

Approved March 20 1990
Date

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT

The meeting was called to order by Elizabeth Baker at
Chairperson

3:39 ~~xxx~~ p.m. on Wednesday, March 14, 1990 in room 423-S of the Capitol.

All members were present except: Representatives Barkis, Samuelson, Goossen, Heinemann, Kline and Foster. Excused.

Committee staff present:
Jim Wilson, Revisor
Lynne Holt, Research
Elaine Johnson, Secretary

Conferees appearing before the committee:
John Davis, President of Fidelity State Bank, Garden City
Ed Bruske, President, Kansas Chamber of Commerce and Industry
Harry Craig, President, Martin Tractor
Charles Warren, President, Kansas Inc.
Bill Martin, Kansas Industrial Developers Association

Chairperson Baker called the meeting to order at 3:39 p.m.

The minutes of the February 27 and March 2, 1990 meetings were approved.

Representative Baker opened the hearing on SB 532 and recognized Bill Wolff of the Legislative Research Department who gave the committee a briefing on the bill.

John Davis, President of Fidelity State Bank in Garden City was the first conferee to testify in support of SB 532. Mr. Davis is currently serving as President-elect of the Kansas Bankers Association and informed the committee of the KBA's strong interest and participation in economic development. He stated that much of the economic development efforts across Kansas have occurred with banker leadership. Mr. Davis said that now is the time we must analyze how our banking system can best meet the challenges of this new decade as Kansas business, agriculture, and industry expand their various roles in what is rapidly becoming an information-based, global economy. The KBA believes it will be necessary for our banking industry to have maximum flexibility if they are going to adequately serve their customers. They believe the granting of authority for interstate acquisition of banks is the next logical, progressive step in creating a safer and stronger banking system for Kansas. Attachment 1.

The next conferee was Ed Bruske, President of the Kansas Chamber of Commerce and Industry who testified in support of SB 532. Mr. Bruske stated that it has always been the KCCI's philosophy that the least amount of government regulation is the best atmosphere for the private sector to flourish and expand its base, ultimately supplying jobs needed in Kansas. Most of us would like to keep things as they are, but there comes a time when we all realize that this is a global economy and we must link up with our neighbors if we are to participate in future growth. Activities around the world in the past six months will offer Kansas a tremendous opportunity to sell our products and services globally, not to mention the opportunity Kansas has to promote itself to these new emerging democracies. He also stated that the banking industry in Kansas has done an outstanding job of meeting our needs and there is no reason to believe that community banks will not continue to thrive. Like any other business, large or small, those that have a good product and personal service will not only survive, but will grow. The KCCI believes that it is time to move forward with a proven procedure and strongly support interstate banking because it opens up a whole new vista of financial opportunities without closing the door to any business, including the banking business. Attachment 2.

Harry Craig, President of Martin Tractor was the next conferee. Mr. Craig testified in support of SB 532. As a businessman who uses banking services, he views the interstate banking issue from several angles. First, he wants a competitive environment that will give him the best interest rates possible and in addition, he wants the best possible banking services and expertise for his company. In order to offer these services, a bank must, of necessity, be a larger institution. He feels that it is very important in Kansas - or any other state - to have a banking system which can meet the

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT,

room 423-S, Statehouse, at 3:39 ~~XX~~ p.m. on Wednesday, March 14, 1990.

needs of all businesses, large or small. As an outside observer it appears to Mr. Craig that granting holding companies the authority to purchase banks is simply a matter of fairness. He believes that the allowance of interstate banking would create a positive inflow of capital and services to Kansas and this can only be a plus for economic development in the state. Attachment 3.

Charles Warren, President of Kansas Inc. testified in support of SB 532. He testified that Kansas needs stronger, more diversified banks that can withstand economic losses and be more effective as risk-takers and partners in economic development. Interstate banking and community banking will exist side by side. Each has its role. SB 532 recognizes the need to ensure community investment while at the same time allowing larger financial institutions to provide their expertise and lending capability. Interstate banking exists in 47 states. Some bankers are fighting to continue the protectionist, anti-competitive policies of the past. Their arguments against interstate banking rest on emotional, outdated notions of Kansas for Kansans. The predictions of doom that you hear against this bill are unsupportable, they are the same dire forecasts raised against multi-bank holding companies and branch banking. None of those consequences have come to pass. Attachment 4. Mr. Warren also provided the committee with "Interstate Banking Questions and Answers" prepared by Kansas Inc. Attachment 5.

Bill Martin representing the Kansas Industrial Developers Association was the final conferee. Mr. Martin stated that the KIDA strongly believes that interstate banking will allow Kansas to be more competitive in the creation of new job opportunities in Kansas. Attachment 6.

The conferees responded to question from the committee.

Representative Baker closed the hearing of proponents on SB 532.

