Approved Del Gross 2-7-91
Date

MINUTES OF THE HOUSE COMMITTEE ON COMMERCIAL & FINANCIAL INSTITUTIONS.

The meeting was called to order by Delbert L. Gross at
Chairperson

3:30 ~~a.m.~~/p.m. on February 4, 1991 in room 527-S of the Capitol.

All members were present except: Representatives Dillon, Graeber, Johnson and Teagarden, Excused.

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

Conferees appearing before the committee: Charles Thacker, Regional Director, Federal Deposit Insurance Corporation, Kansas City
Tom Hoenig, Senior Vice President, Federal Reserve Bank Regional Office, Kansas City
Ronald Ence, Independent Bankers Association of Amercia, Washington, D.C.
Henry Schwaller, IV, University of Kansas

The Chairman called the meeting to order at 3:30 P.M.

The first conferee was Charles Thacker, Regional Director, Federal Deposit Insurance Corporation, Kansas City, stating Kansas is only one of three states that does not allow some form of interstate banking.

The FDIC, as an insurer of bank deposits, is concerned about the health of banks in all the states and said lack of interstate banking authorization could be an artificial barrier to healthy banks in Kansas.

Tom Hoenig, Senior Vice President, Federal Reserve Bank Regional Office, Kansas City, stated the Federal Reserve has supported the concept of interstate banking.

The Federal Reserve initially was concerned about the concentration of financial resources in a few big banks, but changed its mind after watching non-banking firms such as Sears and investment firms such as Merrill Lynch begin to offer bank services in all the states they serve.

Henry Schwaller, IV, Research Associate, Instutute for Public Policy and Business Research, University of Kansas, was the next conferee and stated that interstate banking may lead to a more competitive banking system and, in turn, lead to economies of scale and scope, more uniform deposit rates, convenient and easily accessible delivery systems, and a greater array of products offered at competitive prices.

In fact, research shows that small banks can remain competitive if they maintain: (1) a customer-based focus in offering services and loans and (2) profitable and efficient operations. Small businesses in Kansas may also see increasing financing opportunities as small and medium-sized banks increase their loan to deposit ratios in order to remain competitive and profitable. The result could lead to greater statewide economic growth and a more globally competitive banking climate. (See Attachment #1)

Ronald Ence, Independent Bankers Association of America, Washington, D.C. was the final conferee, warning against authorizing interstate banking in Kansas.

A serious result of interstate banking is the loss of local autonomy in setting bank policy.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON COMMERCIAL & FINANCIAL INSTITUTIONS,

room 527-S Statehouse, at 3:30 ~~a.m.~~/p.m. on February 4, 1991.

It was further stated that interstate banking would cause an exodus of loan money from Kansas banks to their big city holding companies and would lead to increased fees and service charges for customers of Kansas banks owned by out-of-town state banks. (See Attachment #2).

After discussion, the Chairman announced HB 2059 would be voted on Thursday, February 7, 1991.

The meeting adjourned at 4:45 P.M.

Date: 2/4/91

GUEST REGISTER

HOUSE

NAME	ORGANIZATION	ADDRESS
Michelle Liester	John Peterson & Assoc.	Topeka
Ken Baker	4th Financial Corp.	Topeka
JERRY LONERGAN	KS INC.	"
Sue Anderson	Comm. Bankers Assn	Topeka
[illegible] Steppat	Comm. Bankers Assoc	Topeka
Ronald R. Snee	IBAA	Washington, D.C.
Tom Hoenig	FRB-KC	KC MO.
[illegible]	FDI[illegible]	KC Mo
Gary Sherrer	Fourth Financial Corp.	Wichita
Pete McGill	CBA	Topeka
LINDA McGILL	CBA	TOPEKA
JEFF SONNICH	KNLSI	TOPEKA
HENRY SCHWALLER	IPPBR	K.U.
TONY REDWOOD	IPPBR KU	Lawrence
Jim Maag	KBA	Topeka

Date: 2/4/91

GUEST REGISTER

NAME	ORGANIZATION	ADDRESS
Tish Gilpin	Rep. Dawson's Office	Manhattan, Ks
Larry J. Stolz	FNB ALMA, Ks	Alma, Ks
David Fowler	1st State Bank	Burlingame, KS
Harold Stones	KBA	Topeka
W. Newton Male	Ks. BANKING DEPT.	"
John Peterson	Fourth Financial Corp	"

