Approved: March 24, 1998
Date

MINUTES OF THE Senate Committee on Financial Institutions and Insurance.

The meeting was called to order by Chairperson Don Steffes at 9:00 a.m. on March 4, 1998 in Room 529-S of the Capitol.

All members were present except:

Committee staff present: Dr. William Wolff, Legislative Research Department
Fred Carman, Revisor of Statutes
Nikki Feuerborn, Committee Secretary

Conferees appearing before the committee: Newton Male, State Bank Commissioner
Chuck Stones, Kansas Bankers Association

Others attending: See attached list

Hearing on SB 574- Repeal of bank commissioner's wildcard statute
Chairman Steffes suggested to the Committee that they ask the Governor to name a Task Force to study the state regulatory agencies for financial endeavors in the state. This would include the activities of the bank commissioner's office, divisions of credit unions and consumer credit, and the securities administration. The intent of **SB 574** was never to strip the bank commissioner of the statutorily granted powers but to open discussion on the appropriate use and disclosure of the "wildcard statute authority."

SUB for SB 574 was distributed and explained as reinstating almost everything that was originally in the statute but adding a new Subsection C (Attachment 1). When the legislature is in session, the Commissioner could be required to appear before both Senate and House Financial Institutions Committees if a special order is issued. Also an economic impact statement on the proposed special order (prepared according to statute) would be presented. Additional members would be added to the disclosure list of persons to be informed. If such a special order is presented when the legislature is not in session, a written report and a fiscal impact statement on the special order would be presented to the Legislative Coordinating Council, as well as the Committee Chair, Ranking Minority Member, Minority Leaders of the Senate and House of Representatives, the Speaker of the House, and the President of the Senate. It was suggested that such a special order be required to be reviewed during the first week of the returning legislature. Should the Governor's budget amendment be included? During discussion it was determined that it was not the intention of the Committee to take away the wildcard statute but that it was important that such orders not interfere with the state general fund. At this time the State Bank Commissioner does not normally use the services of the Budget Director.

Newton Male, State Bank Commissioner, restated the importance of the wildcard authority for the success of the dual banking system in Kansas. It has worked well for many years and provides good competition for consumers. He named the Comptroller of the Currency as the real culprit when he allowed national banks to form subsidiaries in 1981.

There have been 31 special orders issued since 1967. Of that number only two or three had any impact on the financial status of this state. Eighty-one state banks have been granted permission to form subsidiaries at this time. Commissioner Male said his main concern is that he would ultimately be required to solicit approval from every county and municipal government regarding the use of the wildcard authority. He said great consideration is given prior to issuing special orders. He said he was not willing to support a request to provide an economic impact statement due to his limited staff of 15.

The Committee questioned the public's interest or perceived need for a dual banking system in Kansas. Is it only the bankers who benefit?

Chuck Stones, Kansas Bankers Association, said the Office of the Controller of the Currency has affected the privilege tax policy of Kansas, not the Bank Commissioner's Office (Attachment 2). He reminded the

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.

CONTINUATION SHEET

MINUTES OF THE Senate Committee on Financial Institutions & Insurance, Room 529-S Statehouse, on March 4, 1998.

Committee that it is the right of the state banks to compete and they can readily change to national banks within 30 days. The Commissioner followed the law in issuing the special order and it was the right of any legislator or member of leadership to request a fiscal impact statement at the time of issuing such order. Should this special order be repealed, it will lead state banks to believe any special orders can be reversed, thus encouraging the conversion to national banks.

The hearing was continued.

Senator Becker moved that the minutes of February 19, 20, 23, and 24, 1998, be approved. Motion was seconded by Senator Brownlee. Motion carried.

The meeting was adjourned at 10:00 a.m. The next meeting is scheduled for March 5, 1998.

SENATE FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE GUEST LIST

DATE: 3/4/98

NAME	REPRESENTING
Boyd Grant	KCCI
Rob Mey	Senate
Danielle Noe	Governor's Office
Clyde Graeber	Treasurers Office
Frank & Jesse James	Society of Bank Withdrawers
Susan Anderson	Hein + Weir
Martin Hawver	Hawver's Capitol Report
Chuck Stones	KBA
Kevin Glendening	Office of the State Bank Comm
Judi Stork	✓
Kathy Olsen	Ks Banker Assoc.
Mike Astle	Comm Bankers Assn
Alan Steppat	Pete McGill & Assoc.
Roger Franzke	Ks Gov. Consulting
Stacy Morford	AP
Cindy Denton	DOB
Matt Goddard	HCBA

Substitute for SENATE BILL NO. 574

By Committee on Financial Institutions and Insurance

AN ACT concerning banks and trust companies; powers of bank commissioner; amending K.S.A. 1997 Supp. 9-1715 and repealing the existing section.