The meeting adjourned at 4:53 p.m.

Elizabeth Baker

Date: 3/14/90

GUEST REGISTER

HOUSE

Committee on Economic Development

<u>NAME</u>	<u>ORGANIZATION</u>	<u>ADDRESS</u>
Harry W. Craig Jr.	Martin Trachs G.	P.O. Box 1688 Topeka, Kan
Sinda McMill	KIBA	Topeka
Hal Jano	KBA	Topeka
Reynold Adams	KBA	Topeka
Harold Stoner	KBA	Topeka
John Davis	Fidelity Bank	Garden City
Charles Allen	Kansas Inc	Topeka
Bill Martin	KIDA	Lawrence
Alan Steppat	KIBA	Topeka
Howard Nelson	KAWG	Harcatson
Paul Wright	KCUU	Topeka
Chuck Stone	KBA	Topeka
M. J. Stattelmar	KIBA	Topeka
Smith	KBA	"
Bob Baker	4th Financial Corp.	"
Ralph Henn	4th Financial Corp.	Wichita
John Marshall	Harris News Service	Hutchinson
Tom Misco	Topeka	KIBA

TO: House Committee on Economic Development

RE: **SB 532** - Interstate acquisitions by bank holding companies

Madam Chairman and Members of the Committee:

Thank you for the opportunity to appear before this committee in support of **SB 532**. My name is John Davis and I am Chairman of the Board and Chief Executive Officer of Fidelity Bankshares, Inc., Garden City, Kansas. Fidelity Bankshares is a two bank holding company which owns Fidelity State Bank of Garden City and Heritage Bank of Olathe. I am also Chairman of the Board of Data Center, Inc., Hutchinson, Kansas which processes for approximately 130 banks across Kansas. In addition, I am currently serving as President-elect of the Kansas Bankers Association and have just completed a term as Chairman of the Board of Kansas Technology Enterprise Corporation.

Members of this committee who have served in the Legislature for the past several years are well aware of the KBA's strong interest and participation in economic development. The KBA worked very closely with legislative committees and leadership in 1986 in formulating and working for the passage of the major package of economic development bills passed that session. Once those measures were enacted, the KBA and Kansas banks have worked just as hard to see that their passage would result in more than rhetoric about economic development. Kansas banks have invested approximately \$6 million in the stock of Kansas Venture Capital, Inc. A Kansas banker, Dan Bonine, President of American State Bank in Great Bend, currently serves as Chairman of KVCI. The KBA also yearly contributes \$5,000 to Kansas, Inc. to assist them in gaining state matching funds for their operation in coordinating statewide economic development efforts. As I mentioned earlier, it has been my good fortune and tremendous pleasure to have the opportunity to serve on the board of KTEC. KTEC has been instrumental and extremely successful in a short period of time in creating employment for the state of Kansas by financing Centers of Excellence at our universities which are engaged in basic and applied research and technology transfer, awarding matching grants for applied research between industry and academic institutions, and providing seed capital for emerging technology-based industries. KTEC has significantly helped in creating an environment for innovation, has stimulated the commercialization of new technologies, and, in conjunction with venture capital firms such as KVCI, has helped provide the start-up and expansion capital necessary for business creation and growth.

Therefore, as testimony and discussion proceed on Interstate Banking before this committee and statements are made about who has and who has not forged a strong record for the economic development of this great state, I would ask you to remember what the KBA has done and will continue to do toward being a good citizen of this state -- a record we would challenge most any other organization to match and one we would ask you not ignore! Much of the economic development efforts across Kansas have occurred with banker leadership.

We want to work constantly for the economic benefit of Kansas in every way we possibly can - and that is why the KBA has taken a position in favor of **SB 532** which would allow banks to be acquired on an Interstate basis by bank holding companies.

On November 29, 1989, the Governing Council of the KBA voted to support legislation which would allow Interstate acquisitions by bank holding companies. This was not a

House Eco. Devo. Committee

Attachment 1

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decision arrived at lightly, but one that was the culmination of several months of discussion and analysis by Kansas bankers. Every Kansas banker and bank owner has had the opportunity for input on this issue over the past 9 months and it wasn't until this open and democratic process was completed that the Governing Council made its final decision.

During the past decade, you, the members of the Kansas Legislature, have enacted several major bank structure laws which have significantly improved the state banking system to the benefit of the citizens of Kansas. Due to these positive changes, we have stronger banks, more banking facilities in towns which did not previously have banks, and more services available at bank branches which make banking more convenient for customers. It would be difficult to find any bank customer today who would want to give up the positive changes in banking structure which the Legislature has enacted. And yet every one of those changes was strongly opposed by some who predicted great problems to come - none of which ever came.

