TOO BIG HAS FAILED: LEARNING FROM MIDWEST BANKS AND CREDIT UNIONS

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TOO BIG HAS FAILED: LEARNING FROM MIDWEST BANKS AND CREDIT UNIONS

Monday, August 23, 2010

U.S. House of Representatives,
Subcommittee on Oversight
and Investigations,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in the Capital Federal Conference Center, Regnier Center, Johnson County Community College, 12345 College Boulevard, Overland Park, Kansas, Hon. Dennis Moore [chairman of the subcommittee] presiding.

Members present: Representatives Moore and Jenkins.

Also present: Representative Cleaver.

Chairman Moore of Kansas. Good morning. This field hearing of the Subcommittee on Oversight and Investigations of the House Financial Services Committee will come to order.

Our hearing today is entitled, "Too Big Has Failed: Learning from Midwest Banks and Credit Unions," inspired from the April 6, 2009, Time magazine cover story, "The End of Excess: Why this Crisis is Good for America." This is the second in a series of hearings where we will look at the key issues that may not be receiving enough attention, so we can learn and work towards a stronger and more stable financial system.

Before we begin with the formal proceedings, I want to take a moment of personal privilege to first thank Johnson County Community College President Terry Calaway and all of the staff and faculty here for hosting today's field hearing.

For those of you who do not know, before my constituents sent me to Congress, I was elected and proud to serve on the Board of Trustees for Johnson County Community College, and I am very glad we were able to have one of my last subcommittee hearings here at Johnson County Community College.

I also want to thank the other members who have traveled and taken time out of their busy schedules to be with us today: Congressman Emanuel Cleaver from the 5th Congressional District of Missouri; and Congresswoman Lynn Jenkins from the 2nd District of Kansas. Thank you very much for being here.

We will begin this hearing with the members' opening statements, up to 10 minutes per side, and then we will hear testimony from our witnesses. For each witness panel, members will each have up to 5 minutes to question our witnesses. The Chair advises our witnesses to please keep your opening statements to 5 minutes, to keep things moving, so we can get members' questions in.

Without objection, all members' opening statements will be made a part of the record. I now recognize myself for 5 minutes for an opening statement.

Our economy continues to slowly recover following the worst financial crisis and recession since the Great Depression in 1929. While there were a number of contributing factors that caused the financial crisis, one of the lessons we have learned is that "too-big-to-fail" financial firms can cause a lot of damage if not appropriately supervised.

And who paid the price for these mistakes? Unfortunately, it was not those "too-big-to-fail" firms on Wall Street, but rather our constituents and businesses here in Kansas and across the country. American households lost about $14 trillion in net worth over the course of 2 years. Retirement accounts saw an over 20 percent decline in value, forcing many Americans to delay their retirement. Millions of Americans lost their homes through foreclosure. Bernie Madoff's Ponzi scheme defrauded $65 billion from investors.

And the government was forced to respond to prevent further damage. Congress approved, and even though it was deeply unpopular, I voted for the $700 billion TARP proposal. I did so not because I wanted to, but because it was the right thing to do, I believe, for our people and our country. In fact, while there continue to be misperceptions about it, economist Mark Zandi, an advisor to Republican Senator John McCain in the last presidential election, has recently done some analysis and found that without TARP, the Recovery Act, and other measures, we would have seen the unemployment number double with 8.5 million fewer jobs, and that is on top of the more than 8 million jobs we have already lost.

But given the economic damage we did suffer, it is not surprising that many Americans have lost their faith in our financial system. As Mr. Hoenig has put it, "too big has failed" and we need our financial institutions, big and small, to get back to the fundamental business of banking and financial intermediation. And while not perfect, I believe that the types of smaller and medium-sized banks and credit unions we will hear from today and others here in the Midwest should be held up as an example of what the post-crisis financial system should look like. Financial firms should know who their customers are and perform proper due diligence before making a loan.

To help restore Americans' faith in our financial system, I worked as both a senior member of the House Financial Services Committee and as a House conferee to improve and perfect the financial regulatory reform measure. Part of this work included defending smaller banks, credit unions, and small businesses that did nothing to create the financial crisis.

For example, I worked with my colleagues to provide a full grandfathering of existing trust-preferred securities for all banks with less than $15 billion. I pushed to fully preserve the thrift charter, making the case that while the ineffective Office of Thrift Supervision should be eliminated, the business model with which many Kansas thrifts acted responsibly should not be eliminated. And I offered the amendment to exempt all banks and credit unions with fewer than $10 billion in assets from the new Consumer Financial Protection Bureau's enforcement powers. Many forget, but a new consumer financial protection agency was not only called for by the Obama Administration, but by former Secretary Hank Paulson as well.

The Dodd-Frank Act includes other new powers to regulate "too-big-to-fail" financial firms and provides regulators with a new liquidation tool that will ensure we end "too-big-to-fail" bailouts, and we shut down any financial firm—big and small—that fails. As the bill was being signed into law, the headlines from the Wall Street Journal were, "Big Win for Small Banks" and "Small Banks Avoid Overhaul's Sting."

That said, I understand that with any new set of rules comes unfamiliarity. Something I hope to see as the new rules are implemented is not an endless stream of additional disclosure forms that are difficult for small firms to comply with and only serve to confuse consumers. We created the Consumer Bureau to streamline and simplify these financial forms and documents so that consumers know what they are signing up for, and as a result, will be much easier for small community banks and credit unions to comply with.

It is time to move forward with a stronger financial system, and I look forward to hearing from today's witnesses on what lessons we can and should learn from responsible banks and credit unions we are fortunate to have here in the Midwest.

I now recognize for up to 10 minutes, my colleague, Representative Lynn Jenkins, a member of the House Financial Services Committee.

Ms. JENKINS. Good morning, and thank you, Mr. Chairman, for holding today's important hearing. And I would like to thank Federal Reserve Bank President Hoenig for being here with us this morning. We have an important topic to discuss.

It is important to every American trying to obtain a home loan, small business loan, car loan and even those concerned with their own job stability. Individuals and businesses are asking about the health of their bank and their ability to obtain a loan from their bank when they need it. These questions are essential to every American household and business, and it is my hope that both President Hoenig and our panel of bankers and credit unions can share with us some strategies they have employed to ensure that they can continue to provide these important services to our communities.

I am proud to be here today to highlight lending institutions in Kansas as industry leaders in making prudent financial products available to customers and maintaining the integrity of their institutions throughout that process.

The financial crisis has dramatically impacted the lending industry as a whole and many of the banks represented here today have managed to provide an example to others of what sound judgment and policy looks like during times of irrational exuberance. However, many of our witnesses represent community banks and credit unions already feeling overly burdened by the government and regulators, and now are feeling the crunch more broadly with the passage of financial regulatory reform. Other witnesses represent regional banks, which have performed admirably, but will now have to restructure their business model.

I am eager to learn what lessons you all can share with us today that we can carry back to Washington, and what trends you see that have you concerned for your industry in the future. I am sure the banking community, and the credit unions have much to share with us today, and I am anxious to hear from both sides as to how this can be constructive for all of us.

I want to again thank the chairman for putting this together, holding the hearing, and I look forward to hearing testimony from each of today's witnesses.

I yield back the balance of my time.

Chairman MOORE OF KANSAS. Thank you, Representative Jenkins, for being with us today.

I now recognize Representative Emanuel Cleaver for up to 5 minutes, another member of the House Financial Services Committee. Congressman Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman. I appreciate you allowing me to participate in this field hearing. I am not on the Oversight and Investigations Subcommittee but the work that you have done already has paid off with the legislation we recently approved. It is an honor to participate with you at this very important hearing. You are right on point to look at the "too-big-to-fail" issues and their impact from the view of Midwest banks and credit unions, which have not seen the problems that some of their east, west, and north coast brethren have encountered.

It is my pleasure to welcome the very distinguished witnesses for today's hearing. From time to time, I consult with the financial services industry in my district, and they have always provided sound advice. It is also a great honor that they can come before us today and provide testimony.

Mr. Chairman, earlier this spring, Committee Chairman Barney Frank joined you and me to honor UMB and Commerce Bank, who were named the second and third rated best banks in America in 2009, by Forbes magazine. As I was putting together the background for the awards, I learned some important information about UMB and Commerce Bank that is relevant to today's hearing.

UMB's shared corporate vision is to be recognized for their unparalleled customer experience. One of the corporation's shared values is, "customers first, we do the unparalleled to create an environment that consistently exceeds the expectations of our customers." UMB embodies strong community involvement in all the communities it serves. From financing for small businesses to providing working capital loans to companies that support job creation and retention to employee volunteerism and corporate donations, UMB stands tall with their communities. In fact, UMB recently received an outstanding rating from the Office of the Comptroller of the Currency in their most recent public evaluation of UMB's community lending and participation.

When the largest banks in America were trying to repay billions of dollars in TARP funds and to improve their balance sheets to deal with the impact of the severe economic problems the States were having, UMB was keeping to their business strategy—conservative, with slow, steady growth. And in September 2009, the street.com article entitled “UMB’s Kemper Proves Boring is Better: Best in Class,” Mariner Kemper said, “The Street, the investor population believed that we could leverage our earning streams more if we had taken the same risks as the rest of the industry. I am thrilled to be able to stand up and say our strategies worked for us. We did not erase 20 years of earnings by taking three years of risk.” In a press release around the same time, Mr. Kemper said, “This ranking also shows that the regional banking model works. UMB sticks to our time-tested prudent business practices such as making loans within our territory, building relationships with our customers, and understanding that strong underwriting practices produce quality results. Our standards have remained unchanged in all economic conditions. This principle, as well as a focus on a diverse income stream from fee-based businesses affords us steady growth.”

Likewise, Commerce Bancshares, Inc.’s corporate mission is to “raise the voice of the customer and in doing so create a differentiating experience which encourages our customers to develop a relationship with Commerce and then become long-tenured loyal customers. The company’s customer promise is ask, listen, solve. That means the company promises to ask the right questions, listen carefully to what our customer is telling us, then solve for the appropriate solution to meet our customers’ specific needs. Commerce Banks embody strong community involvement in all that it does in this community.”

And then finally, Mr. Chairman, Commerce is committed to environmental sustainability to reduce their environmental footprint. They encourage recycling, try to consume less paper, encourage employee carpooling and public transportation, and monitor and manage energy usage. In 2008, Commerce opened Missouri’s first LEED-certified bank branch in O’Fallon, Missouri.

Mr. Chairman, more than 100 banks have failed over the past 2 years since our economy began its meltdown. They have taught us valuable lessons on how not to run a bank. And so today, UMB and Commerce Banks, as well as many other community banks, regional banks, and credit unions are juxtaposed to those “too-big-to-fail” banks and teach us what banks should do, or how not to fail.

Thank you, Mr. Chairman, I yield back the balance of my time.

Chairman MOORE OF KANSAS. I thank my colleagues for their statements.

I am very pleased to introduce our first witness, who was so respected the last time he testified before our subcommittee earlier this year that we had to invite him again.

This morning, we will hear from Mr. Tom Hoenig, President and Chief Executive Officer of the Federal Reserve Bank of Kansas City. President Hoenig is currently the longest-serving Federal official and this year is a voting member of the Federal Open Market Committee. He has been a strong, independent Midwestern voice in the national debate on financial reform and economic recovery. In fact, our title from today’s hearing comes directly from a speech Mr. Hoenig made in Omaha in March 2009. And he has been one of the leading experts people turn to on ending “too-big-to-fail.”

I want to publicly thank Mr. Hoenig and his entire staff at the Kansas City Fed for being such a valuable resource to me and our office, as well as for your service to the Kansas City community.

Without objection, Mr. Hoenig, your written statement will be made a part of the record, and you are recognized for 5 minutes to provide a summary of your written statement.

STATEMENT OF THOMAS M. HOENIG, PRESIDENT, FEDERAL RESERVE BANK OF KANSAS CITY

Mr. HOENIG. Chairman Moore, thank you very much, and Congresswoman Jenkins and Congressman Cleaver, thank you for this opportunity to testify before the subcommittee. I think it is a timely hearing about the future of community banks.

Before I begin, I do want to note and share with you, Chairman Moore, that this wonderful campus and this wonderful school was also helped to be formed by an individual by the name of Will Billington, who was a mentor of mine from the Federal Reserve system, and he was one of the founding trustees, and so it is a great pleasure for me to join you here today.

Chairman MOORE OF KANSAS. Thank you.

Mr. HOENIG. Let me just say that over the past 20 years, as the banking industry has consolidated into fewer and larger banks, a perennial question has been, "Is the community bank model viable?" The short answer is "yes." The longer answer is, "yes, if they are not put at a competitive disadvantage by policies which favor and subsidize the largest financial institutions in this country." I have worked closely with community bankers my entire career, through good and bad economic times. I know the business model works, and therefore, they can survive and prosper.

There are more than 6,700 banks in the country, and all but 83 would be considered community banks based on a commonly used cutoff of $10 billion in assets. In the Tenth District, we have about 1,100 banks, and all but 3 would be considered a community bank. A lower threshold of $250 million, which focuses on a far more homogeneous group, still includes about 4,600 banks or about two-thirds of all banks. My submitted material and remarks now are directed towards this group of banks, this smaller group, which serve Main Street in communities across this country of ours.

Community banks are essential to the prosperity of the local and regional economies across the country. The maps I provided show that community banks have the majority of offices and deposits in almost a third of the counties nationwide. However, their presence and market share are most substantial among Midwestern States, where their role is particularly crucial in rural areas and smaller cities. It is the economies in these States that would suffer most significantly without their presence. Why?

Community banks have maintained a strong presence despite industry consolidation because their business model focuses on strong relationships with their customers and their local communities. Banks in our region, for example, serve all facets of their local economy, including consumers, small businesses, farmers, real estate developers, and energy producers. They know their customers and local markets, know that their success depends on the success of these local firms, and they recognize that they have to be more than a gatherer of funds if they hope to prosper as a bank. These factors are a powerful incentive to target their underwriting to meet specific local credit needs. And it gives their customers an advantage of knowing who they will be working with in both good and difficult times. Larger banks are important to a firm as they grow and need more complicated financing, there is no question. But in this region, most businesses are relatively small and their needs can be met by the local bank.

It is said that a community with a local bank can better control its destiny. Local deposits provide funds for local loans. Community banks are often locally owned and managed through several generations of family ownership. This vested interest in the success of their local communities is a powerful incentive to support local initiatives. It is the very "skin in the game" incentive that regulators are trying to introduce into the largest banks, that has been lost for some time. It is the small community's version of "risking your own funds" that worked so well in the original investment banking model, and kept partners from making risky mistakes that would require personal bankruptcy back then, and government intervention more recently.

There is no better test of the viability of the community bank business model than this financial crisis, this recession and abnormally slow recovery that we have experienced over the past 2½ years. The community bank business model has held up well when compared to the megabank model that had to be propped up with taxpayer funding. Community bank earnings last year were lower than desired, but on a par with those of the larger banks. However, community banks generally had higher capital ratios that put them in a better position to weather future problems and support lending.

This is an important point to note as the decline in overall bank lending, particularly to small businesses, is a major concern to all of us. Data show that community banks have done a better job serving their local loan needs over the past year. Community banks as a whole increased their total loans by about 2 percent as compared to a 6 percent decline for larger banks. In addition, community banks have had either stronger loan growth or smaller declines across major other loan categories. Business lending in particular stands out, with community bank loans dropping only 3 percent as compared a 21 percent decline for the larger banks.

Of course, some community banks made poor lending and investment decisions during the housing and real estate boom of the mid-2000's. Unlike the largest banks, community banks that fail will be closed and sold. For community banks that survive, it will be a struggle to recover. Commercial real estate, particularly land development loans, will be a drag on earnings for some time yet. Nevertheless, for those that recover, a business model that continues to focus on customer relationships will be a source of strength for local economies.

Thus, community banks will survive the crisis and recession and will continue to play their role as the economy recovers. The more lasting threat to their survival, however, concerns whether this model will continue to be placed at a competitive disadvantage to the largest banks. Because the market perceived the largest banks as being "too-big-to-fail," they had the advantage of running their business with a much greater level of leverage and a consistently lower cost of capital and debt. The advantage of their "too-big-to-fail" status was highlighted during the crisis when the FDIC allowed unlimited insurance on non-interest-bearing checking accounts out of concern that businesses would move their deposits from the smaller to the largest banks. As outrageous as this may seem, in many cases it is easier for larger banks to expand through acquisition into small communities. This occurs because smaller banks tend to focus on their local markets and, therefore, face significant restrictions to in-market mergers. This policy ignores the fact that the largest 20 financial institutions in the United States now control just under 80 percent of the country's total financial assets. In other words, the anti-competitive market analysis needs to be looked at, given the changing times.

Going forward, the community bank model will face challenges. Factors such as higher regulatory compliance costs and changing technology will encourage community bank consolidation. And despite the provisions of the Dodd-Frank Act to end "too-big-to-fail," community banks will continue to face higher costs of capital and deposits until investors are convinced that advantage has ended. The community banks have always faced these challenges, and survived and prospered despite them. If allowed to compete on a fair and level playing field, the community bank model is a winner and will continue to serve our communities well.

Thank you.

[The prepared statement of Mr. Hoenig can be found on page 52 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Hoenig. I now recognize myself for 5 minutes for questions.

Mr. Hoenig, from your perspective, would you please describe the major differences and advantages that smaller to medium-sized financial institutions may have over the largest financial firms in the United States? And you have spoken to this in your opening statement, but if you have additional—for example, it seems like a smaller financial firm would be easier to manage while also increasing the likelihood that the firm really knows their customers. Is there something unique to the business model and practices utilized by Midwest banks and credit unions that Wall Street banks maybe could learn from?

Mr. HOENIG. I think that the advantage of the regional and community bank is, in a sense, their size. They are of a size that can be managed. We know economies-of-scale advantage cuts off long before $50 billion, so that there is the ability to manage across functions within the bank. There is a greater opportunity, and I think you will hear about that more today, about the fact that you do build your customer relationships with a medium-sized business line, I think, more easily. And so those are extremely important in this country.

I have been told time and time again about other models where you only have three or four banks across the country and that seems to work. And I say this country is the greatest country in part because it has had a greater availability of credit through community banking across the United States over the past 200 years. I think we should change that great model with great care as we look forward. So I have a lot of confidence in this model.

Chairman MOORE OF KANSAS. Thank you, sir.

Do you have any concerns that we may see greater consolidation in the banking and credit union sector in the next few years as more smaller institutions may fail? And what impact might that have on the stability of the financial system? For example, would fewer and larger banks and credit unions create additional systemic risks that might outweigh any benefits enjoyed from economies of scale?

Mr. HOENIG. I think that, first of all, there are going to be more consolidations. I think the cost, the carry cost for a community bank is going to grow per dollar of assets and, therefore, you will want to get the size up in order to spread that cost over more assets. So I think that will be the trend. I do not think that necessarily means the end of community banking. It does mean you are going to have a smaller number of banks, but I think we will still have thousands of banks in this country for some time to come.

As far as looking ahead, I think we have to be careful because the cost of capital is to the advantage of the largest institutions. And so, that will work away at the competitive position of the smaller banks over time and we need to be mindful of that.

Chairman MOORE OF KANSAS. Thank you.

You testified before the subcommittee in Washington on the topic of reversing our dependence on leverage and debt. To be clear, Midwest banks and credit unions never had the levels of leverage that firms like AIG and Lehman Brothers had; is that correct? And if so, why do you think that is and what can we learn from smaller financial firms that are not overleveraged?

Mr. HOENIG. I think first of all, it is correct. The largest banks in this country, as I testified, increased their real leverage, what I call true equity capital, to assets from about 17 to 1 to over 30 to 1 from the early 1990's through to 2007 when the crisis began. Smaller community banks' real leverage ratio did not rise significantly above their original 16 to 1. Part of that is that they were not thought of as being "too-big-to-fail." They knew that they had to have the capital base and the market expected that of them. And therefore, they had an incentive to maintain their capital levels at higher amounts. I think that is important to remember going forward. That is why we spent important time on this issue of resolution in the Dodd-Frank bill to make sure that advantage was at least mitigated, if not eliminated. Only time will tell whether this "too-big-to-fail" will go away and whether this will, through the market as much as regulatory, force them to reduce their leverage levels not only within this country but on a global basis. That is a huge issue coming up for the regulatory authorities, both in the United States and internationally and that is what should be the leverage restrictions on the largest banks. And that is not settled, at this point.

