



**Date:** January 20, 2015

**To:** House Financial Institutions Committee  
Rep. Pete DeGraaf, Chairman

**From:** Doug Wareham, Executive Vice President-Government Relations

**Re:** Kansas Banking Industry Update

Mr. Chairman and members of the committee, I am Doug Wareham appearing on behalf of the Kansas Bankers Association (KBA). Thank you for the opportunity to highlight the many roles of our organization, as well as a brief update on challenges and opportunities facing the Kansas banking industry.

**Kansas Bankers Association Background Information:**

Our organization, which was founded in 1887, is a voluntary, non-profit trade association that is governed by its membership. The KBA is headquartered here in Topeka, Kansas and is led by our 26-member board of directors and twelve banker driven divisions and committees. The KBA staff, which is led by President/CEO Chuck Stones, includes 31 professionals that provide services to Kansas bankers ranging from legislative advocacy to educational training to insurance services to regulatory compliance services. Our mission statement is simply:

***"To support and assist Kansas banks and Kansas bankers."***

KBA's membership includes 99% (268 of the 270 banks chartered in Kansas) of the commercially chartered banks in Kansas. We also have 21 out-of-state bank members bringing our membership total to 289 banks. Kansas banks employ more than 13,400 Kansans that provide financial services in nearly 400 towns and cities across the state. While our member banks range in asset size from just over \$4 million to as high as \$4 billion, each member bank that belongs to the KBA has one vote on policy positions adopted by either our general membership or our Board of Directors.

**Kansas Banking Industry Update:**

The Kansas banking industry is in a very strong and stable position as noted in the Kansas Banking Snapshot graphs attached to my testimony.

- Total Equity Capital Steady and/or Increasing (Attachment #1)
- Total Deposits Increasing (Attachment #2)
- Loan Demand Increasing (Attachment #3)
- Loan Loss Allowances Decreasing (Attachment #4)

All banks are required to report quarterly financial information to the Federal Deposit Insurance Corporation (FDIC), one of the many state and federal regulatory agencies that ensure the safety and soundness of the banking industry. This is referred to as a Bank Call Report and that information is available to the public. To help highlight the fact that we have returned to a period of growth and stability in the Kansas banking industry, I've provided a comparison of consolidated call report data (light blue attachment) for Kansas banks comparing financial indicators in 2005, 2009 and 2014.

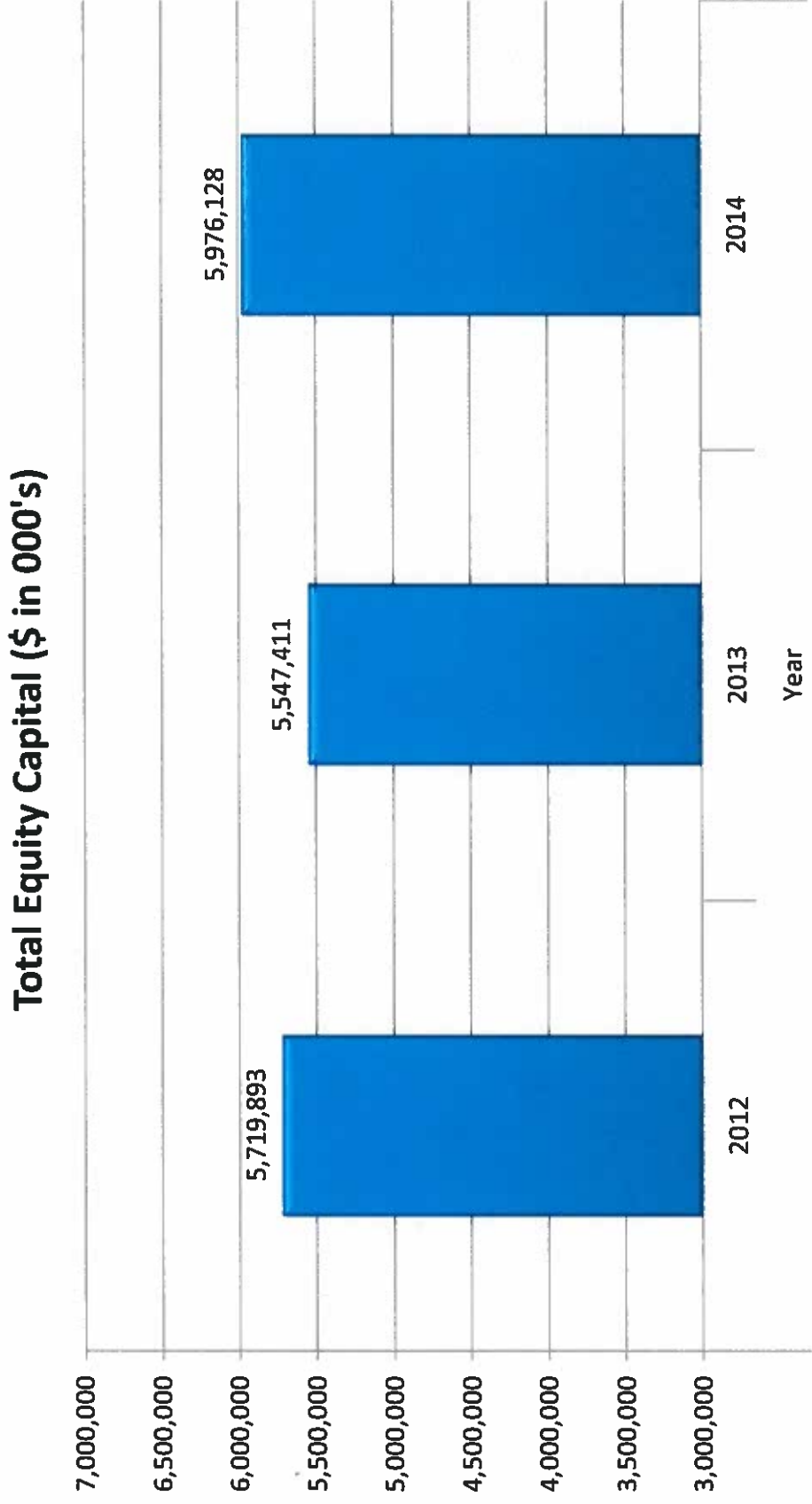
While financial stability that has returned to our industry, bank consolidation is continuing at a fairly rapid pace as banks seek to achieve the size and scale needed to compete in today's very competitive financial marketplace. The number of banks chartered in Kansas has declined by 22 in the past two years and when comparing 2014 to 2004 as noted on Attachment #5, the loss of bank charters totals 85 over the past decade. We expect the consolidation of bank charters to continue, but want to remind the committee that the loss of charters does not mean a loss of service to Kansas communities. In most instances, mergers simply lead to more branch office locations by the acquiring bank and continued services to impacted communities. It's also important to note the number of Kansans employed by the banking industry remains relatively constant, as noted on Attachment #6.

