Interstate Banking

Douglas H. Ginsburg

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Douglas H. Ginsburg*

CONTENTS

INTRODUCTION .................................. 1137
I. CONTEXT OF THE STUDY ..................... 1139
   A. The Current Legal Position ............. 1139
      1. The Dual Banking System: State and National
         Banks .................................. 1139
         a. Origins ........................... 1139
         b. Regulatory Competition .......... 1141
            i. Entry ........................... 1142
            ii. Examination ................... 1146
            iii. Powers ........................ 1147
         c. Increasing Regulatory Uniformity ... 1150
            i. Reserve Requirements ........... 1151
            ii. Branching Authority .......... 1152

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2. The Triple Banking System: BHCs 1155
   a. BHCs and Regulation 1156
   b. Diversification Under the 1970 Amendments 1161
3. The State-by-State Banking System 1165
   a. The Role of Federal Law 1166
   b. The Case for the State-by-State Banking System 1169

B. The Current Business Reality 1175
1. Reasons for Interstate Efforts 1175
   a. Growing and Contracting Markets 1175
   b. Geographical Risk Diversification 1177
   c. Economies of Scale 1179
   d. Technological Opportunities: Computing and Communicating 1183
2. Interstate Banking Today 1185
   a. Commercial Interstate Banking 1186
      i. Loan Production Offices (LPOs) and Call Programs 1186
      ii. Cash Management Services 1188
      iii. Edge Act Corporations 1191
   b. Retail Banking Interstate 1194
      i. Credit Cards 1194
      ii. Retail LPOs 1195
      iii. Solicitation of Deposits 1198
      iv. ATM Networks 1199
   c. Interstate Nonbank Subsidiaries 1204
      i. Extending Credit 1205
         aa. Consumer-Finance Companies 1205
         bb. Mortgage Banks 1206
         cc. Factors 1206
         dd. Commercial Finance and Leasing Companies 1206
      ii. Deposit-Taking 1207
      iii. Trust and Fiduciary Services 1210
   d. Interstate Data Processing 1211
   e. Perspectives on Interstate Banking 1213
   f. Notes on the Significance of Deposit-Taking 1216

C. The Current Legal Position Reconsidered 1219
1. Implications of the Current System 1219
   a. The Branch-Definition Problem 1220
b. Concentration and Competition ........ 1221

c. The Premises of State-by-State Banking ... 1223

2. The State of the Debate ................. 1226
   a. State Legislation .................... 1226
   b. Problems of Reciprocity .......... 1229
   c. The Presidential Report .......... 1230

II. THE CRITERIA FOR DECISION ............. 1233

A. Consumer Welfare ........................ 1234
   1. Depositors ............................ 1236
   2. Retail Borrowers ...................... 1239
   3. Commercial Borrowers ............... 1240

B. Producer Welfare ........................ 1241
   1. Shareholders .......................... 1241
   2. Employees ............................. 1243

C. Equity of Regulation ........................ 1244
   1. Banks in Different Markets ........ 1245
   2. Grandfathered Multistate Foreign Banks and Domestic BHCs ....... 1246
   3. Banks and their Nonbank Competitors .... 1248

D. Soundness Supervision .................... 1252

E. Policy Guidance .......................... 1255
   1. Funding Public Debt ................. 1256
   2. Implementing Monetary Policy ........ 1258
   3. Housing Finance ....................... 1259
   4. Extending Local Credit .............. 1261
   5. Note on the Significance of Foreign Ownership ................. 1262
   6. Implications of Interstate Banking .... 1266
      a. Funding Public Debt ............... 1266
      b. Implementing Monetary Policy ...... 1268
      c. Housing Finance .................... 1269
      d. Extending Local Credit ............ 1269
      e. Conclusions ........................ 1270

F. Undue Concentration of Resources ........ 1270
   1. Market Concentration ............... 1271
   2. Asset Aggregation .................... 1273
      a. Political Influence ............... 1276
      b. Credit Judgments ................... 1277
      c. Failure Intolerable ............... 1278
      d. Implications of Interstate Banking .... 1279

G. Summary and Conclusions ................. 1284
   1. Summary of Part II ................... 1284

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2. Conclusion: The General Case Favors Interstate Banking ............................ 1285

III. ISSUES OF EXTENT AND MEANS ........................................ 1288

A. Geographical Limitations on Interstate Banking .......................... 1288
   1. Consumer Welfare .................................................. 1289
   2. Producer Welfare .................................................... 1289
   3. Equity of Regulation .............................................. 1292
   4. Soundness Supervision ............................................ 1295
   5. Policy Guidance .................................................. 1297
   6. Undue Concentration of Resources .............................. 1299
   7. Summary and Conclusion ......................................... 1301
   8. Note on Phasing-In ................................................ 1303

B. Functional Limitations on Interstate Banking: ATMs Only? .................. 1308

C. Multistate BHCs vs. Interstate Branching .................................. 1314
   1. Consumer Welfare .................................................. 1316
   2. Producer Welfare .................................................... 1318
   3. Equity of Regulation .............................................. 1319
      a. Banks in Different Markets ................................... 1319
      b. Grandfathered BHCs ........................................... 1321
      c. Banks and their Nonbank Competitors ...................... 1322
   4. Soundness Supervision ............................................ 1322
   5. Policy Guidance .................................................. 1327
   6. Undue Concentration of Resources .............................. 1329
   7. Summary and Conclusion ......................................... 1332
   8. Notes on the Definition of a Branch ............................ 1335

D. Interstate Acquisition vs. De Novo Entry .................................. 1341
   1. Methods of Market Entry .......................................... 1343
      a. De Novo Entry ................................................... 1344
      b. Entry by Acquisition ......................................... 1344
      c. Hybrid Entry ................................................... 1346
   2. The Criteria Applied .............................................. 1347
      a. Consumer Welfare ................................................ 1347
      b. Producer Welfare ................................................ 1348
      c. Equity of Regulation ............................................ 1351
      d. Undue Concentration of Resources .......................... 1354
   3. A Mixed National Strategy ........................................ 1355
   5. Conclusion to Part III ............................................ 1358

IV. STANDARDS AND PROCEDURES FOR INTERSTATE ENTRY .................. 1361

A. Standards for Interstate Branching De Novo ................................ 1361
INTRODUCTION

Commercial banking enterprises are unique among major American businesses. Unlike their counterparts in industry, which may transact business throughout the United States, commercial banking enterprises may not engage in "the business of banking," either directly through branch offices or by affiliation with a commonly owned bank, in more than one state.¹ A bank chartered by and located in state A may not open a branch in state B; likewise, a bank holding company (BHC) that owns a bank in state A may not acquire a controlling interest in or receive a charter for a bank in state B. Of course, a bank or BHC with a bank or banks located in one state may lawfully deal with residents of another. As a practical matter, however, without a local branch it will often be at a disadvantage in seeking the business of local residents. Whether the disadvantage is significant depends upon the particular service, since a bank or BHC can offer some services conveniently by mail or telephone and others through a local office that is not a bank or branch—that is, one not engaged, as a matter of law, in "the business of banking."

This cursory statement of the regulatory regime for banking raises a host of questions: What is "the business of banking"? What is a "bank"? A "branch"? Why does the regulatory regime confine a

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¹. Commercial banking enterprises include both banks and bank holding companies. State-chartered mutual savings banks, savings and loan associations, and credit unions are usually similarly restricted, depending upon state laws. Even in the aggregate, however, these thrift institutions do not approach commercial banking either in size or in importance to the nation's economy: hence, this Article's exclusive focus on commercial banking. A separate analysis would be required to determine whether the considerations raised herein with respect to commercial banking apply with equal force to the thrifts. Within commercial banking, there are some exceptional cases of interstate branching and affiliation that were "grandfathered" when prohibitory legislation was enacted. See text accompanying notes 501-507 infra.

². "Control" is defined in this context as the ownership, control, or power, direct or indirect, to vote twenty-five percent of any class of shares, elect a majority of directors, or exercise "a controlling influence over the management or policies of the bank." 12 U.S.C. § 1841(a)(2) (1976).

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banking organization's banks and branches to a single state? Most important, what are the costs and benefits involved? Would an interstate reach for banking organizations—whether nationwide or regional—be preferable?

This Article considers the appropriate geographical limitations for enterprises engaged in the business of banking. Each of the questions raised in the preceding paragraph must be addressed to some extent in order to conduct the inquiry fully; the last two will be dealt with extensively. The Article will develop, and then apply, the criteria for determining that one geographical configuration for the banking industry is “preferable” to another. Accordingly, after establishing in Part I both the legal and business backgrounds against which this inquiry proceeds, I shall specify in Part II the appropriate criteria for analyzing alternative policies respecting geographical limitations. Part III will examine the extent and means of interstate banking indicated by the criteria. There I will take up such issues of means as interstate branching versus multistate BHCs and acquisitions versus de novo entry, as well as such issues of extent as full-service branching versus automated teller machines and the limits to be placed on the geographical reach of banking organizations. This effort will entail both application of the criteria developed in Part II and analysis of the political considerations that may constrain the changes possible or desirable in the geographical structure of the banking industry. Finally, Part IV will detail the standards and procedures that should be applied to a bank or BHC application to open an interstate banking facility. The recommendations developed for interstate market penetration by banking organizations will be offered subject to familiar standards respecting bank solvency and community needs and a preference for the most procompetitive form of entry practically available in the particular circumstances.

On the basis of the criteria developed here, and inferences drawn from current experience, I conclude first that out-of-state BHCs should be able to acquire existing banks or obtain de novo charters on the same terms as local banks and BHCs. It will probably be necessary, however, as the political price of geographical liberalization, to allow states to limit the means of entry by an out-of-state BHC. Thus, as a second-best solution, a state would be able to provide that entry by an out-of-state BHC be accomplished only by acquiring an existing bank, or only by chartering a de novo bank, as long as the state applies the same limitation to intrastate geographical extensions by in-state BHCs.
Second, a bank located within a metropolitan area including more than one state should be able to branch throughout that metropolitan area regardless of state boundaries. Third, I will conclude that banks should be permitted to open "wholesale" branches in major financial centers to serve commercial customers.

I. CONTEXT OF THE STUDY

A. The Current Legal Position

1. The Dual Banking System: State and National Banks.—Express authority, in the form of a charter, is required for entry into the business of banking. A charter may be granted by a state, acting through a banking commissioner or a collegial agency, or by the federal government, acting through the Comptroller of the Currency. In either case, the resulting state or national bank will thereafter be supervised primarily by the chartering authority, its "primary regulator." An existing bank, however, may convert from one type of charter to the other—from state to national or vice versa—with the permission of only the regulator to whose regime it seeks admission. Thereafter, its primary regulator will be the new, rather than the original, chartering authority.

a. Origins.—Until Congress enacted the National Bank Act in 1863, commercial banks had been chartered exclusively by the states, with the brief exceptions of the congressionally chartered Bank of North America (1781-1785) and the bitterly controversial First (1791-1811) and Second (1816-1836) Bank of the United States. The federal government entered the commercial-bank-
chartering field in 1863 in response to problems encountered in financing the Civil War. Under the National Bank Act, charters were available only upon purchasing and depositing a substantial volume of United States bonds, in return for which the bank received national bank notes, a national currency. National banks were given special privileges, such as serving as depositories of government funds, while bank notes issued by state banks were subjected to a two-percent tax. In this way the federal government intended to drive state banks out of existence, subject all banking to federal regulation, establish a uniform currency, and support the market for its debt. When this combination of carrots and sticks proved inadequate to attract many state banks to national charters, Congress raised the tax on state bank notes to ten percent. The constitutionality of the tax was upheld by the Supreme Court in 1869 in an opinion by Chief Justice Salmon P. Chase who had promoted the national bank scheme when he was the Secretary of the Treasury, charged with financing the Union government. Although some state banks persisted after the Supreme

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9. As a contemporary observer noted, "[t]he great argument in favor of the measure was, that it would support the public credit and create a demand for government bonds." S. NEWCOMB, A CRITICAL EXAMINATION OF OUR FINANCIAL POLICY DURING THE SOUTHERN REBELLION 212 (1865). As Bray Hammond has noted, however, the establishment of the national bank system was also part of a more general plan, devised by several members of Congress in December 1861, for financing the Civil War through the sale of bonded indebtedness, as well as taxation and the issuance of greenbacks. Hammond, The North's Empty Purse, 1861-1862, 67 AM. HIST. REV. 1, 8-14 (1961). Earlier that year, Secretary of the Treasury Salmon P. Chase had been so frustrated by the reluctance of New York banks to lend the government $150 million in specie that he threatened to "put out paper until it takes $1,000 to buy a breakfast." A. HART, SALMON PORTLAND CHASE 223 (1899).

10. Only 66 banks, mostly in the Middle West, took out national charters in the first eight months after passage of the National Bank Act, and their note circulation was less than $4 million. P. STUDENSKI & H. KROOSS, supra note 8, at 154.

11. Act of March 3, 1865, ch. 78, § 6, 13 Stat. 469, 484. Thus it has been said that the national bank proposal "was of far less help to the war than the war was of help to it." Hammond, supra note 9, at 10.


13. Hammond, supra note 9, at 10-11.
Court's decision, the great majority converted to national charters. In 1870, about eighty-five percent of all banks, holding eighty-eight percent of all bank deposits, were national. The survival and later resurgence of state banks was made possible, however, by the general shift to the use of checking deposits instead of bank notes as money. Able to circumvent the disability created by the tax on their notes, many states' bank charters again became more attractive than national charters since state regulation was generally less stringent. In fact, the decline in state bank deposits ceased in 1867; state and national bank deposits were about equal in 1871; and state banks again outnumbered national banks by 1892. There have been no other frontal assaults on state banks since 1865. Today there are more state than national banks in every state except Pennsylvania, although national banks hold fifty-four percent of all commercial bank deposits.

b. Regulatory Competition.—Because of the competitive check on state and federal regulators that the dual system provides—each is restrained from “excessive” regulation by the ability of banks to switch charters and therefore regulators—banks have venerated the dual bank system as their “magna carta.” They have fought to preserve the system's vitality against proposals for federal preemption of bank regulation and presumably would be equally

14. In 1864, there were 467 national and 1,089 state banks. By 1866, the numbers were 1,634 and 297 respectively. FEDERAL RESERVE BOARD, BANKING STUDIES 418, table 2 (1941) [hereinafter cited as BANKING STUDIES].
15. Id.
17. Id.
18. BANKING STUDIES, supra note 14, at 418, table 2.
opposed to exclusive state regulation. Indeed, since regulatory competition is the essence of the dual banking system, I pause here to examine how and where it operates.

i. Entry.—Banking entry is controlled and limited primarily for two reasons.23 The first is consumer, particularly depositor, protection, for banks and bankers are foremost the custodians of "other people's money."24 The opportunities for fraud and the severe consequences of mismanagement caution against completely free entry to a greater extent than obtains in many other entry-regulated fields. This concern, however, touches only upon the character, competence, and other qualifications of the individuals and entities admitted to the industry, and not upon the number or location of banks.25

The second reason for controlled entry is limiting competition.26 A highly competitive industry is characterized by a rate of failure and withdrawal unacceptable in banking due to: (1) the disruption of established consumer and commercial borrowing relationships resulting from a bank's closing; (2) the infectious and self-fulfilling character of a loss of public confidence in the solvency of banks; and (3) the financial impact of bank failure on uninsured de-

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23. These are the public policy justifications for entry control. For the view that such entry regulation is procured by the regulated industry in order to secure protection from competition, see Stigler, The Theory of Economic Regulation, 2 BELL J. ECON. 3 (1971).

24. L. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT passim (1914).

25. See, e.g., 12 U.S.C. §§ 1814, 1816 (1976) (Comptroller to certify to FDIC consideration, inter alia, of the "general character of [the] management" of each newly chartered national bank); N.Y. BANKING LAW § 24(1) (McKinney 1971) ("character, responsibility and general fitness" of bank organizers must be "such as to command confidence and warrant belief that the business of the proposed corporation... will be honestly and efficiently conducted in accordance with the intent and purpose of [this section]"); Investigation into Federally Insured Banks: Hearings Before the Permanent Subcomm. on Investigations of the Senate Comm. on Gov't Operations, 89th Cong., 1st Sess. pt. 1, at 22 (1965) [hereinafter cited as Investigation into Federally Insured Banks]. Cf. 47 C.F.R. § 73.24 (1980) (broadcast license applicant must be "of good character"). On the administration of the character requirement in the broadcasting context, see Sharp & Lively, Can the Broadcaster in the Black Hat Ride Again? "Good Character" Requirement for Broadcast Licensees, 32 FED. COM. L.J. 173 (1980).

26. See, e.g., Smith & Greenspun, Structural Limitations on Bank Competition, 32 LAW & CONTEMP. PROB. 40-44 (1967).
positors. In order to limit competition, the number and location of banks in a given area must be controlled.

The unique element in the control of bank entry is competition among regulators to grant charters. Under the dual banking system, state and national governments may both charter a bank at a particular location; if one chartering authority will not grant a charter, perhaps the other will. While both the state regulator and the national Comptroller must consider whether the community "needs" will sustain another bank, as well as the related question whether existing banks can withstand added competition, the two char-


28. Peltzman, Entry in Commercial Banking, 8 J.L. & Econ. 11, 48 (1965), estimates that in the absence of legal restrictions on entry the number of new banks formed in the years 1936 through 1962 would have been about twice the number actually authorized (2,272). But see Edwards & Edwards, Measuring the Effectiveness of Regulation: The Case of Bank Entry Regulation, 17 J.L. & Econ. 445 (1974) (Peltzman's finding reduced by 25 to 50 percent).

The justifications for limiting entry—depositor protection and the maintenance of a less-than-fully-competitive market structure in order to control the externalities associated with unbridled competition—are not uniquely applicable to banking regulation. Indeed, they are the usual justifications for control over entry in the absence of rate regulation. Thus, for example, state control of admission to a trade or profession may be based on either of the justifications, although it is more often justified solely as a means of consumer protection from fraud and incompetence. See T. MORGAN, ECONOMIC REGULATION OF BUSINESS 170 (1976) (entry regulation apart from natural monopolies and the need to allocate inherently limited resources, such as ratio spectrum, arises where "safety or welfare of individuals depends on conduct they cannot dictate and information they cannot acquire without excessive expense"). Cf. M. FRIEDMAN, CAPITALISM AND FREEDOM 137-60 (1962) (need for occupational licensure generally doubted). Further, entry into broadcasting is regulated in part on the ground that the rigors of competition will lead to a degredation of service to the public. See Carroll Broadcasting Co. v. FCC, 258 F.2d 440 (D.C. Cir. 1958).


30. The Office of the Comptroller of the Currency (OCC) has recently revised its charter policy by "a shift in emphasis from the appraisal of economic and competitive conditions in the community to be served to the appraisal of the organizing group and its operating plan." OCC Classification and Revision of Charter Policy; Final Rule and Request for Comments, 45 Fed. Reg. 68,603 (1980). By statute, however, the Comptroller must still, like most state bank commissioners, consider the "convenience and needs" of the target market. 12 U.S.C. § 1816 (1976).
tering authorities may apply these standards differently, with one inclined to a more pro-competition, pro-entry view of the market.\textsuperscript{31}

Indeed, each has an incentive to be the more liberal. If the state regulator, for example, takes a more restrictive view than the Comptroller, applicants will seek and may receive national charters. The result will be additional competitors in the market, notwithstanding the state regulator's preference to the contrary. Worse from the state's point of view, the new competitors will be national banks, supervised by the Comptroller. At the same level of resulting competition, the state regulator might have had additional constituents, justifying a larger staff and budget.\textsuperscript{32} Thus conditions would exist enabling state regulators to pursue personal or

\textsuperscript{31} It is clear, for instance, that Comptroller Saxon had a more procompetitive bias than his predecessors, his successors, and his state counterparts. Thus, the average number of new national banks Comptroller Saxon chartered annually during the years 1962-1966 increased to 448\% of the average for the years 1957-1961. See G. Fischer, American Banking Structure 212, table 5.3 (1968). It was 427\% of the average chartered by Comptroller Camp during the period 1957-71. See Scott, supra note 5, at 24, table 1. Meanwhile, the annual average number of banks converting from state to national charters increased from nine in 1957-1961 to twenty-three in 1962-1966, thereafter decreasing to thirteen in 1967-1971; the annual average number of banks dropping national for state charters increased from four to eight and then increased again to twenty-two over the three quinquennia. See id. at 26, table 3. The last set of data suggests that even in states where a state charter was more desirable, some entrants may ultimately have found it easier to obtain one during the Saxon years by first getting a national bank charter and then converting to state status. In fact, four of the thirteen national banks merged into state banks in 1966 had been chartered in 1962 or 1963; of those converting in 1965, one of the eight national banks converting to a state charter, and two of the eighteen merged into state banks, had been chartered in 1963 or 1964. Even one of the mere six national to state conversions in 1964 had been chartered by Comptroller Saxon, in 1962. Moreover, every one of these eight national banks converting to or merging into state banks was located in California (4), Texas (2), or Virginia (2), suggesting that these may have been particularly difficult states in which to obtain state charters at the time. See generally 55 Cal. Superintendent of Banks Ann. Rep. 12 (1964) (noting decline in number of new state banks chartered and "sharp increase" in number of new national banks); 56 Cal. Superintendent of Banks Ann. Rep. 13 (1965) (noting continued decline in new state banks chartered and increase in new national banks chartered).


state policies respecting such matters as bank reinvestment in home mortgages, local enterprises, and municipal debt, and in states that allow branching, the appropriate number and location of branch offices.

The incentive for both the state regulator and the Comptroller liberally to charter is offset by their concern with avoiding bank failures. Generally, a failed bank is no longer merely liquidated, with the adverse consequences mentioned above. Instead, the Federal Deposit Insurance Corporation (FDIC), which insures the first $100,000 of most accounts in state and national commercial banks, induces another local bank or group of banks to purchase the good assets and branches, and assume the deposit liabilities, of the failed bank. Nonetheless, the failed bank’s primary regulator is often held accountable by the legislature for the failure, which still entails some adverse effects: decreased competition; disruption of banking relationships; loss of some employment; loss to the failed bank’s shareholders; and loss of public confidence in the banking system. Needless to say, regulators wish to avoid such occasions for legislative inquiry which, in the case of a large failure or a number of small ones within a short time, can be embarrassing as well as protracted.

33. See text accompanying notes 25-28 supra.
35. In the period 1975-1979, the FDIC arranged purchase and assumption transactions in 42 of the 52 instances of insured bank failure. [1979] FDIC ANN. REP. 205-06, table 124.
At the point of entry control, then, there are conflicting motivations at work. Entry control was adopted by the legislatures partly to limit entry, but regulatory competition between the Comptroller and his or her counterpart at the state level tends to encourage more permissive administration of entry policy. At the same time, controlled entry is reinforced by legislative oversight, post hoc, when there are significant bank failures.

This is not to suggest that many bank failures result from overly competitive banking markets. In fact, there have been relatively few bank failure in recent decades and most have been caused by fraud or mismanagement. Studies of entry policy and concentration ratios in banking markets suggest that both state and national regulators have limited entry and bank competition, notwithstanding regulatory competition, to a degree sufficient to avoid failures and ensuing legislative disapprobation.

ii. Examination.—For the same reason—avoiding legislative sanctions for bank failures—regulators have not made laxity in solvency examination a locus of regulatory competition. Bank examinations are not as detailed as financial audits but are much broader in scope. Every aspect of a bank's operations relevant to solvency...
may be examined, including the quality of management personnel, security and control systems, liability management procedures, and asset quality.\textsuperscript{41} While the adequacy of some examination staff and procedures has been criticized by legislatures investigating bank failures,\textsuperscript{42} there is little evidence that a state regulator or a Comptroller has even implicitly held out the prospect of lax examination to make a particular bank charter more attractive.\textsuperscript{43}

iii. Powers.—On the other hand, there is evidence of vigorous competition between the Comptroller and the state regulators (including even some state legislatures) to make their respective charters more attractive by interpreting broadly the powers that such charters generally authorize and administering liberally statutory grants of discretion to regulators to confer special powers upon banks.\textsuperscript{44} Thus, for example, the Comptroller has interpreted the National Bank Act as permitting national banks to offer travel-agency services,\textsuperscript{45} establish and operate mutual funds,\textsuperscript{46} open loan production offices,\textsuperscript{47} and so on.\textsuperscript{48} Although each of these interpre-

\textsuperscript{41} See 1980 Senate Staff Study, supra note 38, at 1; Miller, \textit{The Manpower Cost of Bank Examination}, in 2 FDIC Task Force, supra note 31, at 417, 420.

\textsuperscript{42} E.g., Dunne, \textit{Shoring Up the Dual System—A Modest Suggestion}, 95 Banking L.J. 403 (1978). On average, federal-agency examiners are more highly regarded by bankers than their state counterparts; both federal and state examiners regard the former as better trained. Elhat, \textit{The State and Federal Regulation of Commercial Banks: A Survey of Bankers, Regulators, and Consumer Specialists}, in 1 FDIC Task Force, supra note 31, at 305, 319-20.

\textsuperscript{43} The Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations claimed to have “evidence that some of the switching [by state member banks to national charters from 1960 to 1975] was motivated by a belief that OCC supervision would be less strict than supervision at the Federal Reserve.” H.R. Rep. No. 1669, supra note 36, at 7.

\textsuperscript{44} Indeed, an official of the Conference of State Bank Supervisors once observed that “the real value of [the dual banking] system, with its choice and its alternative sources of regulatory innovation, lies in bank powers not bank structure.” Guenther, \textit{The 1970 Bank Holding Company Act Amendments and State Influence on Banking Structure}, 89 Banking L.J. 318, 328 (1972).

\textsuperscript{45} Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972) (interpretive ruling invalid).


\textsuperscript{48} \textit{See} First Nat'l Bank v. Dickinson, 396 U.S. 122 (1969) (interpretive ruling
tations was rejected by the courts, others—most importantly, those authorizing financially related data processing services and personal property leasing—have survived judicial review, though substantially qualified in breadth by the courts.

Some state regulators have also been expansive in interpreting the charter-powers provisions of their organic statutes and a majority of state legislatures have assured state banks of competitive equality with national banks by promulgating statutes authorizing state banks to exercise all powers possessed by national banks, in addition to their enumerated powers.

Regulatory competition through liberal exercise of discretion is somewhat harder to assess. Discretionary grants of special powers involve such matters as applications to open branches, in states permitting branching, and applications to acquire other banks. Although there is some impressionistic evidence of regulatory competition in these areas, discretionary decisions have not been rigorously studied to determine whether liberalization by one regulator has led the other to follow suit. This may reflect the methodological problem of establishing a causal relationship between two

49. 12 C.F.R. § 7.3500 (1981); see National Retailers Corp. v. Valley Nat'l Bank, 411 F. Supp. 308 (D. Ariz. 1976) (ruling authorizing insurance business invalid), aff'd, 604 F.2d 32 (9th Cir. 1979) (data-processing services authorized only to extent they are convenient, useful, or otherwise directly related to the bank's performance of an express power specified in the National Bank Act; the Comptroller was a defendant in action).

50. 12 C.F.R. § 7.3400 (1981); see M & M Leasing Corp. v. Seattle First Nat'l Bank, 563 F.2d 1377 (9th Cir. 1977) (leasing authorized only to extent lease transaction constitutes loan secured by leased property).

51. For example, the New York Banking Department allows state banks to offer financially related data-processing services generally to the same extent as does the Comptroller for national banks. Interview with Arthur Geldman, Attorney for N.Y. Banking Dep't (Jan. 5, 1980).

52. At least thirty-four states have such so-called wild card provisions in some form. See Miller, supra note 31, at 2 FDIC TASK FORCE, supra note 31, at 511; Conflict Hearings, supra note 29, at 241, 242-43 (statement of Floyd W. Kramer, Member, Colorado Banking Bd.).

53. Scott, supra note 5, at 31, cites instances in which state regulators have prevailed upon the Fed to reverse its prior rulings and allow banks to open loan production offices and invest in operations subsidiaries to meet those of the Comptroller in the wake of major conversions by member banks to national charters.
factors in what are inevitably complex situations. Nonetheless, it is fairly inferable in principle that a bank regulator with a significantly tighter policy on branch applications or grants of other discretionary powers than his or her counterpart in the other system would find banks converting their charter status to that of the more liberal regulator.

The recent attempt of the Marine Midland Bank, chartered by New York, to be acquired by the Hong Kong and Shanghai Banking Corporation (HKSB) provides an example. Because HKSB would become a BHC by reason of the acquisition, Federal Reserve Board (Fed) approval of the acquisition was needed, and obtained. New York Banking Commissioner Siebert, however, indicated that she would not approve HKSB's acquisition of control of Marine Midland, whereupon the bank applied to convert to a national charter. The Comptroller granted the charter; the acquisition was consummated; and Marine Midland remains a national bank. Moreover, since the Marine Midland acquisition, Comptroller Heimann has made a lengthy statement dealing indulgently with foreign acquisitions in general. Thus state banks throughout the country trying to be acquired by foreign banks may secure their regulator's approval more readily in the future with implicit or explicit threats to convert to national status.

There are many ways in which national and state banking statutes and regulatory systems can and do differ, and these differences confer competitive advantages or disadvantages upon constituent banks. An example is the disparate treatment of limits on loans to any one borrower. This limit is generally expressed as a

55. It would be almost impossible to demonstrate a statistically significant increase that might not also be explained by other factors applicable to all banks within that state. State-bank branch-application approvals, for instance, lagged after a similar increase for national banks in the same state.
62. CSBS PROFILE, supra note 19, at 126-29.
percentage of capital, itself variously defined, and establishes a maximum loan with respect to any given bank. The maximum may differ in a particular state depending upon whether the bank holds a national or state charter. Accordingly, the lending limit and other statutory differences affecting the choice of charter are de facto terms of competition between the two banking systems. Taken together, however, they are not as important as a significant disparity between the national and state regimes in granting general and special powers to banks.

c. Increasing Regulatory Uniformity.—In recent years, Congress has passed a number of banking laws applicable to both national and state banks. As a formal matter, the predicate for asserting jurisdiction over state banks has generally been, with few exceptions, that their deposits are insured by the FDIC. In most states, banks are required by statute (as are national banks), or by regulatory policy, to insure their deposits with the FDIC. In three states, however, including such a major banking center as Texas, deposit insurance is not required; nevertheless it remains a business necessity for state-chartered banks to obtain FDIC insurance in order to compete with national banks for deposits.


64. For exceptions, wherein federal regulation purports to govern state noninsured banks that are merely eligible for FDIC insurance, see Consumer Checking Account Equity Act, title III of the 1980 Act, supra note 63, and the Monetary Control Act of 1980, title I of the 1980 Act, supra note 63, which extends reserve requirements to such institutions. The first-cited statute, insofar as it authorizes FDIC-eligible but noninsured institutions to offer NOW accounts, would not seem to be effective except where supplemented by state law authorization to such state-chartered institutions; there is no basis for inferring an intent to preempt state prohibitory law, that is, with respect to entities lacking federal deposit insurance.


68. See CSBS PROFILE, supra note 19, at 151-52 (state requirements for deposit insurance); [1979] FDIC ANN. REP., supra note 34, at 150, table 103 (all but 5 of 1,427 banks in Texas FDIC insured).
Since FDIC insurance is a practical necessity, Congress can regulate uniformly by conditioning FDIC insurance upon compliance with desired norms. While states remain free in theory to impose even more stringent conditions upon state-chartered banks, they would do so to their competitive detriment. Thus federal standards linked to insured status are likely to be a uniform feature of bank regulation across the two systems.

i. Reserve Requirements.—The most significant extension of uniform regulation concerns reserve requirements. Since 1914 national banks have had to be, and state banks have been permitted to become, members of the Federal Reserve System. Member banks are required to subscribe six percent of capital as a condition for stock in their regional Federal Reserve Bank. Until 1980 they alone have been subject to the Fed's requirement that a percentage of deposit liabilities be held in vault cash or in a non-interest-bearing account at the Federal Reserve Bank. In this way, member banks were an instrument through which the Fed could exercise monetary policy, for the Fed's adjustment of reserve requirements would affect the amount of member banks' lendable funds and thus the overall money supply. Nonmember state banks, in contrast, were required by the states to hold reserves only for the purpose of meeting liquidity needs. Typically, therefore, they were allowed to meet reserve requirements with Treasury bills, which are readily marketable and earn interest.

The capital subscription and the reserve requirement have acted as implicit, substantial taxes on Fed member banks. The effect of the taxes was offset, to an extent that varied with the size of the bank, by the Fed's provision of free services such as check processing and coin and currency services. Nonetheless, the economic significance of the implicit taxes was so great, in spite of the

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71. Federal Reserve Act, ch. 6, § 19(b) 38 Stat. 270 (repealed by 1980 Act, supra note 63).
72. When a commercial bank makes a loan, it establishes a demand-deposit account in favor of the borrower, which may draw on its loan by writing checks against the account. Under a fractional-reserve system, the establishment of such an account occasions a reserve requirement. Thus the greater the reserves that must be maintained, the more limited a bank's ability to make loans.
73. E.g., FLA. STAT. ANN. § 655.68(1) (West Supp. 1980).
74. See, e.g., Gilbert, Utilization of Federal Reserve Bank Services by Member Banks: Implications for the Costs and Benefits of Membership, FED. RES. BANK OF ST. LOUIS MONTHLY REV., August 1977, at 2.
offset for Fed services, that many banks withdrew from Fed membership during the 1970s. Since national banks have to be Fed members, some national banks switched to state charters; some new and extant state banks were probably deterred from seeking national charters.

When the Federal Reserve Bank convinced Congress that the exodus of Fed members was so severe that the Board's ability to control monetary policy was jeopardized, Congress made the reserve requirements essentially universal by extending them, on a phased-in schedule, to all FDIC-insured banks (as well as other depository institutions offering transaction accounts). In addition, Congress directed the Fed to charge a compensatory price to members and nonmembers alike for all services. Consequently, while member banks are still burdened by the stock-subscription feature of Fed membership, and the benefits of membership are now far from clear, most of the previous burden of Fed membership has been extended to nonmembers, removing a disadvantage long associated with national bank charters.

ii. Branching Authority.—A degree of regulatory uniformity was achieved regarding the branching powers of state and national banks when in 1933 federal law incorporated statutory provisions governing branching. Prior to 1927, national banks were prohibited from opening branches by the National Bank Act, as interpreted by the early Comptrollers. Meanwhile, some states had been authorizing branching with increasing liberality. State-chartered banks in these states were thus able to follow their customers to the newly burgeoning suburbs, making themselves convenient to the public and gaining a competitive advantage over national banks. At the same time, branching policy varied greatly among

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76. 1980 Act, supra note 63, § 103, 94 Stat. 133.
77. The extension of NOW account—an interest-bearing savings account against which check-like negotiable orders of withdrawal may be written—authority to federal savings-and-loan associations and mutual savings banks, see id. § 303, 94 Stat. 146, and the authorization for credit unions to offer "share draft" accounts gave these institutions the ability to create money by making loans in the form of transaction account balances payable essentially on demand. Id. § 305, 94 Stat. 146. The monetary control policies that justified a reserve requirement for commercial banks thereafter applied equally to these other types of depository institutions.
the states. At one extreme were the so-called "unit bank" states, which did not allow branching; at the other extreme were those permitting statewide branching, subject only to prudential considerations. In between were those authorizing branching subject to geographical limitations such as home or contiguous county branching, numerical limitations such as opening no more than one or two new branches per year, or anticompetitive limitations such as protecting a bank from branch competition in its home office community.

Notwithstanding the National Bank Act, some national banks managed to take advantage of the branching powers open to their state competitors. Shortly after its enactment, the Act was amended to induce more state banks to convert to national charters by adding a provision allowing state banks with branches to retain their branches after conversion to national status. Pursuant to the Consolidation Act of 1918, moreover, a bank with branches retained at its conversion from state to national status could consolidate with another national bank. Accordingly, in branch-banking states, national banks could acquire branches by inducing a state bank with branches to convert to national status and then consolidating with it. Indeed, the national bank could cause a state bank to be chartered, to open branches, and then to consolidate with itself. By 1926 national banks had acquired 121 branches by this circuitous route.

In 1927 Congress ameliorated the branching disadvantage through passage of the McFadden Act, which authorized national banks to open a limited number of branches in their home communities. The inadequacy of this home-community solution

81. E.g., PA. STAT. ANN. tit. 7, § 904(b) (Purdon 1967).
82. E.g., MASS. GEN. LAWS ANN. ch. 172, § 11 (West Supp. 1981) (maximum of one branch office per year outside home county).
83. E.g., N.Y. BANKING LAW § 105(1) (McKinney Supp. 1980-1981) (bank may not branch into city of less than 50,000 population where principal office of another bank is located).
87. Act of Feb. 25, 1927, ch. 191, § 7, 44 Stat. 1224, 1228-29. Only one or two branches could be authorized in towns of 25,000 to 100,000 population, whereas in larger cities the Comptroller could determine the number of branches to be authorized. Id.
soon became apparent, however, and in 1932 the Senate passed a bill authorizing national banks to branch throughout their home state and interstate within fifty miles of their home office; the House, however, did not accede. Under the Senate’s approach, national banks would have had an advantage in every state that did not meet the competition by authorizing statewide branching for state banks. Even in states that did authorize such branching, interstate compacts would be required before state banks could branch across state lines in parity with national banks.

In 1933 Congress reconsidered the branching issue amidst the emergency atmosphere created by widespread bank failures and the President’s declaration of a “Bank Holiday.” The branching issue was resolved by a compromise enabling national banks to branch throughout their home state if state banks were authorized by statute to do so, subject to the same locational restrictions imposed upon state banks. As the Supreme Court has stated, whereas “National Banks have been National favorites” with respect to some subjects, in 1933 the Congress adopted a policy of “competitive equality” between national and state banks with respect to branching.

Regulatory competition has resurfaced, however, as the Comptroller has taken a narrow—and thus liberating—view regarding branch definition. The McFadden Act merely defines a branch as “any branch bank, branch office, branch agency, additional office, or any branch place of business . . . at which deposits are received, or checks paid, or money lent.” The Comptroller has interpreted this language to exclude from the definition a national bank’s “loan production office” (LPO), at which bank employees solicit loans and aid customer applications subsequently forwarded to the bank or a branch for acceptance; automated teller machines (ATMs)

90. 12 U.S.C. § 36(c) (1976). The statute provides for branching governed “by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks.” Id.
placed at remote locations, such as supermarkets, and armored-car services used to move cash between bank and customer.

The courts have disapproved each of these interpretations in the interest of competitive equality, but uniformity between the federal definition and state definitions of a branch cannot be achieved. For example, while ATMs are characterized as branches of national banks wherever located, they are not considered branches under some state laws. In these states, a national bank’s ATMs are therefore free of the state’s geographical limitations on branching, but are subject to the other provisions of the National Bank Act which burden branches: The bank must have a minimum amount of capital to support each branch and must receive administrative approval prior to its establishment. The Comptroller has taken steps to mitigate these burdens, but they cannot be eliminated. Those steps he has taken, while sensible, are of doubtful validity.

2. The Triple Banking System: BHCs.—The ownership of multiple banks by one or more individuals, known as "chain banking," began in the 1880s. In 1889 New Jersey became the first state to permit one corporation to purchase the stock of another without a special legislative act, giving rise to the bank-holding-company phenomenon. The BHC, which has superseded chain

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97. The decision invalidating the LPO interpretation was reversed for laches, however. Independent Bankers Ass’n of Am. v. Heimann, No. 78-0811 (D.D.C. Mar. 29, 1979), rev’d, 627 F.2d 486 (D.C. Cir. 1980).
98. E.g., COLO. REV. STAT. § 11-6.5-102 (Supp. 1980); MD. FIN. INST. CODE ANN. § 5-502(f) (1980).
99. The circuit court in Independent Bankers recognized this inequality and the impossibility of achieving complete equality between state and national banks in states that do not characterize as a branch any facility that would be so characterized under the McFadden Act. 534 F.2d at 949.
100. 41 Fed. Reg. 48,333 -34 (1976) (all of bank’s electronic branches in same city to be supported by single capital requirement; capital requirement may be shared where electronic branch is to be shared). The Comptroller has also reiterated the view that a terminal in which a national bank shares use is not a branch of that bank if it is not owned or rented by that bank. Id. This view is disputed at note 318 infra.
102. The phenomenon was originally known as “group banking.” G. FISCHER, supra note 31, at 75 (citing E. DONALDSON, CORPORATE FINANCE 715 (1957)).
banking, is thus distinguished by corporate rather than individual ownership of the stock in operating banks.

a. BHCs and Regulation.—The rapid growth of BHCs during the 1920s has been attributed to a variety of factors. For example, Fischer explains that, especially in rural areas, "[t]he weakness of banks made many of them anxious to join a group system, and the booming stock market made it possible for the holding companies to easily obtain the funds necessary to acquire new affiliates." However plausible this explanation, which posits a booming market for the shares of BHCs acquiring weak banks, it is more certainly true, as Fischer has elsewhere acknowledged, that the BHC movement was fueled "largely" by the desire to circumvent branch banking restrictions. Clearly, a BHC with ten unit banks could substitute, however imperfectly, for a single bank with the nine branches.

