part of the liquidation plan, the investment banking function of Stern was sold to Franklin Savings. The acquisition primarily involved the employees, furniture, and offices of the existing firm.

The firm also had "substantial assets not used in the securities business" that were not bought by the thrift, Mr. Coburn said.

Stern Brothers, which will operate as a subsidiary of Franklin, is expected to offer an expanded range of products in the future, including collateralized mortgage obligations. Franklin Savings has been active in the mortgage-backed securities market.

"All of the products we've been involved with in the past will continue," Mr. Coburn said. "Through Franklin, we will get more involved in mortgage-backed securities."

Mr. Coburn said that there is "a lot of synergism" between the two firms and that there should also be some synergism between Franklin's insurance and real estate subsidiaries and Stern Brothers.

Franklin Savings had assets of $3.2 billion at the end of 1985. ■

Citibank . . .

Continued from Page 2

cials mingled in their lobby to watch as a group of eight protesters locked arms and stood in front of the bank's revolving-door entrance. Effectively, the move did nothing to disrupt business; the "blockade" took place after the branch office had closed for the day, while messengers and employees shuttled in and out of the building through the bank's after-hours doors on 53d Street.

William Wipfler, human rights director for the National Council of Churches, said his participation in the symbolic gesture represented a message that "Citicorp can't carry on its business as usual." He added that the group hoped to organize a series of blockades and rallies against the bank.

"We believe everybody has a right to demonstrate, but they're on the wrong side of the street," Mr. Koplewitz said. "We share the concerns of the demonstrators, we share the concerns of those who disagree with our strategy, and we listen to their criticism. But we don't

Thrift association to offer mutual funds; annuities and life insurance may follow

In what may be the first instance of a bank or [illegible] trade association networking financial [illegible]cts, the U.S. League of Savings Institutions h[illegible] begun to market mutual funds through its member institutions.

Donald Maag, president of U.S. League Investment Services, the League's investment management subsidiary, says he expects some 300 institutions to be participating by the beginning of 1988. Further, the League may offer annuities and single premium insurance in the not-too-distant future.

The program, called Advance America, will involve two independent financial marketing organizations, PAMCO and Marketing One, which will manage the distribution of the products, including sales training, advertising, and back office services. Maag's group will manage the funds.

Already 15-20 percent of savings institutions in this country are offering some form of investment/insurance product, Maag observes, whether it be single premium life (SPL), deferred annuities, mutual funds, etc. The demand "has been increasing each year," buoyed by a strong stock market (at least until recently), the new tax law, and the need on the part of thrifts to compete with other financial services companies. Savings institutions have been losing money to the Merrill Lynches of the world, Maag suggests.

Eager to broaden services

Through extensive surveys and discussions, the League learned that the institutions were eager to broaden their services still further. In fact, one survey revealed that among member institutions that were *not* offering some kind of investment/insurance product, 30 percent would be doing so within 18 months. Counting participating institutions and soon-to-be participating institutions, "That's one half of the industry," Maag notes.

It is expected that 300 institutions will be participating soon.

The League therefore saw merit in developing products specifically tailored to the institutions' needs. U.S. League Investment Services, which has been the League's broker/dealer subsidiary for five years now, was the obvious candidate for the task. Maag says his group spent much of last year scrutinizing products, sales systems, players, manufacturers, etc.

"Our research indicated that 90 percent of all securities sold [through savings institutions] represented fixed income products," observes Maag.

Already 15-20 percent of the nation's savings institutions are offering some form of investment/insurance product.

U.S. League Investment Services therefore settled on four fixed-income portfolios for the fund: 1) a government securities fund 2) a Ginnie Mae fund 3) a high-quality corporate bond fund, and 4) a tax-free municipal bond fund.

As for the actual marketing of the program, Maag observes: "Savings institutions and banks have the same problem: They can buy product from anyone. But how do you sell it?" He says the League decided "not to get into distribution." They selected PAMCO and Marketing One from among 20 companies that offer sales delivery systems.

Fund carries a 4.5 percent load

Maag expects the participating institutions to run the gamut: From the largest savings institutions in the country down to the smaller $100 million (assets) institutions.

Maag says he expects salespeople to come from both within and outside the institutions. All will have to be NASD-licensed.

The funds carry a 4.5 percent load. Of that, the individual institutions will receive 4.25 percent and Maag's group 25 basis points. PAMCO and Marketing One will share commissions with the individual institutions.

As for annuities and single premium life, "We're working on those programs right now." They chose to lead with mutual funds simply because "that was our initial expertise," i.e., in the investment management area.

Do the institutions fear significant disintermediation from the program? "Disintermediation is a concern of most chief executive officers, but if the product is properly positioned, sold and managed, there will be very little disintermediation."

He says the League is the "first trade association to do something like this."

American Banker
Friday, February 12, 1988

Kansas Thrift Snaps Up Experts From Merrill for Merchant Bank

By PHIL ROOSEVELT

NEW YORK — Franklin Savings Association has hired four Merrill Lynch finance professionals, including the head of its asset-backed securities department, to start an unusual merchant banking unit.

The New York unit will invest some of the Ottawa, Kan.-based thrift's capital in leveraged buyouts, venture capital projects, and corporate restructings, Franklin officials said.

"It's a small experiment and will remain so until we feel completely comfortable with it," said Franklin chairman Ernest Fleischer.

Franklin already has attracted widespread attention for aggressive investment in mortgage securities. Its assets have ballooned from about $200 million in 1981 to $9.4 billion.

While many thrifts invest in publicly traded stocks, few are known to take equity positions in small private companies, said Joseph Stieven, an analyst at Stifel Nicolaus & Co., St. Louis.

"I would say that if anyone in the business was going to do it, it would be Franklin," he said. "Franklin is one of the most nontraditional thrifts anywhere."

Gary Lieberman, formerly executive vice president in charge of asset securitization at Merrill, will head the unit. He will be joined by Merrill colleagues Barry M. Levine, who becomes senior vice president, and Polly Morgan Barry and Jeffrey Moses, who become vice presidents. Mr. Lieberman also was named chairman of Stern Brothers & Co., Franklin's Kansas City, Mo., investment banking subsidiary. He will be based in New York.

The four are not the first Merrill employees Franklin has picked up. Last summer, for example, John Scowcroft left his post as head of mortgage-backed securities research at Merrill Lynch Mortgage Capital Inc. to become vice chairman of Franklin.

Mr. Fleischer said the string of hiring from Merrill "is really the result of Merrill being Franklin's primary investment banker," which has allowed Franklin and Merrill professionals to become well acquainted. Franklin also has attracted employees from some other Wall Street houses, he added.

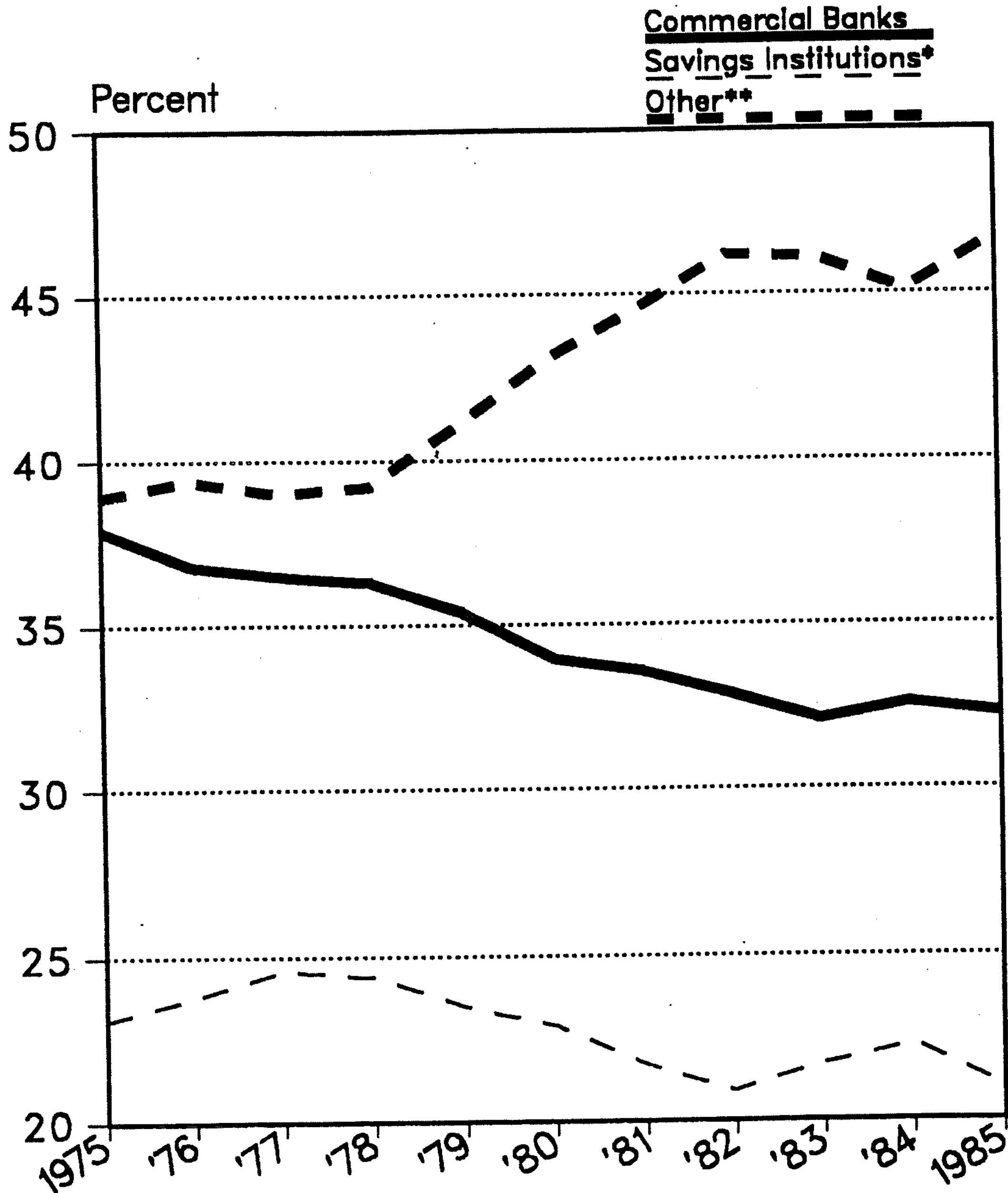
While Franklin's growing stable of Wall Street talent is considered rare among thrifts, some other thrifts are beginning to tap investment banking firms for talent. Miami-based CenTrust Savings Bank, for example, recently hired Ronald DiPasquale, a director in mortgage securities trading at Salomon Brothers, to head a new capital markets group.

Mr. Lieberman and the three other ex-Merrill employees joining Franklin have backgrounds in asset-backed and mortgage-backed securities, which makes them well-suited to Franklin, Mr. Fleischer said. In addition, he said, they are eager to branch out into merchant banking. Mr. Leiberman could not be reached for comment.

Mr. Fleischer said the unit will aim "to serve the smaller business market that is overlooked or can't be served" by larger merchant banking concerns. The likely size of deals, he said, "is best measured in $100,000 increments rather than $100 million increments."