One of the significant contributing factors driving consolidation is increased compliance costs caused by a myriad of new and ever-expanding regulations impacting the banking sector. Attached to my testimony is a detailed impact of the costs of compliance for banks prepared by the American Bankers Association. The report, entitled "*An Avalanche of Regulation*" sites a \$70 million bank in Kansas that now has 15% of its workforce dedicated to compliance-related tasks. Last year, I shared with this committee that our organization had formed a new subsidiary, Kansas Bankers Consulting Services, LLC, to provide our member banks with compliance, audit and legal assistance. During the past year, the number of banks utilizing that service has doubled to 90 community banks across the state. While we appreciate providing this service to our members, the reality is this is a "new" cost of doing business for every bank that utilizes this service.

In spite of rising regulatory costs, the banking industry remains the backbone of local economies across Kansas. The KBA will continue to pursue policies that strengthen the traditional banking industry, because strong and vibrant main-street Kansas banks are a key ingredient to strong and vibrant Kansas communities.

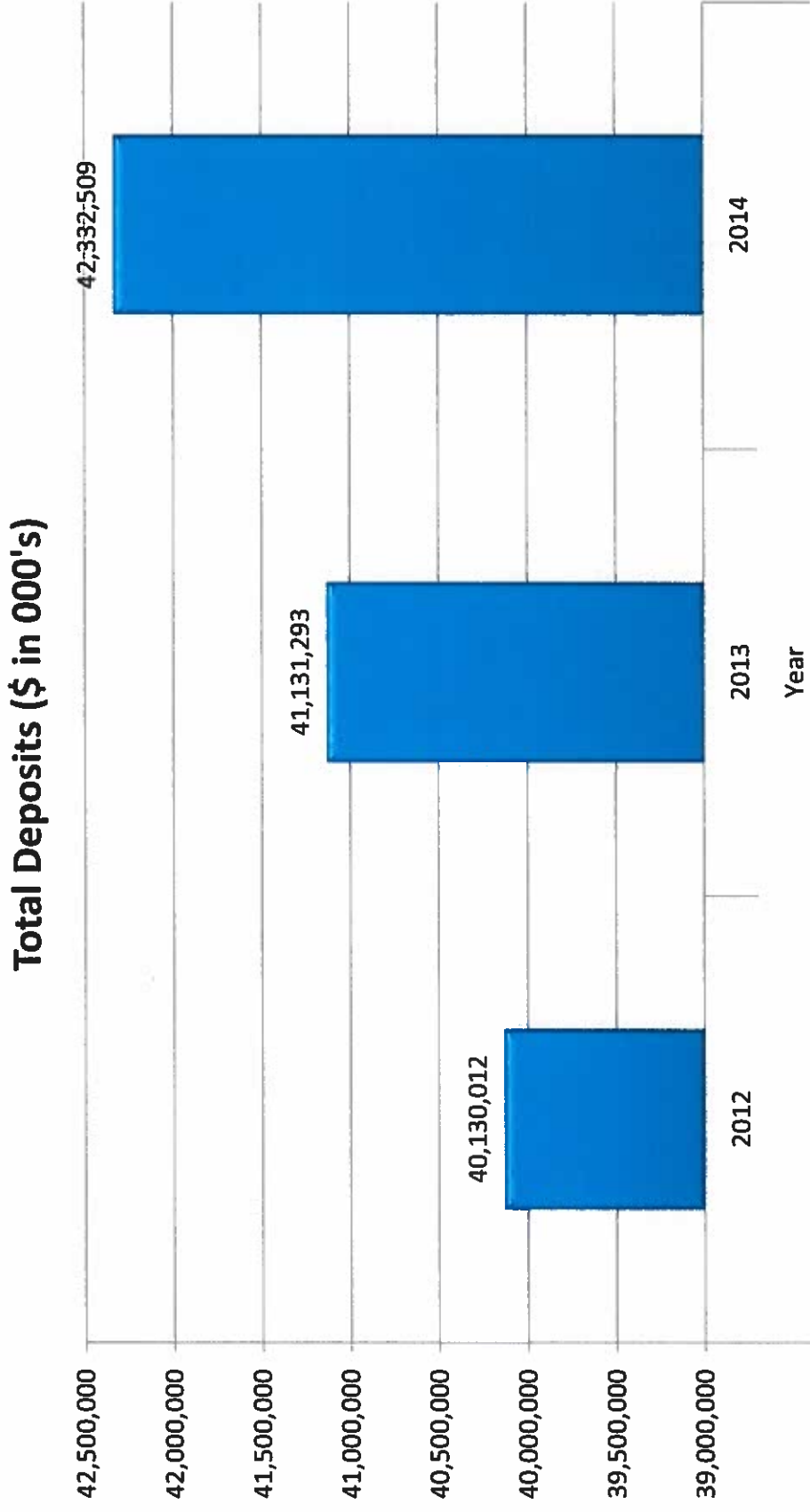
Once again, thank you for the opportunity to provide a brief update from our organization and I would be happy to stand for questions. If at a later time you have questions or require additional information, please contact me at [dwareham@ksbankers.com](mailto:dwareham@ksbankers.com) or at (785) 232-3444.