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

Section 1. K.S.A. 1997 Supp. 9-1715 is hereby amended to read as follows: 9-1715. (a) The commissioner shall have the power to authorize any or all state banks to engage in any activity in which such banks could engage were they operating as national banks at the time such authority is granted, including but without limitation because of enumeration the power to do any act, and own, possess and carry as assets, property of such character including stocks, bonds or other debentures which, at the time authority is granted, is authorized under federal laws and regulations to be done by national banks notwithstanding any restriction elsewhere contained in the statutes of the state of Kansas. This power shall include the power to authorize any or all Kansas trust companies to engage in any trust related activity in which the trust department of a national bank with trust powers could engage at the time authority is granted. This power shall be in addition to any and all other powers granted to the commissioner.

(b) The commissioner shall exercise the power granted in subsection (a) by the issuance of a special order if the commissioner deems it reasonably required to preserve and protect the welfare of a particular institution, or if the commissioner deems it reasonably required to preserve the welfare of all state banks or trust companies and to promote competitive equality of state and national banks. Such special order shall provide for the effective date thereof and upon and after such date shall be in full force and effect until amended or revoked by the commissioner. Promptly following issuance, the commissioner shall cause a copy of each special order to be mailed to all state

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banks and trust companies.

(c) When the legislature is in session, within one week after the state bank commissioner issues any special order under this section, the commissioner shall appear before the senate standing committee on financial institutions and insurance and the house of representative's standing committee on financial institutions. At such meeting the commissioner shall distribute copies of the special order, together with copies of the economic impact statement applicable thereto. The economic impact statement shall include: A description of the cost or benefit, the persons who will bear the costs or receive the benefit and those who will be affected by the special order, including the agency issuing the special order, other governmental agencies or units, private citizens and consumers of the products or services which are the subject of the special order or enforcement thereof. The required statement shall be made by the commissioner, who may receive assistance therefor from the division of the budget and all state agencies from whom information is requested.

~~(c)~~ (d) The commissioner, at the time of issuing any special order pursuant to this section, shall submit a written report, including the economic impact statement required by subsection (c), to the president and the minority leader of the senate and the chairperson and ranking minority member of the senate standing committee on financial institutions and insurance, and to the speaker and the minority leader of the house of representatives and the chairperson and ranking minority member of the house of representatives standing committee on financial institutions.

~~(d)~~ (e) The issuance of special orders under this section shall not be subject to the provisions of article 4 of chapter 77 of the Kansas Statutes Annotated.

Sec. 2. K.S.A. 1997 Supp. 9-1715 is hereby repealed.

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

Kansas Bankers Association

800 SW Jackson, Suite 1500

Topeka, KS 66612

785-232-3444 Fax - 785-232-3484 e-mail - kbacs@ink.org

TO: Senate Financial Institution and Insurance Committee
FROM: Chuck Stones, Director of Research

RE: SB 574

Mr Chairman and Members of the Committee:

The Kansas Bankers Association appreciates the opportunity to appear before you in opposition to SB 574.

SB 574 is not about taxes! It IS about what value the State of Kansas places on state chartered banks operating in Kansas. It is all about maintaining the dual banking system. The dual banking system, as you know, is the existence of two separate, equivalent chartering and regulatory systems at the state and federal level. The dual banking system provides financial institutions a meaningful choice between state and federal chartering, supervision, and regulation. It is a unique system in the world, and has been the major factor in the dynamism of the American banking system.

The existence of two regulatory systems promotes efficiency, as regulators learn from each other and have the incentive to improve their operations to serve their constituencies. The dual banking system also promotes creativity within the banking industry. Innovations that originated at the state level include checking accounts, NOW accounts, ATM's, electronic funds transfers, and bank insurance sales.

I have attached two items to my testimony. The first is stories and speeches about and by Federal Reserve Chairman, Alan Greenspan and former FDIC chairperson Ricki Helfer. Both state their strong support for the dual banking system and explain many of the points previously made.

The second attachment is a very recent article in the *Independent Banker Magazine*. This article outlines why maintaining the dual banking system and the "wild card" authority, as is, is vitally important. The article is about the accomplishments of Eugene Ludwig, Comptroller of the Currency. He is the head of the Federal agency that regulates National Banks. (1) The first point from the article is found on page 21 of the article. It talks about the state of banking in the nation in the early 90's. The industry was just coming out of a terrible period of time. Many bank and S&Ls failed and bank regulators responded by cracking down. Some have said they created a zero failure policy. Under these

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circumstances banks were very reluctant to make loans with any risk whatsoever. The term credit crunch became a widely used term. President Clinton made it very clear that the regulators at the Comptroller of the Currency were to be "reigned in". As a result, State Banking Departments all over the nation also adjusted their examination practices. The risk of conversion from one charter plays a big factor in the maintenance of regulatory parity. These things seem to ebb and flow. From time to time we will hear from bankers about harsh exams from one regulator or another. Then the complaints will shift to the other regulators; this is the beauty of the system, they keep each other in check.

