TESTIMONY OF

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on behalf of the
INDEPENDENT BANKERS ASSOCIATION OF AMERICA

before the
SUBCOMMITTEE ON ECONOMIC STABILIZATION
of the
HOUSE BANKING, FINANCE AND URBAN AFFAIRS COMMITTEE

MAY 15, 1991
Mr. Chairman, I am Pierce Stone -- Chairman and President of the Virginia Community Bank in Louisa, Virginia. I am appearing today on behalf of the Independent Bankers Association of America (IBAA), the only national trade association which represents the interests of this nation's community financial institutions.

I appreciate the opportunity to testify on the effect the Treasury and other legislative proposals on interstate branching will have on community banks.

Let me start off by saying that many of the banking reform proposals introduced would cause a massive consolidation of assets and power, limiting access to credit. If the goal of this country's legislators is to create a few mega-institutions, then some of these proposals, particularly the Treasury bill, would achieve that result. We oppose such a huge restructuring, a restructuring that would benefit only Wall Street to the detriment of Main Street America.

As you may know, the IBAA has formed the Main Street Coalition. Its members are concerned about proposals to cut deposit insurance, to mandate interstate branching, and to eliminate the separation between banking and commerce. This coalition is composed of such diverse organizations as representatives of state and local governments, insurance agents and companies, agriculture and rural groups, and small businesses. The coalition recently wrote each member of Congress about the Treasury's financial industry reform package, saying that "as consumers and providers of financial services, we believe that the plan does not adequately address the needs of Main Street America, its small businesses, consumers, farmers, ranchers, and religious and charitable organizations".

Each of these groups recognizes that, in the brave new world as proposed by the Treasury, its members' access to local credit will be threatened. Credit is the lifeblood for small business, and community banks are the arteries through which that credit flows. Without the unique relationship between community banks and small businesses, the nation would be hard-pressed to replace the source of 80 percent of the jobs that were created in the 1980s. Cut off the access to credit, and the recession that we are now slowly emerging from could return and be much deeper than any of us care to imagine.

My bank has 37 million dollars in assets and operates in Louisa County, Virginia, which is located in Central Virginia. We compete against two large statewide holding company banks with central offices elsewhere. The community perceives them as gatherers of deposits with very little reinvested in our community. They reputedly have very low loan to deposit ratios. I have no way to verify this but do know our loan deposit ratio has varied between 79 percent and 93 percent in the last 12 months and yesterday was 82.4 percent. If you drop our FDIC coverage we feel a great deal of our deposits will go to the too-big-to-fail banks in our community, and they will continue to move these much needed funds to other types of investments.
Mr. Chairman, the Treasury bill should concern you. It cuts deposit insurance for depositors in banks that are too-small-to-save while letting the too-big-to-fail banks continue to offer 100% coverage. It permits these too-big-to-fail banks to open branches in any state they want, without any state role. And it continues the policy of letting the money center banks offer 100 percent insurance coverage for their foreign deposits and non-deposit liabilities while paying no premiums. This is a billion-dollar-a-year free ride at the expense of the taxpayers.

We strongly oppose cuts in deposit insurance and we urge you and your colleagues to vote against them. We have endorsed Congressman Hubbard's amendment to eliminate proposed cuts in deposit insurance which he offered Tuesday before the Banking Committee's subcommittee on Financial Institutions. The cuts proposed in the Treasury bill will make it more difficult for our banks to raise deposits which we use to fund small business loans. Cuts in deposit insurance mean cuts in small business credit; it is just that simple. We urge you to support the Hubbard amendment in any way that you can, and to co-sponsor a resolution offered by Congressman Rinaldo, H. Con. Res. 136, which expresses the sense of the Congress that deposit insurance should not be cut.

There is ample evidence that the current debate over deposit insurance has already led to a loss of deposits from smaller banks. Just last month a community banker from New York told the Consumer Affairs Subcommittee that checks he issued to depositors who said they were leaving town came back to his bank for payment stamped "Chase Manhattan" and "Citibank." His deposits had not gone to out-of-town banks; they had gone into too-big-to-fail banks.