Now you must analyze how our banking system can best meet the challenges of this new decade as Kansas business, agriculture, and industry expand their various roles in what is rapidly becoming an information-based, global economy. The KBA believes it will be necessary for our banking industry to have maximum flexibility if we are going to adequately serve our customers. We believe the granting of authority for interstate acquisition of banks is the next logical, progressive step in creating a safer and stronger banking system for Kansas.

As you well know, interstate banking is not an unknown quantity. There is no need to speculate about its results because all that is required is to look around us. It is present in all of our neighboring states and 43 other states as well. An objective examination of what is occurring in those states totally defeats predictions of doom. Recent economic studies by the Federal Reserve have shown clearly that in those states where there is a relatively high concentration of out-of-state ownership loan volume has increased - most often at a rate higher than those states where interstate activity is dormant.

Experience in those states also indicates large and small banks, as well as all types of bank ownership, can exist side by side and provide even better services to communities and to all segments of the economy. There can be no doubt that community banks do thrive and will continue to thrive in an Interstate environment. As FDIC Chairman, L. William Seldman, has noted, "Success is not necessarily determined by size. Rather, success comes from a firm's ability to supply its product to the customer as he desires and to change with the customer's changing needs." We have a lot of these community-oriented banks in Kansas!

The time has come to give Kansas banking the opportunity to plan for the decade ahead. No other industry in the state has the statutory chains binding it like those which prohibit the interstate activity of banking. While our competitors in the marketplace are allowed to come and go across state lines and grow as they please, we are subject to restrictions on expansion which have no rational reason for existing. A major thrust of the state's economic development plan is to bring more capital to Kansas and create an environment in which Kansas businesses can grow. Too often such growth has forced these businesses to seek working capital with banks beyond the borders of Kansas.

The fact that changes in the banking industry are occurring at an ever increasing pace is reflected in such events as the recent enactment of federal legislation (FIRREA) which has overridden many state restrictions to interstate activity by banks and bank holding companies. Expansion into the banking industry by other types of corporations, i.e., Sears, American Express, J.C. Penney, etc., continues at a rapid rate which further accentuates the need for giving the Kansas banking industry maximum flexibility in

meeting this competition. These and other significant changes are occurring now and will continue. The simple trust is that no one can place a moratorium on "change". We bankers learned some hard lessons in the 1980s. One of them was that in a changing industry, the best way to minimize risk is to be able to change with the industry.

For these reasons and many others which will be expressed by the conferees who follow me, the Kansas Bankers Association is requesting the passage of **SB 532**. We certainly hope the material presented to you by the KBA staff has been of assistance as you ponder your decision on the Interstate issue. As always, the staff and officers of the Association stand ready and willing to discuss the issue with you and provide any additional information which might be needed. Thank you again for the opportunity to appear before the committee and I will be most happy to answer any questions the committee might have.

LEGISLATIVE TESTIMONY

Kansas Chamber of Commerce and Industry

500 Bank IV Tower One Townsite Plaza Topeka, KS 66603-3460 (913) 357-6321



A consolidation of the
Kansas State Chamber
of Commerce,
Associated Industries
of Kansas,
Kansas Retail Council

SB 532

March 14, 1990

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

House Economic Development Committee

by

Ed Bruske
President

Mr. Chairman and members of the Committee:

My name is Ed Bruske, president of the Kansas Chamber of Commerce and Industry.

KCCI would like to take this opportunity to support SB 532, interstate banking for Kansas.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 55% of KCCI's members having less than 25 employees, and 86% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

It comes as no surprise that KCCI because of its membership makeup and historic voting record supports SB 532, interstate banking. It has always been KCCI's philosophy that the least amount of government regulation is the best atmosphere for the private sector to flourish and expand its base, ultimately supplying jobs needed in Kansas.

*House Eco. Devo. Committee
Attachment 2 3/14/90*

A few years ago KCCI surveyed its membership on this banking question. Our banking members voted 60-40 in favor of multi-bank and interstate banking, while our general membership voted approximately 80-20 in favor of multi- and interstate banking. It was interesting to note that our non-banking members indicated they were satisfied with the services they were receiving from their community banks but they indicated that Kansas should move forward and allow the banking industry to grow along with the rest of Kansas business and be prepared to meet the business growth needs of the future. That was approximately three years ago and I'm sure those figures would be substantiated today.

Most of us would like to keep things as they are, but there comes a time when we all realize that this is a global economy and we must link up with our neighbors if we are to participate in future growth. Activities around the world in the past six months will offer Kansas a tremendous opportunity to sell our products and services globally, not to mention the opportunity Kansas has to promote itself to these new emerging democracies.