# Kansas Banking Snapshot



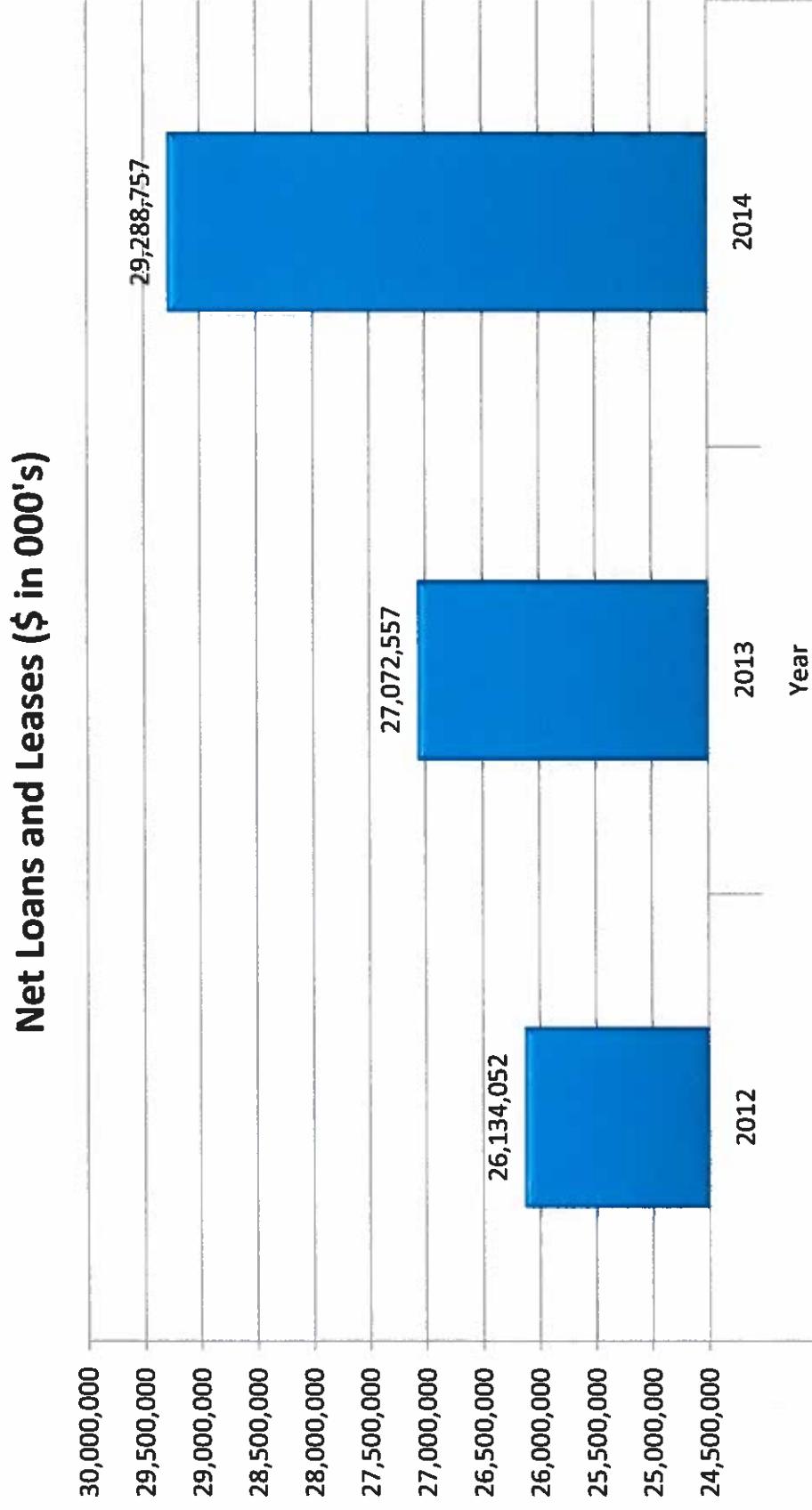
Attachment 1

# Kansas Banking Snapshot



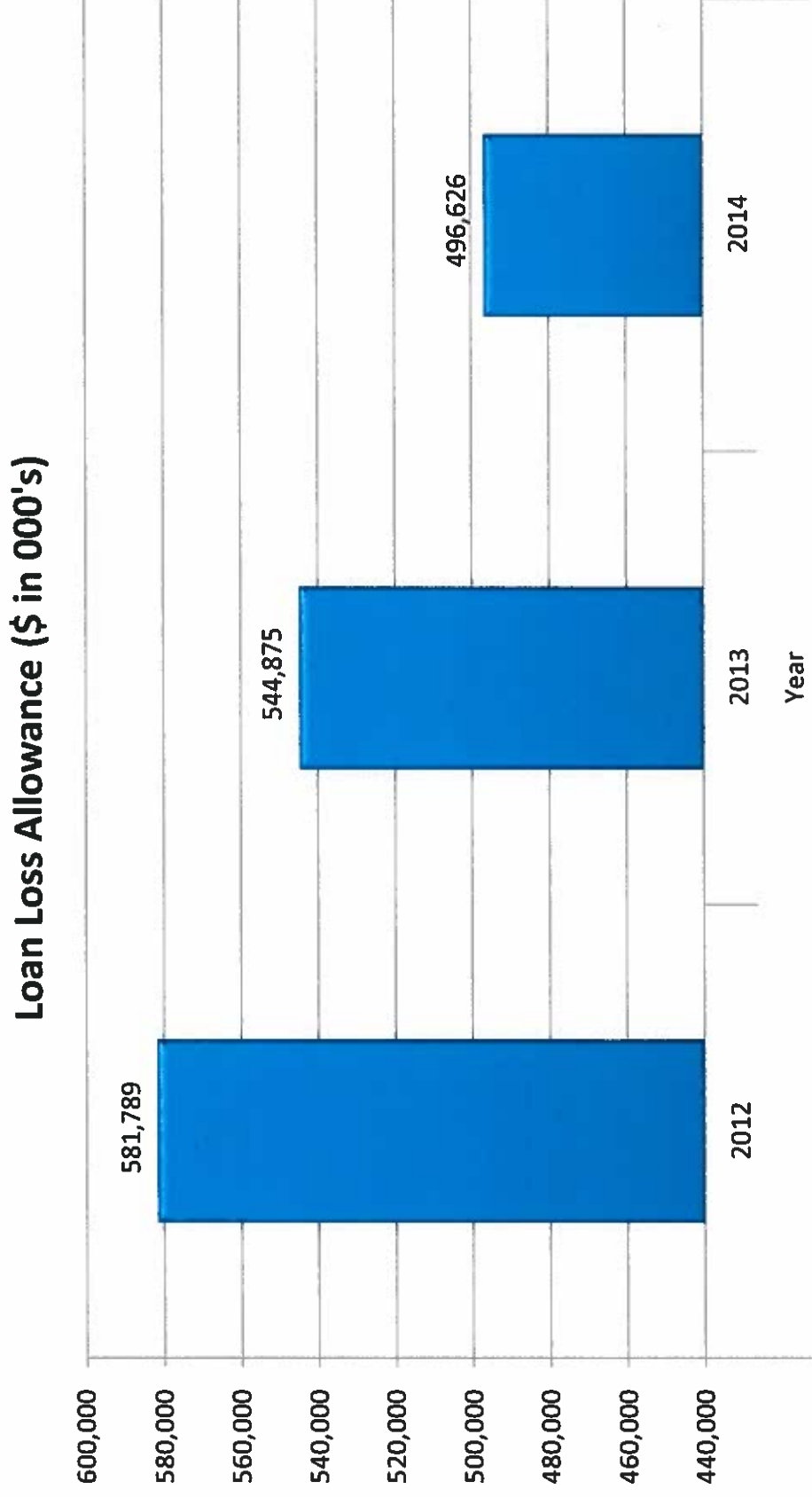
Attachment 2

# Kansas Banking Snapshot



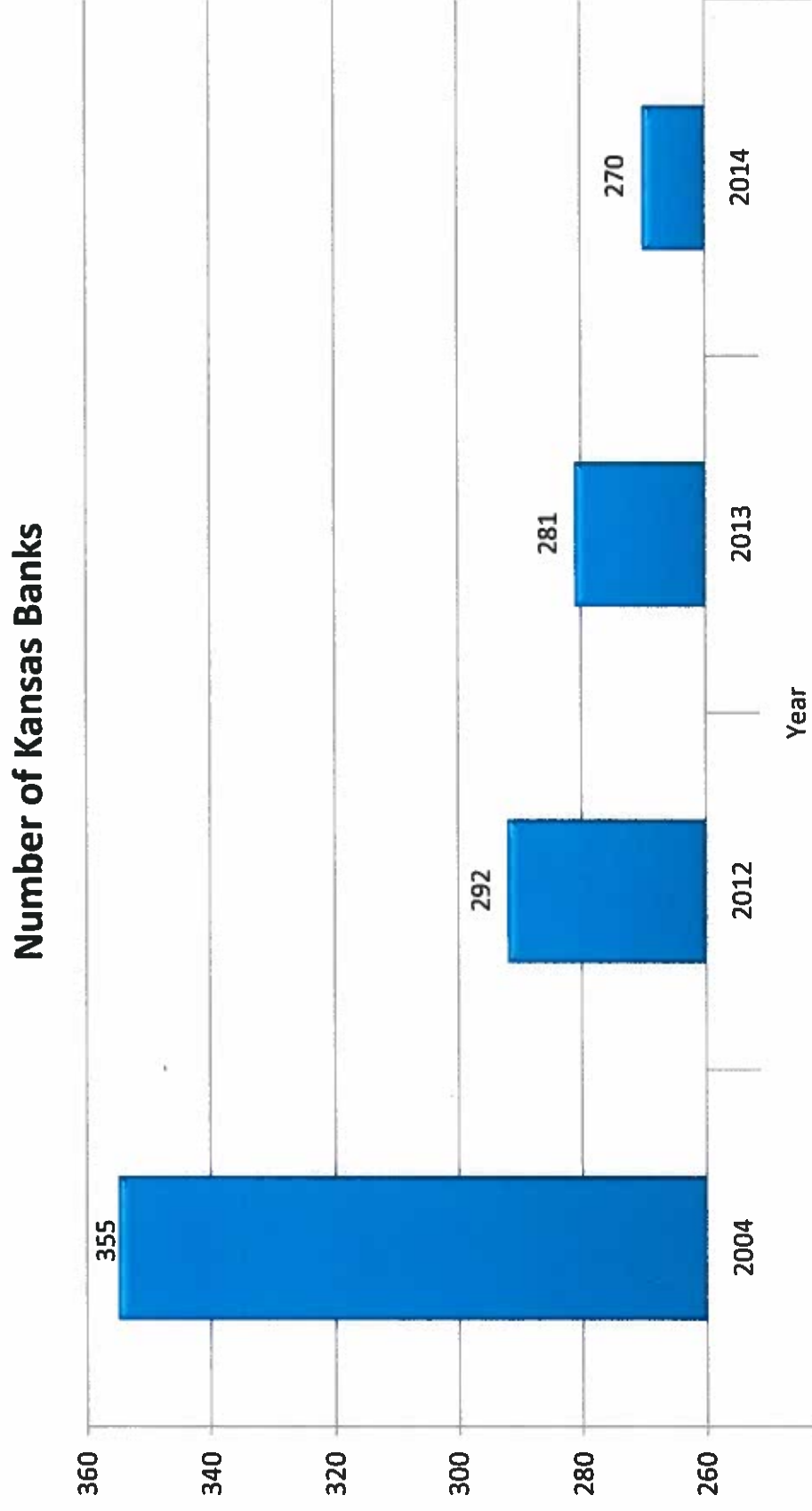
Attachment 3

# Kansas Banking Snapshot



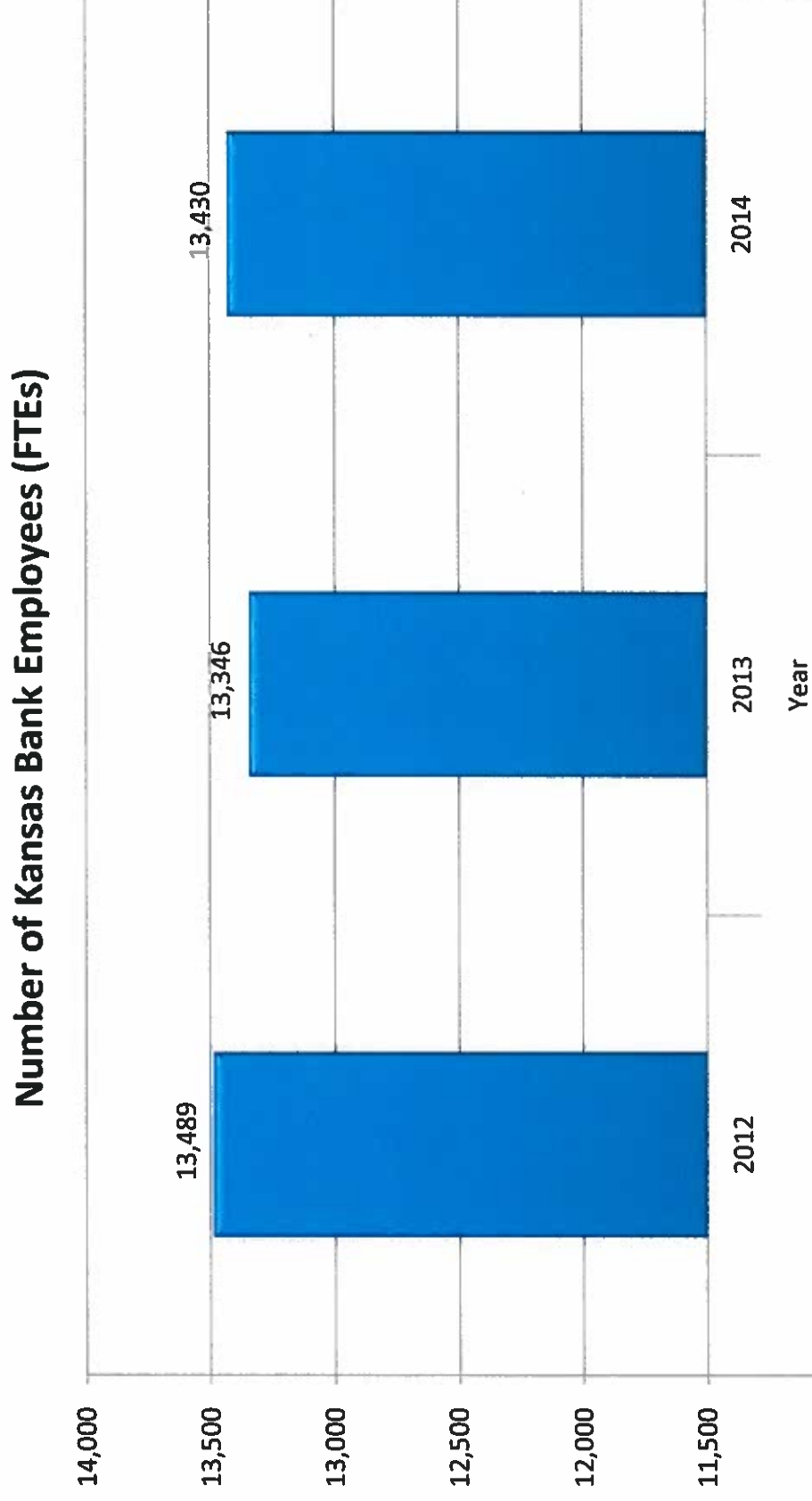
Attachment 4

# Kansas Banking Snapshot



Attachment 5

# Kansas Banking Snapshot



Attachment 6





## State Banking Performance Summary FDIC-Insured Institutions

|  | Commercial Banks<br>Kansas<br>September 30, 2014 |   |   | Commercial Banks<br>Kansas<br>September 30, 2009 |   |   | Commercial Banks<br>Kansas<br>September 30, 2005 |   |   |
|--|--|---|---|--|---|---|--|---|---|
|  | All<br>Institutions                              | Assets<br>less than<br>\$100<br>million | Assets<br>greater<br>than<br>\$100<br>million | All<br>Institutions                              | Assets<br>less than<br>\$100<br>million | Assets<br>greater<br>than<br>\$100<br>million | All<br>Institutions                              | Assets<br>less than<br>\$100<br>million | Assets<br>greater<br>than<br>\$100<br>million |
| <i>(dollar figures in millions)</i>                  |  |   |   |  |   |   |  |   |   |
| Number of institutions reporting                     | 270  | 147                                     | 123   | 325  | 213                                     | 112   | 354  | 259                                     | 95  |
| Total employees (full-time equivalent)               | 13,430   | 1,929                                   | 11,501  | 14,101   | 3,062                                   | 11,039  | 14,980   | 3,959                                   | 11,021  |
| <b>AGGREGATE CONDITION AND INCOME DATA</b>           |  |   |   |  |   |   |  |   |   |
| Net income (year-to-date)                            | 418  | 51                                      | 367   | 82   | 42                                      | 40  | 502  | 94                                      | 408   |
| Total assets   | 52,336   | 7,664                                   | 44,672  | 49,549   | 9,804                                   | 39,745  | 46,542   | 10,780                                  | 35,761  |
| Earning assets                                       | 48,848   | 7,147                                   | 41,502  | 45,755   | 9,038                                   | 36,717  | 43,062   | 9,977                                   | 33,085  |
