pennsylvania
DEPARTMENT OF BANKING
AND SECURITIES

Senate Banking & Insurance Committee
Hearing on Bank Competitiveness
May 13, 2015
North Office Building, Hearing Room #1
9:30 a.m.

Good morning again! Thank you, Chairman White, Chairman Smith and members of the committee, for the opportunity to come before the committee today to discuss competitiveness of the banking industry in Pennsylvania. In order to better understand this topic, I believe it will be useful to expand on my earlier comments regarding the current state of the banking industry as a whole and in Pennsylvania, provide an update on our banking statutes and banking regulation, and touch on some trends we are watching closely.

Pennsylvania consumers are fortunate to live in an enviably rich banking marketplace with a diverse mix of community banks, savings banks, regional banks, large banks with a statewide presence, out-of-state banks with branches in the commonwealth, and more credit unions than all but one state, Texas.

These institutions are at the core of the commonwealth's credit cycle performing the essential functions of linking depositors and borrowers, and serving as vehicles for payments. Banking customers include individuals, businesses both large and small, agriculture, non-profits, health care, education, and government. They provide a safe place for people to deposit hard-earned money. They make loans, contributing directly to the economic vitality of their communities. They also provide jobs in their communities and, if stock-owned, generate returns for shareholders promoting economic growth.

There are 94 state-chartered banks, 48 state-chartered savings banks and 16 state-chartered non-depository trust companies headquartered in the commonwealth. These institutions have 2,420 branch offices, approximately $153 billion in assets, and 26,000 employees in Pennsylvania.

There are 30 national banks, 17 federally chartered savings banks and savings & loan associations, and 4 federally chartered non-depository trust companies headquartered in Pennsylvania. These institutions have approximately $71 billion in assets, about 800 branch offices, and about 14,000 employees in Pennsylvania.

There are 26 banks and 3 savings banks headquartered outside of the commonwealth that have branches in Pennsylvania. Some of these are very large institutions with many branch offices which together employ approximately 20,000 people in Pennsylvania.

There are 55 state chartered credit unions with approximately $11 billion in assets and 415 federally chartered credit unions with approximately $29 billion in assets located in the commonwealth. There are at least 21 credit unions headquartered in other states that have operations here.

Additionally there are 16 credit card banks based in other states and as many as 10 industrial banks (loan companies) that do business with Pennsylvania customers, as well as many commercial banks, savings banks, savings and loan associations and credit unions that do business here but do not have physical locations in Pennsylvania.

These institutions compete with each other at a very high level for good commercial loan and consumer loan business to the benefit of their customers, Pennsylvania businesses and consumers.

State of Community Banking

As you know, the banking industry was under considerable stress nationally due to the financial crisis in 2008, but has been improving slowly as the country recovers from a deep recession. Through the fourth quarter of 2014 the industry has improved greatly, and the number of banks on the problem list nationally has declined to the lowest level since 2008.

I would like to note that community banks did not cause the recession. Our banks operated by conservative Pennsylvania business principles. While a small number of banks in Pennsylvania closed during the worst of the recession, our community banks fared much better during the recession than in many other states.

Particularly noteworthy is that community banks nationally demonstrated more improvement than the overall banking industry. Earnings improved significantly from the previous year, and the pace of loan growth and net interest margins were appreciably higher than those of the industry as a whole.

Community banks turned to longer-term, higher yielding loans to avoid margin compression. While this "reach for yield" has benefited current earnings, these banks become potentially more vulnerable to interest rate risk as rates rise. This requires heightened supervisory attention.

The good news is that asset quality indicators continue to show improvement and capital levels of community banks remain strong and well above the overall industry levels. This is of particular importance as the industry begins to implement the Basel III accord, which is the new global capital regulatory framework.

State of the PA Banking Industry

In Pennsylvania we have been fortunate to weather the Great Recession quite well.

The health of our industry not only continues to improve, but it outpaces banks nationwide in many important areas. Banks headquartered in the commonwealth have consistently held more of their assets in loans, which support economic growth in their communities. In fact, since 2009, net loans comprised anywhere between 7 and 15 percent more on their balance sheets than on those of banks across the country. But more importantly, they hold higher-quality loans. The percentage of past-due loans (as measured against their total assets) was 40 percent lower than the national average at the end of 2014.