Kansas is now spending millions of dollars to promote world trade and assisting our existing business with their marketing efforts. We're spending these dollars in the hope of attracting new capital and jobs to our state. We have a specific department within the Kansas Department of Commerce whose prime objective is to link Kansas business with other businesses around the country and the world; and, at the same time, this department spends millions of dollars attempting to attract new business to Kansas. All of this activity revolves around acquiring financing. The least we can do is to match these efforts by letting our banking industry progress at the same pace. Why do we continue to insist on over-regulating the banking industry from the growth arena? The movement since 1970 has been to de-regulate and let business reach their level of competitiveness. The protectionist attitude has faded and the winners are business, government and the consumer.

The banking industry in Kansas has done an outstanding job of meeting our needs. There is no reason to believe that community banks will not continue to thrive. Like any other business, large or small, those that have a good product and personal service will not only survive, but will grow.

In closing, KCCI believes that it's time for us to move forward with a proven procedure. We strongly support interstate banking because we feel it opens up a whole new vista of financial opportunities without closing the door to any business, including the banking business.



Martin Tractor Company, Inc.

March 14, 1990

Madam Chairperson and Members of the Committee:

Thank you for the opportunity to appear before this committee and discuss the issue of interstate banking. My name is Harry Craig and I serve as President of Martin Tractor Company. We are a 40 million dollar corporation, with 165 employees located at facilities in Topeka, Chanute, Concordia, and Colby.

As a businessman who uses banking services, I view the interstate banking issue from several angles. First, I want a competitive environment that will give me the best interest rates possible. I truly believe that interstate banking would make rates more competitive for companies like ours.

In addition, I want the best possible banking services and expertise for my company. In order to offer these services, a bank must, of necessity, be a larger institution. I am not, in any way, saying that small banks or community banks don't do a good job of serving their customers, but often their ability to loan money or provide a specific service is hampered by their size. It is very important in Kansas - or any other state - to have a banking system which can meet the needs of all businesses, large or small. Obviously we, and most Kansas companies, prefer to work with banks in Kansas. Sometimes this is not possible because of lending limits.

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House Eco. Dev. Committee
Attachment 3 3/14/90

I also believe we are entering a decade when business transactions will be more and more global in nature. Hopefully, Kansas industries can be a significant player in international markets, but to achieve this they will need adequate capital and technical assistance from their banking institutions. From an economic development standpoint, can we really afford to hamstring the development of our banking system in Kansas by continuing artificial barriers?

It would also appear to this outside observer that granting holding companies the authority to purchase banks is simply a matter of fairness. Certainly most of the banking industry's competitors have interstate authority and nothing currently prevents an individual or group of individuals from purchasing banks in other states. Why, then, is it wrong for a holding company to have that same right?

We at Martin Tractor want to see Kansas grow and prosper. We are most supportive and appreciative of the work done by the Legislature in the past few years on economic development. The establishment of Kansas Venture Capital, tax credits for private venture capital companies, the establishment of K-Tech and the Kansas Development Finance Authority have all been good additions for our state. In turn, we believe the allowance of interstate banking would create a positive inflow of capital and services to Kansas and this can only be a plus for economic development in our state.

Thank you again, Madam Chairperson and members of the Committee, for this opportunity to discuss the issue of interstate banking. I certainly urge you to give favorable consideration to SB 532.

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Governor Mike Hayden, Co-Chairman
Eric Thor Jager, Co-Chairman

Charles R. Warren, President

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Senate Bill 532
Interstate Banking

Testimony of
Charles R. Warren
President, Kansas Inc.

House Committee on Economic Development
March 14, 1990

*House Eco Devo. Committee
Attachment 4 3/14/90*

Madame Chairman, members of the Committee, thank you for this opportunity to testify on behalf of the Board of Directors of Kansas Inc. in support of Senate Bill 532 to establish interstate banking in Kansas.

In 1989, Kansas Inc. published a report reviewing the issues related to the availability of capital in Kansas. That report revealed significant weaknesses in the banking system of this State. The primary finding was that commercial lending as a percent of total deposits was far below the national average.

In January 1989, the Kansas Inc. Board of Directors adopted a position encouraging the Legislature "to begin the process of instituting interstate banking in Kansas." That objective was achieved with introduction of this bill and hearings in the Senate last session. In January 1990, the Board of Directors revisited this issue and unanimously approved a motion that "urges the Legislature to go beyond review, and, for 1990, to adopt interstate banking."

It is highly appropriate that this Committee is holding hearings on S.B. 532. Let there be no doubt, this is an economic development issue of major importance. As members of this committee, you realize that availability of financing and lending expertise is one of the most important issues to business start-ups and expansion. The Kansas Legislature has enacted several progressive laws to enhance our system of risk capital. Our venture capital program is being copied by other states. Our certified development companies rank high nationally in financial packaging and SBA lending assistance. These public sector efforts, however, can make only a marginal contribution. Business financing is predominately a private sector, banking function. Business success in Kansas depends on a strong, diversified banking system.