| Total loans & leases                                 | 29,785   | 4,329                                   | 25,457  | 31,591   | 5,885                                   | 25,706  | 30,450   | 6,668                                   | 23,782  |
| Other real estate owned                              | 301  | 26                                      | 275   | 365  | 37                                      | 328   | 66   | 15                                      | 50  |
| Total deposits                                       | 42,333   | 6,444                                   | 35,888  | 39,772   | 8,117                                   | 31,656  | 36,466   | 8,865                                   | 27,601  |
| Equity capital                                       | 5,976  | 884                                     | 5,092   | 5,020  | 1,099                                   | 3,922   | 4,657  | 1,196                                   | 3,461   |
| <b>PERFORMANCE RATIOS (YTD, %)</b>                   |  |   |   |  |   |   |  |   |   |
| Yield on earning assets                              | 3.84   | 4.07                                    | 3.80  | 5.37   | 5.62                                    | 5.30  | 5.84   | 5.79                                    | 5.86  |
| Cost of funding earning assets                       | 0.46   | 0.46                                    | 0.46  | 1.72   | 1.62                                    | 1.74  | 1.97   | 1.73                                    | 2.04  |
| Net interest margin                                  | 3.39   | 3.62                                    | 3.35  | 3.65   | 4.00                                    | 3.56  | 3.88   | 4.07                                    | 3.82  |
| Noninterest income to avg. earning assets            | 1.29   | 0.55                                    | 1.41  | 1.32   | 0.74                                    | 1.47  | 1.64   | 1.01                                    | 1.83  |
| Noninterest expense to avg. earning assets           | 3.24   | 3.00                                    | 3.28  | 3.37   | 3.43                                    | 3.35  | 3.27   | 3.47                                    | 3.21  |
| Net charge-offs to loans & leases                    | 0.18   | 0.22                                    | 0.17  | 1.37   | 0.80                                    | 1.49  | 0.21   | 0.13                                    | 0.23  |
