

TESTIMONY OF

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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 States. 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.

United States House of Representatives
Committee on Financial Services

“TRUTH IN TESTIMONY” DISCLOSURE FORM

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

1. Name: David L. Herndon	2. Organization or organizations you are representing: First State Bank Kansas Bankers Association
3. Business Address and telephone number: 650 Kansas Avenue Kansas City, KS 66105 (913) 371-1242	
4. Have <u>you</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006, related to the subject on which you have been invited to testify? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	5. Have any of the <u>organizations you are representing</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006, related to the subject on which you have been invited to testify? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
6. If you answered “yes” to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets. 	
7. Signature: 	

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