Among the few other thrifts known to have merchant banking units is East River Savings Bank, New York. It's so-called corporate merchant banking unit invests in a variety of companies through a combination of loans and equity positions, said Nelson Stephenson, chief financial officer. ■

CHART 3

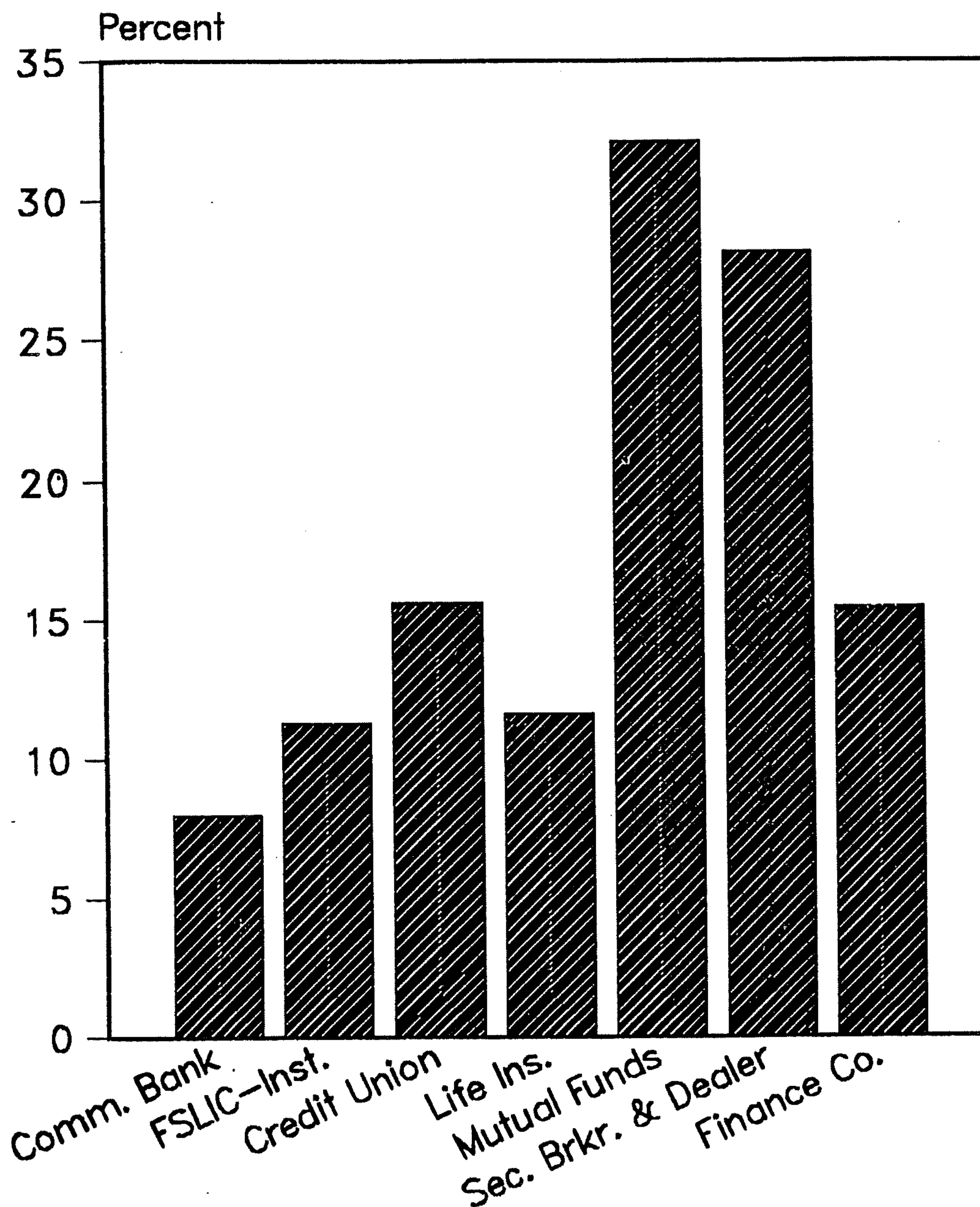


* Savings and loan associations, savings banks, and credit unions.

** Insurance companies, pension funds, finance companies, real estate investment trusts, money market funds, mutual funds, and security brokers and dealers.

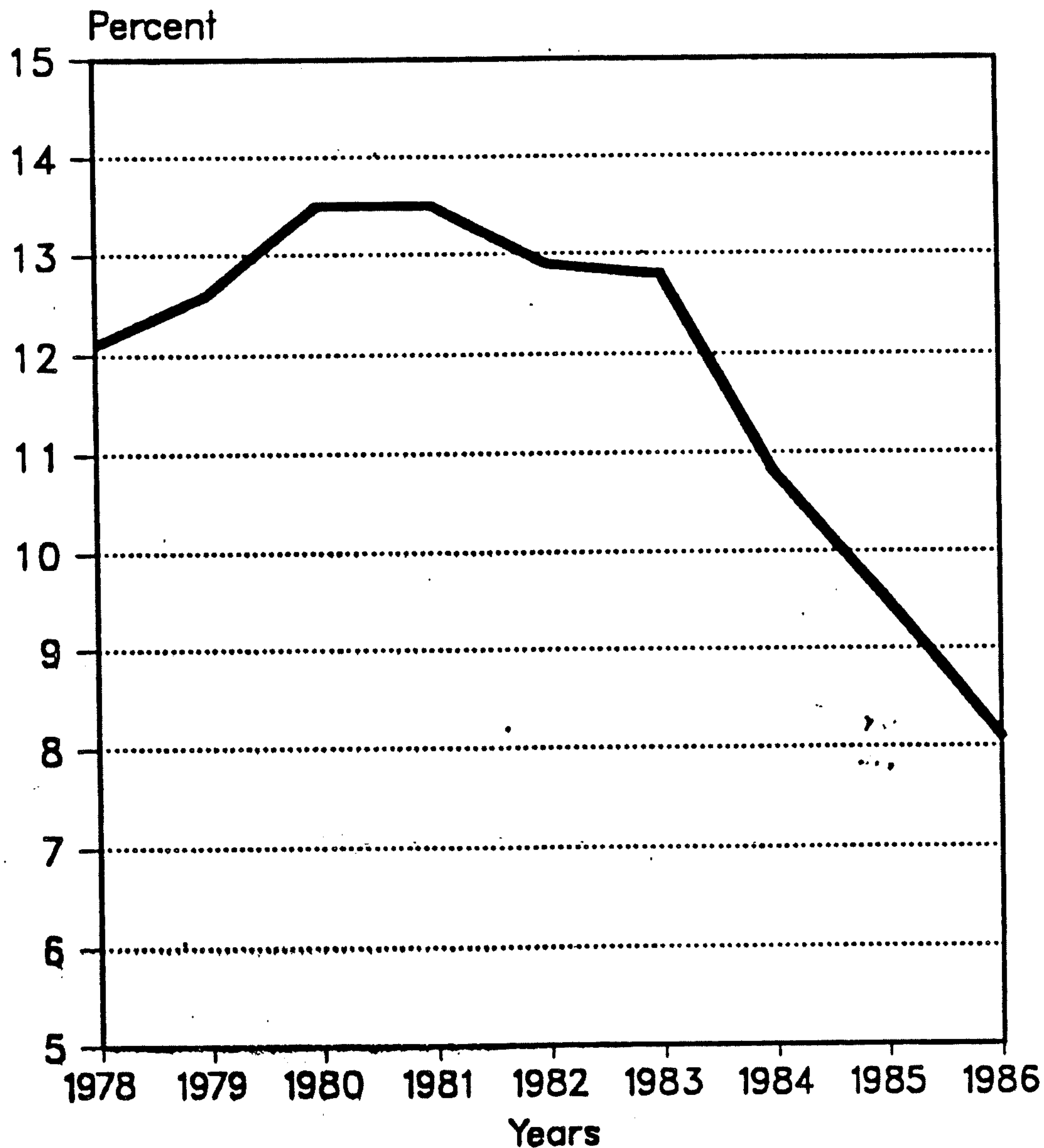
Source: Federal Reserve Board Flow of Funds Accounts.

CHART 5



Source: Federal Reserve Bulletin, New York Stock Exchange Fact Book.

EXHIBIT 8
COMMUNITY BANK RETURN ON EQUITY



Source: Federal Deposit Insurance Corporation

STATE AUTHORIZATION OF SELECTED POWERS FOR STATE-CHARTERED BANKS*
(September 1987)

Insurance[1] Underwriting

- Delaware[2]
- North Carolina
- South Carolina
- → South Dakota
- Utah[2]

Brokerage[1]

- Alabama
- Indiana
- → Iowa
- → Nebraska
- North Carolina
- Oregon
- South Carolina
- → South Dakota
- Wisconsin
- Wyoming

Real Estate Equity — Participation

- Arizona
- → Arkansas
- California
- → Colorado
- Connecticut
- Florida
- Kentucky
- Maine
- Massachusetts
- → Missouri
- Nevada
- New Hampshire
- New Jersey
- New York
- North Carolina
- Ohio
- Rhode Island
- → South Dakota
- Tennessee[5]
- Utah
- Washington
- Wisconsin[6]

Real Estate Equity — Development

- Arizona
- Arkansas
- California
- → Colorado
- Connecticut
- Florida
- Kentucky
- Maine
- Massachusetts
- Michigan
- → Missouri
- Nevada
- New Hampshire
- New Jersey
- New York
- North Carolina
- Ohio
- Rhode Island
- → South Dakota
- Utah
- Washington
- Wisconsin[6]

Real Estate Brokerage

- Florida
- → Iowa
- Massachusetts
- North Carolina
- Oregon

Securities Underwriting[1]

- Arizona
- California
- → Iowa
- Maine
- Maryland
- Massachusetts[4]
- Minnesota[7]
- New Jersey
- North Carolina
- Ohio

Full Service Brokerage/ No underwriting[1]

- Arizona
- California
- Delaware
- Florida
- Georgia
- → Iowa
- Maine
- Michigan
- Minnesota
- New York
- North Carolina

Management Consulting

- California
- → Iowa
- Maine
- Maryland
- → Nebraska
- New Jersey
- North Carolina
- Ohio
- Rhode Island
- Virginia

Travel Agencies

- Alabama
- California
- Connecticut[3]
- Indiana
- → Iowa
- Kentucky
- → Nebraska
- New Jersey
- New York
- North Carolina
- Ohio
- Oregon
- Pennsylvania
- South Carolina
- → South Dakota

*Accuracy and completeness of data not determined; extent practiced also unknown

1 In addition to credit-related insurance activities and other exemptions permitted under the Bank Holding Company Act.
2 Grandfathered institutions.
3 One commercial bank has a travel agency, dating back to 1913. Permitted by tradition.
4 May underwrite mortgage backed securities.
5 Banks not allowed to be active partners in real estate development.
6 Wisconsin - Enacted expanded powers legislation 5/86. New legislation authorizes the Commissioner of Banking to promulgate rules under which state banks may engage in activities that are authorized for other financial institutions doing business in the state.
7 Underwrite mutual funds and may underwrite securities to extent of the state legal loan limit.

**Source: Supervisory Procedures Committee of the Conference of State Bank Supervisors

press release

For further information contact:
JOSEPH E. JONES, Vice President/Director of Public Affairs

Released On Receipt
Tuesday, January 12, 1988

CSBS Supports State Authorized Products And Services; Pledges Continuing Safety And Soundness Vigilance

Washington, D.C., Tuesday, January 12--The Board of Directors of the Conference of State Bank Supervisors (CSBS) has adopted a resolution on the need for states to authorize bank products and services of benefit to consumers. The Board resolved that CSBS "...vigorously supports the authority of states to empower and regulate the activities of state-chartered banks, including the offering of securities, insurance and real estate products and services as determined by the states to serve best the interests of their citizens." The Board further resolved to oppose efforts by Congress or the federal bank regulatory agencies to weaken or preempt state authority. The Board also emphasized CSBS's commitment "...to continue to cooperate and work in close concert with the Federal Deposit Insurance Corporation to ensure that the exercise of ...state authority will not in the future, as it does not today, present an inordinate risk to the banking system as a whole or to the FDIC fund."

The Board noted the historical Congressional support for each state to authorize diverse products and services best suited to its needs and emphasized the good records to date of institutions offering the services and of the state banking departments regulating and supervising them. Special emphasis was placed on the fact that the Office of the Comptroller of the Currency and state banking departments constitute the first and most constructive element in the banking system safety net.

The Board also enumerated the following public interest benefits from state authorizations of bank products and services: (1) Increased cost competition of benefit to consumers; (2) improved local services tailored to local needs and convenience; (3) expertise

(OVER)

Conference of State Bank Supervisors 1015 18th Street, N.W. Washington, D.C. 20036 (202) 296-2840

of the primary regulators in balancing service, profit and risk considerations in evaluating a particular activity; (4) flexibility to provide different services in different markets, including the ability to explore alternative solutions in a responsible manner in areas of the country that are experiencing economic difficulties; and (5) maintenance of the states' potential as the primary vehicle for innovation in the banking system.

# # # # #

GIVE US THE TOOLS, BANKS THE POWERS, REGULATORS AGREE

Banking regulators last week might have provided a glimpse into the strategy they will adopt at this juncture to convince Congress to allow banks a broader array of powers: give the agencies sufficient enforcement authority to insure safety and soundness, and the diversity permitted banks won't matter.

Indeed, regulators are in general agreement that banks and bank holding companies can conduct securities and other non-banking activities safely through subsidiaries or affiliates, despite the concern of the General Accounting Office and others that no current banking industry structure can completely isolate deposits from the dangers of such activities as operating a discount brokerage or securities underwriting.