| Credit-loss provision to net charge-offs             | 98.49  | 94.08                                   | 99.46   | 152.12   | 119.34                                  | 156.05  | 122.28   | 141.03                                  | 119.22  |
| Net operating income to average assets               | 1.05   | 0.86                                    | 1.08  | 0.16   | 0.54                                    | 0.07  | 1.46   | 1.17                                    | 1.55  |
| Retained earnings to average equity                  | 5.36   | 4.39                                    | 5.53  | -2.36  | 1.59                                    | -3.45   | 7.27   | 4.21                                    | 8.34  |
| Pre tax return on assets                             | 1.26   | 1.01                                    | 1.31  | 0.20   | 0.67                                    | 0.09  | 1.91   | 1.37                                    | 2.07  |
| Return on assets                                     | 1.08   | 0.89                                    | 1.11  | 0.22   | 0.58                                    | 0.13  | 1.46   | 1.17                                    | 1.55  |
| Return on equity                                     | 9.84   | 7.95                                    | 9.93  | 2.21   | 5.29                                    | 1.37  | 14.73  | 10.74                                   | 16.11   |
| Percent of unprofitable institutions                 | 4.07   | 7.48                                    |   | 19.08  | 15.96                                   | 25.00   | 2.54   | 2.70                                    | 2.11  |
| Percent of institutions with earning gains           | 64.44  | 57.14                                   | 73.17   | 33.23  | 35.68                                   | 28.57   | 62.15  | 61.00                                   | 65.26   |
| <b>CONDITION RATIOS (%)</b>                          |  |   |   |  |   |   |  |   |   |
| Net loans and leases to assets                       | 55.96  | 55.53                                   | 56.04   | 62.41  | 59.02                                   | 63.25   | 64.51  | 60.92                                   | 65.59   |
| Loss allowance to:                                   |  |   |   |  |   |   |  |   |   |
| Loans and leases                                     | 1.67   | 1.69                                    | 1.66  | 2.11   | 1.69                                    | 2.20  | 1.40   | 1.51                                    | 1.36  |