The next item appears on page 23 of the article, under the heading "Insurance Powers for National Banks". This section points out the rapidly changing nature of banking. Comptroller Ludwig has been tenacious in his quest to provide banks new products with which to compete with others in the financial services industry. His zeal is highlighted by a look at the list of Special Orders issued by the Banking Department. The wild card statute was first enacted in 1967. From that time until 1993, when Ludwig took office, there were 11 Special Orders issued. From 1993 to the present there have been 13 Special Orders issued. This very clearly points to the rapidly changing banking environment. These changes were made necessary not because of federal legislative changes but by interpretations of Federal law made by Comptroller Ludwig. He has not had a free reign. He has been challenged on several instances. The insurance industry has challenged him on his insurance rulings. States, including Kansas, challenged him on the 30-mile ruling. In each case the courts have found that the OCC has broad authority to grant new powers and override State law in some cases. If you remove the ability for State chartered banks to compete, no matter the length of time, the system will be tilted in favor of Nationally chartered banks and many banks, especially larger ones in urban areas, will no longer find benefit in the State system. If a bank feels its ability to compete is threatened it will convert to a National charter. If this happens to a few large banks the affect will be like dominos as larger and larger assessments are passed down on the remaining banks. This would have devastating effects during the next economic downturn. The decision to close banks in communities all Kansas will be made by a Federal regulator with no concern for the State, the communities or the people involved.

This could very well be the most important policy decision regarding banking this committee makes or ever has made. This Legislature, this Committee has the opportunity to tell banks chartered in this state you support them and their ability to compete. Any dilution of the "wild card" authority will have the opposite effect. State chartered banks will question your commitment to them.

We again urge you to defeat SB 574, or any change in the Commissioners wild card authority.

GREENSPAN, HELFER BACK DUAL BANKING

Federal Reserve Board Chairman Alan Greenspan, speaking by satellite to the 96th CSBS Annual Meeting and Conference, endorsed the state banking system in the strongest possible terms.

"State-chartered banks . . . play a critical role in our financial system," Chairman Greenspan said. "The state charter is a key to the robustness of our banking structure," he continued. "The dual banking system not only fosters and preserves innovation but also constitutes our main protection against overly zealous and rigid federal regulation and supervision."

However, Chairman Greenspan said, "The dual banking system . . . is under attack. This attack is neither particularly intentional nor particularly coordinated, but rather consists of the unintended consequences of statutory and regulatory changes aimed at achieving broader policy objectives."

In her remarks, FDIC Chairman Ricki Helfer also emphasized the importance of cooperating to preserve and enhance the dual banking system. "We are all seeking to change with a changing world to assure the strength and viability of the dual banking system," she said. A single banking regulator "places too much power in the hands of one individual." In closing, Chairman Helfer seemed optimistic about the system's future. "Over 132 years, the dual banking system has provided us with a precious resource -- the flexibility to adapt to change. Never has banking needed that flexibility more than it needs it now. Never has the dual banking system been more necessary."

Remarks by Federal Reserve Board Chairman Alan Greenspan

March 22, 1997

The dual banking system and the importance of choice of federal regulators

A key to the effectiveness of our banking structure is what we term the dual banking system. Our system of both federal and state regulation of banks has fostered a steady stream of innovations that likely would not have proceeded as rapidly or as effectively if our regulatory structure were characterized by a monolithic federal regulator. For example, a state-chartered bank invented the NOW account. Also, the liberalization of prohibitions against interstate banking has its origin in the so-called regional compacts that permitted interstate affiliations for banking companies in consenting states. Adjustable rate mortgages are yet another example of innovation at the state level that has benefited financial institutions and their customers.

Just as important as the fostering of innovation is the protection the dual banking system affords against overly rigid federal regulation and supervision. The key to protecting against overzealousness in regulation is for banks to have a choice of more than one federal regulator. With two or more federal regulators, a bank can choose to change its charter thereby choosing to be supervised by another federal regulator. That possibility has served as a constraint on arbitrary and capricious policies at the federal level. True, it is possible that two or more federal agencies can engage in a competition in laxity--but I worry considerably more about the possibility that a single federal regulator would become inevitably rigid and insensitive to the needs of the

marketplace. So long as the existence of a federal guarantee of deposits and other elements of the safety net call for federal regulation of banks, such regulation should entail a choice of federal regulator in order to ensure the critical competitiveness of our banks.

The job of a banking regulator, difficult under any circumstances and for a variety of reasons, is especially critical as it regards the connection running between banking risk and the impact of such risk-taking on the macroeconomy. As I have been pointing out, the historic purpose of banks is to take risk through the extension of credit to businesses and households--credit that is so vital to the growth and stability of the economy. But this fact creates a significant conflict for banking regulators. On the one hand, regulators are concerned with the cost of bank failure to the taxpayer and the impact of such failures on the general safety and soundness of the financial system. On the other hand, banks must take risks in order to finance economic expansion. Decisions about tradeoffs must be made. In the early 1990s, we saw how, in response to FDICIA, new regulations, weakened capital, and large loan losses, banks reduced their willingness to take risks, thereby contributing to a credit crunch and slower economic growth. This recent episode demonstrates clearly how tricky are these tradeoffs between necessary risk taking and protecting the banking system; a swing too far in either direction can create both short-term and long-term difficulties.