By 1929 there were 287 BHCs and chains in control of 2,103 banks and 1,415 branches in the United States. As of that time the twenty-eight largest BHCs owned 511 banks. By 1980 there were 329 multibank holding companies, controlling 2,261 banks and 11,418 branches. Of these multibank holding companies, 125 are in unit bank states and many more are in states with geographically limited branching. In both cases the BHC serves as a substitute for branching.

The BHC could also be used to acquire banks in more than one state, providing local law did not prohibit the practice. By 1929 there were several multistate BHCs: One owned banks in eight states; another "comprised two extensive branch systems in California, one of 287 and one of 160 branch offices, and one branch system of 34 branches located in New York City."

In addition to circumventing restrictions on branch banking, BHCs could be used to aggregate within one enterprise the powers of both state and national banks. Indeed, prior to the extension of the Fed reserve requirements to nonmember banks, some BHCs

103. G. FISCHER, supra note 31, at 95.
105. Id. at 30-32.
106. Id.
108. Id.
109. Id.
adjusted their portfolio of bank charters with aggregation in mind. For example, a BHC might maintain one national bank, with all of the other banks in the group holding state charters. The national bank would have to be a member of the Fed, subject to its reserve requirements. At the same time, however, the national bank could act as the correspondent bank for the other commonly owned state banks. As such, it would access the Fed’s services, principally check collection, on behalf of all banks in the group. The same access could be gained by a BHC retaining all state charters and making one of the banks a Fed member; however, making it a national bank had the added advantage, at no added cost, of obtaining for the BHC any powers that a national but not a state bank in the particular state might be able to exercise.

Prior to 1956 there was little federal regulation of BHCs. The Banking Act of 1933 affected only those companies controlling a majority of the shares of a Fed member bank and wishing to vote their shares to elect the subsidiary bank’s directors. Substantively, the Act did little more than limit intracorporate transactions: Banks were prohibited from lending more than ten percent of their capital and surplus to any one affiliate and more than twenty percent to all affiliates combined.

The Bank Holding Company Act of 1956 established the first comprehensive federal regulation of BHCs, but applied only to multibank holding companies, of which there were fewer than 50. The Act made the Fed the principal regulator of BHCs, with power to examine both BHCs and their banking and nonbanking subsidiaries. Fed approval was required before an organization in control of one bank could acquire more than five percent of the stock or substantially all the assets of another bank.

The Fed was to approve BHC bank acquisitions on the basis of

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111. For example, the Citizens & Southern Holding Company maintained two national banks and five state banks. See United States v. Citizens & Southern Nat’l Bank, 422 U.S. 86, 92 (1975).
rather vague standards, but the background from which the Act emerged indicates that Congress was principally concerned with the potentially anticompetitive aspects of the BHC movement: (1) concentration in the banking industry; and (2) tie-ins "requiring the bank's customers [presumably borrowers] to make use of [affiliated] nonbanking enterprises as a condition to doing business with the bank." The Act required multibank BHCs to divest themselves of their nonbanking businesses, except for:

shares of any company all the activities of which are of a financial, fiduciary, or insurance nature and which the Board . . . has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto and as to make it unnecessary for the prohibitions of this section to apply in order to carry out the purposes of this Act.

It does not appear, however, that significant divestitures were required by the 1956 Act, since almost all multibank BHCs had confined their nonbanking activities to other financial businesses and insurance.

Pursuant to a floor amendment offered by Senator Douglas, section 3(d) of the 1956 Act also prohibited BHCs from acquiring interests in additional banks outside the states in which their subsidiary banks had the largest total deposits as of 1956 "unless the acquisition of such shares or assets of a State bank by an out-of-State bank holding company is specifically authorized by the statute laws of the state in which such bank is located, by language to that effect and not merely by implication." Senator Douglas pre-

116. 12 U.S.C. § 1842(c) (1976) as amended by 1980 Act, supra note 63, § 713, 94 Stat. 190, incorporates the substance of sections 1 and 2 of the Sherman Act and section 7 of the Clayton Act, subjects the last-mentioned standard to a "convenience and needs" defense, and directs the Board in every case to "take into consideration the financial and managerial resources and future prospects of the company or companies and the banks concerned, and the convenience and needs of the community to be served."

117. See S. REP. No. 1095, 84th Cong., 2nd Sess. 2 (1956).

118. Id. at 5.


sented his amendment, which “grandfathered” the nineteen multistate BHCs then in existence.\textsuperscript{122} He believed the protection to be “a logical continuation of the principles of the McFadden Act, which tried to prevent the Federal power from being used to permit national banks to expand across State lines in a way contrary to State policy and, of course, under the McFadden Act, even to expand within a State.”\textsuperscript{123} The Act also reserved to the states, rather cryptically, “such powers and jurisdiction which [they now have] or may hereafter have with respect to banks, bank holding companies, and subsidiaries thereof.”\textsuperscript{124} Several states do regulate BHCs or prohibit multibank BHCs altogether.\textsuperscript{125}

The 1956 Act, when it was passed, did not cover the majority of BHCs, since it did not reach the 117 one-bank holding companies then in existence.\textsuperscript{126} By 1970, however, there were 1,352 one-bank holding companies, including parent companies for virtually every major bank in the country.\textsuperscript{127} The one-bank holding company cannot, of course, circumvent branch-banking restrictions as can the multibank holding company; nor does it permit the combination of state and national bank powers. Nonetheless, it is true that the major attraction of the one-bank BHC was circumvention of the bank regulatory regime.

First, the BHC could issue securities and commercial paper free of the regulation establishing maximum interest rates payable on deposits and of the necessity to hold reserves against such

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\textsuperscript{122} GOLEMBE (1979), supra note 113, at 33.
\textsuperscript{123} 102 CONG. REC. 6860 (1956).
\textsuperscript{124} 12 U.S.C. § 1846 (1976); see Report Under the Bank Holding Company Act, supra note 121, at 780 (requesting clarification).
\textsuperscript{125} E.g., ILL. REV. STAT. ch. 16½, § 73 (1972) (multibank holding companies prohibited). N.Y. BANKING LAW § 1 (McKinney 1971) (comprehensive regulation).
Second, the one-bank BHC could diversify into businesses that would be permissible neither to banks under the powers provisions of their charters nor to multibank BHCs under the 1956 Act. Third, the BHC could diversify geographically, and open offices across state lines, as long as it was not thereby engaging in the unchartered business of banking within the states that it entered (host states).

The 1970 Amendments to the Bank Holding Company Act finally brought one-bank holding companies under the supervision of the FRB, primarily to regulate their diversification into nonbanking activities. First, diversification had long been viewed as a potential threat to bank solvency because the nonbanking activities entered by the bank or BHC would almost certainly be in a higher risk/return category than banking. Congress and the bank regulatory agencies were concerned that entry into riskier, or possibly speculative, activities would impair confidence in the solvency of the bank. It was feared that the failure of a nonbanking subsidiary would cause a confused public, unaware that the bank is a separate corporate entity, to precipitate a “run” on the bank and thus bring about its insolvency.

Second, diversification by banks into nonbanking activities had long been viewed as a threat to competition in those areas. The concern was that the BHC would cause its subsidiary bank(s) to finance its nonbanking affiliates and deny credit to nonbanking firms with which the BHC competed. Related concerns had led Congress to sever commercial banking from investment banking in 1933. Indeed, national and Fed member banks were then prohibited, with minor exceptions, from owning “any shares of stock of

128. The reserve requirements of Regulation D have been extended, pursuant to the 1980 Act, to apply to “any liability of a depository institution’s affiliate that is not a depository institution, on any promisory note [etc.] with a maturity of less than 4 years, to the extent that the proceeds are used to supply or to maintain the availability of funds (other than capital) to the depository institution, except any such obligation that, had it been issued directly by the depository institution, would not constitute a deposit.” 12 C.F.R. § 204.2(a)(1) (1980).


any corporation" and it was thought at the time that the limitation would prevent them from controlling nonbanking enterprises. In addition, if the BHC's nonbanking activities were unregulated, as they usually would be, they might provide new opportunities to avoid legal constraints—for example, by transfer pricing.135

b. Diversification Under the 1970 Amendments.—Ironically perhaps, the 1970 Amendments greatly enhanced a BHC's ability to engage in nonbanking activities at the same time that the Amendments extended control over nonbanking activities to one-bank holding companies.136 As amended, section 4(c)(8) exempts from the general prohibition "any company the activities of which the Board . . . has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto." The same section provides that in making such a determination the Board is to consider

whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.137

The FRB has issued Regulation Y, which lists the activities it considers closely related to banking.138 Any BHC may engage in

134. Id. § 24, para. 7 (1976); see id. § 335.
135. Transfer pricing occurs when sales between commonly controlled enterprises are priced so that profits are realized at their most advantageous locus (e.g., for tax reasons).
136. Under the 1956 Act, BHCs could own "any company all of the activities of which are of a financial, fiduciary, or insurance nature and which the Board . . . has determined to be so closely related to the business of banking . . . as to be a proper incident thereto . . ." Bank Holding Co. Act of 1956, ch. 240, § 4(c)(8), 70 Stat. 135 (emphasis added) (current version at 12 U.S.C. § 1843(c)(8) (1976)). The tortuous legislative history by which this provision was amended is related in Investment Co. Inst. v. Board of Governors, 606 F.2d 1004, 1018-20 (D.C. Cir. 1979). The court there reasoned convincingly that "deletion of the qualifier 'the business of' significantly liberalized [the Act but] was designed only to permit bank holding companies and their non-bank subsidiaries to enter markets not served by their bank subsidiaries. Nowhere was it suggested that the amendment was intended to broaden the lines of business permitted to bank holding companies." Id. at 1020 (emphasis in original).
138. 12 C.F.R. § 225.4 (1980). Nonbank activities permitted to BHCs by regulation include: making extensions of credit (such as those by mortgage, finance, credit card, and factoring companies); operating as an industrial bank, Morris Plan bank, or
any of the listed activities and in necessary incidental activities. The Board has also established abbreviated procedures for a BHC that proposes to engage de novo in any of the listed activities, since such entry, unlike acquisition of a going concern, is considered presumptively procompetitive.\textsuperscript{139} The Board also considers applications to engage in unlisted activities of a financial nature.\textsuperscript{140}

As will be more fully detailed,\textsuperscript{141} some BHCs have aggressively exploited the nonbanking opportunities open to them and have become nationwide or worldwide diversified financial-service organizations, though limited by their inability to have affiliates engaged in the securities business. At the same time, it should be noted that the businesses opened to BHC entry are not only "closely related to banking," they are almost all elements of banking, at least as it is defined in practice under the National Bank Act: "Except for underwriting of credit life insurance and operating an industrial bank, all of the approved activities [are] essentially permissible for national banks;"\textsuperscript{142} and of those that the Board has denied to BHCs, none is permissible for a national bank.\textsuperscript{143} Industrial-loan company; servicing loans and other extensions of credit; performing trust-company functions; acting as an investment or financial advisor; performing full-payment leasing of personal and real property; making equity and debt investments in community-welfare projects; providing bookkeeping or data-processing services; acting as an insurance agent or broker, primarily in connection with credit extensions; underwriting credit, life, accident, and health insurance; providing carrier services; and providing management consulting services. Id.

139. Id. § 225.4(b).
140. Id. § 225.4(a). Nonbanking activities permitted to BHCs by order include: issuing and selling traveller's checks; buying and selling gold and silver bullion and service coin; issuing money orders and general-purpose variable denomination-payment instruments; acting as a futures-commission merchant to cover gold and silver bullion and coins; and underwriting certain federal, state, and municipal securities. See Glassman & Eisenbeis, \textit{Bank Holding Companies and Concentration of Banking and Financial Resources}, reprinted in BHC \textit{Compendium}, supra note 126, at 209, 230.

141. See text accompanying notes 200-398 infra.
142. Glassman & Eisenbeis, supra note 140, at 229. This source mistakenly suggests, however, that national banks are authorized to engage in real estate brokerage and operate travel agencies. With respect to the latter activity, see note 45 supra and accompanying text.
143. Activities denied to BHCs include: insurance-premium funding (combined sales of mutual funds and insurance); underwriting life insurance not related to credit extension; real estate brokerage; land development; real estate syndication; general management consulting; property management; computer-output microfilm services; underwriting mortgage-guaranty insurance; and operating a savings-and-loan association. 12 C.F.R. § 225.126 (1980).

The Board has, however, allowed BHCs to acquire a savings-and-loan association in Rhode Island, and "guaranty savings banks" in New Hampshire, where state law made the operation of such institutions more like that of a commercial bank. See
deed, some of the activities opened to BHCs are expressly limited to financially related services or to servicing banks.\textsuperscript{144}

To be sure, other BHC activities have been given a somewhat broader scope or have been defined to allow riskier transactions under the FRB's regulations than under the Comptroller's so that a BHC can do more than a national bank in some instances. In providing data processing services, for example, a national bank may "collect, transcribe, process, analyze, and store . . . banking, financial, or related economic data. In addition [it may] market a by-product (e.g., program, output, etc.) of an above-described data processing activity."\textsuperscript{145} A BHC, however, not only may process data and sell the by-products of programs, but also may furnish "any data processing service upon request of a customer if such data processing service is not otherwise reasonably available in the relevant market area."\textsuperscript{146} With minimal interpretation, the scope of the data processing business open to BHCs can far exceed that permitted to national banks.\textsuperscript{147}

On the other hand, the full-payout leasing business appears somewhat more accessible to a national bank than to a BHC. The Comptroller permits a national bank to enter into leases from which it can reasonably expect to realize the return of its cost in acquiring the property for lease plus the cost of financing from (1) lease payments, (2) estimated tax benefits, and (3) the estimated (unguaranteed) residual value of the property at the expiration of the initial lease term. The last factor is subject to a maximum of twenty-five percent of the original cost of the property.\textsuperscript{148} Under

\textsuperscript{144} Data-processing, courier, and management-consulting services are so limited. See 12 C.F.R. §§ 225.4(a)(8), (11), (12) (1980).

\textsuperscript{145} Id. § 7.3500(a) (1981).

\textsuperscript{146} Id. § 225.123(e) (1980). But cf. National Courier Ass'n v. Board of Governors, 516 F.2d 1229 (D.C. Cir. 1975) (nonfinancially related courier services not "incidental" to activities closely related to banking, and thus not permissible even if unsolicited and otherwise unavailable). The Comptroller has requested comment on whether the various differences between the regulation governing data-processing services of national banks and the Fed's regulation of such services offered by BHCs should be eliminated. 45 Fed. Reg. 40,613 -14 (June 16, 1980), reprinted in [1980] FED. BANKING L. REP. (CCH) 60,855.

\textsuperscript{147} See text accompanying notes 369-374 infra. See generally Note, National Banks, Bank Holding Companies and Data Processing Services, 14 GA. L. REV. 576 (1980) (BHC data processing authority appropriately broader).

\textsuperscript{148} 12 C.F.R. § 7.3400(b)(2) (1981). The bank may rely on the residual value
parallel regulations of the FRB, however, BHCs are limited in the (unguaranteed) residual-value risk they can assume to twenty percent of original cost.\footnote{149} National banks can thus make some riskier leases than can BHCs and can offer lower rental payments on others—by taking more residual-value risk—in order to compete away some leases otherwise available to BHCs.

The point here is twofold: The BHC cannot invariably, or even frequently, offer services \textit{of a type} that a national bank, or depending upon applicable state law, a state bank, cannot offer. Yet the BHC can offer its services \textit{to an extent} that a bank cannot. The advantage of extent arises in two distinct forms. First, it can operate through nonbank offices without geographical limitation. Second, the BHC may be able to commit more of its total assets—banking and nonbanking—to relatively high-risk investments and products than could a bank with the same total assets.

The reason for the latter advantage is to be found in soundness regulation: Segregating higher risk assets, such as consumer finance, factoring, and equipment-leasing portfolios, in the nonbank parent or in nonbank subsidiaries, means these assets can be financed by nondeposit liabilities, such as commercial paper and longer term debt, of the holding company. Since the bank’s solvency is not directly implicated, the bank examiners and regulators will allow a BHC, in pursuit of a higher return on its assets, to maintain a higher level of overall risk than they would find prudent for a bank. Alternatively, the BHC may wish to assume some higher risks in order to diversify its portfolio of risks, thereby actually lowering its overall risk level.\footnote{150} This advantage is often claimed by BHCs in applications to acquire consumer-finance companies, the loans of which bear a higher risk and rate of return than bank loans,\footnote{151} but the earnings of which are said to be

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\footnote{149}{\textit{Id.} § 225.4(a)(6)(i)(d) (1980). With respect to a lease of seven years or less, up to sixty percent of the acquisition cost of the property may be recovered from residual value if the bank receives an unconditional guarantee thereof. Until 1974 BHCs could assume only 10% unguaranteed residual risk. 39 Fed. Reg. 11,254 (1974).}

\footnote{150}{See generally W. Sharpe, \textsc{Portfolio Theory and Capital Markets} (1970); Chase & Mingo, \textit{The Regulation of Bank Holding Companies}, 30 J. Finance 281, 284 (1975).}

\footnote{151}{Rose & Fraser, \textit{Bank Holding Company Diversification Into Mortgage Banking and Finance Companies}, 91 Banking L.J. 976, 986-87 (1974); see United States v. Household Fin. Corp., 602 F.2d 1255 (7th Cir. 1979).}
countercyclical to bank earnings.\textsuperscript{152} Even where overall risk will be lowered by the inclusion of some higher risk assets in the portfolio, however, bank examiners would surely prefer to see them carried in a nonbank subsidiary of the BHC.

Changes in the risk-bearing characteristics of banking enterprises owing to the availability of the BHC device necessarily remain indeterminate; moreover, the effects probably vary from one BHC to another.\textsuperscript{153} Some BHCs have a lower, and others a higher, level of riskiness than their banks would have if the BHC device were prohibited. Ultimately, the most significant effect of the BHC movement has been the ability it gives banks, through nonbank subsidiaries of the BHC, to circumvent regulation. In this sphere, circumvention of the state-by-state limits on banking has been the most important development. Perhaps it was this development that one observer foresaw when, commenting on the Bank Holding Company Act of 1956, he predicted that “the prospect of new bank holding companies may foreshadow the end of the dual banking system in the United States and the advent of a new triple banking system.”\textsuperscript{154}

3. \textit{The State-by-State Banking System}.—The legal foundation of the state-by-state banking system is the ability of each state to exclude persons—both banks chartered by other states as well as nonbanks—from the business of banking within its borders. Only because of the supremacy of federal law are states unable to exclude banks chartered by the national government.\textsuperscript{155} Until the 1920s some states allowed banks chartered by other states to branch into their territory.\textsuperscript{156} Today, however, no state permits the

\textsuperscript{152} E.g., Johnson, \textit{The Rationale for Acquisition of Finance Companies by Bank Holding Companies}, 42 \textit{Banking L.J.} 304, 309 (1975) (dubitante).

\textsuperscript{153} See Meinstein & Johnson, \textit{Bank Holding Company Diversification at the Risk of Capital Impairment}, 10 \textit{Bell J. Econ.} 683 (1979) (both BHCs studied had effectively diversified). Regarding geographical risk diversification through nonbank subsidiaries see text accompanying notes 206-217 infra.

\textsuperscript{154} M.A. Schapiro \& Co., \textit{The Triple Banking System} 1 (1956).

\textsuperscript{155} Van Reed v. People's Nat'l Bank, 198 U.S. 554, 557 (1905): National banks are quasi-public institutions, and for the purpose for which they are instituted are national in their character, and, within constitutional limits, are subject to the control of Congress and are not to be interfered with by state legislative or judicial action, except so far as the lawmaking power of the Government may permit. Accord, Easton v. Iowa, 188 U.S. 220, 229 (1903). See also McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819).

\textsuperscript{156} See, e.g., 1920 Ore. Laws § 6212. When the McFadden Act was passed in 1927, two national banks with interstate branches were grandfathered, G. Fischer, \textit{supra} note 31, at 64 n.163.
banks of a sister state to branch in,\textsuperscript{157} although some states allow foreign banks to open branches provided that the foreign country offers reciprocal treatment.\textsuperscript{158}

\textit{a. The Role of Federal Law.}—While the state-by-state banking system originates in state law, it has become embedded in federal law. If state A were to invite banks located in state B to branch into its territory, the invitees would have to comply not only with state B's law but also with federal law before they could accept state A's invitation. A bank chartered by state B would have to obtain approval for extraterritorial branching from its primary regulator, state B, and from its federal regulator, the FRB if it is a member bank\textsuperscript{159} or the FDIC if it is an insured nonmember bank.\textsuperscript{160} As currently drafted, however, many state branching statutes preclude a state bank from establishing an extraterritorial branch,\textsuperscript{161} at least within the United States.\textsuperscript{162} A general prohibition on extraterritorial branching—applicable abroad as well as in other states—may reflect the perceived difficulty of supervising and examining a state bank with distant branches. It is possible, however, that state law drafters simply did not consider whether to allow state banks to branch into other states when they imposed geographical branching limitations.

Even if the home-state law did not preclude an out-of-state branch, however, a Fed member bank, like a national bank, would be precluded from interstate branching under the terms of the McFadden Act, which is applicable to member banks through the Federal Reserve Act.\textsuperscript{163} The McFadden Act authorizes the Comptroller, and by incorporation the FRB, to approve a branch of a national or state member bank, respectively, only if the statute law of the bank's home state specifically authorizes such a branch for state

\textsuperscript{157.} Curiously, however, several states provide specific authorization for their banks to branch into other states. \textit{See, e.g.}, N.Y. BANKING LAW § 105(3) (McKinney Supp. 1980-1981).
\textsuperscript{158.} \textit{E.g.}, id. § 202-a (McKinney 1971).
\textsuperscript{161.} \textit{E.g.}, COLO. REV. STAT. § 11-6-101 (1974).
\textsuperscript{162.} HAWAII REV. STAT. § 403-54 (1976) (out-of-state branches permitted "in other countries or in dependencies in insular possessions of the United States").
\textsuperscript{163.} 12 U.S.C. § 321 (1976) provides that the Fed may authorize a state member bank to establish "branches in the United States or any dependency or insular possession thereof or in any foreign country, on the same terms and conditions and subject to the same limitations and restrictions as are applicable to the establishment of branches by national banks . . . ."
banks, and then only “at any point within the State in which [it] is situated.”

Thus, only if the bank were an FDIC-insured nonmember state bank might it be able to obtain federal approval for an interstate branch from the FDIC. That agency may approve a bank’s branch application on the basis of the same factors that it applies in admitting a bank to insured status. These factors relate to the soundness and future prospects of the bank and the “convenience and needs” of the community to be served, but impose no explicit geographical restrictions. Even so, the FDIC understandably might be very reluctant to approve an interstate branch where the result would be to make Fed membership and a national bank charter relatively unattractive and set off a stampede away from them. Thus, while based originally on state sovereignty over banking, the state-by-state banking system has not only been incorporated into federal law out of deference to the states; it has taken on a life of its own at the federal level. It is doubtful whether any state could successfully opt out of the state-by-state system, even by opening itself unilaterally to the branches of sister-state banks.

Under the Douglas Amendment to the Bank Holding Company Act of 1956, states are presumed to want to exclude from the banking industry within their borders any BHC that controls a bank—state or national—in another state. This presumption can be overcome by explicit statutory authorization, but the federal decision to put the burden of obtaining enabling legislation upon those who would admit such BHCs has probably contributed to the nearly universal exclusion of out-of-state BHCs from control of host state banks. There might be more multistate BHCs if federal law

164. Id. § 36(c); cf. id. § 601, para. 1 (Fed may authorize national bank branches in foreign countries or dependencies of the United States).
166. Id. § 1816.
167. Cf. West Helena Savings & Loan Ass’n v. Federal Home Loan Bank Bd., 553 F.2d 1175, 1180 (8th Cir. 1977) (FSLIC may not deny coverage to state-chartered S & L’s based upon own determination of insufficient community need because of “needless friction” with states such reexamination would cause).
168. See text accompanying note 121 supra.
169. Iowa enacted special legislation in 1972 to enable Northwest Bancorporation to acquire two Iowa banks in addition to the four it already owned. 1972 Iowa Acts ch. 1114, § 11; see Iowa Ind. Bankers v. Board of Governors 511 F.2d 1288 (D.C. Cir.), cert. denied, 423 U.S. 875 (1975). A Maine statute provides for the entry of out-of-state BHCs based in home states that reciprocally allow the entry of Maine BHCs “under conditions no more restrictive than those imposed by [Maine].” ME.
had merely granted the states the right to exclude out-of-state BHCs by positive law, leaving the burden of enacting exclusionary legislation to each state. Then local banks might have proposed the exclusion of out-of-state BHCs, and the issue would have been on the legislative and public agenda. Under the Douglas Amendment, however, exclusion did not require a legislative majority in any state. Since it is much less likely that consumers who might benefit from the competition provided by out-of-state BHCs would obtain permissive legislation (or even initiate the debate) than it is that banks, the more organized group with the more intense interest, could obtain exclusionary legislation, the Douglas Amendment's allocation of the burden of going forward has probably been outcome-determinative in many states.

There is some evidence of the Douglas Amendment's independent role in confining BHCs to a single state more completely than state legislation would do if the burden of acting were upon the states. Prior to 1956, when the issue of state exclusionary authority was unclear but when multistate BHCs were a real and growing factor, eight states had regulated BHCs; three effectively prohibited them from gaining majority control of even one bank. Yet no state that allowed domestic BHCs specifically prohibited the entry of out-of-state BHCs. Since 1956, however, only three states have legislated to permit out-of-state-BHC entry under any circumstances—and in Iowa the legislation was tailored to permit a particular acquisition by a BHC that, although “based” elsewhere, already owned four banks in the state.

Accordingly, federal law appears to be substantially responsible for the present situation: The banking subsidiaries of all but the surviving multistate BHCs grandfathered in 1956 are confined to single states while their nonbank subsidiaries can and do provide

Re: Stat. Ann., tit. 9-B, § 1013.2 (1980). To date, no other state has taken up this invitation. Finally, South Dakota permits the acquisition by an out-of-state BHC of a single new national or state bank located in South Dakota “at a location which is not likely to attract customers from the general public in the state to the substantial detriment of existing banks in the state.” S.D. Codified Laws Ann. § 51-16-41 (1980).


172. See id. app. E.

173. See sources cited note 169 supra.

174. Of the nineteen multistate BHCs grandfathered in 1956, sixteen were domestic and three were foreign. The four largest companies, their home states and
services "closely related to banking" nationwide. Contrary to the statement of its author, the Douglas Amendment is not "a logical continuation of the principles of the McFadden Act, which tried to prevent national banks [from expanding] across State lines in a way contrary to State policy." Instead of deferring to state policies existing in 1956, the Douglas Amendment established a new policy for the states, albeit with an escape clause. In this way, the state-by-state banking system became federal policy.

b. The Case for the State-by-State Banking System.—In considering the merits of the state-by-state banking system, it is important to keep in mind the distinction between state-by-state banking, which entails each bank operating in its own state, and dual banking, which entails both state and national bank chartering and regulation. State-by-state banking is a scheme of territorial market allocation. Dual banking is a scheme for allocating regulatory responsibility. In principle, and to some degree in practice, the two schemes are separable. For example, it would be possible to have state-by-state banking without duality. The states might charter and regulate all banks, as they did from 1836 to 1864, or the national government might preempt the field but confine each chartered bank to a single state much as it confines broadcasters to serving a particular locality. Likewise, a dual system might operate without state-by-state banking, as it would if state and national banks or BHCs were given regional or nationwide scope. An analogous system of shared authority operates to a limited extent in corporate chartering, although Congress now charters very few corporations. Perhaps the only other gov-

number of states-of-operation, were Transamerica Corp. (California and ten other states); Northwest Bancorporation (Minnesota and six other states); First Bank Stock Corp. (Minnesota and four other states); First Security Corp. (Utah and two other states). At present there are twelve multistate BHCs, of which seven are domestic and five are foreign companies. The reduction in the number of multistate companies was accomplished by various corporate reorganizations motivated, it seems, primarily by “[a] desire to avoid supervision as multibank holding companies, rather than any considerations relating to interstate banking . . . .” GOLEMBE (1979), supra note 113, at 33-34 & n.1.

175. 102 Cong. Rec. 6860 (1956).
176. See 47 C.F.R. § 73.1120(a) (1980).
ernmental field in which duality and state-by-state "markets" are combined is the court system.\textsuperscript{178}

As a scheme of territorial allocation, state-by-state banking is moderately local in orientation; in unit banking states it is extremely localized. Accordingly, the advantages that can be claimed for state-by-state banking are the virtues of localism.

First, local institutions are often thought to be more responsive to variable local needs, especially credit needs. As Comptroller Dawes said of the "small community" banker, in making the case for unit banking in 1923,

\begin{quote}
[h]is loans take into account, as a first consideration, character and moral responsibility. He is naturally inclined to encourage young, aggressive, and enterprising individuals who will, in the course of time, bring business to the institution as he succeeds, and will develop commercial and industrial enterprises . . . .
\end{quote}

\textsuperscript{179} It is inconceivable that the representative of a nonresident board of directors should be granted the authority and discretion to make a type of loan which is based on character, knowledge of local conditions, and ultimate benefits to be realized by the community and by the banks.

Even where the issue is not unit versus branch, but statewide versus regional or national, there is some force in Dawes' vision of the community banker. States are economically more heterogeneous, in ways relevant to making credit judgments, than his focus on the "small community" implies—for example, agricultural and commercial borrowers have different needs—but they are not as diverse as larger regions or the nation as a whole. The broader a bank's territory, the more challenging is the task of responding to varied local conditions within that territory.

\begin{itemize}
\item \textsuperscript{178} Thus, for example, the federal courts may apply state law, usually that of their situs, 28 U.S.C. § 1332 (1976) (diversity jurisdiction) and state courts may normally apply federal law. See D. CURRIE, FEDERAL COURTS 355-69 (1968). Thus, plaintiffs may choose their forum for some types of cases, and the courts may compete for their patronage. See Rosenberg, Passive State Policies and State Responsibility Under the Fourteenth Amendment for Private Deprivations of "Life, Liberty or Property," ABA Nat'l Inst. on Civ. Rights Liability, Kansas City, Mo. (June 9, 1981).
\item \textsuperscript{179} [1923] OFFICE OF COMPTROLLER OF THE CURRENCY ANN. REP. 10-11.
\end{itemize}
Second, local institutions are considered less likely to cause a flow of capital from one state to another by borrowing in one (i.e., taking deposits) and lending in the other. When a bank intermediates funds from one local economy to another it finances the growth of the capital-receiving area at the expense of growth in the capital-contributing area. To be sure, while pursuing private gain the bank may be allocating capital to its most productive use, thereby benefiting society at large. That, however, is little consolation to the capital-exporting population. Assuming a competitive market, depositors of the capital-exporting bank will be rewarded with higher interest rates on their deposits, but depositors and nondepositors alike will bear the externalized costs of local economic underdevelopment. For example, where employment opportunities for their children become few at home, forcing the capital-exporting area to become a labor-exporting area, disrupted family life can be counted as a cost.

Third, state-by-state banking is considered better able to accommodate diverse attitudes among states regarding the desirable size of banks and level of market concentration. Populist and agrarian sentiment has been very hostile to large size and high concentration in banking. This has led some states to prohibit both branching and multibank BHCs. Other states have prohibited branching but allowed multibank BHCs, while still others have set a maximum share of statewide deposits for a single banking or-

180. More precisely, while "[t]he effect of exporting capital is to reduce the creation of fixed capital at home, and therefore to reduce the demand for labor," it is still possible that "the capital may be used in foreign countries in ways which raise the standard of living of the capital exporting country and so offset wholly or partly the first effect, or in ways which lower it (thus aggravating the first effect). The result depends on the type of competition which there is between the capital exporting and the capital importing countries." Lewis, Economic Development With Unlimited Supplies of Labor, 22 Manchester Sch. Econ. & Soc. Stud. 139, 177-78 (1954). Reduced opportunities for labor in capital-exporting areas may be offset if the capital is applied to lowering the cost of things imported or may result in increased wage costs in capital-importing areas that compete in third markets. The diminution of labor opportunities is aggravated if the capital export raises the cost of imports or reduces costs in competing areas. Id. at 190.


182. The list of states with this configuration of laws has been dwindling, and now includes only Illinois, Kansas, Nebraska, Oklahoma, and West Virginia. See State Banking Law Serv., supra note 3, at 117, 337-39.

183. For example, Texas and Colorado. Id. at 85, 337, 339.
ganization, above which no new branches or acquisitions will be approved.\textsuperscript{184}

Some states have pursued a policy of becoming major financial centers by fostering the growth of large banking organizations. California has done so by allowing statewide branching and liberally granting the branch applications of even the largest banks.\textsuperscript{185} Colorado, a unit banking state,\textsuperscript{186} now seems to be on a similar course. It has authorized electronic banking,\textsuperscript{187} approved loan production offices,\textsuperscript{188} and liberally granted the applications of major out-of-state BHCs to charter “industrial banks” and finance companies.\textsuperscript{189}

Still another approach to bank market structure, namely state enterprise, was taken for a time in Alabama. The Alabama Constitution of 1819 provided for state establishment of one wholly-owned bank.\textsuperscript{190} As of 1839, there were seven banks in Alabama, five wholly owned by the state and two in which the state had a forty-percent interest.\textsuperscript{191} Although Alabama is now out of the banking business, the Bank of North Dakota remains a state enterprise.\textsuperscript{192}

The national aspect of the dual banking system makes state-by-state control of bank size and market structure less than complete. The Comptroller can increase competition by chartering additional

\textsuperscript{184} See, e.g., Mo. Rev. Stat. § 362.915 (Vernon Supp. 1980) (prohibiting BHCs from gaining control over bank where the BHC will thereby control banks with more than thirteen percent of total bank deposits in state).

\textsuperscript{185} Thus United California Bank, the largest state bank in California, had 274 branches at the end of fiscal 1978; 21 branches were added during fiscal 1979. [1978] CALIFORNIA SUP'T OF BANKS ANN. REP. 60; [1979] id. at 208.

\textsuperscript{186} In November 1980, however, Colorado voters, in a referendum, defeated a proposal to allow branch banking. Am. Banker, Nov. 6, 1980, at 1, col. 3.

\textsuperscript{187} COLO. REV. STAT. § 11-6.5-101 (Supp. III 1979).

\textsuperscript{188} 3 Colo. Code Regs. 701-1, § CB-101.28.

\textsuperscript{189} Thus, twenty-nine of the 105 industrial banks operating at the end of 1978 had been chartered in the period 1975-1978. The information is tabulated from the report by the COLORADO DIVISION OF BANKING, STATEMENTS OF CONDITION OF STATE BANKS AND INDUSTRIAL BANKS AS OF DECEMBER 31, 1978 (1979).

\textsuperscript{190} ALA. CONST. art. 6, § 1 (1819). The current constitutional provisions on banking in Alabama were renumbered in the 1875 and 1901 revisions to art. XII §§ 247-255.

\textsuperscript{191} Bank of Augusta v. Earle, 38 U.S. (13 Pet.) 519, 594 (1839). In still another variation, in 1810 when the State of Georgia reserved to itself one-sixth of the capital stock in the first two banks it chartered, its objective was purely to make a profitable investment of surplus state funds. M. HEATH, CONSTRUCTIVE LIBERALISM 165 (1954).

\textsuperscript{192} N.D. CENT. CODE § 6-09-01 (1975). The voters of Minot, N.D., however, have just “resoundingly defeated a proposal to make Minot the home of America's first city-owned bank.” Wall St. J., April 23, 1981, at 20, col. 3. For contrary advice see Frug, The City as a Legal Concept, 93 HARV. L. REV. 1057, 1128, 1150 (1980).
national banks or he can allow concentration to rise, subject to the antitrust laws, by approving mergers of state or national banks into a surviving national bank.\textsuperscript{193} Despite the Comptroller's potential, however, the states retain much greater influence over bank size and market structure and remain free to pursue their different policies.

Finally, the state-by-state banking system may be thought to contain banks and BHCs on a scale where examination and regulation are manageable. In the context of examination, both the size of a banking organization and the breadth of its geographical dispersion are relevant. All offices of a banking organization should be examined simultaneously, lest problem-assets be transferred from one office to another and escape detection.\textsuperscript{194} As asset size increases, simultaneous examination may strain the capacity of any examination staff.\textsuperscript{195} In addition, as the operating area of a bank or BHC increases, problems of coordinating a simultaneous examination increase more than proportionately. If the area spans multiple states, each would presumably insist upon examination of either the whole enterprise or at least the state banks taking deposits within its borders. The coordination required for simultaneous and effective examination by multiple jurisdictions would have to be exquisite.

Regulators apparently believe that effective regulation is increasingly difficult as the size of a banking organization increases.\textsuperscript{196} With greater potential earnings or costs at stake, a larger entity may be more willing to invest in circumventing a particular regulation.\textsuperscript{197} Furthermore, a larger enterprise can spread

\textsuperscript{194} V. Willit, Chain, Group and Branch Banking 56, 111 (1930); [1923] Office of the Comptroller of the Currency Annual Report 9.
\textsuperscript{195} See Miller, supra note 41, at 443. This is not inconsistent with the finding "that the examination process exhibits significant scale economies with respect to asset size. Therefore, the examiner manpower requirements per dollar of assets supervised is less for states containing large asset size banks." Id.; accord, Murphy, Determinants of the Demand for Bank Examiner Manpower in the First National Bank Region, 9 J. Money, Credit, & Banking 500, 502 (1977).
\textsuperscript{197} Cf. Seelig, Convenience and Advantage Clauses as a Barrier to De Novo Entry by Bank Holding Companies in the Consumer Finance Industry, 30 J. Econ. & Bus. 124, 129 (1978) ("results also appear to suggest that large firms, or at least firms experienced in dealing with regulatory authorities (such as bank holding companies), can be at a relative advantage in overcoming regulatory barriers to expansion."
the fixed costs of circumvention—strategic planning, new product
development, legal fees, etc.—over a larger number of transactions
and at a lower average cost than a smaller banking company. As a
result, some products or services that a smaller company would be
able to offer at only an unattractive price, and therefore does not
develop, will be developed by the larger company because it can
spread fixed circumvention costs and thus attract the price-
conscious market.

Each of the virtues claimed for state-by-state banking may be
disputed on either normative or empirical grounds, or both. Re-
ponsiveness to local credit needs may be achieved more readily by
a regional or national banking enterprise with a substantial devolu-
tion of internal authority and yet greater expertise and resources
than a community bank could offer. Interstate or interregional
capital flow may be in the long-term national interest even if it has
adverse short-term consequences for capital exporting areas. As for
the diversity of banking market structures that states may wish to
pursue, one would need to know much more about the political
process in each state before reposing confidence in the idea that the
present—and diminishing—diversity of banking structures reflects
current community sentiments and not the reified vestiges of an-
cient, perhaps corrupt, political struggles. Finally, the extreme pau-
city of empirical literature concerning the problems of bank exami-
nation, and the impressionistic nature of the perception that large
banking organizations are more difficult to regulate because of their
smaller number, make evaluation of these claims difficult.

Thorough investigation and evaluation of these claims is un-
necessary, however, if the goal is a comparison of the state-by-state
banking system as it exists today with alternative approaches al-
lowing some form of interstate banking. The reason is simply the
magnitude of interstate banking currently conducted within the
state-by-state regulatory framework and the likelihood that the
needs of commerce and the incentives facing bankers will escalate

198. E.g., Johnston, The Structure of Banking in Small California Communities
and a Look to the Future 12 (April 6, 1967) (unpublished study by the Research
Dep't, Fed. Reserve Bank of San Francisco) (finding that in rural areas and smaller
towns in a state-wide branching state, branch banks had higher loan-deposit ratios
than unit banks, and that it is “simply their status as branch offices, unburdened as
they are by considerations of reserves, liquidity, and portfolio balance that enables
them to operate on the basis of loan-deposit ratios in excess of those which can be
supported by independent banks of comparable size.” Id).