"Professional regulators are in agreement that with proper statutory support, we can allow banks to compete through subsidiaries and affiliates with proper safety and soundness," L. William Seidman, chairman of the Federal Deposit Insurance Corporation, told Congress last week.

The FDIC believes that if the banking system is to remain "adequately profitable," it must be allowed to pursue profit opportunities "throughout the financial services industry," he explains.

Q → "We believe these opportunities can be pursued in a manner that is consistent with safety and soundness considerations if appropriate safety surveillance is provided by regulators," Seidman says.

→ Long-range banking industry restructuring is overdue, he adds, "and should be undertaken to improve competitiveness, reduce regulatory costs and provide increased safety and soundness for the financial system."

And, adds Robert L. Clarke, Comptroller of the Currency, "If we buy the argument that bank deposits and the bank can be protected through adequate safeguards, it doesn't make a whole lot of difference how broad the activities banks are allowed to participate in."

The regulators believe the industry is doing what it should to improve its capital position, and a major detriment to the safety and soundness of the industry are banking laws designed 50 years ago.

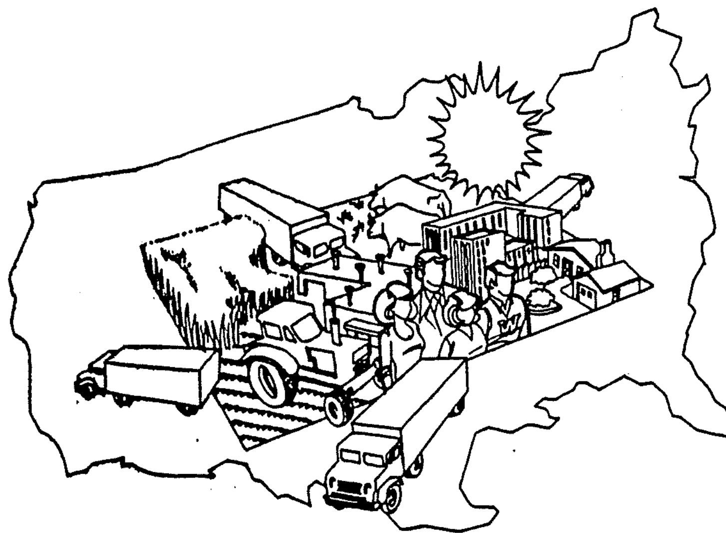
Q → "Banking laws are going to have to be modernized and banks are going to have to be allowed to compete," Clarke says.

→ The competition, Clarke says, retailers, brokerages, insurors and mutual funds, "are becoming ingenious in offering services which compete with banks," and Congress must respond by providing a "structural system that allows banks to compete in virtually every area."

Indeed, Manuel H. Johnson, vice chairman of the Board of Governors of the Federal Reserve Board, the most conservative banking industry regulator, also agrees. "Expanded powers are definitely needed for bank holding companies," Johnson says, "although the Federal Reserve Board does have problems with allowing banks themselves to have these powers."

Johnson explains that the Fed "is hesitant to let banks in particular use their capital to engage in riskier activities. "A far safer approach is to allow banks to use subsidiaries or affiliates to engage in these activities."

Report of the Commission on the Future of Kansas Agriculture



Kansas Agriculture and Rural Communities: Changing and Adapting To Survive

October 1987

KANSAS AGRICULTURE AND RURAL COMMUNITIES: CHANGING AND ADAPTING TO SURVIVE

This report of the Commission on the Future of Kansas Agriculture is respectfully submitted to the Governor, the Kansas Legislature, and the rural and urban residents of this state. In the following pages, the Commission identifies the 10 key issues facing the state's agriculture and submits ways and means for addressing those issues. Submitted on behalf of the Kansas State Board of Agriculture and the Commission on the Future of Kansas Agriculture.

Sam Brownback, Chairman
Kansas Secretary of Agriculture

Senator Gerald L. Karr
Farmer/Stockman
Emporia, Kansas

Senator Don Montgomery
Farmer/Stockman
Sabetha, Kansas

Representative William M. Bryant
Farmer/Veterinarian
Washington, Kansas

Representative Lee Hamm
Farmer/Dairyman
Pratt, Kansas

Ernie Mosher
League of Kansas Municipalities
Topeka, Kansas

Tom Kruse
Farm Credit Services
Wichita, Kansas

Dwayne Jones
Kansas Bankers Association
Oberlin, Kansas

Edie Dahlsten
Farmer/Stockman
Lindsborg, Kansas

Robert Paris
Farmer/Stockman
Dighton, Kansas

Dean Walter R. Woods
Kansas State University
Manhattan, Kansas

Wilbur Leonard, Legislative Agent
Committee of Kansas Farm Organizations
Topeka, Kansas

Ed Bruske
Kansas Chamber of Commerce & Industry
Topeka, Kansas

For more information contact:

Kansas State Board of Agriculture
109 SW 9th Street
Topeka, Kansas 66612-1280
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2. Improve business management.
   A. Farmers must understand their own business operations and manage them appropriately to ensure the greatest net profit. Business management in agriculture can be improved by:
      1. Supporting and expanding the Kansas Farm Management Association programs offered through Kansas State University to assist farmers in further developing their financial information systems and management skills. Kansas bankers and the Farm Credit System can assist by strongly urging their borrowers to become involved in the Farm Management Association.
      2. Fostering financial and business management counseling programs to make management self-improvement opportunities available to farmers, ranchers and rural business owners.
      3. Supporting the wise use of credit and better understanding of the problems associated with credit.
   B. Help strengthen the financial institutions which serve agriculture.
      1. Agriculture must have credit and use it wisely to survive. Many of the basic financial institutions providing credit to agriculture have suffered during the recent agricultural downturn. Use of agricultural credit can be improved by:
         a. Creating a secondary loan market for agricultural loans. The Commission supports the creation of an "Aggie Mae" federal program as a secondary market for agricultural loans.
         b. Providing early assistance to the Farm Credit System. The Commission supports assistance to keep the system viable and keep its stock from being impaired.
         c. Allowing agricultural banks to offer a full range of financial products and services including insurance, security transactions and others. Not only would this cause the price of those products to decline to consumers through increased competition, but it would also allow loan losses to be repaid from sources other than interest rates on loans.
         d. Allowing loan losses at agricultural banks to be amortized over a ten-year-period.
         e. Continuing all possible efforts to find and implement ways to lower interest rates paid by farmers.

3. Cooperate with the Legislature to examine the role of corporations in farming and food production, in particular the issue of corporate hog production in Kansas. All the facts of whether this would be good or bad for the state should be examined.

4. Facilitate the development of a Blueprint Study for Kansas Agriculture emphasizing areas of greatest opportunity for value-added agricultural enterprises and diversifying Kansas agriculture.

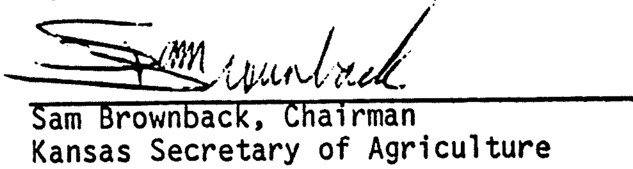
5. Work with existing agribusinesses to improve their operating environments.

6. Promote the sale of American produced agricultural products through the use of labeling.

CONCLUSION

Kansas agriculture and rural communities are in a period of transition. They are changing and adapting to survive. As a rural state with an agricultural base it is imperative that Kansas marshall all of its resources to assist these transitioning entities. All of us as Kansans have a stake in assuring that our rural economy makes the transition in a healthy form. The Commission hopes that this report will help to focus the efforts of all Kansans in assisting agriculture and rural communities to a more prosperous future.

Respectfully Submitted by the Commission on the Future of Kansas Agriculture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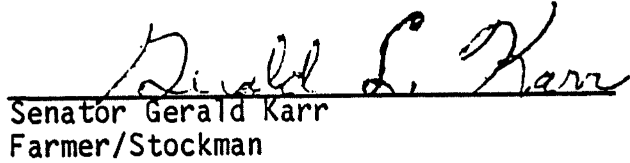
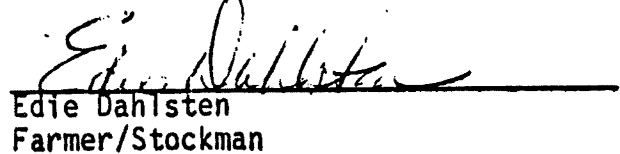
Kansas Secretary of Agriculture

Dwayne Jones
Kansas Bankers Association


Senator Gerald Karr
Farmer/Stockman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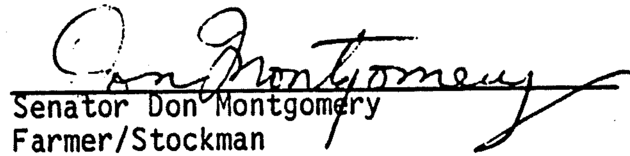
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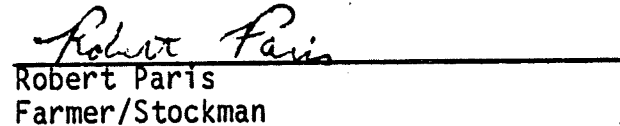
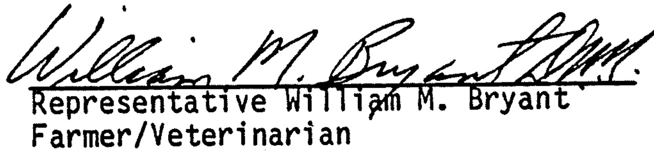

Robert Paris
Farmer/Stockman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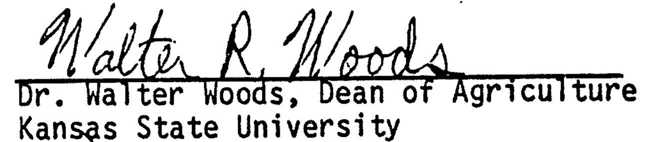
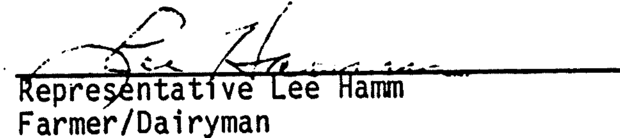

Dr. Walter Woods, Dean of Agriculture
Kansas State University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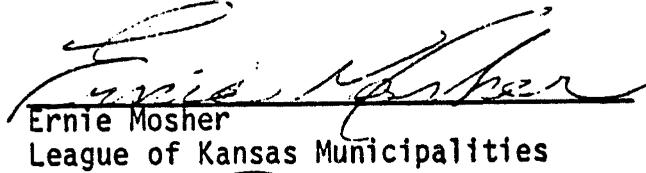
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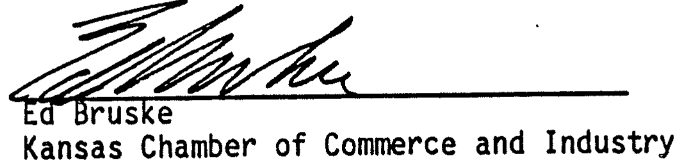

Ed Bruske
Kansas Chamber of Commerce and Industry

Tom Kruse
Farm Credit Services

KANSAS STATE BANK
MEMBER FDIC
P.O. Box 327 / Garnett, KS 66032 / (913) 448-3191
P.O. Box 8 / Westphalia, KS 66093 / (913) 489-2231

House Commercial and Financial Institutions Committee

Mr. Chairman and Members of the Committee:

My name is Jim Cooper. I am President of the Kansas State Bank, Garnett, Kansas, and chairman of the State Affairs Committee of the Kansas Bankers Association. I ask for your support of House Bill 2738, to grant additional powers to state-chartered banks in the areas of real estate investment and securities services.

Attached are some charts revealing some alarming figures:

1. Over the last six years return on equity for community banks nation wide has reduced 40%
2. In Kansas, return on assets for all banks has dropped 45%
3. Net income for Kansas Banks has dropped from 200 million in 1983 to 145 million in 1986.

I think we all understand how important strong and viable banks are to communities. We are seeing our role as the backbone of financial services being steadily weakened by our inability to provide services that other entities are providing.