A regulator without responsibility for macroeconomic growth and stability tends to have a bias against risk-taking. Such a regulator receives no praise if the economy is functioning well, but is criticized if there are too many bank failures. For such a regulator, the tradeoffs are one-sided and, if the decisions of such a regulator were left unchecked, the result might be a stagnant economy at whose core was a stagnant banking system. In contrast, the Federal Reserves economic responsibilities are an important reason why we have striven to maintain a consistent bank regulatory policy, one that entails neither excessive tightness nor ease in supervisory posture. The former would lead to credit crunches, the latter, with a lag, would lead to excessive bank failures.

Just as the probability of bank failure should not be the only concern of the effective regulator, bank regulation is not the only, or even the most important, factor that affects the banking business. The condition of the macroeconomy also has something to say about your success as a banker. In that regard, the generally favorable macroeconomic conditions we have been facing for the past few years suggest that bankers should now take pause and reassess the appropriateness of their lending decisions. Mistakes in lending, after all, are not generally made during recessions but when the economic outlook appears benevolent. Recent evidence of thin margins and increased nonbank competition in portions of the syndicated loan market, as well as other indicators, suggest some modest underwriting laxity has a tendency to emerge during good times. This suggests the need for a mild caution that bankers maintain sound underwriting standards and pricing practices in their lending activities.

THE DUAL BANKING SYSTEM:

Historical Perspective:

From an historical perspective, the dual banking system has been important to the United States in many respects. It has provided the competitive equality that Congress has time and time again stated as its goal for state and national banks . . . that one charter would not be favored over another.

It has prevented a concentration of power in one monolithic regulator. As you know, monopolies can result in:

o higher costs to the regulated entities;
o unresponsiveness on the part of the monopoly; and
o no incentive for creativity.

Instead, the dual banking system has resulted in competition between state banking departments and federal regulators in the areas of fees, powers, and responsiveness to the industry.

Creativity:

Historically, and up to 1991, the states have been the incubator of innovation, with Congress being able to adopt these new ideas if they prove successful. Unfortunately, the passage of FDICIA curbed the states' ability to allow bank powers that go beyond national bank powers without FDIC permission.

The innovations that have been produced by the states may be surprising to you, but they include:

o checking accounts
o real estate lending
o trust services
o deposit insurance
o ATM machines
o NOW accounts
o branch banking
o interstate acquisitions of banks by bank holding companies

In Congress, any discussion of new bank powers needs to again include letting the states be the incubator for new products and services. This creative thinking is crucial to the banking industry at a time when non-bank competitors are taking away market share in increasing percentages. This creative thinking is vital to the very survival of the banking industry.

RESPONSIVENESS TO THE BANKING INDUSTRY:

I would like to turn now to the beneficial impact of the dual banking system on the regulators' responsiveness to the banking industry.

If you ask bankers what they liked about being a state bank, they inevitably came up with the same four issues:

o They liked access to the Commissioner.
o They liked the Department's knowledge of the local markets and local pressures.
o They liked the quick turnaround time on their questions.
o And they liked the low exam and corporate fees.

I believe that the steady stream of conversions from national charters to state charters has forced the OCC to become more customer-oriented in order to retain charters. In turn, the state banking

departments have begun to review their operations to improve their service to the banking industry.

Summary of the Dual Banking System Section:

As you can see, I am a firm believer in the dual banking system. I have been on both sides of the fence and believe that the system is good for the banking industry and keeps the state and federal regulators striving to be the best they can be to the benefit of the banking industry.

The President's Pointman

With a bold agenda, OCC chief Eugene Ludwig reshaped banking's role in our financial system

By Jennifer Ruhlen

Five years ago, William J. Clinton, was inaugurated the 42nd president of a nation facing a precarious economy, propped up by a troubled banking industry. A key component of his successful election campaign was his promise to revive a stagnant economy that was contributing to failing banks and businesses and a high unemployment rate.

On Clinton's transition team, in charge of banking policy issues, sat his Rhodes Scholar classmate from Oxford University and Yale University, Eugene Ludwig. Ludwig was Clinton's designated hitter to reach out to the banking trade associations and the banking industry to take their pulse, hear their concerns and understand their priorities. And it soon became apparent that Ludwig would be named to one of the Clinton administration's highest posts.

* On April 5, 1993, Ludwig was confirmed as comptroller of the currency. Since then, he has pursued a boldly ambitious agenda that not only helped right a listing banking industry, but stood in the forefront— and not without controversy—of several innovative industry reforms. Ludwig pressed hard for regulatory relief, encouraged interstate banking and branching, and expanded national bank powers. A regulator ever mindful of community banking concerns, he has also articulated a clear, thoughtful vision of how banks should prepare for the many challenges in the next century.