199. See text accompanying notes 582-583 infra.
interstate activity. The state-by-state regulatory system is not adequate, however, to deal with the present and increasing interstate activity—neither to contain it nor to encourage its orderly development. The policy question for bank regulation, therefore, is whether to persevere with the state-by-state framework and hope for the best, perhaps even requiring banks and BHCs to recede to within their home state borders, or whether and how to substitute a regime that explicitly acknowledges, regulates against the detriments, and exploits the benefits of, interstate banking.

The empirical foundation for the claim that interstate banking is a substantial reality at present is set out as follows in section B. With the details of the current business reality in hand, it will be possible to turn to the criteria by which to address the policy issue.

B. The Current Business Reality

1. Reasons for Interstate Efforts.—During the last fifteen years most of the largest banks in the nation have made successful efforts to establish an interstate presence notwithstanding the constraints imposed by the state-by-state banking regime. Typically, they have made extensive use of BHCs to open nonbank offices in multiple states, although, as will be seen in section 2 below, some interstate offices are those of the banks themselves. If the factors identified in this section 1 accurately account for this development, then efforts to expand the scope of interstate banking activity can be expected to continue.

   a. Growing and Contracting Markets.—In its pristine form, the state-by-state banking system connotes that each bank does all of its business within its home state. Long before the growth of interstate banking, however, there had emerged a national credit market within which banks competed to supply funds to national and international corporate borrowers. This market for large loans has been concentrated in New York, where New York-based banks have acted as lead banks in arranging nationwide banking syndicates to participate in financings too large to be undertaken alone. In recent years the growth of regional banks has allowed them to pursue lead positions, which were previously beyond their reach.

   Apart from the market for large loans, however, the business of banking has traditionally been conducted on a relatively localized basis. Retail banking customers, including households and small businesses, patronize a bank within convenient distance for a personal visit. Deposits and withdrawals are typically made at the bank; even the opportunity to use the mails for making deposits
and ATMs for deposits and withdrawals has not significantly changed this fact. Likewise, consumer and small business loans are typically negotiated and consummated at the bank’s premises. The provision of trust services is highly personalized and thus it, too, is generally carried on at the bank’s offices.

Retail banking is therefore comparable to retail merchandizing of largely standardized items, such as drug or grocery stores sell. In both types of retailing, location is a prime determinant of customer relationships and the establishment of branch locations reflects the small radius within which the retail establishment can expect to draw customers.\(^2\) Both retail banks and retail merchandisers may also participate in wholesale markets. In banking this entails not only making large loans but also servicing commercial accounts with cash management, data processing, and other services. Wholesale customers infrequently need to pay personal visits to banks, and with larger transactions at stake will shop for a banking service over a larger area. This, combined with the large scale required to offer many wholesale services efficiently, has tended to favor large, centrally based banks in the wholesale market.

Office location is thus important to success in retail, and to a lesser degree, in wholesale banking; it simply matters where a bank is—downtown or suburbia, small town or large city—in a way that is not true for many other industries. Moreover, the rate of economic growth, and thus of growth in demand for banking services in the geographical market in which a bank is located, is probably also an important determinant of profitability.\(^2\) There are significant differences in the rate of growth among various geographical markets; indeed, some have negative rates.\(^2\) Banks located in markets that are declining, either absolutely or relatively,

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\(^2\) The proliferation of bank branches, where allowed, probably reflects also the diversion of bank competition from price to service considerations brought about by Regulation Q, which sets the maximum interest payable on deposits. See A. Kahn, 2 THE ECONOMICS OF REGULATION 209 (1971):

If price is prevented from falling to marginal cost in the short run or to average total cost in the long run, then, to the extent that competition prevails, it will tend to raise cost to the level of price. Only when, in this way, marginal cost is once again equated with price will the tendency to service inflation be halted.

\(^2\) To the author’s knowledge, however, there is no published evidence directly establishing this relationship. Cf. Mellon Bank N.A., Interstate Banking Legislation: A Need for Change 12-13 (1979) [hereinafter cited as Mellon Study] (growth patterns of population, employment, and personal income by state closely associated with bank-deposit growth).

\(^2\) Id.
have the greatest incentive to look for market opportunities elsewhere.

It is therefore understandable that a disproportionate number of the banks that have been aggressive in establishing themselves in host-state markets have declining home markets. In 1975, the thirteen BHCs whose lead bank was one of the fifty largest in the nation and whose subsidiaries had the largest number of offices outside the bank’s home state included the parents of three banks based in Philadelphia, one in Pittsburgh, three in New York City, and one each from Chicago and Boston. Two of the others were from California and there was one each from North Carolina and Georgia. Thus the first nine of these thirteen BHCs are from four states that experienced low growth in bank deposits over the period 1967-1977; the other four are from states that had below median growth.

While it is true that the largest banks logically would be the first to search for new markets, and that many of the largest banks are in the older and relatively declining cities of the Northeast, the representation of large northeastern banks among the most interstate-oriented BHCs nonetheless seems disproportionate. While it is necessary to rely on imperfect measures, it does seem fair to conclude that the banks most determined to enter new geographical markets are those whose home-state markets have the least desirable futures. This is not to suggest that the desire to escape declining markets alone accounts for the interstate banking activity of the largest BHCs. For example, it clearly could not explain the interstate motivation of the large California BHCs. Rather, a declining market merely heightens the inclination, seen among aggressive banks in growing markets as well, to penetrate new territories.

b. Geographical Risk Diversification.—The advantages of diversifying economic risk across a variety of product markets have already been discussed. Risk, both political and economic, may also be diversified across geographical markets, and this benefit

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204. See Mellon Study, supra note 201, at 13. Moreover, two of the four—North Carolina and Georgia BHCs—were still regional organizations, having almost all their nonbank offices in the Southeast. (One had a New York City office and another had corporate-service offices in Chicago and Los Angeles.) Bank Holding Co. Map Series, supra note 203.

205. See text accompanying notes 150-153 supra.
must underlie to some extent the tendency of banks to seek markets offshore, through overseas branches and subsidiary banks, and throughout the nation, by means of nonbank BHC subsidiaries.\footnote{\textit{Abrams}, \textit{Regional Banks and International Banking}, \textit{Fed. Res. Bank of Kansas City Econ. Rev.}, Nov. 1980, at 3, 4.}


Domestically, political risk is less extreme though not unknown. The profits of a New York City bank, for example, depend to some extent upon political decisions made in the state capitol, Albany. Changes in state usury laws, income taxation, and branch banking and BHC powers are elements in the political environment that can have a profound effect on a bank's prospects. If a bank's earnings are derived from several states, however, it will be exposed to less risk from adverse political decisions, since it is less likely that multiple states would take unfavorable positions, particularly at the same time.

Domestic economic-risk diversification is possible because regions of the country are affected differently by the business cycle. Each region is also subject to special circumstances apart from the general business cycle. Thus, agricultural lending in the Plains states, consumer lending in the Midwest manufacturing states, and export financing in California may have very different business cycles of their own. A bank serving all three markets can diversify its risk better than a bank serving only one of the three.\footnote{\textit{Cf. Mingo}, \textit{Managerial Motives, Market Structures and the Performance of Holding Company Banks}, 14 Econ. Inquiry 411, 421 (1976) (finding that holding company banks "seem to be less risk-averse," and suggesting that this is "perhaps explained by their geographical diversification").}

It is true that individual shareholders could diversify their portfolios of bank shares to diversify personal risk. The single shareholder could own shares of banks located in California, the Midwest, and the Plains states. This is not a complete substitute for bank diversification of risk, however. First, the shareholders...
taken collectively would probably incur greater transaction costs in diversifying their portfolios of shares than would the banks in diversifying their portfolios of risks. It would probably be less expensive, that is, for the Bank of America or its BHC to add the desired portfolio of Michigan consumer loans than it would for each of its 175,134 shareholders to purchase an appropriate interest in a Michigan bank.

Bank managers would find it even more difficult than bank shareholders to diversify their risk if the bank cannot directly or indirectly do so for them. They cannot split their time between banks in California and Michigan, and so must expose themselves to heightened risks to their employment and compensation owing to the bank's inability to diversify for them. Indeed, the result may be for bank managers to cause banks to pursue a socially undesirable level of risk avoidance in their one home market.209

c. Economies of Scale.—Early empirical investigations of scale economies in commercial banking generally indicated that a bank's average unit costs did not decrease (or increase) significantly with size above a very modest level—in one study, $5 million of deposits.210 These studies are of limited value, however, since they examine only selected products or services,211 and not necessarily those with the most sharply declining average costs.212 They predate the effects of widespread computerization on bank operations and "do not fully account for possible capital (or financial) economies."213

Recent studies, although subject to some of the same limitations, show that banks' average costs continue to decline even as deposits increase to well above $10 million,214 and distinguish be-

212. It has also been observed that banking is characterized by "a chronic lack of depth in management in the smaller institutions," which can be thought of as a diseconomy of small scale. Casson & Burrus, Federal Regulation of Bank Mergers, 18 Am. U.L. Rev. 677, 680 (1969).
213. Edwards & Scott, supra note 211, at 92. This literature is critically analyzed in Benston, The Optimal Banking Structure, 4 J. Bank Research 220, 224 (1973), and Schweitzer, Economies of Scale and Holding Company Affiliation in Banking, 39 S. Econ. J. 258 (1972).
214. See Longbrake & Haslem, Productive Efficiency in Commercial Banking,
tween banks with and those without computerized operations.\textsuperscript{215} Even these studies, however, do not reflect advances in technology now in use at larger banks. They neither address the potential economies of scale available if banks were allowed to operate inter-state\textsuperscript{216} nor examine home-office scale economies.\textsuperscript{217}

Dealing in Fed funds—purchased reserves and correspondent balances—is one example of a service with obviously significant scale economies. In order to meet their reserve requirements and avoid having either excess reserves or correspondent balances that do not earn interest, member banks “buy” and “sell” their FRB and correspondent balances to one another for one-day periods. Money-center banks act as dealers in this interbank market, known as the Fed funds market, serving the needs of other banks and taking a dealer’s profit.\textsuperscript{218} Typically, the money-center bank buys

\footnotesize{7 J. Money, Credit & Banking 317, 329-30 (1975) (using 1968 data): [T]he number of offices operated by a branch bank has little effect on average operating costs per dollar of demand deposits. However, when average office size, as measured by the number of demand deposits accounts, increases, average costs decline in all banks except unit banks which are not affiliated with holding companies; Murray & White, Economies of Scale and Deposit-Taking Financial Institutions in Canada, 12 J. Money, Credit & Banking 58, 69 (1980), finds significant evidence of sizable and increasing returns to scale in a study of credit unions during 1972-75; expenses of branching are “more than offset by the cost reductions made possible by the growth in output.” See also Wolken & Navratil, Economies of Scale in Credit Unions: Further Evidence, 35 J. Finance 769 (1980).


216. Banks cannot realize scale economies in advertising, for example, because they must purchase local rather than network broadcast time and local or regional rather than national magazine and newspaper space.

217. Economies of reporting, accounting, legal counsel, and other overhead or home office costs cannot be captured by studies that examine the average cost curve for specific bank products. They could be isolated by a study of financial returns (on investment, assets, or revenues), perhaps, but only over the range of output with which there is present experience. Either great sophistication, or only a little common sense, are required to see that such home office economies as mentioned above must exist, however. Cf. Gilbert & Longbrake, The Effects of Branching by Financial Institutions on Competition, Productive Efficiency and Stability: An Examination of the Evidence, in SUBCOMM. ON FINANCIAL INSTITUTIONS OF THE SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94TH Cong., 2D Sess., COMPENDIUM OF ISSUES RELATING TO BRANCHING BY FINANCIAL INSTITUTIONS 475, 493 (Comm. Print 1976) (production of financial services that can easily be centralized in main office, such as business loans, real estate loans, and securities, less costly in branch than unit banks).

funds from other banks for itself and for resale to major banks. Indeed, according to Martin Mayer, in the 1960s "[t]he crucial function of the money-center bank in its relations with its correspondents became the purchase of their excess reserves at a price at or just under each day's national market price for money."\(^{219}\) By 1973, he reports, the Bank of America was trading $2.5 billion a day in Fed funds. Clearly, the cost of running this operation would not rise or fall proportionately with increases in the dollar balances involved; the addition of three zeroes to the end of every number would not require greater capacity.

The provision of expert advice is another service for which one would expect average cost to decline until a very large scale is achieved. Banks provide expert advice to their branches, their correspondent banks,\(^ {220}\) and their customers.\(^ {221}\) This advice may concern general economic conditions, industry studies, or a particular financing transaction. In any case, accumulating the expertise necessary to render advice may be expensive. It may entail assembling an extensive data base, building an economic model, or simply learning from experience in prior transactions. Once these investments in expertise are made, however, their exploitation occurs initially at a low marginal cost; hence average cost declines with scale for a considerable time until increasing administrative and coordination costs are incurred. As long as average costs decline, an enterprise will seek opportunities to expand its output. If commercial banking consists of a variety of products and services only some of which continue to experience decreasing average costs, banks would seek to expand those products or services selectively. If selective expansion is not feasible, they will still seek to expand until the diseconomies of scale associated with some products outweigh the economies realized on others.

One method that banks have to increase their scale and thus


\(^{221}\) In addition to personal trust management, banks provide investment management, custody and advisory services to employee benefit funds, endowments, charitable organizations, and other institutional investors. Such portfolio management is extremely information intensive. See K. Smith, Portfolio Management 42 (1971); Graham, The Impact and Extent of Computer Applications on the Construction and Evaluation of Commercial Bank Investment Portfolios, in The Impact of the Computer on Commercial Banking (F. Fabozzi ed. 1975) (2 Hofstra Univ. Yearbook of Bus., series 11).
to realize economies is branching. Banks have pressed for and in general received from the states increasingly liberal branching laws. At the same time they have expanded across state lines through nonbank subsidiaries of their BHCs in order to increase the scale at which they provide some services. Indeed many of the activities permitted to nonbank subsidiaries by Regulation Y are probably characterized by declining average costs over a very wide range of output. These are the information-oriented services—i.e., those in which there is a high initial investment in data, programming, or experience, but a low marginal cost for drawing on the information—such as servicing loans and other extensions of credit; providing bookkeeping or data processing services; investment or financial advising; and management consulting for unaffiliated banks. In addition, many of the activities that are related to the extension of credit, such as credit-card operations and real estate appraisals, are themselves information-intensive activities for which one would expect average costs to decline over a wide range of output.

222. The leading studies of the 1960s concluded that the additional costs of bank branching were offset by the economies of scale. See F. Ball & N. Murphy, Costs in Commercial Banking (Research Rep. No. 41, Federal Reserve Bank of Boston, 1968); Benston, Branch Banking and Economies of Scale, 20 J. Finance 312 (1965). According to a recent study, the staff of the OCC now believe that the costs of branching are more than offset by the scale economies of branching. MAJORITY STAFF OF SENATE COMM. ON BANKING, HOUSING, & URBAN AFFAIRS, 96TH CONG., 2D SESS., CHARTERING OF NATIONAL BANKS: 1970-1977, at 57-58 (Comm. Print 1980).

223. A survey of the various states is illustrative:

<table>
<thead>
<tr>
<th>Branching Classification</th>
<th>1929</th>
<th>1951</th>
<th>1961</th>
<th>1978</th>
</tr>
</thead>
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<tr>
<td>U</td>
<td>27</td>
<td>12</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>U*</td>
<td>1</td>
<td>5</td>
<td>10</td>
<td>11</td>
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<td>L</td>
<td>11</td>
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<tr>
<td>S</td>
<td>9</td>
<td>19</td>
<td>19</td>
<td>22</td>
</tr>
<tr>
<td>Total (States)</td>
<td>48</td>
<td>49</td>
<td>50</td>
<td>50</td>
</tr>
</tbody>
</table>

STATE BANKING LAW SERV., supra note 3, at 89.

224. Underwriting credit life and disability insurance, in addition to the scale economies associated with being information intensive, requires a substantial scale of operations (and geographical risk diversification) just to accomplish its purposes of risk pooling and spreading.
d. Technological Opportunities: Computing and Communicating.—As suggested, essential bank operations consist to a large degree of gathering, managing, and distributing information. Decisions to extend credit, for example, begin with the accumulation and analysis of data relevant to the credit-worthiness of the applicant. In the case of a consumer borrower, there may be relatively little information, consisting of a credit application, a report from a credit bureau, and the results of a computerized credit-scoring system. In the case of a commercial borrower, extensive information about the corporation and its industry may be required and this information may be analyzed through industry- or economy-wide computerized economic models. Deposit services are also information-intensive, reflecting the fact that money in the modern world has become a datum rather than a tangible item.

Today, a bank deposit or withdrawal is little more than a series of book-entry adjustments. In the simple case of a check drawn on one bank and deposited at another in the same city, for example, the depository bank increases the depositor’s balance and decreases the balance that the drawee bank has on deposit with it; the drawee bank registers on its own books the decreased balance with the depository bank and makes an offsetting decrease in the account balance of the check’s drawer. Extensions of credit are also handled by adjustment of balances. When a bank lends money, it increases the borrower’s account balance by the amount of the loan; the borrower then draws the loan down by writing checks against the balance.


226. Historically, money consisted first of commodities, such as cattle, and then specie—usually gold, silver, or copper. The drawbacks of using precious metals as money in a sophisticated economy are obvious; accordingly, specie was supplemented by paper currency—bank notes, or originally, receipts—that represented deposits of, and could be redeemed in, specie. See generally R. EDERER, THE EVOLUTION OF MONEY (1964).

In the United States we now use fiat money. Fiat money is paper money that is accepted in exchange for goods ultimately because the law requires that it be accepted; its tender in payment of a debt is “legal tender.” The issuing government does not stand ready to redeem such currency in specie or any other thing of value. Fiat money was introduced in the United States when the Civil War Congress authorized the issuance of “greenbacks” in the hope of paying its wartime debts for the cost of the paper.

Once fiat money was more or less accepted, which took at least a decade, see J. GALBRAITH, MONEY 45-57 (1975), it was a small matter to eliminate the paper itself and deal in bank balances.
With banking operations essentially information-handling, the unit costs of a bank operation are now intimately affected by developments in information technologies, i.e., computing and communicating. Developments in these fields have vastly lowered unit costs. For example, IBM memory technology has fallen in cost from two dollars per byte in 1964 to about eight cents per byte in 1977; the cost of 100,000 calculations has fallen from twelve cents to one cent over the same time. Regulatory changes in the telecommunications field have enabled new intermediaries between the monopoly telephone company and the commercial user to resell and share use of telecommunications lines. This has enabled commercial users that do not require full-time dedicated lines to have access, when needed, to a more sophisticated telecommunications network than they otherwise could afford.

When telecommunications networks are further combined with distributed electronic data processing, in which "smart" terminals do many of the functions previously performed by central processing units, the efficient scale of operation for the information-handling aspects of banking may be much further increased. Moreover, it is likely that this trend will continue, if not accelerate. The introduction of new telecommunications-networking technologies over the next several years is assured and the rate of technical advance in the computing field is making each generation of ever-increasing-capacity computers less expensive than the generation of machines displaced.

Indeed, there is evidence suggesting that computing and telecommunication networks together may have an efficient scale so large that only a small number of enterprises could be supported in any one market. To the extent that the value of banking services is attributable to such information-handling tech-
nologies, the efficient scale for banking enterprises can be expected to increase similarly and to tend, in the extreme, toward "natural oligopoly." Regulation that prevents the realization of such scale economies will therefore impose increasingly high opportunity costs on banks and deadweight efficiency losses on the public.

It is reasonable to infer that banks will devote increasing efforts to circumventing such scale-reducing limitations, including the state-by-state banking system. In fact, as detailed at the end of the following subsection, banks are already turning their attention to electronic means of penetrating interstate markets: in 1980, several banks announced plans for interstate ATM networks.

2. Interstate Banking Today.—Virtually all of the activities in which BHCs are allowed to engage are also permissible for national and most state banks. Insofar as the BHC engages in the activity through an office outside of its home state, however, it will generally be exercising a power that is not open to the bank. Still, as will be shown, banks themselves have been able to establish some commercial and retail direct presence in host states. Generally, the type of banking activities conducted through host-state offices of the bank could lawfully be routed through the BHC or a nonbank subsidiary. Other limitations, however, such as the availability of capital in light of the restrictions on credit transactions between the bank and its affiliates, generally make it preferable to organ-

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233. The nature of a communications network would be critical in creating a tendency toward natural oligopoly or monopoly in the handling of banking data. Just as two telephone networks serving the same area would be wasteful, so too are dual interchange systems for standardized credit card sales slips (or on-line data transmissions in lieu thereof), and two separate networks of interconnected teller machines serving the same area, each with a central computer. See Bernard, New Directions in Bankcard Competition, 30 Cath. U.L. Rev. 65, 82 (1980). But see Letter from Donald I. Baker, Assistant Attorney General, Antitrust Div., U.S. Dep't of Justice to William B. Brandt, Nebraska Bankers Ass'n (March 7, 1977) [hereinafter cited as NETS letter] (copy on file in office of Hofstra Law Review).

234. Of course, the alternative arrangement, in which a monopolist or a few firms supply banking services, also promises to impose opportunity costs on society, such as those derived from a lack of technological innovation in the absence of competition. See NETS letter, supra note 233. But cf. R. Posner, Economic Analysis of Law 205 (2d ed. 1977) (reward for successful innovation often greater for monopolist).

235. See text accompanying notes 311-324 infra.

236. See text accompanying notes 92, 138-144, supra.

237. With minor exceptions, member and nonmember insured banks are prohibited from lending to any one affiliate more than 10%, and to all affiliates more than 20%, of their capital and surplus. See 12 U.S.C. §§ 371c (1976) (member banks), 1828(j)(1) (Supp. III 1979) (nonmember insured banks).
ize activities directly through the bank where permissible. With this understanding, the typology of interstate activities used below, which is based in part upon the distinction between bank and nonbank offices, will not be misleading.

a. Commercial Interstate Banking.—In order to serve commercial customers nationwide, major banks have established three types of presence on an interstate basis. These are directed respectively to cultivating loan business, providing cash-management services, and servicing international transactions.

i. Loan Production Offices (LPOs) and Call Programs.—The larger a borrower's needs, of course, the more willing it is to invest in shopping among banks. The largest corporate borrowers and the banks that serve them operate in international and national markets. Middle-sized corporations typically shop among only the larger banks in their region of the country. In recent years, however, major money-center banks have attempted to compete for the business of these middle-sized companies that was previously the exclusive province of the regional banks.

At first the money-center banks relied on "call programs" to market their loans. Salesmen would be dispatched to call on potential borrowers and solicit their business. Some states attempted to limit the call programs of out-of-state banks. There seems to have been little justification for their efforts other than the desire to protect home markets for home-state banks. As a formal matter, however, they took the position that the out-of-state bank was engaged in the business of banking, without a charter, when its loan officers called upon in-state borrowers. Rhode Island took the strictest view, maintaining that an out-of-state bank could not lawfully send a "warm body" into the state.238 Connecticut may have taken a slightly less extreme view by providing that the representative of an out-of-state bank could not lawfully stay overnight in the state.239

After experience with call programs, some banks determined that it would be more effective to open permanent LPOs from which to base their marketing operations. In 1974, Martin Mayer reported that the First National Banks of Chicago and Boston, and

238. Telephone interview with Edward Blue, Chief Examiner, R.I. Dep't of Business Regulation, Banking Division (Mar. 25, 1981).
239. Apparently, any hotel room in which a representative of an out-of-state bank might stay would thereby become an unlawful branch of the out-of-state bank. In telephone interviews with representatives of the Connecticut Division of Banking, this view was embraced in 1978 but disavowed in 1981.
the First Pennsylvania Bank, all planned to open regional offices throughout the United States within the next few years.\textsuperscript{240} It is not known how many LPOs exist, however, or what banks have established them, or where.\textsuperscript{241} Some states prohibit or require approval of LPOs on the ground that they are branches; some require them to register with the state regulator; still others, including California, freely permit them by statute or policy, thus vexing any hope of getting an accurate tally.\textsuperscript{242}

Whether an LPO is a "branch" within the meaning of the McFadden Act is unclear. The Comptroller has issued an interpretive ruling that LPOs are not branches "[p]rovided, that the loans are approved and made at the main office or a branch office of the bank . . . ."\textsuperscript{243} In litigation challenging this interpretation, evidence was presented indicating that "the Comptroller has construed the ruling narrowly in letters sent to banks subject to his jurisdiction."\textsuperscript{244} Some of these letters clearly responded to inquiries from banks interested in establishing LPOs oriented toward the retail-loan market, for they expressly prohibited LPOs from being used for such activities as "making forms available for opening checking or savings accounts" and "accepting loan payments."\textsuperscript{245} Nonetheless, the district court could still accurately characterize LPOs as "facilities [that] provide all essential services connected with obtaining loans except approval (which may be communicated by telephone to the LPO from the main or branch office), and disbursement of proceeds."\textsuperscript{246} It concluded that an LPO "gives national banks a distinct competitive advantage over state banks in those states where state banks are prohibited from operating simi-

\textsuperscript{240} M. Mayer, supra note 219, at 259.

\textsuperscript{241} The Bank of New York, in an advertising supplement to the American Banker, asserts that New York banks alone "have over a hundred commercial loan production offices in 24 states." Am. Banker, June 24, 1981 (advertising supplement).

\textsuperscript{242} The position taken by each state as of May 1, 1978, and its source in law or administrative practice, are reported in Brief for Amicus Curiae Conference of State Bank Supervisors at E:11-20, Independent Bankers Ass'n of Am. v. Heimann, 627 F.2d 486 (D.C. Cir. 1980). While California does not require LPOs to obtain licenses, it does require that individual representatives of out-of-state banks be licensed, pursuant to CAL. FIN. CODE § 1780 (West Supp. 1981). The State Banking Department has proposed to license officers rather than individuals. See CAL. SEN. BILL 785 (1981).


\textsuperscript{244} Independent Bankers Ass'n of Am. v. Heimann, 627 F.2d 486, 488n. (D.C. Cir. 1980).

\textsuperscript{245} Id. at 488-89n.

\textsuperscript{246} Independent Bankers Ass'n of Am. v. Heimann, No. 78-0811, slip op. at 5 (D.D.C. Mar. 29, 1979).
lar facilities," and on this ground characterized LPOs as branch banks. Accordingly, they would be subject to the McFadden Act and could not be established in states other than the home state of the bank. The district court's opinion was reversed on other grounds, however, and the legal status of a national bank's LPOs under the McFadden Act remains unsettled.

ii. Cash Management Services.—Banks provide a variety of services to aid corporate treasurers in the management of their deposits. A corporation may arrange, through the bank managing its cash and that bank's correspondents, to receive payments from customers in banks throughout the country in order to minimize the amount of mail time and maximize interest. The corporation will therefore maintain a "concentration account" at one bank to which excess balances will be transferred by wire on a daily basis. The bank providing the concentration account will undertake to keep all balances invested in interest-earning assets each day. Consequently, it will continually be receiving, aggregating, and investing funds on behalf of the corporate depositor. It may also maintain target balances in each of the depository banks in order to compensate them for their services to the corporation; indeed, this entire operation may be conducted on a multinational basis involving hundreds of banks and dozens of currencies every day.

A bank performing cash-management services may report to the treasurer of the corporate customer by telephone or wire several times each day. In this way the corporate treasurer can retain control over the decisionmaking process as situations requiring investment or currency transactions arise. Recently some banks have offered improved communication and control capacity by linking their corporate customers directly to the bank's computer and money-market desks through the installation of an on-line com-

247. Id.
249. Examples are lock boxes, remote disbursements, multilateral netting for affiliate payments, and foreign-exchange dealing. See generally Bonocore, Making Cash Management More Marketable, BANKERS MAG., Jan.-Dec., 1980, at 49.
250. For example, the Kroger Company was once reported to use more than 800 banks through which to receive collections. Mathur & Luisada, Cash Management Services Offered by Banks, BANKERS MAG., Jan.-Dec., 1980, at 62, 63, citing Z. MELNYK & C. BARNGROVER, CASES IN BUSINESS FINANCE (1971). Recently, however, corporations have been reducing the number of their banking relationships. Wittebort, The Frantic New Pace of Cash Management, 15 INSTITUTIONAL INVESTOR, June 1981, at 179, 181.
251. See Wittebort, supra note 250, at 191.
computer terminal that has a cathode-ray tube used for video display (jointly referred to as a CRT) at the customer's premises. In its most sophisticated form to date, the customer's CRT continuously provides current information on the corporation's cash position, is preprogrammed to instruct the bank's computer regarding recurring transactions such as dividend payments and payrolls to be met at particular times and places, and enables the corporate treasurer to instruct the bank or its computer regarding nonrecurring or irregular transactions such as payments to suppliers and investment of proceeds of loan transactions. Indeed, one major bank gives its customers direct access to its account at the Fed; the corporation can transfer funds in and out of the bank's Fed account over lines linking the bank's computer to the Fed's.

Under current case law it is unclear whether terminals and CRTs installed in corporate offices and linked to bank computers are branch banks under the McFadden Act. In Independent Bankers Association of America v. Smith, the court of appeals held that customer-bank communication terminals (CBCTs) are branch banks. CBCTs, which include both ATMs and point-of-sale (POS) terminals, were described by the court:

CBCT's are manned or unmanned electronic terminals which, depending on how the machines are programmed, permit an existing bank customer to accomplish various financial transactions, including the deposit and withdrawal of funds and the transfer of funds between accounts. These automated tellers may be installed off bank premises in shopping centers, supermarkets, stores, factories, office buildings, etc., and any approved bank customer with a plastic "key card" can effect transactions at these terminals. Some CBCT's are connected directly to their bank's central computer . . .

In the court's view CBCTs were branches within the Supreme Court's reasoning in First National Bank v. Dickinson, which characterized an armored-car deposit-pickup service as a branch because it enabled the bank to gain a competitive advantage with respect to the convenience of locations at which "deposits are re-

254. Id. at 924.
The CBCT received deposits within the meaning of the McFadden Act not only by accepting an "ordinary deposit into a customer's checking or savings account" but also by allowing customers to make "(1) transfers of funds between two accounts of the same customer and (2) payments on installment loans or credit card accounts." In the case of CRTs installed in corporate treasurers' offices, the bank is clearly enabling the customer to make "transfers of funds between two accounts." When the customer moves funds from the Fed or another bank into its account at the linked bank, therefore, it is as clearly making a "deposit" as would be the retail customer effecting a transfer between savings and checking accounts through the CBCT. Furthermore, if the corporate customer repays a loan or compensates the bank for its cash-management services by making payments or keeping compensating balances effected over the linked system, it may be making the second type of "deposit" found in the CBCT case.

The court also held that CBCTs are places at which "checks [are] paid." The court admitted that it would be difficult to fit anything involved in an unmanned-CBCT withdrawal transaction into the definition of a "check" as it is used in either the Uniform Commercial Code or in ordinary language. Reasoning that "the technological change from paper checks to plastic cards as a new means by which banks 'pay checks'" was of no significance to the policy underlying the McFadden Act, however, the court stated: "If future technological innovations render paper checks totally obsolete, [the McFadden Act] will still include within its broad standard those facilities that permit bank customers to perform the traditional banking function of withdrawing funds from their accounts." Of course, the court here was contemplating technological advances that still resulted in a retail customer receiving a bundle of currency from a banking facility. It did not contemplate that a corporate customer would be transferring large sums of money from its account at the linked bank to its accounts elsewhere. Nonetheless, under the court's approach it is difficult to see how the corporate CRT can be distinguished from the retail CBCT as a place where deposits are received and checks paid.

257. 534 F.2d at 940, 941.
258. See U.C.C. § 3-104(2)(b).
259. 534 F.2d at 944.
260. An alternative interpretation of the McFadden Act's definition of a
Of course, the issue will arise only if some banks are put at a competitive disadvantage because their state determines that CRTs are branches and thus either prohibited or geographically limited. There would seem to be no policy reason for a state to so hold, except in the interstate context. Consider the situation faced by the small and even some regional banks that are not competitors in the cash-management market. Concerned about losing balances to money-center banks, such banks might well convince their state regulator that CRTs are branches of the money-center banks to which they are linked and thus attempt to prevent their installation in the host state.

As in the case of LPOs, comprehensive information about the prevalence, location, and interstate penetration of cash-management CRTs is not available because the banks that provide this service have assumed that they are not engaged in branching. Accordingly, they have not sought official approval of their activities and have certainly not filed branch applications for each CRT unit installed.

iii. Edge Act Corporations.—Since 1919 the FRB has been empowered to charter so-called Edge Act corporations “for the purpose of engaging in international or foreign banking” and other foreign financial operations. Until the International Banking Act of 1978, any United States citizen could establish an Edge Act corporation, but in fact only domestic banks did so. Some banks, indeed, established Edge Act corporations in several states, since they could not branch. These parent banks tended to be very large, since each Edge Act corporation must have at least $2,000,000 of paid-in capital, while their banking activities are limited to the facilitation of international transactions. Thus they could issue letters of credit, create bankers’ acceptances, make loans to finance imports and exports, accept domestic deposits

"branch," which would exclude the corporate CRT from its ambit, is offered at text accompanying notes 729-737 infra.

linked to payments for international transactions, and accept any deposits from foreign sources. As of 1979 there were only 131 Edge Act corporations.265

The International Banking Act of 1978 made foreign banks eligible to own Edge Act corporations266 as part of a compromise under which the foreign banks lost their de facto exemption from the McFadden Act.267 Foreign banks, that is, lost the privilege of adding new, full-service domestic banking facilities outside of a designated "home" state, but were allowed to open branches in multiple states, state law permitting, if they limited their deposit-taking to those an Edge Act corporation could accept.268 Lending authority was not similarly restricted, however; thus, foreign bank branches retain an advantage over a domestic (or foreign) bank's Edge Act corporations. At the same time, Edge Act corporations were given the right to exercise substantially broader powers,269 making them more attractive to domestic banks and less unattractive to foreign banks as a substitute for full-service interstate banking.

Edge Act corporations are still limited to transactions with an international aspect. Within that limitation, however, Congress instructed the FRB to reregulate them in order better to realize their statutory purposes, especially that of facilitating United States exports.270 Accordingly, the FRB has broadened its concept of what is related to an international transaction.271 For example, an Edge Act corporation may now finance not only the sale and shipment of exported goods but also their production and storage where they are identifiably destined for international commerce.272

The FRB has also determined that Edge Act corporations may open branch offices273 "to foster the participation by regional and

267. See Note, supra note 263, at 292.
273. Id. § 211.4(e).
smaller banks throughout the United States in the provision of international banking and financing services. Prior to being given branching authority, each location required separate incorporation and capital of $2,000,000. With branching, it is now possible for a single Edge Act corporation with $2,000,000 of capital to have as many offices as the FRB agrees the parent bank can prudently manage, in any community whose international banking and financing needs warrant the addition of a new competitor.

In the first eighteen months under the new regime for Edge Acts, eleven banks received approval to establish twenty-eight new Edge-Act-corporation branch offices. In addition, several banks have proposed to consolidate their existing Edge Act corporations into one company with branch offices, thereby increasing the loan limit, which is ten percent of the corporation's capital and surplus, available at each location. For example, the Bank of America has merged its Edge Act corporations in Chicago, Houston, Miami, and New York, and intends to open new branches of the consolidated company in Atlanta, Boston, Cleveland, Dallas, Minneapolis, and St. Louis. Citibank plans to convert its Chicago, Houston, Los Angeles, and San Francisco Edge Act corporations into branches of its Florida Edge Act corporation (Citibank Interamerica) and to open new branches of the Florida unit in Atlanta, Boston, Cleveland, Minneapolis, St. Louis, and Seattle. Other major banks are considering or pursuing similar plans to consolidate and extend their existing Edge Act networks.

The Edge Act corporation is now an important element in interstate commercial banking. It enables major banks to establish a commercial bank presence in many cities while giving regional

277. Id.; Wall St. J., July 31, 1980, at 8, col. 1. The Bank of America's Nassau, Bahamas branch was also to be merged into the new Edge Act corporation, to be called BankAmerica International. Id.
banks access to locations they consider important for servicing existing customers’ international transactions or acquiring new international business. Thus a regional bank in Atlanta may open an Edge Act office in Miami because many of its present and potential customers import and export through that city; at the same time, it may establish a presence in the New York market which is a source of prestige to a regional bank and can “lead to more loan opportunities, both in a managing as well as a participating position.”

Each Edge Act office may also serve to cross-sell, implicitly or explicitly, the services of its parent bank and act as a loan production office for it. The FRB would disapprove of the Edge’s acting as an LPO with respect to domestic transactions that the Edge could not itself book, but business-development activity of this kind does not necessarily come to the attention of the Fed’s examiners.

b. Retail Banking Interstate.—Banks’ inability to open branches across state lines has more effectively impeded their penetration of distant retail markets than of out-of-state commercial markets. Nonetheless, some banks have attempted to overcome the competitive disadvantage inherent in being physically absent from a retail-market area.

i. Credit Cards.—The interstate extension of consumer credit has been vastly facilitated by the popularity of bank credit cards. Prior to the widespread use of these cards, banks’ consumer loans were heavily weighted toward secured loans. Security usually consisted of the chattel purchased with the loan’s proceeds, securities, or a savings account passbook. As late as 1974 most banks were still uncomfortable making unsecured personal loans. They were typically made only to established depositors as an accommodation. In the latter part of the 1960s, banks entered the credit card business on a large scale. Today most banks are issuers of either MasterCard or Visa, or both, and there are thirty-five million of these bank cards outstanding. Almost all of the nearly $6 billion in credit extended by means of these cards is unsecured.

Once involved in extending unsecured consumer-credit lines accessed by cards, some banks have realized that there is little reason to limit their sights to the local market. Bank credit card rela-

281. M. MAYER, supra note 219, at 334.
283. Of these, more than 23 million represent active accounts. Id.
284. Id. (dollar volume).
tionships, unlike personal loans, are typically established through impersonal applications. If the application is approved, the bank establishes a line of credit and mails a card to the new account holder. Making inquiries of the card applicant’s employer, local credit bureau, and credit references is no more expensive when done by mail. Processing sales drafts and billing customers are equally insensitive to distance; even collection efforts are probably no more difficult over distance, since most banks give delinquent consumer accounts to outside collection agencies even when the borrower is within the local market.

Some major banks have engaged in mass solicitation of credit card accounts on a regional or nationwide basis. In August 1977, Citibank, which then had more than one million MasterCard holders in metropolitan New York, conducted a mass mailing to Visa holders in twenty-five states. It is reported to have as many as 5.8 million Visa and MasterCard holders now, and claims to have at least 25,000 in each of twenty-five states. In Marquette National Bank of Minneapolis v. First of Omaha Service Corp., it was stipulated that the First National Bank of Omaha solicited Minnesota residents “on a continuous and systematic basis” to accept Visa and that it did so by “direct mail solicitation, telephone contact and through Minnesota banks.” The First National Bank of Chicago, as amicus curiae, informed the court that more than 400,000 of its more than 1.5 million Visa accounts were held by residents of states other than Illinois. Before the advent of nationwide bank credit card systems, it would have been inconceivable even for a bank as large as the First National Bank of Chicago to have established that many consumer loans, secured or unsecured, across state lines.

ii. Retail LPOs.—There is some evidence that banks have established LPOs for the purpose of originating consumer loans. In

286. OCC Opinion on Application to Charter Citibank (South Dakota), N.A. 3 (Nov. 19, 1980).
288. Id.
Independent Bankers Association of America v. Heimann, the district court found that "[n]ational banks operating such facilities advertise them as 'financial centers,' 'Money Marts,' 'consumer loan offices,' 'personal banker,' etc.," all of which imply a consumer orientation, as does advertising them. As indicated earlier, the district court held that these LPOs were "branches," contrary to the Comptroller's interpretive ruling, and the court of appeals, in reversing it on other grounds, referred to several letter rulings of the Comptroller in response to bank inquiries concerning the provision of various retail services at LPOs. The case of Oklahoma v. American National Bank & Trust Co. was a suit under the McFadden Act to close a particular bank's clearly consumer-oriented LPO. Finally, Maryland National Bank opened a loan production office in Wilmington, Delaware in 1977 to solicit consumer-loan business. The State of Delaware sought to enjoin operation of the office on the ground that it constituted an unlawful branch. The action was settled in 1979, however, when the bank agreed to close the LPO for what it says are business reasons.