Chairman MOORE OF KANSAS. Thank you, sir.

I now recognize for up to 5 minutes Representative Jenkins for questions.

Ms. JENKINS. Thank you, Mr. Chairman.

In your statement, you said that the community bank model is a viable one but only if they are not put at a competitive disadvantage by policies which would favor the larger institutions.

Mr. HOENIG. Yes.

Ms. JENKINS. So I am just curious if you think that the Dodd-Frank bill puts the community banks at a competitive disadvantage, and if so, how?

Mr. HOENIG. The Dodd-Frank bill is designed to, as I said, mitigate that advantage by—it calls for a resolution of the largest banks should they fail, should they become insolvent or unable to meet their obligations. So it is designed to eliminate that advantage. But the only way we will know that is how the market reacts and whether the market thinks that is a viable resolution process. And that is not a foregone conclusion, because I will tell you that if you have a trillion dollar institution and it is in difficulty and you have a weekend in which to make a decision, so you are on a Friday, it is incurring a huge liquidity problem, people are running from this largest institution.

And you know that the impact of its failure, of the liquidity crisis, will be to affect the broader economy, and you have only a weekend. You have to have it resolved by Sunday night before the Asian markets open. Will you actually be able to get two-thirds votes from the FDIC, two-thirds votes from the Federal Reserve, get a court to agree to it, get the Secretary of the Treasury to agree to it and actually take it into receivership, which will be a very disruptive process—I think only time will tell.

The markets are trying to figure that out right now. If they are convinced that it will be taken into receivership, then I think the advantage to the largest institution will be reduced. It will not be eliminated, but it will be reduced. And that will make it a more equal, more level playing field for the community bank.

If it does not take it, then that largest bank, number one, will be thought of still as “too-big-to-fail.” So, number one, if a large firm or a medium-sized firm has to have a payroll account that is, say, several million dollars, it will not put it in a community bank that it knows can fail, but will put it in the largest bank where it may not fail. Secondly, knowing that and the markets who are issuing the debt to the largest banks know that they will get bailed out in a crisis, even though it is not supposed to happen, then they will provide funding to those banks at a less costly level. And so that will give them a cost of capital advantage.

So those things have to go away. And that can only happen if the markets are absolutely convinced that “too-big-to-fail” has finally been ended, and only time will tell. So it is an open question. I am sorry I cannot answer yes or no.

Ms. JENKINS. Okay. I guess to follow up on that, considering the Dodd-Frank reform bill seems to perpetuate the “too-big-to-fail” problem, is it not likely that the leverage problems will even get worse in the future and those “too-big-to-fail” institutions will continue to have funding advantages over the institutions like the ones that we have here today, so that the big will get bigger? Can you just comment on that potential problem?

Mr. HOENIG. That is a risk. One of the things in the early parts of the discussions that I was actually in favor of was breaking up the largest institutions so it would become clear that they were not "too-big-to-fail." But that is not what was done and we do have this resolution process. And I think it all depends on how carefully we enforce the Dodd-Frank bill in terms of eliminating "too-big-to-fail" or they will continue with an advantage over the regional and the community banks. So it is a major concern of mine, yes.

Ms. JENKINS. Okay, thank you. I yield back.

Chairman MOORE OF KANSAS. Thank you. Now, I recognize Representative Cleaver for up to 5 minutes, sir.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Hoenig, I was in the room, and my colleague Dennis Moore was there, when President Bush sent over his Treasury Secretary Hank Paulson. Ben Bernanke was there, Christopher Cox from the SEC was there, and Sheila Bair from the FDIC. Most of us had no idea what would fall from their lips and we were in horror when they told us exactly what you just mentioned, that if we failed to act—or if they failed to act, then by Monday, we could have one of the worst economic crises in history. And I do not know about Congressman Moore, but I was shaking under the table. I have always been fascinated when I go to townhall meetings and people who majored in geography say, "That was stupid, you people are stupid.

Retrospectively, do you think we acted correctly in responding to the Bush Administration's call for action?

Mr. HOENIG. I think that under the circumstances, there were not a whole lot of choices. And one of the things that you have to keep in mind is there was no contingency. For example, one of my arguments was not that you did not take actions to make sure our financial system and our economy did not collapse, but that in doing so, we bailed out the stockholders of the largest institutions, whose responsibility it was to oversee these institutions by their selection of directors and so forth. And there were models—the Continental Illinois failure, which was itself "too-big-to-fail," but at least the stockholders were not wiped out and the market did have some discipline back on those institutions. In this instance, there was not that kind of ability to pre-plan and, therefore, you ended up with this very chaotic weekend.

What I am also saying though, is what is the lesson from that? We have a new bill and it has a resolution process. And I encourage all the authorities—the Federal Reserve, the FDIC and others—to say all right, let us say very clearly, let us make sure we have rules that will be in place should we have a crisis 10 years from now or whenever it is, that says when this happens, we have enough notice, we set up who will be the management who comes in as we wipe out the other management, the directors who come in as we wipe out the directors who are responsible for this, make sure that we are in fact putting it into a receivership with an operating unit so that it does not have to be shut down, it can be run but with new ownership. And that we have in place how we are going to hold the debtholders who loaned maybe at very good rates to these institutions, so that they share the burden rather than the taxpayer.

The main thing we ought to take from this is it was a crisis, we went through it as we did, but let us not repeat that process the next time through. That is my best advice going forward.

Mr. CLEAVER. Thank you. I agree with you absolutely.

Last night, I re-read this article by Kurt Anderson that was written in March of 2009, "The End of Excess." In a very interesting part of this, he says, "I don't pretend we didn't see this coming for a long time." And now when you look back, there were those who suggested that we were heading for the precipice. Six months before this weekend that we all experienced in terror, we had the Fed Chairman, we had the SEC Chairman, we had the FDIC Chairman, and the heads of the three credit rating agencies before our committee. And not one of them—not one—expressed concern about the direction of the economy. People criticize John McCain for making some comments about the economy being healthy. He was simply reporting what the financial services oversight group said we were experiencing. And yet, there are those who said that they saw this coming for a long, long time.

I guess my question is, is there something in the financial reform or is there anything that we can do to take the long view of the U.S. economy to prevent us from a weekend collapse?

Mr. HOENIG. I think that there is not only in the legislation, but in the regulatory scheme, there is a mechanism there to give warning. For example, financial stability, oversight committee and the researchers around that, the economists at the Federal Reserve, others. There is the mechanism, but I will tell you that the real test is in whether you can act in the face of an economy, a broad populace who at the moment feels everything is very good. And just to give you examples, these people that you are talking about saw this coming in 2005 and 2006 and 2007, saying there is this leverage and so forth. And in fact, the regulatory authorities put out proposed guidelines to begin to put some kind of guideline limit around exposures to certain kinds of real estate—land development, commercial real estate. And the blowback on that was enormous. You cannot do this because we want everyone to have a home. We want to make sure that the economy stays strong and the only way you do that is have it continue.

I do not think it will be—I do not think we will miss it again in the sense of seeing where there is risk. We may not identify specifically when the economy will go into a slowdown, but the ability to go against the wind and against the forces that are in play is overwhelming in any economy, and certainly in the United States. So that will be the real test: can we step up to it and say I know you think things are really good, but we are going to put some limits on this because we do not want another bubble and we do not want the leverage to continue. And that will be a lot harder than any of us realize right now.

Mr. CLEAVER. So measuring the systemic risk—thank you, Mr. Chairman.

Chairman MOORE OF KANSAS. Thank you. The gentleman's time has expired.

Mr. Hoenig, if you are available, we have time for a second round of questions, if you are available for just one more round of questions, please?

Mr. HOENIG. Sure, I would be happy to stay.

Chairman MOORE OF KANSAS. Thank you.

Mr. Hoenig, you testified before this subcommittee in Washington on the topic of reversing our dependence on leverage and debt earlier this year. To be clear, Midwest banks and credit unions never have had the level of leverage that firms like AIG and Lehman Brothers had; is that correct? And if so, what can we learn from the smaller financial firms that are not overleveraged?

Mr. HOENIG. I think we can learn about the principles of leverage regardless of firm. It is just a fact that as you leverage up to— if you really run a normal leverage of about 15 to 1 and you leverage up to 30, you have that much less capital to absorb any losses. And therefore, your margin of error slims out increasingly as you leverage up. And the thing about it is when you get the economy going into a downturn on asset value, those values fall immediately. That debt stays there with all that cash flow. And it is inevitably a crisis. When you have more capital, you have the ability to weather a downturn for a longer period. You still may fail if you have too many bad assets on your books, but certainly the margin of error is in your favor. That is what we have to learn going forward. And it is a huge issue because a lot of the issue right now is maybe what Representative Cleaver was referring to, when you talk now—and there is a lot of discussion about raising the capital level for the largest institutions, in other words, lower the leverage that we will accept. The first thing that is talked about is you are going to cause a credit crisis because as you have to build capital, you have to constrain your asset growth or bring in new capital and that will slow the ability to fund new loans. Right away, you are in a conflict. You know you need to get to a stronger position but you know it is not a free choice. It is going to cost something else and how you work through that, my suggestion has been you put the leverage number out there that is the right number, 15 or 16 to 1, and you give the industry time to get there. And it is part of the very harsh—it is painful. And that is the deleveraging of the country, which I am afraid has to take place.

Chairman MOORE OF KANSAS. Right. Thank you. You have used the word "painful" referring to the recession and it has been very painful for a lot of people in our country. According to the New York Times, the popular belief is that as housing prices rebound, they will continue to go up forever. The article cites a recent survey by Case-Shiller where many people said they still believe, "prices would rise about 10 percent a year for the next decade." Yale economist Shiller was quoted saying, "People think it's a law of nature." Should people have new expectations for the housing market in the next generation? Should we believe that the housing market is going to continue to rise and rise?

Mr. HOENIG. If the American people are looking for the housing market to be their investment opportunity, I think they are making a mistake. I do not think that the economics of the housing industry, as Professor Shiller is suggesting, is really designed for that. And right now, the facts are we have an excess supply and we created that by providing financing leverage that was almost nonsense. So now we have to adjust from that. Housing may eventually start to rise again, as other assets across the country begin to rise again; but it is not something that I think that the American consumer should be speculating on in terms of investment.

I would like everyone to have a home, but not everyone can afford a home, and if we try and make it so when it is not possible, you create the next problem. So that is the challenge going ahead.

Chairman MOORE OF KANSAS. Thank you, sir.

Reform of Fannie Mae and Freddie Mac will be hotly debated in the next Congress. How will those reforms in the housing market generally affect Midwest banks and credit unions?

Mr. HOENIG. It will vary widely depending on what they in fact decide. If, as I read some of the discussions that went on here very recently, it is determined that this is not the way to go with government guarantees where you privatize the gains and socialize the losses and if you try and bring the financing in housing back to the private industry banks, credit unions, thrifts and so forth, whatever it is, and they take both sides of the risk, then it will have profound effects, because it will take and put I think additional opportunity on regional and community banks, but also additional risk. You cannot just sell it off your books. But if they then—on the other hand, if they decide to merely make this a government agency that does it, you make Fannie and Freddie like Ginnie and it is all guaranteed, then you will have a different outcome. So I think it is really in the hands of the Congress and the Administration right now as they define what should be the future of how you finance housing in America. It is more than just what do you do with Fannie and Freddie. That is hard enough. But it is how you are going to decide to finance housing in America in the future that will define what impact it has on regional and community banks.

Chairman MOORE OF KANSAS. Thank you. My time has expired.

Representative Jenkins, if you have any additional questions, you have 5 minutes.

Ms. JENKINS. Thank you, Mr. Chairman.

I really just have one final question for you today. If I have heard one thing in the last 20 months since I have been in office, it has been from my local financial institutions who are frustrated that they are getting mixed messages. They hear from policymakers that they need to lend and regulators tell them that they need to tighten lending standards and increase their balance sheets. So I am just curious as to what steps you suggest that we all take to ensure that undue pressure is not placed on our financial institutions during these hard times, but that it allows them to continue to make worthy loans to our constituents?

Mr. HOENIG. That is one question that is a very difficult question. The first thing about it is the amount of pressure across community banks, regional banks, will vary very much depending on the condition therein. If you have a bank that has had a heavy portfolio of commercial land development loans, they are under pressure and the examiners are probably going to be saying, you need to build your capital up, you need to prepare for that. And there will be impediments to lending, because that institution is under real stress.

On the other hand, if you are a bank that has been more conservative during that period, then I think there is clearly less pressure on you from the examiner to hold down your lending. They would, I think, be in favor. And I tell people no examiner that I know, no examiner worth their salt would ever say we want a bank to fail. It is just not in anyone's interest, even that examiner's, as tough as they may be. So that is not the goal. The goal is to separate out those banks that can lend and those that have to rebuild their capital.

The other thing about it is, and this is where I think leadership within the agencies, the Federal Reserve, the FDIC, the Comptroller, has to be. What we tell our examiners is if you go into a bank and it has a portfolio, it has some stress—it is hard not to have some stress—but you see the loans and they have structured them in a way that can work, you do not have to come down on them harshly. It would serve no useful purpose, and I will stand—as the leadership of this institution, I will stand behind you in your judgments regarding that institution. That is important for me and for the leadership to say because I will assure you that if a bank does in fact fail, whether it is large or small, there is an IG review of how well you supervised. And that examiner, just like any other human being, does not want to be the one to say, you were too easy on them and that is why they failed. So you have this very important balance and that is why we train our examiners well and why we do give them discretion in the field and stand behind them. And I think that is critical going forward.

There is still going to be pressure, many banks still are under earnings pressure. But I think there is the ability now beginning to emerge to lend and we want to encourage them to do that.

Ms. JENKINS. So you would not have any advice and counsel for things that we could do?

Mr. HOENIG. I think you have passed the law. I think you need to let the regulatory authorities carry it out, with good oversight. I think we need to be accountable to you, answer questions specific to the issue that may come up before you. Our bank gets calls from various Representatives around the district and we try and answer their questions about the bank to the extent that we can in terms of confidentiality. So we have to be responsive to you and I think you have to give us some benefit of the doubt, given where we are today in this economy of ours.

Ms. JENKINS. Thank you.

Chairman MOORE OF KANSAS. Congressman Cleaver, you are recognized for 5 minutes, sir.

Mr. CLEAVER. Thank you, Mr. Chairman.

I want to stick with this article, I just think it is so fascinating, Kurt Anderson's article, "The End of Excess: Is this Crisis Good for America?" And he goes on to write, "We are in a state of shock. In a matter of months, half the value of the stock market and more than half of Wall Street's corporate pillars have disappeared along with several million jobs. Venerable corporate enterprises are teetering, but as we gasp in terror at our half glass of water, we really can—we must—come to see it as half full as well as half empty. Now that we are accustomed to the unthinkable suddenly becoming not just thinkable but actual, we ought to be able to think the unthinkable on the upside, as America plots its reconstruction and reinvention."

Do you think with all of our new financial structure and practices laid out in the Wall Street Reform bill that the United States is now in a position where we are able to think the unthinkable on the upside as we plot our reconstruction and reinvention?

Mr. HOENIG. I think one of our country's strongest points has been that we have always been optimistic and I think we will continue to be so.

We do have in the meantime though—I do not consider a crisis a good thing. It is sometimes unavoidable when you do not take necessary steps, and that is the nature of capitalism, it gets very enthusiastic on the upside and then overdoes it and then has to adjust. And that is part of the process. It is what you learn from that. One of the things we need to do—and to answer your question, yes, I think the economy will continue to improve. I think we will have new opportunities and I think we will prosper. However, we have some things to get through.

First of all, we have a great deal of uncertainty. I have no other opinion other than we have new pieces of legislation we have to learn. And that takes time. And so we have to learn about both the healthcare bill, about the regulatory reform bill and as we do that, then that will be put behind us and we will build going forward from here. So that is the process we are in right now. And we are also in the process of deleveraging.

An economy that is well capitalized, which has a high savings rate, at least a reasonable savings rate, systematically does better than an economy that has a very low savings rate and is highly leveraged. We are adjusting, and as we adjust, new opportunities will present themselves and I think, given our basic capitalistic system, that we have every reason to be optimistic long term. But we have, as I have talked about before this committee actually, we have to think about what we are going to do with our national debt in a systematic fashion that gives the American people confidence that we will not try and solve it all in one year, but that we will get on a path that will solve it and, therefore, they can make decisions, both consumers and businesses can make decisions that are long-term oriented. And then we can think about very optimistic outcomes for the U.S. economy.

Mr. CLEAVER. Thank you.

Chairman MOORE OF KANSAS. Thank you Congressman Cleaver. And thank you, President Hoenig, for your testimony and your years of public service.

You are now excused and I will invite the second panel of witnesses to please take your seats and we will have about a 3-minute recess while the panelists change. Thank you, sir.

Mr. HOENIG. Thank you very much.

[recess]

Chairman MOORE OF KANSAS. The committee will come to order. I am pleased to introduce our second witness panel: Mr. Chuck Stones, president, Kansas Bankers Association; Mr. David Herndon, president and CEO, First State Bank; Mr. Mariner Kemper, chairman and CEO, UMB Financial Corporation; Mr. Jonathan Kemper, chairman and CEO, Commerce Bank, Kansas City, and vice chairman, Commerce Bancshares, Inc.; Ms. Marla Marsh, president and CEO, Kansas Credit Union Association; and Mr. John Beverlin, president and CEO, Mainstreet Credit Union.

I want to thank our panelists for being on the panel today and sharing your information with us and your wisdom with us. Without objection, your written statements will be made a part of the record and you will each have up to 5 minutes to summarize your written statements.

We will start with Mr. Stones. You are recognized, sir, for 5 minutes.

STATEMENT OF CHARLES A. STONES, PRESIDENT, KANSAS BANKERS ASSOCIATION

Mr. STONES. Thank you, Mr. Chairman, Representative Jenkins, and Representative Cleaver. It is a pleasure to be here. I think it is appropriate that we are in the Capital Federal Auditorium within the Regnier Center at the Johnson County Community College. It is a pleasure to be here.

My name is Chuck Stones, and I am the president of the Kansas Bankers Association. Just a few comments on banking in Kansas to start off with, and these statistics early on are meant to represent commercial banks, not savings banks or credit unions.

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 from $4.5 million in assets to $3.7 billion in assets. The average size of a Kansas chartered bank is $155 million, and 36 percent of all chartered banks in Kansas have less than $100 million in assets. The total assets of all chartered banks in Kansas is just a little over $50 billion. So it is not surprising that a high percentage of our Kansas banks can be found in rural communities. Nearly 20 percent of all Kansas chartered banks are located in towns of fewer than 500 people, and 60 percent of all Kansas 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 14 or fewer employees.

The overwhelming majority of Kansas banks—or banks in the Midwest and specifically in Kansas—were performing well leading up to the current economic downturn and continue to do so. The agriculture economy has been very strong and banks in rural areas continue to be strong and profitable. However, as Tom Hoenig said, some banks in the few metropolitan areas of Kansas that experienced rapid commercial and residential development growth in the early part of the decade are now experiencing some distress and are attempting to address those issues to the best of their abilities. They are dealing with declining value of collateral and the slow market causing their customers to be unable to remain current on their loans. It is important to remember that banks are reliant on their customers' ability to repay the loan commitments in order to remain profitable and well capitalized.

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—capacity, 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 never would have been in a free market system. The Community Reinvestment Act is one example of this type of intervention, as is the relaxed underwriting standards of Fannie Mae 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 that same free market system to work on the back end is unrealistic.

Traditional banking needs to be strengthened and encouraged because, as in years past, it will be the engine that drives any economic recovery. Traditional bankers are just like any other small business men and women trying to keep their communities strong.