We do not have a banking system in Kansas capable of meeting the needs of Kansas businesses.

- o Kansas has fewer total deposits in loans than banks across the nation -- 60.3 percent versus 77.6 percent.
- o Commercial lending in Kansas is far below the national average (a commercial loan to deposit ratio in 1988 of 15.9 percent versus 24.6 percent nationally).

- o From 1987 to 1988, the dollar total in commercial/industrial loans was reduced over \$226 million (a decline of over 6 percent in one year). Only the largest banks increased the total number of dollars in commercial and industrial loans.
- o Low lending ratios are due in part to the sluggish economy, but are directly related to the small size of Kansas banks. In 1988, banks with more than \$100 million in assets made over 43 percent of all commercial loans. Banks of that size represent less than 10 percent of all banks in Kansas (41 of 587).

Kansas needs stronger, more diversified banks that can withstand economic losses and be more effective as risk-takers and partners in economic development.

Kansas also needs a strong system of community banks. Our smaller banks play an important role. Interstate banking and community banking will exist side by side. We would not expect our medical profession to consist solely of general practitioners. Larger more specialized medical practices are needed to serve the full range of our health needs. Our financial health requires the services of small, community banks as well as large, sophisticated regional banks. Each has its role. Senate Bill 532 recognizes the need to ensure community investment while at the same time allowing larger financial institutions to provide their expertise and lending capability.

Interstate banking will bring several advantages to the State's business community:

- o Increased access to international and national financial markets, especially in public and private debt financing.
- o Greater expertise in export financing for international trade. Only one bank in the State of Kansas has an international finance department. Kansas exporters deal with out-of-state banks today to handle their international and export transactions.
- o Greater expertise in commercial lending for today's sophisticated, global financial markets.

I would like to elaborate on this last point. Attached to my testimony is a memorandum from Allen Bell, President of the Kansas Development Finance Authority. During the last two years, we tried to establish a composite Industrial Development Bond program that would pool the financing needs of smaller companies. The program

we attempted has worked successfully in Missouri, Ohio and other states. It failed in Kansas. One of the major reasons was our banking structure. The IDB program required a master letter of credit from a foreign bank. The foreign banks do not recognize the small banks in Kansas as credit worthy. They were only willing to deal with one bank in the State. International banks have only one criterion for credit worthiness: size. Only one bank in our state reaches the \$1 billion threshold to meet that test.

Interstate banking exists in 47 states. Interstate finance is a reality in almost every aspect of personal and commercial affairs. Some bankers are fighting to continue the protectionist, anti-competitive policies of the past. Their arguments against interstate banking rest on emotional, outdated notions of Kansas for Kansans. The predictions of doom that you will hear against this bill are unsupportable. They are the same dire forecasts raised against multi-bank holding companies and branch banking. None of those consequences have come to pass.

Before Kansas can participate fully in the global economy, it must first join as an equal participant in the the United States banking system. Your support in favor of Senate Bill 532 will be the most important positive action that you can take for the economic future of Kansas.


Attached for your information is a set of questions and answers on interstate banking that address the most common arguments for and against. It was prepared by Kansas Inc.

I would be pleased to answer any questions.

Kansas Development Finance Authority

March 13, 1990

M E M O R A N D U M

TO: Charles Warren
FROM: Allen Bell 
SUBJECT: KDFA's Composite Industrial Development Bond Program

As you know, in April 1989 the Governor announced the kickoff of the KDFA composite IDB program. At the same time, over 5,000 brochures were sent to manufacturers and industrial developers in the state. Several newspapers and radio stations reported on the program, and two well-attended seminars were held for interested businesses. Within days we had logged over two hundred telephone inquiries, and sent out twice that many information and application packets.

The response was much greater than expected. Within days we had received hundreds of serious inquiries. The program is limited to manufacturing businesses and to capital expenditures because of federal tax regulations relating to the issuance of tax-exempt IDBs. Refinancing of pre-existing commercial loans is not allowed, nor is use of bond proceeds for working capital expenditures. These restrictions eliminated many of the projects for which inquiries were made. Nevertheless, by July 1989 we had received eight applications, for a total loan demand of \$9.5 million.

Credit Structure Problems

The structure of nearly all of the successful pooled IDB programs around the country that do not involve state credit enhancement is substantially the same. Its called the back-to-back letter of credit (LOC) structure. Each project in the pool is required to secure a separate bank LOC in order to get into the program. This bank LOC guarantees that the bondholders will be paid no matter what. If there is a default by the borrower, the bank takes over payments, and potentially the loan collateral. The banks take all the risk in exchange for fee income, but without having to commit any capital. The decision whether or not to finance a particular project is left up to someone qualified to make that assessment.