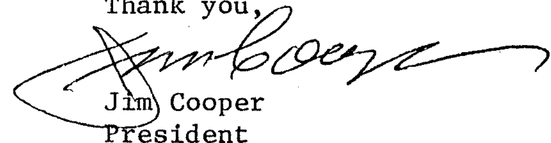
Enclosed are copies of advertisements whereby stock brokers are advertising FSLIC and FDIC insured deposits, however we cannot even offer our customer access to funds investments. We are losing the ability to retain our customers.

Insurance companies are making consumer loans and home equity loans.

We are not asking that you prohibit our competition from these services. We are asking for fair and equitable treatment. We are merely asking for what many states have already granted, equal opportunity to serve and compete. Bankers are not afraid to compete, given a "fair playing field".

Since we are state chartered banks, and since historically states have been able to best decide what is good for their banks we come to you for support so we may expand our services to the customers of our communities.

Thank you,



Jim Cooper
President

JWCbb

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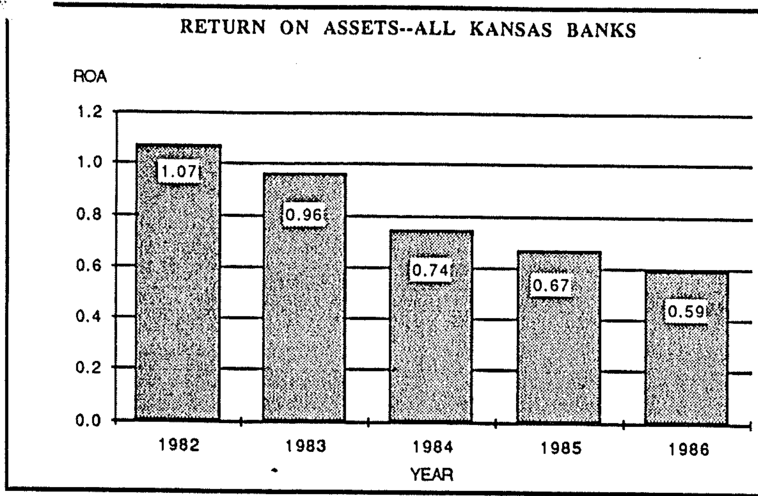
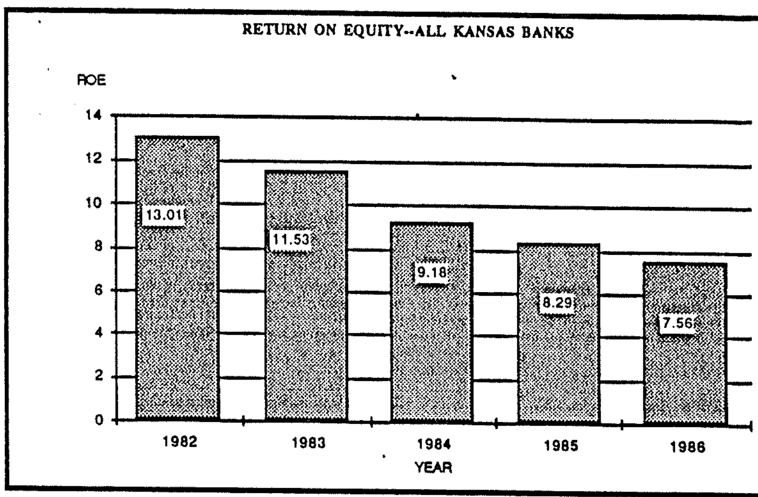
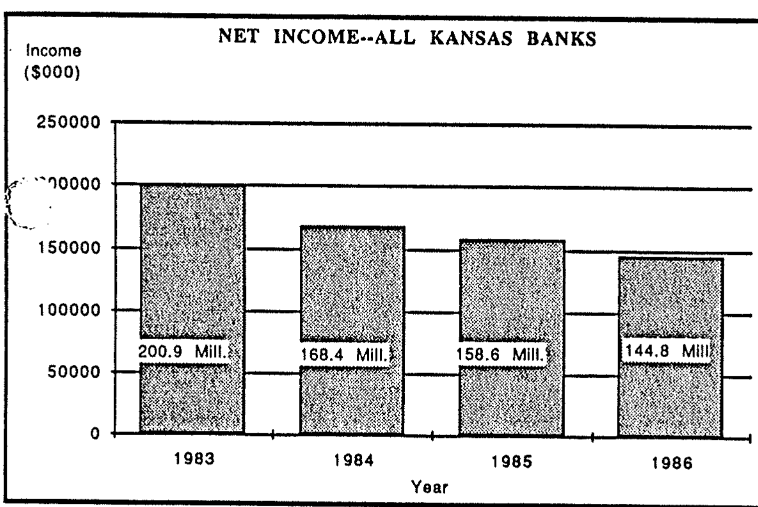
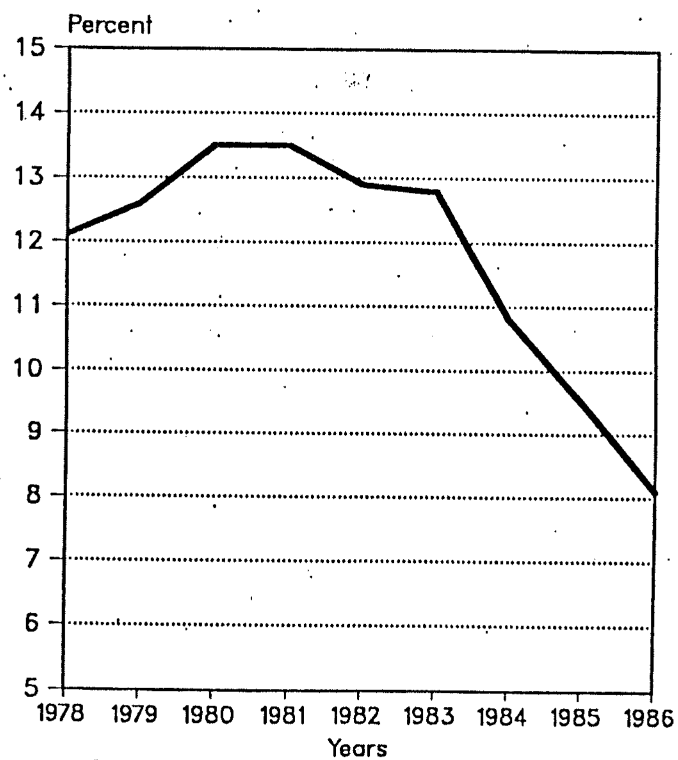


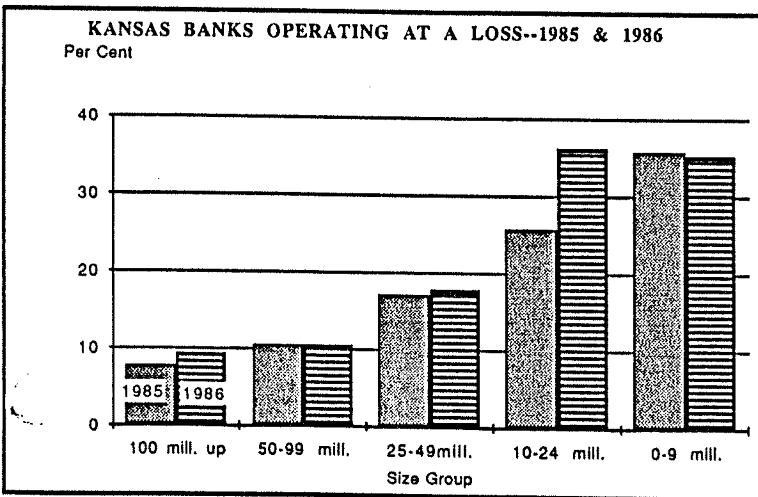






Banks - Nationwide

Source: Federal Deposit Insurance Corporation



Financial Letter
FEDERAL RESERVE BANK OF KANSAS CITY

Bank Profitability in Tenth District States

The profitability of commercial banks in Tenth District states declined in the first half of 1987, continuing the recent trend of deterioration. However, performance of banks varied by size, type, and location. Profitability declined in Colorado, Kansas, Missouri, New Mexico, and Wyoming, but improved in Nebraska and Oklahoma.

Performance comparisons

Overall, banks' return on assets (ROA), the ratio of after-tax profits to average assets, continued to decline in the first half of 1987. The ratio fell to 0.39 percent down from 0.53 percent in the first half of 1986 and 0.70 percent in the first half of 1985 (Chart 1).

Chart 1
RETURN ON ASSETS
TENTH FEDERAL RESERVE DISTRICT
(Profits as a percentage of average assets)

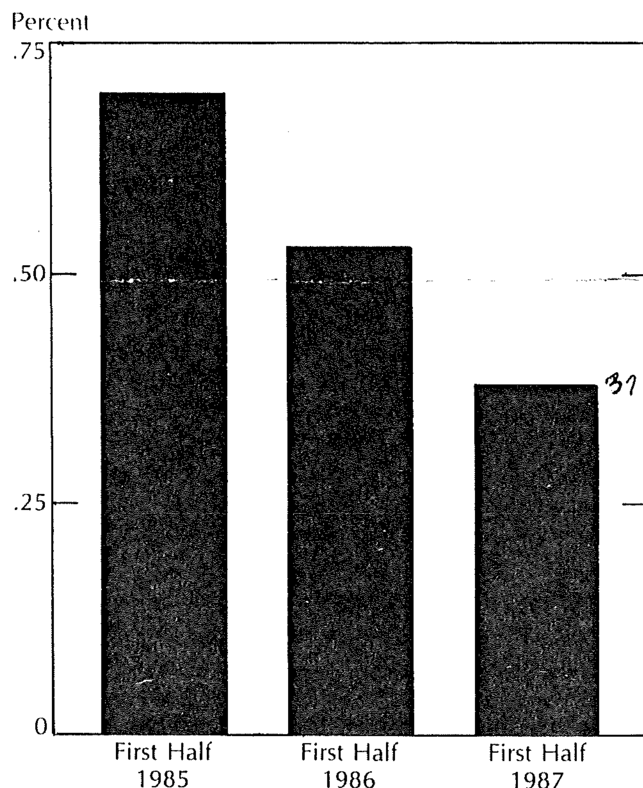
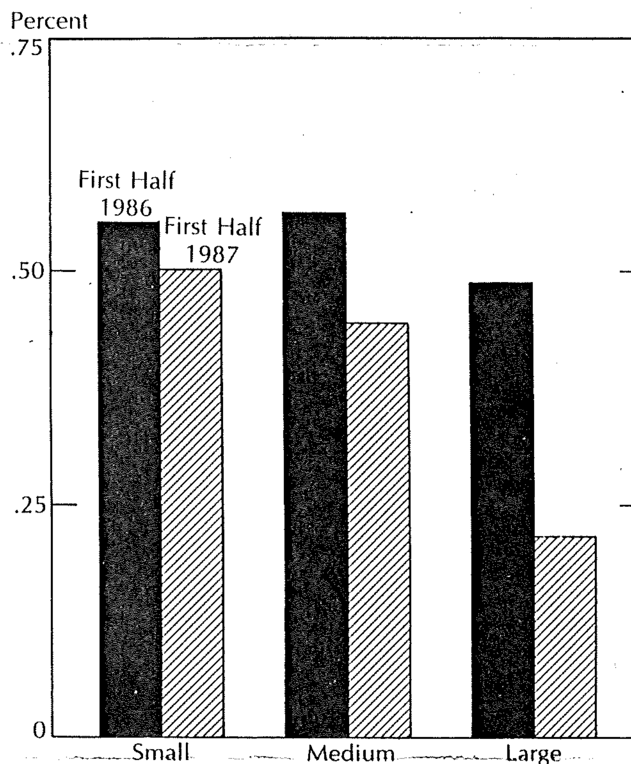


Chart 2
RETURN ON ASSETS BY SIZE OF BANK
TENTH DISTRICT BANKS
(Profits as a percentage of average assets)



NOTE: Small banks had assets less than $62 million in the first half of 1987, medium-sized banks had assets between $62 and $375 million, and large banks had assets of more than $375 million.

Although profitability declined overall, the performance of individual banks varied widely. From the first half of 1986 to the first half of 1987, ROA decreased at 1,590 banks in district states but increased at 1,160 banks. And while 780 banks showed declines of 50 basis points or more, 540 banks showed profitability increases of 50 basis points or more.

The magnitude of the decline in performance also varied with the size of banks. Chart 2 shows ROA for three size groups, each holding one-third of the banking assets in district states. Although ROA was down for all three size

Research Division, Federal Reserve Bank of Kansas City
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9-17-87

long and will start at the Lutheran Church traveling to the downtown square, out to the north lake and then finishing up at the church.