Too big has failed. There are no chartered banks in Kansas that meet the criteria of "too-big-to-fail." In fact, at $50 billion in assets, the entire State of Kansas probably fails to meet that test. In some people's eyes, that makes Kansas and Kansas banks 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 megabanks are systematically bailed out time after time, they no longer see downside to their overly risky behavior, yet traditional community banks in the whole country are hurt 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 have put the FDIC Deposit Insurance Fund at risk. Those functions need to be identified, segregated and capitalized separately; thereby, reducing the risk to the entire banking system. Will the new systemic risk council and other policies put in place by the Dodd-Frank bill work? As Tom Hoenig said, time will tell. It will take a great amount of fortitude by policymakers and regulators to see if that does ultimately work.

In the last part of my testimony, I would like to focus on regulatory burden and its effects on banks, on consumers, and on the economy as a whole. There are some policymakers who believe there is no such thing as too much regulation. Traditional banks feel the burden of regulation. With a typical small bank, more than $1 out of every $4 of operating expense goes to pay for governmental regulation and that was before the Dodd-Frank bill.

We are aware that traditional community banks have a growing list of regulatory burden. I have brought a list of those new rules and regs that have been put in place the last 2 years. The customers are hurt by overregulation. Banks in Kansas have told me that they are trying to decide whether it is just impossible or not to remain in business after the Dodd-Frank bill takes effect. And the realities of lending, especially in the mortgage area in the rural area are not given consideration when new rules are implemented.

Chairman MOORE OF KANSAS. The gentleman's time has expired. Can you wind up, sir?

Mr. STONES. Yes, thank you.

Just briefly, everyone should be concerned about overregulation and an efficient banking industry. The term "financial intermediation" from economics 101, from my economics textbooks, "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-creating abilities, commercial banks are unique and highly strategic institutions in our economy."

It should be important to all of you, policymakers and consumers and business people alike, to maintain a highly efficient banking system.

Thank you.

[The prepared statement of Mr. Stones can be found on page 84 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Stones.

Mr. Herndon, you are recognized for 5 minutes, sir.

STATEMENT OF DAVID L. HERNDON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FIRST STATE BANK OF KANSAS CITY, KANSAS

Mr. HERNDON. Good morning, Chairman Moore, Representative Jenkins, and Representative Cleaver. My name is David Herndon, and I am the president and chief executive officer of First State Bank in Kansas City, Kansas. I am also the immediate past chairman of the Kansas Bankers Association.

First State Bank was founded in 1901. We celebrated our 109th anniversary on July 1st of this year. Special uniqueness to our bank is that it was founded and remains headquartered in Kansas City, Kansas, and it has always been privately and locally owned. I have been associated with the bank since 1978 and served as its President and CEO since 1990.

Based on asset size, First State Bank is one of the smallest banks in the Kansas City metropolitan area. Yet we offer a full range of bank services and delivery systems directed to our customers and to our community. Our trade area is primarily southeast and south central Wyandotte County, Kansas, northeast and north central Johnson County, Kansas, and west central Jackson County, Missouri. This area includes a sizable portion of the urban core of Kansas City, Kansas, and it represents a significant number of our customers. Our business customers are primarily manufacturing, transportation, warehousing, distribution, and subcontracting businesses. The consumers that we serve are historically employees of these businesses as well as other low- to moderate-income, urban core residents.

Our business model reflects our clients' banking requirements. When depositors and borrowers are enjoying good times, so do we. The challenge is just the same when those times are not so good.

Throughout the 1990's and the early 2000's, First State Bank led its peers in nearly all measures of financial performance. Following 12 consecutive years of increasing net income and asset growth, profits suffered a decline but remained positive after the terrorist attacks of September 11th. The bank worked with its business customers at that time to help them recover from the far-reaching economic shocks and business setbacks from this event. But some of our clients did not make it and were unable to repay their borrowings. The result was that we were forced to boost our reserves, increase our capital, and slow our asset growth. Despite the adverse impact to the earnings, we still remained profitable and we still remained well capitalized.

We rebounded our earnings in 2005 and returned to the pre 9/11 levels in 2006 and 2007. Then 2008 hit and the world changed again. But they changed and led to headlines that reported that banks were in trouble, that banks were failing, that banks were not going to be able to help their clients. Unfortunately, many of those reports were true.

But they were not true at First State Bank and they were not true at other Kansas banks.

First State Bank, like it has for 109 years, still makes loans to qualified borrowers, still offers professional banking services, and strives to build the same strong relationships with its clients. And those relationships allow us to adjust our business model and work with the bank clients as their business models change, whether it be by economic circumstances or other circumstances. That adaptability has allowed us to survive through the Depression of the 1930's, the 1980's, the post-9/11 economy, and it is allowing us to survive today.

We are trying to position ourselves to persevere in this economy just as the other banks throughout the Midwest are doing. To put it simply, we are healthy, and we are profitable and we remain cornerstones in our communities. But as you heard before, many banks and bankers and directors of small banks are judging whether they can stay in business and feel that they are needlessly under attack. Too many feel that they are being punished for actions which they never undertook. For example, we never participated in any subprime lending and never relaxed our lending standards, yet we were brushed into that group when it was in vogue to do so.

Most of our borrowers are repaying their loans, but some are not. And we are working diligently to work with those who are struggling. It usually takes a long time to turn around a troubled debt but we are not being granted that time in too many cases. Banks should not have to write down loans to legitimate borrowers who are working through a financial crisis they have never seen before but yet they are required to do that.

Additionally, our profits of small and medium-sized banks are being attacked. Recent legislative and regulatory actions have dramatically decreased income sources and increased operating expenses. Increased deposit insurance premiums, compliance costs, and restricting interchange fees are certainly examples. It appears that many of the banks in this area are concerned that government regulators have begun choosing winners and losers and if so, the small and medium-sized banks will regrettably be those losers.

We were well equipped to meet the requirements of our clients, both depositors and borrowers. Liquidity at our bank and throughout Kansas banks is and has been significantly higher than our peers in several areas of the country. And most certainly higher than many of those non-regulated or lesser-regulated institutions that are mistakenly referred to by so many as banks. We are profitable, we have strong reserves, and we have aggressively added to those reserves since the economy turned sour, further protecting our clients. Our capital is strong. First State has and will as long as the current ownership is involved always be well capitalized or above based on the regulatory definitions. And the majority of bankers throughout this region have the same attitudes. Our clients have confidence in us and because they know we are their financial partners in their success, their success will breed our success.

That mutual process will prove to be the catalyst for an economic recovery, I believe. The sources will create and sustain jobs.

Chairman MOORE OF KANSAS. The gentleman's time has expired. If you can wind up, sir.

Mr. HERNDON. I can, thank you.

The risk of unsubsided legislative and regulatory burdens will have unintended adverse consequences. Too many of us will be put out of business. We respectfully request the continued work—we are anxious to work with regulators and legislators to make that happen. But only through persevering in a diverse financial industry will our economy sustain.

Thank you.

[The prepared statement of Mr. Herndon can be found on page 45 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, sir.

Mr. Mariner Kemper, you are recognized, sir, for 5 minutes.

STATEMENT OF MARINER KEMPER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, UMB FINANCIAL CORPORATION

Mr. MARINER KEMPER. Thank you, Chairman Moore, Representative Jenkins, and Representative Cleaver. We are pleased to be with you today to join in this dialogue along with my colleagues here in the credit union arena and the banking sector. The country is entering a new era for financial services after a very rough time for many in the financial sector, as well as consumers and businesses.

I particularly appreciate the comments by Tom Hoenig. Tom has shown outstanding leadership, both in the Federal Reserve's relationship with banks here in the Tenth Fed District, as well as a sound voice for reasoned policy nationally.

From our interactions with customers, we can tell you that many businesses and consumers continue to face a challenging economy, whether through unemployment or weak demand for products and services. This makes it especially important that we are having this conversation today.

We believe, as you do, that solid Midwestern businesses like UMB and our colleagues here today are very much a part of the solution. It is critical that policymakers focus on constructive actions now to strengthen business, create private sector jobs, and restore growth in places like Kansas and Missouri.

Let me comment briefly on UMB's approach to banking. Unlike some financial institutions, UMB did not plunge into the bubble mentality. UMB has pursued three goals as pillars of our business strategy—quality, diversity, and stability. These goals have served us, our customers and our shareholders very well over the years.

UMB ranks as number two in the United States, according to a study by Forbes magazine ranking banks on asset quality, capital adequacy, and profitability. We take great pride in the fact that relative to industry averages, UMB has posted strong and consistent earnings year over year through the financial crisis. Throughout the crisis, we have had no need or desire to seek government bailouts or outside capital infusions.

In 2010, the Nation is entering a new financial era in what we call the "new normal." There is a hangover from this period of financial excess, which is hindering the lending environment and there is an increase in regulatory involvement with banks and other financial institutions, which has only begun.

The lending environment is a topic of much concern. Let me assure you, UMB Bank never stopped making loans and has plenty of liquidity to meet the needs of any qualified prospective borrower. We have increased our total loan balances through 2007 to the mid-2010 period an average of 5 percent per year and our total commercial loan commitment figures have increased 40 percent since 2007.

As the economy has slowed down, however, we have experienced a decline in demand for commercial and industrial loans. The strains of the recession have caused many businesses to scale back their plans. We believe it would be a mistake for banks to loosen underwriting standards now and take speculative loans on in an attempt to return to what we perceive as normal levels.

If our goal is to stimulate prosperity, I encourage political leadership to act on the counsel from leaders in the private sector who identify specific constructive actions to help restore a more vibrant economy. For instance, the Business Roundtable has called on Congress for tax reform to help U.S. corporations stay competitive and get on a path of expansion. The Roundtable has spelled out specific provisions of the Tax Code that create a drag on growth and competitiveness. To bring on economic recovery and put people to work, we need to stimulate business spending, not by increasing government spending or pressuring banks to lend, but by reducing the burden on businesses.

Another example of constructive action involves the regulation of banking and finance. Passage of the Dodd-Frank Act this summer was just the beginning, not the end of this process. And many, many questions remain unanswered.

As further changes are made and rules are developed, we support the strengthening of bank capital requirements, including both the tiered and risk-based capital levels. But this approach should be risk-based to start with, and should focus on incentives rather than regulatory penalties. Deposit insurance rates also could be incorporated into a set of incentives. That is, the higher the risk profile in an institution, the higher the insurance rate they should pay. The reverse should be true. This distinction between both categories is very slight today. This would drive the principal behavior that poses less systemic risk such as that demonstrated by UMB and others today.

Although the Dodd-Frank Act was designed with good intention of addressing excessive leverage and the "too-big-to-fail" issue, it has unfortunately become a mechanism to regulate bank profitability as well as product design and competition. History tells us that a lack of regulation is not the catalyst for a financial crisis. Rather, the stability of a system rests on the will of business and political leadership to do what is right when it is right.

If we truly wish to change behavior and counter the forces of human nature, we need to provide incentives for financial discipline. We believe banks and other players in the financial system, including policymakers and regulators, would do well to pay attention to quality, diversity, and stability. We will achieve long-term recovery by encouraging sound financial practices at every level from banks to business to consumer and even government.

I am happy to discuss the particulars with you as we move forward. I will leave you with one of my favorite quotes from President Truman, and it seems to apply to shaping this new era for our financial system: "Men make history, not the other way around. In periods where there is no leadership, society stands still. Progress occurs when courageous, skillful leaders seize the opportunity to change things for the better."

Thank you again for having me with you today.

[The prepared statement of Mr. Mariner Kemper can be found on page 72 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Kemper.

And Mr. Jonathan Kemper, sir, you are recognized for 5 minutes.

STATEMENT OF JONATHAN M. KEMPER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, COMMERCE BANK, KANSAS CITY, AND VICE CHAIRMAN, COMMERCE BANCSHARES, INC.

Mr. JONATHAN KEMPER. Thank you, Chairman Moore, Representative Jenkins, and Representative Cleaver. I always love it when my cousin quotes our former employee, Harry Truman.

[laughter]

Mr. JONATHAN KEMPER. I am Jonathan Kemper and, as mentioned previously, I am vice chairman of Commerce Bancshares and chairman of Commerce Bank of Kansas City.

In the interest of time, rather than recite my formal testimony and repeat those of the co-panelists which I certainly endorse, I will attempt to keep to a few major points, which I believe are of critical importance, especially given Representative Jenkins' comments of taking lessons back to Washington.

As has been said, we really appreciate your efforts in setting the record straight, because much of the financial crisis stemmed from the very largest financial services companies and not the community-oriented banks that you have heard from already. The banks have been lumped together without distinction and we find ourselves blamed for a financial meltdown that we actually warned people about and had no part of. This has been the biggest financial crisis since the Great Depression and has caused sweeping changes in the banking business, not all of which are complete now.

In the discussion of the questions, I would expand small and medium-sized Midwestern banks to traditional banks in my remarks and I would say that except for the top four banks in our country, the rest of us are all small banks in many of the ways that have been described today. I have put a graph into my testimony, and I think you have a copy of it, which shows where Commerce Bank fits. And when I put this together, I just could not believe that there are really two orders of magnitude between us and the largest banks.

To give you a sense of what is going on here, the four largest banks are in a world all unto themselves in the trillion dollar club. It falls off from Wells Fargo to U.S. Bank by a factor of four. So there really has been a complete sea change and Tom Hoenig went through that, about how much banking has been concentrated in the very, very top. Those trillion dollar clubs of megabanks and brokers differ from traditional banks both in size, in business style, and on their individual impact on the national and global financial systems. So we have resisted and certainly would caution against lumping us in that pot.

It has also been fashionable, many have said that the government bailed out the banks with TARP. And just to set the record straight on that one, not only did traditional banks not cause the crisis, but the government will in fact make a profit on the money placed into the traditional banks and the bad actors who caused the large bailouts, AIG and GMAC, are going to have us pay their bills, which is really galling.

Commerce Bank today is $18 billion. We have operations in five States, primarily Missouri and Kansas. Our success—and you have seen this in our testimony—is really because we have stronger customer focus. Our growth has been a solid organic basis and a knowledge and involvement in our communities. We would characterize ourselves as a good bank and a good corporate citizen. We are among the best capitalized banks, we declined TARP funds, and we did not contribute to the crisis, but we are paying the cost and bearing the extraordinary regulatory burdens. And I will just mention a comment made in the press in the signing of the Dodd-Frank bill, President Obama said, "Unless your business model depends on cutting corners and bilking your customers, you have nothing to fear from this reform." I respectfully submit we are concerned and we do not believe that is a true statement. We think that the FDIC insurance costs have increased already and are now going to increase on banks of $10 billion and above. That is clearly something that is going to affect our bank. The Consumer Financial Protection Bureau has potential to add substantial cost and restrict business and the price setting as established by the Durbin amendment significantly affects future fee income. In fact, there are more than 200 new regulations in the Dodd-Frank bill that are going to tax our staff and increase our costs.

I am going to skip over the comments about the last few years. I think they have been well summarized previously. All I can say is that we, as has been mentioned before, saw what was going on in the excesses and did not make the mistakes that others did, but we are tremendously affected by it, that the growth in borrowing taught by the hedge funds using leverage and credit default swaps still is out there and we still have a very difficult and ugly picture.

In fact, in 2007, we had—financial services represented over 25 percent of all the profits in the United States.

In conclusion, I just wanted to say that there is terrible trouble if the government gets involved in the level of pushing the scale in favor of the largest banks and against us. And I have given you a recent—in fact, it is coming out next month—a Harvard Business Review on where the judgment deficit is going to be and I recommend it for your reading. It was done by a classmate of mine at the Harvard Business School, and talks about the need and importance of local decision-making, and if we see the disincentives to the community-oriented banks that are represented by the panel and by mid-sized banks and small banks, we are going to see a deficit in judgment in the field that will provide the future for the economy that we need to see grow.

Thank you so much.

[The prepared statement of Mr. Jonathan Kemper can be found on page 60 of the appendix.]

Chairman MOORE OF KANSAS. Thank you for your testimony, Mr. Kemper.

Next, the Chair recognizes Ms. Marsh for 5 minutes.

STATEMENT OF MARLA S. MARSH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, KANSAS CREDIT UNION ASSOCIATION

Ms. MARSH. Chairman Moore and members of the subcommittee, I appreciate the opportunity to appear before you today on behalf of the Kansas Credit Union Association. Kansas has 103 credit unions serving 590,000-plus member owners.

Heavy focus has been placed on the risky practices that contributed to the great recession and what the government needs to do to prevent systemic failures in the future. We appreciate your willingness to also look at the players that did not contribute to the recession and are helping to restore economic stability. Much can be learned from credit unions with their philosophy of putting people before profit. My written testimony provides pertinent statistics on the State of Kansas' economy and Kansas credit unions in general.

Here are a few highlights:

The economy and Kansas credit unions have fared better on many economic indicators without the dramatic boom-and-bust experienced in other regions. However, we have felt the effects of actions by those less cautious and/or more greedy. A flight to the safety of a trusted partner is evidenced by our sizable asset growth over the past 18 months. Loan growth remains strong at over 5 percent as of March. Overall, credit unions are healthy and well capitalized at an average 10.8 percent net worth to assets ratio. And any consolidation since 2008 can be attributed more to the increasing marketplace complexity and the escalating compliance and regulatory burden than the recession. We hope that the committee will monitor the overall impact of new and current regulations and how the Dodd-Frank law is implemented.

As far as systemic risk, no credit union or group of credit unions is large enough to negatively impact the entire financial system and, therefore, the cost of any credit union failures would be contained within the credit union system itself.

The greatest risk to credit unions comes from collateral damage caused by the "too-big-to-fail" institutions. The devaluing of property, the decrease in consumer confidence and the increase in unemployment all negatively impact our member owners.

A second and equally damaging result of "too-big-to-fail" is the rise in regulatory burden, an examiner one-size-fits-all approach that stifles our efforts to provide solutions that meet member needs and help grow local economies.

So what lessons can be learned from Kansas credit unions? First, structure matters. The biggest difference between the Wall Street business model and the credit union business model is the member ownership component. When the institution is owned by the customer, there is a mutual responsibility to act in the best interest of each party. The large degree of separation from decision maker to end user seen in large financial firms encourages an internal profit focus and excessive risk-taking.

Second, business practices matter. Credit unions have solid underwriting processes, hold most of their loans on their books, and their loan decisions rely on character and capacity to repay, not just collateral or a credit score.

Third, people matter. Credit unions focus on member needs, not greed, offering solutions such as restructuring loans, deferring payments, and providing financial education and counseling.

In summary, credit unions are a small portion of the overall marketplace. In Kansas, it is only 6 percent. They have a strong role to play in financial services as a solid alternative to for-profit banking. Even though credit unions did not cause the problem, they face steep compliance costs as part of the clean-up. We urge Congress to recognize the enormous challenges these regulatory changes present to small and mid-sized institutions. We also urge Congress to allow flexibility and to increase options for credit unions to serve their members, such as passing legislation to increase the statutory credit union member business lending cap.

The credit union mission of putting people before profits has been good for Kansas. Please help us to continue to deliver on that mission. On behalf of Kansas credit unions and their member owners, I thank you for inviting us to testify.

[The prepared statement of Ms. Marsh can be found on page 79 of the appendix.]

Chairman MOORE OF KANSAS. Thank you.

The Chair next recognizes Mr. Beverlin for 5 minutes, sir.

STATEMENT OF JOHN D. BEVERLIN, Sr., PRESIDENT AND CHIEF EXECUTIVE OFFICER, MAINSTREET CREDIT UNION

Mr. BEVERLIN. Chairman Moore, and members of the subcommittee, I am John Beverlin, president and CEO of Mainstreet Credit Union, formerly the Credit Union of Johnson County, a $260 million cooperative serving over 52,000 members. We were chartered in 1953 by a group of school teachers who wanted to control their own financial destiny. We currently have branches in Johnson County, Lawrence, Leavenworth, and Kansas City, Missouri. We serve employees of the community college where this meeting is being held, employees of the Shawnee Mission Medical Center and the Honeywell plant in Olathe, and over 100 employee groups.