In order to successfully market composite or pooled bonds, a master LOC is used to overcome the problem of credit diversity. Most states use large international banks with high credit ratings for the master of LOC. The bonds are marketed with the bank's high credit rating, which more than compensates the borrower for the annual fee paid for the master LOC. In recent years, for various reasons, these off-shore banks have been very aggressive in pursuing this type of business. Apparently that is changing, at least with respect to IDBs and the program we've tried to put together for Kansas.

a-4-5
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In the Kansas program, after two month's effort, we were only able to attract the interest of one rated master LOC bank, Credit Commercial de France (CCF). This is also the master LOC bank for the Missouri program. All of the other banks active in this type of program declined to make a proposal, either because they were no longer interested in this type of program, or because of the lack of large banks and the hometown banking system in general in Kansas.

The real exposure of the master LOC bank is the possibility that the bank guaranteeing the loan of a defaulted borrower will fail. To evaluate that risk, the international banks typically have but one criterion: that is, size. Total bank assets of \$1 billion seems to be the minimum comfort level for the international banks. In Kansas that means only Bank IV Wichita.

Barriers Encountered

Even though the credit structure had been revamped to what the financing team believed was a more workable structure, we still ran up against several barriers; some were old, some were new:

- 1) Many banks were unfamiliar with Letters of Credit and did not want to do something they were unfamiliar with.
- 2) Some banks had policies against issuing Letters of Credit.
- 3) Banks found that the compensation for a LOC wasn't enough and they would prefer to do a shorter term conventional loan for the applicant at a higher return for the bank.
- 4) Banks who were interested in issuing LOC's couldn't cover the entire cost of a project due to their lending limits. As an example, one bank agreed to do an LOC for a project up to their \$600,000 lending limit but couldn't find another bank to cover, with another LOC, the remaining \$400,000 of the project cost.
- 5) Banks indicated a reluctance to issue a LOC due to Federal Statutory changes taking place in 1990 that require banks to count their dollar amount of outstanding LOC's as part of their total loan indebtedness.
- 6) Banks felt uncomfortable issuing LOC's for periods longer than 1 to 3 years, which makes marketing a 15-20 year bond impossible.
- 7) In instances where banks agreed to issue LOC's, the combination of the MLOC fee and the local bank's LOC fees made the program too expensive. EXAMPLE: In one case, the borrower would have been paying an annual interest rate of 11½% with 4% of that amount being the two LOC fees. The price that borrowers have to pay for credit enhancement makes the KDFA program uncompetitive even with conventional loans. Some businesses that applied to the program have either secured or are in the process of securing stand alone financing with interest rates ranging from 8% to 11%, compared to KDFA's 10% to 11½% interest rates.
- 8) The IDB program turned out not to be 100% financing. To consider issuing an LOC, banks wanted at least 20% borrower equity if not more toward the project.

**INTERSTATE BANKING
QUESTIONS AND ANSWERS**

Prepared by

**KANSAS INC.
400 SW 8th - Suite 113
Topeka, KS 66603-3957
913-296-1460**

January 22, 1990

*House Eco. Devo. Committee
Attachment 5 3/14/90*

1-22-90

KANSAS INC.
INTERSTATE BANKING QUESTIONS AND ANSWERS

1. What do you perceive to be the basic arguments supporting interstate banking? Can the potential negative impacts be addressed through legislation?

* Too often the debate implies we can either have interstate banking or have community banking but not both together. The financial markets are large and diverse enough to accommodate both regional and community banks.

* The primary advantages to interstate banking for Kansas are to bring to the state:

increased access to international and national financial markets, especially in public and private debt financing;

greater expertise in export financing for international trade; and,

increased expertise in commercial lending;

* Any disadvantages to interstate banking, could be addressed through legislation that protects and preserves community banking and ensures that out-of-state banks invest in Kansas communities. (See Question 8, pp. 6-7)

* Interstate banking would most likely result in larger banks competing more aggressively for accounts providing technologically current customer services, and managerial expertise to deal with increasingly complicated commercial lending deals.

* Larger banks have a number of advantages (Wichita Eagle, September 1, 1989):

stronger banks are more diversified, they can withstand economic losses and be more effective as risk-takers and partners in economic development;

with the ability to have larger staffs they are more aggressive marketers and compete against each other for market shares;

they offer more convenience through their branch network and other increasing technological advances;

they have more money available for lending and they will actually loan it out; and,

there are larger loan limits and faster responses times, they do not have to seek participating lenders and money can be shifted from subsidiary banks.

2. Do you see a trend toward banking consolidation?

* Absolutely! In 1983, Kansas had a total of 623 banking institutions, by mid-year 1989 the number had declined to 574.