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Testimony on HB 2738
by Larry W. Magill, Jr., Executive Vice President
Independent Insurance Agents of Kansas
Before the House Commercial & Financial Institutions Committee
February 16, 1988

Thank you Mr. Chairman and members of the committee for the opportunity to appear today in opposition to HB 2738. As we understand the measure, it would grant broad, expanded real estate and securities power to Kansas banks.

We view this legislation as an intergral part of the entire debate over the historical separation of banking and commerce. If you begin to tear down this critical economic safeguard this year, relentless pressure will mount for new powers next year and the year after that until banks have been given complete freedom to engage in any form of commerce.

The appropriate forum for this debate is the U. S. Congress. Kansas' banking laws have traditionally followed federal authority rather than taken the lead. If Congress should decide to grand expanded bank powers, Kansas would surely follow or state banks would simply change to federal charters.

Congress currently has a moratorium on expanded bank powers enacted in 1987 as part of CEBA, the Competitive Equality Banking Act of 1987. The moratorium is due to expire March 1, 1988, but Congress will not act by then and may not act on the issue of expanded powers in 1988. Nevertheless, we feel that is the appropriate forum for this debate.

The Glass-Steagall Act was passed 54 years ago in 1934 following the tragic stock market crash and resulting bank failures, many of which were due, at least in part, to investment activities by banks.

In 1987, 184 banks failed, the largest number since 1934. Yet U.

Atch 3

S. banks emerged from the stock market crash of Black Monday, October 19, 1987, virtually unscathed because of Glass-Steagall. Please refer to the attached ad run by our national association in a Washington, D. C. newspaper recently showing the increase since 1977 of bank failures.

The one exception was Continental Illinois National Bank that had cost the FDIC a huge sum in 1984 to prop them up and avoid a devastating failure. Continental Illinois was caught exceeding its lending limits to its securities subsidiary to cover losses incurred by the market crash according to the attached article titled, "Outlook 88" from Bottomline magazine.

Likewise, the recent bankruptcy of one of the areas best known real estate developers, Kroh Brothers, graphically illustrates the risks associated with real estate development.

We feel that separation of banking and commerce is essential for the safety and soundness of the banking industry. If they are failing at this rate in their principal activity, banking, how can letting them enter even higher risk new fields improve that picture?

Further, we envision a potential regulatory nightmare. Will there be a clear line between banking, securities and real estate regulation and control? The securities industry involves extensive regulation at both the state and federal level. If a question arises over a particular product or service, who will decide which regulatory body has control? Will bank examiners know enough about the securities and real estate fields to adequately regulate solvency?

Banks' ability to tie-in credit with other services and the resulting potential for coercion pose a significant threat to consumers. Bank abuse of credit insurance sales through extraordinary

penetration of their lenders on sales and their use of the highest commission products regardless of cost to the consumer are well documented. Attached to my testimony is an article titled, "Credit Tie-Ins: The Banks Credibility Gap" which provides detailed examples.

This same ability to tie-in the sales of other services exists, if only in the mind of the consumer. Even if banks did nothing, many creditors would feel compelled to buy other services to "improve" their credit worthiness. No law against tie-ins can prevent this from happening.

There has been no consumer outcry for expanded bank powers. In fact, the American Banker's own consumer survey shows that the majority of Americans do not favor expanded powers. Attached is a copy of their article.

Finally, we are concerned about the continued concentration of economic power in our state which will inevitably have a negative effect, particularly on the small consumer.

For these reasons, we urge the committee to not act favorably on HB 2738.

Insurers Hit Bill To Give Banks Securities Powers

By LEAH R. YOUNG
Journal of Commerce Staff

WASHINGTON — Both life insurers and independent insurance agents Wednesday criticized compromise proposals to give banks new securities powers, saying they include underwriting and sale of some insurance products.

Robert R. Googins, executive vice president of Connecticut Mutual Life Insurance Co., told the Senate Banking Committee that the limited program agreed to by committee chairman William Proxmire, D-Wis., and Sen. Jake Garn, R-Utah, will invite interpretation to include insurance products.

The bill would permit bank affiliates to underwrite or distribute securities of any type. It would amend the Glass-Steagall Act to allow commercial banks to have securities affiliates.

Mr. Googins, who represented the American Council of Life Insurance, said the wording would include all variable annuity and variable life insurance contracts since they have a securities component.

The bill would also authorize the underwriting and sale of guaranteed interest contracts such as group annuities used in the corporate pension market.

The wording would permit national banks that do not have securities affiliates to market variable annuity and variable life insurance products, as well, Mr. Googins said.

He characterized the legislation as establishing "an insurance loophole for many bank holding companies and national banks through which they could engage in the business of insurance. This loophole scenario would undoubtedly be endorsed by banks and their regulators."

A. William Bailey — vice president of the Independent Insurance Agents of America Inc., speaking for a coalition of the five national trade associations that represent insurance agents — agreed with this interpretation.

He contradicted testimony by large financial services institutions that banks need more insurance and other powers than contemplated in the compromise.

Mr. Bailey argued that increased bank powers will not create a level playing field as characterized by the Financial Services Council — a group of major financial conglomerates, including John Hancock Mutual Life Insurance Co.

Those companies want a much freer hand to amalgamate financial services under one corporate roof and are supporting broader legislation offered by Sens. Alfonse D'Amato, R-N.Y., and Alan Cranston, D-Calif.

"Insurance agents do not stand on the same economic level as big bank holding companies," Mr. Bailey protested.

"Citicorp can buy as many insurance agencies as it wishes. But we've not heard anyone suggest that insurance agencies will be able to snap up bank holding companies."

Sen. Garn was harshly critical of the position of the life insurance industry, saying to Mr. Googins that his testimony was "boring and self-serving."

Sen. Phil Gramm, R-Texas, then defended the testimony, observing that "if you don't all advocate your interests it is unlikely your interests will be advocated around here."

Sen. Gramm suggested that it's up to Congress, not affected groups, to create legislation that reflects perceived public interest.

E. James Morton, chairman and chief executive officer of John Hancock, told the committee that the major financial players that he represents want passage of the Cranston-D'Amato bill and will not endorse the lesser compromise.

He told Sen. Proxmire that he could only endorse his bill if it were "the first step in a program designed for comprehensive reform," and not a last step, as he believes it will be perceived.

Others in the coalition did not agree. Harry Freeman, executive vice president of American Express Co., emphasized: "We don't want the piecemeal approach. We prefer to have nothing."

A third view was voiced by William Fitzpatrick, executive vice president of Calfed Inc.

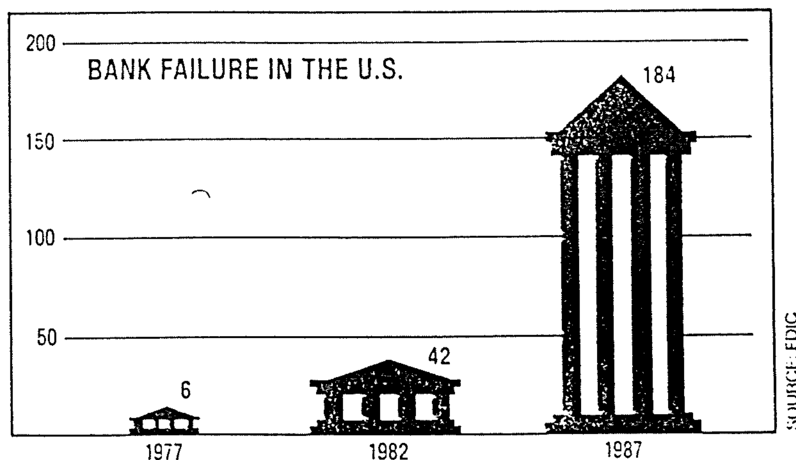
"If it were the only choice we would support it," he told Sen. Donald Riegle Jr., D-Mich.

The debate in the committee may not be confined to how many new powers to extend to bank affiliates. Sen. James Sasser, D-Tenn., said he is concerned about the prospects for tie-ins between banks and other industries.

"I'm concerned about a concentration of economic power," Sen. Sasser said.

Make The Right Choice, Again.

Banks Need To Worry About Banking, Not Insurance



An unhealthy banking system is unhealthy for your constituents. We agree that properly capitalized and profitable banks are essential to a sound economy. But giving banks insurance powers is not the answer to banks' problems.

Insurance is a complex product requiring highly skilled professionals to sell it and to underwrite it. Believe us — the 225,000 insurance professionals of the nation's largest property-casualty insurance trade association. IIAA — we know.

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OUTLOOK '88

VISIONS OF MOVING FORWARD

Putting Glass-Steagall to Pasture Will Be the Thrust of Congressional Efforts

GRAY LYLES

THE STAGE FOR BANKING reform legislation is set for 1988, but this year many thrifts and other depository institutions will be behind the curtain instead of in the spotlight like they were in 1987.

The Competitive Equality Banking Act of 1987, a statute inspired by the flagging Federal Savings and Loan Insurance Corporation, placed a moratorium on regulatory approval of new products and services federally chartered institutions could offer. This is set to expire March 1, 1988.

In light of this impending due date, Congress has three choices: (1) legislate; (2) simply let the moratorium expire, returning to the premoratorium environment of letting the regulatory agencies and the courts decide new products and services; or (3) extend the moratorium.

The plot for new legislation in 1988 will thicken around ridding the industry of Glass-Steagall. Elimination of this 54-year-old statute would open up the world of securities to depository institutions, a prospect particularly attractive to big banks. This issue will dominate the House and Senate banking committees' agendas in 1988 and probably will carry over into 1989.

The money-center banks and the securities industry will occupy center stage. But the insurance groups stand ready to join the chorus if banks move too close to gaining securities powers.

Robert A. Rusbuldt, director of federal affairs of the Independent Insurance Agents of America, observed that once you let banks into securities, insurance and real estate probably will follow.

"We believe there's a good chance the moratorium will be extended. Even though Congress said they will keep the promise and let the moratorium expire, they also said they would enact comprehensive banking legislation by March 1 to deal with the issues," he said.

On a more skeptical note, however, Donald J. Crawford, senior vice president and director of government relations of the Securities Industry Association said, "The only condition the moratorium would be extended is if Congress is in the middle of working on a legislative solution. But even then they might let it expire and extract promises from the regulators that they won't do anything drastic."

The most consistent response from all sides is that the odds are against substantive legislation passing in 1988. Many say, however, if anybody can pull off such a feat, it will be Sen. William Proxmire (D-Wis.), the retiring chairman of the Senate banking committee. No one dares to underestimate this legislator after his show-stopping performance with the 1987 banking bill.

But examining the present situation leads most to believe a legislative victory on securities powers for banks is next to impossible in 1988.

"I've been in this business for 15 years and I have never seen a Congress in a more hostile mood toward financial institutions across the board," James J. Butera, group vice president for legislative and regulatory policy of the National Council of Savings Institutions, said.

Take, for instance, the October 19 stock market crash. This evokes one question: Can banks handle se-

curities powers? Even though a bill by Chairman Proxmire and Sen. Jake Garn (R-Utah) sets up securities affiliates through subsidiaries of bank holding companies to promote safety and soundness, the negative association between 1933 and banks is still there, reinforced by the 1987 downturn in the market.

In conjunction with this, Congress had a case of *déjà vu* when Continental Illinois National Bank, an institution that cost the government big dollars to bail out in 1984, got caught exceeding its lending limits to its securities subsidiary to cover losses incurred by the market crash.

Adding to the problem, it was reported that a record number of banks and thrifts failed in 1987. The press is playing it as the worst year since 1934.

Butera noted these incidents will serve only to make Congress, in general, nervous about new securities powers for banks.

Phil Corwin, senior federal legislative counsel of the American Bankers Association, believes the crash may hurt the possibility of new powers in the short term, but over the long haul it will not have that much of an effect.

"The crash brought home just how integrated the financial markets are on a global basis and again just how silly Glass-Steagall is in preventing commercial banks from doing here what they're doing everywhere else in the world."

One point that bodes well for depository institutions is the tides may be turning for the securities industry. The insider trading scandal coupled with the overpublicized image of yuppie investment bankers running rampant on Wall Street has tarnished the securities industry's halo on Capitol Hill.