Mainstreet has had employee groups that have faced employment uncertainty and layoffs. This continues today. I share this information so that you understand the diverse group we serve. In 2009, Mainstreet was making adjustments to our operations to better survive the economic downturn. We faced assessments from NCUA for the year 2009 of over $627,000, over a third of our anticipated net income for the year. We did, nevertheless, record a positive bottom line for 2009 and remained very well capitalized.

We continue to review expenses. We froze management salaries, reduced the amount of employee raises, and cut contributions to employee retirement.

Some good things did happen in 2009, loans grew as a result of larger lenders exiting the lending market. Auto loans issued increased over 195 percent, mortgage loans over 75 percent. In the end, we survived 2009. A good part of it has to do with Mainstreet's conservative approach to business, including a diversified loan portfolio, avoiding concentrations in any one area.

Another part of it has to do with the nature of a credit union. As a financial cooperative, a member is an owner of their credit union. We get to know our member owners and will work with members when they are faced with financial difficulty.

So far, we have faced continuing challenges in 2010. We have had an assessment of $295,000 from NCUA with an additional of up to $400,000 expected. Mortgage lending continues to be on the increase; however, auto loans are down. Large national auto lenders have re-entered the market utilizing subsidized rates as low as zero percent. To date, we have not laid off any employees and have refrained from increasing fees to our members.

We continue to review expenses looking for ways to lend money, our main source of income and ways to better serve our members. We anticipate additional premiums for several years to come from NCUA. NCUA assessments aside, these are things we do every year. What was unique for this past year and will pose additional concerns for us in the future are legislative and regulatory burdens. It seems to me that the mere presence of this subcommittee and the topic of today's discussion, that there is agreement that Midwest banks and credit unions did not cause the financial crisis we are dealing with. Yet all financial institutions seem to be grouped together when any attempt is made to look for solutions to the crisis.

This past year, Mainstreet has had to deal with credit card legislation, spend almost $50,000 educating our members because of imposed regulatory changes to overdraft protection, and the recent passing of an amendment on debit/credit card interchange will result in additional lost income.

We are concerned with where it will all stop. The impact of these regulatory changes will ultimately fall on the shoulders of our members and Kansas consumers.

One area where I think credit unions can help is in the area of business lending to members. Mainstreet does not currently do business lending by definition of regulation. An arbitrary business lending cap of 12.25 percent of assets was legislated in 1998 and it is hard to justify putting the needed resources in place with a cap at the current level. Legislation has been imposed that would increase this cap to 27.5 percent of assets. An alternative, it would seem to me, would be let our regulator determine the cap. The regulator is in a better position, while examining a credit union for risk, to determine the cap.

Mainstreet will survive and continue to serve our members. We are anticipating continued pressure on our bottom line, reducing our net income for the next 3 to 5 years. It is important to note that as a not-for-profit cooperative, we are not after net income just for its own sake. Retained earnings are our only source of capital.

In conclusion, Mr. Chairman, I appreciate the subcommittee taking the time to explore these important issues. And thank you for inviting us to testify.

[The prepared statement of Mr. Beverlin can be found on page 40 of the appendix.]

Chairman MOORE OF KANSAS. Thank you, Mr. Beverlin. And I thank the panelists for their testimony. I am going to start with questions.

Mr. Hoenig testified that community banks will survive the crisis and recession and will continue to play their role as the economy recovers. The more lasting threat to their survival, though, concerns whether this model will continue to be placed at a competitive disadvantage to larger banks. I would like to ask each of the panelists if you would care to comment, and please keep your responses kind of short so everybody will have a chance to comment. Do you believe that is a concern? I would like to hear your opinion, please.

Mr. STONES. Absolutely, we think that is a concern. Thank you for the question. We think that in the long run, the regulatory burden placed on all banks by this law and laws in the past have placed an undue burden, a more heavily concentrated burden, on community banks. They just simply do not have the resources to hire new people, to do whatever it takes to comply, to try to comply with the new laws and regulations.

Chairman MOORE OF KANSAS. Thank you, sir. Mr. Herndon?

Mr. HERNDON. I would concur. Our bank has 26 people who work for it. Other banks have departments of 260 people to absorb that. So it is absolutely tilted—we need to level the playing field.

Chairman MOORE OF KANSAS. Thank you, sir. Mr. Kemper, Mariner Kemper?

Mr. MARINER KEMPER. There are a couple of areas I think to focus on. One is just the pure compliance costs of living with the new bill. I think we will all be finding out what that is over the coming years, there are what, 2,000 pages of it. There is a tremendous amount of that we do not know what it looks like yet, it is going to cost the industry a great deal and the smaller banks obviously have a harder time shouldering that burden.

Additionally, I still have a hard time bringing together the intended purpose of Dodd-Frank to end or affect the crisis, in a lot of the things that have ended up in there like the Durbin bill and things like that, that have really nothing to do with the crisis and will cost us. I think that is really where the greatest fear for the industry is, is the fee income that will disappear over the next few years.

Mr. JONATHAN KEMPER. Without question, the Dodd-Frank bill disadvantages community banks and it is going to add to their cost and restrict their activities. I think this is a very valid concern and should be looked into, especially as it affects the Midwest.

Chairman MOORE OF KANSAS. Ms. Marsh?

Ms. MARSH. I think the complexity of the Dodd-Frank bill leaves us all kind of wondering exactly what is going to affect each of us. It is very complex, 200 new rules, and we know at least 35 affect credit unions at this time. Debit interchange is a major cost for our credit unions and the Fed sitting on identifying what those tier levels will be is very important for us. The Consumer Protection Agency and who heads that is going to be very important out of that bill. Mortgage lending and disclosures and then payments and settlements are also contained in there, and that will have a direct impact on us too.

Chairman MOORE OF KANSAS. Thank you. Mr. Beverlin?

Mr. BEVERLIN. I think overall the credit unions' concern has always been that because of our size, we sometimes are forgotten. And the impact that regulation has on us is not, a lot of times, looked at. I know Mainstreet, for the very first time 2 months ago, we now have a full time VP of Risk Management or Regulation and Compliance. A lot of small credit unions cannot afford to do that. So they rely on other sources and sometimes, it is the manager of that credit union who has to fill that need and it takes him away from doing other things and helping his members.

Chairman MOORE OF KANSAS. Thank you.

I talked to Mr. Hoenig about this and would like to ask your reaction, if you have reaction to this. Despite the painful recession, according to today's New York Times, the popular belief is that as housing prices rebound, they will continue to go up forever. The article cites a recent survey by Case-Shiller where many people said they still believe prices would rise about 10 percent a year for the next decade. Yale economist Bob Shiller was quoted, saying, "People think it's a law of nature." Should people have new expectations for the housing market for the next generation? Mr. Mariner Kemper, do you have any thoughts about that?

Mr. MARINER KEMPER. I absolutely concur with Mr. Hoenig. What goes up must come down. We have had 36 some-odd recessions since the mid-1850's, most caused by a real estate crisis. That is the only fact out of this whole thing is we will see it again.

Chairman MOORE OF KANSAS. Mr. Jonathan Kemper?

Mr. JONATHAN KEMPER. Housing is one of the most important industries as well as important feature in America. And we would like to be supportive of responsible resurgence of housing, but as you say, there is an unrealistic—as Tom said, there is an unrealistic expectation that it is going to recover and bounce back. I think the new normal is going to be related much more to the value of housing relative to income. It got way out of whack and as Tom said, we had several years' supply that created a damping effect. As that is worked off, I think the valuation of housing will be much more reflective of the income available to support it and with the increases in energy prices and changes in living, we are going to have to look at our housing stock that is fit more for what our Nation's needs are.

Chairman MOORE OF KANSAS. Thank you. My time has expired, and I would ask the other panelists if you have some comment you would like to make, if you would submit those please in writing, I would appreciate that very much.

The Chair next recognizes Representative Jenkins for 5 minutes.

Ms. JENKINS. Thank you, Mr. Chairman, and thank you all for your words this morning.

I will start with Mr. Stones. Your written testimony indicates that a majority of traditional community banks in Kansas serve towns of fewer than 5,000 citizens and operate with just a few employees. Given that regulatory costs already represent more than 25 percent of the operating budgets of these community banks, can you just summarize again for us how the Dodd-Frank bill will add to these banks' operating costs?

Mr. STONES. As I think Mr. Mariner Kemper mentioned, there are over 240 new regulations that will come out of the Dodd-Frank bill. It is estimated based on historical legislation to regulation that there is going to be in excess of 5,000 to 10,000 new pages of regulation that banks are going to have to comply with. Obviously, it would be speculation on my part to say how much additional cost that would be, but obviously with those kinds of numbers, the amount will be significant. KBA employs four full-time attorneys whose job is to answer compliance questions for our members. They answer—currently in the past few years, they answer somewhere around 5,000 inquiries per year. That is starting to exponentially increase. Most of those are obviously from community banks, but some of the larger banks in our State like to just kind of ask questions of other attorneys to kind of make sure they are thinking along the same lines, but we are trying the best we can to help our smaller banks comply with all the laws and get ready for the new Dodd-Frank legislation.

Thank you.

Ms. JENKINS. Okay, thank you.

Moving right down the table, I guess I will address this one to Mr. Herndon, but certainly if anybody has anything to add, please do. You mentioned in your written testimony that many bankers and directors of small to medium-sized financial institutions in the Midwest feel that they are needlessly under attack and many feel that they are being punished for the actions for which they never took and that government and regulators are choosing winners and losers and it seems that small and mid-sized banks are the losers.

What can Washington do or could we have done differently to treat traditional community banks better and what can we do in the future to ensure that this very reliable sector of banking is not the recipient of further unintended consequences?

Mr. HERNDON. It seems that every time that we mention that—we being small and medium-sized banks throughout the country—did not participate in the events that led to the crisis, that the response was, "Yes, we know, you were not part of the problem." In fact, the legislation has directed the cure to those that were not part of the problem. We did not participate in those new and exotic financial instruments, most of them, and probably those that did create them do not understand the consequences.

So, despite the fact that we were doing our jobs serving our communities, serving our customers, the new regulations are going to have a tremendous adverse unintended consequence on the banks of my size, in my opinion. We cannot absorb the cost of compliance; the burden is just too great to stay in business. So I think that had the direction been to those that were responsible instead of the easy target that we turned out to be, it would have been more effective.

Ms. JENKINS. Okay, thank you.

Mariner, I think you mentioned in your testimony that your bank has expanded further into the financial services sector in order to hedge and diversify your profit centers. How will the enactment of the financial regulatory reform bill affect the way you and other banks do business?

Mr. MARINER KEMPER. For the most part, our furthering of our diversity actually stabilizes that. It helps minimize the impact of the bill because most of our diversity comes from non-consumer oriented business lines. Most of the pain in the bill is directed at the products and services that we provide for consumers as an industry and our diversity actually moves us away from that. So as a particular institution, our diversity helps us.

I guess my greatest concern is that the bill has moved away from what its intended purpose was, and that was to address excess in the system and "too-big-to-fail." The "too-big-to-fail" has many loopholes in it still. I think that would be something I would have you focus on, as to how you tighten—as Mr. Hoenig mentioned, it is going to be awfully hard to see what can happen over a weekend. So I think we focus on the "too-big-to-fail" issue and then as it relates to the excess, bringing in the unregulated is great, but there are too many things in that bill that have absolutely nothing to do with the problems that came about. And I would ask that we try to minimize the impact of those things and focus on the crisis oriented issues.

Ms. JENKINS. Thank you, I yield back.

Chairman MOORE OF KANSAS. I thank the gentlelady. The Chair next recognizes Congressman Cleaver for 5 minutes, sir.

Mr. CLEAVER. Thank you, Mr. Chairman.

Let me thank all of you for giving this kind of time to us today, and your testimony has been much appreciated.

Mr. Stones, in your testimony, I agree with almost all of your comments, with a slight disagreement that the most misused word in the English language for the last 18 months is "banks." I agree we misuse it. I think the most misused word for the last 18 months and the last 18 centuries is "love."

[laughter]

Mr. STONES. I defer to that, thank you.

Mr. CLEAVER. But my concern centers on your comments on page 2 and they relate to the Community Reinvestment Act. The Community Reinvestment Act was approved long before any of us were here. In fact, I think most of us were just getting out of school when it was passed, but it was enacted because there was a severe shortage of credit in low- to moderate-income communities. And during this financial meltdown—actually before, from time to time, we have people who say, as did you, that CRA was somehow connected to the financial collapse.

All the evidence points to the contrary. In fact, I debated this issue on the Floor for 1 hour, and it is one of those things that just continues to roll in spite of the evidence. The Federal Reserve conducted a study which showed that only 6 percent of the mortgages that were made just prior to the collapse were made in CRA assessment areas.

The language in the bill, and I am paraphrasing it, I did not know I would end up talking about it, but the language in the bill says something like "and loans should be made with the highest possible prudence" and so forth. In hearing after hearing after hearing, we have asked experts, we have asked Treasury Secretaries, FDIC Chairs, economists who appear before our committee, and we have never had anyone from the expert community say that CRA contributed. But it is still one of those things that floats around out here and is said repeatedly.

So I am just curious about your comment.

Mr. STONES. Thank you, Representative Cleaver. I guess my comment is meant to talk about a broader issue. I agree with you, I am not convinced that Community Reinvestment Act loans in and of themselves were a large contributing factor to the crisis. The point I was trying to make was that there were laws and regulations put in place, like the Community Reinvestment Act, that took over the free market system, in that loans were made—and again, not necessarily created the crisis—but loans were made, and just one example was the CRA.

Loans were made that would not necessarily have been made otherwise, that loans were made in order to comply, to make sure your bank complies with CRA and, as you said, low- to moderate-income areas, that those individuals might not qualify for a loan. Now if you take that out into California and Florida and Arizona, and I agree these were not CRA loans that were involved in the crisis necessarily, but they were the same kind of loan that were talked about by the theory and the wont of Administration—and the Bush Administration was part of this also—was that homeownership is the American dream and that every person should have the ability to own a home. That just is not going to happen in a real free market system. I saw evidence and stories about people making $100,000 in California who were purchasing $800,000 and $1 million dollar houses that in Kansas, there is not a bank in Kansas that would have made that loan. Yet, these were loans that were being made, piling subprime loans on top of each other to these consumers who had no business having those kinds of loans. And they were being told—and this goes to Chairman Moore's question to Ton Hoenig—they were told that asset value of that collateral would continue to grow and that even when they decided to sell, if they could no longer make those payments, that the value of that home would be high enough that they could sell the home, pay off the loan and still come away with some value in their property. When the bubble collapsed, that just went away.

And so the general philosophical economic point I was trying to make is there were policies put into place that in a totally free—

that allowed loans to be made that would not have been made in a totally free market system.

Mr. CLEAVER. I would agree, everyone should not own a home. I think that was a big mistake. I have a cousin, Herman, Junior, and I would not sell him a $200,000 home for $200. So I agree.

I guess my deep concern is that it has leached into the community that somehow poor people being addressed in CRA caused the collapse, and so I understand what you are saying. You are saying that in general, pushing toward giving everybody a home loan, helped. But I am just—I have been pushing back against this, along with other members of our committee and the Fed Chairman and everybody else, because the Community Reinvestment Act has contributed to this issue.

And I yield back no time.

[laughter]

Chairman MOORE OF KANSAS. I have one more question. The other panelists up here may have another question as well, the other members of our committee.

I appreciate the concern about new rules from the Dodd-Frank Act, and one number used is that there are 250 new rules from it. Many of these rules relate to derivatives, securities and insurance regulation. Many only apply to the very biggest financial firms in the United States.

Mr. Stones, most banks in Kansas are not engaged in derivatives or securities transactions; is that correct? So those rules would not apply to the smaller banks. Is that also correct, sir?

Mr. STONES. I think the rules on derivatives are one of the big question marks in the bill. I think you are correct that the majority of banks in Kansas do not deal in the kinds of derivatives that were addressed in the law. However—and I am basing this on another Wall Street Journal article which talked about the agricultural community that does deal in the kinds of derivatives that possibly could be affected. And those, while they are not affected directly within the bank, are going to affect our agricultural customers in their ability to address the risk within their crops.

Chairman MOORE OF KANSAS. Thank you. Ms. Jenkins, do you have any questions?

Ms. JENKINS. Thank you, Mr. Chairman. If I could maybe just ask one more at this end of the table.

Ms. Marsh, you expressed concern in your written testimony that a one-size-fits-all view towards regulation stifles our efforts to do what we do best, which is to provide solutions to meet the financial needs of our members and to help grow economies.

I happen to share that concern and, in fact, that was one of the many reasons that I did oppose the financial reform bill when it was before the House. But I would like to know, and I am just curious, is it your belief that this Dodd-Frank bill is guilty of imposing a one-size-fits-all view towards credit unions and could perhaps provide a competitive advantage to the larger institutions? And then, Mr. Beverlin, if you would like to comment on that as well, then I would yield back. Thank you.

Ms. MARSH. I think that the devil is in the details and it will depend upon the regulations that are promulgated out of the law itself. It has all indications that we will have some negative impact, but until we see the actual regulations—right now, the Credit Union National Association, our national trade association, is saying that although there are over 200 sections of the law that could impact financial institutions, just as Chairman Moore said, some of them are dealing with large institution issues like derivatives. We estimate that it is more in the 30s to 40s that will be actually directly impacting our credit unions.

But there are also auxiliary issues that come out of this and that is, right now, you being a CPA in a former life know that they are looking at mark-to-market of loans. Of course, we were also having the impact of the OTTI for us. And so things that start out simple in the law have a tendency to balloon and even though we really do not need to have mark-to-market on our loans, I think that will be something that will be extended out on this. And the same thing will happen on other parts of the Dodd-Frank.

Mr. BEVERLIN. Just this morning, before heading over to this hearing, KCUA did put out an email that they feel that there are, as Marla said, about 35 areas that could affect credit unions. But it really does come down to what regulation ends up being written to impose those 35. And again, our fear is that we are such a small part of the market, that we will not be heard, we will not be looked at and how it might affect us versus larger financial institutions.

Chairman MOORE OF KANSAS. Thank you.

The Chair next recognizes Representative Cleaver for 5 minutes.

Mr. CLEAVER. I do think that we have to be vigilant now. I think most people—you obviously know the difference but most people believe that when we pass legislation, that is it. We pass a broad overview of the legislation and then these various regulators will put all of the rules together. And I think we have to be vigilant during that process.

But I love to brag about UMB and Commerce in front of our committee and in Washington. It is a great story, I think. One of the responses that I have gotten from some of my colleagues is that the Midwest is simply more conservative and some of the residue from the Great Depression seems to linger around in the Midwest and so the truth of the matter is, they did nothing special, they just practiced the same conservatism and that in fact prevented them from experiencing a problem.

Do you think that it was just the conservative nature of banks in the Midwest that enabled you to have such a good record? And if that is the case, how do we export it?

Either or both of you?

Mr. MARINER KEMPER. I will take a stab at it.

First of all, I guess if conservative is a bad word, shame on me. I think that I look at it as sound business practices and, if not participating in subprime is somehow conservative, then I guess we are conservative. And if knowing that asset values go up and down is conservative, then we are conservative. Selling products we understand, if that is conservative, we are conservative. It is just sound business, I guess, and if that is Midwestern or conservative, then I guess that is what we are.

Mr. JONATHAN KEMPER. That is a good question. I think you should just go back to them and tell them that we are the heartland of America and they should not criticize us because they are criticizing what we are all about. Our basic business model is customer oriented, community-oriented banking. And as Mariner said, we handle the money as if it were our own. It is backed by our own capital. We do not get involved in things we do not understand and we stress long-term relationships. That may be conservative, but it also happens to be best for our shareholders and best for our customers and best for the communities we serve and we are going to make no apologies for it.

Mr. CLEAVER. I am a non-conservative, and I appreciate and celebrate your conservative nature, and I think it has made not only the State and this community look good, but I think we have some valuable lessons for the rest of the country.

Thank you, Mr. Chairman.

Chairman MOORE OF KANSAS. Thanks to our panel and thanks to our members who appeared here today for this hearing.