Our banks are well positioned to implement the higher capital standards required by the Basel III accord. Since 2009, Pennsylvania banks have consistently held higher capital buffers not only to help weather the headwinds of the recession but to fund growth and expansion and many continue to attract new capital.

A great example of the health and competitiveness of the banking industry in Pennsylvania can be found in a rural community in Lancaster County. Bank of Bird-in-Hand was chartered in 2013. At that time, this Pennsylvania state-chartered bank was the first de novo bank approved in the United States in more 3 years. This is a "first" of which we can all be proud.

Nonetheless, the current banking environment as a whole remains challenging. Further consolidation within the banking sector is expected to continue. Since 2008, we have seen the number of FDIC-insured institutions in Pennsylvania decrease by more than 18 percent, from 232 at the end of 2008 to 189 at the end of 2014.

In addition, the banking industry and all our financial services industries face challenges posed by interest rate risk, the higher capital levels required under Basel III, and ever-increasing and sophisticated cyber threats.

Trend: Industry Consolidation

Pennsylvania ranks 13th in the country in the number of banks headquartered here and 14th in total banking assets. However, we continue to experience the same industry consolidation as many other states.

There are approximately 46 fewer banks, 27 fewer savings banks and savings & loan associations, and nine fewer non-depository trust companies based in the commonwealth than there were 10 years ago.

Credit union numbers have been reduced by 230 during the same period. There has been, however, significant growth in the number of out-of-state banks and credit unions operating in the commonwealth during the past ten years.

The consolidation of the Pennsylvania banking industry is expected to continue, along with the expansion, through acquisitions and branching, of out-of-state banks operating in the commonwealth.

The decision to merge or be acquired by another bank is driven by many factors. In some cases, institutions see business opportunity to expand. In other cases, the price is just right. In others, the scale of the business model needs to change. Sometimes we see situations where old-fashioned competition dictates that one institution swallows up another.

Pennsylvania's Banking Statutes

Legislation enacted by the General Assembly in recent years with the help of your committee has made Pennsylvania's banking and credit union statutes the "state of the art."

Amendments simplifying and modernizing the Department of Banking and Securities Code, the Banking Code of 1965, the Loan Interest and Protection Law, the Credit Union Code, and repealing the Savings Association Code enhanced our institutions' competitiveness and reduced unnecessary regulatory burden at the state level.

Your updating these statutes also significantly strengthened the Department's regulatory and enforcement authority. All of these changes should assist in promoting a safe and sound, competitive and healthy industry in the commonwealth.

Regulatory Update: Conversions to State Charter

Since we are talking about banking competition, I would like to discuss the number of banks that have converted to a Pennsylvania state charter. Since 2010 more than 20 federally chartered banks have chosen to convert to a state charter.

This indicates that bankers recognize and respect that Pennsylvania regulators understand local markets and the uniqueness of Pennsylvania banks business models.

Currently 75 percent of the banks that are headquartered in Pennsylvania are state chartered institutions.

Bank Shares Tax

I would like to add a few words about Pennsylvania's bank shares tax. The bank tax reform enacted in Act 52 was supposed to be revenue neutral. Revenue neutrality was a core principle and goal of Act 52.

However, Act 52 has proven not to be revenue neutral. The administration is willing to work with the General Assembly and the industry to fix the revenue problem caused by Act 52. The administration has proposed changes to language relating to deductions for goodwill and apportionment issues, which are important to the industry.

Conclusion

Finally, I believe it is safe to say that, overall, Pennsylvania banks are on much firmer competitive ground these days. FDIC data show them lending more than they did last year and the year before that. Thanks to the work of the General Assembly, Pennsylvania's banking statutes have been modernized and updated for the 21st century marketplace. And the Department of Banking and Securities offers what is clearly the "charter of choice" for banks in Pennsylvania.

Thank you, and I'd be happy to take any questions.