In addition, Richard S. Carnell, Counsel to the Senate banking committee, noted "Restructuring proposals,such as the Proxmire-Garn bill, seem to have put the securities industry on the defensive. They're starting to wonder whether the old tactics and arguments will still do the trick."

But that still leaves the insurance and real estate groups, two major grass-roots lobbies, to contend with. And if they want to halt legislation, they most likely could do it on at least one of the avenues in the legislative process.

"I've never seen a Congress in a more hostile mood toward financial institutions across the board."

The Clock Is Ticking

Another element against legislation is time. Even if the Senate banking committee does get a bill rolling through the process, there is not a whole lot of time left in the 101st Congress. For starters, approximately one legislative month is left before the moratorium expires. The Senate banking committee still is trying to put a bill together that can get a majority to vote it out of the committee. So, one thing is fairly certain, and that is legislation won't be on the President's desk come March 1, 1988.

Carnell cautioned against using this as the measuring stick for success or failure, and emphasized that developing affirmative legislation is the real issue. He did say, however, proposals to extend the moratorium are in disrepute as of the committee's December hearings.

The next question, then, is what are the chances of legislation being enacted by the end of Congress? One consideration is that 1988 is a presidential election year. Many believe this does not play in favor of major banking legislation being enacted because lawmakers may shy away from such a controversial issue until after the election.

The 1988 race also will be the first one since 1968 that does not involve an incumbent. This will make the issues extremely partisan, probably around July, predicted one observer. But Joe Belew, president of the Consumer Bankers Association, challenges these theories.

"Financial services reform is difficult in any year. You are trying to come up with a new public policy to allow greater competition and at the same time ensure the safety and soundness of the system. That's a tall order, but it's a necessary task regardless of whether it's an election year or not. Congress will have time to work on it if they choose to," Belew said.

Another factor is legislation, which has a good chance of passing the Senate, will be slowed in the House. Two committees, the Banking, Finance and Urban Affairs Committee and the Energy and Commerce Committee, have jurisdiction over such legislation. Traditionally, Fernand J. St Germain (D-R.I.), chairman of the banking, committee, and John D. Dingell (D-Mich.), chairman of the commerce committee, have not been in favor of uniting banking and securities.

Kenneth A. Guenther, executive vice president of the Independent Bankers Association of America, said, "You have a lukewarm St Germain and a very lukewarm John Dingell and that does not bode very well for the prospects for legislation. In addition, if past is prologue, I can't see [House Speaker] Jim Wright [D-Texas] getting real aggressive behind new securities powers for big banks. So that statement looks at the possibility of Jim Wright getting behind Dingell. . . . You wouldn't beat that lineup in the House."

Other Issues on the Agenda

Even while most Hill observers agree restructuring legislation will be in the spotlight, other legislative issues will surface as well.

For example, the banking bill of 1987 imposed a moratorium on FSLIC-insured institutions, prohibiting them from exiting to the Federal Deposit Insurance Corporation. This is scheduled to expire August 1, 1988. One legislative priority for many thrifts will be ensuring this moratorium does not get extended.

Another legislative possibility is a congressional response to the Federal Reserve Board's proposal that

allows bank holding co. .anies to acquire healthy thrifts.

On the consumer front, there are a few loose ends to be tied up. A separate credit card disclosure bill passed both the House and Senate in 1987, and now differences must be negotiated by a House-Senate conference committee.

Home equity loan disclosure legislation is another big issue for 1988. Reps. David E. Price (D-N.C.) and Charles E. Schumer (D-N.Y.) both have proposals on the table.

And finally, a truth-in-savings bill passed the House in 1987, and now must be acted on by the Senate.

"All of these issues are basically disclosure-oriented. Having not only banks and savings and loans but retailers and other participants give useful, simple, up-front information on financial service products—I think this is going to be a continuing theme, instead of regulating the pricing of these products," L..ew said.

A new consumer issue to be discussed in 1988 will be the cashing of government checks for anyone who walks through the door of a thrift or a bank. That's under study by the General Accounting Office. Whether legislation will be proposed depends on the outcome of the study.

In the tax arena, technical corrections to the Tax Reform Act of 1986 will be addressed. This bill includes several provisions that would benefit savings institutions. For example, one provision would bring in line the 1987 tax rates for both fiscal- and calendar-year taxpayers. Another provision would exempt real estate owned and foreclosed by thrifts from at-risk rules.

No Definitive Answers

The issues for 1988 are certain. The solutions, alas, are less clear.

But the likely areas for banking legislation in 1988 will be disclosure legislation covering credit cards, home equity loans and truth-in-savings. The emphasis will be on disclosure requirements as opposed to actual rate or product regulation. Also, chances are good that a technical corrections tax bill will pass in this Congress.

Repeal of Glass-Steagall will be attempted with a bill perhaps passing the Senate. The general consensus, however, is that such a controversial bill will be sidetracked in the House.

Said the National Council's Butera, "The bottom line is that it will be a very tough year to accomplish anything in the form of substantial restructuring legislation—what used to be called deregulation before that became a four-letter word in the minds of most members of Congress."

Regulatory Outlook,
Continued from page 26

ary. However, other areas, which lacked specific deadlines, still need to be addressed. For instance, the banking bill allows for the creation of mutual holding companies. The FHLBB will have to determine what institutions will be eligible to file for such a holding company status. In addition, issues must be resolved about diversified S&L holding companies, such as what should be included in a list of acceptable diversified activities.

Chairman Wall in a recent speech before top executives of the National Council of Savings Institutions said he's interested in ruling on thrift merger-conversions, which involve stock-owned associations that want to purchase mutual savings institutions. It's unclear what will be decided on this issue, but some say the FHLBB staff does not favor such conversions. According to Rebecca H. Laird, partner, Kirkpatrick & Lockhart, Washington, D.C., the feeling is that the agency's staff does not think merger-conversions are fair compared to stand-alone conversions. The right of account holders in the mutual savings institution are not as clearly protected when an institution is owned by an outside organization, such as a holding company or when an institution is absorbed into another one.

Other issues the agency is most likely to confront next year, she says, include corporate governance regulations and a broader interstate branching policy. Laird says the FHLBB may grant broader branching powers to help make thrift charters more appealing to investors.

Changes proposed in the corporate governance regulations, which stipulate how federal thrifts should be organized, were so extensive the FHLBB had to break them into four parts. Parts one and two were proposed in 1985 and the other two parts in July 1987. Since proposing the last two parts, the FHLBB has extended the comment period on the regulations until February 15. If other issues arise, many industry observers expect the board again will extend the comment period.

Smith of Stroock & Stroock & Lavan believes regulation should take a back seat and that the first priority for the FHLBB should be to devise a streamlined approach to marketing troubled thrifts.

"Fighting for more money for FSLIC is a good objective but unless the FHLBB deals with the systematic problems of investing in thrifts, it will be going back to recapitalizing FSLIC every year," Smith says.

The first priority: a streamlined approach to marketing troubled thrifts.

He argues that the board is sending conflicting signals to investors about purchasing thrifts. Examples, he says, are the FHLBB direct investment and appraisal regulations and accounting guidelines.

"Who wants to invest in a thrift if you're not certain what you can do with the institution and how to account for its assets and liabilities?" he says.

Unless the board makes some policy changes, it "will wake up one day

by David A. Winston
Counsel, Government Affairs

Credit Tie-Ins: The Banks' Credibility Gap

ON FEBRUARY 22, 1984, the Senate Banking Committee received testimony concerning "Competitive Equity in the Financial Services Industry." To no one's surprise representatives from the major banking trade associations translated "competitive equity" to mean, among other things, additional securities, insurance and real estate powers for banks. The Chairman of the Association of Bank Holding Companies (BHC) proclaimed to the Committee members that "these powers are essential for our industry if our institutions are to remain competitive and continue to meet the needs of the American consumer." The representative of the American Bankers Association (ABA) echoed this contention and invoked the "needs of the public" to support his association's position.

The bankers' purported concern for the consumer, however well intentioned, is undermined by their own abysmal record on bank fees which according to a study by the Consumer Federation of America have doubled since 1979. House Banking Committee Chairman Fernand St Germain was quoted as follows in the September 23, 1984 edition of the *Washington Post:* "The fees have become a virtual buzz saw. Fees for deposits, fees for low balance savings accounts, with the 'low balance' arbitrarily defined by the bank, fees for transfer of funds, fees for closing accounts. In some cases the fees virtually wipe out the interest on small accounts, negating congressional efforts to give small savers a break."

On the specific subject of insurance sales the bankers went to great lengths to assuage the concerns of the Committee members regarding the credit tie-in issue.

The ABA representative maintained that tie-in sales are not only precluded by law, but by competition itself. He stated that, "(p)rohibiting banks from offering new products and services because of the possibility that a bank customer might assume that the purchase of a product from a bank affiliate will somehow improve his status for credit approval would unnecessarily deny these consumer benefits." He cited the "increased convenience of being able to conduct several types of financial business in one trip, and the increased competition among providers of financial services" as consumer benefits.

As with fees, the banks' own record on the sale of credit life insurance belies their claims of consumer benefits. NALU Secretary David F. Woods testifying at the same contentious hearing before the Senate Banking Committee cited the numerous congressional and regulatory studies since the early 1950's confirming the rampant consumer exploitation due to credit tie-ins relating to the sale of credit insurance in connection with small loans. (Credit life insurance and credit accident and health insurance were first introduced in 1917.) Mr. Woods stated, "no matter how you look at it, the banks' record on credit tie-ins paints a clear and unappealing picture of abuse; higher premiums, exorbitant profits, reverse competition for higher commissions, massive market penetration rates, unnaturally low loss ratios, and inadequate disclosure to consumers of double coverages, policy expirations, and claims collections.

Tennessee Insurance Commissioner John C. Neff, who also serves as the Chairman of the NAIC's Credit Insurance Task Force, put it this way in comments filed January 9, 1984 to the Federal Reserve Board: " ... the business of credit insurance in the United States is a national scandal. I know of no other product where the public is so blatantly abused by what are supposed to be responsible financial institutions ... Every insurance commissioner in the United States has struggled valiantly to try to lower the price of this insurance to a fair level in the face of tremendous opposition by banks and other creditors ... If there is a single reason why the various insurance commissioners are opposed to the banking industry entering the business of the sale and underwriting of insurance, it is credit life insurance. Every bank that I know of sells credit insurance at the maximum price allowed by law and makes no attempt to sell it at a price that would produce a fair return of benefits to consumers."

Commissioner Neff further indicated that on the basis of preliminary data gathered on a national basis for 1982 that "consumers are being overcharged by approximately $650,000,000," and he noted that this figure was a substantial understatement.

Credit life overcharges and tie-ins were amply demonstrated by the evidence adduced in the case of *Independent Insurance Agents of America (IIAA) v. Board of Governors of the Federal Reserve System Board* 736 F.2d 468 decided June 13, 1984. The Eighth Circuit Court of Appeals granted the application of Missouri's two largest bank holding companies, Commerce Bancshares, Inc. and Mercantile Bancorporation, to engage in the sale of credit-related property and and casualty insurance but noted in the majority opinion that "IIAA provided convincing evidence which showed that ... both Commerce and Mercantile may have tied credit to the purchase of credit life insurance in the past. Evidence of high penetration rates in the credit life field was presented on both banks, as well as evidence that Commerce rewarded employees who sold substantial amounts of credit life with recognition and awards." Id at 474.

According to IIAA's appellate brief, Missouri's two largest bank

holding companies acting as agents and as underwriters (through credit life reinsurance subsidiaries) had engaged in systematic campaigns to sell the *highest* possible volume of credit life and credit disability insurance at the *highest* commission level permitted by Missouri law (40 percent) and at rates *40 percent higher* than identical coverages offered in Missouri by Prudential Insurance Company.

Despite the availability of the credit life insurance at more favorable rates elsewhere the evidence disclosed that Mercantile had 16 banking subsidiaries with credit life penetration rates of more than 60 percent. Ten of those subsidiaries had penetration rates in excess of *80* percent. One subsidiary had achieved a 98.8 percent penetration rate.

The market penetration rates of Commerce were even more impressive. Of Commerce's 38 banking subsidiaries, 14 had penetration rates in January 1981 of 80 percent or better. Four of Commerce's subsidiary banks achieved a 100 percent penetration rate.

On the basis of this evidence the Administrative Law Judge in this case concluded that both bank holding companies had been guilty of tying sales of credit insurance to extensions of credit.