And an April 16 article in the Wall Street Journal confirms this: "...small banks are losing some of their biggest depositors because of the proposals being considered in Washington to limit the scope of deposit insurance."

The article goes on to describe not only the connection with the too-big-to-fail policy, but also suggests that this outflow of deposits may exacerbate the credit crunch:

"Clearly funds are moving out of the banking system," says L. William Seidman, chairman of the Federal Deposit Insurance Corp. "They're moving into money funds; they're moving into Treasuries, and they are moving into mattresses. There is a loss of confidence out there that is very worrisome. It can have an effect on bank lending ability."

I will now address the issue at hand:
NATIONWIDE BRANCHING

The IBAA is adamantly opposed to mandated nationwide branching. Two principal laws are under attack in this debate: the Douglas Amendment to the Bank Holding Company Act, which prohibits a bank holding company from owning a bank in another state unless explicitly permitted by that state’s statute; and the McFadden Act, which says that nationally chartered banks may only have branches to the extent that state chartered banks may under state law. Together, these two laws have given state governments the power to decide if their banks may be controlled by out-of-state owners and whether to permit the growth of statewide branch banks within their borders.

The states have actively exercised these powers after strenuous debate, particularly in the last several years. Branching laws have ranged from unrestricted statewide branching, as in my home state of Virginia, to unit bank states that restricted each bank to a single location (e.g. Colorado). There have been wide variations with states permitting countywide or contiguous county branching. In fact, 46 states have adopted some laws permitting some form of the above. The IBAA does not necessarily think these actions were the right ones. However, the key point is that both branching and interstate bank ownership have been actively debated in state after state over the past decade. The legislatures have debated the issue of local control over deposit taking and lending in their states. The states have had the power to make these decisions and have actively used it, each one determining what structure it believes is in its own best interest.

Mr. Chairman, in your letter of invitation, you asked specifically about four issues:

1. What economic inefficiencies and competitive disadvantages, if any, arise as a result of the current restrictions against interstate branching with the U.S. banking industry?

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

The Administration claims that branching will result in significant gains both for the banking industry and the consumer, yet they are able to demonstrate little, if any, evidence to support the contention. In fact, there is overwhelming evidence that full interstate branching, especially if it is combined with any cutbacks in deposit insurance coverage, will lead to a massive consolidation of the banking industry to the detriment of community banks, the consumer, small businesses, farmers, and ultimately the taxpayer.
A recent study on this topic by the Southern Finance Project, a labor think tank based in North Carolina, laid out the case against the Treasury plan. Some of its conclusions were that:

1) the banking industry can already expand geographically and diversify its use of funds;

2) banks operating under geographic limits were sounder and more profitable than their counterparts operating under liberal branching and interstate regimes;

3) banks operating in more restrictive states had lower costs of funds and lower expenses;

4) banks in states that eased geographic restrictions had faster-growing fees and relaxing those restrictions has not benefitted small business borrowers or resulted in enhanced community investment;

5) bank industry consolidation went entirely unchallenged by the government during an era of massive merger and acquisition activity—from FY86-90, the Justice Department received about 9,000 applications, but only found a "significantly adverse" impact on competition was likely to result in only four of those cases; and

6) the Treasury seems to have based almost all of its arguments on a paper by a lobbyist for NCNB Corp, the nation's seventh largest banking company.

An article in the New York Times on April 18, 1991, reported that NCNB has purchased its $17.6 billion bond portfolio primarily with deposits collected in Texas since 1988 when it first acquired First Republic Bank of Dallas. This portfolio is second only to JP Morgan and last year earned a profit of $66.6 million. Community banks, on the other hand, keep their deposit base close to home. They use it to make loans to their own communities and to boost their own economies. It should also be noted that the NCNB Dallas banks are not lending in the Texas community. In fact, other Texas community bankers report that the NCNB Dallas average loan to deposit ratio is less than 30%; most community banks are at 70%.