I ask unanimous consent that the following documents be made part of the hearing record: a letter from the National Association of Federal Credit Unions; a letter from Dennis McKinney, the Treasurer for the State of Kansas, who will be testifying at our hearing tomorrow at the Dole Institute in Lawrence on the topic of financial literacy; and a two-page document my office put together on a list of provisions where community banks, credit unions, and small businesses were shielded from excessive regulation in the Dodd-Frank Act.

Without objection, these documents will be made a part of the record.

Again, I would like to thank our first and second panel of witnesses for your testimony today. I know my colleagues and I will take what we learned from today's hearing back to Washington with us and share it with our colleagues.

I also want to thank Johnson County Community College for being such an excellent host for us today.

I will also want to invite everyone here to attend a second field hearing we are doing in Kansas this week, and that will be on the topic of financial literacy. The hearing is open to the public and will begin at 10 a.m. tomorrow at the Dole Institute in Lawrence, Kansas.

Finally, the Chair notes that some members may have additional questions for our witnesses which they may wish to submit in writing. Without objection, the hearing record will be kept open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

This hearing is adjourned, and again, I thank all of our panel members and I thank our colleagues up here. Thank you all.

[Whereupon, at 10:50 a.m., the hearing was adjourned.]

A P P E N D I X

August 23, 2010

Opening Statement of Chairman Dennis Moore
"Too Big Has Failed: Learning from Midwest Banks and Credit Unions"
House Financial Services Subcommittee on Oversight and Investigations
Field Hearing | Overland Park, Kansas | Monday, August 23, 2010

Our economy continues to slowly recover following the worst financial crisis and recession since the Great Depression. While there were a number of contributing factors that caused the financial crisis, one of the lessons we've learned is that "too big to fail" financial firms can cause a lot of damage if not appropriately supervised.

And who paid the price for these mistakes? Unfortunately, it was not those "too big to fail" firms on Wall Street but rather our constituents and businesses here in Kansas and across the country. American households lost about $14 trillion in net worth over the course of two years. Retirement accounts saw over 20 percent decline in value, forcing many Americans to delay their retirement. Millions of Americans lost their homes through foreclosure. Bernie Madoff's Ponzi scheme defrauded $65 billion from investors.

And the government was forced to respond to prevent further damage. Congress approved, and even though it was deeply unpopular, I voted for the $700 billion TARP proposal. I did so not because I wanted to, but because it was the right thing to do for our people and our country. In fact, while there continue to be misperceptions about it, economist Mark Zandi, an advisor to Republican John McCain in the last presidential election, has recently done some analysis and found that without TARP, the Recovery Act and other measures, we would have seen the unemployment number double with 8.5 million fewer jobs, and that's on top of the more than 8 million we've already lost.

But given the economic damage we did suffer, it's not surprising that many Americans have lost their faith in our financial system. As Mr. Hoenig has put it, "too big has failed" and we need our financial institutions, big and small, to get back to the fundamental business of banking and financial intermediation. And while not perfect, I believe that the types of smaller and medium-sized banks and credit unions we will hear from today and others here in the Midwest should be held up as an example of how the post-crisis financial system should look like. Financial firms should know who their customers are and perform proper due diligence before making a loan.

To help restore Americans faith in our financial system, I worked hard as both a senior member of the House Financial Services Committee and as a House conferee to improve and perfect the financial regulatory reform measure. Part of this work included defending smaller banks, credit unions and small businesses that did nothing to create the financial crisis.

For example, I worked with my colleagues to provide a full grandfather of existing trust-preferred securities for all banks with less than $15 billion. I pushed to fully preserve the thrift charter, making the case that while the ineffective Office of Thrift Supervision should be eliminated, the business model which many Kansas thrifts acted responsibly with should not be eliminated. And I offered the amendment to exempt all banks and credit unions with fewer than $10 billion in assets from the new Consumer Financial Protection Bureau's enforcement powers. Many forget, but a new consumer financial protection agency was not only called for by the Obama Administration, but by former Treasury Secretary Hank Paulson as well.

The Dodd-Frank Act includes other new powers to regulate "too big to fail" financial firms and provides regulators with a new liquidation tool that will ensure we end "too big to fail" bailouts, and we shut down any financial firm – big and small – that fails. As the bill was being signed into law, the headlines from the *Wall Street Journal* were "Big Win for Small Banks" and "Small Banks Avoid Overhaul's Sting".

That said, I understand that with any new set of rules comes unfamiliarity. Something I hope to see as the new rules are implemented is not an endless stream of additional disclosure forms that are difficult for small firms to comply with and only serve to confuse consumers. We created the Consumer Bureau to streamline and simplify these financial forms and documents so that consumers know what they are signing up for, and as a result, will be much easier for small community banks and credit unions to comply with.

It is time to move forward with a stronger financial system, and I look forward to hearing from today's witnesses on what lessons we can and should learn from responsible banks and credit unions we are fortunate to have in the Midwest.

Testimony of John D. Beverlin, Sr.

President/CEO of Mainstreet Credit Union

Before the

Subcommittee on Oversight and Investigations

Of the

Committee on Financial Services

United States House of Representatives Field Hearing

August 23, 2010

Chairman Moore, Ranking Member Biggert and members of the subcommittee, I am John Beverlin, President and CEO of Mainstreet Credit Union. I am also on the Board of the Kansas Credit Union Association. I am here today to share information on how Mainstreet Credit Union has fared during these tough economic times and to express my thoughts on what we face in the future.

Mainstreet Credit Union, formerly the Credit Union of Johnson County, is a $260 million cooperative serving over 52,000 members in the greater Kansas City Area. We were chartered in 1953 by a group of school teachers who wanted to control their own financial destiny. We served just Johnson County, Kansas with four full service branches until five years ago. In the last two years we have merged with three smaller credit unions adding branches in Lawrence, Leavenworth, and on the campus of the Midwestern Baptist Theological Seminary in Kansas City. We serve employees of the Community College, where this meeting is being held, operating a satellite branch in the Student Center. We also serve the employees of Shawnee Mission Medical Center and the Honeywell plant in Olathe, as well as, one hundred employee groups. I share this information so that you understand the diverse group we serve.

While the Kansas City area has fared better than some areas of the country, Mainstreet Credit Union has had employee groups that have faced employment uncertainty or layoffs. This continues today.

In 2009, Mainstreet, like other credit unions, was making adjustments to our operations to better survive the economic downturn. Issues beyond our control soon took over. Early in 2009 NCUA placed US Central Federal Credit Union into conservatorship despite the fact that the overwhelming majority of US Central's investments held investment grade ratings at the start of the crisis. The conservatorship caused assessments or write downs to Mainstreet Credit Union for the year 2009, of over $627 thousand, over a third of our anticipated net income for the year. We did nevertheless record a positive bottom line for the year and we remain very well capitalized, but this issue resulted in Mainstreet having to look for further adjustments to our operations. We reviewed expenses, froze management salaries, reduced the amount of raises to other employees, cut contributions to employee retirements and looked for other ways of cutting.

Some good things happened in 2009. Loans grew. It was not because more members felt confident in their future, it was a result of larger lenders exiting the lending market. We issued over 2180 auto loans for over $30 million for the year 2009. This was a 195% increase. We also issued over 336 mortgages for over $46 million, a 75% increase. While these may not be impressive numbers to some financial institutions, these are impressive numbers for us.

In the end we survived 2009. How do I think we survived? I think a good part of it has to do with Mainstreet's conservative approach to business. Mainstreet's conservative approach comes as a result of having a board of directors made of primarily educators, about as conservative a group as you can get. Mainstreet also maintains a diversified loan portfolio, avoiding concentrations in any one area. Another part of it has to do with the nature of a credit union. As a financial cooperative, a member is an owner of their credit union. And we know our member/owners. We work with members when they are faced with financial difficulty. I have attached examples of how we worked with a couple of our members when no one else would.

So far we have faced continuing challenges in 2010. We have had an assessment of $295 thousand for corporate stabilization so far in 2010 from NCUA with an additional premium for 2010 of up to $400 thousand expected.

Mortgage lending continues to be on an increase for Mainstreet so far in 2010, closing $24 million year to date. However, auto loans are down. Large national auto lenders, including GMAC and Ford Motor Credit, have re-entered the market utilizing subsidized rates as low as 0%. Local lenders such as Mainstreet cannot compete with these rates.

We continue to review expenses for further cuts. To date we have not laid off any employees and have refrained from increasing fees to our members.

We anticipate additional premiums for several years to come while NCUA continues to determine what to do with investments from US Central and the possibility of additional losses to the insurance fund.

We also continue to review expenses for areas to cut, look for ways to lend money, our main source of income, and ways to better serve our members. NCUSIF assessment aside, these are things we do every year. What was unique for us this past year and what will pose additional concerns for us in the future are legislative and regulatory burdens. It seems to me that the mere presence of this subcommittee and the topic of today's discussion, that there is agreement that Midwest banks and credit unions did not cause the financial crisis we are all dealing with. Yet, we all seem to be grouped together when any attempt is made to look for solutions to the crisis.

- This past year Mainstreet Credit Union has had to deal with legislated changes to our credit card portfolio.
- While not one of the abuser's of fees on over draft protection, we spent almost $50,000, educating our members because of the imposed regulatory change.
- The recent passing of financial reform legislation with an amendment on debit/credit card interchange will result in additional lost revenue.

We are concerned with where it will all stop. Any additional legislation or regulation will result in additional financial burden and more manpower to implement.

One area where I think credit unions can help in the future is the area of business lending to members. Mainstreet Credit Union does not currently do business lending per se. We have done loans to members who may need a truck because they have a plumbing business as a second job. Or we have loaned money to the contract postal carrier for a right hand drive vehicle. These loans were all under $50,000 each and fall under the floor for being considered a business loan.

An arbitrary business lending cap of 12.25% of assets was legislated in 1998 as part of the field of membership legislation. Mainstreet Credit Union has not been willing to make the financial investment in hiring qualified personnel and purchasing the necessary software or equipment with the existing cap in place. It is hard to justify putting everything needed in place with the cap at the current level. It would seem to me the most qualified group to determine what an individual credit union should have outstanding in business loans would be our regulator. A regulator is in a better position, while examining a credit union for risk, to determine an appropriate cap. An appropriate cap for Mainstreet may not be the same cap for XYZ credit union.

Mainstreet Credit Union will survive and continue to serve our members. We are anticipating continued pressure on our bottom line for the next three to five years. But at what cost and to whom? The impact of these regulatory changes will ultimately fall on the shoulders of our members and Kansas consumers. (It is important to note that as a not-for-profit cooperative, we are not after net income just for its own sake. Retained earnings are our only source of capital, and we need to maintain our capital to protect our members and the share insurance fund.)

In conclusion, Mr. Chairman, I appreciate the subcommittee taking the time to explore these important issues. If I can offer any other input from a credit union perspective please let me know. Thank you for inviting me to testify.

Mainstreet Credit Union Helps Olathe Resident When Another Financial Institution Turns Him Away

Things were looking bleak for one Mainstreet Credit Union family. Job losses combined with unexpected medical expenses led to past-due mortgage payments – both on a first mortgage with a regional financial institution and a second mortgage with Mainstreet. When their first mortgage holder gave them the choice of paying up or being foreclosed upon, they turned to Mainstreet CU and found a solution.

Mainstreet brought the mortgage in-house, and consolidated it into a single home loan, with affordable payments and flexible terms. As a result, the family lowered its outflow by $330. The credit union went further by allowing the family to skip a payment and erasing the past-due notice.

"Rather than taking the easy or normal route of foreclosure, we wanted to work with this member, to help them take charge and get back on their feet," said Lenexa Branch Manager Ken Armstrong. "As they were 19-year members, we wanted to keep that relationship intact. With our support, they are making current payments again."

-----Original Message-----
From: XXXXXXXXXXXXXXXX
Sent: Wednesday, August 04, 2010 4:34 PM
To: Pollie XXXXXXX
Subject: Scott XXXXXXXX

To: Polly XXXXXXX

Ms. XXXXXX,

I wanted to express my appreciation for the professionalism and concern that Scott XXXXX has taken with me and my family concerning my mortgage. I have been struggling for the past year to get this loan current but have never been completely sucessful. Past Real Estate Managers that I've delt with have been threatning and cold. They would take nothing less than double payments with no other work around. All that they would give me were accusations or given me a lecture of how bad it is to be late on mortgage payments. I knew my situation very well and that type of attitude from a banker made me shy away from talking with them or ever wanting to do future business with them.

Scott has been great the whole time. He has never "brow beat" me. He gave me options like partial payments above my normal payment. He explored relief under a federal program. He explored restructuring the mortgage with Fanne Mae. He offered the ability to take out a second mortgage when I thought that my credit was so messed up that this wasn't even an option.

Long story short, Scott XXXXXX worked with me to find a solution, and we did. I will do my very best to never get in a situation like I was before. And because of Scott, I will be a good and reliable customer for Mainstreet Credit Union for a long time to come.

Sincerely,

XXXXX XXXXXXX

TESTIMONY OF

DAVID L. HERNDON

PRESIDENT and CHIEF EXECUTIVE OFFICER
FIRST STATE BANK of KANSAS CITY, KANSAS

On behalf of

FIRST STATE BANK OF KANSAS CITY KANSAS

and

THE KANSAS BANKERS ASSOCIATION

on

"TOO BIG HAS FAILED: LEARNING FROM MIDWEST BANKS AND CREDIT UNIONS"

Before the

THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

August 23, 2010, 9:30 AM

Capitol Federal Conference Center at the Johnson County Community College's Regnier Center, Overland Park, Kansas

Good morning, Congressman Moore, Congresswoman Jenkins, Congressman Cleaver and distinguished guests of the Subcommittee. My name is David Herndon. I am the President and Chief Executive Officer of the First State Bank of Kansas City, Kansas. In addition, I am the Immediate Past Chairman of the Kansas Bankers Association (KBA), our state trade association. I currently chair the KBA's Federal Affairs Committee and serve on the Government Relations Committee of the American Bankers Association. These two Committees develop their respective associations' policy on all federal and regulatory issues. It is my pleasure to testify before you today on behalf of my bank as well as Kansas banks.

First State Bank celebrated its 109th anniversary July 1, 2010. A special uniqueness is that our bank was founded and remains headquartered in Kansas City, Kansas. It has always been privately and locally owned. I have been associated with the Bank since 1978 and have served as its President / CEO since 1990.

Based on asset size, First State Bank is one of the smallest banks in the Kansas City metropolitan area. Yet, it offers a full menu of banking services and delivery sources directed to consumers and small businesses. Our trade area is all of greater Kansas City but most of our market is in southeast and south central Wyandotte County, Kansas northeast and north central Johnson County, Kansas and west central Jackson County, Missouri. This area includes a sizeable portion of the urban core in Kansas City, Kansas.

A significant number of the First State's business clients are manufacturing, transportation, warehousing, distribution and subcontracting businesses. Consumers served by the Bank have historically been employees of those business clients as well as low-to-moderate income, urban core residents.

First State Bank's business model reflects its clients' banking requirements. When depositors and borrowers are enjoying good economic times, so does First State. The challenge is for that same group to continue doing well when the economy is not good.

Throughout the 1990s and early 2000s, First State Bank lead its peers in nearly all measures of financial performance. Following twelve consecutive years of increasing net income and asset growth, profits suffered a decline, but remained positive after the September 11, 2001 terrorist attacks on the United States. The Bank worked with its business clients throughout this time to help them recover from the far-reaching economic shocks and business setbacks that were attributable to this event. But some of the Bank's clients did not survive and were unable to repay borrowings. The result was that the Bank boosted reserves and increased capital by retaining its earnings and intentionally stymied asset growth. Despite this adverse impact to earnings, First State was still able to produce profits, remain well-capitalized and in good regulatory standing.

Earnings rebounded in 2005 and returned to pre 9/11 levels in 2006 and 2007. Then 2008 ushered in this on-going financial crises that brought the United States economy to the brink of collapse. Lead stories in daily news reports claimed that banks were in dire straights and could only survive with the help of federal bailouts. Further, banks around the country curtailed their lending practices compounding the crises. Unfortunately, many of those reports were true.

But they weren't true at First State Bank and they weren't true at other Kansas banks.

First State Bank, like it has for 109 years, still makes loans to qualified borrowers, still offers professional banking services and strives to build the same strong relationships with clients. And those relationships allow us to adjust our business model and work with bank clients through these difficult times instead of abandoning them when they need us most. That adaptability allowed First State to survive the economic crises of the 1930s, the 1980s, and the post 9/11 economy just as it is allowing us to survive this one.

First State Bank has positioned itself to persevere just as the other institutions represented here today and institutions across Kansas and Missouri. To put it simply, we're healthy, we're profitable and remain cornerstones to our communities. But many bankers and directors of small to medium-sized financial institutions in the Midwest feel they are needlessly under attack. Too many feel they are being punished for actions for which they never took. We never participated in sub-prime lending activities and never relaxed our lending principles even when it was in vogue to do so.

Most borrowers are repaying their loans. Some aren't, but we're working diligently with those that are struggling. It usually takes a long time and a lot of work to rehabilitate a loan but too often that time is not granted. Banks should not have to write down or charge off legitimate loans to legitimate borrowers who are working through a financial crisis greater than any they've previously faced.

Additionally, the profits of small and medium-sized banks are being attacked. Recent legislative and regulatory actions have dramatically decreased income and increased operating expenses. Increased deposit insurance premiums, compliance costs and restricting interchange fees are examples. It appears to me and many of my banker friends the government and regulators have begun choosing winners and losers. If so, small and medium-sized banks will regrettably be the losers.

We are well equipped to meet the requirements of our clients, both depositors and borrowers. Liquidity at First State and throughout Kansas banks is, and has been significantly higher than our peers in several areas of the country. And most certainly higher than many of the non-regulated or lesser-regulated institutions that are mistakenly referred to by so many as "banks". We're profitable and have strong reserves. In fact we've aggressively added to our reserves since the economy turned protecting our depositors. Our capital is strong. First State has never been below the "well-capitalized" category as established by bank regulators and as First State's President / CEO I don't intend the Bank to ever be. The majority of bankers throughout this region have the same attitudes. Our clients have confidence in us and because they know we are their financial partners in their success. And, their success breeds our success.

That mutual success will prove to be the catalyst for the economic recovery. That success will create and restore jobs.

Bankers understand their job is to manage risk. One key component in risk management is diversification. Individually, it is doubtful any Midwest bank or credit union poses a systemic risk to financial stability in the United Sates. Collectively they might, especially if that collectivity is through their elimination.

Diverse small and medium-sized banks fill a very significant role in the U. S. economy. Their diversity spreads risk throughout the country's economy and absorbs the risk that larger more-complex institutions either can't or don't want to hold. Consequently, a system of fewer and larger banks and credit unions could create systemic risk where it doesn't now exist.

But a political risk of un-subsided legislative and regulatory burdens will have unintended adverse consequences. Too many small and medium-sized banks will be put out of business either by their own decisions or those by their regulators. For example, First State Bank employs 26. We know the recently passed Financial Reform legislation will create nearly 250 new regulations for these 26 people to read, comprehend, implement and then try to explain to clients. My concern is many small and medium-sized banks will decide the costs and risks of compliance are too great. Mergers and acquisitions will decrease the number of banks serving small and medium-sized communities or sections of larger metropolitan areas creating a void for small and medium-sized businesses. One unique characteristic of the business models and practices utilized by Midwest banks is the ability to adapt and be flexible. Bankers in small and medium-sized institutions don't operate their banks from a textbook or software program. They operate it by listening and reacting to the needs of their clients for the benefit of their clients.

They become and remain successful as a result. Only through preserving a diverse financial industry will we sustain economic recovery.

I can attest that Midwest bankers stand ready to work with regulators and members of Congress to make a recovery happen. I appreciate the opportunity to testify before you today and would welcome any questions.

Oral Statement of

Thomas M. Hoenig

President

Federal Reserve Bank of Kansas City

before the

Subcommittee on Oversight and Investigations

United States House of Representatives

Overland Park, Kan.
Aug. 23, 2010

Materials for the Oral Statement before the congressional
Subcommittee on Oversight and Investigations

Chairman Moore and members of the Committee, thank you for the opportunity to testify at this timely hearing on the future of community banks.