Eighth Circuit Judge Ross took issue with the majority opinion to permit credit property and casualty insurance authority in the face of such evidence. He criticized the majority for failing to recognize the evidence and sworn testimony regarding the record of credit tie-ins. He stated, "the majority recognizes that both Mercantile and Commerce are linked to tying in the past and that both have enjoyed an unusually high success rate (penetration) in the sale of credit life insurance to borrowers. We are confronted then with the specter of an extremely successful 'sales program' peddling overpriced coverage to a captive market ... Enforcement of the law against coercive tying will be very difficult."

At the February 22, 1984 hearing of the Senate Banking Committee, the representative of the Association of Bank Holding Companies cou'd "not understand how the tie-in argument survives." He stated that, "the facts amply demonstate that the argument about banks' power over the extension of credit is without foundation.

Perhaps the gentleman's myopia on the issue of tie-in sales would be cured were he to glance at Wall Street Journal dated February 26, 1985. The lead article on the front page comprehensively details how the American consumer has been unconscionably exploited by lenders who combine extensions of credit and the sale of credit-related insurance. Numerous consumers who were victimized by credit tie-ins are interviewed in the article as are former employees of ITT consumer loan subsidiaries who discuss how they packed "optional" insurance to the amount of the loan either without the customer's knowledge or request.

The Wall Street Journal article constitutes a powerful indictment against authorization of further insurance powers for banks. It confirms what has almost universally been acknowledged as fact for many years. In hearings before the Senate Banking Committee in 1969 the Federal Reserve Board recognized the coercive power associated with credit leverage: "Because of the inferior bargaining position of the debtor, he may be susceptible to the loan officer's "suggestions" concerning choice of coverage, premium rates, insurer and agent. As a result, the debtor easily may receive the impression that his loan application may be more favorably considered if he follows such suggestions."

While Congress did not pass final banking legislation in the 98th Congress, both the Senate and House Banking Committees agreed in separate bills that banks should not be granted further insurance authority. In fact, the so-called "Dodd amendment" in S.2851 and also contained in H.R.5916 strengthened the restrictions in the Bank Holding Company Act on insurance agency activities as amended by Title VI of P.L.97-320 in 1982. ■

People Are Unsure About the Bank Powers Issue

The lack of strong public demand means the banking industry faces another uphill battle

BY JAY ROSENSTEIN

American consumers remain split on the issue of whether banks and nonbanking firms should be allowed to diversify into each other's business, according to the *American Banker*'s latest consumer opinion survey.

According to the national poll, 41% of the public say banks should be permitted to offer financial services they have been prohibited from offering in the past, such as selling insurance and real estate. But 49% say they oppose letting banks expand into these areas.

On the question of allowing companies other than banks to get into the banking business, 40% say yes and 45% vote against the idea.

Congress is on the verge of another round of hearings and votes on whether banks should be permitted to offer more financial services. A moratorium barring new securities, real estate, and insurance powers for commercial banks will expire March 1, 1988. The freeze is intended to give lawmakers time to consider revamping the financial services industry.

Meanwhile, the absence of a nationwide consensus on the issue of extended bank powers could mean more tough times for bankers who want to be able to sell new products and services.

Observers say that without strong public demand for new banking powers, lawmakers will continue to be faced with a turf war among competing industries. To date, that war has been dominated by the strong forces of the insurance, securities, and real estate industries. They oppose the entry of banks into their fields.

Adding to bankers' problems is the finding that while consumers are split on the issue of banking deregulation, slightly more of them say they oppose letting banks offer new services.

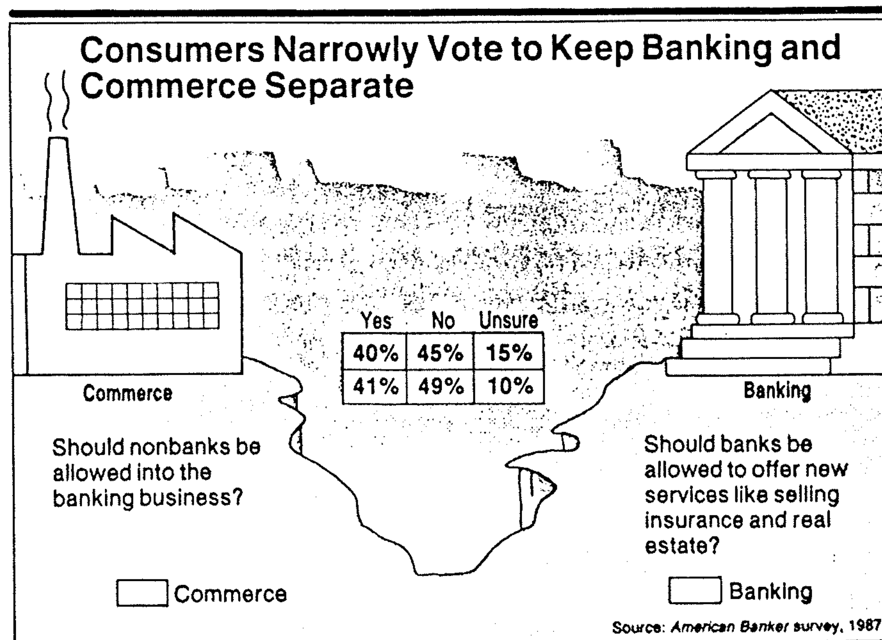
"In general, when you have this kind of division, you are more likely to stick with the status quo," says Sen. William Proxmire, D-Wis., chairman of the Senate Banking Committee. The Wisconsin senator adds that it will be especially tough for bankers to get approval from Congress to expand into real estate and insurance sales.

"Frankly, the number of insurance agents, from a political standpoint, makes it unrealistic to expect banks to move in [to insurance sales] as a national policy. Maybe they will be able to do that in certain states, as they have in Wisconsin but, on a national basis, I think that's not realistic," he says.

Mr. Proxmire has urged his committee to allow banks greater leeway to sell other financial services. He says Congress would be most likely to authorize banks to underwrite mortgage-backed securities, municipal bonds, and mutual funds.

Ken McEldowney, executive director of the San Francisco group Consumer Action, cautions that the issue of new banking powers "is probably not something consumers have thought that much about or care much about."

He adds, "These are the types of issues



New Services for Banks: The Vote Is Close

The Deregulators

Forty-one percent of the public thinks banks should be able to sell insurance, real estate, and other new services. These groups are more willing than others:

• Nonwhites	64%
• Those favoring nonbanks in banking	62%
• People 25-39 earning over $40,000	56%
• Consumers favoring one-stop financial shopping	54%
• Suburbanites	52%

The Regulators

Forty-nine percent of the public thinks banks should be prohibited from offering new, nonbanking services. Those most reticent:

• People who oppose nonbanks in banking	68%
• Consumers 55 and older	59%
• Those who like using more than one financial institution	59%
• People with little or no confidence in the banking system	58%
• Residents of rural areas and small towns	56%

Source: *American Banker* survey, 1987

that will be fought out by the big, moneyed interests. I can't imagine any of those forces being able to mobilize the populace on these issues like a few years ago, when bankers were able to get people to send in zillions of postcards against withholding of [tax on] interest income."

Donald Ogilvie, executive vice president of the American Bankers Association, adds that while the nation may be unsure about letting banks sell other financial services, there is "a growing awareness among the legislators on the House and Senate banking committees that these laws are badly in need of an overhaul."

He adds, "I would think the Congress would look favorably on the fact that, from your survey, almost half of the consumers in America are in favor of new powers for banks. I think that's a positive sign and I think it will continue to grow."

In the *American Banker* surveys of 1984 and 1985, fewer consumers — about a third — said it was a good idea to let banks offer new services. The 1987 survey seems to indicate that there may have been a slight increase in public support for this form of deregulation in the past few years, but the data are not directly comparable because the questions asked in the latest survey differ from earlier ones.

Banking industry officials say they sense an increase in public support for expanded powers in recent years. Joe Belew, president of the Consumer Bankers Association, attributes that change in part to the recent controversy over regulation of limited-service banks, or nonbank banks, owned by diversified firms.

After years of debate, Congress passed the Competitive Equality Banking Act of 1987 this July, permitting more than 160 existing nonbank banks owned by firms such as Sears, Roebuck and Co. and American Express Co. to stay in business, but with restraints on growth and activities.

"The fact that there has been a debate over who gets to sell what in the way of financial products has raised public awareness that banks are facing more and more competition" and is leading more people to favor giving banks expanded powers, according to Mr. Belew.

Impressions More Than Analysis

Financial industry officials and consultants generally agree that banking deregulation is a complex issue that the public has not grasped in its full implications. They say this means that opinions may be based more on emotions and superficial impressions about banks or deregulation, than on careful analysis.

"People find it difficult to concentrate, conceptualize, and visualize that with which they are not familiar," says Justin L. Moran, a banking consultant in Ann Arbor, Mich. "Whether we're talking about banks as insurance brokers, banks as real estate brokers, or insurance companies as bankers, a tremendous number of the respondents are likely, in my judgment, to give a gut reaction but not an informed opinion."

Paul Equale, vice president for government affairs in Washington for the Independent Insurance Agents, agrees but adds that deregulation is out of favor in the United States. He also says the public has a distrust of large banks in particular. "I think the banks have a terribly heavy burden. They have to change their image," he says.

Karen Shaw, executive vice president of the Institute for Strategy Development, a financial industry consulting firm in Washington, also says consumers have not focused on banking deregulation. But Ms. Shaw also detects a basic conservatism in the U.S. that she said would give people some doubts about linking banking and commerce too extensively. "I think it raises a level of fear and concern in average consumers, even if they're not quite sure why."

According to the *American Banker* survey, there is a segment of the population that supports deregulation in general — for both banks and nonbanking firms. There is also a segment that supports maintaining the traditional boundaries between these industries.

The survey found that of those who say nonbanking firms should be permitted to get into the banking business, six out of ten say banks should be able to get into nonbanking activities. And of those who say that nonbanking firms should be blocked from expanding into banking, seven out of ten say banks likewise should be kept out of nonbanking fields.

Among other findings that indicate where some Americans stand on the issue of banking deregulation:

• 56% of the consumers 25 to 39 years old and earning at least $40,000 annually say they support new bank powers. Also, 54% of the people who say they like to do business with just one institution say that banks should be able to offer them more services. Observers say that busy, younger, upwardly mobile Americans are more open to change and more interested in convenience, thus making them receptive to letting banks provide various services.

• Many people who typically are considered more conservative or set in their ways — the elderly and those who live in small towns — say they oppose new bank powers. The results show that 59% of respondents 55 or older and 56% of those who live in rural areas and small towns say they are against granting new powers to banks. People in small towns

may be the most likely to distrust large banks, even if they hold their local banker in high regard.

• 64% of the nonwhites say they support expanded bank powers. One possible explanation is that many in this group consider themselves disadvantaged and may want the opportunity to buy a variety of financial services in a neighborhood bank, where they already have a relationship.

Opinion 'Split All over the Map'

But even within these various segments, there are large enough numbers on both sides of the issue to highlight the finding that the nation is unsure about banking deregulation.

"This means that American opinion is split all over the map and there are no consistent trends that might guide members of Congress," says Ms. Shaw. "The data don't break along traditional indices like Republican-Democrat, urban-rural, that sort of thing."

Financial industry officials on both sides of the deregulation issue also warn that who you ask, and how you phrase the question, can influence the outcome of a poll on an issue as foreign to the average consumer as banking deregulation.

Mr. Equale of the independent insurance agents says there may be a more negative view of expanded banking powers from people who were required to purchase life insurance or some other form of insurance when they recently went to a bank for a commercial loan.

"These consumers are more sensitive to the potential coercive nature of the ability to tie the extension of the credit to the purchase of insurance," he says. "Ask them if they would have liked the bank to sell insurance or not. I doubt they would feel comfortable with that kind of a transaction."

Bankers disagree. They say that the law — both current and proposed — provides adequate protection for consumers when insurance purchases are linked in with loan approvals.

Carter Golembe, chairman of Golembe Associates, a banking research and consulting firm in Washington, says, "Banks are not lovable and cuddly. If you ask if they should expand, people will say no. I'm surprised they got 41% who said yes." But he says that if consumers could be shown the benefits of bank competition, more would say yes.

He also says, for example, that municipal finance officers are the real consumers when it comes to municipal bond underwriting, since they want to raise money for roads or other projects at the lowest cost. He says if they were asked whether banks should be allowed to compete with securities firms for their underwriting business, "they would overwhelmingly favor it."

