Kansas Bankers Association

August 23, 2010

TO: The United States House of Representatives Financial Services Committee
Subcommittee on Oversight and Investigations

From: Charles A. Stones, President
Kansas Bankers Association

Mr. Chairman, Members of the Sub Committee, invited Members of Congess,

The Kansas Bankers Association appreciates this opportunity to testify at this field hearing on this important topic.

The Kansas Bankers Association represents 320 traditional community banks in Kansas. Kansas is a state with a large number of community banks. As of 12/31/09 there were 323 chartered banks in the state ranging in asset size from $4.5 **M**illion to $3.7 **B**illion. State charters outnumber national charters by a 3.2 to 1 margin. The average asset size is $155 million. 36% of all chartered banks in Kansas have less than $100 million in assets. The assets of all Kansas chartered banks, state and national charters, total $50.2 billion.

Kansas covers a large geographical area (82,000 sq. miles), therefore, it is not surprising that a high percentage of our Kansas banks can be found in rural communities. Nearly 20% of all Kansas chartered banks are located in towns of fewer than 500 people and 60% of all chartered banks are located in towns of fewer than 5,000 population. It is also important to understand that nearly two-thirds of all Kansas banks have an average of less than 14 employees. Kansas banks currently employ 14,020 people. Banks continue to want to make loans to deserving businesses and individuals.

Traditional banks feel the burden of regulation. For the typical small bank, more than **one out of every four dollars** of operating expense goes to pay the costs of government regulation. The passage of the recent Financial Reform legislation, which includes a new Consumer Financial Protection Bureau, will certainly add to the regulatory burden now faced by banks. In addition, the past year has seen a multitude of new regulations, from RESPA to Reg E, these new regs are taking a toll on banks, especially traditional community banks. For instance, the new RESPA rules are causing many banks, especially in rural areas to reconsider their participation in residential real estate lending. The question is: who will pick up the slack in these areas if the local community bank exits that market? Again, new Reg E rules are making banks reconsider whether to continue paying overdrafts for their customers using debit cards. This will cause a great deal of inconvenience to consumers who utilize this service. The bottom line is that most of the changes and technological advances in banking over the past several years have been for the sole purpose of customer convenience. Those advances have costs associated with them. When businesses are not fairly compensated for services they perform, those services stop being available. The consumer pays the ultimate cost in loss of that service.

These new regulations and laws are putting, and will continue to put, a huge amount of pressure on the earnings of banks. From exponential increases in FDIC premiums to the new laws and regs mentioned above, one consultant put it very succinctly, "Banks will have a harder time making money in the future." This will inevitably drive banks to consolidate. Again, who will fill the void in small town Kansas if the current local bank decides it can no longer make a fair profit, and closes? **It is time for Washington to realize that traditional banks have economic value in this country.** It is not enough to say the words, it is time that policies, laws, rules and regulations begin to demonstrate that fact. Actions speak louder than words.

Traditional banking has been the backbone of our nation's economy and **yet** the term "bank" has been misused by almost everyone in the media and in Washington D.C. Kansas banks still adhere to the 3-C's of credit: credit, character and collateral, when making loans. The extension of credit is, in essence, the evaluation of risk. We believe Government intervention into this process altered decision making by many lenders, and allowed loans to be made that would never be made in a totally "free" market system. The Community Reinvestment Act is one example of this type of intervention, as is the relaxed underwriting standards of FNMA and Freddie Mac. While homeownership is a worthy goal, encouraging people to purchase homes they cannot afford is much worse, in the long run, for everyone. Government intervention in the lending process altered decision making and interfered with the "free market system" on the front end of many transactions. Expecting the same "free market system" to work on the back end of the process is unrealistic if it is not allowed to function on the front end.

Traditional banking needs to be strengthened and encouraged because, as in years past, we will be the engine that drives any economic recovery. Traditional bankers are just like every other small businessman and businesswoman trying to keep their communities strong. We ask you to not confuse these banks on Main Street with those on Wall Street.

Impact of Financial Reform and new regulations on consumers

Those who support the idea of the Consumer Financial Protection Bureau believe it will protect the consumer from overzealous financial institutions. However, the traditional community banker exemplifies the ultimate in "consumer financial protection". Traditional banks live with their customers; they see them in the community and at school events, serve on boards with them, etc. If a traditional bank treats a customer badly, the whole community knows about it. This is in contrast to many non-bank competitors whose dealing with the consumer is usually a onetime experience. Being sales-based operations, they typically gather a fee and move on to the next customer, with little regard for their customer's long term satisfaction. Unfortunately, the CFPB will not make a distinction between the banker and the salesman in its approach to "protect" consumers.

We believe that the CFPB will actually hurt consumers. A study by David Evans and Joshua Wright (**Evans** is Lecturer, University of Chicago Law School; Executive Director, Jevons Institute for Competition Law and Economics, and Visiting Professor, University College London; and Managing Director, LECG. **Wright** is Assistant Professor, George Mason University Law School and Department of Economics.) showed that:

"Under plausible yet conservative assumptions the CFPB would:
- *increase the interest rates consumers pay by at least 160 basis points;*
- *reduce consumer borrowing by at least 2.1 percent; and,*
- *reduce the net new jobs created in the economy by 4.3 percent.*

These unintended consequences will hurt everybody while only "protecting" a very small few. And this is only the start. As we stated earlier, the unintended consequence of new very strict RESPA rules will likely be the departure of many small banks in rural areas from the residential real estate market. The result will be that many consumers will be unable to secure credit purchasing a home in rural areas of Kansas from a local bank. They will be forced to go out of market, if they can. Most non-bank lenders are unfamiliar with rural areas and the low volume makes rural areas unattractive for those types of lenders.