2. Specifically, what will be the economic impact of the Treasury proposal allowing full interstate branching on small community banks? Do any other interstate branching proposals better serve the needs of small community banks?
One of the IBAA's fundamental goals over the years has been to limit the concentration and control of financial resources from outside the communities which individual banks serve. Our view is that if we can avoid undue concentration of ownership, the public will be better served and we will avoid an unstable and dangerous pooling of economic and political power. The consolidation of the banking industry will occur at an accelerated pace if national branching, combined with cuts in deposit insurance coverage, is put in place.

Since 1976, the increase in concentration in the banking industry has been dramatic -- and alarming. In the years 1976 to 1987, the number of banks controlled by multi-bank holding companies doubled from 2,296 to 4,465, while the number of unit banks plummeted 59 percent, from 10,608 to 4,375.

Even more alarming, multi-bank holding companies increased their share of assets in that period from 36 percent to 70 percent, while the share of assets for one-bank holding companies declined from 34 percent to 21 percent, and for unit banks from 30 percent to only 9 percent.

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

This has been an ominous trend. The top 1 percent of banking institutions in this country control nearly three-fourths of the assets in the entire banking industry. Can anyone seriously suggest that this kind of concentration is good for consumers, for farmers and ranchers, for small businessmen and women, for the communities whose very survival often depends on the commitment of their local bankers? I think the answer is obvious.

Another very serious concern about regional banking is relinquishing local control over bank policy. There is evidence that branching will result in the bypassing of local offices in favor of regional or corporate headquarters in the decision-making process. There are many real-life examples of the loss of local autonomy in setting bank policy from regional banking states. Bank of America, for example, has pulled all loan officers out of its branch banks and set up a series of "regional loan offices" to consider loan applications.

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

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

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

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

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

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

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

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

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

There has been no demonstration of any public benefits from regional interstate banking. The proponents claim that regional banking will lead to faster regional economic growth, but there is no evidence that there is any relationship between banking structure and economic development. They claim that the merging banks will achieve economies of scale, but there is no evidence to support that opinion.
They claim that by growing larger they will be in a better position to survive the eventual entry of the nation’s largest banks. However, there is no evidence that the regional banks need to be larger to survive. Survival is the result of providing good service at competitive prices and there is no evidence to suggest that this is directly related to the size of the organization.

The advocates claim that larger banks can better serve the needs of large businesses, but there is no evidence that the credit needs of large business firms are not being met. In summary, there is no evidence to support the claims of the proponents of regional banking.

Paul Craig Roberts in the Washington Times on March 15, reported on his discussion with George Champion, former head of Chase Manhattan Bank, about the benefits of branching. Roberts wrote:

What about the claim, I asked, that national branching lets banks diversify their risks by lending in different markets? Mr. Champion replied that the big New York banks have diversified their lending for years all over the world, and it didn’t keep them from getting into trouble. His opinion is that bankers who can’t judge their local markets certainly can’t judge far distant ones.

And I would add that Martin Mayer, a leading author on banking, had this to say in Forbes, April 15, 1991, on the Treasury proposal for interstate branching:

Nationwide branching, which is a big part of the U.S. Treasury proposals to help our banks, might provide cheaper funds, and some minor economies of operation. But no bank consulting firm other than McKinsey & Co., which somehow got the Treasury’s ear, thinks that savings as great as one-tenth the $10 billion Treasury has been talking about can be gained by repealing the McFadden Act strictures on national banking.

Banks and S&Ls can already make loans anywhere -- the Arkansas S&Ls went bust by the dozens by lending to Clint Murchison’s Sundance project in Palm Springs. We the taxpayers ended up owning the Lake Placid Club, the 1980 Olympics site, because its owners mortgaged it to North Mississippi Savings & Loan, which imploded soon after. Bank of New England’s losses in Florida probably exceed its losses in Boston.