Over the past 20 years, as the banking industry has consolidated into fewer and larger banks, a perennial question has been, "Is the community bank model viable?" The short answer is, yes. The longer answer is, yes, if they are not put at a competitive disadvantage by policies which favor and subsidize the largest financial institutions. I have worked closely with community bankers my entire career, through good and bad economic times. I know their business model works.

There are more than 6,700 banks in the country, and all but 83 would be considered community banks based on a commonly used cutoff of $10 billion in assets. In the Tenth Federal Reserve District, we have about 1,100 banks, and all but 3 would be considered a community bank. A lower threshold of $250 million, which focuses on a far more homogeneous group, includes about 4,600 institutions or about two-thirds, of all banks. My submitted materials and remarks now are directed toward this group of banks, which serve Main Street in communities across the country.

Community banks are essential to the prosperity of the local and regional economies across the country. The maps I provided show that community banks have the majority of offices and deposits in almost a third of all counties nationwide. However, their presence and market share are most substantial among Midwestern states, where their role is particularly crucial in rural areas and smaller cities. It is the economies in these states that would suffer most significantly without their presence. Why?

Community banks have maintained a strong presence despite industry consolidation because their business model focuses on strong relationships with their customers and local communities. Community banks serve all facets of their local economy including consumers, small businesses, farmers, real estate developers, and energy producers. They know their customers and local markets well; they know that their success depends on the success of these local firms; and they recognize that they have to be more than a gatherer of funds if they hope to prosper. These factors are a powerful incentive to target their underwriting to meet specific local credit needs. And it gives their customers an advantage of knowing with whom they will work in both good and difficult economic times. Larger banks are important to a firm as they grow and need more complicated financing, but in this region, most businesses are relatively small and their needs can be met by that local bank.

It is said that a community with a local bank can better control its destiny. Local deposits provide funds for local loans. Community banks are often locally owned and managed – through several generations of family ownership. This vested interest in the success of their local communities is a powerful incentive to support local initiatives. It is the very "skin in the game" incentive that regulators are trying to reintroduce into the largest banks. It's the small community's version of "risking your own funds" that worked so well in the original investment banking model, and kept partners from making risky mistakes that would result in personal bankruptcy back then, and government intervention more recently.

There is no better test of the viability of the community bank business model than the financial crisis, recession, and abnormally slow recovery that we've experienced over the past 2½ years. The community bank business model has held up well when compared with the megabank model that had to be propped up with taxpayer funding. Community bank earnings last year were lower than desired but on par with those of larger banks. However, community banks generally had higher capital ratios that put them in a better position to weather future problems and support lending.

This is an important point to note as the decline in overall bank lending, particularly to small businesses, is a major concern. Data show that community banks have done a better job serving their local loan needs over the past year. Community banks, as a whole, increased their total loans by about 2 percent as compared to a 6 percent decline for larger banks. In addition, community banks have had either stronger loan growth or smaller declines across major loan categories. Business lending in particular stands out, with community bank loans dropping only 3 percent as compared with a 21 percent decline for larger banks.

Of course, some community banks made poor lending and investment decisions during the housing and real estate boom of the mid 2000s. Unlike the largest banks, community banks that fail will be closed or sold. For community banks that survive, it will be a struggle to recover. Commercial real estate, particularly land development loans, will be a drag on earnings for some quarters yet. Nevertheless, for those that recover, a business model that continues to focus on customer relationships will be a source of strength for local economies.

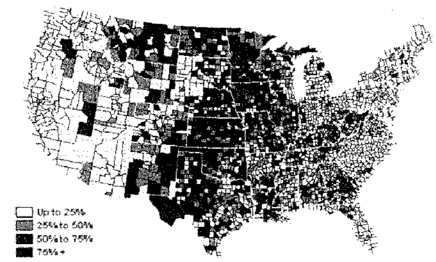
Thus, community banks will survive the crisis and recession and will continue to play their role as the economy recovers. The more lasting threat to their survival, however, concerns whether this model will continue to be placed at a competitive disadvantage to larger banks. Because the market perceived the largest banks as being too big to fail, they have had the advantage of running their business with a much greater level of leverage and a consistently lower cost of capital and debt. The advantage of their too-big-to-fail status was highlighted during the crisis, when the FDIC allowed unlimited insurance on non-interest-bearing checking accounts out of concern that businesses would move their deposits from the smaller to the largest banks. As outrageous as it seems, in many cases it is easier for larger banks to expand through acquisitions into smaller communities. This occurs because smaller banks tend to focus on their local markets and therefore often face significant antitrust restrictions to in-market mergers. This policy ignores the fact that the largest 20 banking organizations in the United States now control just less than 80% of the industry's total assets.

Going forward, the community bank model will face challenges. Factors such as higher regulatory compliance costs and changing technology will encourage community bank consolidation. And despite the provisions of the Dodd-Frank Act to end too big to fail, community banks will continue to face higher costs of capital and deposits until investors are convinced it has ended. But community banks have always faced such challenges. They have survived and prospered. If allowed to compete on a fair and level playing field, the community bank model is a winner.

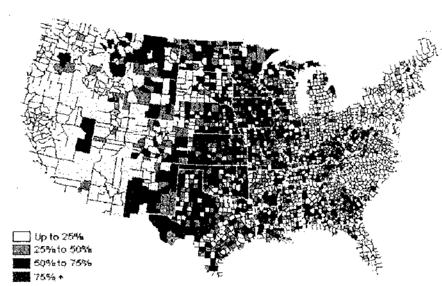
COMMUNITY BANK LENDING AUGUST 2010

Community Bank Market Share and Location

(Banks With Less Than $250 Million in Assets)



Percentage of Offices owned by Community Banks



Percentage of Deposits Held by Community Banks

- Community banks hold substantial market share, particularly in the Midwestern states.
- The top map illustrates by county the percentage of bank offices that are owned by community banks. In almost 30% of all counties nationwide, community banks have the majority of banking locations.
- The bottom map illustrates by county the percentage of deposits that are held in offices of community banks. In 28% of all counties, community banks have the majority of commercial bank deposits.
- Despite their dominance in more rural areas, over 40% of community bank offices and 46% of deposits are located in a Metropolitan Statistical Area (MSA). Large banks, in contrast, have 60% of their offices and 54% of their deposits in MSAs.
- The community focus of smaller banks is evidenced in the smaller number of offices; only 43% of community banks have 3 or more offices, compared to 90% of large banks.

Source: FDIC Survey of Deposits (June 2009)

Community Bank Summary Statistics

	Tenth District Community Bank (< $250 Million)	Tenth District Large Banks (>$250 Million)	All U.S. Community Bank (< $250 Million)	All U S Large Banks (>$250 Million)
Number of Banks	888	209	4618	2100
Total Assets	75,276,479	202,391,030	487,642,819	11,466,514,181
Total Loans	46,923,733	123,003,177	312,833,579	6,325,023,491
Total Deposits	62,969,382	157,693,608	410,752,663	7,796,175,536
Total Equity Capital	7,978,993	18,119,249	52,157,996	1,245,154,944
Return on Average Assets (2009)	0 59%	0 25%	0 04%	0 06%
Return on Average Assets (March 2010)	0 79%	0 95%	0 41%	0 52%
% Nonaccrual Loans & Other Real Estate Owned	2 89%	4 94%	4 12%	4 15%
Capital Ratio	9 92%	8 09%	10 08%	8 10%
% Change in Lending**	0 64%	-11 14%	1 88%	-6 12%
% Increasing Lending**	52 29%	34 20%	53 15%	39 42%
% Agricultural / Total Loans	23 85%	7 55%	13 67%	1 25%
% Commercial Real Estate / Total Loans	30 84%	41 87%	38 25%	22 82%
% Commercial & Industrial / Total Loans	14 92%	17 65%	14 22%	16 80%
% Residential / Total Loans	20 85%	14.94%	23 74%	22 68%
* Source Report of Condition and Income (March 2010)				

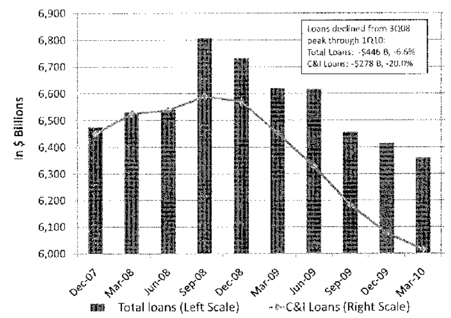
*Capital Ratio – Tier 1 capital as a percentage of total assets

*Agricultural Loans - Agricultural production loans and real estate loans secured by farmland
* Commercial Real Estate Loans - Real estate construction and development loans, loans secured by commercial real estate properties, loans secured by multi-family properties, and loans to finance commercial real estate not secured by real estate
*Commercial & Industrial Loans - Commercial and industrial loans
*Residential Loans - Residential mortgage loans (first and second lien)

**Note The sample of banks used to calculate these trends was adjusted to eliminate distortions from acquisitions, including failed banks, and the accounting changes for credit card loans that took effect in 2010

- Community banks have performed as well or better than large banks over the last 15 months; earnings and problem asset ratios, while clearly impacted by economic conditions, were on par with larger banks while capital ratios were generally higher.
- Community banks in the Tenth District (20% of all community banks) performed better than the average for all community banks, with stronger earnings, fewer problem assets, and only slightly less capital.
- For both the district and nationwide, community banks increased their outstanding loans over the last 15 months, while larger banks reported declines.
- Over 53% of all community banks increased their lending over the last 15 months, compared to less than 40% of larger banks.

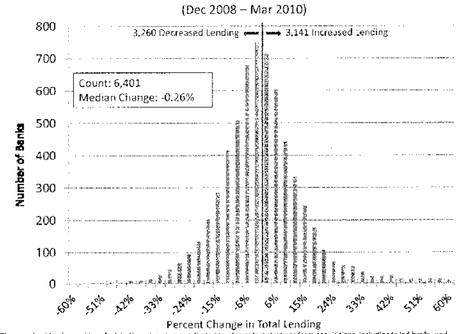
Bank Lending Contracted Over the Last 6 Quarters



Source: Reports of Condition and Income, excludes impact from FAS 166/167 in 1Q10

Loans Outstanding Increased at 49% of All Banks

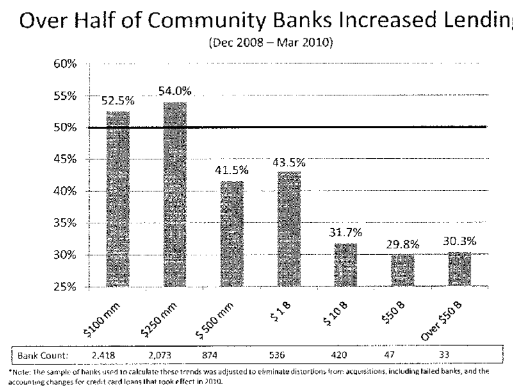
(Dec 2008 – Mar 2010)

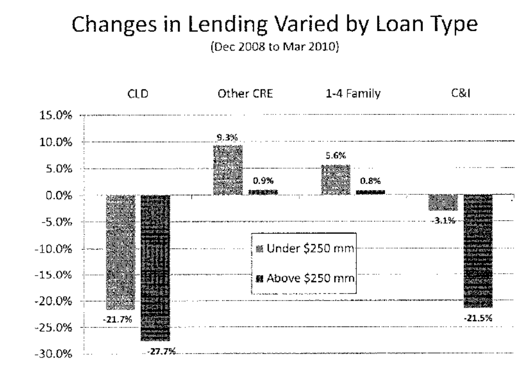


Note: The sample of banks used to calculate these trends was adjusted to eliminate distortions from acquisitions, including failed banks, and the accounting changes for credit card loans that took effect in 2010.

- Lending for the banking industry has declined since the peak at September 2008. Total loans have declined almost 7%, while commercial and industrial (C&I) loans have declined by 20%.
- Reductions in lending were not uniform across banks. Almost half of all banks increased their loans outstanding over this 15-month period. While total loans outstanding dropped in aggregate for the industry, the median change at all U.S. banks was actually a decrease of 0.26%.

Source: Reports of Condition and Income (1st Quarter 2010)





- There were also differences in lending across different sizes of banks. A majority of community banks increased their outstanding loans over this period, while a much smaller number of larger banks reported increases. Only 30% of banks over $10 billion increased outstanding loans.
- Changes in loan volume varied widely by loan type. Construction and land development (CLD) outstanding loans dropped across all sizes of banks, reflecting stressed real estate conditions. For commercial and industrial (C&I) loans, volume changes were relatively smaller for community banks compared to a decline of 21.5% for larger banks.

Source: Reports of Condition and Income (1st Quarter 2010)

TESTIMONY OF

JONATHAN KEMPER

CHAIRMAN AND CEO, COMMERCE BANK, KANSAS CITY

VICE-CHAIRMAN, COMMERCE BANCSHARES, INC.

ON

"TOO BIG HAS FAILED: LEARNING FROM MIDWEST BANKS AND CREDIT UNIONS"

Before the

THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

FINANCIAL SERVICES COMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES

August 23, 2010. 9:30 a.m.

Johnson County Community College, Overland Park, Kansas

Introduction

Good morning Congressman Moore and distinguished members of the Subcommittee on Oversight and Investigations. My name is Jonathan Kemper, and I am chairman and chief executive officer of Commerce Bank Kansas City and vice chairman of Commerce Bancshares, Inc. It is my pleasure to speak with you today on behalf of Commerce Bank.

The last two years have brought about some very trying times for our country. We've all been witness to the biggest financial crisis since the Great Depression and, along with that, sweeping changes in the banking business. We do appreciate your effort today to help us make the distinction between the mega-banks and traditional banks like Commerce and my colleagues here. In fact, while much of this financial crisis was caused by the actions of the largest financial services companies – both largest banks and non-banks – it often appears that "banks" have been lumped together without distinction and have been blamed for this financial meltdown.

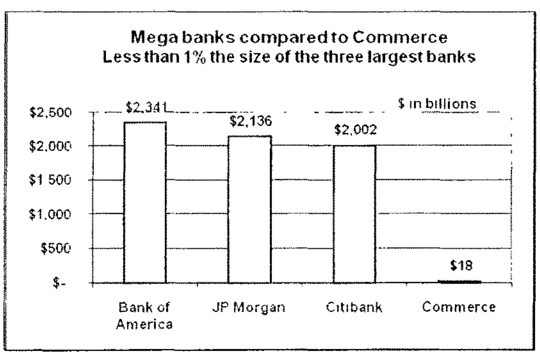
Commerce Bank is a mid-sized bank founded in Kansas City 145 years ago – our long history suggests that we take the long-term focus, and we do. Today, our strong Midwestern culture and engaged workforce of more than 5,000 serves our customers from 214 full-service branches and 412 ATMs in five states – Missouri, Kansas, Illinois, Oklahoma and Colorado. We attribute our success to stronger customer focus, solid, organic growth and a knowledge and involvement in our communities.

The Dodd-Frank legislation which was presented as "financial reform" will affect us deeply. Our costs for FDIC insurance rose tenfold during 2009 as we were compelled to support the government insurance fund for bank failures of huge banks such as IndyMac due primarily in retrospect to lax regulatory oversight. The new law will create a new agency – the Consumer Financial Protection Bureau -- which has the clear potential to add to our costs and restrict our business. Price setting established by the "Durbin Amendment" will significantly affect future fee income, which have been important vehicles for banks to maintain profits and cushion against volatile credit losses. Costs for more than 200 new regulations in the Dodd-Frank bill will tax the staffs of all banks and greatly increase costs for ongoing compliance.

Commerce Bank is a good bank and a good corporate citizen. We are counted among the best capitalized banks in the country, we declined TARP funds and we did not contribute to this crisis by originating even $1 in sub-prime products, yet we are being made to pay the cost and bear the extra regulatory burdens of this problem.

On July 21, while signing the Dodd-Frank bill, President Obama said "unless your business model depends on cutting corners or bilking your customers, you have nothing to fear from this reform." I respectfully respond that the idea that this new law is not adversely affecting good banks is not true.

As a point of clarification, we would like to expand a key term being used here, "small, Midwestern banks," to "traditional banks." Commerce is a good example of a traditional bank, with $18.4 billion in assets. In fact, as the chart below shows, except for the top banks in the country, you could say that the rest of us are all "small banks."



This is a key point, because the "trillion dollar club" of mega banks and brokers are simply a different breed from traditional banks – different in their size, business style, and their individual impact on the national and global financial system.

It is fashionable today to say that the U.S. Government "bailed out the banks with TARP" and a multitude of other extraordinary programs – but just to set the record straight, with the benefit of hindsight we now know that it wasn't the traditional banks which caused the crisis, and that the Government will make a significant profit on the funds it injected into banks – even the largest banks. The bad actors who took the large "bailouts" were AIG and GMAC, and it was the surviving banks and their customers who will pay for this exercise in government discretion.

Performance of smaller banks before and through the crisis

The question refers to all Midwest banks, but I can best start by speaking about Commerce Bank and our own experiences in the lower Midwest, which I think may be even more useful for your purposes.

Commerce is conservative by nature but we are clearly impacted by national trends. Commerce has avoided the highs and lows in the financial world by resisting fads such as sub-prime lending and by considering the assured return of our money more important than the return on our money. As a rule, we have not made loans outside of our service area. Regarding other banks in the Midwest, however, especially among smaller, community banks in our markets; there is still a lot of stress because they are more reliant on real estate lending. Fee income is an important part of the banking business model, and many smaller banks have few fee income sources to offset the costs from credit issues and the costs of maintaining their staff and facilities. Moreover, because of their smaller size, their access to capital markets to raise additional capital is very limited, especially in these difficult times.

In the last five years, deregulation, promoted by the largest banks and financial services companies, has intentionally blurred the distinction between banks and non-banks such as merchant banks, brokers and insurance companies. Accompanying this was the creation of a "shadow banking system" where brokers bought and sold loans of very questionable quality to the mega-banks and "conduits" then repackaged them into securities such as Collateralized Debt Securities. This new financial mix was the fuel for the disastrous housing bubble, and unsustainable growth in consumer debt. Add to this the growth in borrowing, topped by hedge funds using leverage and credit default swaps which destabilized markets. It all adds up to a very ugly financial picture.

In 2007, banks recorded the best performance ever. But low interest rates and low loan losses which made bank performance appear strong masked material problems. A low capital level in the largest banks was masked by accounting goodwill and off balance-sheet entities. In fact, back then the accountants and regulators criticized conservative banks, like Commerce Bank and UMB for holding reserves in excessive of their historical loss experience. Today, traditional banks like Commerce and UMB are the envy of the industry for our conservative practices, including those same loan loss reserves.

Outlook for U.S. Financial system

Our best assessment of the current outlook for the U.S. financial system in the coming years is a cautious optimism, adjusting to the "new normal" – which means higher unemployment, lower consumption, less reliance on debt for growth, but a recommitment to fundamental growth in employment and industrial competitiveness. This said, we agree with those who warn that Federal borrowing will soon begin to crowd out access to capital markets; that monetary policy will continue its course of being "highly accommodative" which translates to continued extraordinarily low interest rates. This monetary policy may be good in the short term for borrowers and the mega banks, but becomes a zero-sum game, punishing the savers, especially retirees, who are an essential component to a healthy financial system. And the continued extraordinary intervention of the Federal Reserve has clear potential for future inflation.

Smaller banks will be negatively impacted by a prolonged period of 'zero" interest rates. These banks, which are more dependent on net interest income, under this scenario, have this prospect: decline in income on their investments while they will be unable to futher reduce the cost of their funding. On top of this, total revenues will be depressed by lower loan volume due to the continued slack loan demand caused by the economic recession.

We are fearful that the United States will continue to be ever more dependent on foreign investment; and that uncertainty over the domestic economy will reduce investment in new plant and equipment; while uncertainty over the cost of labor will reduce demand to hire new employees. Finally, the depressed real estate market will continue to put stress on banks in the Midwest.

Systemic risks from smaller banks; [or] from larger banks

Traditional banks have, by definition, lower systemic risk because:

1. Traditional banks have a simpler, understandable business model,
2. Traditional banks have more stable funding sources,
3. Traditional banks have diversified portfolios and loans and securities, and
4. Traditional banks have experienced regulatory oversight with easy access to all managers and systems.