While the number of retail LPOs is unknown, it is doubtful there are many of them in operation either inside or outside the parent bank's home state. It is significant that there is no litigation, other than the three cases reported above, implicating retail LPOs. Given the risk that an LPO would be characterized as an unauthorized branch, a bank would not be likely to establish an LPO where it could lawfully establish a branch (or perhaps even just an office of a consumer-finance-company affiliate). In the concrete cases reported above, American National Bank was located in a unit banking state and Maryland National Bank was attempting to cross a

291. Id. at 2 n.3.
292. See text accompanying notes 244, 246-247 supra.
295. According to the state, "the matter was settled in light of the pleadings, the District of C.C.'s order [in IBAA v. Heimann] to the Comptroller to rescind the [LPO] Interpretive Ruling, and its eventual rescission." Letter from Don C. Brown, Deputy Attorney General of Delaware to the author (Sept. 5, 1980). The settlement agreement was not filed with the court however. Id. According to Mr. Raymond Nichols, a vice president of Maryland Nat'l Bank, the bank was thus able to maintain its legal position while closing the LPO in light of money market conditions that made consumer lending unattractive. Telephone interview with Mr. Nichols (Aug. 21, 1980).
state line; thus neither had the option of branching. In such situations, the LPO would certainly be challenged by a competing bank or other lender in the host community, if not by the host state itself. 297

Commercially oriented LPOs, on the other hand, are less likely to provoke legal challenges from competitors. First, they compete with other large banks that are themselves likely to want to establish LPOs and thus unlikely to bring suit. Second, their operations need not be as visible as those of a retail-oriented LPO. Retail LPOs need a retailing location and may well advertise. Consequently, one can reasonably infer that retail LPOs, unlike commercial LPOs, are probably not much more extensive than published reports reveal. 298

The legal status of retail LPOs, like that of commercial LPOs, is unclear. In the American National Bank299 case, an intrastate office of a national bank was held to be a branch at which money was lent; that result seems indisputable, however, since all steps in making a loan—except approval by a loan officer, which was done by telephone—were handled at the branch, including the disbursement of loan proceeds. Whether a consumer LPO that neither approves loans nor disburses loan proceeds—such as the OCC has required—is a branch, remains unsettled.

There is no basis in the McFadden Act, however, for distinguishing nonapproving and nondisbursing consumer LPOs from

297. Curiously, it seems that both of the banks mentioned in the text could have opened a finance company subsidiary of their BHC in the targeted markets; neither Delaware nor Oklahoma appears to impose a “convenience and need” test to the licensing of finance companies. See DEL. CODE ANN. tit. 5, § 2101-2111 (1974 & Supp. 1980) (small loan law); OKLA. STAT. ANN. tit. 14A, § 3-504 (West 1972) (licensure of supervised lenders). Perhaps their preference for a direct branch of the bank reflected more liberal regimes governing the terms of bank loans than finance company loans.

298. The three cases discussed above are reported in Machalaba, Legal Fight is Starting Over Offices Used by Big Banks to Obtain Consumer Loans, Wall St. J., June 2, 1978, at 6, col. 2. Adverse opinions of the Attorney General of Arkansas (June 4, 1969), and the Georgia Supt. of Banks (Dec. 31, 1968), concerning LPOs are noted respectively in 1 FED. BANK L. REP. (CCH) ¶ 3169.757, 3169.294. Consumer LPOs have also been used in attempts to overcome intrastate geographical restrictions on branching. See Ind. LPO is 1st Cross-County Action, Am. Banker, Sept. 4, 1980, at 2, col. 1 (non-approving, non-disbursing LPO in Indiana, which limits branches to bank’s home county); cf. Ill. Op. Att’y Gen’l S-1040 (Jan. 26, 1976); id. S-512 (Sept. 14, 1972); id. UP-2036 (Nov. 22, 1968); 1 FED. BANK. L. REP. (CCH) ¶ 3169.332 (proposed bank loan solicitation offices would be branches and thus unlawful).

nonapproving and nondisbursing commercial LPOs. Thus their legal status will necessarily be resolved together.

iii. Solicitation of Deposits.—There are no legal inhibitions on a bank’s soliciting deposits from individuals in other states. There are, however, practical constraints. The maximum rates of interest payable on various types of insured-bank deposits are set by regulation. In recent years, these maxima have often been below rates available to depositors from competing investments, notably money-market funds. In addition, they have been kept consistently below the rates payable by insured savings and loan associations (by one-quarter of one percent). Unable to engage in effective interest-rate competition for deposits, banks have emphasized service competition (for example, opening convenient branches and maintaining longer banking hours). Banks without a physical presence in a market are therefore at a substantial disadvantage when they solicit depositors by mail or advertising.

Even when there is interest-rate competition among banks,

300. See text accompanying note 93 supra.

301. A national bank, for example, may “transact” its business only at its main and authorized branch places of business, 12 U.S.C. § 81 (1976), and any place at which it “receives” deposits is a branch, id. § 36(f), but these limitations do not encumber its ability lawfully to solicit deposits anywhere. The Constitution almost certainly prohibits the states from preventing an out-of-state bank’s solicitation of deposits so long as it is not “doing business” in the host state.

302. See 12 C.F.R. § 217.7 (1980) (Reg. Q governing member banks); id. § 329.6 (1980) (insured nonmember banks). The anti-competitive purpose and effect of regulating the interest rates payable on deposits are obvious; congressional authorization of such regulation in 1933 can be seen as part of the general, then orthodox, philosophy of political economy that held “excessive competition” responsible for exacerbating the Depression. See Chandler, Monopolistic Elements in Commercial Banking, 46 J. Pol. Econ. 1, 13 (1938). See also Clark, The Soundness of Financial Intermediaries, 86 Yale L.J. 1, 26-44 (1976) (anticompetitive regulation as one of four common strategies of risk regulation).

303. As a result, money market funds now hold balances in excess of $120 billion, notwithstanding their uninsured status. See Wall St. J., June 12, 1981, at 31, col. 4. Most of these balances would almost certainly be held in bank and thrift transaction and savings accounts but for the interest rate controls to which those institutions are subject; some of the balances are apparently made up of temporarily available investment funds, however.


there are substantial drawbacks for a consumer doing business with a distant bank. First, without a local bank, many individuals would be without a convenient place to obtain cash. Second, although consumers are more likely to succeed in obtaining a personal loan at the bank where they maintain a deposit relationship, they may nonetheless have difficulty if that bank is distant. This factor will be particularly compelling for relatively high-income depositors who are most likely to have business and personal banking needs sufficient to warrant cultivating a personal relationship with an individual bank and bank officer.

Periodically, nonetheless, competition for deposits spurs a bank to solicit deposits from distant markets. In order to succeed, of course, the bank must offer some innovation not locally available in the host state. Thus a New York savings bank recently began offering a "finder's fee" to Floridians who convinced a friend to deposit $3,000 or more. The same offer had been met by competing banks in New York but was new in Florida and attracted deposits of $500,000 in the first week.306 For another example, in 1980 the Chase Manhattan Bank offered by interstate mail a package of banking services including not only deposit accounts but also bill paying by telephone, Visa credit, and other features not available together at a single bank in most, if any, markets.307

Citibank is considering offering a "credit balance" feature on Visa accounts as a substitute for a conventional bank account.308 The idea would be to attract funds from cardholders nationwide, giving them access by card, Visa draft, and telephone bill-paying service, and paying them at higher rates of interest than are permitted on insured deposits subject to Regulation Q.309 The Bank of America is also considering a credit-balance feature on its cards.310

iv. ATM Networks.—Several banks have opened or announced plans to open interstate networks of shared-use ATMs.311

307. See Letter from Todd Hoffman, Chase Manhattan Bank, N.A. to the author describing "Chase Full Benefit Banking" (April 17, 1980).
308. See Rose, supra note 285.
309. See note 302 supra. Regarding the closely related credit card product since offered by Citicorp Financial, Inc., a nonbank subsidiary of the BHC, see text accompanying notes 363-368 infra.
310. See BankAmerica's Cards Ready, Am. Banker, Mar. 5, 1980, at 3, col. 3.
311. See, e.g., 1st Tenn. Launches ATM Network for Correspondents in 7 States, Am. Banker, July 22, 1980, at 3, col. 1; Girard of Phila. Forming EFT Net in
These are unmanned CBCTs at which the customers of any participating bank can make deposits, withdraw cash, transfer sums between accounts, and make loan payments. Customers will not be able to make deposits at ATMs in a state other than that of their bank in all except one of the interstate systems announced thus far. This limitation is apparently being imposed in the hope of avoiding characterization of the ATMs as branches for McFadden Act purposes.

In the Independent Bankers case, discussed above, an unshared ATM located at a site remote from a bank was held under the McFadden Act to be a branch of the bank that established it. Unshared remote ATMs are thus permitted equally to state and national banks in states that do not treat ATMs as branches and in states that do treat them as branches but in which branching is lawful. In either type of state, a national bank must make an abbreviated branch application to the Comptroller, whereas a state bank must apply to its primary regulator only in states that treat ATMs as branches.

Independent Bankers did not deal with networks of shared ATMs programmed to enable card holders to access their accounts at one bank from a terminal that is established by a second bank, either on its premises or at a remote site. The case also did not address ATMs that could access a bank account across state lines. Shared use of an ATM raises the question, "Of which bank(s) is the ATM a branch"? The shared ATM could be characterized as a branch only of the bank that owns or leases the machine but this leaves a major gap in the law, for it is not necessary that any bank own or lease the ATM. A nonbank subsidiary of a BHC or a "bank service corporation," a type of joint venture among banks, could do so, as could a computer communications network company.

Three States, Am. Banker, July 1, 1980, at 1, col. 1; W. Coast ATM Net Goes Interstate, id. at 15, col. 1.

312. See FG Electronically Links Area Banks, Washington Star, Sept. 6, 1980, at B-5, col. 1. Financial General Bankshares, Inc., a grandfathered multistate BHC with subsidiary banks in Maryland, Virginia, and the District of Columbia, has established a nonbank subsidiary, Money Exchange Service, that would operate the 59 ATMs of the three banks in the metropolitan Washington area; depositors of the D.C. and Maryland banks would be able to effect any transaction, including a deposit, at ATMs in either jurisdiction. Id.

313. See, e.g., id.

314. See text accompanying note 253 supra.


unaffiliated with any bank or BHC. Alternatively, the ATM could be characterized as a branch of each bank that shares its use, or of none of them. In the interstate context, the Comptroller has taken the position that an ATM is a branch only of the bank in the host state, if any, that owns or leases it, and not of the home-state national bank that arranges for its customers to use the ATM for a transaction fee. In the intrastate context, this ruling reintroduces the potential for competitive inequality that the court of appeals sought to minimize in Independent Bankers Ass'n of America v. Smith, 534 F.2d 921, 951 (D.C. Cir.), cert. denied, 429 U.S. 862 (1976), that any facility that performs the traditional bank functions of receiving or disburse funds is a "branch" within the meaning of section 36(f) if (1) the facility is established (i.e., owned or rented) by the bank, and (2) it offers the bank's customers a convenience that gives the bank a competitive advantage over other banks (national or state). (emphasis supplied in OCC Letter).

The OCC is thus elevating form over substance in ruling that an ATM at bank A is not a branch of bank B whose customers use it to access their accounts at bank B simply because bank B does not "own or rent" the ATM. The policy objections to this approach are discussed in the text. It should also be noted that the OCC's position is tenuous even as a matter of form alone. First, in the court's own terms, bank B has "established" the relationship with bank A that makes such use by its customers possible. Second, to recur to the language of the Supreme Court in Dickinson, the ATM of bank A is indeed "a bank facility." Unlike a mailbox or telephone, therefore, its installation at bank A could be arranged by bank B, or by bank A in anticipation of bank B's interest, to suit the convenience of bank B's customers and thus to confer a competitive advantage on bank B over other banks in its home area.

319. OCC Letter No. 153, supra note 318, purports to address the branch issue raised by ATM sharing only in the interstate context; it thus cautions that an interstate ATM should not be shared by a national bank where it would thereby gain an advantage over host state banks. It cannot be so limited, however. Consider the case of intrastate geographical limitations on branching presented by Pennsylvania. If Girard Bank of Philadelphia can give its customers access to their accounts through ATMs at banks in New Jersey, that is, see Girard of Phila. Forming EFT Net in 1981

Ginsburg: Interstate Banking

INTERSTATE BANKING

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69
In *Independent Bankers*, the court characterized unshared ATMs as branches because they performed the banking functions by which a branch is defined in the McFadden Act and, if freely allowed to national banks, would bestow a competitive advantage over state banks in states that characterized ATMs as branches and prohibited branching or limited the geographical area in which a state bank could branch. The McFadden Act policy of competitive equality also suggests that an intrastate shared ATM should be treated as the branch of each national bank using it in states where it is treated as a branch of each state bank. Since the McFadden Act must be applied uniformly both in states that do and do not treat a shared ATM as a branch of each state bank using it, however, the resolution closest to complete competitive equality is for the Comptroller to treat the shared ATM as a branch of the national banks but, as with unshared ATMs, to minimize the burden of the branch application procedure imposed thereby on national banks. Complete competitive equality could be achieved only by interpreting the McFadden Act to incorporate state law on whether an ATM is a branch of each bank that shares its use and to let the results vary from state to state. This possibility, however, was foreclosed by the Supreme Court's interpretation of the McFadden Act in *Dickinson* as providing a uniform federal definition of a branch.

The policy of competitive equality also requires that a national bank be allowed to share use of an out-of-state ATM if a state bank in its home state would be allowed to do so. If the home-state bank were allowed to share an out-of-state ATM on the ground that the ATM is not a branch under home-state law, and the Comptroller followed this interpretation, no competitive disparity would arise. If the home state would treat an out-of-state ATM as a branch of a home-state bank, however, and if it permits out-of-state branching, an inequality would be created because the Comptroller could not authorize an out-of-state branch. Here the resolution that mini-

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*Three States*, supra note 311, on the ground that the distant ATM is not a branch of Girard, then it should be able likewise to overcome Pennsylvania's contiguous county branching limitation by arranging for shared use of ATMs established by other banks in non-contiguous counties of Pennsylvania. If the competitive branching advantage forbidden to national banks by the McFadden Act is only that over host area banks (whether in New Jersey or distant Pennsylvania counties) and not that over home area state banks (in Philadelphia), then the results must be the same intrastate as interstate.

321. See text accompanying note 164 supra.
mizes the potential for competitive inequality is for the Comptroller to look to the host state to determine whether the ATM is a branch of the out-of-state bank.

If the host state regards the ATM as a branch of the out-of-state banks that share its use and prohibits out-of-state banks to branch in—as all states now do—host-state law will prevent a state bank from branching in electronically and the McFadden Act should be held to prevent a national bank from branching in electronically. If host-state law holds that the ATM is not a branch of the out-of-state bank, and thus allows its entry, the Comptroller should have no difficulty under the McFadden Act allowing national banks to follow suit. If a host state were to regard the shared ATM as a branch of the out-of-state banks that share its use but did not prohibit this mode of branching in, then neither should the Comptroller. Again, however, if the Comptroller accepts the host state's characterization of the ATM as a branch of the home-state national bank, it could not be authorized. Competitive equality would then be more nearly achieved if the Comptroller treated an out-of-state shared ATM as a branch where the host state also considered it a branch and prohibited it, but treated the ATM as not being a branch where the host state did not treat it as such and thus allowed it. Then, if the home state regarded the out-of-state ATM as a branch, only state banks would bear the burden of going through state branching application procedures, which would presumably be abbreviated by state regulators as the Comptroller has abbreviated the branching procedures for the intrastate unshared ATMs of national banks. In fact, however, no state that treats an ATM as a branch of the out-of-state bank authorizes interstate branching into its territory. At least for the present, therefore, competitive equality will be achieved if the McFadden Act is interpreted to defer to the host state on the question whether an ATM is a branch of an out-of-state bank.

Nothing in this analysis turns on whether the shared ATM accepts deposits in one state for a bank located in another. The deposit-taking function has, however, been determinative for some state bank regulators in deciding whether the ATM is a branch of

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322. South Dakota law allows banks to agree with out-of-state banks to share access to their ATMs. S.D. CODIFIED LAWS ANN. § 51-20A-7 (1980). Utah makes provision for ATM use sharing by customers of banks in contiguous states, and expressly authorizes their interconnection "with a regional or national consumer funds transfer system." UTAH CODE ANN. § 7-16-9 (Supp. 1979). Again, however, it does not regard nor regulate an ATM as a branch bank. Id., § 7-16-1(1).
the out-of-state bank: If it can take deposits for the out-of-state bank, it is a branch of that bank; if it cannot, it is not a branch. As a formal matter, regulators are treating deposit-taking as the essential element of engaging in the business of banking and therefore of operating a branch bank.323

Functionally, an out-of-state bank taking deposits at a host-state ATM would still be at a disadvantage in competing for the accounts of host-state residents because it lacks a local office. Of course, in an interstate metropolitan area, the bank may not be far away and the disadvantage not great. For an out-of-state bank that cannot take deposits in the host state, the primary purpose in sharing an out-of-state ATM is to accommodate home-state residents who find themselves in the vicinity of the out-of-state ATM.324 Account holders away from home more frequently want to withdraw than to deposit funds and the ATM will be able to offer them this convenience. It will therefore be of competitive significance in the home-state market, not the host-state market, that a bank can offer access from out-of-state ATMs. Assuring state and national banks equal treatment in the host state will thus preserve competitive equality between them where it matters, that is, in their common home-state market.

c. Interstate Nonbank Subsidiaries.—It has already been noted that nonbank subsidiaries of BHCs engage almost entirely in activities that banks themselves engage in, their principal advantage being that they are not subject to branching limitations as are banks.325 Accordingly, nonbank subsidiaries can operate as vehicles for providing specific bank services to distant and interstate markets.

It is not feasible to obtain a complete picture of the degree to which BHCs have penetrated interstate financial markets. The following discussion focuses on the few lines of business in which BHCs are thought to have concentrated most of their resources and which account for most of the interstate offices that they operate. For convenience, these major lines of business have been grouped into four categories: extending credit; taking deposits; providing trust services; and processing data.

323. See text and authorities at note 312 supra.
324. Access to an out-of-state ATM for cash withdrawal would also make the bank's credit card more attractive to consumers in the area of the ATM. Furthermore, a bank marketing lines of credit by mail to consumers interstate would find it advantageous to be able to provide them with local access to cash at the ATM.
325. See text accompanying notes 52, 138-144 supra.
i. Extending Credit.—BHCs extend several types of credit through nonbank subsidiaries, including commercial credit, consumer credit, and equipment and automobile leasing, which are equivalent to extensions of credit.

aa. Consumer-Finance Companies.—Undoubtedly the largest number of interstate BHC offices extending credit are those of consumer-finance-company subsidiaries. Consumer-finance companies make direct cash-installment loans and purchase finance paper from dealers; a few of them issue credit cards as well. Domestic BHCs have acquired more than 100 consumer-finance companies with several thousand offices, including thirty-nine of the 100 largest noncaptive finance companies. In addition, they have established more than 850 de novo consumer-finance-company offices.

The largest BHC-owned consumer-finance company for which data are available is FinanceAmerica Corporation, a subsidiary of BankAmerica Corporation. It has 338 offices in thirty-eight states and assets of $1.2 billion at the end of 1979. The ten largest consumer-finance companies owned by BHCs at that time had a total of 2,039 offices; the nine companies reporting financial data had just under $3 billion in receivables and the one company that does not report separately, Citicorp's Nationwide Finance, is believed to have had more than $1 billion in receivables.

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327. "Captive" finance companies are those whose principal activity is financing the purchase of their affiliates' goods.

328. Tabulated from 100 Largest Independent or Affiliated Finance Companies, Am. Banker, June 20, 1980, at 24, col. 3 (data as of end of 1979 or nearest fiscal year). See also Bank-Related Finance Companies with Corporate Funds Greater than $4 Million, id., at 23.

329. The Fed has received 857 notifications of BHC de novo consumer finance offices since March 31, 1973. BEQ, supra note 326, at 48. Since 1971 it has also received notification of 370 de novo "general" finance company offices, many of which may do a consumer finance business, especially since it received 123 general de novo notifications in the period from Jan. 1, 1971 to March 31, 1973 when it did not distinguish among types of finance companies (e.g., consumer, commercial). Id.

For perspective, it should be noted that in 1975 there were 26,884 finance company offices, operated by 3,376 companies; the 88 largest such companies, however, operated 18,899 offices. Nat'l Consumer Finance Ass'n, 1978-79 Office Manual 1 (1978).


332. Nine companies reporting financial data had just under $3 billion in re-
bb. Mortgage Banks.—The mortgage banking industry originates, packages for resale, and services residential and commercial mortgages. As of mid-1980 BHCs had been allowed to acquire 106 mortgage-banking companies and had given notice of de novo establishment of 730 more. In 1979 seventy-six banks and BHCs accounted for about one-half of the mortgage-banking business done by the 196 companies responding to a national survey.

cc. Factors.—Factoring involves the purchase of business accounts receivable. Manufacturers, particularly of soft goods, sell their accounts receivable at a discount in order to obtain working capital. According to Glassman and Eisenbeis, “the industry comprises some thirty-five large factoring firms, several smaller factors, and commercial banks.” According to Schotland, banks and BHCs dominate the industry, having obtained a clear majority of the market by 1975. They controlled nineteen of the thirty largest factors in 1976. As of mid-1980, BHCs had been permitted to acquire twelve independent factors and had notified the FRB of their de novo establishment of sixty-five others.

dd. Commercial Finance and Leasing Companies.—Commercial finance companies make loans to small and middle-sized businesses and provide inventory financing to distributors and dealers of consumer durables. In some cases they also lease equipment.
INTERSTATE BANKING

and real property to businesses, but this is more commonly done by BHCs through a specialized leasing subsidiary. As of mid-1980, BHCs had received approval for the acquisition of twenty-one leasing firms and notified the Fed of their de novo establishment of 548 leasing-company offices.339

It is impossible to obtain sufficient data about the commercial-finance industry to determine the significance of banks and BHCs in the field. It is known, however, that the Fed has approved fourteen BHC acquisitions of commercial-finance companies and has been notified of 187 de novo entries into the field by BHCs as of June 1980.340 According to a press report, in 1979 alone "Citibank established a new subsidiary and a network of 29 offices under the name of Citicorp Industrial Credit Inc. Several months later Chase Manhattan Bank also said it was setting up a new corporate unit; Chase Commercial Credit Group with as many as thirty-five offices in nineteen states."341 Since then Manufacturers Hanover Corporation "announced the opening of a full-service commercial financial office"342 in Chicago, to supplement its commercial-finance subsidiary's offices in Atlanta, Dallas, Charlotte, Los Angeles, and New York.

ii. Deposit-Taking.—BHCs may own nonbank depository institutions in the approximately twenty states that have chartered "industrial banks."343 These institutions, also known as industrial loan companies, loan-and-thrift companies, and originally as Morris Plan banks, vary from state to state in the powers they may exercise. Their most common features, however, are the ability to take savings deposits, make secured and unsecured loans, sell credit-related insurance, and purchase sales-finance paper. Accordingly, they are like consumer-finance companies that can also take savings deposits. In some states they can issue bank credit cards, engage in

339. Id. Current information on the market share of nonbank leasing subsidiaries of BHCs is not available. In 1975, however, Fed Governor Holland attributed to the Board an estimate of 10% as the share of the leasing business held by BHCs as of December 1974. Holland, Bank Holding Companies and Financial Stability, 10 J. FINANCIAL & QUAN. ANAL. 577, 580 (1975).
340. BEQ, supra note 326, at 48.
341. Am. Banker, Dec. 21, 1979, at 1, col. 3, at 12, col. 3. Continental Illinois Corp. proposed to acquire the Foothill Group, Inc., with assets of $121.5 million, specifically because the firm was "well positioned in key geographic markets," id. at 1, col. 3, but the acquisition was not consummated.
Because industrial banks are not banks within the meaning of the Bank Holding Company Act, BHCs may own them on an interstate basis. The Act defines a bank as a domestic institution (other than an Edge Act corporation) that both makes commercial loans and "accepts deposits that the depositor has a legal right to withdraw on demand," that is, offers checking ("demand deposit") accounts. Industrial banks are not permitted to offer checking accounts in any state except Rhode Island and Connecticut and even in those states an industrial bank that did not in fact offer checking accounts and make commercial loans would not be a bank within the meaning of the BHC Act. In Colorado and Utah industrial banks are permitted to establish or share use of ATMs and point-of-sale systems, giving depositors a partial substitute for checking accounts. As long as depositors do not have a legal right to withdraw upon demand, however, these forms of electronic access may presumably be offered even by an industrial bank that makes commercial loans without its becoming a "bank."

Industrial banks tend to be small institutions. In some industrial-banking states there are very few; in some, such as Florida, where there are three, no new charters will be issued. New York has legislatively deleted industrial banks from the typology of institutions it will charter. In other states, however, the industrial-bank business is booming, largely in response to the entry of BHCs. Colorado is the leading example. In 1971 there were

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348. See S. Booth, supra note 343, at 15. In Minnesota, for example, there are at present three "industrial loan and thrift companies" with five offices that are authorized to take deposits through the sale of "investment certificates." Telephone interview with Mr. Terry Meyer, Office of the Minnesota Commissioner of Banks (Dec. 29, 1980).
349. Telephone interview with Mr. Ed Stripling, Florida Dep't of Banking and Finance (Nov. 15, 1979).
sixty-two industrial banks chartered in that state,\textsuperscript{351} in 1980 the number had risen to 131.\textsuperscript{352} The BHCs of Chemical Bank, Citibank, First Pennsylvania Bank, and Manufacturers Hanover have all acquired or applied to acquire one or more industrial banks in Colorado.\textsuperscript{353} Out-of-state BHCs also own industrial banks in California, Massachusetts, and Utah.\textsuperscript{354} The Fed has approved twenty-three BHC acquisitions of industrial banks and has been notified of seventy-nine de novo openings, including an unknown number of intrastate affiliations.\textsuperscript{355}

Although industrial banks are eligible for FDIC insurance, few are so insured;\textsuperscript{356} some are or must be members of state guaranty funds that insure deposits to a more limited extent than does the FDIC.\textsuperscript{357} Similarly, industrial banks are eligible for Fed membership\textsuperscript{358} but none has joined. An industrial bank that became a Fed member would have to be FDIC insured\textsuperscript{359} and an insured industrial bank would be subject to Regulation Q governing the maximum interest rates payable on deposits.\textsuperscript{360} At present the states either leave industrial-bank deposit rates unregulated\textsuperscript{361} or set them slightly above the Regulation Q rates\textsuperscript{362} to offset the drawbacks for consumers of being uninsured and perhaps even to give industrial banks a small advantage in attracting deposits.

\textsuperscript{351} [1971] \textsc{Colo}. \textsc{State Bank Comm'}r \textsc{Ann}. Rep. 122-23.
\textsuperscript{352} [1980] \textsc{Colo}. \textsc{State Bank Comm'}r \textsc{Ann}. Rep. 197-99.
\textsuperscript{353} Arenson, \textit{A Bank Bridge Over State Lines}, \textsc{N.Y. Times}, Apr. 20, 1979, at D1, col. 3.
\textsuperscript{354} \textit{See id}. (Utah; California); 62 \textsc{Fed. Res. Bull}. 1055 (1976) (Massachusetts).
\textsuperscript{355} BEQ, supra note 326, at 48. In the period 1971-1978, BHCs opened or acquired seventy-five industrial banks, of which thirty-one were outside their home states. See \textsc{Golemb\'e} (1979), supra note 113, at 96.
\textsuperscript{356} \textit{See 12 U.S.C. } \textsection 1815(a) (Supp. III 1979) (state nonmember banks eligible); \textit{id}. \textsection 1813(a)-(b) (definitions of state bank, state nonmember bank); Letter from William Via, FDIC (Dec. 11, 1980).
\textsuperscript{357} \textit{See, e.g.}, \textsc{Colo}. \textsc{Rev. Stat}. \textsection 11-22-201 -203 (1973 & Supp. 1980) (bank must either be a member of state guaranty corporation or insured by FDIC); cf. \textsc{Minn. Stat. Ann}. \textsection 53.07 (Supp. 1980) ("industrial loan and thrift companies" that sell "certificates of indebtedness" must obtain insurance thereof acceptable to the Commissioner of Banks).
\textsuperscript{359} \textit{See 12 U.S.C. } \textsection 1814(b) (1976).
\textsuperscript{360} \textit{See 12 C.F.R. } \textsection 329.6 (1980).
\textsuperscript{361} For example, Utah.
\textsuperscript{362} \textit{See, e.g.}, \textsc{Cal. Fin. Code } \textsection 18315 (West Supp. 1981); Memorandum from H.J. Desz, Special Administrator, \textsc{Industrial Loan Law}, \textsc{California Department of Corporations}, to \textsc{All Industrial Loan Cos. Issuing Investment Certificates}, concerning Maximum Interest Rate on Investment Certificates (Feb. 2, 1981); Telephone interview with Mr. Harry Bloom, \textsc{Colorado State Bank Commissioner} (Oct. 3, 1979).
Thus far BHCs have not aggressively exploited the interstate deposit-taking potential of their industrial bank subsidiaries. They have not, for example, used their industrial banks to exploit the savings-rate differential by marketing industrial-bank savings certificates nationwide. BankAmerica Corporation, however, has obtained twenty-six industrial-bank charters in California in the last few years in order to offer higher savings rates within California.\(^{363}\) It has also obtained such charters in Colorado, Iowa, Kansas, and Utah. This effort might be extended by interstate advertising to attract a substantial volume of interstate deposits by paying higher rates than are available to consumers elsewhere.\(^{364}\) Similarly, a BHC could use an industrial bank in another state as an LPO of the home-state bank, subject to the policies of the industrial bank's regulator.

Citicorp recently attempted to take deposit-like account balances through a nondepository subsidiary, Citicorp Financial, Inc., which issues the "choice" credit card to residents of the Baltimore-Washington area. Cardholders were offered 8.45% interest on credit balances left in their accounts. These funds, repayment of which was guaranteed under a letter of credit issued by Citibank, could be accessed by use of the card, which would then function as a debit rather than a credit card. The Fed noted the Regulation Q and reserve-requirement questions raised by this product but did not have to resolve them because it determined that the "setting aside of funds for future use [was] not within the scope of credit card activities for which Citicorp [had] received approval"\(^{365}\) under Regulation Y, and thus would have had to be stopped. If Citicorp or another BHC seeks such authorization, of course, those issues will recur, but the basic issue raised by the "choice" plan is that of defining a "deposit" where the consequence is that deposit-taking can be done only by chartered depository institutions.

\(\text{iii. Trust and Fiduciary Services.} - \text{Trust services are investment-management services used by wealthy individuals and by collective investors, such as employee benefit funds. Fiduciary services include acting as an executor or guardian and serving as an escrow agent. Trust and fiduciary services are typically provided by}

\(^{363}\) Telephone interview with Mr. Randy Russell, Sr. Vice-President, Finance-America Corp. (Mar. 26, 1981).

\(^{364}\) See text accompanying note 306 supra.

commercial banks through separate trust departments but in some states nonbank trust companies may also be chartered for these specialized purposes.\footnote{366} Such trust companies do not accept deposits or make loans but rather receive funds in trust for prudent investment.

As of mid-1980, BHCs had received Fed approval for eighteen trust company acquisitions and had given notification of opening 110 de novo trust companies.\footnote{367} California, Chicago, and New York BHCs have been particularly active in the interstate provision of trust services, largely by following their bank's personal trust customers to Florida and other second home and retirement areas.\footnote{368} Out-of-state BHCs now operate five trust companies in Florida alone, which has led that state to attempt to prohibit the entry of additional out-of-state BHCs into the in-state investment-advising, and therefore the trust-company, business. When that failed,\footnote{369} the Florida Bankers Association managed to procure a federal moratorium on new interstate entry until October, 1981.\footnote{370}

d. Interstate Data Processing.—The precise degree to which banks and BHCs are involved in the provision of data-processing services on an interstate basis has not been determined. Enough facts are known, however, to infer that it is significant.\footnote{371} It is useful to distinguish two types of BHC data-processing services—those provided to other financial institutions and those provided to the public at large. In general BHCs are permitted to "process . . . data for others of the kinds banks have processed" for themselves and others, sell the by-products of programs developed therefor, and furnish "any data-processing service upon request of a customer if such data-processing service is not otherwise reasonably available in the relevant market."\footnote{372} As has been pointed out, the scope of the data-processing business open to BHCs under this

\footnotesize{367. BEQ, supra note 326, at 48.}
\footnotesize{368. Four are subsidiaries of Northern Trust Corp., a BHC that owns a major Chicago bank; one is owned by NCNB Corp., parent of North Carolina National Bank. Telephone interview with Mr. Ed Stripling, Administrator, Banks and Trust Companies, Florida State Controllers Office (Mar. 26, 1981).}
\footnotesize{369. See Lewis v. BT Investment Managers, Inc., 447 U.S. 27 (1980).}
\footnotesize{372. 12 C.F.R. § 225.123(e) (1980).}
standard is quite broad.\textsuperscript{373} Giving the standard the broadest interpretation possible, Citicorp has announced its plans to establish a time-shared computer network called Citishare, serving users in 244 cities throughout the United States and five foreign countries.\textsuperscript{374} Customers of the Citishare system need not be financial institutions, even if the service is nominally limited to the processing of financial and related data. The payrolls and bookkeeping entries of industrial companies, for example, are financial or related data.

In contrast some banks and BHCs specialize in the provision of data-processing services to other financial institutions. In local markets, downtown banks typically provide many outlying banks and thrift institutions with data-processing services to maintain their accounts. At the close of each banking day the customer bank sends information on the day’s transactions to the processing bank, which returns a computer print-out by morning showing the updated status of each account. Monthly statements and loan-payment posting may be processed by the downtown bank as well. In this way both the customer and the processing bank can benefit from the realization of scale economies in computing.

The necessity to transmit data back and forth on a daily basis made the bank-data-processing-service industry one of local markets. With the advent of computer networking and distributed processing, however, the emergence of regional and national data processing services for financial institutions can be expected. Perhaps in anticipation of this, Citicorp is reported to have acquired several local-bank data-processing services around the country.\textsuperscript{375}

In addition Citicorp is marketing an ATM system called “INCA” to banks nationwide. Citicorp will be opening local and regional data centers to service the ATMs in each area. Although the centers now in operation are not in communication, they could be linked “in order to permit customers from one state to activate ATMs with INCA cards in another state.”\textsuperscript{376}

\textsuperscript{373} See text accompanying note 147 supra.


\textsuperscript{375} See Citibank: A Rising Giant in Computer Services, Bus. Week, Aug. 4, 1980, at 54.

Thus BHCs such as Citicorp may soon provide both the internal accounting and the ATM system needed by small banks. They will do so through a data-processing and communications network with processing centers and offices around the country as the needs of customers and the advance of technology dictate. The large BHC that provides these services will ultimately be responsible for much of the value of local banking services. Although the name of the bank may still be local, the service it provides will be a national one for which it is a local retail outlet—much as the corner drug store provides access to film-processing services.

e. Perspectives on Interstate Banking.—There is no accepted or reliable method of measuring interstate banking activity and the data are fragmentary. Although some attempts at measurement have been made, the methods used are more likely to understate than overstate the degree of activity.

One method is to count BHC offices. In June 1979, for example, when Connecticut enacted a one-year moratorium on the expansion of nonbank BHC activities within the state, the legislature initiated a study of the desirability of limiting BHC activities. Five out-of-state BHCs were known to have twenty-three subsidiary-company offices in Connecticut. These consisted of one data-processing service company, seven commercial-finance companies, and fifteen consumer-finance-company offices. The BHCs extending credit through Connecticut offices were the holding companies of Bank of America and Security Pacific National Bank (California), Citibank (New York), and Merchants Industrial Bank and Trust (Indiana).

It is impossible to know whether this seemingly substantial penetration of the Connecticut consumer- and commercial-credit markets by out-of-state BHCs is typical. On the one hand, Connecticut's suburban relationship with New York City has probably made it unnecessary for New York banks to locate offices of their BHCs there in order to reach Connecticut customers. Among the New York BHCs only Citicorp has a commercial-credit office in Connecticut, while the Bank of America and Merchants Industrial Bank of Indianapolis have six such offices between them. The New York banks are similarly underrepresented in the consumer-
finance field, probably for the same reason. Citicorp has one Connecticut office and had planned to open a second, while the Bank of America and Security Pacific, both of California, have fourteen offices between them. 382

Thus, while the New York banks are underrepresented, because Connecticut is an affluent state it has attracted twenty consumer- and commercial-credit extending offices of distant BHCs. Unfortunately, comparable data for other states are not available. Even if they were, they would probably understate the presence of out-of-state BHCs, since there is no way to confirm the existence of bank LPOs or nonbank subsidiaries in many states.

The American Banker reported in 1975 that thirteen large BHCs had 1,642 nonbank subsidiary offices, of which 1,483 were located outside of the BHCs' home states. 383 The number of such interstate BHC offices has increased substantially since 1975. Four of the largest BHCs for which approximate figures are available increased their nonbank out-of-state offices as shown in the table below: 384

<table>
<thead>
<tr>
<th>BHC</th>
<th>1975</th>
<th>1979</th>
</tr>
</thead>
<tbody>
<tr>
<td>BankAmerica Corp.</td>
<td>339</td>
<td>350</td>
</tr>
<tr>
<td>Citicorp</td>
<td>284</td>
<td>400+</td>
</tr>
<tr>
<td>Manufacturers Hanover Corp.</td>
<td>151</td>
<td>190</td>
</tr>
<tr>
<td>Security Pacific Corp.</td>
<td>45</td>
<td>400+</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>819</strong></td>
<td><strong>1340+</strong></td>
</tr>
</tbody>
</table>

There are no data available on the number of such offices for all BHCs. Clearly, however, the total, even in 1975, was much larger than the number attributable to the 13 BHCs studied. Since 1975 the total number has grown by considerably more than the 500 new offices reflected in the table above. Since that time, large

382. *Id.*. The Westport office of Person-to-Person Financial Center of Connecticut, Inc., was approved by the state banking commissioner and the Fed, but the latter's decision was remanded by the court of appeals to determine whether the finance company office in a suburb of New York City would result in voluntary tie-in sales and unfair competition generally. Connecticut Bankers Ass'n v. Board of Governors, 627 F.2d 245 (D.C. Cir. 1980). After remand the Fed again approved the finance company office. BNA Wash. Financial Rep., Apr. 27, 1981, at A-4.


BHCs have added a number of commercial-credit offices, chartered several industrial banks in Colorado alone, incorporated twenty-seven Edge Act corporations with a larger number of offices, and established an unknown number of LPOs.

There are other ways of attempting to assess the degree to which banking has become an interstate industry but they are as imperfect as counting BHC offices. For instance, it has been estimated that the Bank of America has 14,436 employees outside of California and 1,361 employees in New York City alone. At the same time, Citicorp is thought to have 3,000 employees in California. Again, these are crude data.

The Conference of State Bank Supervisors (CSBS) has made conservative estimates for four types of interstate banking operations. CSBS estimates (1) the assets of banks located outside the state in which the lead bank of their holding company is located at $23 billion (i.e., the secondary banks of those multistate BHCs grandfathered by the 1956 BHC Act); (2) the banking assets of foreign banks located in states other than their home state at $18.3 billion (i.e., those grandfathered by the International Banking Act of 1978); (3) the assets of nonbank subsidiaries of BHCs at $38 billion; and (4) the volume of commercial and personal loans made by banks with assets exceeding $1 billion to borrowers in other states at $26 billion. The total estimated volume of assets devoted to interstate banking on this basis is $105 billion; if the figure for the assets of nonbank subsidiaries were adjusted from $38 billion to the staff of the Federal Reserve Board’s estimate of $55 billion the total would be $122 billion. This is approximately 7.17 percent of banking-industry assets. Further, beyond the conservative nature of these estimates, no attempt is made to factor in the inter-

385. J. Houpt, supra note 276, at 41-42.
386. Janssen, supra note 384, at 39, col. 2; Telephone interview with Bernice Riordan, Sr. Public Information Officer, News Relations Dep’t, Bank of America.
387. Telephone interview with Charles Klensch, Press Information Officer, Public Affairs Dep’t, Citicorp.
389. Id.
390. Id.
391. See 67 Fed. Res. Bull. A17 (March 1981) (calculation based on all commercial banking institutions’ total assets of $1,702.7 billion as of end of 1980). The same $128 billion of assets devoted to interstate banking would constitute 8.17% of the $1,493 billion of assets held by domestically chartered commercial banks as of February, 1981. Id.
state flows of Fed funds and correspondent balances that knit the banking industry together.

f. Notes on the Significance of Deposit-Taking.—However measured, banks and BHCs are in practice conducting a substantial interstate business in bank and bank-related activities. As a practical matter the greatest limitation on their activities is the limitation on their ability to take deposits interstate. The principal exceptions are the international banking deposits taken at Edge Act corporations and the consumer savings deposits taken at industrial banks in approximately twenty states.392 Notwithstanding these exceptions, however, deposit-taking is still highly localized, even if no other aspect of banking is. As long as banks are unable to offer full-service banking in a host state they will continue to be at a serious disadvantage in competing with host-state banks for local consumer- and commercial-deposit business. The inability to take local deposits also inhibits an out-of-state BHC’s ability to compete for consumer- and commercial-credit business, albeit to a lesser extent.