Last March, the Senate Banking Committee held a hearing on interstate banking and branching. Texas Bank Commissioner Ken Littlefield stated that:
Interstate branching will magnify the trends experienced in interstate banking. The large nationwide banks will offer standardized products to consumers and new services to large and medium sized corporations. Studies of the impact of branching on small business credit show reduced availability from branches than from local banks.

Littlefield believes that:

Nationwide networks of branches will funnel credit into growth economies and away from regions that are stagnant or experiencing a recession. This activity will tend to increase the boom bust cycle experience in most regions.

Just recently, First Chicago Corp. pulled credit cards from many customers in the New England region, even if their balances were paid up. This is an ominous illustration of Littlefield's thoughts and has severe implications for nationwide banking.

An Alternative

Last week, the IBAA's Executive Committee agreed to support an amendment that Congressman Vento will offer in the Financial Institutions subcommittee to H.R. 1505 that would permit the states to pass interstate branching laws. As with the current law on interstate bank ownership, state legislatures and governors would be able to determine for themselves whether or not to permit interstate branching. That leaves the decision where it belongs, at the local level, not here in Washington. We urge you to support this amendment.

3. What competition do small banks currently face from large banks and other sources and how successfully have small banks competed with these entities? To what extent will the Treasury and other proposals to allow interstate branching affect the competitive nature of small banks?

The too-big-to-fail policy, along with a decline in public confidence and the debate over cuts in coverage, undermines the stability of small banks. In fact, "silent runs" have been reported by the Federal Reserve Board, professional investors, and community bankers from across the country. The American Institute of Certified Public Accountants (AICPA), in its January 1991 newsletter, advised its clients to consider moving accounts to other institutions.

According to one North Carolina banker:

Our bank has lost at least $200,000 in deposits because of the press releases coming from the Treasury. We further get calls every day
about reduced FDIC insurance. The outflow of funds is killing us. We have the loan demand but little money to take care of our community loan needs.

James Fletcher of South Shore Bank of Chicago, an urban bank in a distressed neighborhood, stated before the Consumer Advisory Council of the Board of Governors of the Federal Reserve System on March 14, 1991:

We are concerned about the rhetoric of the weakening of the system and the positioning of many people that it is unsafe to bank with small banks. About a month ago those of you that put your TV on on Sunday mornings and looked at the Brinkley show will recall the debate about the reform system and what was happening. One of the experts said that the only smart thing for depositors to do was to move their money out of small institutions and put it into large institutions. That went out over the airwaves.

The too-big-to-fail system has been advertised and it makes us appear—and it’s not the exact dollar amount of $100,000, but it makes it appear that smaller banks are less safe because larger banks will not fail and, therefore, they have 100 percent insurance.

We gather deposits from all over the country. We have $90 million of deposits in our bank to support the activities of renewing poorer, distressed communities. I am concerned about the outflow of those deposits based on us being a small bank.

Continuous talk about changing our system of deposit insurance has caused confusion and concern among this nation’s citizens, especially the elderly. These people grew up when federally insured banks were considered the safest place for their money, and they feel that their security base is being threatened.

Even the GAO, in a March 4, 1991 report to the House Banking Financial Institutions Subcommittee, advised that cutbacks in deposit insurance levels are dangerous because only a perception of no confidence in the system could cause a collapse to begin.

Interstate branching coupled with cuts in deposit insurance coverage and the maintenance of the too-big-to-fail doctrine would exacerbate a huge inequity for community banks. Not only would doors open for nationwide branching, but the larger banks would come into their new markets with an unfair competitive edge because they are deemed too big to fail. Governor Wayne Angell of the Federal Reserve System said just this in a speech before the Federal Reserve Bank of Atlanta in March: “Despite its many benefits, interstate branching would permit too much unfair competition if some banks retained a funding advantage from being too large
to fail." As long as the government maintains the too-big-to-fail policy, if it mandates interstate branching, the government would be condoning extremely unfair market operations.

James B. Watt, president of the Conference of State Bank Supervisors put it even more bluntly in an article in the Los Angeles Times on March 24. He said that the Administration’s "McDonald’s approach to banking would strike a death blow to smaller banks, which create most of the local credit for small businesses and entrepreneurs."