Ludwig formally announced last month that he would not seek a second go-around as comptroller of the currency and will step down when his term expires April 4. He said the chance to spend more time with his family and to return to the private sector persuaded him not to seek a second term. If his replacement is not confirmed by April, OCA Chief Counsel Julie L. Williams will become acting comptroller.

As the end of Ludwig's five-year term approaches, a growing chorus of observers look back and view Ludwig's record at the OCC as one of the most productive and accomplished ever. "Gene Ludwig has been a controversial comptroller, as highly intelligent, effective and activist officials tend to be," remarks IBAA Executive Vice President Kenneth Guenther. "I think he will go down in the history books as one of the most effective comptrollers in this half century."

The 1993 Credit Crunch

In 1993, the nation was in the midst of a major credit crunch, which developed as regulators cracked down on banks in the wake of the massive savings and loan and banking crises. In this environment, bankers grew nervous about lending. Many economists said that banks' reluctance to lend had slowed an economic recov-

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Making Things Happen—Eugene Ludwig's record in leading the Office of the Comptroller of the Currency has been an extraordinarily productive one. He made banks key players in the nation's economic recovery, took on regulatory reform and expanded national bank powers. Industrious, and at times controversial, Ludwig became a prominent player in helping the banking industry rebound to unprecedented vigor during the 1990s.

ery not only in New England, but throughout the country. Both the White House and the Federal Reserve were facing intense pressure to do something.

Even before his confirmation, Ludwig, a relatively unknown in political and regulatory circles before he became comptroller, carried on his shoulders the challenge of formulating and carrying out an early Clinton regulatory relief initiative to ease the credit crunch. The regulatory pendulum had swung too far and had to be reversed. In mid-March, Clinton called the nation's top bankers, including the IBAA leadership, to the White House to discuss a major initiative to ease banking regulations and encourage more lending, especially to small businesses.

Clinton vowed his plan would "take a big chunk" out of the "10-foot wall called the credit crunch." And the president wanted the banking industry's leadership to spread the word that the regulators were being reined in. Banks were also expected to step up to the plate to act more aggressively in lending.

Ludwig's fingerprints were all over this important initiative—an initiative that laid the foundation for his successful run as comptroller. More importantly it put into place a key component of the economic expansion and the reemergence of the banking industry as a healthy and profitable industry.

Ellen Seidman, the present director of the Office of Thrift Supervision and a key staffer on financial matters at the Clinton White House in 1993, commented that Ludwig, working with Deputy Treasury Secretary Frank Newman, played an enormous role in putting together this part of the president's economic initiative, which significantly and beneficially changed the regulatory climate in very short order.

One element to the president's program was an initiative to increase the flow of credit to small farms and small- and medium-size businesses. It allowed banks to create a basket of small business loans requiring only minimal documentation. Another important element revamped the way regulators would examine banks and streamline regulations to reduce regulatory burden.

The reduced regulatory burden, coupled with improving economic conditions, including a more favorable interest rate, helped eradicate the widespread fear of bank failures that gripped the industry in the early 1990s. The industry has witnessed just one bank failure since August 1996. Compare this with 1992, when 122 banks with assets of more than

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Eugene A. Ludwig

Position: Comptroller of the Currency

Age: 51

Family: Married with three children

Education: Bachelor's degree, magna cum laude, Haverford College; bachelor's and master's degrees on scholarship, Oxford University; bachelor's degree in law, Yale University

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$45 billion closed their doors. Today, capital is at record levels, profits are soaring and performance figures are unparalleled.

Reforming CRA, Community Development

In July 1993, another major theme of the Clinton presidency and Ludwig's comptrollership emerged. This was the expectation that the banking industry would respond to this new regulatory climate by increasing its community development lending.

In 1993 and 1994, the nation's budget situation was very different than it is today. Few were predicting that the federal budget would move toward balance, if not surplus, and those who were so predicting weren't taken seriously.

Bank lending to promote community development emerged as an integral part of the game plan of the activist president and his comptroller of the currency. The initiative was controversial both in the banking industry and among consumer groups. The centerpiece of the initiative was the revision of Community Reinvestment Act regulations. Comptroller Ludwig was again put on point by the president, as was Federal Reserve Governor Larry Lindsey. The creative tension between these two very different and able men at very different agencies resulted in a highly significant CRA reform package. CRA had long been considered the most burdensome and expensive of the consumer compliance regulations.

Along with his drive to overhaul CRA, Ludwig pushed banks to eliminate lending discrimination. He remained opposed to rigid and inflexible underwriting standards that impeded character loans and halted the progress toward equal economic opportunity. Ludwig was again criticized for sending controversial "testers" to banks—black and white decoys posing as customers who needed lo[illegible] He wanted to learn whether banks truly were discriminating in their loan decisions.