INSTITUTE FOR PUBLIC POLICY AND BUSINESS RESEARCH
UNIVERSITY OF KANSAS

INTERSTATE BANKING: A REVIEW OF RESEARCH LITERATURE

Presented to

The House Commercial and Financial Institutions Committee

Presented by

Henry Schwaller, IV
Research Associate

February 4, 1991

2-4-91
CF&I
Atch #1

INTRODUCTION

The Institute for Public Policy and Business Research initiated a review of research literature regarding the effects of the removal of geographic banking restrictions. The purpose of this review was to investigate the possible impact of interstate banking legislation on the Kansas economy. The search for current and relevant research literature determined the major issues and findings outlined in empirical studies.

The structure of the review focused on: (1) the present banking structure in Kansas, (2) national interstate banking activity, (3) arguments made against interstate banking, and (4) benefits derived from interstate banking. Because the majority of research has explored opposition to interstate banking, the greater part of the paper offers the results of research addressing those concerns.

MAJOR FINDINGS OF RESEARCH STUDIES

Research based on the present state and national banking structure and the possible effects of interstate banking shows that:

1. Most states with reciprocal or national interstate banking laws have benefitted from initially passing regional reciprocity legislation and then moving to full reciprocal/unrestricted interstate banking. This two-step approach has been influential in creating and strengthening regional banks, preserving the existing banking structure, increasing access to capital markets, and diversifying loan portfolios through additional lending opportunities.

1-2

2. Interstate banking may lead to a slight decrease in concentration in local markets, and both small and large banks will be able to coexist and compete by differentiating products and services. Furthermore, the threat of unfriendly takeovers is low if banks continue to remain competitive and profitable.

3. While the effect of interstate banking on small businesses has not been directly researched, other studies, taken together, suggest that the supply and cost of small business financing will not be harmed by interstate banking, and in fact, it may increase capital available to small businesses.

4. Interstate banking may lead to a more competitive banking system and, in turn, lead to economies of scale and scope, more uniform deposit rates, convenient and easily accessible delivery systems, and a greater array of products offered at competitive prices.

5. While the present state policy has avoided statewide concentration and control over the allocation of credit by outside institutions, it has created heavily concentrated and uncompetitive local markets. Moreover, it is worth noting that this banking structure may have a negative effect on economic growth within the state. According to the most recent study on the state's banking structure done by Kansas Inc., Kansas' banking industry is highly decentralized and unconcentrated statewide but is very concentrated at the local level, with 88 of the state's 105 counties exceeding the federal threshold of a highly concentrated market area and 306 communities being served by one bank.

6. Kansas Inc.'s study also found that Kansas' average loan to deposit ratio of 59.8 percent is significantly lower than the national average of 79.8 percent. When compared to its neighbors, Kansas' loan to deposit ratio is higher than Nebraska and Oklahoma and below Colorado and Missouri. Loan to deposit ratios were not found to be linked to community factors, such as population or the local economy. Instead, it could be seen that larger Kansas banks have a higher ratio than medium and small-sized banks. If Kansas banks loaned money at a mid-point between the state and national average (68 percent), an additional $2.4 billion in loans would be made.

CONCLUSION

Opposition to interstate banking continues in Kansas, even though most states have already passed regional or national reciprocity legislation. The primary focus of the interstate banking debate in Kansas has centered on the potential impact on small, community banks. There is little evidence to support the fears that small banks will suffer or disappear with interstate banking. In fact, research shows that small banks can remain competitive if they maintain: (1) a customer-based focus in offering services and loans and (2) profitable and efficient operations. Small businesses in Kansas may also see increasing financing opportunities as small and medium-sized banks increase their loan to deposit ratios in order to remain competitive and profitable.

Taking this information and the research findings of the literature into account, one can see that Kansas could benefit from interstate banking in the following ways: (1) improved access to capital, especially for small businesses as small and medium-sized banks increase their loan

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to deposit ratios in order to remain competitive and profitable; (2) more diversified banking institutions; (3) stronger regional banks; (4) easier consumer access to banking facilities; (5) greater array of services and products; and (6) more competitive prices and rates. The result could lead to greater statewide economic growth and a more globally competitive banking climate.