* The share of total deposits among larger banks has increased significantly just over the past five years:

Bank Size by Total Assets	Percent Share of State Deposits		
	1983	1987	1988
+ \$100 Million	28.9%	36.1%	37.4%
\$50-\$100 Million	24.8%	25.8%	25.8%
\$25-\$50 Million	25.0%	21.3%	20.8%
- \$25 Million	21.3%	16.8%	16.0%

* In the past, Kansas has lagged the nation in following this trend toward bank consolidation. From 1983 to 1987, banks with less than \$25 million in assets declined by 22 percent nationally and only by 13 percent in Kansas. Those banks with assets greater than \$100 million increased by 40 percent in the U.S. and increased by almost 21 percent in Kansas.

* With the increased merging and branching activity in Kansas from multi-banking holding legislation, Kansas' consolidation should continue at a pace comparable to the nation's. From the start of the year to the end of 1988, there were 13 fewer banks with assets less than \$25 million and two additional banks with assets above \$100 million.

3. Interstate banking presumes that bigger banks are better, are they?

* The data demonstrate that larger banks are superior in terms of international finance, commercial lending, and, in terms of efficiency of operations, they have consistently performed better.

* Small banks may be better in terms of personalized, customer service, but bigness does not prevent a bank from paying attention to the consumer.

* The data supports the fact that larger banks provide greater capital for loans and particularly commercial and industrial loans, critical to business formation and expansion. Loan to deposit ratios have historically been significantly higher for larger banks.

* Larger banks with 37.4 percent of all Kansas deposits, do over 43 percent of all lending. The 41 larger banks (out of 587) do almost 52 percent of all commercial/industrial lending:

<u>Bank Size</u> <u>by Total Assets</u>	<u>Percent Share of State Loans</u>		
	<u>1983</u>	<u>1987</u>	<u>1988</u>
+ \$100 Million	30.6%	41.7%	43.4%
\$50-\$100 Million	24.4%	25.0%	24.4%
\$25-\$50 Million	24.5%	19.8%	18.8%
- \$25 Million	20.5%	14.3%	13.5%

* Kansas, with smaller banks relative to the nation had a total loan to deposit ratio of 60.3 percent compared to the national ratio of 77.8 percent.

- * The Commercial/industrial loan to deposit ratio difference was even greater, nationally it was 24.6 percent and in Kansas the ratio in 1988 was 15.9 percent, a decline from the 1987 ratio of 17.4 percent.
- * Beyond lending practices, studies have shown that significant economies of scale exist for banks which approach \$100 million in assets size. (Economic Review, Fed. Reserve Bank of Kansas City, Sep/Oct 1988)
- * The stabilization of profits for larger banks is apparent in return on asset data from 1980 through 1987. While smaller banks outperformed larger banks early in the decade, as the oil price decline and farm crisis reared, smaller banks began to decline in profitability. In fact the under \$25 million banks in Kansas, as a group, in 1986 experienced a negative return on assets. The larger banks, even during the severe recession of the early 1980's, had stable returns on assets that fluctuated between .88 percent and .96 percent.

4. What effect would interstate banking have on the state economy and the people of Kansas?

- * Most small communities would likely be unaffected by interstate banking because of the small asset size of local banks and the declining local economies. These banks and the communities would be unattractive to out-of-state banks. The communities' survival will rest, as it always has, on the people and leadership in them.
- * Both bank sizes can survive well with interstate banking. This too is related to the quality of leadership and the entrepreneurial skills of the local bank owners/managers. The Wall Street Journal in 1988 reported on how independents are effectively competing with out-of-state large banks. The independents were successful largely by providing exactly the kind of personal services the Kansas Independent Bankers' Association notes are crucial to some customers.

* In the same article, the Journal noted that other Florida customers enjoy the "consistently higher interest rates [on deposits] and lower rates on consumer loans". Additionally, the business community expressed satisfaction with the end of parochialism and the good old boy network. The large bankers, according to business owners interviewed, "are more competitive and have a broader geographical view."

5. Do you believe corporate bank ownership across state lines would result in better or increased competition? Is fear of out-of-state ownership justified?

* The argument for interstate banking does not rest on the need for more banks competing in Kansas. We have plenty of banks and, in some cases, particularly in the smaller communities, too many banks competing over too few customers.

* Maine is an example of a state that has taken a fear of outside ownership and made it a positive economic development tool. While Maine does indeed have a larger share of its total assets (85 percent) owned by out-of-state banks (Wall Street Journal, October 1987), it also has a requirement that annually banks file a report detailing the net new funds provided to Maine. In 1984, the report showed that over \$50 million in loans and investments were generated above the Maine funds in these banks. The study found that the \$50 million was reflected a shift from the acquired banks portfolio in federal securities to state and local issues.

* Legislation comparable to Maine's net investment requirement can be a part of any Kansas legislation. The "fear" may be related to banks' concern of new competition.