In the lower Midwest, there are still a sizeable number of independent banks, but their continued vitality is threatened. There have been some bank failures, primarily stemming from over-concentration in real estate lending. New regulations have put even more pressure on community banks and we will not be surprised if the combination of stresses on community banks concentrates more banking with the largest banks, creating an even heavier concentration of business among the big banks.

Comparative advantages of smaller banks

The key advantage of traditional banks strong is that they reflect the strength of their communities and their customers. These banks know their self-interest creates a duty to serve those customers on a daily basis in relationships measured in years. In fact, that customer-centered business model stresses relationships over transactions, which means more use of local judgment and less use of robotized decision making.

Generally, traditional banks are not disadvantaged in the breadth of products they offer. Traditional banks offer simpler structures of products but do not require securitizations or derivatives.

Our people are often our best competitive advantage. Managers of smaller banks are much more engaged, they know their customers, they know the products being sold and they understand the systems being used. High employee engagement means that employees know they are responsible for their actions and the bank relies on their personal values and trust.

On top of this external strength is how we view our financial strength: we have "skin in the game" and do not generate substandard assets, and have not developed exotic loans to be securitized and sold.

Traditional banks also tend to have a longer term investor focus which does not stress unsustainable growth in quarterly earnings.

Effects of further consolidation

The effect of greater consolidation among banks and credit unions is that "Too Big to Fail" will become a basic tenet undermining market discipline. The crisis proved that several very large banks and non-banks were too complex and basically unmanageable and unregulatable.

It has been widely reported that Dodd-Frank will further significantly depress fee income. An unintended consequence of this so-called reform bill will be to lessen the stability of community banks which depend on debit and overdraft fees to support their participation in the payment system. We also fear that the many new regulations add up to a complexity which will cause smaller banks to just give up, with the result that even more banking business will end up with the very largest banks, further concentrating assets among few institutions -- where all the risk has been taken in the past.

While the rhetoric has been that Dodd-Frank would eliminate future bail outs, in fact there is the strong probability that just the opposite will occur and with the continued push to concentration, that there will be more chances for future crises and future bailouts. In addition to the increased susceptibility to panics, we believe that there is a danger in concentrating the decision making into ever smaller number of banks.

The economic vitality and growth of any region – especially the Midwest – depends on the participation and support of bankers who understand and are part of their communities. The effects of further consolidation include the severe reduction of local decision making, which could be replaced by a concentrated national, robotic, decision processes.

Lessons which other (largest) banks can learn from smaller banks

The answer is that we don't have any "secret sauce" – just the opposite; we avoided trendy financial innovations such as sub-prime loans and we have maintained strong capital positions as part of our business culture.

We're talking the basics here. We were recently asked how we have been able to weather the current financial crisis relatively unscathed.

- We firmly believe that traditional banking, based on private capital, plays an essential role in a market-based, capitalist society. Informed judgment is more valuable than mechanistic systems based on flawed models. The best value we can provide is in the careful, considered judgment we employ in investing the assets entrusted to us by our customers.

- We can only speak about Commerce Bank, but we think good bankers should constantly be thinking about their customers, the communities in which they do business and their stockholders. We have strived to develop quality, long-term customer relationships rather than simply to produce volumes of business.

- Commerce Bank has chosen not to engage in huge mergers and acquisitions. We have chosen to grow organically rather than make "game changing" acquisitions which entail huge risk. While we have acquired banks within our region, this was done with great care and always **an eye toward the reduction of risks.**

Commerce has a strong risk culture and we have never loosened our lending standards. Our consistent management and engaged employees have allowed us to have consistent goals and objectives. It all comes down to making decisions for the best long term, economic outcome versus short term reported results.

The unfortunate reality is that far from creating good policy, Dodd-Frank reflects political punishment and compromise. While traditional banking didn't cause this financial crisis, we are being saddled with the costs. And the solutions are riddled with loopholes and carve outs favoring politically powerful entities which limit the overall effectiveness of the legislation.

Other observations

Some things should be obvious to anyone who has read any history. Economic cycles are endemic to market economics. "New era" thinking that maintains "this time it's different" is in fact, a sure sign of the end of an expansion cycle and a sure sign of trouble ahead. Bad loans are made in good times, and in fact prudent regulation is most needed in times of growth.

Aggregation models used so much by the mega banks, have fatal downsides in developing systematic risks, including replicating simplistic and/or replicating bad judgment and mechanized decisions on massive pools of assets.

Dodd-Frank may have profound unintended consequences for banking in the United States. The policy of government price setting will tend to devolve into a utility model for financial services, focusing on the recovery of defined costs rather than profits, making capital attraction and formation difficult if not impossible for traditional banks.

Let's be clear: Dodd-Frank misses the mark. The 2,300 page financial regulation bill is excessively complex; with new agencies established and much uncertainty about what the final rules will be. The financial industry has serious concerns about where this is going. We believe the strength of the banking system is tied to the many small to mid-sized banks in this country working in the communities, making small business loans to help the United States grow. Many of the regulations did not support fixing the banking system and seemed to increase government without benefit; much of it to bash banks rather than create good solutions. The intervention on debit card interchange is a good example of this. This will undoubtedly result in added costs, reduced service levels and reduced innovation. Contrary to what has been said, we believe the change to debit interchange will dramatically hurt small banks and force business to the largest banks.

What the economy needs now is an environment for loan demand which gives opportunities for all 7,900 banks to make good loans. We believe that Congress should be concerned that many smaller banks, now finding themselves falsely targeted by new regulation and burdened with the new costs and limited opportunities for new revenue, will instead simply wither and go out of business.

Other important issues

"Fair Value accounting" doesn't work when markets are dislocated, and in fact is pro-cyclical and works against long term decision making. This is a significant issue and the new bill **does** provide Congressional oversight in this area. Accounting is simply too important to leave to the accountants, and clear policy direction on "Fair Value accounting" is critically important -- this should be assigned a higher priority as currently proposed new rules will have severe impacts to banks of all sizes and provide less stability to our banking system. Smaller banks again will struggle with these proposals.

Actually, fundamental remedies can often be simpler and yet more effective: require stronger capital standards, tighter regulation of complex derivatives such as Collateralized Debt Obligations and Credit Default Swaps. Far from reducing risk and volatility, Credit Default Swaps have now been seen to introduce instability and become uncontrollable forces at times of panic. In a multitude of ways, the Dodd-Frank bill went way beyond what was necessary to address the causes of the financial crisis and will severely impact the banking industry, especially smaller banks.

Public guarantees should be limited and extraordinary. The government can't and shouldn't guarantee everything. The further the government involves itself, the more the economy will be directed by political rather than economic decision making. If we believe in the free market, then we believe in the rights of people to succeed and to fail. It's really about asking people to make responsible choices, fully understanding the implications of their actions.

Unaddressed has been the issue of fixing Fannie Mae and Freddie Mac. While these agencies have been an increasingly important part of the U.S. housing industry for many years, through Congressional urging, they assumed huge new risks of the last ten years that has resulted in a monumental problem for our country and economy. Risky lending and limitless growth in these entities must stop and solutions to fix these agencies going forward must be determined quickly.

Paying for Dodd-Frank

And, in order to pay for this, Dodd-Frank includes new tax on banks over $10B under the guise of FDIC surcharge which was not contained in either House or Senate bill. This punishes mid-sized traditional banks, which fund themselves on deposits rather than mega-banks, who use cheaper, more exotic, short-term, wholesale funding, but backstop themselves with "Too Big to Fail" access to Fed and ultimately bailouts during panics.

This concludes my testimony. Again, on behalf of Commerce Bank, I want to express my sincere appreciation for being asked to appear in this hearing.

UMB

TESTIMONY OF MARINER KEMPER
Chairman and Chief Executive Officer
UMB Financial Corporation

"Too Big Has Failed: Learning from Midwest Banks and Credit Unions"
Before the Subcommittee on Oversight and Investigations
of the Committee on Financial Services
United States House of Representatives
August 23, 2010

Thank you, Chairman Moore. We are very pleased to have the opportunity to join this dialogue with the United States House of Representatives and specifically the Subcommittee on Oversight and Investigations of the Committee on Financial Services, as well as our colleagues from the banking sector. The country is entering a new era for financial services, after very rough times for many in the financial sector as well as consumers and businesses. We welcome this conversation.

I appreciate the comments by Tom Hoenig of the Federal Reserve Bank of Kansas City. Tom has shown outstanding leadership – both in the Fed's relationships with banks here in the Tenth District, and as a voice for sound, reasoned policy nationally. He understands what the nation needs to work our way out of the financial crisis and recession, as well as the perils we face from potential unintended consequences.

UMB perspective on financial crisis

The context for this meeting is the very difficult economic slowdown our nation is experiencing. And from our interactions as a financial institution recognized for our principles, practices and performance, we can tell you that many businesses and consumers continue to face a challenging economy – whether through unemployment, or weak demand for products and services. This makes it especially important that we are having this conversation. The actions we take – in our businesses and in our policies as a nation – will influence how quickly and completely we recover.

Our perspective is that the financial crisis—now commonly referred to as the Great Recession—was gradual and not just a sudden, one-time event. It was not created in a vacuum or cooked up in the boardrooms or on the trading desks of Wall Street in 2008. The crisis emerged from years and years of developments – in the economy, in legislative and monetary policy, and in banking practice. Together, many changes led to what we recognize in retrospect as "the bubble."

A bubble of debt was what the nation's public and private institutions created. By 2007, it was clear that many consumers, businesses and financial institutions were overcommitted with debts backed by real estate – and people in all sectors made the erroneous assumption that asset prices would always go up. During the Great Recession, every $1 of economic output in the United States equated to $3.73 of debt –compared to $2.60 of debt during the Great Depression. And, it still appears this burden of debt will continue to plague us for a long time.

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We do not need to go into detail on the causes of the bubble – or its collapse in 2008 and following. The experts can analyze that history for years to come. Certainly, some Wall Street institutions that came to be seen as "too big to fail" did, in fact, fail to manage the risks of their huge investment operations. There were lapses in judgment all up and down the line – with plenty of blame to go around. But the more urgent issue now is how to restore a vibrant financial system and recover a healthy economy.

We believe, as you do, that solid Midwestern businesses like UMB and our colleagues here today are very much part of the solution for our economy. We have some ideas to offer the nation as we go through this economic transition – a time of change that some are calling "the new normal." Rather than instituting punitive actions against an industry (which ultimately drives up the cost of doing business), sound practices that improve employment and productivity rates should be recognized and offered incentives. It is critical that policy makers in Washington focus on constructive actions now to strengthen businesses, create private-sector jobs and restore growth in places like Kansas and Missouri.

Let me comment on UMB's approach to banking and then come back to thoughts on "the new normal."

UMB approach to banking

First, a snapshot of UMB. We are a 98-year-old banking and financial services company with assets of $10.9 billion in the most recent quarter. We serve businesses and consumers through 135 banking centers in Missouri, Kansas, Illinois, Colorado, Oklahoma, Nebraska and Arizona. So we are a mid-sized regional bank, with a full suite of financial service businesses in asset management and asset servicing, treasury management, health savings accounts, corporate trust, capital markets, and a wide range of personal banking and financial services.

UMB ranks as the No. 2 bank in the United States according to a study by *Forbes* magazine that ranked banks on asset quality, capital adequacy and profitability. We have always been known for principled and sound practices. We simply do not chase short-term earnings or growth at the expense of our future.

Relative to an industry average, we can take great pride in the fact that UMB has posted strong and consistent earnings year-over-year during this financial crisis, and we maintain a healthy balance sheet and make loans with high standards of asset quality. Throughout the crisis, we have had no need (or desire) to seek government bailouts or outside capital infusions.

Quality, diversity and stability

Unlike some financial institutions, UMB did not plunge into the bubble mentality – which seized upon low interest rates and rising real estate prices to drive transactions in the form of loans that, in the long run, could not stand up economically. Instead, UMB stuck to a strategy that you could attribute to our deep-seated Midwestern values and the principles of people in the communities where we do business.

UMB

UMB has pursued three goals as the pillars of our business strategy: quality, diversity and stability. These goals have served us, our customers and shareholders well, and we commend them to other banks – and policy makers in Washington – as the path toward restoring a sound financial system and economy. Let me comment briefly on each.

- **Quality.** The development of UMB Bank has engaged members of my family more than four generations, so customer relationships and the bank's strength in our communities are near and dear to my heart. We have an unwavering commitment to quality. This is why, when fashionable business practices said UMB should be lowering our underwriting standards, we did not. When critics said we should shift more assets from safe investment securities into risky categories of credit, we did not. When some people questioned whether we should lower our capital and leverage up, we did not.

  Commitment to quality is why UMB's loan charge-offs and nonperforming loans stayed low throughout the financial crisis. While the industry's median nonperforming loans jumped from 0.68 percent in 2007 to 3.39 percent at the end of the second quarter of 2010, UMB experienced only minimal change during that same time span – from 0.17 percent to 0.52 percent. We remain far below industry averages in the various measures of problem loans. This was not good luck. This success came from following sound underwriting practices and making quality loans in the first place. Sound banking should not be something that comes in and out of favor.

- **Diversity.** An important pillar of our strength is the diversity of our business UMB serves all types of customers – personal, commercial and institutional – with an array of needs from basic financial services to sophisticated payment technologies. For example, we are the 12th-largest issuer of purchasing cards in the United States according to the Nielsen Report. We provide administrative services to top asset-management firms. UMB products or services are used by one-in-eight U.S. banks. We provide financial solutions to the healthcare industry by administering health savings accounts and flexible spending accounts. And so on.

  These varied businesses add up to diversification for UMB: In 2009, more than 50 percent of our total revenue came from what bankers call fee income. We continue to grow the scale of these services through internal investment and acquisitions that augment and complement our existing businesses. This diversity helps protect UMB from the dramatic ups and downs of interest-rate cycles, as well as cushioning the impact of the difficult credit environment that has crippled many banks. While others from all spectrums of the industry were lured into reckless practices, we remained focused on building our top line quality business. UMB remains strong, in part, because we have built our position as an increasingly diversified financial services company.

- **Stability.** Finally, stability is a commitment for UMB – and a strategic advantage. Our banking and related businesses have always placed a high premium on risk management, liquidity and a strong balance sheet. UMB's financial strength tends to match the profile of our customers. As bankers we attract quality businesses and individuals who take pride in responsible, long-term engagement in the communities where we live and work. While much of the banking industry has been distracted by recent turmoil in the credit markets, the stability of UMB allows us to focus on serving customers.

UMB Financial Corporation
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Kansas City, Missouri 64106

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Since 2008, many bankers and policy makers have rediscovered the benefit of high capital levels as a safeguard against tough economic times. UMB has always recognized the importance of high capital levels. We have consistently maintained capital in the top 15 percent of the industry. While some banks have scrambled recently to raise capital through government contributions, going to the stock market or selling off assets, UMB has continued to increase our capital – thanks to old-fashioned earnings.

So that is UMB's perspective on the banking industry and where we are today. Let us turn to the future.

Financial system faces "new normal"

We are entering a new financial era. This "new normal" for banks and other institutions is a time of change that will affect every consumer and every business – our customers. In 2010, it is hard to do more than sketch out a few incomplete outlines of the new normal, because the financial system is still adapting after a tumultuous time of crisis. Rather than focusing efforts on fixing what is broken, we ought to consider what kind of system we would like to emerge.

Let me mention two characteristics that are already in place, already affecting the real economy.

- The *hangover from a period of financial excess* and the ensuing crisis is very much affecting our financial system – and the lending environment – as the country strives toward recovery. The underlying fundamentals of business and lending will reflect a "new normal" for years to come.

- The *increase in regulatory involvement* with banks and other financial institutions has only begun. Passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act this summer was the beginning, not the end, of the process – and many questions remain unanswered.

These are "facts of life" in the post-crisis era, and we expect each of them to have significant repercussions.

The lending environment is a topic of much concern. People outside of banking are worrying about whether "the banks are lending," because this has an influence on the ability of businesses to survive and expand. If the economy is to recover and create millions of jobs, the reasoning goes, banks must lend money to small businesses and other enterprises that can create those jobs. Bankers understand this concern.

Let me assure you, UMB Bank never stops making loans and has plenty of liquidity to meet the needs of qualified perspective borrowers This is true of most other banks we have contact with across the country. But the situation is more nuanced than simply whether "banks are lending." Our experience at UMB is that we have increased our total loan balances through the 2007 to mid-2010 period, expanding our lending an average of five percent per year And overall, our total commercial loan commitment figures have increased 40 percent since 2007.

As the economy has slowed down, however, we have experienced a decline in demand for commercial and industrial loans. The strains of recession have caused many businesses to scale back their borrowing plans. For example, we have expanded commercial lines of credit, but customers are

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not utilizing as much of this funding. Meanwhile, credit card and home equity lending have increased faster.

As bankers, *we are in business to lend* – but the economic landscape has a great impact on the demand for loans, as well as the ability of business borrowers to qualify for loans. We believe it is a mistake for banks to loosen underwriting standards and take on speculative loans. Just as the subprime lending boom led to big problems, so would relaxing lending standards in an attempt to return to 'normal' levels. In reality, expectations may need to be reset as to what lending volume should be versus what they were in an irresponsible environment.

In terms of stimulating business prosperity and promoting sound financial practices, political leaders should act on counsel from leaders in the private sector who identify specific actions that would help the country address these complex issues.

For instance, the Business Roundtable – some of the best business minds in our nation – has called on Congress for "real tax reform" to help U.S. corporations stay competitive and get on a path to expansion, which in turn would bolster economic prosperity and job creation. The U.S. corporate income tax rate is tied for the dubious honor of the highest tax rate among developed countries, which hinders growth.

The roundtable has identified "double taxation" of two kinds, which both create a drag on U.S. growth:

- U S.-based companies often must pay U.S. taxes on income earned abroad, in addition to the relevant foreign tax. It puts U.S. businesses at a disadvantage to multinational corporations headquartered in other countries, which often do not pay taxes twice on their foreign income. Congress ought to create a more level competitive playing field.

- Another "double taxation" aspect of the U.S. tax code is that profits are taxed first at the corporate level, and then again when profits are distributed in the form of dividends to shareholders. While all major U.S. trading partners have either permanently eliminated or lessened this practice, U.S. corporations are left at a competitive disadvantage.

Another concrete example is in the regulation of banking and finance. Speaking as one of the financial institutions that has remained sound throughout the recent crisis, we encourage strengthening bank capital requirements, including increasing both the tiered and risk-based capital levels.

In a risk-based approach, Washington should focus on incentives rather than regulatory penalties. For example, a greater safety cushion in capital could be required for institutions that invest in riskier assets such as subprime loans, asset-backed securities or off-balance sheet transactions.

UMB

Additionally, Washington should fashion insurance premiums in a similar manner. That is, the higher the risk profile, the distinction should be made that these institutions clearly pay a higher rate insurance premium. The reverse should also be true, in that the more sound and less risky the profile, there should be clearly be a lower rate in the premium. This should certainly drive the principled behavior that poses less systemic risk, such as UMB consistently demonstrates.

If we really want to bring on economic recovery and put people to work, we need to stimulate *business spending* – not by increasing government spending or pressuring banks to lend, but rather by reducing the tax burden on businesses. I hope you will consider tax cuts for businesses as one of the most important items on your economic agenda Productivity equals earnings and jobs, which ultimately leads to a more stable tax base.

The increase in regulatory involvement is, frankly, a response we have seen after nearly every financial crisis. History has a tendency to repeat itself. We have had about 36 recessions since the 1860s, and each time we've come out with new regulations. The collapse of the dot-com bubble and Enron led to the Sarbanes-Oxley Act, but then another bubble followed and another financial collapse. It is dangerous to talk about "Never again!" because economic cycles and financial crises seem to recur throughout history.