INSTITUTE FOR PUBLIC POLICY AND BUSINESS RESEARCH
UNIVERSITY OF KANSAS

INTERSTATE BANKING: A REVIEW OF RESEARCH LITERATURE

Presented to

The House Commercial and Financial Institutions Committee

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Henry Schwaller, IV
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February 4, 1991

1-4

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2. Interstate banking may lead to a slight decrease in concentration in local markets, and both small and large banks will be able to coexist and compete by differentiating products and services. Furthermore, the threat of unfriendly takeovers is low if banks continue to remain competitive and profitable.

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5. While the present state policy has avoided statewide concentration and control over the allocation of credit by outside institutions, it has created heavily concentrated and uncompetitive local markets. Moreover, it is worth noting that this banking structure may have a negative effect on economic growth within the state. According to the most recent study on the state's banking structure done by Kansas Inc., Kansas' banking industry is highly decentralized and unconcentrated statewide but is very concentrated at the local level, with 88 of the state's 105 counties exceeding the federal threshold of a highly concentrated market area and 306 communities being served by one bank.

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Taking this information and the research findings of the literature into account, one can see that Kansas could benefit from interstate banking in the following ways: (1) improved access to capital, especially for small businesses as small and medium-sized banks increase their loan to deposit ratios in order to remain competitive and profitable; (2) more diversified banking institutions; (3) stronger regional banks; (4) easier consumer access to banking facilities; (5) greater array of services and products; and (6) more competitive prices and rates. The result could lead to greater statewide economic growth and a more globally competitive banking climate.

IBAA
INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Testimony of
Ronald K. Ence, IBAA
Before the
Kansas House Committee on Commercial & Financial Institutions

SUMMARY

IBAA is a 6,200 member national trade association representing the interests of our Nation's community banks. IBAA is opposed to the concentration and control of financial resources from outside the communities that individual banks serve. We believe that banks whose policies are set locally are better able to meet local needs.

Since 1976, the increase in concentration in the banking industry has been alarming. Today, the top 1% of banking interests in this country control nearly three-fourths of the assets in the entire banking industry.

IBAA welcomes healthy competition, but such concentration reduces, rather than increases, competition. States that have adopted interstate banking have experienced severe losses in unit banks operating within their borders.

Locally-owned banks are dependent on the local market for their success. Banks controlled by corporate offices hundreds or thousands of miles away would not have to rely on the local economy for profits and would have less incentive to promote local growth.

Small business, including farmers and ranchers, would be hurt most by interstate banking because branches of large regional banks would probably concentrate on deposit taking and consumer lending, rather than commercial lending. There is no evidence to suggest that interstate banking contributes to economic development.

A serious result of interstate banking is the loss of local autonomy in setting bank policy. A Texas branch of a large North Carolina regional bank maintains a loan-to-deposit ratio of 17.5%, and reduced its workforce from 136 to 28 employees. Clearly, there are more losers than winners in regional banking states.

The U. S. Congress will consider a proposal to permit interstate branching in interstate banking states. So adopting an interstate banking law could carry unintended baggage in the form of branching.

Finally, 52% of Kansas voters said they opposed interstate banking, while only 21% favored it. This is a reflection of the strong health of banking in Kansas. Adoption of interstate banking laws would put the strength of the Kansas banking industry in jeopardy.

2-4-91
CFI
Atch #2

WASHINGTON OFFICE, ONE THOMAS CIRCLE NW, SUITE 950, WASHINGTON, D.C. 20005-5802 • 202/659-8111

IBAA
INDEPENDENT BANKERS
ASSOCIATION OF AMERICA

Testimony of

Ronald K. Ence
Director of Agricultural Finance
Independent Bankers Association of America

Before the

Committee on Commercial & Financial Institutions
Kansas House of Representatives
Topeka, Kansas
February 4, 1991

Mr. Chairman and Members of the Committee, my name is Ronald K. Ence, and I am Director of Agricultural Finance for the Independent Bankers Association of America (IBAA) in Washington, D.C. I would like to thank you for this opportunity to be with you today to discuss regional interstate banking, and to share with you our Association's views on this subject.