The Ludwig-Lindsey CRA reforms worked. The results? Streamlined CRA exams for community banks with less than $250 million in assets that emphasize the bank's lending record and that review five, instead of 12, assessment criteria. Compliance is less intrusive, and the focus is on performance, rather than process and paperwork. The amount of time CRA examiners are spending in community banks has decreased by half.

The concomitant legislative initiative was the Community Development and Regulatory Improvement Act that passed in 1994. This came from the Clinton administration's 1993 initiative to provide grants and other subsidies to community development lenders. IBAA, working with Ludwig, other top bank regulators and its friends in the Congress, tied regulatory relief measures to this bill. The passage of the CDFI bill, as amended, signaled the end of the most severe banking crisis since the Great Depression and the prevailing climate of regulatory overkill.

Community development lending has increased. "In less than four years, we have witnessed new commitments for low and moderate income loans totaling more than $175 billion—more than 80 percent of the total loan commitments under CRA since the law was enacted," Ludwig notes. In 1996 alone, national banks and their community partners invested almost $1.5 billion in community development corporations and community development projects to produce affordable housing, finance small businesses and develop retail and commercial revitalization projects. Since Ludwig took office in 1993, national banks have invested four times as much in public welfare projects as they did in the previous 30 years.

Ludwig applauds the community banks that are expanding credit to previously overlooked areas of the country. He encourages banks to keep up the great work, to "eliminate discrimination from our financial system, root and branch."

Interstate Banking and Branching

For the IBAA and community banks, interstate banking and branching is perhaps one of Ludwig's thorniest legacies as comptroller. He carried much of the Clinton administration's water in getting nationwide banking and branching passed by Congress in 1994, the legislative rocket fuel for the resulting volatile merger-and-acquisition environment, which is significantly diminishing the number of independent banking units while increasing financial concentration.

During the interstate banking and branching debate, Ludwig also played a key role in preserving the 30-mile rule, a measure allowing many national banks to leapfrog over state lines virtually at will, circumventing several state laws and regulators in the process. Texas, Maryland and Kansas were a few notable examples of states that clashed with Ludwig and the OCC over the issue. And in taking

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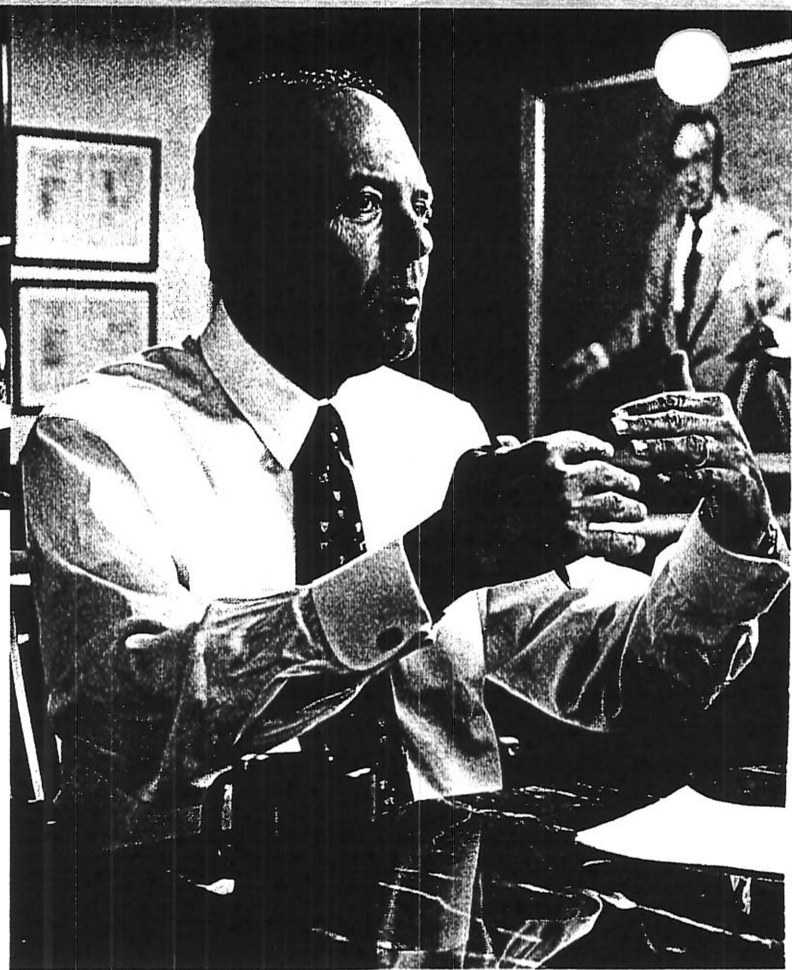

such an assertive stance on interstate branching, Ludwig had to deflect attacks from states' rights defenders, including the IBAA.