The Depository Institutions Deregulation and Monetary Control Act of 1980393 allows insured banks, savings-and-loan associations, and savings banks nationwide to offer NOW accounts—interest bearing accounts accessed by draft—for the first time; credit unions will have the functionally identical product in “share draft” accounts.394 These thrift institutions will now be able to compete with banks for transaction balances of the sort that would previously have been maintained in bank demand accounts. The same law provides for the phasing out over six years of Regulation Q maximum interest rates payable on all deposits—including NOW accounts, savings accounts, and even demand deposits, on which the payment of interest had been prohibited.395 This will enable

392. The Fed has recently ruled that a national bank acquired by Gulf & Western, an industrial company, was not a “bank” within the definition in the BHC Act because it did not, as a matter of policy, make commercial loans, with the result that the acquiring company had not become a BHC. See letter from FRB to Mr. Robert C. Zimmer (Mar. 11, 1981). It would thus also appear to be possible for a BHC with banks in one state to acquire such a “consumer bank” in other states consistent with the BHC Act’s definition of “bank,” 12 U.S.C. § 1841(c) (1976), and thereby to take deposits in any number of states.

393. 1980 Act, supra note 63.


banks to compete for some of the balances that previously would have been kept in passbook savings accounts at thrift institutions. Thus each local market for transaction and savings accounts will see the entry of a substantial number of new local competitors and the gradual introduction of competition among them on interest rates as well as service.

Ironically, this enhanced competition for deposits may lessen the disadvantage that BHCs now face by reason of their inability to take more deposits interstate. First, core deposits—stable consumer time and demand balances—will cost depository institutions higher, market rates of interest. Banks in economic-growth areas will still have easier access to core deposits than banks in economically stagnant older cities; but the cost differential between core deposits (cost equaling interest plus processing costs) and money purchased in the money market (Fed funds and correspondent deposits, certificates of deposit, Euro-dollars, etc.) will have lessened and, in a perfect market, equilibrated.

Second, the rising cost of core deposits will also put nonbank lenders on a more equal footing with banks regarding their cost of funds. The bank in a growth area will have lost its advantage in the cost of funds not only in comparison to banks in stagnant areas, but also in comparison to nonbank lenders—including BHC subsidiaries—in their own geographical markets. This will occur because the increased interest paid for core deposits will make them closer in cost to money raised through the sale of commercial paper by a BHC or its nonbank subsidiary. Consider the following example: At present the Valley National Bank of Arizona enjoys access to a large volume of core deposits at low, regulated interest rates. Citibank, in New York, also has access to core deposits at regulated rates, but in a stagnant market. Accordingly, in order to fund growth of its loan assets, the New York bank must turn to a greater extent to purchased funds at unregulated rates. Finally, Citibank's sister corporation in the consumer credit field, Nationwide Finance, obtains its funds from the sale of commercial paper at unregulated rates closer to those paid by Citibank for purchased funds than by either bank for core deposits. In the future, however, both Citibank and Valley National will be paying a price for core deposits that, together with the costs of servicing deposit

396. The total cost of core deposits consists of the interest paid to depositors, plus the processing costs incurred, less any transaction fees received.
accounts, will equal the cost of their alternative sources of funds, purchased funds. If funds from one source cost more, banks would turn to the other until their prices were again equal at the margin. True, Nationwide may still pay a higher price for funds than either bank, but that will reflect the market’s evaluation of the somewhat greater riskiness of its loan portfolio versus the banks’ and not a regulation-induced bargain price for bank deposits.

Finally, the deregulation of interest rates paid on deposits will mitigate to some degree the disadvantage that BHCs now face in competing for consumer- and commercial-loan business. At present a borrower that could turn either to a local bank or the nonbank affiliate of a distant bank may prefer the local bank for two reasons. First, even if the nonbank lender offers the same interest rate as the bank, the bank offers the convenience of a demand account as the medium for accessing loan proceeds or a line of credit. The nonbank lender can at best arrange for a bank to perform this service for its borrowers.

Nationwide’s “Ready Credit” product is an example of how this can be done. Ready Credit borrowers are given a line of credit and a book of drafts drawn on Nationwide’s account at Citibank but “payable through” the First National Bank of Denver. These drafts may be used and accepted as checks. When they are presented for payment, however, the Denver bank seeks authorization from Nationwide, which instructs it to honor the draft or return it depending upon whether the drawer has unused credit available. If the drawer has credit and the draft is honored, Nationwide covers it by a transfer of funds from Citibank to the Denver bank. As far as the customer is concerned, however, he has the convenience of accessing his credit line by drafts as though it were a balance in his checking account. For a distant consumer there may be some disadvantage in the draft being drawn on a Denver bank, which may impair its acceptance in some areas; on the other hand, the drawer in such an arrangement, whether consumer or commercial, gets the benefit of any “float” because he does not incur interest costs on that portion of his credit line unused until the draft is presented for payment.

In addition to convenient access, the second reason for a borrower to prefer bank credit to nonbank credit is price. At present banks may be willing to offer somewhat lower interest rates on

398. See brochures distributed by Citicorp Person-to-Person Financial Services, Inc., One Market Tower, 3033 So. Parker Rd., Denver, Colo.
loans to depositors in partial compensation for the depositor's business and thus take some business that would otherwise go to non-bank lenders. Core deposits at regulated rates are a bargain and in any well-functioning marketplace bargains tend to be competed away. One way that banks have to compete for bargains is to charge depositors less for loans than they charge to nondepositors. Nonbanks do not have this ability to cross-subsidize loans because they are not in the deposit-taking business. When core deposits are no longer a bargain, however, banks will no longer be as willing to offer depositors the lower loan rate. Nonbanks will then be on more equal footing in competing for the depositor's loan business.

C. The Current Legal Position Reconsidered

1. Implications of the Current System.—At the outset of this Part I, the current legal regime affecting the structure of the banking industry was described in terms of three systems: the dual banking system, under which state and national bank regulators compete to construe banking powers liberally;\(^399\) the state-by-state banking system, under which the banking operations of any one company (bank or BHC) are confined to one state;\(^400\) and the triple banking system, under which the importance of BHCs in extending nonbank operations interstate is recognized.\(^401\) It was then shown that the motivations driving banks to reach interstate markets though their BHCs are significant and likely to endure, and that some mostly large banks have already made significant inroads in interstate and, indeed, nationwide markets for most bank services except deposit-taking.\(^402\) Yet, even though the state-by-state banking system is thus being redefined in practice to apply only to deposit-taking, the formal structure remains.

Notwithstanding the unchanging legal regime, the wisdom and the possibility of maintaining the state-by-state banking system, or some pretense thereof, even for deposit-taking, must be reconsidered in light of the changes that have taken place in the banking industry. Admittedly, there is no visible crisis to occasion this

\(^{399}\) See text accompanying notes 16-100 supra.
\(^{400}\) See text accompanying notes 155-199 supra.
\(^{401}\) See text accompanying notes 101-154 supra.
\(^{402}\) See text accompanying notes 200-235 supra. Some smaller BHCs do participate in interstate markets, including taking deposits interstate—for example, Financial Services Corp. of the Midwest, which owns the ninety-first largest commercial bank in Illinois and Federal Discount Corp., which has a deposit-taking industrial bank in Minnesota. See 63 Fed. Res. Bull. 948 n.2 (1977).
reexamination. Banks are not failing in inordinate numbers, nor are the nonbank markets in which BHCs compete, for the most part, unduly concentrated in the hands of banking enterprises. There are, however, three important reasons to reconsider the state-by-state banking system, and therefore to consider the question of interstate banking. Resolution of that question may help to resolve the problem of branch definition and alleviate the problem of banking industry concentration. Furthermore, the erosion of the fundamental premises of the state-by-state banking system itself indicates that reexamination of that system is in order.

a. The Branch-Definition Problem.—Under the current regime, a bank that wants to establish a physical presence other than a bricks-and-mortar branch, whether intrastate or interstate, must often avoid endowing its new office or other facility with the characteristics of a “branch.” As a result, banks have striven to design their presence to fit within the law and still serve the perceived public demand for banking convenience. In the hands of the courts, however, the definition of a branch has become at the same time highly plastic and very rigid; it has been stretched to reach armored cars and CBCTs, yet is incapable of selective application where state law and the policy of competitive equality warrant it.

Judicial craftsmanship will not provide a serviceable meaning for the term “branch” as it is used in the McFadden Act, because there is no essential characteristic of “branchness.” It is not helpful to observe, as the Supreme Court has told us, that we are dealing with a branch if we are dealing with a physical location at which one of the functions mentioned in the statutory definition is performed and a competitive advantage is gained by the bank performing it there. Competitive advantage will always be found; that is what will have motivated both the bank to undertake whatever activity is being challenged as a branch, and the challenger to bring its suit. As for the prerequisite that one of the named functions be performed there, that is almost no limitation at all. The court that holds that a CBCT is a place where checks are paid because it dispenses cash, and that it is a place where money is lent because it dispenses cash, and that it is a place where money is lent

406. Id. at 136-37.
because cash may be drawn against a pre-established and pre-approved line of credit rather than an account balance, and that a deposit is received by the bank at a remote terminal but not at a mailbox, is clearly responding to its perception of competitive advantage without giving meaningful content to the limitation that one of the statutory functions be performed.\textsuperscript{407}

The problem of defining the term "branch" inheres in the present regime and derives from the limitations now placed on branching. If branching were completely unlimited, there would be no reason for "branch" to be a term of art; nothing would turn on whether a particular type of facility is a branch. In light of the problems that the courts have had with the present statutory definition of branching, and the accumulated technological change since it was written in 1927, the issue should again be addressed legislatively. Only Congress can resolve the present uncertainty that infects a variety of banking facilities, including LPOs, cash management CRTs, ATM networks, and even a BHC's nonbank subsidiary offices whose operations are arguably too integrated with those of the affiliated bank.\textsuperscript{408} Uncertainty about the status of these facilities deters banks from investing in them, although they may eventually be characterized as permissible non-branches. This uncertainty may have the further effect of deterring innovation in the provision of banking services.\textsuperscript{409} Both consequences disserve the consuming public and foster concentration in the banking industry.

\textit{b. Concentration and Competition.}—As a system of territorial market allocation, state-by-state banking is far from fully successful. Its greatest success has been in allocating markets for deposit-taking services. Its success in dividing this product market geographically has also, however, affected markets for other products (banking services) by making it more difficult to offer them competitively without being able to offer depository services at the same place. The market for banking services generally is therefore

\textsuperscript{407} It is for this same reason that cash management CRTs are arguably in danger of being characterized as branches. \textit{See} text accompanying notes 252-260 \textit{supra}.

\textsuperscript{408} \textit{Cf.} Connecticut Bankers Ass’n v. Board of Governors of the Fed. Reserve Sys. 627 F.2d 245, 253 (D.C. Cir. 1980) (in absence of evidence beyond fact of common ownership, Board could rely on BHC's assurances and long history of lawful operation that nonbank subsidiary would not be used as de facto branch of bank subsidiary).

less competitive than it would be if territorial markets were not allocated by law. Of course, to the extent that it would increase the number or likelihood of bank failures, uninhibited competition in the banking industry cannot be considered an unalloyed benefit. Nonetheless, there is good reason to question whether banking markets need to be as concentrated as they are at present\(^4\) and whether some relaxation of the state boundaries presently placed around banks could result in more competition among them without engendering an unacceptable rate of failure.

State-by-state banking has led to concentration not only within intrastate markets, but also in the interstate provision of banking services. Large banks and their BHCs are at a competitive advantage, as compared to small and regional banks, in surmounting the legal as well as the scale barriers to interstate banking, just as they were historically advantaged by the capitalization and anti-branching aspects of Edge Act corporations before 1978.\(^{411}\) The costs of legal planning in the design of banking products and the strategy for their delivery interstate, and the cost of defending one’s interstate services in litigation—usually against the charge of unlawful branching—are not related to a bank’s size. Consequently, a larger bank will be readier to devote the resources necessary to this effort from which, if it is successful, it expects to have lower average costs per interstate transaction than would a

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410. The average local banking market is highly concentrated. Using the Herfindahl Index to measure concentration, Heggestad and Mingo found that the average SMSA has a numbers equivalent of 4.3 equal size banks, the average rural county banking market being even more concentrated with a numbers equivalent of 2.2. Only 10% of SMSAs had a numbers equivalent greater than 9.3. Heggestad & Mingo, The Competitive Condition of U.S. Banking Markets and the Impact of Structural Reform, 32 J. Finance 649, 656 (1977).

In 1979, the weighted average concentration ratios, measured by insured commercial bank deposits in SMSAs, were:

<table>
<thead>
<tr>
<th></th>
<th>Largest Bank</th>
<th>Three Largest Banks</th>
<th>Five Largest Banks</th>
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<tbody>
<tr>
<td>Unit banking states</td>
<td>22.5%</td>
<td>49.4%</td>
<td>60.2%</td>
</tr>
<tr>
<td>Limited branching states</td>
<td>29.9%</td>
<td>62.5%</td>
<td>76.3%</td>
</tr>
<tr>
<td>Statewide branching states</td>
<td>34.0%</td>
<td>67.5%</td>
<td>80.3%</td>
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U.S. DEP’T OF THE TREASURY, GEOGRAPHIC RESTRICTIONS ON COMMERCIAL BANKING IN THE UNITED STATES app., at 48 (1981) [hereinafter cited as MCFADDEN ACT REPORT].

411. See text accompanying note 264 supra.
smaller bank.\textsuperscript{412} It is thus the very largest banks in the country that have made the greatest inroads toward interstate banking. If this pattern of successful interstate penetration by a limited number of banks is allowed to continue, the markets for some interstate banking services, such as cash management, bank data processing, and consumer credit cards, may also become concentrated.

Furthermore, policy options will gradually be eliminated as this concentration grows. For example, it would no longer be desirable, or even equitable, to remove all constraints on geographical expansion and allow BHCs to convert their nonbank offices to branch banks, since that would give some of the largest BHCs an immediately commanding position in the newly-created national market for banking; they would have many hundreds of branch locations before some regional banks in what were unit banking states could open a first branch. The Bank of America, that is, would have almost 400 branch locations outside California—including twenty in Illinois at what were previously FinanceAmerica offices,\textsuperscript{413} before a Chicago bank that had not acquired a finance company could open one branch in Illinois. Thus, as a matter of concentration policy, removing all restrictions on interstate banking locations is no longer a plausible policy alternative, although it probably was ten or fifteen years ago. Alternatively, prohibiting BHCs from opening additional nonbank offices interstate, while grandfathering existing operations, would confer a permanent competitive advantage on just a few firms; this option also has been made unattractive by developments taking place within the ostensibly state-by-state banking system.

c. The Premises of State-by-State Banking.—The claimed advantages of the state-by-state banking system have been considerably eroded as interstate banking has grown up within the state-by-state framework. Many money center and regional banks, which hold the great majority of bank assets\textsuperscript{414} and which lend on re-

\textsuperscript{412} Cf. Seelig, Convenience and Advantage Clauses as a Barrier to De Novo Entry by Bank Holding Companies in the Consumer, Finance Industry, 30 J. ECON. & BUS. 124, 129 (1978) (results “suggest that large firms, or at least firms experienced in dealing with regulatory authorities (such as bank holding companies), can be at a relative advantage in over-coming regulatory barriers to expansion.”).

\textsuperscript{413} In 1975 FinanceAmerica had 20 offices in Illinois. Bank Holding Company Map Series, supra note 203.

\textsuperscript{414} At the end of 1980, the 100 largest BHCs controlled commercial bank assets of $1,137 billion, which was 74% of the total assets of all 14,693 domestically chartered commercial banks. Even the 100th largest BHC, First National
gional, national, and international scales, cannot realistically be considered "local" institutions. Commercial and consumer lending, carried on through the BHC, is also, indeed principally, conducted on a regional or national plane. Furthermore, to the extent that banks serve commercial customers with broader than statewide operations, they are inevitably non-local in their orientation. Smaller banks that do not participate in these markets directly do so indirectly, through the sale of funds to regional and money center banks which, in turn, lend to large corporate borrowers.

Even retail banking is no longer focused on local service, except with respect to deposit-taking. Banks with hundreds of thousands of credit card holders outside their home state are not likely to be sentimental about directing credit to local consumers if local consumers are prohibited by law from paying rates as high as consumers in other states or are otherwise less attractive.

With regard to this, it is very significant that the state-by-state banking system has been supplemented with the Community Reinvestment Act, which makes the various applications of banks (and other depository institutions) for new deposit-taking facilities depend upon their "meeting the credit needs of [their] entire community." This Act gives the force of federal law to the expectation embedded in the state-by-state banking system that bank credit will be extended in the geographical markets from which deposits are taken. The need for this legal norm arose only when small banks became part of the integrated money market managed by the larger banks, i.e., when it periodically became more profitable to sell funds to distant money center banks than to lend them to local customers.

Interregional capital flows are now substantially uninhibited by the state-by-state banking system. Indeed, a deposit made in Massachusetts may be only marginally more likely to result in a


415. For example, United Jersey Bank (Hackensack), a subsidiary of the 97th largest BHC, see 1981 Annual Banking Survey, supra note 414, at 136, 138, has a branch in the British West Indies. 1 Moody's Bank & Finance Manual 1502 (1980).


417. The overnight market in Fed funds began to grow in the mid-1960s with the entry of an increasing number of regional banks. "In the Fed funds market now, regional banks buy up funds from even tiny banks, use what they need, and resell the remainder in bulk amounts in the New York market." M. STIGUM, supra note 218, at 285.
INTERSTATE BANKING

bank loan to a Massachusetts borrower than to a developer in the Southwest. If that is where the best market opportunities are for bank creditors, it is hardly credible that a banking system in which billions of dollars are lent by wire overnight and all major transactions are accomplished by electronic entry would not be able to route a dollar from Massachusetts to its highest return, even if that is in Arizona.

Finally, the problem of supervising the soundness of a bank with far-flung interstate operations has already been encountered without serious mishap. Banks with domestic Edge Act corporations strewn around the country and with branches throughout the world should be at least as difficult to supervise as banks with offices in multiple states.\footnote{418} National banks operate 646 branches overseas, under the supervision of the Comptroller.\footnote{419} Citibank alone has 216 branches and representative offices abroad.\footnote{420} Seventeen banks and trust companies chartered by the State of New York operate branches abroad, under the supervision of the New York State Banking Commissioner.\footnote{421} In each case, the regulator has been able to devise special examination procedures for the foreign branches that it considers adequate to the task of soundness supervision. New York is also host to fifty-six branches of forty-seven foreign banks,\footnote{422} which it has regulated without encountering insurmountable problems of supervision or coordination; indeed its requirement that New York branches of foreign banks hold, in lieu of a separate capital structure, certain qualifying assets—loans booked to New York, CDs, Fed funds sold, etc.—equal to 108% of branch liabilities “has been viewed abroad as a model for foreign bank branch regulation and has been widely copied.”\footnote{423}

\footnote{422. See [1978] N.Y. SUP’T OF BANKS ANN. REP. 150-53.}
\footnote{423. M. STIGUM, supra note 218, at 144. Indeed, perhaps because New York’s reputation is so good, when American Express Company’s subsidiary American Express International Banking Corporation required an annual global examination of its 80 offices in 34 countries, in order to satisfy British regulators, it contracted with the New York State Banking Department for the work. Wall St. J., Apr. 1, 1980, at 12, col. 4.}
The Fed, moreover, reports no special practical difficulties in examining the operations of BHCs with interstate, nationwide, or even overseas offices. While it is of course possible that there are serious undetected problems or that the ability of regulators to examine far-flung banking enterprises may be stretched beyond practical or effective limits, these possibilities seem increasingly unlikely with the passage of time. On the contrary, examination procedures and inter-jurisdictional coordination have demonstrably improved with time, to the point that the occasional closing of a failed bank with branches in multiple countries can be accomplished in an acceptably orderly, if perhaps not tidy, fashion by the diverse regulators acting in concert.  

In short, such supervisory problems as would be likely to arise with overt interstate banking have to a large extent already been encountered successfully in the context of international banking and BHC supervision. The claim that state-by-state banking performs the necessary service of keeping banks at a scale of operations that is manageably supervisable must therefore be relaxed in the light of experience.

2. The State of the Debate.—At the request of some banks and BHCs, several state legislatures have considered bills intended to allow out-of-state banks to enter their state directly by branching or indirectly by the BHC acquiring a bank there. In contrast, other states have taken or are considering steps to prohibit out-of-state BHCs from opening nonbank offices within the state, at the behest of home-state banks and other competitors of the nonbank subsidiaries of BHCs.

a. State Legislation.—Among the exclusionary efforts, reference has already been made to Connecticut’s enactment and extension of a moratorium on the expansion of activities by nonbank subsidiaries of BHCs,  and to Florida’s 1972 statute making out-of-state BHCs ineligible to own an investment advisory service, and therefore a trust company, in that state.  

The Supreme Court held the Florida statute unconstitutional for discriminating unduly against interstate commerce, although it

424. See [1978] OCC ANN. REP., supra note 419, at 40; Bennett, Curb on Foreign Banks Studied, N.Y. Times, May 2, 1980, at D1, col. 3 (reporting that when New York authorities took possession of New York branch of failed Argentine bank “the branch itself appear[ed] to be highly liquid and that if the Argentine Government were to guarantee payment of any unforeseen obligations, the New York depositors and creditors could be paid with the branch’s existing assets.”).


426. See text accompanying note 369 supra.
acknowledged the legitimacy of the State’s interests in “[d]iscouraging economic concentration and protecting the citizenry against fraud.”\(^{427}\) Regulation, the Court suggested, might have been a more appropriate means of protecting those interests than an “outright prohibition of entry.”\(^{428}\)

When repeal of the Florida banking code was about to become effective on July 1, 1980, pursuant to a “sunset” law enacted in 1976, the legislature passed a new banking code with a provision expressly prohibiting out-of-state banks and BHCs from having LPOs in Florida.\(^{429}\) This provision was passed in response to the complaints of the Florida Bankers Association that out-of-state banks could compete for loan business in Florida on unfair terms since they were not subject to certain Florida taxes.\(^{430}\) The Governor vetoed the entire new code, arguing that the prohibition on an out-of-state BHC having LPOs for the purpose of soliciting loans for its bank subsidiaries was unconstitutional in light of the \textit{BT Investments} case.\(^{431}\) The legislature then deleted the offending provision, and the new banking code was enacted, prohibiting only the LPOs of out-of-state banks and restoring by its silence regarding BHCs what some interested parties have managed to see as an ambiguity.\(^{432}\)

On the other hand, Maine, South Dakota and Delaware have enacted legislation to allow out-of-state BHCs to own banks within those states. The Maine statute is conditioned upon reciprocal treatment for Maine-based BHCs that wish to expand into the home state of any BHC acquiring a bank in Maine.\(^{433}\) The South Dakota and Delaware laws do not require reciprocity from the out-of-state BHC’s home state, but they are narrowly drawn to allow the out-of-state BHC to establish a single new bank that is not allowed to branch and is located where it is “not likely to attract customers from the general public in the state to the substantial detriment of existing banks in the state.”\(^{434}\)


\(^{428}\) Id.

\(^{429}\) The provision relating to BHC offices soliciting loans for affiliated banks was section 97, amending section 659.52 and purporting to renumber it as section 663.821. The renumbered section appears, however, at Fla. Stat. Ann. § 659.74(b)(2) (West Supp. 1981). See id. § 658.74 note.


\(^{432}\) See Fla. LPO Ban Cut from Bill, supra note 430, at 14, col. 1.


The South Dakota law, although of general application, was procured specially by Citicorp in order to enable it to establish a South Dakota national bank to which it could transfer its credit card operations. The Delaware law was similarly negotiated by the Chase Manhattan and Morgan banks. Under the National Bank Act, a national bank may charge interest at the rate permitted by the state in which it is located. Whereas New York limited the interest that banks may charge on credit card purchases to 12 percent, South Dakota and Delaware, as part of the legislative packages by which they invited the New York and other banks partially to relocate there, removed all limitations on the interest rates that banks could charge borrowers. In other words, Delaware and South Dakota are offering themselves as base states from which lenders, through the establishment of a national bank, may escape their home state usury laws, at least when they are making loans to residents of other states. South Dakota's and Delaware's purpose in providing such a base is conventional economic development: the relocation of credit card processing centers to those states will yield tax revenues and employment opportunities there. Citicorp alone has "committed itself to maintaining a staff of more than 300 people in South Dakota," even if it fails to move its credit card operations there.

Both California and New York legislative committees have considered bills to establish reciprocity between those two states. This was done at the behest of the New York banks, which were more eager to enter the California retail banking market than were the California banks to enter the New York market. The New

441. See Hearings on A.B. 1926 Before the Comm. on Finance, Insurance, & Commerce of the Calif. Assembly 2 (1977) (statement of Assemblyman Berman that he sponsored reciprocal banking bill at initiative of Citicorp) [hereinafter cited as Hearings on A.B. 1926]. In 1980 each state considered a virtually identical bill that would have enabled the BHCs of reciprocating states to establish or acquire two unit banks or one bank with one branch in cities where there is a Federal Reserve Bank or branch. BHCs from states reciprocating to the extent of only one banking office could open one bank in these host states. See, e.g., N.Y. Assem. Bill 1452, 204th
York bill, which was proposed by the State Banking Commissioner, failed to pass, apparently in large part because of the embittered relationship between the large New York banks and the state legislature arising out of their struggle over the usury law—the issue over which, when New York failed to change its law, Citibank turned to other states for relief and found it in South Dakota. California, too, tabled the legislation after hearings at which the California Bankers Association registered its strong opposition and at which representatives of the New York banks appeared in favor of the bill.442

b. Problems of Reciprocity.—The divergent views taken by the New York and California banks of what was nominally equal and reciprocal treatment demonstrates the inevitable failure of reciprocity as an approach to interstate banking, and the inaptness of the view that the states could today, through the Douglas Amendment, provide for interstate banking if they were inclined to do so. In fact, reciprocal treatment is an elusive concept. The non-reciprocal appeal of different markets, as illustrated by the New York and California banking markets, is a matter of business rather than law. There are, however, a multitude of legal problems in implementing reciprocity.

Consider, for example, the problem created by the different powers that various states confer on banks. Even the New York and California bills would have applied only to states that allowed a "substantially similar acquisition" by their BHCs. Admission of a California BHC to the New York banking market might, however, enable it to exercise quite different, either narrower or broader, powers than could the New York entrant in the California market under California law. If entry is by means of a state bank charter, soundness supervision will be administered differently, with differ-

Assem. (1981) (proposed amendment to N.Y. BANKING LAW §§ 141-142); N.Y. Legislative Proposal No. 11 (1979) (proposed Banking Code art. III-C). Thus, in essence, if the bills had passed, California BHCs could have opened two banking offices in New York City and a New York BHC could have opened one banking office in San Francisco and one in Los Angeles (or two in either city).

ent rigor, and reserve requirements may impose different costs on banks in different states.\textsuperscript{443}

Whether these differences would be obstacles to reciprocal entry is not clear. A state might, perhaps at the behest of its own banks, hold that these differences precluded another state from treating its banks reciprocally. Or a state might ignore them, or incorporate them in its treatment of the other state's banks. If they are incorporated, then, as Governor Wallich of the Federal Reserve Board observed in the international banking context, reciprocity "would lead to a crazy quilt of divergent rules,"\textsuperscript{444} under which banks from jurisdictions $A$ and $B$ are treated differently in $C$ because the banks of $C$ are treated differently in $A$ and in $B$.

Reciprocity as a means to interstate banking would also require a substantial number of bilateral agreements among the 50 states—1,225 determinations that treatment is reciprocal would have to be reached before each state's banks could obtain access to each of the other states. Moreover, such agreements would be very difficult, almost certainly impossible, to reach in light of the disparate attractiveness of various markets and the administrative problems already mentioned. In sum, reciprocity is not a promising means to interstate banking, as shown by the fact that, in the twenty-five years since the Douglas Amendment was enacted, only Maine has invited other states to enter reciprocal banking arrangements, and none has taken up the invitation.

c. The Presidential Report.—With change at the state level thus stymied by business, legal, and political realities, Congress in 1978 directed the President to study and report on whether there should be changes in the federal law respecting branch banking.\textsuperscript{445}

Thus defined, the subject encompasses a variety of alternatives to the McFadden Act—not only proposals for interstate banking, but also those that are consistent with the state-by-state banking sys-

\textsuperscript{443} Under the proposed legislation, it is unclear whether a South Dakota BHC would be able to enter New York and California now that its state offers access to out-of-state BHCs through banks with no retail orientation.


The Report of the President, which was submitted by the Department of Treasury in January 1981, made three recommendations.446 First, the Administration concluded in general that “the existing de facto system of interstate banking should be ratified and further liberalized through a phased relaxation of current geographic restraints.”447 Though unable to determine from the evidence examined whether modification of the McFadden Act or relaxation of the Douglas Amendment to the Bank Holding Company Act would be superior, the Report suggested modification of the Douglas Amendment as a transitional step because it “would have a less intrusive impact upon many institutions and the existing regulatory structure.”448 Specifically, the Report recommended that over the short term “Congress enact a phased liberalization of the Douglas Amendment,” perhaps initially to allow interstate acquisitions on a regional basis of banks holding not “more than a specified percentage of local market share.”449 “However, over the longer term, the Administration recommend[ed] that the Congress consider what changes in the McFadden Act as it applies to brick-and-mortar facilities might be appropriate,” such as permitting federally chartered institutions to branch statewide and within “‘natural market areas’ such as SMSAs.”450

Second, the Administration further recommended that “the deployment of EFT terminals ought to be subject to less onerous geographic restrictions than those imposed on brick-and-mortar branches, and that this modification of the McFadden Act should be undertaken along with liberalization of the Douglas Amendment in the first phase of geographic deregulation.”451 Specifically, the Report suggests that EFT terminals be permitted statewide and throughout interstate SMSAs for all purposes at once; thereafter, authorization would be extended nationwide.452

Finally, the Report endorses “[i]nterstate BHC acquisitions to accommodate the ‘failing bank’ problem.”453

446. See McFADDEN ACT REPORT, supra note 410, at 17-21.
447. Id. at 17.
448. Id.
449. Id. at 18.
450. Id. at 19.
451. Id.
452. Id.
453. Id. at 20.
tion was essentially endorsing the Fed’s bill, supported by each of the federal regulatory agencies, to increase the number of potential merger partners for a troubled depository institution. At present, under the state-by-state banking system, a failing bank may only be merged with an institution located in the same state or acquired by a foreign bank. The specific bill endorsed would amend the BHC Act and the Savings and Loan Holding Company Act to authorize the Fed and the Federal Home Loan Bank Board to permit interstate holding company acquisitions in distress situations, as determined by the Federal Financial Institutions Examination Council.

The Report does not specifically address the criteria by which its recommendations were formulated, but it does clearly attempt to link its recommendations to identified public policy concerns. These are labeled “Competition and Concentration,” “Service to Local Communities,” “Viability of Small Banks,” “Safety and Stability of the Banking System,” and “The Dual Banking System.” The relationship between each of these issues and the recommendations is suggested but not fully articulated. Instead, there is appended to the President’s brief (21-page) Report a “Compendium of Research on Branch Banking” more than ten times as long as the Report itself and devoted to eight different topics. Although these are useful summaries of source material, they are not linked explicitly to the recommendations in the Report. Instead, they represent the views of various individuals in the several different agencies that prepared the chapters.

The disjointed character of the President’s Report and the fact that it deals with geographic restrictions in general—both intrastate and interstate—makes extended analysis of it unfruitful. The ultimate significance of the Report may lie not in its content but

457. The Council, which was established by the Financial Institutions Regulatory and Interest Rate Control Act of 1978, § 1004, 12 U.S.C. § 3303 (Supp. III 1979), to prescribe uniform principles and standards for the federal examination of depository institutions, consists of the Comptroller, a Governor of the FRB, and the Chairmen of the FDIC, Federal Home Loan Bank Board, and National Credit Union Administration. Id.
459. Id. at 14-15.
460. Id. at 15-16.
461. Id. at 16.
462. Id. at 16-17.
rather in the momentum it lends, through presidential attention, to the debate over interstate banking. Issuance of the Report accordingly enhances the urgency of identifying the criteria by which the subject should be addressed before attitudes are formed or decisions are made on the basis of inadequately articulated standards. Accordingly, in Part II of this Article, I suggest and apply a set of criteria for the evaluation of problems associated with the implementation of de jure interstate banking.

II. THE CRITERIA FOR DECISION

The general question is whether banking organizations should in principle be prohibited from operating full-service facilities in more than one state. If the case for interstate banking can be made in principle, then it will be necessary to address the specific issues of implementation. These issues include whether there are any special circumstances under which interstate banking should not be allowed; whether a bank should be able to branch interstate or instead be required, through its BHC, to form a separate banking affiliate in each state; whether entry into a new state should be by acquisition or de novo; if entry by acquisition of an existing bank is allowed, whether it should be more limited than it would be under the antitrust laws of general application; and by what standards and under what procedures interstate entry should be authorized. Each of these questions should be answered by reference to a consistent set of criteria for the evaluation of alternative answers.

463. As was seen in Part I, interstate banking activity is already extensive, with the exception that deposit-taking interstate is quite limited. In the discussion that follows, references to and proposals for interstate banking are meant to encompass full-service banking, including deposit-taking and the exercise of such incidental powers as banks are now permitted under state and national chartering laws.

464. A complete inquiry into the question of the appropriate geographical limitations, if any, to be placed on banking enterprises would consider the full range of options running from unit banking to nationwide branching. This Article, however, does not address geographical limitations within state boundaries, such as unit banking, limited intrastate branching, and statewide branching. If, as I assume, there is to be a dual banking system, states must be able to determine bank structure questions for state banks and, in light of the competition between them, for national banks within the state as well. It is quite sensible to leave the structure of banking within each state to state policy and yet to inquire whether interstate banking should be permitted as a matter of federal policy. Even if federal law were changed to give banks or BHCs a federal right to enter and do business in every state, that is, they could still be expected to comply with local law concerning intrastate branching, multibank BHCs, and the like.

465. See parts III and IV infra.
In this Part II, six criteria are introduced and applied to the general question of whether banking organizations should in principle be prohibited from operating full-service facilities interstate. Some of these are the conventional criteria of welfare economics; others are peculiar to the banking industry, as regulated by state and federal governments. Throughout, the discussion assumes the continued existence of all major institutions—states, the dual banking system, deposit insurance, private ownership of banks, etc.—other than the state-by-state banking system that is here under reconsideration.

A. Consumer Welfare

In economic theory, consumer welfare is increased as competition to meet a consumer demand increases. Banking may depart from the model that tells us that more competition is better for consumers and society if, in a perfectly competitive banking market, some consumers of bank services and other persons would experience uninsured losses due to bank failures. Perhaps for this reason, and an excess of caution, much of the debate over interstate banking has been conducted as though interstate banking and increased—indeed often fatal—competition in local markets were synonymous. At the same time, concern that interstate banking will lead in the long run to a banking industry concentrated at both the national and local market levels suggests that there is a need for some clarification of the relationship between interstate banking and competition.

466. It is possible that in a perfectly competitive banking market depositors could purchase actuarially fair insurance that, in the absence of moral hazard, would provide full coverage of any losses otherwise arising from bank failures. In addition, however, insurance against the externalized costs of bank failures would have to be available even to nondepositors for unrestrained competition in banking to be clearly efficient.


First, interstate banking does not necessarily imply increased actual competition in any local markets. Entry into local markets will presumably be regulated much as it is today, even if interstate banking is permissible. Regulators, that is, will limit the entry of new banks and branches into local markets at least to the degree necessary to prevent significant numbers of failures among either incumbent or newly entering banks.

Second, interstate banking does necessarily imply increased potential competition in at least some markets. At present, there are few potential entrants into some highly concentrated local markets. Assume, for example, that five or six banking organizations control virtually all of the deposits in a local market. Potential competitors would, in principle, include other banking organizations within the state, which might seek to branch into the concentrated market, and new bank incorporators that might obtain a charter for a new bank in the area. There may well be no other banking organizations in the state, however, or none that is capable of mounting a significant de novo entry into the concentrated market. It is possible that the highly concentrated market will not attract new bank incorporators either, since potential incorporators would perhaps correctly fear that the existing banking organizations would be able to underprice them due to scale economies, greater experience, or even price predation. Furthermore, even if new banks do enter the market, they will not be able to do so with such great and rapid success as substantially to deconcentrate the market.

With interstate banking, however, potential entrants would include banks and BHCs in other states whose scale and experience would make them efficient competitors in the concentrated market. Once the costs of entry had been incurred, scale and experience would allow the newcomer to operate within a cost structure similar to that of the incumbent banks. Indeed scale alone would serve to deter price predation as an effective response by the incumbents to new competition; it simply would not pay for them to price below marginal cost in the hope that their staying power would be.

469. As Professor Bernard Shull has wisely observed: "It is sometimes argued that geographic market extension by large banking organizations is inevitably pro-competitive; sometimes that geographic expansion is inevitably anticompetitive . . . [T]he competitive impact of geographic expansion is simply not inevitable. The impact will depend on a variety of factors, including the regulatory constraints imposed." Shull, Bank Expansion: The New Competition and the Old Predatory Practices, 91 Banking L.J. 726, 727-28 (1974).

greater than that of an equally large or larger out-of-state banking organization that has entered the local market.

Thus, it seems reasonable to assume that interstate banking: (1) does not necessarily imply increased actual competition; (2) does necessarily imply increased potential competition; and (3) may in fact lead to increased actual competition in at least some markets. At the same time, we will continue to assume that regulators will permit new entry only in "underbanked" markets, at least in the sense of not permitting entry where it would lead to increased bank failures.

In order to analyze the consumer welfare implications of increased competition in banking, it is necessary to distinguish among different groups of consumers. In 1963, in United States v. Philadelphia National Bank, the Supreme Court held that commercial banking is a distinct line of commerce, in that commercial banks offer a unique "cluster of products" that differentiates them from other institutions competing with banks in only some product lines. Since the decision in Philadelphia National Bank, of course, the cluster of products offered by commercial banks has come to seem less unique. Today savings and loan institutions may offer transaction accounts, make consumer loans, and invest in commercial paper; and finance companies may issue the same credit cards that banks issue and compete on similar terms for much, although not all, consumer loan business. Regardless of whether the cluster of products offered by banks may still be regarded as unique to the banking industry, however, a close examination of the expected impact of increased competition requires that that cluster be unbundled and that a separate analysis be made of how the consumers of the various bank products would be affected.

1. Depositors.—Consumers of deposit services have two conflicting interests. On the one hand, they are interested in the

472. Id. at 356.
475. Even before these developments, there was good reason to doubt the Court's holding that commercial banking constituted a distinct line of commerce. See Weston & Hoskins, "Line of Commerce" and Commercial Banking, 42 So. Cal. L. Rev. 225 (1969).
safety and soundness of the depository institution to which they are essentially lending money. On the other hand, they want to receive the most desirable price (i.e., interest) and service combination possible. If banks freely competed to offer more desirable combinations, however, they could ultimately jeopardize the safety of the deposits that they attracted.

In a completely unregulated market, consumers would choose among combinations of the risks to and the prices paid for their deposits. Even in the world of partial regulation that existed in 1933, when entry into banking had long been regulated and banks examined for safety and soundness, regulators and consumers alike proved to be rather poor judges of risk. Since then, deposit insurance provided by the FDIC has relieved depositors of the need to be much concerned with bank safety. As long as they maintain deposits that do not exceed the amount insured by the FDIC, which is currently $100,000 per account per person, they need not worry at all.