IBAA is a 6,200 member national trade association. We are the only national trade association dedicated exclusively to the views and interests of community financial institutions. It is this fact that differentiates IBAA from other banking trade associations, such as the ABA, which is heavily influenced by the money center banks and other large financial institutions.

Our community bank members are typically small, with 90% having assets under $100 million. In Kansas, 275 out of the state's 580 banks are members of IBAA.

Over the years, a number of state associations have been established with the purpose of providing services to community bankers. One such organization is the Community Bankers Association of Kansas, which works closely with our national association in representing community bank interests and providing community banks with a wide variety of services. CBA, in our opinion, has done an outstanding job in this regard.

Mr. Chairman, Maine was the first state to enact a general statute providing for regional interstate banking back in 1975. Since then, all but four states -- Kansas being one of the four -- have adopted laws permitting interstate banking on either a regional or nationwide basis. Can 46 states be wrong? The IBAA believes they can

. . .and were!

One of IBAA's fundamental goals over the years has been to limit the concentration and control of financial resources from outside the communities which individual banks serve. Our view is that if we can avoid undue concentration of ownership, the public is better served and we will avoid an unstable and dangerous pooling of economic and political power.

Please allow me to read directly from our charter:

> "The Independent Bankers Association of America is an organization of independent community banks, locally owned and operated, dedicated to meeting the financial needs of their communities. IBAA and its members believe these banks are better able to serve their communities than financial systems which follow policies that are not set locally and thus may not meet local needs.
>
> "What is an 'Independent' Bank? An Independent bank is a locally owned, locally operated bank. Its deposits come from, and its loans are made in, the area where it is located. It may operate with a single office (a unit bank) or may have a limited number of offices or subsidiaries. In either case, its policies are set locally."

That proposition has been advanced by the Independent Bankers Association of America since its creation more than 60 years ago, and it still represents the foundation upon which our association is built. We believe very strongly in local control and local ownership.

Mr. Chairman, since 1976 the increase in concentration in the banking industry has been dramatic -- and alarming. In the years 1976 to 1987, the number of banks controlled by multi-bank holding companies doubled from 2,296 to 4,465, while the number of unit banks plummeted 59 percent, from 10,608 to 4,375. Even more alarming, multi-bank holding companies increased their share of assets in that period from 36% to 70%, while the share of assets for one-bank holding companies declined from 34% to 21%, and for unit banks from 30% to only 9%.

Between 1976 and 1987, assets controlled by the top 1 percent of banking organizations grew from 53% to 62%. And if you count all assets, domestic and foreign, of U.S. chartered banks, that 62% becomes 67%. And if off-balance-sheet assets and assets of non-bank subsidiaries are added, the level of concentration would go up even more.

Mr. Chairman, this has been an ominous trend. Think of it . . .the top 1% of banking interests in this country control probably three-fourths of the assets in the

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entire banking industry. Can anyone seriously suggest that this kind of concentration is good for consumers, for farmers and ranchers, for small businessmen and women, for the communities whose very survival often depend on the commitment of their local bankers? I think the answer is obvious.

What's so bad about concentration? Are we opposed to "interstate banking" in its most basic form? Let me make perfectly clear that IBAA is not opposed to interstate banking, i.e., establishing customer relationships across state lines. We have had interstate banking since Alexander Hamilton provided the framework for our current financial services system, and IBAA welcomes competition among our members.

We refute the claims of interstate banking proponents that they represent the pro-competitive viewpoint. They argue that restrictions on entry into certain markets diminishes competition. In the abstract, this argument has some plausibility. But reality shows otherwise.

The examples are sobering. Virginia opened its doors to statewide branching in 1961 and within 20 years lost 65% of its unit banks -- dropping from 207 banks to only 73. North Carolina, when branching restrictions were removed, lost all but 17 of its 100 unit banks. Other states have seen individual bank competition drop 40%, 50% and more. Is this the kind of competition you want in Kansas?