Acceptance After the Fact

According to Mr. Moran, once consumers have used a service, they are more receptive to it. "Consumer enthusiasm for things that are new and radically different is always after the fact." Mr. Moran says more positive views of bank insurance sales, for example, would come from people in Indiana, who have used banks to buy insurance, under laws that are more broadly permissive there than in many other states.

"In many Indiana counties, the largest insurance agency is a bank. That tells me that people in those counties, where they are used to banks selling insurance, like to buy their insurance from a bank."

It is difficult to determine from the *American Banker* survey how consumers who have used banks for some nontraditional activities view a broad expansion of banking powers. But on the surface, the poll shows no great difference between these consumers and the public at large.

Among the 240 consumers surveyed who say they bought mutual funds, stock, or insurance from a bank, there is still a split in opinions on whether banks should be given new powers. The survey finds that 43% of the people who have used banks for these investment services say banks should be permitted to offer new services such as insurance and real estate sales. Another 46% say banks should not be let into these new areas. The rest say they are not sure.

The survey also shows that bankers cannot necessarily depend on customer loyalty to help them get expanded powers. The people who say they use a commercial bank as their principal financial institution also report opinions on expanded powers that are nearly identical to those of the public at large — 41% in favor of the new powers and 50% opposed.

It is difficult to determine why many bank customers, even those who have used a bank for investment purposes, say they oppose new powers for the industry. Some observers say this may be yet another indication that American consumers are confused about what financial services the law allows banks to provide and the reasons why banks are excluded from other services.

Another thought comes from Frederick S. Hammer, chairman and chief executive officer of Meritor Financial Group in Philadelphia: "The overall viewpoint on the part of everybody is, 'Let's be sure the banks are sound.' Even though they would get greater convenience, it's stability they're looking for. You can't ask everyone to have the sophistication to recognize that true safety only comes out of viability, and viability comes from the ability to compete."

Mr. Hammer points to insurance sales as a low-risk service that banks should be able to offer. "If there was ever a case of vested interests making a dubious argument at the expense of consumer benefit, this is the perfect example," he says.

Mr. Ogilvie of the American Bankers Association says the industry is making progress in getting editorial boards and consumer organizations to back additional competition by banks. "This is a gradual education process," he says, adding that if more consumer groups like the Consumer Federation of America come to favor expanded bank powers, consumers themselves will become involved.

Mr. McEldowney of Consumer Action agrees that bankers can successfully use advertising and other methods to win more public support for new powers. But he stresses, "I think these issues are probably so low on a person's list of priorities that I can't imagine individual consumers writing letters to their elected officials. I don't think it's a cutting issue."❑

Jay Rosenstein is an American Banker reporter in Washington, D.C.

KANSAS ASSOCIATION OF REALTORS®

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TO: THE HOUSE COMMERCIAL AND FINANCIAL INSTITUTIONS COMMITTEE

FROM: KAREN MCCLAIN, DIRECTOR, GOVERNMENTAL AFFAIRS

DATE: FEBRUARY 16, 1988

SUBJECT: HB 2738 BANKING POWERS

On behalf of the Kansas Association of REALTORS®, I appear today to oppose HB 2738.

In the beginning we would like to say that, while this appears to be only a small expansion of bank powers into the real estate industry, we view it as only the beginning of a serious threat to small businesses and to the security of the banking availability for consumers across Kansas.

The NATIONAL ASSOCIATION OF REALTORS® has taken a strong position against similar legislation in Congress. The NATIONAL ASSOCIATION OF REALTORS® Statement of Policy for 1988 states the Association's opposition to the involvement of financial entities in real estate:

> We strongly oppose the authority of all financial entities which benefit from federal deposit insurance, favorable tax treatment, and special access to credit (including their parents, subsidiaries, affiliates and divisions) to participate in the business of real estate brokerage, fee appraising, leasing, real estate development, real estate syndication, property management and other real estate services and/or activities not directly related to their primary function. Such activites may conflict with the interests of their customers, threaten the safety and financial stability of the institution, increase the risk of taxpayer liablity and pose a threat to the competitive structure of the real estate industry.

This statement reflects our own deliberation of this important state policy question. One of the primary concerns of the Kansas Association of REALTORS® is for the health of the state's financial system, upon which both our state's economy and our industry's survival depend.

REALTOR®—is a registered mark which identifies a professional in real estate who subscribes to a strict Code of Ethics as a member of the NATIONAL ASSOCIATION OF REALTORS.

Atch 4

We believe that bank [illegible]titutions hold an important pu[illegible]c trust and that any legislation or regulation that affects that public trust must not be altered without very careful consideration. In addition, our policy reflects the practical business concerns of our membership--that is, the myriad of potential problems that the restructuring of the financial services industry present to both the public and to the existing real estate industry.

COMPETITION

Mr. Chairman, as you know, REALTORS® are not afraid of competition. The real estate industry is one of the most competitive businesses in America. Nevertheless, the members of the Kansas Asssociation of REALTORS® are grievously concerned about the unfair competitive advantages banks could possess if allowed even a small step into our line of business.

The real estate industry consists of small businesses made up of independent business people, who, by their own determination and energy earn a living by performing certain real estate services. The typical real estate agency in Kansas consists of 5 agents or less. The bulk of our members work on a straight commission basis with no guaranty of any minimum income. To the extent that a new person, or company, enters into our industry, the competition that evolves takes place betweeen equals. The business of real estate brokerage is one of customer service and the result of competition within our industry is better service to the home buying public. This is competition among equals. While the banking industry may be seeking "parity" here, we ask how our members will have "parity" with banks who become involved in our industry? Our concern is that banks would not compete as equals in the real estate management or development industries. The following is a list of some advantages we foresee:

1. Allocation of Resources Banks enjoy tax benef. s, not to mention capital resources which would allow them to utilize a greater proportion of their resources toward competition than existing real estate companies could even begin to think about. We do not feel that the language limiting total investment to 15% of the banks unimpaired capital stock, surplus and undivided profits in any one tract of land is any significant restriction. Any one tract of land can consist of many many acres.

2. State Deposit Insurance The existing state deposit insurance system provides a "cushion" of safety for banks engaging in high risk activities. We ask, who bails out our small, five person operations if they fail? The answer: no one.

3. Economic Discrimination Banks would be able to provide discounted interest rates, fees, lease agreements, and/or quickened or guaranteed loan approval processes to it's real estate clients. We believe such abilities actually rise to the level of conflict of interest which we feel the legislature should not be legislating.

4. Consumer Access Banks would competitively benefit from access to confidential credit information and which could be utilized for consumer solicitaion purposes. In addition, banks already enjoy a special relationship with consumers which would provide a distinct advantage if permitted to be used in another market.

These advantages are not merely speculation. The nearby state of Iowa permits banks to operate in the real estate industry. My colleagues there passed on these incidents:

1. A broker made several visits to a town to assist one of his salespeople in listing a property. The client wanted to list but informed the salesperson that a banker in the community was also licensed, and the banker had informed the prospective client that financing would not be available if the property was listed with someone other than the banker.

2. Another REALT[illegible] had a house listed for severa[illegible] ionths. The sellers were several months behind in payments and could not come up with the money. While the listing was still in effect, the lender who held the mortgage called on the sellers and said they were going to foreclose. However, they said that they would give them an additional three months if they would list the property for sale with them.

While both these examples involve the sale of real estate, they illustrate the conflict of interest issue which would also underlie the power of a bank to "construct, alter and manage improvements of any description on real estate in which it holds a substantial equity interest."

This bill would permit banks to start building homes on land which the bank owns and then sell them, in direct competition with local real estate offices. Even in a small town, a bank could build one or two houses, in direct competition with agencies in town who would never have the capital assets to be able to build new homes. Larger scale housing or commercial development by banks in large cities is also possible under this bill.

SAFETY AND SOUNDNESS OF FINANCIAL INSTITUTIONS

REALTORS® are concerned that the expansion of the financial services industry into the real estate industry will materially harm the safety and soundness of the financial system. In particular, we are concerned that individual institutions would be allowed to incur unnecessary risk, and that the failure or losses of these institutions would undermine the viability of the entire financial system. The availability and accessibility of lending funds is dependent upon a strong, vibrant financial structure and should not be jeopardized by ill-considered deregulation.

We strongly question whether real estate services of any kind, whether it be real estate management or development or brokerage, are appropriate businesses for banks. We additionally believe that bank involvement in real estate investment activities should be strictly limited to those of a "passive" nature in order to preserve the safety and soundness of banks.

In today's econom. banks still play a role which . absolutely unique and unlike that of any private corporation. To meet these challenges, banks institutions must be assured certain protections and advantages provided by the government. However, as long as banks continue to receive these to receive these benefits, it is essential that limitations be place on their permitted non-banking activities.

We understand that banks offering traditional services come under competitive pressure from security firms, retailers, and nonbank institutions offering these same services, and that is why they are seeking new asset powers, such as direct real estate investment. However, we feel the exercise of these new powers has the potential to increase the financial risk to individual depository institutions, and this risk is passed on to and born ultimately by the public

PROFITABLILITY vs. RISK

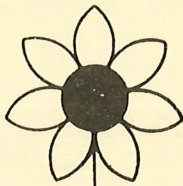
Last, it is important to note the cyclical nature of the real estate industry and it's affect on the profitability of real estate firms. The real estate industry is a cyclical business that prospers during "boom" periods of low interest rates and economic growth, and suffers during "bust" periods of volatile interest rates, high inflation and economic recession. The potential for profit is matched by the potential for failure--a reality to which many REALTORS® can attest as a result of the downturn in the economy during the early 1980's and which many of them are still experiencing.

The point is that REALTORS®, as well as other participants in the real estate industry, must manage the risks inherent in our business without a government safety net. We do not recommend the real estate industry as an endeavor which would provide any kind of stability to a portfolio.

CONCLUSION

At a time when recent experience has heightened depositor sensitivity and the danger of illiquidity of financial institutions, the state should reaffirm it's commitment to the objectives of a safe and sound banking system; reduce the potential for conflicts of interest; prevent concentration of economic power in the hands of a few; and avoid the extension of credit being tied to acceptance of other services.

Thank you.



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HOUSE
COMMERCIAL AND FINANCIAL INSTITUTIONS
COMMITTEE

HB 2738

February 16, 1988

Mr. Chairman and Members of the Committee:

My name is Janet Stubbs, Executive Director of the Home Builders Association of Kansas, which has a membership of over 1800 statewide.

We are appearing today in opposition to HB 2738 which would permit banks to acquire real estate for the purpose of constructing improvements of any description on real estate in which it holds a substantial equity interest.

We understand the proposed legislation is a request for equity in the financial community and to enable banks to explore new avenues for revenue.

Lets explore the goal of obtaining more revenue. There seems to be a misconception about the margin of profit made by the builders and developers in Kansas. On several occasions, I have heard builder members express a desire to make the same profit he pays a realtor to sell his finished product on which he, the builder, has taken the risk. I have talked with former builder members who have abandoned that business and concentrated on selling only and they have expressed the relief of letting someone else take the risk.

Risk. What about the risk involved? There are examples of individual builders who have failed, there are examples of S & L's who have ventured out of state into large land developments and failed and S & L's, who have built projects in Kansas with little success, and have ceased this venture. One school of thought about this piece of legislation is that most banks will not try it, those who do will not stay in the business very long and will be much more understanding of the builder's problems when dealing with him on construction loans in the future.

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Members of this Association do not object to "fair" competition and are not opposing HB 2738 on that basis. HBAK is comprised of strong free enterprise minded individuals. However, there is concern regarding the interest rate which would be enjoyed by banks for the purpose of building construction vs. the construction loans made to individual builders. This would not be "fair" competition in our minds.

If the majority of this Committee believes this legislation is in the best interest of the home buying public and the banking institutions, HBAK requests the insertion of language into the statute prohibiting this practice and penalizing such actions.

Beginning in line 228, the bill limits the bank's investment "in any one tract of real estate" to 15% of the unimpaired capital stock, surplus and undivided profits. In how many tracts of land is a bank permitted to invest?

Again, if the Committee recommends this bill for passage, we believe an amendment is needed to more effectively limit the total amount of investment in real estate.

In closing, Mr. Chairman, we oppose passage of HB 2738. However, if the Committee's decision is to recommend it favorably, we urge the adoption of the amendments we have addressed.