The unintended consequences of new Reg E rules and new Interchange rules will likely be that fewer consumers will have access to debit cards, which have become a major consumer convenience.

Maybe the most mis-used word in the English language for the last 18 months is the word "bank".

It has been used to describe everything from Wall Street investment firms, to insurance giants (like AIG) to payday lenders. And rarely has it been used to describe what it really is – the word "bank" really should be used only to describe a business that accepts deposits, AND makes loans, AND is insured by the FDIC – ALL 3 – PERIOD!!!

Many in the media, especially the national media, seem to think that investments companies, mortgage brokers and traditional banks are all alike. The VAST majority of traditional banks did NOT write those wild toxic sub-prime mortgages that led to the housing bust. You know the ones – there's a whole cable TV channel basically dedicated to buying and selling houses that would sell for $120 – 150,000 in Topeka or Salina, but sell for $800,000 - $1 million in California. And they are sold to people making $100,000 or less. Hence the name "SUB PRIME" loan. They were told that when their adjustable rate, no down payment mortgage loan was ready for an adjustment, if they couldn't make the new payment, they could always sell the house and make a killing!!!

Traditional banks were not the ones who bought any loan that was sent to them, in the name of putting every American in a home, whether they could afford it or not, and then sliced and diced those sub-prime loans up and sold them as mortgage backed securities to hedge funds all over the world as AAA credits.

Traditional banks, like we mostly have in Kansas, are business women and men in the relationship business. They are working to make their communities a better place, just like others in the business community. They are trying their best, under whatever environment they find themselves – political, economic, regulatory – to help people achieve their dreams. Whatever it may be, to buy a car, buy a home, educate their children, start or expand their business, or whatever their dream happens to be.

Bankers all over Kansas are involved in almost every community or economic development project that comes along. They are neck deep in United Way campaigns, sponsoring Little League, 4H, FFA and bank employees are involved in all kinds of charity work from Let's Help, Rescue Missions, church's all over the State and country.

Finally, and probably most importantly, I would submit to you that banks are the economic engine of this country. You REALLY should care if banks are being too highly regulated, with over constraining new rules and regulations, the economic future of our country may depend on an efficient innovative banking system.

Remember economics class? Remember the term "financial intermediation"?
That's what banks are and do – they are financial intermediaries.
Quoting from the college economice text book, "*Economics*", by Campbell McConnell, about commercial banks –

"But commercial banks also perform an additional function which other financial institutions and businesses do not. That unique function is to CREATE money by taking deposits AND making loans. Because of their unique money-making abilities, commercial banks are unique and highly strategic institutions in our economy."

Some people call this the "roll over" effect - money is deposited, loaned out, re-deposited and loaned out again – the typical number used in the rollover effect is 4 times.
So, you really should care what happens to the banking system.

Bankers understand and welcome that challenge. And even though this new law will make things more difficult to operate in an efficient manner, they will learn the new "road map" for our industry and continue to do the best they can.

Too Big HAS Failed

There are no banks chartered in Kansas that would come close to being deemed "Too Big to Fail". In fact, at just over $50 billion of assets, the combined assets of all banks chartered in Kansas would not meet the size threshold of "Too Big to Fail". In some people's eyes, that is very insignificant. Yet, when you look at the thousands of individuals, small businesses and agricultural operations that are financed by the traditional community banks in Kansas, one could hardly call it insignificant. However, the 325 banks in Kansas are negatively impacted by the policy of "Too Big to Fail". When the "mega-banks" are systematically bailed out, time after time, they no longer see any downside to overly risky behavior. Yet, traditional community banks and the whole country are hurt badly by the economic downturn that inevitably follows.

It has been my view for quite some time that business lines, operations and functions, outside of the traditional banking function of taking deposits and making loans, by the large Wall Street "banks" have put the FDIC deposit insurance fund and the whole banking system at risk. Those "functions" need to be identified, segregated, and capitalized separately, thereby reducing the risk to the banking system.

Will the new, Systemic Risk council and other policies and procedures placed in the Dodd-Frank Wall Street Reform legislation eliminate the policy of "Too Big to Fail"?, only time will tell, but I sincerely doubt it. It will take a great amount of strength and fortitude on the part of regulators and policy makers to systematically dissolve a bank that has been deemed to by "systemically significant".

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name: Charles A. Stones	**2. Organization or organizations you are representing:** Kansas Bankers Association
3. Business Address and telephone number: 610 SW Corporate View, Box 4407, Topeka, KS 66610 — 785-232-3444	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006, related to the subject on which you have been invited to testify? ☐ Yes ☒ No	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006, related to the subject on which you have been invited to testify?** ☐ Yes ☒ No
6. If you answered "yes" to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	

Please attach a copy of this form to your written testimony.