Because it would bear the impact of most depositor losses in the event of bank failure, the FDIC has joined the Fed and the primary regulators—the Comptroller and the state banking commissioners—in concerning itself with bank safety. Depositors with balances in excess of $100,000, primarily commercial depositors and wealthy individuals, are also exposed to the risks of bank failure, but they are presumably better evaluators of bank risk than are small depositors. They can also diversify their risk by maintaining accounts in more than one bank.

As part of the effort to control risk, the Fed and FDIC have regulated the interest rates that banks may pay to depositors. Interest-rate regulation, however, is now being phased out by congressional directive, so that interest paid on deposits in the future will more closely reflect market rates for money. As a result, the FDIC will have to rely on other techniques to assure bank soundness. Unable to control the cost of deposit liabilities, the FDIC, in

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478. Fed. Res. Bd. Regulation Q, 12 C.F.R. § 217 (1980); id. § 329 (parallel FDIC regulation of interest rates paid by insured nonmember banks). Through the differential that enables thrift institutions to pay ¾% more than commercial banks for most types of deposits, interest-rate regulation has been used in an effort to channel funds to the residential mortgage market, in which thrift institutions are major providers.
supervising banking activity, will presumably pay more attention to asset quality and the match of asset and liability maturities.

In markets where interest rates on deposits are lower than the competitive level, either because of tacit or explicit price fixing, the entry of an interstate competitor will tend to raise interest rates to competitive levels, so that depositors in all local markets receive the benefits of interest-rate deregulation. While such entry may not affect the interest paid on deposits in markets that are already competitive, it may still affect bank assets and safety by its operation; with the addition of new competitors, banks may find it necessary to make loans of poorer quality, or at lower rates.

If bank failures increase, the FDIC will have to raise its insurance premium, and insured banks will have to recover the added cost from their depositors. But increased failure seems unlikely. The federal banking agencies would restrict entry to prevent overbanking, and while the burden on bank examiners may be increased, there is no reason to think that they will be unable to prevent bank failures as well as they do now.

In conclusion, depositors may benefit from the potential and such actual competition as is introduced by the relaxation of inter-

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481. There is some empirical support for the foregoing analysis. Many states have moved from unit or limited area branching regimes to allow statewide branching. Since the large New York City banks are among those most likely to seek interstate expansion opportunities, if allowed, New York's experience in moving from limited to statewide branching is of particular interest. The change occurred in 1960, and since that time the New York City banks have opened numerous branches upstate, as well as acquiring several existing banks, and chartering some de novo bank subsidiaries of their BHCs. During the years 1960-79, however, there were only two insured bank failures in New York State and one of those (Franklin National) was caused by losses from foreign exchange dealing. See [1960]-[1979] FDIC ANN. REP. This suggests that neither the Comptroller nor the New York State Banking Commissioner has allowed local banking markets to become overbanked to the point of causing some banks to fail simply because they have the authority to allow statewide banking. See generally E. Kohn & C. Carlo, The Competitive Impact of New Branches (N.Y. Bank. Dept. 1969). In this regard, the transition in New York appears to have been typical, moreover. See, e.g., Shull, Multiple-Office Banking and the Structure of Banking Markets: The New York and Virginia Experience, in Conference on Bank Structure and Competition 30 (Fed. Res. Bank of Chicago 1972).

Of course, the experience in New York, and indeed in all other states, occurred during a time when interest rates on deposits were regulated. As suggested above, however, banks will have to pay a market price for deposits in the future regardless of whether there is interstate banking. See text accompanying notes 393-397 supra. The only effect that the relaxation of territorial market boundaries should have is to insure that a fully competitive interest is paid in all markets.
state banking barriers. They may not benefit very much in fact if market entry is too tightly controlled, but there is surely no reason to expect that their welfare would be decreased by reason of interstate banking.\textsuperscript{482}

2. Retail Borrowers.—Borrowers are benefited by increased competition among lenders. Having more lenders in a credit market implies not only more vigorous competition in price and terms, but also more independent judgments being made about the creditworthiness of a particular loan applicant; the more such independent judgments, the more likely that, for any given set of rates and terms, someone will be willing to lend to a particular borrower.

Viewed in isolation, the market for consumer bank loans is relatively concentrated in most areas of the country. Empirical studies of the relationship between loan terms and concentration yield mixed results, but tend to show a small and statistically significant price effect in the expected direction.\textsuperscript{483} Heggestad and Mingo found that new car loan interest rates increased with concentration up to a Herfindahl index of .14 which means that there would be monopoly pricing of consumer loans in markets with seven (the reciprocal of .14) or fewer banks.\textsuperscript{484} They found that the average SMSA has the equivalent of 4.5 equal size banks; rural counties the equivalent of only 2.2 equal size banks.\textsuperscript{485} Thus, the inconsistent results of the various studies of bank prices and their relation to

\textsuperscript{482} Rhoades, supra note 468, at 7, suggests that under interstate banking competition in a local market could be adversely affected if the leading firms meet in other markets. This “linked-oligopoly” or “mutual-forebearance” theory claims some support from an empirical study showing that changes in rank of leading banks in a market were fewer in markets “when the leading firms met in a relatively large number of other markets.” Id.; see Heggestad & Rhoades, Multi-Market Interdependence and Local Market Competition in Banking, 60 REV. ECON. & STAT. 523 (1978). But see Whitehead, An Empirical Test of the Linked Oligopoly Theory: An Analysis of Florida Holding Companies 13 (Atl. Fed. Res. Bank, working paper, June 1978) (linkage “positively associated with market competition”). To the extent that linked oligopoly is important—and more empirical work is needed to determine that extent—it should affect regulators’ bank entry decisions, intrastate and interstate. Under interstate banking, however, more bank expansion could be allowed with fewer meeting points between any two firms than otherwise. Indeed, interstate banking would make it possible for regulators to frustrate linked oligopolies by preferring market entrants that have fewer (or no) meeting points with incumbent firms in any given market.


\textsuperscript{484} Heggestad & Mingo, supra note 410, at 654.

\textsuperscript{485} Id.
concentration ratios can be explained on the ground that no significant changes in price would be expected with changes in concentration above the "effective monopoly" level.

Unfortunately, the same data could be explained on the ground that the markets under study are highly competitive when one considers consumer loan sources other than banks; again, changes in concentration among banks alone would not then affect expected price levels. The studies that have taken account of competition from other institutions, particularly thrifts and savings banks, suggest that inter-institutional competition does not have a significant influence on the price of bank services, however. Thus, they tend to support the inference that in most banking markets the price of consumer loans is effectively monopolized rather than highly competitive, and that is what explains its relative insensitivity to further moves towards concentration.

Thus, consumer borrowers stand to benefit to the extent that interstate banking increases competition in local banking markets. They certainly cannot be harmed by such a development, and if prices are indeed effectively monopolized at present, they may benefit significantly.

3. Commercial Borrowers.—Because large commercial borrowers now enjoy nationwide competition for their loan business, interstate banking would not affect the interest rates they pay unless interstate banks realize economies of scale in gathering deposits, in which case one would expect that competition among them would result in lower prices to all borrowers, including large commercial borrowers.

Small and intermediate size corporate borrowers face a more limited number of lenders competing for their business. Intermediate sized borrowers that shop for bank loans on a regional basis are being courted by the money center banks that have LPOs in each region of the country. Banks now represented only by LPOs


487. Of course, with increasingly liberal asset powers, thrift institutions are becoming ever more direct competitors of banks and may someday provide effective competition in markets that are now effectively monopolized.

488. See PAYMENT SYSTEMS, INC., FOREIGN BANKS 31 (1979). It has been estimated that the intermediate-sized group of corporations traditionally served by regional banks numbers "perhaps 10,000 firms." Id. On the relationship between banking-market concentration and interest rates on commercial loans to small and
would be more effective competitors if they could provide depository services to their intermediate sized borrowers, because they could then offer a service package comparable to that available from the indigenous regional banks. Small businesses are not generally reached by and thus do not benefit from the money center banks’ presence in the form of LPOs. If the ability to take deposits induced money center banks or regional banks from other regions of the country to open full-service facilities in their locale, small businesses would face a more competitive market among the lenders serving them.

Again, it is possible that regulatory control would so limit entry that these potential benefits from interstate banking would not be realized by borrowers, as they might not be realized by depositors, but it is quite impossible to imagine any adverse consequences for borrowers (or depositors). Instead it seems quite likely that at least some regulators would exploit the possibilities for interstate entry to make local and regional markets for intermediate and small business loans more competitive.

B. Producer Welfare

The impact of interstate banking on producer welfare is likely to be mixed. Producer interests include those of bank shareholders, employees, and indirectly, creditors (other than depositors). In general, the interests of these three groups are coincident in that they all want the banks on which they are claimants to prosper. Non-depository creditors are least affected by changes in bank profits, however; short of balance sheet insolvency, their claims will be satisfied in full regardless of whether the debtor bank is profitable. Therefore, since increased bank failure is not a necessary result of interstate banking, we need not be concerned here with the welfare of bank creditors.

1. Shareholders.—In contrast, the welfare of shareholders is most intimately correlated with profitability. If interstate banking makes the industry as a whole more profitable, then shareholders as a group will be better off. If the disaggregated effects of interstate banking are to make some banks more profitable and others less profitable while the industry as a whole is more profitable,
then adequately diversified shareholders will be better off; inadequately diversified shareholders in banks that are adversely affected will, of course, be worse off, but it is within their ability to diversify their holdings, and they will do so if they are risk-averse.

On the other hand, interstate banking may make the industry less profitable if it is administered to increase the level of competition. Regulation Q and controls over entry may have kept bank profits above the competitive rate of return on investments of equivalent risk;\(^491\) if not, it would be because bank rents have been dissipated through price competition for loans and service competition for deposits.\(^492\) In either event, though, increased competition should lead to lower average returns on investments in banking—permanently if profits are now at super-competitive levels, and at least in the short run if they are already down to the point at which only a competitive return is being earned.\(^493\)

It thus seems at first anomalous that a leading bank-stock analyst believes interstate banking will increase bank profits.\(^494\) The reason given, however, is that banks now compete for deposits with other institutions, such as securities and non-financial companies, that are not limited by state boundaries but can branch nationwide.\(^495\) In other words, when viewed as part of the wider market to provide financial services, banks may be at a relative disadvantage. If so, then they may now be earning less than competitive returns on investment.\(^496\) A move to interstate banking may increase their profits, therefore, even though it also increases intra-industry competition in banking, since the truly relevant market is broader. If this possibility is added to the possibility that interstate banking may result in greater scale economies, some of which

\(^{491}\) See Rhoades, A Comparative Investigation of Risk and Rates of Return in Commercial Banking and Manufacturing Industries, 25 ANTITRUST BULL. 589 (1980).


\(^{493}\) A subcompetitive return would be tolerated only while specialized physical capital that has been dedicated to the banking business is allowed to wear out.

\(^{494}\) See Unequal Opportunity, BANK STOCK Q., May 1978, at 1, 19.

\(^{495}\) Id. at 19. Of course, these nonbanks are not regulated with respect to the rates they can pay public investors for funds either; this fact may be as important as their ability to operate nationwide—and thus perhaps to realize scale economies unavailable to banks—in giving them a competitive advantage over banks. Id.

\(^{496}\) See note 493 supra. In addition, banks might remain in the industry at subcompetitive returns if they expect the law to undergo a favorable change and if exiting now would not enable them to re-enter in such a way as to profit from the change in law.
could be retained by producers under a condition of less than perfect competition, then it seems plausible that interstate banking will benefit bank shareholders as a group.

2. Employees.—Employees are more like creditors than shareholders in that their fortunes do not rise and fall with every quarterly report of profits. But unlike either of those groups, employees must depend upon a single firm and cannot diversify in such a way as to minimize their risk of unemployment. Thus, their economic prospects are affected by the growth or contraction of the enterprise for which they work, as well as the growth or contraction of the industry to which their skills are specialized. If interstate banking creates additional competition in a local market with the result that an incumbent bank contracts, then some of that banks' employees will lose their jobs and some of those that are discharged, particularly among the managers, will not be re-employed by the new market entrants.

While some bank employees would undoubtedly be harmed by enhanced competition in banking, it should also be borne in mind that, other things being equal, increased competition will increase the demand for all banking inputs, including labor. If the banking industry is now less than fully competitive, then it is producing less than the competitive level of output and thus probably using less inputs than it would under competition. Increased competition should occasion a general expansion of the industry, therefore, and a net increase in the number of persons it employs. Of course, all other things are not equal, and an increase in banking competition may accelerate the discovery of technological and managerial innovations that reduce costs by substituting capital for labor. In that event, the overall demand for banking labor could decrease.

The effects of increased competition on banking employment are necessarily very speculative. The possibility of adverse effects on employment in a particular industry should not and do not generally weigh heavily in the formulation of legislative policy unless they have a high probability of occurring at a fairly severe level in a particular locale. That was the case, for example, when the airline industry was substantially deregulated; it was reasonably expected that ground employment would be very adversely affected at some locations.497 Provision was therefore made to protect the interests

497. See Reform of the Economic Regulation of Air Carriers, Hearings before the Subcomm. on Aviation of the House Comm. on Public Works & Transportation,
of those who would be laid off by giving them priority claims on
the new job opportunities that could be expected to arise at other
locations as the industry expanded to a competitive level of out-
put. If interstate banking is similarly likely to result in increased
competition that in turn would work to the detriment of some em-
ployees in some local markets, consideration should perhaps be
given to a labor-protective approach that would mitigate the harm
to them; such ameliorative steps must at least be considered before
any expected adverse effect on employees is counted as a cost in
moving from state-by-state to interstate banking.

In summary, the implications of interstate banking for pro-
ducer welfare are necessarily indeterminate and probably mixed;
some producer interests will almost certainly benefit, while others
will almost certainly be harmed, at least if protective measures are
not provided for them. Specifically, bank creditors will probably be
unaffected; some shareholders may be harmed if interstate banking
increases competition and lowers the return on investment for the
industry as a whole. Meanwhile, some employees will gain security
and opportunities for advancement in expanding banking enter-
prises, while others will lose their jobs. Holding constant the rate
of bank technological innovation, however, overall employment in
the industry will probably increase.

C. Equity of Regulation

There is a public interest in regulation being equitable and in
its being perceived as equitable by those who are regulated. The
first is an economic and the second a political interest.

Equitable regulation treats like parties alike. It imposes like
burdens on competitors so that the victors in economic competition
are those who produce goods and services most efficiently, rather
than those who are most benefited by regulations for reasons
unrelated to their efficiency as competitors. It is nearly impossible
to devise regulations that do not affect competitors differently,
however. Nominally neutral regulations impose different compli-
ance costs on competing firms that have different endowments;
thus, some firms gain relative price advantages and market share as
a result of even the most stringent regulations applied alike to

94th Cong., 2d Sess. 1224 (1976) (statement of Roderick Gilstrap, First Vice-Presi-
dent, Airline Pilots Association).
them and their competitors.\textsuperscript{499} At the same time, however, it is generally difficult or impossible to implement regulations in such a way as to equalize their impact on the regulated firms.

The impossibility of achieving anything like precise equality of impact makes it more, rather than less, important that direct competitors be subjected to like regulation. Subjecting some competitors to more burdensome regulations or excusing others altogether exacerbates the unavoidable degree to which regulation rather than efficiency affects competitive outcomes.

In addition to its implications for allocative efficiency, inequitable regulation cannot be accepted as fair by those whom it disadvantages. It is the essence of an arbitrary regime to treat like cases differently and different cases alike. Insofar as a regulatory system is perceived as arbitrary, it cannot command the acquiescence, let alone allegiance, of those who believe they are its victims. Regulatees-as-victims engage in minimal compliance strategies that induce officials to redouble their efforts at enforcement. This cycle in which regulatees circumvent regulations and regulators extend them consumes real resources and produces only disrespect for regulatory law.\textsuperscript{500} The key to making regulation equitable, of course, is deciding which cases are alike and which are different.

1. \textit{Banks in Different Markets}.—The state-by-state banking system penalizes banks in declining markets by preventing them from reaching out to growing markets. Reciprocally, state-by-state banking protects the banks in growing markets from the competition of those who would enter from declining markets. This distribution of benefits and burdens cannot be realistically justified as necessary to provide incentives to foresight by investors or managers. Since 1956, even a bank with superior foresight could not, if it was located in a declining market, establish an affiliate in a


growing out-of-state market. Prior to that time, and to the communications and transportation advances since then, it would have simply been impractical for banks in the now-declining northeastern quadrant of the country to have established affiliates in the growing states of the South and the West. The banks in declining markets, that is, are not unlike the banks in growing markets in any relevant respect.

Yet these banks, and the natural persons who are their shareholders, managers, and employees now find their economic opportunities limited by their location—a circumstance that they might gladly change if only the law allowed. Their regulatory confinement in relatively declining markets certainly seems to be an inequity of regulation that can only be cured by some form of interstate banking.

2. Grandfathered Multistate Foreign Banks and Domestic BHCs.—Until the International Banking Act of 1978, foreign banks were not subject to the state-by-state regime. They could establish branches or subsidiary banks in any state that let them in, and several states did so. As a result, when this advantage was eliminated in 1978, some foreign banking organizations had built extensive interstate operations. Thirty-six foreign institutions had deposit-taking banks or branches in more than one state; one had deposit-taking banks or branches in as many as five states, and many had agency offices in additional states. 501

The 1978 legislation required each foreign bank to designate one of the states in which it had operations as its “home” state. Thereafter, additional offices—banks or branches—could be opened only in the home state, and only if the home state permitted multibank holding companies or branching, respectively. 502 Operations established in other states prior to 1978, however, were grandfathered. 503 The sixty-five foreign banks with multistate operations prior to the Act 504 were therefore given a permanent advantage over their domestic competitors operating under the state-by-state system.

When the 1956 BHC Act was passed, the domestic multistate BHCs then in existence were also grandfathered. These BHCs

501. GOLEMBE (1979), supra note 113, at 101, 110-14 (Table 5-2).
504. See GOLEMBE (1979), supra note 113, at 110-14 (Table 5-2).
compete in twenty-four states\textsuperscript{505} with banks and BHCs that are limited to banking in only one state. Whatever the advantages of multistate BHC operation may be, therefore, they are realized by some firms and not by others in direct competition with them.

Consider the advantages enjoyed by Western Bancorporation, which owns twenty-one banks in the eleven western-most states of the lower 48. These banks have a total of 859 offices, 369 ATMs, and 2.1 million cards outstanding. All of the offices and ATMs are linked by 41,000 miles of leased telephone lines, giving the customers of each bank access to cash withdrawal, credit line, and check guarantee services at all of the banks and ATMs in the system.\textsuperscript{506} With this interstate access feature, it is difficult to see why any person living in the vicinity of a subsidiary bank and expecting to travel in the West would fail to open an account with a Western Bancorporation bank. The BHC's multistate advantage will only be enhanced, moreover, if it implements a plan now under consideration to establish an on-line regional POS system; holders of debit cards issued by any of the BHC's subsidiary banks could use this payment system throughout the eleven-state region.\textsuperscript{507}

The inequity of regulation inherent in requiring some banks to compete with others that have grandfathered multistate operations could be resolved either by extending the reach of all banks, or by requiring the division of the multistate banking organizations into separate entities, separately controlled, in each state. Multistate BHCs may well have argued in 1978 that another kind of inequity would have been involved if they had been required to dismember along state lines; after all, in becoming multistate they had not failed to comply with the law as it then was. Yet it is far from clear whether any hardship, or even loss, would have been entailed if they had been required to comply with the new regime. If so, it suggests that there are significant economies from interstate operation; the "grandfathering" of these economies conferred a permanent competitive advantage on some banks and a corresponding—and permanent—disadvantage on others. The inequity of regulation is obvious.

\textsuperscript{505} \textit{Id.} at 66 (Table 4-1).

\textsuperscript{506} Address by Lisa E. Smith, Ass't Vice Pres., Western Bancorporation, Before the Electronic Funds Transfer Ass'n: Debit Card I (Sept. 8, 1980) [hereinafter cited as Address]; see Hollie, \textit{Coast Bank Going Interstate}, N.Y. Times, Apr. 9, 1981, at D1, col. 3 (profile of Western Bancorp., which has since changed its name to First Interstate Bank).

\textsuperscript{507} Address, \textit{supra} note 506.
In any event, both instances of grandfathering rewarded those organizations that had sought their advantage by circumventing the general prohibition on interstate branching. They did not violate the law in establishing an interstate presence. Rather, they demonstrated a superior ability and willingness to exploit the lacunae in it. It is true that any bank could have formed a multistate BHC prior to 1956. This may have been influential in the decision to grandfather those who did take advantage of the opportunity, and it may still be thought to temper the resulting inequality somewhat. It was not open to any domestic bank, however, to make itself a foreign bank and thereby to gain an interstate branch presence. The advantage of foreign banks can in no way, therefore, be attributed to foresight, insight, or even just greater aggressiveness. They had a unique opportunity, and they took it; when it was closed, their advantage was made permanent. Since it turned upon an immutable status, this was the essence of inequitable regulation.

3. Banks and their Nonbank Competitors.—An increasing variety of nonbank institutions compete with banks for deposits. In most local markets, savings and loan institutions and credit unions are the principal nonbank competitors. Although savings and loans had historically been limited to taking savings passbook and time deposits, they have offered accounts accessed by “remote service units,” which are off-premise ATMs, since 1974,\(^508\) and were authorized in 1980 to offer NOW accounts starting in 1981.\(^509\) Credit unions, which have offered transaction accounts called “share draft” accounts since 1977,\(^510\) have also been able to offer NOW accounts as of 1981.\(^511\)

Some savings and loans institutions and credit unions do in

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\(^{511}\) 1980 Act, supra note 63, § 303, 94 Stat. 146 (amending 12 U.S.C. § 1832(a) (Supp. III 1979)).
fact operate interstate at present, but not to an appreciable extent.512 This is not a limitation of statute law, however. The Federal Home Loan Bank Board could authorize a federally chartered savings and loan association to open branches interstate. In fact, it is currently considering the question whether to authorize interstate branching in metropolitan Washington, D.C., which encompasses portions of Maryland and Virginia.513 If it does authorize interstate branching in this area, then most local banks will be in direct competition with institutions that have a distinct advantage in being able to offer convenient access points throughout the relevant geographical market, while each bank is limited to operations in one of the three jurisdictions that the market spans.514 Equity of regulation requires that savings and loans associations and banks be treated alike in this respect, however, absent a strong countervailing reason for the distinction. Thus far, no such reason has been offered. Any resulting disparity in regulation can be viewed more as the product of "regulatory competition" and of different statutes than of a considered judgment.

Nationally chartered credit unions are also operating interstate. Historically, credit unions existed to serve a limited class of potential customers, often an employee affinity group. Such a group consists of the employees of a particular employer, which may have operations and employees in many states. Perhaps the most extensive interstate operation is that of the Navy Credit Union, which offers share draft accounts in sixty-five branch offices located in ten states and several additional places overseas.515

512. Perpetual Savings and Loan Association is perhaps the most extensive such interstate institution, having eleven offices in the District of Columbia and five in Maryland.


514. The sole exception is Financial General Corporation, a grandfathered BHC with a bank in each of the three metropolitan Washington jurisdictions and a network of 77 offices and 59 ATMs. Even it would be at some disadvantage relative to a coextensive savings and loan association, however, since its Washington and Maryland banks cannot accept deposits for, nor receive deposits through, the Virginia bank. See FG Electronically Links Area Banks, Wash. Star, Sept. 6, 1980, at B5, col. 1.

The brokerage house of Merrill, Lynch, Pierce, Fenner and Smith, Inc. (hereinafter Merrill Lynch) has demonstrated the ability of stockbrokers to compete for deposit business through a network of nationwide offices. Merrill Lynch, which has 390 retail offices nationwide, offers its Cash Management Account (CMA) through 250 offices in 40 states now, and these numbers are increasing.\textsuperscript{516} CMA consists of a money market fund with a transaction account feature linked to a securities trading account at Merrill Lynch. CMA customers are given a Visa card and "Visa drafts" issued by Bank One of Columbus, Ohio. When sales drafts and the check-like Visa drafts are presented for payment at Bank One, the bank seeks authorization and cover from Merrill Lynch. Merrill Lynch will authorize the payment and cover it by wire transfer, drawing first on any cash balances in the customer's trading account, then on shares in the money market fund, and then on margin credit. The principle is to draw on the cheapest money first. All cash balances are automatically invested in the firm's money market fund on a weekly basis, so the customer gets the advantage of money market rates on funds that would otherwise earn, at best, the rate paid on NOW accounts; and the funds are immediately available for either investment or for transactional purposes.\textsuperscript{517}

At least two states have maintained that CMA is unchartered banking. Oregon prohibits it on this ground.\textsuperscript{518} The state of Colorado settled its suit upon Merrill Lynch's undertaking not to allow customers to access their balances with drafts of less than $200, thereby limiting the competitive impact of CMA on local banks.\textsuperscript{519} Merrill Lynch itself imposes a $20,000 minimum of cash and securities that one must deposit in order to open a CMA account. This, too, somewhat limits direct competition with banks for transaction balances, but it leaves the brokerage firm in competition for the most desirable customers' balances, and it is in any event a self-imposed limitation that could lawfully be removed at any time.


\textsuperscript{517} CMA Money Trust Prospectus (Aug. 25, 1978).


\textsuperscript{519} Agreement between Colorado State Bank Commissioner and Merrill Lynch, in settlement of People v. Merrill, Lynch, Pierce, Fenner & Smith Inc., No. C-79745 (Denver Dist. Ct.).
CMA is already of some competitive significance—there is $4 billion in the component money-market fund—and it represents a potential competitive force of unknown dimensions. Moreover, there is no barrier to other brokerage houses entering the competition for what are essentially transaction balances and exploiting their advantages over banks in being able to operate nationwide and to operate a money-market fund. Any brokerage house could accept deposits into a CMA-like account and allow withdrawals from it at any of their offices around the country, and presumably could do so also through ATMs, giving their customers deposit and withdrawal access nationwide, twenty-four hours a day. Perhaps access could even be gained from off-premise locations if a broker is allowed to share in ATM networks or customers are allowed to make deposits to and withdrawals from the broker's account at a bank that does share in a network.

Brokerage houses, such as Merrill Lynch, have clearly resolved to compete with banks and other financial institutions over as broad an array of products as they can offer, and to exploit their interstate advantage in doing so. For example, Merrill Lynch also sells $100,000 insured certificates of deposit (CDs) issued by about twenty banks and savings and loans. It thus reaches interstate markets on behalf of banks that cannot do so directly, and charges them a fee for acting as a conduit between bank and investor. This may be the most efficient means in any event for banks to reach substantial investors around the country, but one cannot know because the arrangement is not the product of competition between Merrill Lynch, on the one hand, and vertical integration by banks themselves, on the other hand, but rather arises in a legal environment that leaves most banks no adequate alternative to using an agent to reach depositors in other states.

Finally, ever since Sears, Roebuck announced that it was contemplating selling small-denomination notes to the public, banks have been facing the possibility that major retailers would

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521. Dean Witter Reynolds, Inc., and Shearson Loeb Rhoades, Inc., have each announced their intention to offer products similar to Merrill Lynch's CMA account. The Consumer Should Be the Biggest Winner As Competition Transforms Financial Services, Wall St. J., Apr. 27, 1981, at 56, col. 1.
enter the competition for deposits and, again, exploit their nationwide branching advantage. The Sears proposal is simplicity itself. It would accept deposits into what are now credit accounts, pay interest to customers who have a positive balance during a month, and charge interest to those who had a negative balance, i.e. charge users and pay extenders of credit. Sears, too, could provide deposit and withdrawal access to its millions of cardholders through on-premise or off-premise ATMs. The same possibilities might attract Wards, Penneys, K-Mart, and others, each with hundreds of locations across the nation.

If plans such as these are not characterized as banking and prohibited without a charter, they could offer very substantial competition to banks by reason of the retailers' convenient locations, interstate operations, and freedom from other bank regulations. Retailers would be free, that is, not only of branching restrictions but perhaps also of reserve requirements, interest rate maxima, examination fees, and FDIC insurance premiums, all of which would give them the ability to pay more for deposits than could banks. Whether these inequities of regulation would be allowed to arise cannot be determined as yet, since no retailer has in fact implemented what Sears has been considering. Moreover, even if soundness-oriented regulations or their equivalents are extended to retailers taking deposits, they will still enjoy the advantages of interstate operation.

D. Soundness Supervision

Any change in the state-by-state banking system must be evaluated also in terms of its implications for soundness supervision. Supervision of banks for safety and soundness is ultimately linked to consumer and producer welfare, since bank failures impose losses on both the consumers and producers of bank services. Soundness supervision has a distinct role, however, apart from consumer and producer welfare, because bank failures impose an economy-wide externality in the form of impaired confidence in the banking system. When confidence in banks is generally impaired, the economy as a whole suffers because banks experiencing net withdrawals must contract their credit extensions, and when the net withdrawals are significant enough, credit must contract even if the Fed lowers its reserve requirements and increases its extensions of credit to banks at the discount window.

It is certainly arguable, and indeed probable, that the now virtually universal deposit insurance provided by the FDIC would
prevent a run on banks today even if several large banks failed. There is, however, understandably little sentiment for testing that hypothesis by relaxing soundness supervision to the point of inducing bank failures. Therefore, any change in the state-by-state banking system must be considered unacceptable if and to the extent that it would make extensive bank failures likely.

Whether interstate banking would have any effect on supervisability is far from clear, but there is no reason to think that it would make the task easier. In essence, interstate banking introduces the possibility of banking enterprises with far-flung operations within the United States and perhaps increases the probability that some banking enterprises will attain a scale much larger than anything known to date. At the same time, the ability of state and national supervisors to oversee a bank with far-flung operations should no longer be in doubt; as previously observed, the Comptroller and the banking commissioners of several of the states currently examine banks with worldwide operations, and the addition of interstate offices within the United States would not make the task any more difficult in nature. Interstate and perhaps nationwide banking would, of course, increase the number of supervised banks with far-flung operations, and thus could increase by degrees some of the difficulties now encountered in international bank supervision by extending them to additional, but this time domestic, banks. There might be a much increased demand for trained examiners, for example. Since all national and some state banks bear the cost of their own examination, however, increasing examination resources should not be considered a problem for public policy, except perhaps for the short time required to train more examiners. Furthermore, the availability of examiners or examination procedures could be considered a constraint on the rate at which interstate banking is allowed.

Experience with grandfathered foreign banks and multistate BHCs suggests that interstate banking by additional domestic banking enterprises will raise no problems of a type not already encountered and dealt with successfully by both state and national supervisors. That experience also suggests the feasibility of co-

524. See text accompanying notes 419-423 supra.
525. E.g., 12 U.S.C. § 338 (1976) (state member banks); id. § 196 (national banks).
526. See, e.g., GOLEMBE (1979), supra note 113, at 80, 138 (both multistate BHCs and bank regulators report no special or insurmountable problems of supervision).
ordination among several banking jurisdictions in arranging simultaneous examinations when necessary. Coordination is, of course, more difficult if uniform standards must also be agreed upon by each examining authority. There is no particular difficulty in applying diverse standards to the various banks of a single BHC where each operates in only one state, however. Direct branching interstate may pose a more difficult problem, although New York has found it possible to regulate foreign branches as though they were separate entities.\textsuperscript{527}

Direct interstate branching is at least somewhat more likely than multistate BHCs to alter the present distribution of supervisory authority.\textsuperscript{528} Where a bank chartered in state \textit{A} opens a branch in state \textit{B}, both states \textit{A} and \textit{B} have a clear interest in the examination process. State \textit{A} cannot risk allowing the branch in state \textit{B} to serve as a warehouse for overvalued assets, such as delinquent loans, nor as a haven for imprudent or impermissible transactions. State \textit{B}, on the other hand, where the bank has only a branch, is reasonably concerned with the solvency of the entire bank, since the branch in state \textit{B} is taking deposits from residents of state \textit{B} on behalf of the entire bank. Those deposits lose their separate identity once taken and failure of the bank may involve closure and liquidation of the branch. Unless the liabilities and assets of each branch outside a bank's home state are segregated, and the branch effectively treated as though it were a separate bank, the host state will understandably assert an interest in the bank's operations in the home state, and indeed in any other host states. The interests of home-state \textit{A}, host-state \textit{B}, and any other host states can be served by simultaneous examination, perhaps even without uniform standards, but that does not mean that coordination among the perhaps many states involved will always be possible.

If cooperation fails to achieve coordination, the interstate bank will presumably be examined in full by each of the interested jurisdictions. The cost and disruption that this would occasion would tend to make the interstate bank favorably disposed either to tak-

\textsuperscript{527} See N.Y. BANKING LAW § 202-b(2) (McKinney Supp. 1980) (foreign branch must hold qualifying assets equal to 108% of liabilities); M. STIGUM supra note 218, at 144.

\textsuperscript{528} See Federal Reserve Bank of New York, Implementing a Policy of Interstate Banking 5 (Aug. 22, 1979) (paper submitted to White House Domestic Policy Staff in preparation of MCFAADDEN ACT REPORT, supra note 410); text accompanying notes 706-708 infra.
ing out a national bank charter or to federal preemption of the examination process. Of course, federal preemption of banking regulation in the wake of interstate banking would end competitive or dual regulation. While many banks would therefore oppose federal preemption, as they presently do, it must be acknowledged that interstate banking at least raises the possibility that some major banks would favor and perhaps achieve federal preemption of the examination process, and that that might lead to more general federal preemption as well.

At present, all insured banks are subject to examination by a federal agency; most state banks are in fact examined by both their state and federal regulators every year, although some states have reached an accord whereby they alternate years with the FDIC in examining their banks. If federal examination is, as often asserted, equal to the best state examination process and superior to many states’ processes, then federal preemption would not adversely affect the quality of soundness supervision. State bank supervisors may nevertheless oppose anything that threatens to make federal preemption more likely, in order to preserve their domains. If interstate banking is allowed, this threat may provide a substantial incentive for cooperation and coordination among the state bank supervisors in examining state-chartered banks interstate.

E. Policy Guidance

Banks are everywhere subject to a significant degree of actual or potential political control. For example, in many countries, this control is exercised in order to assure that banks are major purchasers of public-debt issues, and that their expansion and contraction of the money supply through changes in the volume of loans outstanding furthers governmental monetary policies. Political control may be exerted through any of a variety of means, ranging from outright state ownership of the major banks, as in France.

529. See text accompanying note 22 supra.
532. See, e.g., 1965 Consolidation Hearings, supra note 22, at 121.
to the "administrative guidance" exercised by the Ministry of Finance in Japan. In the United States, political influence is exerted through a combination of statutory limitations and incentives, more and less formal Fed policies, and an implicit "chit" system. Under the chit system, banks need permission to make a variety of decisions that are ordinarily left to entrepreneurs; if they do not accept the policy guidance of their regulators, they cannot expect that their applications—to branch, to establish an ATM, to acquire a business closely related to banking, etc.—will be as readily approved.

In the United States, policy guidance is used both for fiscal and monetary purposes and for the purposes of allocating credit to the housing market in general and to local credit markets in particular. Before examining the implications of interstate banking for the effective exercise of policy guidance, it is necessary to explicate the ways in which guidance is now used to further these four ends.

1. Funding Public Debt.—The evidence of policy guidance for fiscal purposes is clear. The national banking system originated precisely because the federal government could not induce the state-chartered banks to purchase its debt instruments at the nadir of its fortunes during the Civil War. Furthermore, when the National Bank Act was amended by the Glass-Steagall Act in 1933 to take commercial banks out of the investment banking business, national banks were forbidden to purchase corporate stock for their own account, and were subjected to the regulations of the Comptroller respecting "investment securities," meaning corporate bonds, notes, and other evidences of indebtedness. At the same time, however, these limitations and conditions were made inapplicable to bank investments in obligations of the United States and the general obligations of states and political subdivisions, i.e. municipal bonds.

535. See, e.g., H.R. Rep. No. 94-1669, supra note 36, at 6: "The OCC has on several occasions attached such conditions [as an increase in capital or ceasing an unsafe or unsound practice] to the approval of branches, mergers, acquisitions, and other actions by banks." Judicial review of adverse decisions on such applications is not adequate to assure that decisions are based on, or even supported by, their osten-
sible grounds, and mere agency delay, or selectively strict application of statutory standards, escapes review altogether. Thus, use of the implicit chit system may be seen as an exercise of unreviewable agency discretion to implement policy.
536. See note 9 supra.
538. Id.
Since 1933, a long list of exceptions of Glass-Steagall have been made in order to enable banks to invest liberally in the obligations of federal agencies, public housing authorities receiving federal assistance, agricultural credit corporations, and other public-sector entities. Many of these obligations are backed by the full faith and credit of the United States, so that unlimited bank investment in them raises no soundness issue—they are virtually risk-free—and the exception may be justified on this ground. The blanket exemption for investment in municipal bonds, which do carry a risk factor, is clearly, however, a gentle form of credit allocation in favor of the public sector. And banks do tend to be major purchasers of both municipal bonds and United States agency securities.

Banks have large municipal bond holdings for several reasons, including tax considerations and the requirement, imposed by many states, that deposits of public monies be backed by municipal bonds in the bank’s portfolio. It seems probable, however, that banks buy even more municipal bonds than these factors would explain. In some cases, local banks buy local municipal and agency obligations for which there would otherwise be no market. The reason for this is that local officials expect them to do so, and would be more than mildly upset if the banks refused to do so. They would certainly carry their complaints to their state’s banking commissioner and their state legislators.

State chartered banks are, of course, more dependent on harmonious relations with state, and therefore local, governments than are national banks. National banks can hardly be indifferent to their standing with state authorities, however, since they may wish to switch to a state charter at any time in the future.

539. See Hearings on Rev. Proc. 80-55 Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means, 97th Cong., 1st Sess. 5-7 (1981) (statement of John E. Chapoton, Ass’t Sec’y (Tax Policy), Dep’t of Treasury, and Roscoe L. Egger, Jr., Comm’r of Internal Revenue).

540. Consider, for example, the ten largest banks in Texas, each of which had domestic deposits in excess of $750 million in 1978, and 9 of which were national banks. These 10 banks together held securities worth $4.6 billion, or an average of 18.15% of their total assets. Almost 62% of their securities holdings were in municipal bonds, and almost all those would certainly have been issued by the State of Texas, its authorities, and political subdivisions. While 11.17% of the assets of the 10 largest banks in Texas were invested in municipals (61.57% of 18.15% = 11.17%), the 10 largest state chartered banks in Texas had almost 14% of their total assets in municipal securities. See generally Sheshunoff & Co., The Banks of Your State 1980, at 10-11.

Conventional scholarship examining bank portfolios of municipal bonds does not
2. Implementing Monetary Policy.—Monetary policy is implemented by the Fed in three different ways. The first, and by far the most significant, is through open market operations, in which the Fed buys and sells United States Treasury obligations.\textsuperscript{541} When the Fed sells Treasury bills and notes, the money used to pay for them is removed from the commercial banking system. When the Fed buys T-bills, its payments end up in the commercial banking system. In this way, the Fed can raise or lower the money supply by controlled amounts. In open market operations, banks may act as buyers and sellers of Treasury obligations; but their principal connection to monetary policy is that they make loans that become bank balances, which are part of the money supply.\textsuperscript{542} Due to the fractional reserve requirement, the Fed’s open market activities affect the volume of bank credit in the money supply by the reciprocal of the reserve requirement.\textsuperscript{543}

Second, the Fed occasionally resorts to adjustment of its reserve requirements, which makes banks even more directly, but still passively, the instruments of its monetary policy. In essence, their role is again primarily one of creating money by making loans in the form of bank balances. When the reserve requirement is raised, of course, they can make fewer loans, and when it is lowered, they can make more.