| Noncurrent loans and leases                          | 148.65   | 162.36                                  | 144.25  | 52.05  | 82.94                                   | 48.86   | 187.85   | 162.89                                  | 197.26  |
| Noncurrent loans & leases to<br>total loans & leases | 1.14   | 1.04                                    | 1.15  | 4.05   | 2.04                                    | 4.51  | 0.74   | 0.93                                    | 0.69  |
| Nonperforming assets to assets                       | 1.23   | 0.92                                    | 1.28  | 3.32   | 1.62                                    | 3.74  | 0.63   | 0.72                                    | 0.61  |
| Core deposits to total liabilities                   | 78.76  | 79.81                                   | 78.58   | 72.31  | 75.81                                   | 71.46   | 72.19  | 77.78                                   | 70.53   |
| Equity capital to total assets                       | 11.42  | 11.53                                   | 11.40   | 10.13  | 11.21                                   | 9.87  | 10.01  | 11.10                                   | 9.68  |
| Core capital (leverage) ratio                        | 10.73  | 11.08                                   | 10.67   | 9.15   | 10.34                                   | 8.86  | 9.71   | 10.94                                   | 9.33  |
| Total capital to risk-weighted assets                | 17.16  | 18.80                                   | 16.89   | 14.23  | 16.70                                   | 13.67   | 14.44  | 17.50                                   | 13.62   |
| Gross 1-4 family mortgages to gross assets           | 11.84  | 13.93                                   | 11.48   | 11.58  | 12.89                                   | 11.26   | 10.95  | 13.30                                   | 10.24   |

Source: Call Report and Thrift Financial Report  
Prepared by the FDIC-Division of Insurance and Research

# An Avalanche of Regulation

*"As battle-scarred survivors of a financial crisis and deep recession, community bankers today confront a frustratingly slow recovery, stiff competition...and the responsibility of complying with new and existing regulations. Some observers have worried that these obstacles—particularly complying with regulations—may prove insurmountable."*

— Ben Bernanke,  
October 2, 2013

Each new regulation is hundreds of single-spaced, 3 column, 9-point font pages.