Insurance Powers for National Banks

In perhaps his most politically controversial decisions, Ludwig has ruled that all national banks may sell annuities and that national banks with offices in small towns may sell insurance nationwide. The insurance industry protested the decisions, saying the OCC had overstepped its bounds. This powerful lobby also turned to its allies in the Congress, pushing for legislation to rein in the comptroller.

Ludwig made the decision to give national banks the flexibility to take advantage of new sources of revenue to fit the needs not only of their customers, but their entire market. Said Ludwig, "innovation and diversification" of new banking products will give banks the means by which to ride out the highs and lows of industry changes.

In the fight for valuable and profitable customers, banks no longer had one hand tied behind their backs. They could fight with the most aggressive financial services providers. Today, mutual funds, annuities and insurance "have given bankers the confidence they need to compete head-to-head with nonbank financial services providers," Ludwig says.

Yet these pro-banking changes have not come easy. Banking and the OCC have found themselves targets of a major effort in the House of Representatives to roll back these initiatives. The pending financial restructuring legislation (H.R. 10) strikes not only at national bank insurance powers but also at the future effective of the OCC in designing new banking products. The comptroller and the actions of his agency have shared center stage as this historic legislative battle proceeded in the House. Ludwig remains undaunted in the face of his critics. "The potential rewards—more competition, lower prices for consumers and businesses, increased economic growth and a broader, more level playing field for a stronger banking industry—are too great to allow us to be deterred." It remains to be seen whether the Congress will reverse these gains in 1998. The banking industry continues to face this major test.

Also during Ludwig's tenure, the OCC has dodged several lawsuits from various banking industry foes, all from which the OCC has escaped unscathed. In 1995, the Supreme Court ruled for the OCC when insurance companies challenged the authority of national banks to sell annuities. In the 1996 Barnett decision, the Supreme Court upheld the right of national banks to sell insurance in towns with less than 5,000 inhabitants as authorized by the National Bank Act, even when state law expressly prohibited banks from doing so.

"The greatest risk in my view is the risk of not being able to offer the products and services that the market demands. Banks must offer a wide array of products and services if they are going to prosper—and help the communities they serve to grow and prosper along with them."

—Eugene A. Ludwig

"And the courts have agreed time and again that we are doing the right thing," Ludwig says when defending the OCC's actions on insurance and other bank powers. "Not only have we won each time, but we won with unanimous decisions. That is some kind of record, not only for a banking agency, but probably for any governmental department."

Under Ludwig's direction, the OCC recently approved

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the first application from a bank to establish an operating subsidiary to conduct business that the bank cannot conduct directly. In December 1997, the OCC granted Zion's First National Bank in Salt Lake City, Utah, the authority to underwrite municipal revenue bonds through its operating subsidiary. The OCC's decision was monumental for all banks, for what was at stake was not only a ruling to broaden banks' authority, but to give banks another vital source of revenue and the flexibility to conduct the business through an operating subsidiary rather than a holding company affiliate. This also was a controversial decision that has been attacked by the securities lobby and its congressional allies.

"The greatest risk in my view is the risk of not being able to offer the products and services that the market demands. Banks must offer a wide array of products and services if they are going to prosper—and help the communities they serve to grow and prosper along with them," Ludwig says.

The Year 2000 Dilemma

Banking is also facing another threat, but not from the courts. The Year 2000 glitch promises to make the next 18 months miserable for banks that don't address the issue now. Ludwig has flagged the Year 2000 problem as one of the agency's highest priorities. The OCC has devised a series of important implementation strategies for all banks to follow to avoid the serious implications caused by the failure of most computer systems to read "00" in a two-digit year field as "2000" instead of "1900."

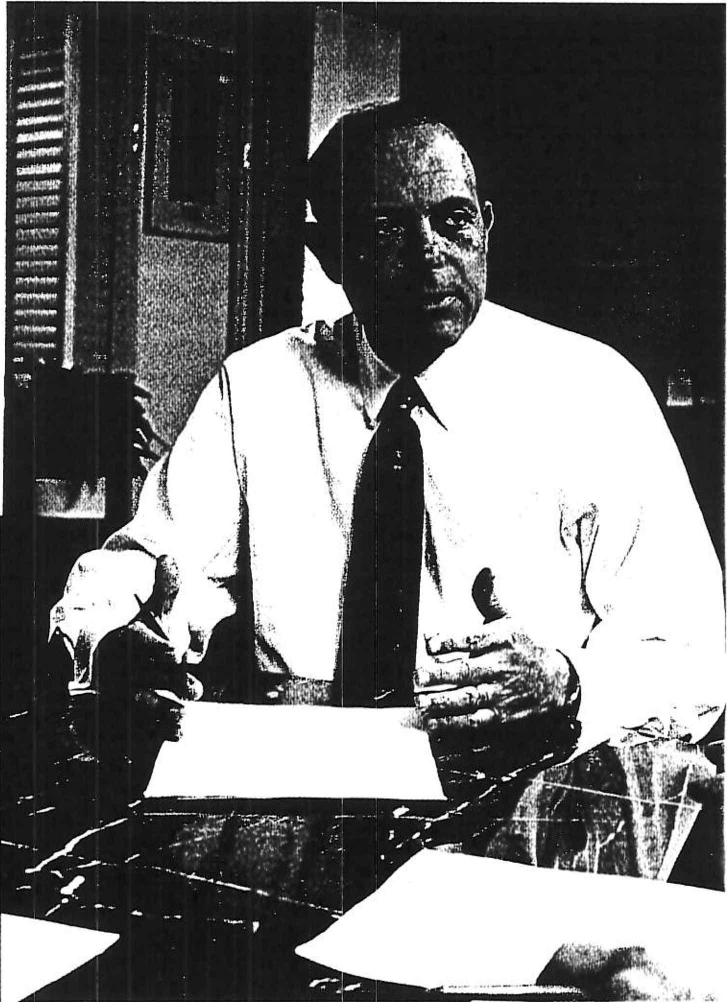
"We know this issue places substantial demands, particularly on community banks, because vendors' conversion efforts are often expensive and difficult to verify." Ludwig calls the OCC's efforts to remedy the situation "aggressive" and "forceful," because banks' failure to be prepared would be truly damaging.