The Fed’s third tool for implementing monetary policy is the “discount window” at which it makes loans to banks at rates below the Fed-funds rate. Discount-window loans were at one time the Fed’s principal technique for creating bank reserves, since the full amount lent became part of the borrower bank’s reserve account balance at the Fed. At present, discount-window loans are intended only to aid the bank that occasionally and unexpectedly finds itself unable to meet its reserve requirements.\textsuperscript{544} In fact,

\begin{footnotesize}
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\textsuperscript{541} See, e.g., J. Cochran, Money, Banking, and the Economy 440 (3d ed. 1975); M. Mayer, supra note 219, at 401; M. Stigum, supra note 218, at 180.
\textsuperscript{543} On the operation of fractional reserves and their relationship to open-market operations, see A. Alchian & W. Allen, University Economics 613-14 (3d ed. 1972).
\textsuperscript{544} See 12 C.F.R. § 201.3(a) (1980). But cf. id., at § 201.3(b)(1), -(2) (extended
\end{footnotesize}
however, some banks are particularly aggressive in exploiting the
discount window, borrowing every dollar that they can at below-
market rates.\textsuperscript{545} The Fed has traditionally jawboned excessive users
of its discount window facility,\textsuperscript{546} but it realized during the credit
restraint program of 1980 that it could more effectively discipline
these aggressive banks by price discrimination against them; banks
that borrowed during successive weeks or too many weeks in a
quarter were charged a higher rate than were others.\textsuperscript{547}

Jawboning is a familiar, and perhaps an effective, Fed tech-
nique for pursuing monetary and related policies. It has been used
in attempts to reduce float by chiding banks against remote dis-
bursement practices;\textsuperscript{548} during periods of tight credit, it has been
used to coax banks into lending to feedlot operators and perhaps
others whose costs of funds affect consumer price levels, and
against lending for corporate takeovers, speculation, and other
"non-productive" purposes.\textsuperscript{549}

Jawboning, of course, depends upon there being an implicit
chit system as well. The Fed's jawbone has teeth because the Fed
can foreclose a bank from access to the discount window and can
withhold or delay approvals for various BHC applications; chits
may be even more important to Fed member banks, since they are
also examined by the Fed and it can be more or less demanding
based in part upon whether a bank has shown its willingness to
cooperate with the Fed in the past.

3. Housing Finance.—After fiscal and monetary policy, the
third purpose for which political control of banking is used in the
United States is that of assuring funds to the housing market.
Housing construction in the United States is heavily dependent
upon debt financing. Thus, in addition to providing subsidies to in-

\textsuperscript{545} See M. Stigum, supra note 218, at 201.
\textsuperscript{546} Id.
\textsuperscript{547} See FRB's Announcement of Monetary and Credit Actions, and Imple-
24, 1980, at T-1, -3. See generally 12 C.F.R. § 201.3(b) (1980) (rate above basic dis-
count rate charged for "other extended credit").
Res. Bank of Minneapolis, Circ. No. 8501, Remote Disbursement Practices (Jan. 22,
1979).
\textsuperscript{549} See Hearings on H.R. 212 Before the Subcomm. on Domestic Monetary
Policy of the House Comm. on Banking, Currency, & Housing, 94th Cong., 1st Sess.
65-68 (Comm. Print 1975) (statement of FRB Governor Brimmer) [hereinafter cited
as Hearings on H.R. 212].
dividual renters and homeowners, nonprofit housing developers, 
and public housing authorities, and to creating government mort-
gage insurance programs, the federal government has encour-
gaged banks and other depository institutions to provide credit to housing 
markets. 550

Thrift institutions, of course, have long-term housing finance 
as their primary mission. In contrast, commercial banks participate 
in housing primarily by providing construction mortgages, which 
are then "taken out" by long-term mortgagees, such as insurance 
companies. 551 In their capacity as investors in government obliga-
tions, however, the banks play a major role in funding govern-
ment-insured and agency debts incurred in order to finance hous-
ing, including the obligations of the Federal Home Loan Banks, 
the Federal National Mortgage Association, the Government Na-
tional Mortgage Association, and the various public housing 
agencies and other issuers of obligations insured by the Secretary 
of Housing and Urban Development. It is thus for understandable 
reasons of policy, not accident, that each house of Congress has 
vested in a single committee responsibility for both banking and 
housing affairs.

When Congress directed that the Regulation Q maxima on in-
terest rates paid to account-holders be phased out, it also directed 
the President, through an interagency task force, to study and 
make recommendations concerning the options available to provide 
balance between the interest rates on the assets and liabilities of 
thrift institutions and to enable them to pay market interest rates 
for deposits during periods of high interest rates. 552 Congress was 
here concerned that in the absence of interest rate controls, the in-
stitutions providing long-term fixed-rate financing to housing buy-
ers would experience both depressed or negative earnings and a 
shortage of funds as savers transferred money from thrift institu-
tions to money-market funds and other higher-rate alternatives.

Interstate banking would thus run contrary to established na-
tional policy if it either diverted bank investments from housing or 
housing-backed obligations, or if it exacerbated the problems ex-
experienced particularly by thrift institutions during periods of substantial dis-intermediation. On the other hand it would further national housing policy if it facilitated housing finance. Furthermore, since high interest rates and the associated dis-intermediation are themselves products of inflation, the relevance, if any, of interstate banking to the control of inflation should also be considered in relation to established national housing policy.

4. Extending Local Credit.—Finally, political control of banking is exercised to encourage the investment of locally originated deposits in local credit needs. It has already been mentioned that banks are encouraged to serve local public sector credit needs through the municipal bond exemption from the Glass-Steagall Act, the tax system, and the chit system implicit in bank regulation.\footnote{See text accompanying notes 535, 538-539 supra.} Local private sector lending is encouraged also, generally by informal policy guidance.

The principal exceptions to the norm of informality in the allocation of bank credit to local communities are the Community Reinvestment Act (CRA), passed by Congress in 1977,\footnote{12 U.S.C. §§ 2901-2905 (Supp. III 1979).} and the various linked-deposit schemes found in some of the states.\footnote{See text accompanying note 561 infra.} The CRA policy is expressed in congressional findings that:

(1) regulated financial institutions are required by law to demonstrate that their deposit facilities serve the convenience and needs of the communities in which they are chartered to do business;
(2) the convenience and needs of communities include the need for credit services as well as deposit services; and
(3) regulated financial institutions have continuing and affirmative obligations to help meet the credit needs of the local communities in which they are chartered.\footnote{12 U.S.C. § 2901 (Supp. III 1979).}

The purpose of the Act is to enlist each of the federal financial supervisory agencies in encouraging their regulatees to discharge these obligations. Thus, the supervisory agencies are to assess in their examination process each institution’s “record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods”\footnote{Id. § 2903(1).} and to “take such record into account in its evaluation of an application for a deposit facility” by that institu-

\footnotesize{553. See text accompanying notes 535, 538-539 supra.}
\footnotesize{554. 12 U.S.C. §§ 2901-2905 (Supp. III 1979).}
\footnotesize{555. See text accompanying note 561 infra.}
\footnotesize{556. 12 U.S.C. § 2901 (Supp. III 1979).}
\footnotesize{557. Id. § 2903(1).}
tion. CRA compliance records are therefore made a part of the process by which a national bank is chartered and a state bank obtains deposit insurance; and by which any insured bank establishes a domestic branch or other deposit-taking facility, relocates an office, or merges with or acquires another bank. Federal regulators have denied branch applications of several banks on CRA grounds, as has the Massachusetts Commissioner of Banks who has chosen to apply CRA, as a matter of discretion, to state-chartered savings banks, which are not FDIC-insured and thus are not subject to CRA at the federal level.

Under the linked-state-deposit schemes of some states, a state's demand-deposit-account business is placed with banks with superior performance in meeting selected local credit needs, typically those involving housing finance. In the program established by Colorado State Treasurer Sam Brown, for instance, banks first bid purely on price for the State's business. The bids are then adjusted (solely for the purpose of awarding that business and not for the purpose of actual pricing) on the basis of the banks' in-state loans to finance the purchase of residences in general and older and lower-priced residential units in particular.

The economic wisdom of credit allocation schemes such as CRA and linked-state-deposit programs is arguable, but there is no doubt that these efforts represent national and state policy decisions properly and openly taken and within the lawful authority of those governments. Accordingly, the impact of interstate banking on the pursuit of these policies must be taken into account. To the degree that an interstate banking proposal would frustrate their achievement, that must be considered a drawback of the proposal.

5. Note on the Significance of Foreign Ownership.—In light of the recent controversy concerning the acquisition of major United States banks by foreign banks and foreign individuals, there may be some doubt about the continuing importance of local, state, and national political control over banking in United States policy.

558. Id. § 2903(2).
562. Compare Hearings on H.R. 212, supra note 549, at 88-95 (statement of Prof. Lester Thurow), with id. at 187-88 (statement of Prof. Yale Brozen).
Indeed, the Comptroller of the Currency and the Federal Reserve Board have cautioned against efforts suggested by others, such as the New York State Banking Commissioner, certain members of Congress, and the Government Accounting Office, to prevent further acquisitions of major domestic banks.\footnote{Compare The Operations of Federal Agencies in Monitoring, Reporting on, and Analyzing Foreign Investments in the United States, Hearings Before the Subcomm. on Commerce, Consumer, \& Monetary Affairs of the House Comm. on Gov't Operations, 96th Cong., 1st Sess. 55 (Aug. 1, 1979) [hereinafter cited as Gov't Operations Hearings] (statement of Comptroller Heimann), and Letter from Griffith L. Garwood, Deputy Secretary of the FRB, to William J. Anderson, Director General Gov't Division General Accounting Office (July 9, 1980), reprinted in Report by the Comptroller General, Despite Positive Effects, Further Foreign Acquisitions of U.S. Banks Should be Limited Until Policy Conflicts are Fully Addressed, app. XII (1980), with N.Y. Sup't of Banks, Report on Proposed Acquisition of Marine Midland Banks, Inc. (June 28, 1978) [hereinafter cited as Marine Midland Report] and Report by the Comptroller General, supra.}

Other than a brief moratorium on such acquisitions,\footnote{1980 Act, supra note 63, § 902, 94 Stat. 193 (moratorium from Mar. 31 to July 1, 1980).} the United States has taken no steps to hinder their occurrence; it thus remains unique among the countries of the world in allowing foreign control over major domestic banks.\footnote{See Report by the Comptroller General, supra note 563, at 2-4 to 2-5.}

New York Banking Commissioner Siebert has been a leading opponent of allowing further foreign acquisitions of major banks. Her report on the proposal of the Hong Kong and Shanghai Banking Corporation to acquire the Marine Midland Banks, Inc. appealed clearly, if indirectly, to the perceived need for local political control over banks. Thus, she stated that “[w]hile credit generally tends to be allocated through the operations of the free market, local, domestic-owned banks share certain pre-dispositions that might not be applicable if they were foreign-owned.”\footnote{Marine Midland Report, supra note 563, at 23.} Most important, she said, is that pre-disposition towards meeting domestic credit needs:

\begin{quote}
[F]oreign ties . . . make it far more likely that the bank would be responsive to requests from the government of the foreign controlling stockholder that cause it to act in ways that meet the needs of the foreign country regardless of whether such actions are in the best interest of the U.S. economically or politically.\footnote{Id. at 25.}
\end{quote}

Diversion of funds from retail banking or from local communities...
in favor of other ties is an exercise of asset management policies which is neither unlawful or dangerous to the safety or soundness of an institution, though it may well be inconsistent with the public interest in having the credit needs of the local communities adequately served.\textsuperscript{568}

Commissioner Siebert went on to note that Marine Midland had a "substantial investment position in securities of New York State and its agencies as well as local municipalities throughout the State." Indeed, the bank held the obligations of more than 250 municipalities and school districts, and its portfolio of New York State municipal obligations amounted to $275 million. According to the Commissioner:

There [was] a serious risk that under HSBC ownership, Marine would reduce its local support and commitment to New York and its municipalities, which could have an adverse effect on the market for such securities and could lead to higher interest rates on the securities.\textsuperscript{569}

It should be clear that a bank making investment decisions in order to maximize its return on assets would make pretty much the same decisions regardless of whether the majority of its stock was held by United States citizens or by a foreign BHC. Yet there is no reason to doubt the foundation for Commissioner Siebert's apprehensions. As a regulated bank, Marine Midland was presumably not in a position to make investments solely on the basis of their nominal economic return; it needed to make certain sub-optimal investments in order to store up chits with the Commissioner. HSBC, on the other hand, might feel freer to pursue economic maximization because its banking interests are diversified among many jurisdictions and it is not as dependent upon the approval of the New York Banking Commissioner if it is to prosper and grow. Denied an application for additional authority in New York, such as a new branch, HSBC might be better able than Marine Midland to find equally attractive opportunities abroad.

As recounted before, when Commissioner Siebert indicated that she would not approve the acquisition, Marine Midland applied for a national charter and the Comptroller granted it so that the acquisition could be consummated.\textsuperscript{570} The Comptroller, too,
has spoken out on the issue of foreign control over major American banks. In congressional testimony pre-dating the Marine Midland affair, the Comptroller emphasized the pro-competitive benefit of enabling foreign banks to acquire a position in United States banking markets. He acknowledged that most foreign banks seeking to operate in the United States have emphasized wholesale or corporate business, where their influence has clearly been pro-competitive. He added, however, that “[t]he beneficial impact of competition among banks applies no less forcefully to the services available for small businesses and individual consumers.”

The Comptroller did not deny the relevance of the concerns later to be expressed by Commissioner Siebert, however. He simply doubted their foundation, saying “neither logic nor experience convinces us that foreign owners of U.S. retail banks are any more likely than domestic owners to shift away from the provision of retail services.” Indeed, in approving the conversion of Marine Midland to national bank status, he “conclude[d] that the improved flexibility which [HSBC’s] acquisition will bring to the [Marine Midland] organization [through an infusion of capital] carries the potential for more effective satisfaction of CRA obligations by the holding company and its principal banking subsidiary.”

It is doubtful that the Comptroller considered the Community Reinvestment Act completely adequate to allay the New York Commissioner’s concerns, particularly regarding the market for New York municipal bonds. His decision can best be understood as resting at least in part upon the adverse implications for United States banks abroad should United States policy turn hostile to foreign acquisitions. True, United States banks can not acquire banks abroad, as a matter of host-country law, but they branch quite freely and hold a very large percentage of the international banking business. Retaliatory pressures exerted abroad could harm

571. See Gov’t Operations Hearings, supra note 563, at 55-56 (statement of Comptroller Heimann).
572. Id. at 71. Thus, while the few foreign banks that have acquired domestic banks with a retail orientation have done so in “lucrative and growing local markets,” a study by the California Superintendent of Banks found that additional foreign banks increased competition and improved services in all markets, including growing retail markets. Id.
573. Id.
575. See NATIONAL TREATMENT STUDY, supra note 444, at 13-35.
United States banks, and to some extent the national interest, far more than could even several additional foreign acquisitions of domestic banks.

In short, the United States' unique openness to foreign-bank acquisitions is not inconsistent with the view, held at both the national and state levels, that banks in the United States must be kept amenable to official policy guidance. With the increasing internationalization of bank ownership, however, policy guidance may have to be exerted more frequently through explicit measures, such as CRA, rather than continuing to rely on the implicit chit system. Diversification of banking organizations across administrative jurisdictions may lower the value of the chits held by any one jurisdiction.

6. Implications of Interstate Banking.—From the foregoing discussion, it appears that interstate banking has conflicting implications for political guidance of bank policies.

a. Funding Public Debt.—With respect to the funding of public debt at the federal level, interstate banking is unlikely to have any effect. While it is true that the largest banks tend to hold a smaller percentage of their assets in United States government obligations, and that interstate banking might imply an increase in the number of large banks, any effect on the demand for government debt would certainly be inconsequential. Likewise, there is no reason to associate interstate banking with any concern that the market for federal debt instruments could become oligopsonistic. That would require consolidation in a few banks of most of the assets now held by all 14,000 banks in the United States, which would be unlikely to result even if the antitrust laws did not almost certainly prevent it. In conclusion, interstate banking in any plausible form represents no threat to the ability of the United States to market its debt at fully competitive rates.

Notwithstanding the previous discussion of foreign BHC acquisitions of United States banks, the implications of interstate banking for the municipal bond markets are unclear. A bank or BHC


with operations in multiple states, that is, may be more independent of any one state’s influence (the “independence hypothesis”), since expansion opportunities would not depend upon the good will or chits of a single regulator. Alternatively, the multistate bank or BHC may simply be subject to multiple sources of official influence, having to serve many masters and buy the debt of each (the “many-masters hypothesis”).

The empirical evidence bearing on these competing hypotheses is ambiguous. First, it is reasonably well established that subsidiary banks of BHCs keep a significantly smaller percentage of their assets in United States government securities and significantly more in municipal securities than do independent banks. They have significantly higher loan-to-asset ratios as well, suggesting that BHC subsidiary banks hold either less cash and/or less public debt overall than independent banks. There is no reason to think that ownership by a BHC lessens a bank’s cash needs or holdings, however, so it is reasonable to infer from their higher loan-to-asset ratios that BHC banks do hold less public debt. A separate study of the subsidiaries of multistate BHCs, moreover, showed that they were not significantly different from one-state BHC banks of similar size in their loan-to-deposit ratios. From this it may reasonably be inferred that multistate BHC banks, too, hold less public debt than independent banks, but probably no more or less than one-state BHC banks. It cannot be determined from available sources, however, whether the multistate BHC banks, like BHC banks generally, hold more state and municipal (as opposed to total governmental) securities than independent banks. The independence hypothesis suggests that they need not do so. On the other hand, since the banks within any one state would probably be run as one or more profit centers under a multistate BHC, they may each find it just as advisable to invest in state and municipal securities as they would have if the BHC were limited to one state. Indeed, the BHC as a whole may find municipal bonds even more attractive, measured by the percentage of assets invested in them, with the more diversified municipal portfolio that interstate bank-

579. See generally Curry, The Performance of Bank Holding Companies, in BHC Compendium, supra note 126, at 95, 99 n.5.
580. Id. at 99 n.7.
581. Goelman (1979), supra note 113, at 84. The data show some tendency for the multistate BHC banks to have higher loan-to-deposit ratios than peer group independent banks, but that is true regardless of whether the BHC is multistate or one-state. See generally Curry, supra note 579, at 99 n.7.
ing would give a BHC, \textit{i.e.}, even if it still bought primarily from issuers where it had operations. These questions simply cannot be answered without additional empirical investigation.

It can be said, however, that even if multistate BHCs and banks are more independent of the individual states in which they operate, the market for each state’s debt could only become stronger, not weaker, with the entry of additional out-of-state banking enterprises into its territory. If out-of-state banks or BHCs enter de novo that is, they can only increase or leave unaffected, but not diminish, the market for the host-state’s debt. On the other hand, the diversification of home-state banks into other states could lessen their appetite for home-state debt.

\textbf{b. Implementing Monetary Policy.}—The implications of interstate banking for monetary policy are also conflicting, but more certain to be of minimal significance. Insofar as interstate banking implies fewer and larger banks, the Fed may find it more necessary to discipline their use of the discount window, since it has been the largest banks in the past that have been most aggressive in borrowing from the Fed at below-market rates for investment at higher rates.\footnote{582. Use of the discount window seems to be correlated with bank size. See M. Stigum, supra note 218, at 200-01.} Nonetheless, the Fed has shown that it can use price discrimination to deter overuse of the discount window, as it did during the 1980 credit restraint program.\footnote{583. See FRB’s Announcement of Monetary and Credit Actions, and Implementing Regulations (Mar. 14, 1980), \textit{reprinted} in BNA Wash. Financial Rep., March 24, 1980, at T-1.}

If interstate banking brings about an appreciable consolidation of the banking industry, the Fed may find jawboning easier with fewer banks to oversee. The smaller number of banks overseen by the Bank of England—about one hundred domestic and two hundred foreign banks—is said to make its task more easily managed on a more informal basis, with perhaps equal or greater success than United States regulators have had in dealing with their thousands of banks.\footnote{584. See M. Stigum, supra note 218, at 138.} It is hardly necessary to imagine that interstate banking would bring about the consolidation of the industry into a couple of hundred institutions, however, in order to realize some of the benefits of a more personal and informed relationship between banks and their regulators, and to make it easier for the regulators to review the banks’ compliance with official policies. If each of the fifty-one bank regulatory jurisdictions in the United
States had primary responsibility, on average, for only one hundred banking enterprises, and additionally concerned itself secondarily with two hundred more that were based in another jurisdiction but had a presence in their own, there would still be 5,000 separate banking organizations in the United States, instead of 15,000; yet there would still be on average only three hundred banks competing in each state’s retail markets. While an even distribution of competitors to markets is of course unrealistic, the basic point remains that policy guidance would probably be facilitated by some consolidation in the banking industry, and that an equivalent degree of consolidation without interstate banking would result in there being far fewer competitors in each market.

c. Housing Finance.—With respect to housing finance policy, interstate banking would probably further the flow of funds to housing markets. It may reasonably be assumed that many banks expanding interstate will seek to enter economically growing markets, which will have the greatest demand for housing construction and financing. That demand may presently be met by the limited number of local banks originating, packaging, selling, and servicing mortgages in the market. Those local banks may already be experiencing competition from mortgage banks owned by out-of-state BHCs, but the introduction of out-of-state bank competitors into such local mortgage markets could only make them more competitive and probably reduce the cost of housing credit.

If mortgage markets then become more fully competitive, mortgages may become less attractive investments than others open to banks. As between keeping mortgage markets oligopolistic to attract banks, however, and making them more competitive at the risk of then having expressly to allocate bank credit to mortgages, as does CRA to some extent, credit allocation is the more appealing policy. Maintaining concentrated banking markets affects many bank products, not just mortgages, whereas opening banking markets to increased competition and then assuring the desired flow of funds to housing, at any given level of housing finance, requires less of a departure from allocatively efficient results.

d. Extending Local Credit.—Finally, it is doubtful that full-service interstate banking will much affect the degree to which locally generated deposits are now devoted to local credit purposes. The nationwide interbank money market described earlier has already succeeded in intermediating between depositors in one loca-

585. See text accompanying note 334 supra.
tion and borrowers in another, although more than one bank may have to be involved in order to accomplish this result. Interstate banking enterprises might be able to accomplish the same results somewhat more efficiently through their internal organization, but it is doubtful that the volume of interstate intermediation could much increase for that reason simply because the interbank system is already so well integrated. Nonetheless, if states that now export capital found that they were doing so to an even greater extent because their local banks were branches or affiliates of banks in other states, the CRA principle could be extended to require a portion of locally booked deposits to be invested in local loans. In practical effect this would be akin to but less onerous than New York's requirement that branches of foreign banks maintain qualifying assets in New York equal to at least 108% of liabilities. The New York rule means that each foreign branch must be a net importer of capital to the host state, not just refrain from large-scale capital export.586

e. Conclusions.—In summary, interstate banking may make policy guidance in general more effective if it decreases the number of banking organizations; in any event, it is unlikely to have adverse implications for political control over banks with respect to monetary policy, housing finance, or local credit availability. The implications of interstate banking for bank demand for public debt, particularly at the state and local levels, are unclear, although more probably favorable than not. Empirical data concerning the present operation of the multistate BHCs grandfathered in 1956 would be helpful in this connection. For present purposes, in the absence of evidence to the contrary, it should be assumed that interstate banking will have no effect on the demand for municipal bonds.

F. Undue Concentration of Resources

There are two senses in which concentration in banking seems to offend established national banking policy. The first is market concentration in the sense conventional to the antitrust laws: banking markets should not be more concentrated and less competitive than necessary to serve other regulatory ends. The second, which is less clearly articulated, deals with mere asset aggregation in a way not applicable to non-financial industries: banks should not be allowed to attain a size so great that they can exert an "undue" force in the community, notwithstanding that they may operate in

586. See M. STIGUM, supra note 218, at 144.
competitive economic markets. These two concerns are taken up seriatim in this section.

1. Market Concentration.—The business of banking is subject to the antitrust laws of general application, with certain minor variations. In general, the substance of the Sherman and Clayton Acts is applied to bank mergers and BHC acquisitions of banks, first by the appropriate bank regulatory agency.\(^{587}\) The regulatory agency may, however, approve a consolidation that would not otherwise meet the standards of Section 1 of the Sherman Act or of the Clayton Act if it determines that “the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.”\(^{588}\) The Department of Justice may thereafter bring an original antitrust action in the district court to challenge de novo a consolidation that has received regulatory approval.\(^{589}\)

Nothing in the applicable statutes, or the banking agencies’ administration of them, suggests that interstate banking would exacerbate concentration in the banking industry in any relevant market. Most banking markets are relatively concentrated now,\(^{590}\) in part because they are legally subdivided by state lines, so that removing legal barriers to interstate banking should only make them more competitive and less concentrated. It is true that if some of the largest banks in the country become larger still by virtue of interstate expansion, they could conceivably gain a significant share of the total loans and deposits held by banks in their region or nationwide, but the antitrust laws are not powerless to prevent a trend toward concentration from developing in a regional or nationwide product market.\(^{591}\) For example, the Bank of America, which is the largest commercial bank in the United States, holds about 8.6% of all commercial bank deposits.\(^{592}\) Through a few well-


\(^{588}\) 12 U.S.C. §§ 1828(c)(5)(B), 1842(c)(2) (1976). While the banking agencies may approve a consolidation that would not meet normal antitrust standards, where community needs so require, they may not disapprove on competition grounds a consolidation that would not be condemned by the antitrust laws. See Mercantile Texas Corp. v. Board of Governors, 638 F.2d 1255 (5th Cir. 1981).

\(^{590}\) See note 410 supra.


\(^{592}\) The Bank of America had deposits of $88.4 billion as of December 31,
chosen acquisitions interstate, that bank's national market could perhaps be doubled and its regional market share raised further still. But it is difficult to believe that, in view of the Department of Justice's merger guidelines and the potential competition doctrine, a single banking company's national or regional market share would be allowed to reach troublesome levels, or even to approach the Bank of America's present share of the California deposit market, which is 24%.

Furthermore, even if a single bank or BHC had a relatively substantial share, say 10%, of the national or a regional market, that would not represent as significant an anticompetitive development as it might at first seem, since the relevant geographical markets for most banking services are local. The principal exceptions are the markets for loans to intermediate and large corporations, which are regional and international respectively; the market for cash management services, which is national and increasingly international; and the market for bank-issued consumer credit cards, which is becoming more of a national market.

In the international market for large loans and cash management services, concentration is not a realistic possibility. The number of major banks in the international loan market is large, and their ties to many different home countries preclude any possibility of their future amalgamation into a few institutions, each with market power.

Insofar as there are truly banking product markets that are national, i.e., in which international competition is not practical, national concentration ratios would be relevant. As suggested, these might include cash management services to large corporations and consumer credit cards for individuals. At present, however, neither market seems to be at all concentrated. More important, neither would be much affected by interstate banking. Cash management services and consumer credit cards have become national competi-


593. U.S. Dep't of Justice, Dep't of Justice Merger Guidelines (1968), reprinted in 1 TRADE REG. REP. (CCH) ¶ 4510.


tion arenas precisely because banks need not be near their customers in order to provide them. This would remain true under interstate banking, so that at least as many competitors should remain in the market, other things remaining equal, even with interstate banking. In any event, antitrust law enforcement policy would appropriately be concerned with nationwide market shares in these product markets insofar as they are achieved by interstate acquisitions.

Regional market concentration is a more plausible concern than national market concentration, of course. Concentration ratios in large statewide markets, such as California, Texas, and New York, indicate that a few banks can obtain significant market shares even in areas that are very populous and geographically large, at least when they are protected from interstate competition. With interstate banking, again, the antitrust laws should be sufficient to prevent regional or national market concentration from arising through acquisitions, and if it arises from internal growth in the absence of legal territorial market protection, then the superior efficiencies that must make it possible should be welcomed.

2. Asset Aggregation.—While the implications of interstate banking for antitrust law and concentration in interstate markets are thus quite limited, might some banking organizations expanding interstate grow so large as to have an undue influence in the economy or the affairs of government? While “mere size is no offense” to the antitrust laws, limitations upon size may conceivably be appropriate public policy in the case of banks and other financial intermediaries. There is some, albeit ambiguous, implication to that effect in existing law. Congress has expressly directed the Fed to avoid the “undue concentration of resources” under the control

596. Indeed, if interstate banking enables additional banks to attain the size and distribution of facilities that would enable them to enter the market for cash management services, the result would be to increase the number of competitive providers. Likewise, interstate banking may produce more banks of a size sufficient to realize scale economies in the processing and marketing that go into nationwide consumer credit card distribution.

597. The following table, which shows the 1979 concentration ratios for commercial banks in three states, serves to illustrate this point:

<table>
<thead>
<tr>
<th></th>
<th>Top 3 Banks</th>
<th>Top 5 Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>57.6%</td>
<td>73.8%</td>
</tr>
<tr>
<td>New York</td>
<td>37.2%</td>
<td>55.1%</td>
</tr>
<tr>
<td>Texas</td>
<td>24.7%</td>
<td>35.9%</td>
</tr>
</tbody>
</table>

McFADDEN ACT REPORT, supra note 410, app., at 46-47 (table 2.5). States, of course, are not relevant geographical markets for any banking products, but multistate regions would be relevant markets for some wholesale banking products.
of a single BHC in passing upon holding company applications to enter nonbank activities.\(^{598}\) Specifically, having determined that an activity is closely related to banking, the Fed is required in addition to determine whether it is “a proper incident to banking” in light of the various public benefits and “possible adverse affects, such as undue concentration of resources [or] decreased or unfair competition,” that it may have.\(^{599}\) The implication of this passage seems to be that “undue concentration of resources” is something other than the market concentration associated with decreased competition in antitrust theory.\(^{600}\)

The Fed has occasionally adverted to the undue concentration criterion in disapproving particular nonbank acquisitions, but it has not been very clear about its understanding of the criterion in doing so. For example, in denying the application of the Chase Manhattan Corporation to acquire Dial Financial Corporation, the Board stated that the proposed acquisition “by one of the nation’s largest bank holding companies, of a major consumer finance company with a large national network of offices and a commanding position in the market for provision of data processing services to the industry, involves the issue of concentration in credit-granting resources that was within the intent of Congress in enacting the 1970 Amendments” to the BHC Act.\(^{601}\) The Board’s concern with “concentration in credit-granting resources” suggests that it may be reading the undue concentration criterion as a type of market concentration standard. As such, however, it is considerably more stringent than the standards of the antitrust laws themselves, since “credit-granting” is probably too broad to be a line of commerce for antitrust purposes, and the Board’s finding of undue concentration did not rest on any reference to market shares either of the proposed consolidated company or of the leading four or eight firms in the “credit-granting” industry.

The Board was even more obscure in its opinion denying the application of BankAmerica Corporation to acquire a 50% interest in an overseas affiliate of the Allstate Insurance Company subsidiary of Sears, Roebuck & Company.\(^{602}\) Noting that the firms involved were respectively the “largest U.S. Banking organization


\(^{599}\) Id.

\(^{600}\) But see Mercantile Texas Corp. v. Board of Governors, 638 F.2d 1255, 1260-63 (5th Cir. 1981).


and one of the nation's largest insurance companies, which . . . is wholly-owned by the largest retailer of general merchandise in the U.S.,” the Board stated:

Close working relationships abroad between large U.S. banking organizations and large U.S. insurance companies could in time weave a matrix of relationships between the joint venturers in the U.S. and abroad that could lead to an undue concentration of economic resources in the domestic and foreign commerce of the United States.603

Without further elaboration, it remains unclear whether the Board considered the firms to be in actual or potential competition in the domestic market, or whether it simply feared that their conglomer-ation abroad would lead to their effective conglomeration in the United States; if the Board held the latter concern, then the undue concentration criterion would more clearly be a matter of absolute size and not of competition. In other words, for a BHC, mere size may be an offense after all, at least if it is achieved through acquisition rather than internal growth.604

The relevance of “mere size” remains obscure, but it is possible to speculate about why Congress might have been concerned with something other than “decreased competition” in characterizing the “undue concentration of resources” in the BHC Act as an adverse effect of some acquisitions made under the Act.605 The undue concentration criterion was added to the BHC Act at the same time that the limitations on the nonbanking activities of BHCs were liberalized. It is plausible that Congress was prepared to allow BHCs to diversify into activities closely related to banking, and yet to prohibit their doing so by the acquisition of large firms in those related lines of business.

First, since the BHC would, by hypothesis, be entering into activities closely related to banking, Congress may have sensed that banks would be acquiring firms with which they were at least in some degree of competition. But this concern merely duplicates the desire to avoid decreased competition.

Second, Congress may have hoped to use the opportunity of BHC diversification to make the fields being entered more compet-

603. Id. at 519.
604. The FRB may also have been concerned that the bank would acquire an undue influence over the co-venturer's nonbanking domestic operations, which were not “closely related to banking,” but it did not say so.
605. See note 134 supra and accompanying text.
itive by effectively channeling BHC acquisitions toward smaller “toeholds,” even if those fields were not already concentrated. This interpretation is consistent with the suggestion implicit in the sentence that follows the references to undue concentration and decreased competition; that sentence authorizes—and by implication directs—the Board to “differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern.”\textsuperscript{606} Congress may, in other words, have preferred that a BHC diversify by de novo entry or by toehold acquisition, and moved to assure this result by discouraging the acquisition of very large firms even in unconcentrated industries. This approach would maximize the pro-competitive effects of liberalizing BHC powers (at least if de novo entry into fields closely related to banking was not too expensive or risky). Still, it is not really possible to determine, with confidence, whether Congress was merely expressing a pro-competitive policy or whether it was also condemning mere size in its reference to the undue concentration of resources within a BHC.

Mere size becomes a more clearly appropriate limitation when considering liberalization of the geographical limitation placed on banking itself through the relaxation of the state-by-state system. Specifically, there are three potentially adverse affects to be expected from the emergence of “megabanks,” i.e., very large banks or BHCs with very large aggregate bank assets.\textsuperscript{607}

\textit{a. Political Influence.}—It is reasonable to believe that megabanks would acquire substantial political influence at the national level,\textsuperscript{608} as have the trade associations representing smaller banks today. At the state level, it may already be true that individual large banks and BHCs in highly concentrated states have substantial political influence in state governmental affairs, as do bank trade associations in unconcentrated states. As employers of many


\textsuperscript{607} There is no need here to quantify the terms “megabank” and “very large”; for present purposes they may be defined loosely as being of a size sufficient to make plausible the concerns raised in the text, since they are what make the megabank’s size an “undue” concentration.

thousands of state residents and important lenders to the state and its political subdivisions, the voices of large banks are undoubtedly, and not inappropriately, heard clearly—along with the voices of large non-bank employers in the state. Banks of such size and influence are the creatures of state policy, however. States that wished to prevent them have adhered to unit banking. Others may have deemed the risk of individual banks obtaining political influence to be worth the benefits of having large banks or BHCs, particularly if the alternative was that a large number of small banks would collectively achieve the same political influence anyway.

Under the state-by-state banking system, however, no bank can attain a size sufficient to give it, individually, significant influence at the national level. Thus, while Citicorp may obtain special legislation from South Dakota and its chairman may venture an implicit threat to the New York legislature, it is far from able to command a sympathetic hearing in Congress. If it were an important institution in perhaps a half dozen states rather than one, however, it would predictably have greater access to more congressional delegations. The representatives from states in which it was an important employer, and buyer and perhaps underwriter of municipal bonds, would understandably be concerned with its welfare and its views on proposed legislation, just as would be their state government. It is not difficult to imagine that at some point, a megabank’s appropriate access to legislators could conceivably become an undue influence over the national legislature.

b. Credit Judgments.—Insofar as interstate banking would encourage or allow the emergence of a few megabanks, there would necessarily be fewer smaller banks. The market for banking services is relatively fixed at any given moment; whether large banks expand by acquisition or by internal growth, therefore, the existence of such megabanks inevitably implies the existence of fewer banks overall.

If the resulting market structure under interstate banking were to include a number of megabanks, it is inferable that there would be substantially fewer independent credit judgments being made in the market place. Assume, for example, that there are 100 regional banks large enough to be potential participants in a syndi-
cated loan to a major corporation. If the same 100 banks were consolidated into, say, twenty nationwide banking enterprises, there would be only twenty and not 100 independent credit judgments making the market. In other markets for the sale of fungible commodities, such as steel, twenty suppliers would certainly be enough to assure that vigorous competition prevailed. While commercial credit is also a fungible commodity, the decision to provide it and the price to be charged for it may require a complex judgment about the borrower, its prospects, management, etc. The fewer suppliers there are making such judgments in the market, the less likely it is that any particular borrower will find a willing lender at an acceptable price. Riskier and new borrowers in particular may find it more difficult to borrow in a market made by twenty lenders rather than 100.

611. 

The alternative certain to be tried in these circumstances would be some form of government rescue.612 There is already a statutory provision for the FDIC to organize a new national bank to assume the deposits of a closed bank and operate in its place for up to two years with any losses it sustained to be replaced by additional funds from the FDIC.613 Whether the FDIC could reorganize or wind up the affairs of a troubled megabank in two years is far from clear, however. More likely, the FDIC would be authorized to continue as the (semi-permanent) receiver of the bank, thus introducing into banking an unprecedented element of state enterprise, with the probable inefficiency and potential for corruption that experience has shown to be associated with such state activity.

In addition, if a megabank ever did encounter severe difficulties, for which FDIC management would not be a desirable solu-

611. Cf. Glassman & Eisenbeis, supra note 140, at 215 (government may be reluctant to permit failure to occur).
tion, it would certainly acquire substantial leverage in dealing with the national and several state governments. Consider the example provided by the Chrysler Corporation's recent difficulties. Of course, Chrysler did not willingly, or at least intentionally, put its own survival in doubt. Once the corporation's finances became precarious, however, it was no longer a mere supplicant in seeking state and federal governmental aid. The affected governments wished very much to avoid Chrysler's failure. Although that would probably have resulted only in its reorganization rather than its being liquidated, they were concerned about local and state unemployment effects if many plants were closed, and about the market concentration that would have obtained among the surviving firms in the automobile industry. Consequently, Chrysler, prostrate though it was, had a good deal of bargaining leverage and was able to obtain federal loan guarantees to the extent of $1,430 billion.\textsuperscript{614}

Certainly the impending failure of a megabank would occasion at least as much solicitude from bank regulators, and others answerable for the orderly workings of the economy, as did that of Chrysler. The widespread disruption of depositor and, more important, of credit relationships would be viewed as an intolerable public hardship. This would be true particularly for the local communities of deposit that would feel the concentrated effects of the failure—including unemployment and perhaps substantial concentration of the local market in a few remaining banks.\textsuperscript{615}

d. Implications of Interstate Banking.—An undue concentration of banking resources may be an outcome much to be abhorred, but it is by no means clear that even the removal of all geographical limitations on banking enterprises would result in any undue concentrations of resources being created. Banking regulators and the antitrust laws would presumably continue to restrain the growth of banking enterprises by acquisition and thus prevent undue concentration of the market, measured, as in antitrust analysis, by market shares. Still, it is at least conceivable that one or


\textsuperscript{615} Such concerns may have been implied when the regulators who arranged $500 million in credit for the ailing First Pennsylvania Bank said their plan to aid the bank was "designed to enable the bank 'to maintain its service to the community.'" \textit{First Pennsylvania Bank Gets Assistance of $500 Million From FDIC, 22 Banks, Wall St. J.,} Apr. 29, 1980, at 3, col. 2.
more megabanks would evolve through internal growth, and it is only prudent to assume that even in a competitive banking market there could be an "undue concentration of resources" defined in terms of an undesirable level of political power, credit markets that are, although competitive, excessively conservative from a social point of view, and the potential need for government either to take over or otherwise assume financial responsibility in the event of a failure. This possibility does not, however, require prohibiting otherwise desirable interstate banking, especially if the danger can be made improbable or avoidable. Two principle safeguards should be considered.

First, the growth of any banking organization operating interstate (or for that matter, intrastate) could be limited by supplemental antitrust-type prohibitions upon the acquisition of going concerns. For example, a banking enterprise could be precluded from acquiring a bank outside its home state; entry into other states would then have to be de novo, whether by branching or by obtaining a new bank charter. This approach, which could entail significant efficiency losses by preventing those who could best manage a particular bank's assets from acquiring them, would also probably be unnecessarily stringent as a prophylactic to undue concentration; but intermediate variations can readily be devised. An example would be to limit or prohibit acquisitions above a certain size. As discussed below, however, it may be necessary for political reasons to allow the states to require that expansion into their territory be by acquisition.

A second and more modest proposal would deny interstate expansion opportunities, at least by acquisition, to banks over a specified size. Federal Reserve Board Governor Caldwell, for example, has suggested that, in conjunction with interstate banking, "acquisitions in state and interstate markets" respectively be denied to banks or BHCs with 25% of state deposits or 5% of the total national deposits. This proposal was apparently directed in whole or in part to the undue concentrations of resources issue under discussion here, since a state would rarely, if ever, be the relevant geographical market for an antitrust analysis of banking.

617. See text accompanying notes 738-763 infra.
619. Moreover, this proposal would prevent a bank with more than 25% of one
Five states already deny both acquisitions and new branch applications to banking organizations that hold more than a set percentage of statewide deposits.\textsuperscript{620} Growth by acquisition is thus precluded, and internal growth is limited by the inability to establish new facilities. To the extent that a bank at the ceiling size seeks growth, it must do so through price and service competition.