A majority of small banks tend to have just **one compliance officer** who must understand and implement all the new regulations.

Source: ABA 2013 Bank Compliance Officer Survey

**456 pages** Servicing Rules

**408 pages** ATR/QM

**313 pages** 2013 HOEPA Rule

**275 pages** Basel III

**272 pages** Volcker Rule

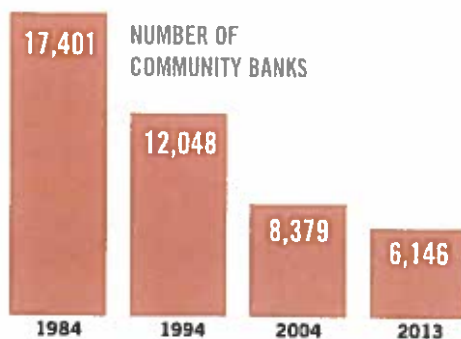
**248 pages** Remittance Rule

**225 pages** Loan Originator Rules

Source: Number of Federal Register Pages



Heavy regulatory burden has helped fuel consolidation of community banks.



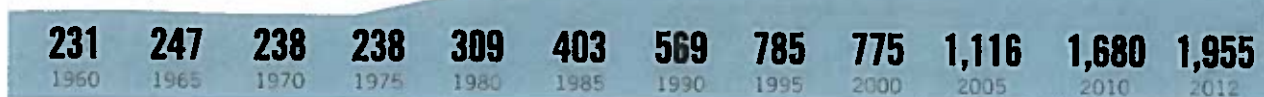
Source: Federal Deposit Insurance Corporation. Number of banks with assets under \$1 billion



"Almost one out of every five U.S. counties...have no other physical banking offices except those operated by community banks."

— FDIC Community Banking Study

Number of Items  
per Call Report Jump

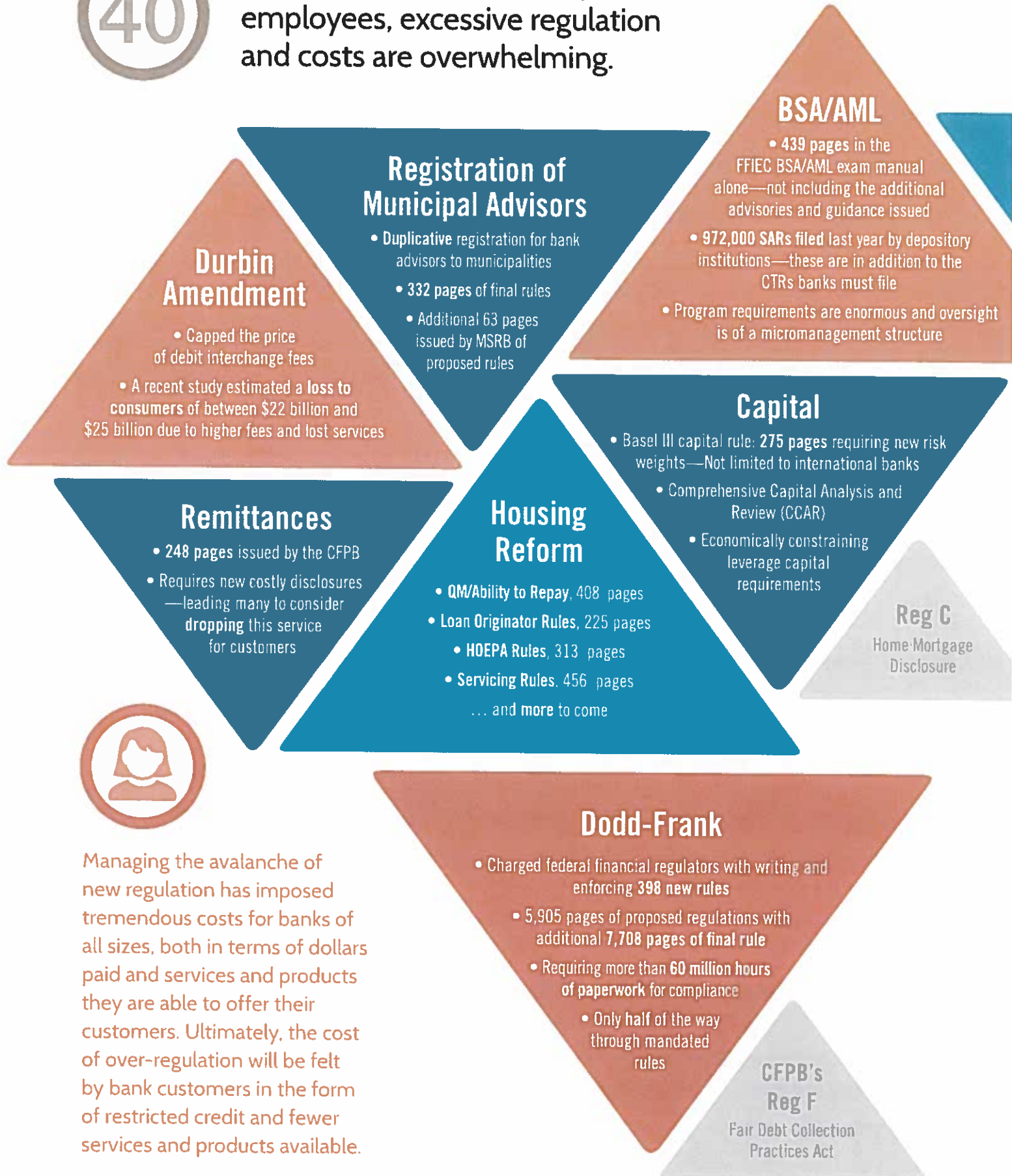


Source: Call Report, Federal Financial Institutions Examination Council

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For the median bank with just 40 employees, excessive regulation and costs are overwhelming.