Or you may ask, why do we need all this competition? What is the harm if a local market loses a competitor through concentration. Here is our answer. Locally-owned independent banks are dependent on their local market for their success. They must -- if they are to survive and profit -- have the best interests of their community foremost in their mind.

Compare that to a branch office run by an agent of a large banking corporation who will be in the community only a short time before making his next step toward corporate headquarters. This problem becomes even more compounded when the decision-making authority rests in a money center bank hundreds or even thousands of miles away. Does anyone really believe that those decision makers would be interested in anything other than the bottom line? I contend that it is naive to believe that decision makers not located in the community would have the best interests of the community at heart.

There are many examples around the country where small-town branches of large regional banks fold-up their tents and leave town as soon as the economy begins to turn a little sour. There is no incentive for these branches to stay in the community and help get the economy back on its feet.

Also, let us not forget that political power follows financial power. Would you really want your local communities influenced by the political whims of out-of-state decision makers? Once again, I think the answer is obvious.

Perhaps the biggest loser in this kind of scenario is the local small businessman or woman who relies on the community bank for financial backing, even during tough times. The National Federation of Independent Business, small business's trade association in Washington, said the following in testimony before the U.S. Congress:

> "Small businessmen and women are very concerned that as geographic restrictions are eliminated, the small bank on which they rely will be taken over by large bank conglomerates, whose focus will be on deposit taking (and consumer lending) rather than making commercial loans (local business loans). They are afraid that their money will be channeled toward large corporations in money centers and toward international investments."

They stated further:

> "If, as many interstate banking supporters contend, there is an economy of scale in the expansion of large interstate banks, then the scale derives not from the size of the bank, but the size of the borrower; in this, small business will reap no economy."

Mr. Chairman, of the 580 banks currently operating in Kansas, about 480 of them are located in rural areas. Only 26 are located in urban areas, with the balance being suburban banks.

It is the 480 rural banks that will be hurt most by interstate banking; and it is the farmers, ranchers and small businesses in those rural communities who will eventually have to pay the price of "getting in step with the rest of the country," as some interstate banking proponents have put it.

And what about consumers? Will consumers benefit from interstate banking? A little while ago, Professor Nicholas M. Didow testified before the U. S. Congress on bank service charges. His message could not be more clear. He said:

> "The larger the bank, the higher the level of fees. The smaller the bank, the lower the level of fees."

Where is the economy of scale here? For consumers, it does not exist.

Separate studies by the Federal Reserve Bank of Boston and the New York State Banking Department show that independent banks in those jurisdictions charge consistently lower rates on both commercial and consumer loans than branch banks in the same market. The California Superintendent of Banks testified before the U.S. Senate Banking Committee that the statewide branch banks in his state almost

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without exception charge significantly higher rates than the state's smaller independent banks.

A comprehensive study by the Federal Reserve found that a 10 point increase in concentration would increase business loan rates by six basis points, and a 20 percent increase in concentration would raise loan rates by 10 basis points. This, Mr. Chairman, is not what interstate banking proponents would have you believe -- but it is fact.

Mr. Chairman, one of the very serious concerns about regional banking is relinquishing local control over bank policy. I would like to give some real-life examples of the loss of local autonomy in setting bank policy from regional banking states.

A little more than a year ago, Joel Stevens resigned as chairman of Key Bank of Maine, a bank he had been with for nearly 20 years. He resigned because of "irreconcilable differences" with KeyCorp, the bank's Albany, New York-based holding company. "They were unhappy with the direction I was taking, and I was uncomfortable with what they were asking me to do," he said. His settlement agreement forbade him to say anything more.

In a later interview, however, he said this about his future plans:

> "I would not be interested in a large, out-of-state holding company. I have been that route before and found our objectives are not similar. Policies that determine the bank's direction are made by the central office. There is no question you lose some local autonomy and management freedom when you are dealing with a large holding company."

Another example: Just last December, the entire Board of Directors of the NCNB bank in Victoria, Texas, resigned to protest the firing of the bank's two top officers. NCNB, as you know, is a large regional bank headquartered in Charlotte, North Carolina. The two officers were fired by NCNB's corporate district office in Houston suddenly, with no prior warning and no explanation to the Board.