4. To what extent will interstate branching affect economic development, employment and the availability of credit in local economies? Does empirical evidence exist to substantiate these findings?

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

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

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

And according to the recent National Survey of Small Business Finances, conducted jointly by the Federal Reserve System and the Small Business Administration:

Local commercial banks are still the main suppliers for most of the financial services used by small and medium-sized business...local commercial banks are the dominant suppliers of virtually every financial product...Almost all of the small businesses surveyed used a local community bank...

Pointing to the results of this study in a March 8, 1991, Wall Street Journal
article, National Small Business United claims that "If local controls go to larger, more centralized banks, more decisions will go against small business."

In her study entitled *The Impact of Deregulation on Rural Commercial Credit Availability in Four New England States* (May 1990), Deborah Markley concluded that "Businesses indicated more credit problems in markets dominated by large affiliated banks....when larger banks have some market power, i.e., they dominate the local market."

Professor Nicholas M. Didow testified before the U. S. Congress on bank service charges. His message could not have been more clear. He said, "The larger the bank, the higher the level of fees. The smaller the bank, the lower the level of fees." Where is the economy of scale here? For small business, it does not exist.

Separate studies by the Federal Reserve Bank of Boston and the New York State Banking Department show that independent banks in those jurisdictions charge consistently lower rates on both commercial and consumer loans than branch banks in the same market. The California Superintendent of Banks testified before the U.S. Senate Banking Committee that the statewide branch banks in his state almost without exception charge significantly higher rates than the state's smaller independent banks.

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

The AARP studied the impact of banking deregulation on older consumers. It released the results of its study in September, 1990, concluding that:

Extensive geographic deregulation...could eventually lead to undue concentration...interstate banking may also make credit less available to local communities...banks owned by out-of-state companies may be insensitive to local needs and characteristics...rather than reinvest their deposits in the local community, these banks might use deposits obtained locally to finance their investments in other states.

And in contrast to the Administration's claims of benefits to consumers by lower prices and fees from the increased efficiencies and competition, the AARP study found that:

...Deregulation of deposit account interest rates has not resulted in higher returns for everyone. Large banks where the majority of consumers deposit their money are often paying lower interest and
charging higher fees for their service than smaller banks...as
deregulation continues, the market share of large banks is expected to
continue to increase. The result would be less competition and still
higher prices.

CONCLUSION

The Treasury Department has proposed a massive restructuring of our nation's
financial services industry. While it contains some worthwhile recommendations,
such as those relating to risk-based premiums, an early intervention system, and
elimination of the use of brokered deposits, the IBAA is convinced that its overall
impact is a prescription for disaster. The Treasury bill poses a serious threat to the
continued viability of community bankers as providers of credit and financial services
to Main Street. This, in turn, will mean less credit availability for consumers, small
business, and farmers, along with higher fees and services.

Much of the media has concurred in this conclusion. In the New York Times
of March 31, 1991, an article by James L. Pierce concluded that the Treasury

...plan virtually dooms most small banks and leaves the Federal Deposit
Insurance Corporation to absorb the cost of propping up the larger
ones...Major depositors at small banks would move their money to larger
institutions. Small banks would suffer as the bigger banks monopolized
the most valuable accounts...If the Treasury proposal becomes law, big
would become down-right ugly.

Community bankers are committed to serving their communities and the small
businesses, farmers and merchants who reside there. Mandated interstate branching
could drain deposits -- vital to lending out of those communities. The examples we
have seen to date of out-of-state acquisition, anecdotal though they have been, show
that out-of-state banks do not have the same concerns as the local bank. We strongly
urge this subcommittee not to turn its back on states' rights and the role of
community banks. Mandated interstate branching is a loser for all but the big --
those that are too-big-to-fail. We agree with Mr. Mayer that the salvation of our
banking system is not to create a system of even bigger banks. Community bankers
urge you to create a system that is fair for all players.