6. What effect on small business in Kansas would you expect to see from the passage of interstate banking and why?

* We do need banks that can offer a broader range of services and compete in terms of more sophisticated lending and the ability to offer expertise to the small business owner.

* Kansas Inc. recently completed an evaluation of Certified Development Companies. The study involved a survey of CDC clients to determine their satisfaction with the process of acquiring loans. Thirty-two percent of those surveyed, all who eventually received funds from Small Business Administration loan programs, felt that their local banks ability to handle their financial needs was inadequate.

7. How can legislation in Kansas be written to insure that out-of-state corporate ownership would not drain away Kansas capital?

* The question presumes that the capital in Kansas banks is staying in the state under our current system. Nothing could be further from the truth.

* Kansas has fewer total deposits in loans than banks across the nation (60.3 percent versus 77.6 percent), and it has even less loans in commercial and industrial lending (15.9 percent versus 24.6 percent). Most likely, the alternative uses of deposit dollars are in securities and bonds that leave the state anyway.

* From 1987 to 1988, the dollar total in commercial/industrial loans was reduced over \$226 million (a decline of over 6 percent in one year). Only the largest banks increased the total number of dollars in commercial/industrial loans.

8. Can legislation be crafted that addresses potential problems that may occur with the introduction of interstate banking?

* Kansas does have the benefit, given other state's experiences in interstate legislation, of seeing what statutes can effectively ensure the healthy transition to interstate banking. Provisions might include (similar to HB-2272):

review of the acquiring banks record of community service and investment under Community Reinvestment Act (CRA), tough state monitoring;

acquiring bank make proposal of how it will meet CRA requirements in the community;

required net investment in the community or state, provision for funds into the state above the dollars that go from the community to the acquiring bank; and,

provisions for local banks to exempt themselves from being acquired.

9. The most often repeated reason for having interstate banking is that Kansas is the only one of three states which have not adopted this type of legislation. Is this a good enough reason to adopt it?

* No, but given all the information available, there should be little doubt that it can have a positive impact on the state's image and business climate.

* From an economic development perspective, as the state seeks to demonstrate to relocating and new business that Kansas wants to be a partner in future growth, the lack of interstate banking contributes to a negative state image of being a backward, parochial state with little vision.

10. What effect on agriculture would be expected from the passage of interstate banking and why?

* There is no reason to expect a negative impact on agriculture. Recent data does not support the contention that the small local banks are the only support for the farm community.

- * In fact between 1987 and 1988 total farm loans increased by less than 1 percent. Continuing a trend, banks with assets greater than \$100 million increased their farm lending by over \$38.6 million a gain of 16.4 percent. Banks with assets below \$25 million decreased their loans to farms by over \$35.6 million, a 5 percent drop.

- * Banks with assets above \$100 million, while representing only 7 percent of all banks, now account for 14.5 percent of all farm loans. This 14.5 percent is an increase in the share of farm loan of 2 percent since 1987 alone. We expect that as the farm economy turns around, this trend will continue.

- * The smallest banks share of statewide farm lending decreased by 2 percent from 33.4 percent to 31.4 percent. In effect, the larger banks are picking up the farm lending that the smaller banks are losing.

- * The ability of smaller banks, with a historical reliance on agriculture lending, to diversify has been identified as critical to the future of rural banks and communities. Federal Reserve economists in a June 1988 Economic Review article noted:

Earnings at agricultural banks turned up in 1987. But earnings did not rebound at small agricultural banks like they did at medium size agricultural banks, which hold smaller concentrations of agricultural loans. Earnings at larger banks ... have been more resilient to market shocks than earnings at smaller banks."

The article speaks to the inevitability of great change in the banking industry. It concludes that in order to be competitive in the future and serve local needs (regardless of the presence of interstate banking laws) banks must diversify and compete.

Remarks before the
HOUSE ECONOMIC DEVELOPMENT COMMITTEE

in support of
INTERSTATE BANKING IN KANSAS

March 14, 1990

by Bill Martin
Kansas Industrial Developers Association

The Kansas Industrial Developers Association (KIDA) is made up of over 100 economic development professionals serving Kansas. KIDA supports interstate banking for Kansas.

Access to capital at competitive rates is an essential element in the attraction of new firms to Kansas. Kansas economic developers compete on a daily basis with other states and need the same tools available in 47 other states.

Interstate banking could also be essential to the expansion of existing Kansas firms. At the KIDA meeting last week, we heard presentations from two of the four Kansas firms ranked in "Inc." magazine's list of the 500 fastest growing companies in the United States. Both mentioned the lack of local financial capacity as a major roadblock to their growth. Both firms currently must look outside Kansas for financing.

KIDA strongly believes that interstate banking will allow Kansas to be more competitive in the creation of new job opportunities in Kansas.

House Eco. Devo. Committee
Attachment 6 *3/14/90*