The Dodd-Frank Act has some positive aspects, such as addressing capital standards and shadow banking – although we are just now learning about the myriad of exemptions for those who qualify as lenders to consumers. Adjusting to the many regulatory changes, however, will be part of the "new normal" for financial institutions and our customers for years to come. What we do know is that we can anticipate more than a hundred new regulations and, as one could imagine, many smaller banks like those in the Midwest will likely have a difficult time dealing with that. Certainly, banks and other financial institutions comply and will subsequently incur additional costs of doing business.

Overall, the Act moves in a positive direction by establishing a mechanism to deal with systemically important failures Hopefully, this will end the too-big-to-fail issue and ensure that future failures can be addressed quickly, without burdening the taxpayer.

But this is not the end of the too-big-to-fail issue. While a Resolution Authority is in place, it is imperative that the Systemic Risk Council created by the Act be able to address risks in advance of a crisis. There is a moral dilemma when trends in the financial markets are popular – but potentially harmful – at the same time. The industry has resources in place to control risk management issues and to make tough decisions in the face of adversity, but during the bubble years very little was done to stop the bus of "progress." The challenge will remain in the coming years—as at the height of the Great Recession – to make certain we all have the discipline – as a nation, as legislators, as industry leaders – to step in and do what's right at the right time.

Although the Dodd-Frank Act was designed with the good intention of addressing excessive leverage and the "too-big-to-fail" issue, it has unfortunately become a mechanism to regulate bank profitability as well as product design and competition. History tells us that lack of regulation is not the catalyst for a financial crisis, but rather that stability of the system is highly contingent on the will of business and political leadership to do what is right, when it is right If we truly wish to change the behavior and counter the forces of human nature, we need to provide incentives for sound financial disciplines.

UMB

Details of this wave of new regulation, of course, are mostly to be worked out by the regulatory agencies as they develop rules under the Act. Where we have expertise to contribute, we hope to be a constructive part of the dialogue in that process. It is important not to overburden the system with costs and create disincentives that run counter to the interests of businesses and consumers as banking customers.

Summary

Allow me to conclude by going back to core issues. We believe banks and other players in the financial system – including policy makers and regulators – would do well to pay attention to quality, diversity and stability. We will achieve long-term recovery by encouraging sound financial practices at every level from banks to businesses to consumers and even our government

One of my favorite quotes is from President Truman, our plain-speaking president from Missouri, and it seems to apply to shaping this new era for our financial system.

> "Men make history and not the other way around. In periods where there is no leadership, society stands still. Progress occurs when courageous, skillful leaders seize the opportunity to change things for the better."

- End -

KANSAS CREDIT UNION ASSOCIATION

Testimony of Marla S. Marsh
On behalf of the
Kansas Credit Union Association

Before the
Subcommittee on Oversight and Investigations
of the
Committee on Financial Services
United States House of Representatives Field Hearing
August 23, 2010

"Too Big Has Failed:
Learning from Midwest Banks and Credit Unions"

Chairman Moore, Ranking Member Biggert, and Members of the Subcommittee:

I appreciate the opportunity to appear today before the sub-committee on behalf of the Kansas Credit Union Association to speak to the lessons that Wall Street can learn from Kansas credit unions. The 103 Kansas credit unions are not-for-profit financial cooperatives whose purpose is to serve the financial needs of their 590,000+ member/owners. My experiences over the past 14 years as President/CEO of KCUA along with my years working with credit union trade associations in Ohio, Illinois, and New York and serving on the Board of Directors for the Credit Union National Association give me a wide perspective of the credit union industry.

To say that the past 24 months have been tumultuous for the financial services industry would be an understatement. Undoubtedly, there is much that has gone wrong and many risky practices undertaken by certain players in the financial services marketplace that have contributed largely to the Great Recession. In the ensuing months, there has been a heavy focus on what went wrong and what the government needs to do to prevent such systemic failures in the future. However, it would be shortsighted of us to ignore the players and practices that did not contribute to the recession and are helping to restore economic stability. There is much that can be learned from credit unions—both in Kansas and across the nation—with their founding philosophy and continued commitment to putting people before profit.

Kansas Credit Unions: Strong Before and After the Recession

To understand the impact of the recession on the credit union industry, it is helpful to have a perspective of the effects of the recession on the Kansas economy. In general, Kansas has fared better on many economic indicators than our peers on the coasts. Kansas did not see the dramatic boom that other areas of the country experienced leading up to the recession and, consequently, we have not seen the bust to the same degree that other states have. For example, according to the Federal Housing Finance Agency, home prices on conforming home loans in

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Kansas are currently down just -2.6% from their peak whereas nationally home prices have declined -13.2% from their mid-year 2007 peak. Moreover, the Bureau of Labor Statistics reports that the state's 6.5% June 2010 unemployment rate is three percentage points lower than the 9.5% national average. Still, the landscape differs significantly based on location: the unemployment rate in both Dodge City and Leawood is now 4.2% but it is 9.8% in Leavenworth and 10.4% in Kansas City.

In general, however, Midwest values, both personal and commercial, support what some might consider a conservative viewpoint but we would say reflects a more calculated risk analysis process that produces a balanced approach to growth and innovation. Although the Kansas economy may not have had the precipitous and rapid decline faced by other states, the Kansas economy has felt and continues to feel the effects of actions by those who either were less cautious or were greedily proceeding without heeding the warning signs.

Similarly, while Kansas credit unions today are generally healthy and well capitalized, they have not been immune from the effects of the downturn. Kansas credit union loan loss rates have more than doubled during the recession from 0.53% in 2006 to 1.30% in the year ending March 2010. Kansas credit union capital ratios declined from 12.6% at the end of 2006 to 10.8% at the end of March 2010.

Yet compared to their credit union and bank peers Kansas credit unions stand out.

In the year ending March 2010, Kansas credit unions continued their trend of asset growth reporting a 6.5% increase in assets. In the same period, U.S. credit union assets increased by 4.7% while Kansas banking institution assets declined by -0.4% and U.S. banking institution assets declined by -1.3%. The trend of sizeable asset growth over the past 12 to 18 months reflects a flight to safety by consumers as they curbed spending to build their savings or transferred Wall Street investments to local institutions. It is also a demonstration of continued consumer confidence in Kansas credit unions as trusted financial partners. This trend of turning to community financial institutions has been seen in broader, national movements, such as movemymoney.org, that encourage consumers to utilize local financial institutions. In addition to asset growth, the pace of lending in Kansas credit unions remains strong. In the year ending March 2010, Kansas credit union loans grew by 5.7%. During the same period Kansas banking institution loans declined by -7.3% and U.S. bank loans declined by -3.0%.

And while it is true that Kansas credit union capital ratios and asset quality has declined the deterioration has been less pronounced than what has been experienced by others. At the end of the first quarter 2010, the Kansas credit union 10.8% average net worth-to-asset ratio compares favorably with the 9.9% national credit union norm and the 10.1% Kansas bank average. Kansas credit union asset quality has deteriorated but the 60+ day dollar delinquency rate stood at 1.30% at the end of March - marginally lower than the 1.77% national credit union average and substantially lower than the 90+ day dollar delinquency rate at both Kansas banks (3.39%) and banking institutions throughout the nation (5.50%). Similarly, since the start of the recession, Kansas credit union net chageoffs averaged 0.93% of average loans – lower than the U.S. credit union average (1.08%), and lower than both the Kansas bank average (1.01%) and the U.S. banking institution average (2.33%).

At the end of 2008, there were 108 Kansas credit unions—85 state chartered and 23 federally chartered. Today, the number has decreased to 103—82 state chartered and 21 federally chartered. It is important to note that this trend is not a direct result of the economic recession. Rather, it is a continuation of a 10 year trend of declining numbers of credit unions, ranging from 3 to 5 credit union consolidations per year. This decrease can be attributed to a number of factors including the increasing complexity of the financial services marketplace, the ever increasing cost of technological changes, and onerous compliance and regulatory burdens faced by small to mid-sized financial institutions. We hope that the Committee will be mindful of and will monitor how the new Dodd/Frank law is implemented, including the overall impact new and current regulations will have on the operations of these institutions.

The Dodd/Frank law has addressed some of the issues surrounding the "too big to fail" financial institutions. No credit union or group of credit unions is large enough to negatively impact the entire financial system. Failures of credit unions would be contained within the credit unions system itself. The National Credit Union Administration (NCUA), as regulator of federally chartered credit unions and insurer, has worked in concert with state regulators and the Administration to actively address any systemic risk that would impact the credit union system. In September, NCUA is scheduled to release new regulations on the structure of the Corporate Credit Union Network and legacy assets held by some of the corporate credit unions (which function like bankers' banks providing correspondent services to retail, natural person credit unions).

The greatest risk for credit unions comes from the collateral damage caused by the "too big to fail" institutions. The devaluing of property, the decrease in consumer confidence and spending, the failure of support organizations, the increase in unemployment contribute to a strain on the financial well being of our member/owners and in turn force adjustment to credit union operations. The second and equally damaging impact of "too big to fail" is the rise in regulatory burden and examiner "one size fits all" approach that stifles our efforts to do what we do best—provide solutions to meet the financial needs of our members and help grow local economies.

Lessons to be Learned from Kansas Credit Unions

As the data demonstrate, Kansas credit unions are faring well compared to their peers in the financial services industry nationwide and particularly their peers on Wall Street. This is the result of time tested, prudent business practices that have served Kansas consumers well through many adverse situations. There are a number of lessons to be learned from the Kansas credit union industry.

The key lesson, in a nutshell, is that relationships matter. The biggest difference between the Wall Street business model and the credit union business model is the member ownership component. When the institution is owned by the "customer", there is mutual responsibility to act in the best interest of each party. Every decision made at a credit union is driven by the focus on bettering the members and the financial institution they co-own, while a for-profit entity's primary focus is on driving the bottom-line return back to their owners, whether that is one individual or family or a large and diverse group of stockholders. While capitalism is a primary element of business in this entire country, the focus on return to owners by some large financial firms and institutions certainly contributed to excessive risk taking, confident that they would be considered too big to fail if things didn't work out.

Credit unions recognize that to protect the interests of their member/owners they need to be partners with their members. Credit unions are closer to the end user than large Wall Street institutions that caused the crisis. Credit unions still adhere to lending principles that consider more than just a credit score or collateral, but also weigh the character and personal capacity of the borrower to handle the terms of the loan. The large degree of separation from decision-maker to end user (borrower) seen in large financial firms encourages an internal institution focus and risky behaviors to increase profits. There is no incentive for credit unions or their employees to offer products that will harm their member/owners, unlike the enormous Wall Street incentives paid on future performance that can be harmful to the end user—the consumer.

In addition to this close relationship to their member/owners and a focus on making decisions that are in the mutual best interest of both parties, credit unions have solid underwriting processes and hold most of their loans on their books. Having skin in the game results in financial institutions that care about whether the loans are successfully paid back. In the sub-prime mortgage crisis we saw what can happen when lenders loan irresponsibly knowing that the loans will be passed down the line and become someone else's problem. Another benefit is that credit union decision makers live and work in the communities alongside their members. Knowledge of local and state economy provides insight into potential risk and at the same time allows us to identify how we can best help our members with appropriate products and services.

The focus on working with members in the interest of maintaining a strong and secure institution for all is what credit unions have done for decades. The credit union movement in the United States started to flourish during the Great Depression as consumers created opportunities for savings and lending by pooling their money. Then, as today, credit unions provided another avenue for consumers and businesses to access credit and cooperatively benefit from sound thrift principles. The importance of having local, safe, and reliable alternatives to the Wall Street firms cannot be overstressed. Credit unions today, as they have everyday and in every economic downturn, provide options for their members to cope and deal with the hardships.

Conclusions: Moving Forward

Moving forward credit unions have a strong role to play in the financial services marketplace. Though we are a small portion of the overall marketplace, the need for sound alternatives to the for-profit banking industry still exists today. As Congress continues to address the lingering effects of the recession and prevent future abuses, we urge Congress to recognize the challenges faced by credit unions as they address increasing compliance burdens. Though credit unions did not cause this recession, they face steep costs associated with complying with regulations targeted at the abuses that occurred at Wall Street firms. The regulatory burden is making it increasingly difficult for small institutions to mid-size institutions to compete in this economy.

We also urge Congress to continue to allow flexibility and increase options for credit unions to continue to serve their members and put much needed capital back into their local economies. For example, Congress could help create hundreds of jobs and make thousands of dollars of capital available to Kansas small businesses with zero expense to taxpayers by increasing the statutory credit union member business lending cap. Representatives Paul Kanjorski and Ed Royce have introduced bi-partisan legislation which would increase this cap from 12.25% of total assets to 25%. Similar legislation has been introduced in the Senate by Senator Mark Udall. Senator Udall's bill would increase the cap to 27.5% of total assets and includes safeguards to ensure that increased business lending is done in a prudent and gradual manner, further protecting the National Credit Union Share Insurance Fund. This legislation was developed in conjunction with the Administration, and it enjoys the Administration's support. We encourage Congress to enact this no-cost to the taxpayers job creation measure as soon as possible.

Credit unions in Kansas today continue to do business as usual. Their mission in both the pre and post crisis economy is to serve their members in a way that puts members before profit. On behalf of the 103 credit unions in Kansas, I thank you for allowing the Kansas Credit Union Association the opportunity to testify on this important topic.

KBA
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

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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".

The Dodd-Frank Wall Street Reform & Consumer Protection Act (P.L. 111-203)

"Big Win for Small Banks" Says Wall Street Journal

"Some of the smallest U.S. banks are heading toward a big boost from financial-overhaul legislation. A string of provisions tucked into the bill being voted on by the House on Wednesday would reduce the premiums that small banks pay to the Federal Deposit Insurance Corp., exempt them from parts of the newly proposed consumer-protection agency and reduce their financial exposure to some mortgages by allowing the small banks to sell the loans to investors. The bill also would permit small institutions to count certain types of securities toward their capital requirements. Larger U.S. banks wouldn't be permitted to do so." -- *Wall Street Journal*, 7/1/10

"Small Banks Avoid Overhaul's Sting"

"In a recent letter, the nation's top lobbyist for small banks noted how well the financial-regulation bill had worked out for his members. That is an understatement. At nearly every turn, small banks were able sidestepped more-onerous regulation, or at least blunt the impact of potential changes, from new rules on capital to fees that will pay for new regulations. "If you are Main Street, you got most of the curbs on Wall Street that you wanted, and a few other nice breaks for community banks as well," Camden Fine, president of the Independent Community Bankers of America, wrote in his notes to members. Community bankers and their many backers on Capitol Hill say the changes help them compete with larger firms, and are appropriate because small banks didn't cause the financial crisis." --*Wall Street Journal*, 7/20/10

Community Bank Proclaims:

"New Regulatory Regime Favorable to Main Street Banking"

In a press release, the mid-sized Valley Community Bank based in California says the Dodd-Frank Act succeeded in standing up for Main Street banks: *"Washington policymakers understood the difference between Wall Street and Main Street banking when they included important concessions for community banks in the new Wall Street Reform Act that was signed into law in July, 2010. The law gives community banks concessions from certain lending and capital reserve regulations and directs the biggest banks to pay higher FDIC premiums. Because community banks represent a different banking business and have a different risk profile from large and internationally-active institutions, the new law recognizes that they should be regulated differently. By holding the too-big-too-fail institutions accountable and creating special accommodations and provisions for community banks, the law creates an important precedent, which recognizes that Wall Street megabanks require significantly more regulatory checks and supervision than Main Street community banks."* -- Press Release, 8/17/10

Responsible community banks, credit unions and small business should not endure unnecessary regulatory burdens that instead should be focused on Wall Street and other actors that created the financial crisis. That is why the Dodd-Frank Act includes these important provisions and exemptions:

- **Fully preserving the thrift charter** while eliminating the ineffective Office of Thrift Supervision (OTS) and shifting its functions to the Office of the Comptroller of the Currency (OCC). This will preserve a business model that has worked for highly regulated institutions that play by the rules and make responsible lending decisions [Title III].

- **Exemption of community banks and credit unions from the new Consumer Bureau's enforcement power**, leaving consumer protection enforcement for community banks and credit unions with $10 billion or less in assets with their primary bank regulator [§1026].

- **Exemption of small businesses from the Consumer Bureau's regulatory powers** for small businesses that sell their products and services to consumers if they meet a three-prong test. Specifically, the conference report exempts a small business from the Bureau's regulation if it sells non-financial products, does not securitize its consumer debt, and falls within the North American Industry Classification System code's definition of a small business [§1027].

- **Community banks will pay less for their Deposit Insurance Fund (DIF) assessments** with new authority for the FDIC to make assessment calculations based on a risk-based asset and liability metric [§331].

- **Community banks exempted from paying for higher DIF reserve ratio**, as all banks with less than $10 billion in assets will be held harmless under a provision to raise the minimum DIF reserve ratio from 1.15% of total deposits to 1.35% of total deposits by 2020 [§334].

- **Permanent increase to $250,000 of deposit insurance** will help community banks and credit unions compete with larger competitors [§335].

- **Two-year extension of FDIC's Transaction Account Guaranty (TAG) program**, which provides depositors with unlimited coverage for noninterest-bearing transaction accounts at participating FDIC-insured institutions. Similar authority is provided to the NCUA to have a similar program for credit unions [§343].

- **Eliminating Senate bill's authority to apply national lending limits to state-chartered banks**, which would have had the effect of undermining the dual-banking system that has worked well for many decades. New language was added to ensure state-chartered banks don't circumvent the intent to count derivative transactions in the lending limit [§611].

- **Full grandfather of existing trust-preferred securities (TruPS) for community banks.** Trust-preferred securities (TruPS) issued before May 19, 2010 by a depository institution holding company with total consolidated assets of less than $15 billion as of December 31, 2009, or any mutual holding company will not be forced to take any capital deductions on these instruments. The conference report does not change the treatment of small bank holding companies with less than $500 million in assets under the Federal Reserve's Small Bank Holding Company Policy Statement [§171].

- **Fair treatment and consideration of small business credit** by specifying that during the rulemaking process, the consumer regulator is required to consider the impact that their rules will have on the cost of credit for small businesses and consider specific alternatives to minimize increases in the cost of credit [§1031].

- **Community banks and credit unions under $10 billion exempted from the Federal Reserve's power to regulate interchange fees.** Tough anti-discrimination language was included in the conference report to ensure larger financial competitors can't have an unfair advantage over community banks and credit unions [§1075].

- **Small businesses will be relieved from the burden of paying excessive and disproportionate swipe card fees**, freeing up resources to allow them to grow their businesses and hire more workers [§1075].

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Fred R. Becker, Jr.
President and CEO

August 20, 2010

The Honorable Dennis Moore
Chairman
Subcommittee on Oversight and Investigations
House Financial Services Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman ~~Moore~~: Chairman Moore

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the interests of our nation's federal credit unions, I am writing to you regarding Monday's field hearing entitled "Too Big Has Failed: Learning from Midwest Banks and Credit Unions."

It has been well-recognized in both houses of Congress that credit unions were not the cause of the current economic crisis and did not make the loans that helped lead to the downfall of the housing market. The abuses that took place on Wall Street and in the unregulated mortgage market, at the expense of hard-working Americans, should never be allowed to occur again. Credit unions have long fought the prevalence of these bad practices and have led the way in consumer protection by seeking to offer better financial products and exceptional customer service to their members.

NAFCU applauds efforts to find remedies to our current financial crisis and prevent future problematic products from evading regulation. As small, not-for-profit financial institutions, however, credit unions may be disproportionately impacted by some of the valiant efforts in the financial reform bill. As the provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* are implemented, we hope that the subcommittee will keep in mind the unique structure of credit unions and the increased compliance burden they face. Unlike large for-profit banks, credit unions do not have economies of scale nor stockholders to turn to in order to ease new compliance costs. We hope that as Congress tackles a "corrections" bill for the reform package it looks for ways to ease new compliance burdens on good actors such as credit unions. We look forward to working with the subcommittee to address this issue.

We thank you for holding this important hearing on what the financial services industry can learn from Midwest banks and credit unions. Should you have any further questions, please do not hesitate to contact myself or NAFCU's Director of Legislative Affairs, Brad Thaler, at 703-842-2204.

Sincerely,

Fred R. Becker, Jr.
President/CEO

cc: Members of the House Financial Services Subcommittee on Oversight and Investigations

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