And coupled with the Year 2000 glitch is the ever-present issue of maintaining high quality lending standards. Ludwig told community bankers last March at IBAA's annual convention, "Now, when the economy is hea[illegible] [illegible]nd bank earnings are strong, is precisely the time when we must be on our guard against actions that could sow the seeds of future banking problems—problems that will only become apparent when the economic cycle turns."

Although many industry experts initially were skeptical of his aggressive reforms, most bankers and regulators today would argue that Ludwig has left an indelible handprint on his office. "He left the banking industry far stronger than he found it and played a major role in shaping the financial issues of the day," Guenther says.

An Affinity for Community Banks

The jury is still out on the future of our diversified financial system and community banking. Comptroller Ludwig firmly believes the opposite—that the consolidating industry is a potential boon, creating new opportunities for community banks.



In competing directly with big banks, Ludwig says community banks must safeguard their longstanding reputations for commitment within their communities. "Community banks should never drift from their traditionally strong civic focus—or give away that ground to larger competitors. They have been and must continue

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...e relationship and high-integrity players," he says.

Ludwig believes that community banks competing in markets of intense consolidation will thrive if they pursue three fundamental strategies: maintaining strong relationships through integrity and service, adopting new technology and expanding product offerings.

"These are the three legs of the community bank stool," he says. "Time and again I have seen many banks, even though they may not be the highest fliers, end up winning because they stick with the fundamentals. The tortoise often wins the race."

But there will always be a niche for community banks, he says. "Community banks that pay attention to their local markets and their own communities will always do well. Time and again, we see that mergers create new opportunities for community-based institutions."

"Now, when the economy is healthy and bank earnings are strong, is precisely the time when we must be on our guard against actions that could sow the seeds of future banking problems—problems that will only become apparent when the economic cycle turns."

—Eugene A. Ludwig

When Clinton bestowed upon him the duties of comptroller, Ludwig rose to the challenge. His own strategic view of the industry has better positioned it to meet the challenges of the next century, and his five-year run has ensured him a place in the nation's financial history. IB

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Recollections of Youth in Small-Town Pennsylvania

The son of a small-town country doctor, Eugene Ludwig remembers when, as a young boy accompanied by his father, he opened his first savings account at the local community bank in York, Pa. As he grew into his teens, he would regularly visit the bank with his father to make deposits into their savings accounts—lessons learned both about responsibility and commitment.

"The bank was a very friendly place," he says. In high school, several of his friends worked as tellers at the bank, considered one of the best summer jobs to have back then.

Ludwig's experience as a child and young adult with his hometown bank was not so different from the role community banks play today. Community banks still know their customers, and a customer's character is as important as his net worth. What's more, working for a community bank is still a highly regarded job.

Community bankers today have discovered a regulator heading the OCC who is acutely sensitive to industry trends, including differences within the industry. Gene Ludwig took over the reins as comptroller of the currency in April 1993. And although his term ends this April, he reflects with a feeling of satisfaction upon his tenure as comptroller. His assessment? Today's favorable banking climate calls for smooth sailing for community bankers.

During Ludwig's tenure as comptroller, banking has never been better or more profitable. And although many community banks offer many of the bells and whistles associated with high-tech banking products, they are still dedicated to good old-fashioned hometown service. Much like Mr. Ludwig's father experienced some 40 years ago.

Ludwig recalls some good business advice the banker gave his father, a conservative man by nature. "Dad was very reluctant to have an office. He came out of the Great Depression. He worked his way through medical school. It was the banker who encouraged him to open his first office. My father responded, 'Well, you have to walk before you run,'" Ludwig remembers. "The banker said, 'At your age, doc, you better get up and start running.'"

Good advice for community bankers during this challenging transitional period.