Managing the avalanche of new regulation has imposed tremendous costs for banks of all sizes, both in terms of dollars paid and services and products they are able to offer their customers. Ultimately, the cost of over-regulation will be felt by bank customers in the form of restricted credit and fewer services and products available.



**Reg V**  
Fair Credit  
Reporting

## Liquidity

- Proposals do not fit U.S. markets and banks
- Small banks held to internationally active bank standards

**Reg B**  
Equal Credit  
Opportunity

## Derivatives Rules

- Too few banks are treated as "end users"
- Cost to small banks: about \$600 million



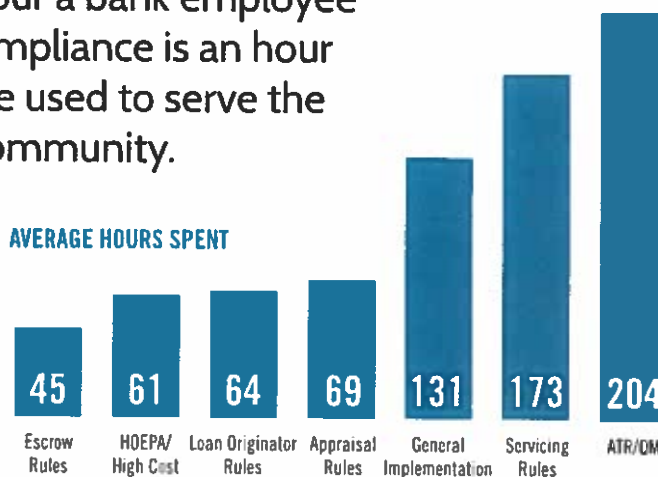
## What's Being Said:

- A \$70 million bank in Kansas has dedicated 3.5 of 25 employees to compliance-related tasks. This means **15% of the bank's employees focus just on red tape.**
- Of community banks, **6%** report having **discontinued residential lending** following DFA, with an additional **9%** **anticipating exiting** the mortgage business.
- Federal Reserve Governor Elizabeth Duke noted that "hiring one additional employee would **reduce the return on assets by 23 basis points** for the median bank in the group of smallest banks, those with total assets of \$50 million or less. To put this estimate in perspective, such a decline could cause about **13 percent of the banks of that size to go from profitable to unprofitable.**"
- A Texas community bank originated 1,296 mortgages in 2009 with a total mortgage staff of 18. In 2012, the bank originated 1,080 mortgage loans with a total mortgage staff of 25—due to **increased compliance burden.**
- **18%** of banks subject to the remittance rule **plan to stop offering remittance services altogether** while **42%** plan on increasing fees to cover additional compliance costs.
- A regional bank operating in the Midwest spent **\$20 million** on FinCEN's BSA/AML regulation alone.



Every extra hour a bank employee spends on compliance is an hour that cannot be used to serve the bank's local community.

AVERAGE HOURS SPENT



Source: Average results of 10 ABA member banks for the year 2013

# More Regulation = Fewer Products



Many banks have decided not to launch a new product, delivery channel, or enter a new market due to expected increased regulatory costs/risks, while nearly an additional third are holding off on these decisions to determine the regulatory impact.



**44%**  
Reduced current consumer financial products or services due to compliance regulatory burden.



In addition, 78% of banks have said they will or may need to change their nature, mix and volume of mortgage products in response to regulatory changes.

Source: ABA 2013 Bank Compliance Officer Survey

## Excessive Rules on Banks Push Business to Less Regulated Shadow System

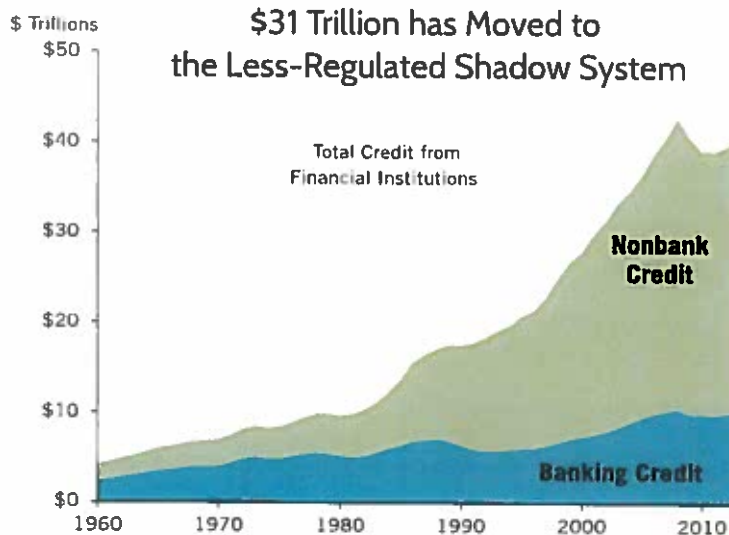


Market share of non-bank mortgage servicers has nearly tripled in 3 years



Source: "Mortgage Market Gets Reshuffled," *The Wall Street Journal*, March 9, 2014. Includes the 30 largest servicers in data.

## \$31 Trillion has Moved to the Less-Regulated Shadow System



Source: Federal Reserve and Bureau of Labor Statistics. Inflation Adjusted. Base = 2013.

take  
action  
now

## The Avalanche of Regulations has Become Overwhelming

*"Policymakers should take action to promote the strength and resurgence of America's banks—large, medium, and small—for the benefit of the customers and communities that rely upon them."*

— Frank Keating, ABA President and CEO