Resigning Board Chairman Bill Noble had this to say about the bank's relationship with its out-of-state parent company. He said, "My main concern is what's happening to Texas banking. Ownership is being controlled by out-of-state banks."

Mr. Noble said there was a lack of commitment to the community by the North Carolina-based bank, with a paltry loan-to-deposit ratio of only 17.5%. "Go out and try to get a loan," he said. "It's almost impossible."

Mr. Noble also charged that profits from NCNB's Texas branches were being used to

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bolster corporate operations in the sagging East Coast economy. He pointed out that NCNB's Texas division had a net income of $82.2 million. During that same period, all corporate operations for NCNB showed a net income of $56.9 million. Without the income from the Texas division, the East Coast operations would have shown a $25 million loss, he said.

Mr. Noble also charged that NCNB showed a callous disregard and disrespect for its Texas employees. When NCNB first took over the Texas bank, the bank had 136 employees. Today, the bank has 28 employees, and the branch has a year-end mandate to cut back to 24 1/2 full-time employee equivalents.

"It is management by intimidation -- pass the word down," he said, adding that employees are afraid to stray from corporate policy for fear of losing their jobs.

Mr. Chairman, interstate banking proponents would have you believe that regional banking is one of the blessed events from which there are all winners and no losers . . .that all states and all banks will benefit. I contend that this will not be the case . . .that some states will be aggressed upon, while other states will be the aggressors . . .that some banks will win, but that most banks will lose. The anecdotal evidence I just offered from Maine and Texas make this point vividly.

Several years ago, Federal Reserve Governor Emmett Rice summed up the arguments as well as anybody. His words still ring true today. He said:

"There has been no demonstration of any public benefits from regional interstate banking. The proponents claim that regional banking will lead to faster regional economic growth, but there is no evidence that there is any relationship between banking structure and economic development. They claim that the merging banks will achieve economies of scale, but there is no evidence to support that opinion. They claim that by growing larger they will be in a better position to survive the eventual entry of the nation's largest banks. However, there is no evidence that the regional banks need to be larger to survive. Survival is the result of providing good service at competitive prices and there is no evidence to suggest that this is directly related to the size of the organization. The advocates claim that larger banks can better serve the needs of large businesses, but there is no evidence that the credit needs of large business firms are not being met. In summary, there is no evidence to support the claims of the proponents of regional banking."

Mr. Chairman, the U. S. Treasury Department is about to release a 600-page study unveiling the most sweeping banking reform proposals since the Great Depression. One of Treasury's proposals will be to repeal the Douglas amendment, opening the doors for bank holding companies to acquire banks in other states without that state's consent. Another proposal will be to permit national banks to branch across state lines to the extent that state law permits interstate banking.

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This is my point: On the one hand, while we are sitting here discussing the relative merits or lack of merits of permitting interstate banking in Kansas, that decision may well be made for you by the U.S. Congress. On the other hand, even if the Douglas amendment survives, you should clearly understand that opening the doors to interstate banking could also open the doors to interstate branching, again, courtesy of the U. S. Congress. So you may get more than you bargained for in your proper exercise of states rights. And as onerous as we consider interstate banking to be, our view is that interstate branching is more so.

Mr. Chairman, in a January 16 letter to Treasury Secretary Nicholas Brady about these very proposals, your very able and highly-respected Senator Bob Dole had this to say:

"It's one thing to encourage competition; it's something quite different to uproot banks that have ably served local communities for generations." Senator Dole has been a valued champion in protecting the rights and interests of community banks.

Mr. Chairman, allow me to introduce one last compelling argument against opening-up Kansas to interstate banking: The voters don't want it!

A statewide poll taken just three months ago by Central Research Corporation revealed that only 21% of registered voters in Kansas favored changing Kansas law to allow interstate banking. A majority -- 52% -- said they opposed it. Voters in Kansas evidently are proponents of that old adage, "If it ain't broke, don't fix it."

Mr. Chairman, the banking system in Kansas ain't broke. Speaking for IBAA's 6,200 members nationwide and particularly our community bank members in Kansas, I urge you to avoid the temptation to tamper with it just because it seems fashionable to do so.

Thank you, again, for allowing me the opportunity to share with you the views of the Independent Bankers Association of America.

# # #

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