This approach has one possible drawback as a safeguard against undue concentration of resources, however; when market growth exceeds the internal growth of a bank at the ceiling size, it again becomes eligible to acquire or open new facilities. This could be prevented if the ceiling size were expressed in absolute terms. Expression in terms of statewide market share is not entirely inappropriate, however; at least in a large state, the likelihood of encountering the problems that make a concentration of resources "undue" is probably correlated with market share as well as mere size.

If this approach were adapted for use at the federal level in conjunction with interstate banking, it would be best to leave statewide ceilings, if any, to state policy, and to adopt a nationwide ceiling indexed to the size of the national economy as measured, for example, by gross national product. The antitrust laws would continue to impose a market share ceiling on acquisitions for each geographically relevant market. Since deposit-service is an inherently local banking product, it makes no sense to limit acquisitions based on the acquiring and acquired banks' shares of national deposits. Limits based on market shares of national product markets would be sensible for antitrust purposes, and will presumably be used by the Department of Justice,\textsuperscript{621} while limits based on absolute size, measured by deposits or assets, would be sensible for the purpose of precluding an undue concentration of resources.

Third, one might attempt to respond narrowly and directly to the problem of undue concentration by devising a special remedial approach to the emergence of banking enterprises above a ceiling size. The added objective here would be to avoid creating inefficient incentives for bank managers. Limiting the further growth of

\textsuperscript{620} See \textit{State Banking Law Serv.}, \textit{supra} note 3, at 318. The states are Iowa (8%), Missouri (13%), Tennessee (16.5%), New Hampshire (15%), and New Jersey (20%). The bases for computation vary among them. \textit{Id}.

\textsuperscript{621} See Dep't of Justice Merger Guidelines, \textit{supra} note 593.
a bank through acquisitions and new facilities may induce lethargy among the managers of a bank at the ceiling size. Shareholders, of course, could not be expected to tolerate this to an unlimited degree, but their ability to monitor its occurrence and extent is problematic. One possible alternative, a rule that automatically divided a bank at the ceiling size into multiple enterprises, could provide an incentive for the management to prevent its growth to the point at which division would be required. This would present a problem to the extent that managerial compensation, status, or perquisites depended upon the size of the enterprise. The concern here is that in establishing a maximum enterprise size, management of a firm approaching the maximum would engage in inefficient behavior in order to avoid dismemberment. They might, for instance, raise prices in order to lose loan and fee business. It would be very difficult for either shareholders or antitrust authorities to detect such a purpose in pricing policies. The managers might also consume resources and perquisites or side payments in order to keep the company from exceeding the maximum size. It is perhaps most likely, however, that the managers would simply slacken their efforts in order to restrain the enterprise's growth.

In principle, therefore, one wants to fashion a rule requiring the division of banking enterprises above a certain size that is objective, so that there is little or no room for arguments from managers (or shareholders) that it does not apply to a particular case, and yet does not create perverse incentives for managers of banks below but approaching the ceiling size.

There may be no way to accomplish the latter task completely, but it should be possible considerably to mitigate the undesirable incentive effects that would arise if a ceiling were merely placed on the growth of a banking organization. For example, advance provision could be made for the mitosis of any bank or BHC that attained a certain size, the bifurcation to be carried out along predetermined geographical lines. For example, when a bank or BHC had assets in excess of some figure, say $200 billion in 1980 dollars,

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it would be required to devise a plan for its reorganization into two organizations of approximately equal size, each operating in a non-overlapping set of contiguous states, the plan to become effective when the organization attained a size of $300 billion. The period between regulatory approval of the plan of reorganization and the time for its implementation could be several years. Meanwhile, the firm could be required to organize along divisional lines that would reflect its later bifurcation. Indeed, if interstate bank growth were accomplished through a BHC with a separate bank subsidiary for each state or set of contiguous states, their later separation would be much easier than if a single bank with interstate branches were to be separated into two enterprises.\footnote{See G. FISCHER, supra note 31, at 279 (1968) (in formulating strategy to break up BHC, FRB "realized that something would have to be done quickly to prevent the conversion of numerous Transamerica banks to branches.").}

None of these approaches to the prevention of an undue concentration of resources is entirely satisfying, of course. If the probability of an undue concentration arising seems sufficiently high, further efforts should be made to refine these approaches or to devise a better one. It should be emphasized, however, that the principal drawbacks of the various safeguards discussed herein relate to the incentives they create, and not to their ultimate ability to prevent an undue concentration of resources from arising and persisting. The problem of potential undue concentrations of resources, therefore, should be considered solvable. The solutions offered thus far all entail some inefficiency, but the efficiency losses encountered to safeguard against an undue concentration of resources would surely be less than those inherent in the state-by-state banking system.

It is therefore possible to conclude with some confidence that the necessary implications of interstate banking for the undue concentration of resources are negligible. Completely unrestrained interstate banking, in which a single bank could branch throughout the country, would naturally be the approach to interstate banking most likely to cause a problem of undue concentration. That problem could be solved by placing a ceiling, in one form or another, on the size of bank organizations; this solution would be less costly if the banking organization had been required from the outset to expand interstate in such a way to facilitate its later mitosis should that be required.
G. Summary and Conclusions

In this Part II, the general question, whether banking organizations should in principle be allowed to operate full-service facilities interstate, has been examined with reference to six criteria: consumer welfare; producer welfare; the equity of regulation; amenability to safety and soundness supervision; amenability to policy guidance; and avoidance of undue concentrations of resources.

1. Summary of Part II.—First, because interstate banking would increase potential and could increase actual competition in banking without threatening bank safety, it was shown that the welfare of consumers, including depositors, retail borrowers, and commercial borrowers, would probably be enhanced and could in no event be lessened. Second, with respect to producer welfare, a possible division of interests emerged. As a group, shareholders in banks would probably be better off with interstate banking. Bank employees, on the other hand, would experience mixed effects, with some gaining and some losing as a result of interstate banking. Overall, employment in the banking industry would probably be increased, and new opportunities open to most present employees. Moreover, the losses experienced by some employees could be averted or mitigated through a labor-protective approach.

Third, interstate banking would unequivocally increase the equity of regulation. It would lower the legal barriers by which some banks are fenced into declining markets, while others benefit from regional prosperity and growth. It would also eliminate the inequitable terms of competition under which most banks and BHCs must compete with a favored few grandfathered BHCs that have banks in as many as eleven contiguous states and grandfathered foreign banks with branches in several money center states. (These inequities could also be eliminated by the dismemberment of the grandfathered firms, however.) Additionally, interstate banking would put banks on more equitable terms of competition with nonbanking enterprises that have begun to offer close substitutes for demand deposit-taking in conjunction with the other financial services that they have traditionally provided. These enterprises include interstate credit unions, brokerage houses, and money market funds. They may soon be joined by interstate savings and loan institutions, at least in some markets.

625. See text accompanying notes 466-488 supra.
626. See text accompanying notes 489-498 supra.
627. See text accompanying notes 499-523 supra.
Fourth, interstate banking will not impair the quality of safety and soundness supervision.\textsuperscript{628} It could complicate the task, however, particularly insofar as interstate activity is accomplished by direct branching rather than by separate bank subsidiaries of multi-state BHCs. If the multiple jurisdictions involved in soundness supervision of interstate operations cannot coordinate their efforts adequately, federal preemption of the examination function would be an appropriate response, and would ensure against any deterioration in the quality of soundness supervision.

Fifth, the implications of interstate banking for political control of banks' policies are generally favorable.\textsuperscript{629} If interstate banking results in substantial consolidation within the industry, the smaller number of resulting organizations will probably be more tractable to policy guidance and their compliance will be more readily monitored. Interstate banking may also have a favorable effect on housing finance and the funding of public debt, but the latter proposition must be regarded as very speculative. While there is no reason to think that interstate banking would further the policy of using local deposits to extend local credit, it is not likely to contribute to its frustration. Even if interstate banking does increase the interregional flow of funds beyond the levels desired by capital-exporting jurisdictions, those areas would be more able to staunch the flow of funds through explicit efforts at credit allocation than through the territorial market allocation scheme of state-by-state banking.

Sixth, interstate banking would increase somewhat the possibility that a problem of undue concentration of resources would arise, but that problem could easily be met, especially if it has been properly anticipated when interstate banking is first authorized.\textsuperscript{630} Specifically, it should be sufficient to require that interstate growth occur at least to some extent through separate bank affiliates of a BHC so that their later separation, should it become necessary, will be made easier.

2. \textit{Conclusion: The General Case Favors Interstate Banking.}—The criteria by which the general case for interstate banking has been evaluated do not have a common denominator; nor is it practical to make realistic quantitative estimates of the various benefits and costs to be expected from interstate banking, so that a net gain or loss could be determined from their summation. While the

\begin{itemize}
\item \textsuperscript{628} See text accompanying notes 524-532 \textit{supra}.
\item \textsuperscript{629} See text accompanying notes 533-586 \textit{supra}.
\item \textsuperscript{630} See text accompanying notes 587-624 \textit{supra}.
\end{itemize}
exercise of some judgment is therefore required in order to resolve the matter, it does seem apparent by the criteria used here that interstate banking would be a net improvement over state-by-state banking. Indeed, it may and probably will have substantial benefits for all consumers, most producers, and the equity of regulation; it could improve the effectiveness of soundness supervision and policy guidance. Meanwhile, it has only the most speculative drawbacks—some bank employees may be harmed and the problems of undue resource concentration may arise. Moreover, each of these possibilities could be averted or substantially ameliorated by rather minor departures from the general proposition that banking organizations should in principle be allowed to operate full-service facilities interstate.

If interstate banking is desirable in general, it follows that the present regime, under which the states are merely authorized to allow the entry of out-of-state BHCs, will not produce a desirable level or pattern of interstate banking. First, the opposition of local banks to the introduction of new competition will generally be sufficient to prevent state legislatures from inviting interstate entry under the Douglas Amendment. Experience bears this out, in that only two relatively underdeveloped states, viz. Maine and South Dakota, have opened themselves to out-of-state banking organizations, and then only on a conditional or limited basis.

Second, even if banks in particular states were prepared to encounter competition from out-of-state entrants in return for reciprocal entry rights into other states, experience and logic indicate that few such reciprocal entry arrangements will be consummated. There will almost always be reasons for the bankers in one of any two states to object that their market is more desirable than the one to which they will be gaining access; and their legislators will understandably be loathe to disadvantage local banks relative to those of other states.

Third, even if the banks in each of two states were generally inclined to favor reciprocal entry rights, it would be very difficult for them to agree on what constitutes reciprocal treatment both in principle and in practice. It would be difficult if not impossible, for example, to determine whether a reasonably subtle host-state banking commissioner is discriminating against out-of-state bank applications for new bank and branch charters in the host state, or in the examination process. Experience with intrastate banking shows that practices of this sort defy judicial review. Consequently, there would be many opportunities for real and imagined discrimi-
nation against outlanders under what is nominally reciprocity between two states.\footnote{631} New York's experience with reciprocity as a requirement for the entry of a foreign bank branch offers no real evidence that reciprocity can be made to work. The banks of sixteen countries operated branches in New York as of the end of 1979.\footnote{632} In the great majority of cases, however, there was no question about reciprocal treatment for New York banks, since New York banks had established branches in those countries before the foreign banks branched into New York. Meanwhile, banks likely to benefit both themselves and New York residents by branching in New York have been precluded from doing so by that state's reciprocity requirement.\footnote{633}

In any event, any pattern of interstate banking likely to result from reciprocal bilateral agreements between the states would not meaningfully be related, except by chance, to the criteria employed above, with the probable exception of producer welfare. A given pair of states would be most likely to reach a reciprocal banking agreement, that is, if their home-state bankers found it mutually advantageous and if the respective state-bank supervisors did not object on supervision grounds to the introduction of out-of-state banks. The circumstances in which these conditions would obtain and reciprocal agreements would be reached would certainly be more limited than the circumstances favorable to interstate banking under the criteria developed here. For example, cases in which consumers and some producers would be benefited, and in which supervision would be unaffected, might not result in bilateral agreement due to the opposition of the most risk averse or inefficient bank managements in one of the states, if they can persuade their state commissioner or legislators that they would be unable to compete.

This analysis suggests that the present legal structure, under which interstate banking is permitted only to the extent that a state enacts a statute authorizing the entry of an out-of-state BHC, should be changed to permit interstate banking to the geographical

\footnote{631} Discrimination could be minimized to the extent that entry was by means of a national bank branch or charter. It is unlikely, however, that two states would readily enter a reciprocal banking arrangement where the likely result was to encourage use of, and conversions to, national charters.\footnote{632} [1979] N.Y. SUP'T OF BANKS ANN. REP. 148.\footnote{633} Id.; see N.Y. BANKING LAW § 202-a (McKinney Supp. 1980-1981). The reciprocity requirement prohibits Canadian banks from branching into New York.
extent most consistent with the criteria used above. In addition, the particular means by which interstate banking is conducted—whether by subsidiary bank, branch banking, or ATMs—should also be evaluated according to those criteria. Part III of this essay accordingly turns to issues of the appropriate extent and means of interstate banking.

III. Issues of Extent and Means

Having answered affirmatively the general question whether banking organizations should be allowed to operate full-service facilities in more than one state, two questions of implementation then arise. First, should there be any limitations on the geographical reach of a banking organization? Second, within its appropriate reach, should the enterprise be restricted with respect to the means by which it crosses state lines? Specifically, should the bank be required to form a sister subsidiary of its BHC in each of the states in which it operates, or be left free to branch directly across state lines? Insofar as direct branching is to be allowed, there is the further question of whether bricks-and-mortar branches are to be treated differently from ATMs.

It is difficult to separate questions of geographical extent from questions of the means by which interstate expansion is achieved. It would be possible, for example, to determine that a BHC should be able to reach nationwide through the organization of several regional banks, each of which could operate bricks-and-mortar branches in several states and be accessed by ATMs in a lesser area (such as one state only) or a greater area (such as nationwide). The combinations are legion, but there is little reason to explore many of them. Take the example just given; there would be no reason seriously to consider limiting the ATMs of a regional interstate bank to a single state. But even the number of plausible regulatory patterns is too large to be subjected to a simultaneous comparison under the six criteria used in this analysis. As a practical matter, therefore, it is useful to separate, at least initially, the question of geographical reach from questions of form.

A. Geographical Limitations on Interstate Banking

There are three types of geographical areas within which interstate banking could plausibly be permitted. These are the country as a whole; a multistate region of the country, such as a Federal Reserve District or other group of contiguous states, such as those bordering each bank’s original home state; and a “natural trade
area," such as an interstate metropolitan area (SMSA). Accordingly, each of these possibilities will be considered in connection with each of the standard criteria.

1. Consumer Welfare.—In Part II, we saw that consumer welfare would be served by a move to interstate banking primarily because it would entail increased potential and could entail increased actual competition in local markets. This would tend to increase the interest rate paid on deposits and decrease the rates charged on loans, except in the case of large commercial borrowers who already receive the benefit of a highly competitive nationwide market.

It follows that the larger the geographical area from within which banks may enter a particular local market, the more consumer welfare will be served. Accordingly, consumer welfare would be best served by nationwide banking, and least enhanced if banks were allowed to operate interstate only where a metropolitan area within their home-state territory spills over into another state. Under nationwide banking, every bank would immediately have scores of potential competitors in the wings of its market. With regional interstate banking, every bank would face at least some new potential competition. Under the metropolitan area approach, however, banks in entirely intrastate SMSAs would face no new potential competition and those in interstate SMSAs would face only little added potential competition from the banks located in the out-of-state counties of their own SMSA.634

A regional approach to interstate banking encompassing several contiguous states would necessarily imply more potential competition, and more potential benefit to consumers, than a metropolitan area limitation on interstate banking. It is impossible to determine the precise degree to which nationwide banking would be superior to the most promising regional approach, but potential competition analysis leads irresistibly to the conclusion that it would be superior.

2. Producer Welfare.—To the extent that interstate banking increases the potential competition facing incumbent banks, shareholders in banks will presumably be adversely affected. In this respect, the producer welfare effects of interstate banking appear to be

634. Intrastate SMSAs with high three-bank concentration ratios, using mid-1974 data, included Elmira, N.Y. (100%); Honolulu, Hawaii (75.5%); Pittsburgh, Pa. (85.6%); and San Francisco-Oakland, Cal. (79.6%). Carter H. Golembe Assocs., Inc., Some Thoughts on Interstate Banking 38-39 (Dec. 1, 1975).

635. Interstate SMSAs with high three-bank concentration ratios, using mid-1974 data, include Augusta, Ga.—S.C. (77.8%); Fall River, Mass.—R.I. (85.9%); and Memphis, Tenn.—Ark.—Miss. (79.6%). Id.
the reciprocal of the consumer welfare effects, and the more limited
the geographical range from within which potential competitors may
be drawn, the better off the owners of banks will be.

There are countervailing and complicating considerations, how-
ever. First, many banks may be able to realize scale economies from
interstate banking that are not entirely competed away. It is very
difficult to estimate, however, the extent to which the economies
may continue with scale, and thus one cannot know whether inter-
state banking regions would be sufficiently large to exhaust the avail-
able economies of scale, or whether, on the contrary, only
nationwide banking could do so. The latter possibility seems doubt-
ful under present technological circumstances, although it may fast
be coming true. The geographical area of the eleven western-most
states in which Western Bancorporation finds it economical
electronically to link all of its 859 offices suggests that the efficient
area over which a single banking enterprise may operate—i.e. at
least before diseconomies set in—may be very large indeed, if it is
not already nationwide.

Second, most banks are at a disadvantage insofar as they are
competing with grandfathered multistate banks and BHCs, inter-
state brokerage houses, and money-market funds. If the ability to
operate interstate would improve the banks' ability to attract core
deposits, and to diversify their deposit base regionally, they would
be more effectively able to meet this competition.

These points do not apply with equal force to all banks, of
course. Some banks will be able to realize scale economies, for in-
stance, while others—perhaps because they are less well-
managed—will lose a market share to them; in a more competitive
environment, they will clearly be worse off for their poor manage-
ment. Moreover, if the banks that gain from interstate banking gain
more as the scope of interstate operations is expanded, those that
lose from interstate banking will presumably lose more. Finally,
some banks will benefit from remaining small, emphasizing person-
alized service, and attracting customers from other banks that grow
too large and impersonal for some customers' taste.

Under these conflicting circumstances, it would be entirely too
speculative to suggest whether bank shareholders, as a group, would
be better off with nationwide or regional or metropolitan interstate
banking. Nonetheless, it is possible to identify three categories of
bank owners that would clearly be better off the broader the scope

636. See text accompanying note 506 supra.
of interstate banking. These are the owners of problem and failing banks, the owners of banks that would be purchased at a premium if interstate acquisitions were allowed, and, most obviously, the owners of banks that would profit from expanding into new markets.

If the area within which acquisitions were allowed was larger, problem and failing banks would have more potential buyers who could be expected to bid up the price of the shares. Even in local markets with several banks financially capable of acquiring a failing bank, antitrust standards may eliminate most of the potential purchasers already in the market; in addition, the state-by-state banking system precludes acquisition by any bank or BHC not already chartered in the state. As noted in the Bank Stock Quarterly, “when it became clear in 1974 that Franklin National Bank [of New York] would have to be acquired by another organization . . . [large West Coast and Chicago banks that would presumably have been more than casually interested were automatically excluded] from the bidding.” Indeed, the Federal Financial Institution Examination Council has since requested that Congress pass legislation enabling failing banks and thrifts and credit unions to be sold interstate in order to avoid a market-concentrating consolidation with a local competitor.

Other bank-stock analysts have pointed out that there are many potential “buyee banks” that “may be purchased at substantial premiums” by other banks if interstate acquisitions are permitted. These are not problem or failing banks, but banks that are now healthy. In this analysis, the phasing-out of Regulation Q and the increased competition sure to result from homogenization of the powers of various financial institutions, both brought about by the Depository Institutions Deregulation and Monetary Control Act of 1980, will “result in severe [profit] margin pressure on many smaller banks.”

. . . precipitate a change in the independent banker’s attitude about branching laws, and his profit problems will result in significant industry merger and consolidation. . . . It is likely that re-

637. Unequal Opportunity, supra note 494, at 18.
638. See 126 CONG. REC. S3802 (daily ed. Apr. 17, 1980) (S. 2575 introduced by request). The Council is composed of the three federal banking agencies, the Federal Home Loan Board, and the National Credit Union Administration.
640. 1980 Act, supra note 63.
moval of geographic restrictions will be in the best interest of the small bank's stockholders as it will increase the number of potential buyers.642

If this analysis is correct, then banks that are not themselves likely to profit by expanding interstate will want to be in a position to be acquired by others that can. Again, nationwide banking would maximize the number of potential buyers for any given "buyee bank." Thus, all bank shareholders, not only those whose banks will be able to realize scale economies from interstate expansion, or are failing banks, may benefit from the broadest possible geographical reach for banking enterprises. In this respect, the interests of bank employees will be virtually congruent with those of bank shareholders.

3. Equity of Regulation.—As between nationwide, regional and metropolitan interstate branching policies, the approach that allows the widest possible geographical scope for banking enterprises best serves the public interest in equitable regulation. Only completely nationwide banking opportunities would fully eliminate the geographical disparities now embedded in the state-by-state banking system. Regional interstate banking would do little, in fact, to alleviate the inequity of confining some banking organizations to declining territorial markets while others enjoy the benefits of regional growth.

Both regional and metropolitan interstate banking would have one salutary effect in this regard, however: they would enable some banks that are at present severely confined, such as those in the downtown or inner-city sections of a unit or limited branching state, to enter the other, and especially the suburban, counties of their own SMSA, at least insofar as those counties were in another state. In fact, under regional interstate banking, these banks could often operate more freely throughout nearby states than in their home state. For example, under either approach the banks in the Springfield-Chicopee-Holyoke area of Massachusetts, a state which allows county-wide branching, could branch throughout Connecticut because one county of that state is in their SMSA and Connecticut allows statewide branching.643 Under a regional approach enabling Illinois banks or BHCs to enter contiguous states,
however, an Illinois BHC could hold one unit bank in Illinois and several banks throughout Missouri.\(^\text{644}\)

Under a metropolitan area approach, new differences in opportunity, equally as arbitrary as those under state-by-state banking, would be created. Consider an example drawn from Pennsylvania, which allows branching into contiguous counties.\(^\text{645}\) Banks in metropolitan Pittsburgh would not be benefited at all, since the Pittsburgh SMSA is entirely within one state. At the same time, banks in Philadelphia would be able to branch into the New Jersey and Delaware counties within the Philadelphia SMSA.\(^\text{646}\) This might be viewed superficially as even-handed treatment in that Philadelphia banks would then, like those in Pittsburgh, simply be able to reach their entire metropolitan area, including some of the affluent suburban areas to which they are presently denied access, unlike the banks of Pittsburgh. In reality, however, since Philadelphia is already a much larger and more desirable retail market than Pittsburgh, this would only exacerbate the inequality of opportunity facing Pittsburgh and Philadelphia banks.

An analogous example under regional interstate banking would depend upon how the regional boundaries were devised. If they follow Federal Reserve Districts, for example, New York, northern New Jersey and Fairfield County, Connecticut banks would be able to enter only each others' territories,\(^\text{647}\) whereas California banks would have access to six additional states, including several with above-median economic growth, such as Arizona and Colorado.\(^\text{648}\) Other regional schemes might be more equitable, but their determination would not be obvious. The resulting debate could exceed in acrimony that over the location and number of Federal Reserve banks, which had "deeply divided Congress on banking reform for several years" until passage of the Federal Reserve Act in 1913 and then plagued the system's Organization Committee in 1914.\(^\text{649}\)

The disparity between domestic banks and foreign banks that established branches or subsidiaries in multiple states prior to the


\(^{646}\) See Statistical Abstract, supra note 643, at 942.


\(^{649}\) R. Johnson, supra note 647, at 37.
International Banking Act of 1978 would be eliminated only if interstate banking were allowed nationwide.\textsuperscript{650} Short of that, neither a regional nor a metropolitan interstate approach would cure the disparity. On the other hand, since the foreign banks with branches or subsidiaries in multiple states are concentrated in New York, Illinois, and California, and found to only a limited extent in a handful of other states, it would theoretically be possible to restore equality of treatment if these states were to treat the banks of other states as they do foreign banks. Any domestic bank, that is, would be able to apply for subsidiary or branching authority in New York, California, Illinois, and perhaps the other states with a foreign bank presence.

This scheme is obviously of limited and questionable practicality, however. First, those few states could not accommodate most of the out-of-state banks that would seek to enter them. Second, it would only increase the inequitable treatment of banks in those host states, since they would now have to compete with domestic as well as foreign multistate banks. While host-state banks could seek to enter other host states—for example New York to California and vice versa—they could not enter other home states; a Georgia bank could enter New York, that is, but not vice versa.

The inequity presently existing between grandfathered multistate domestic BHCs\textsuperscript{651} and other banking organizations could also be cured by nationwide interstate banking authority. Metropolitan interstate banking would do little to give other banks the opportunity presently enjoyed by the grandfathered BHCs. On the other hand, most of the advantage now enjoyed by grandfathered BHCs could be extended to others under a regional approach to interstate banking as well, since each of the grandfathered companies tends to operate in a single region of the country. Indeed, each of the seven grandfathered holding companies operates in a group of contiguous states, with the exception of Financial General Bankshares, Inc., which has subsidiaries in New York as well as the District of Columbia and three contiguous states in the south-central region of the country.\textsuperscript{652} Some of the regions are very large, however; as mentioned before, Western Bancorporation operates banks in the 11 western-most of the lower 48 states. Each banking organization

\textsuperscript{650}. See text accompanying notes 501-503 \textit{supra}.
\textsuperscript{651}. See text accompanying notes 505-507 \textit{supra}.
\textsuperscript{652}. The companies and their states of operation are listed in \textsc{Golembé} (1979), \textit{supra} note 113, at 66-67.
would presumably have to be admitted to a similarly large or populous area to be given a truly equal opportunity.

Finally, the nonbank institutions with which banks must compete now or in the future for retail deposits operate nationwide. Brokerage houses, money-market funds, and retailers are completely unlimited with respect to location. Credit unions may operate nationwide, subject to the important limitation that they serve only an employee affinity group. The extent to which savings and loan institutions will be authorized to operate interstate remains to be seen and, of course, may depend in turn upon changes in the policy respecting interstate banking.

It is thus clear that the public interest in equitable regulation would best be served by nationwide interstate banking. A regional solution that would largely cure the inequity now favoring grandfathered multistate BHCs could perhaps be devised but only the nationwide approach could eliminate the disparity now favoring grandfathered multistate foreign banks and nonbank competitors.

4. Soundness Supervision.—If interstate banking complicates the process of safety and soundness supervision, then the more dispersed the operations of a banking enterprise may be, and the more jurisdictions in which it may operate, the more complicated the task of supervision will be. To illustrate, consider the coordination now required for the examination of a BHC with banking subsidiaries in only one state. Assume that the lead bank is a national bank, and that there are state member and insured state nonmember banks in the system. In addition, assume that the national bank has a significant branch operation in London, that the BHC has substantial nonbank subsidiaries in the United States, including an Edge Act corporation based in a state other than its home state, and that the Edge Act corporation itself has branches in several states around the country. Examination of this system would require coordination among the Comptroller of the Currency, to examine the national bank at home and abroad; the FDIC and/or the state banking commissioner, whose cooperation in examining the insured state nonmember bank could be helpful, and the Fed. The Fed's role would include examination of the BHC itself, the state member bank subsidiary, and significant nonbank subsidiaries, including the Edge Act corporation. In order to examine the Edge Act corporation's branches efficiently, moreover, the Federal Reserve Bank in the district where the BHC is based would require the coordinated efforts of all the Federal Reserve Banks in whose districts the Edge Act corporation had branches.
Clearly, the present structure of banking can require a good deal of coordination among the federal examining agencies and is facilitated by the coordination of the relevant state banking commissioner. If the BHC operated banks in additional states, the task would become only slightly more complex; their examination could require coordination among additional Federal Reserve Banks or regional offices of the Comptroller; in the case of state-chartered banks, the cooperation of the host-state banking commissioners would be helpful, but not essential.

In the case of direct interstate branching by a national bank, coordination would be required only among the regional offices of the Comptroller and, in the event that the national bank is a BHC subsidiary, the Federal Reserve Bank for the district in which the national bank is located. Where the bank engaged in direct interstate branching is a state bank, however, coordination would also be required among the host- and home-state-banking commissioners and, if the state bank is a Fed member, the Federal Reserve Bank for the district in which it is headquartered, and possibly the Federal Reserve Bank for the district in which the branch is located.

Clearly, as the number and dispersal of the states in which a banking enterprise has operations increases, the number of supervisory entities—separate agencies or separate regional offices of the federal agencies—whose coordination is required in order to perform an examination increases. Therefore, it appears that metropolitan area interstate banking would add the fewest complicating elements to the bank examination process. In the case of an independent national bank branching interstate, no additional regulating entities would be implicated. In the case of a state bank branching interstate, two state banking commissioners would be concerned rather than one. Where the interstate presence is in the form of a new subsidiary bank of a BHC, either one or two primary regulators (depending on whether both banks are nationally chartered) and the Fed would be implicated in the examination process. In sum, metropolitan area interstate banking would not pose formidable problems for examination and supervision.

Regional and nationwide banking enterprises could clearly implicate many more regulatory entities, and complicate the examination process significantly more than a metropolitan area approach. At the same time, few banking enterprises would become jurisdictionally more complex under regional or perhaps even under nationwide interstate banking than some BHCs with many
large overseas branches and banking subsidiaries may become under the present regime. This will become even more true as Edge Act corporations continue to branch throughout the country without regard to Federal Reserve district lines. Still, there would be a larger number of complex organizations requiring examination under interstate banking, thus increasing the overall burden of soundness supervision.

From the point of view of examination simplicity, interstate banking has a potentially negative effect, and the more states that may be comprehended by a single banking organization, the more potential that effect may have. This should not necessarily be considered a significant drawback, however. Coordinating procedures among the federal examining agencies are not difficult to establish; indeed, they will have to be improved anyway, simply in order to deal with the challenge presented by Edge Act corporations.

The only real potential for a failure of coordination arises where the several states are involved. This is a concern to the extent that state banks are allowed to branch directly into other states, or one state in which a BHC has a subsidiary bank insists on duplicating the Fed’s examination of the BHC itself, including the lead or other subsidiary banks chartered in other states. If the concerned states are not able to coordinate their efforts adequately, however, their state-chartered banks will have an incentive to convert to national charters. Accordingly, as long as the federal agencies are adequately able to coordinate their examination processes, one need not fear that banks will be subjected to impossibly burdensome and duplicative examinations, nor that they will be insufficiently supervised.

5. Policy Guidance.—It was previously suggested that interstate banking may make policy guidance in general, and particularly that for monetary policy, more effective if it decreases the number of banking organizations. The potential for consolidation within the industry is, of course, greater if the area over which banking enterprises can operate is greater. In this regard, then, nationwide banking may be superior to regional and metropolitan interstate banking. It is impossible to estimate, however, whether

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653. See text accompanying note 273 supra.
655. See text accompanying note 584 supra.
the degree of banking consolidation that would be desirable overall (i.e., when market-concentration effects are taken into account) could not be accommodated just as well with regional banking organizations. Only metropolitan interstate banking would be clearly insufficient to make the Fed's task measurably easier.

The implications of interstate banking for the banks' demand for public debt depends upon whether the "independence" or "many masters" hypothesis is correct.\textsuperscript{656} In the absence of empirical data, it seems likely that a bank would want to purchase some of the public debt of each of the states in which it has regulated operations that periodically require it to apply for additional authorities. If this "many masters" hypothesis is correct, then each state would have some incentive to admit a certain number of out-of-state banks to its jurisdiction. While metropolitan interstate banking authority might not create a large number of potential entrants, both regional and nationwide interstate banking would do so: the more potential entrants to a particular state market, the higher they could be expected to bid up the price, paid in part through additional municipal bond purchases, that they would be willing to pay for admission. Each state, as a potential host, would then be better off with nationwide than with regional interstate banking.

Conversely, if the "independence" hypothesis holds true after all, each state's ability to extract municipal bond purchases from its home-state banks would diminish as the number of states in which they had alternative expansion opportunities increased. That is, if interstate banking inherently increases the difficulty of selling public debt to home-state banks, then the more interstate banking opportunities there are, the more difficult it would make this type of political control over banks.

Earlier it was suggested that housing finance policy may be furthered by interstate banking insofar as it facilitates the (intra-organizational) flow of funds to growing markets better than the present state-by-state (interbank) system does.\textsuperscript{657} While there might be only little room for improvement in the banking system's present ability to intermediate housing (and other) funds interregionally, it seems obvious that any further improvement would best be accomplished through nationwide interstate banking, rather than through the regional or metropolitan area approaches. With

\textsuperscript{656} See text preceding note 579 \textit{supra}.

\textsuperscript{657} See text preceding note 585 \textit{supra}.
respect to the devotion of local deposits to local credit needs, it probably does not much matter whether interstate banking takes the form of metropolitan, regional, or nationwide banking; the state-by-state system already directs funds effectively to their most profitable geographical area for investment, except to the extent that laws like the Community Reinvestment Act\textsuperscript{658} succeed in keeping more deposits invested in local loans.

In sum, political control over banking will probably not be greatly affected by the decision whether interstate banking should be implemented on the nationwide, regional, or metropolitan area scale. It is clearest that the most limited option, that of metropolitan interstate banking, would have virtually no effect on political control. It is less clear whether nationwide interstate banking would be materially better or worse for policy guidance than regional interstate banking; unless nationwide banking made banks less responsive to the fiscal needs of the states in which they operate, however, it would seem that nationwide banking is the superior option.

6. \textit{Undue Concentration of Resources}.—With respect to market concentration in the sense with which the antitrust laws are concerned, the broadest possible area for interstate banking will have the most salutary effect in local and regional markets. Opening them to additional potential and actual competitors could do much to deconcentrate these markets, which would be desirable.\textsuperscript{659} National market concentration would decrease as well if interstate banking enables more banks to attain the size needed to enter national product markets, such as the market for large commercial loans. On the other hand, national market concentration could increase with any move to interstate banking, in relation to the extent of the geographical area over which banking enterprises are allowed to operate, if the largest banks are best able to exploit the opportunity with respect to a particular product market.

In projecting market concentration effects, of course, much depends upon the measure of concentration that one uses, and different measures are appropriate to different size markets. In local banking markets, the three-firm concentration ratio is a conventionally used and appropriate index of concentration. In a nationwide market, however, one would be more concerned with the market share of the top 50 and 100 firms; three-firm and even

\textsuperscript{659} See notes 410, 634-635 supra.
five-firm concentration ratios would not be sensitive enough to reveal an early trend toward concentration or deconcentration.

Using these measures to illustrate the point made above, assume that the largest 100 banks in the country are the most likely to expand interstate. Of course, many smaller banks as well, especially in interstate SMSAs and near state borders, will probably expand interstate; their interstate activities are likely to be dwarfed, however, by those of the 100 largest banks or BHCs. The local and regional markets that the largest banks enter de novo or by toehold acquisition would then become less concentrated even as the national-market share of the largest banks, measured say by deposits, is growing. For example, several large banks may seek and obtain entry into a growing but relatively concentrated market, such as Dallas. If a few of them gained any significant (5%-10%) shares of the local market, it would become less concentrated; meanwhile, to the extent that smaller Dallas banks lost market share to the larger banks entering that market from out-of-state, national deposit concentration would be increased.

Increases in national market shares measured by deposits or assets should not be troublesome, however. It has already been pointed out that the banking products for which the relevant market is national are few—large commercial loans, cash management services, and perhaps the issuance of bank credit cards. Since only large banks make large commercial loans and offer cash management services, competition in these products markets will not be affected if these large banks grow larger at the expense of small banks. In contrast, many small and most intermediate size banks are now issuers of bank credit cards. This market is undergoing some transition toward national competition among very large banks. They may come to dominate the market, particularly if consumers have a preference for a bank card issued by a “local” bank and interstate banking enables these large banks to obtain a local presence.

Nationwide interstate banking may therefore represent some threat to the competitiveness of the bank-credit-card issuing business. It is not at all clear how realistic this possibility is, however. There are thousands of card-issuing banks, and only a few signs

660. Of course, many smaller banks as well, especially in interstate SMSAs and near state borders, will probably expand interstate; their interstate activities are likely to be dwarfed, however, by those of the 100 largest banks or BHCs.

661. See text preceding note 596 supra.

662. MasterCard has 11,666 member institutions, Visa 11,646. Am. Banker, Feb. 3, 1981, at 3, col. 1. Most members are commercial banks and belong to both systems, but not all members are card-issuers; some act only as merchant banks, processing credit slips engendered by merchants. See Bernard, supra note 233, at 67.
that the money center banks may be able to obtain a significant share of the nationwide total of cards outstanding. Moreover, it is not clear whether even significant concentration in this market should be of much concern, inasmuch as the prices that are charged for bank-card credit are regulated in almost every state. It would still be preferable to maintain a competitive market, so that prices are held below legal maxima by market forces whenever possible, but even under a rather far-fetched worst case in which the credit-card-issuing business comes under the domination of a handful of banks, consumers could presumably be protected from monopoly pricing by usury laws or some more particularized form of regulation.

While nationwide banking is clearly superior to regional or metropolitan interstate banking from the point of view of avoiding market concentration, it equally clearly represents the greatest potential for the emergence of an undue concentration of resources in the special sense of an undesirably large asset aggregation. Metropolitan area interstate banking holds no such threat; of the largest banks in the country, it would potentially enable only those in New York, Chicago, and Philadelphia to increase their retail deposit base to an appreciable degree—almost certainly too little to be material to this concern.

Regional interstate banking could be implemented on a scale designed to provide assurance against the creation of undue concentrations of resources. The regions within which banking enterprises are allowed to operate could be established in such a way as indirectly to impose a ceiling upon resource concentration. While the implicit ceiling would in practice be somewhat imprecise and variable from one region to another, this would have the added benefit of obviating the need for setting an explicit ceiling on enterprise size and providing for the dismemberment of oversized banks or BHCs.

In conclusion, market deconcentration could best be served by nationwide banking. On the other hand, undue concentrations of resources would be more likely with nationwide than with regional interstate banking. The weight to be given to this latter factor should probably depend upon one's fear that the problem will arise and one's willingness to undertake a remedial approach of the sort discussed earlier should it do so.

7. Summary and Conclusion.—In this section, three possible

663. See text accompanying note 285 supra.
geographical ranges within which interstate banking might take place, viz. nationwide, regional, and metropolitan areas, were evaluated according to the standard criteria. It was first seen that in principle consumer welfare would best be served by allowing banking enterprises to operate over as wide a geographical area as possible; but it was impossible to say whether nationwide banking would be materially superior to regional interstate banking.

Initially, producer welfare concerns seemed to be in conflict. Insofar as interstate banking enhances competition, the welfare of producers as a group would be served by restraining banks to the narrowest possible geographical reach; on the other hand, the realization of scale economies and the ability to compete with non-banks for deposits suggested that producer interests may lie in the direction of regional or even nationwide operations. Finally, it was suggested that the owners and employees of problem and failing banks, and of the probably very large number of banks that will find it difficult to operate profitably in the absence of Regulation Q and with increased competition from thrift institutions, will find their interest served by the broadest possible range for interstate banking in order to increase the number of potential buyers for their banks. Thus, producer welfare is probably best served by nationwide banking.

The public interest in equitable regulation would unequivocally best be served by nationwide interstate banking; lesser geographical ranges would do little or nothing to make regulation more equitable.

Soundness supervision could become somewhat more complicated as the geographical reach of banking institutions increases and they span more regulatory jurisdictions. Metropolitan area banking would have only a trivial effect, whereas regional and nationwide banking could create complications that would require adaptation and coordination among regulatory entities. Nonetheless, the same type of cooperation will be required to a similar degree even in the absence of interstate branching or BHC subsidiary banks simply in order to supervise the interstate activity presently authorized for Edge Act corporations and nonbank subsidiaries. In perspective, then, the task of supervision will be only marginally more complicated with nationwide or regional banking than with metropolitan area or indeed with state-by-state banking.

Political control over banking is not likely to be much affected by the geographical decision at hand. Policy guidance in general, and monetary policy in particular, might be better served if there
were fewer banks, presumably serving larger areas. Housing finance might be slightly improved as the area of bank operations is increased from state to nationwide scales as well. While the issue of geographical limitations could conceivably have the greatest policy implications for the market for state and local municipal bonds, both the magnitude and direction of any effect are uncertain, and should be ignored for present purposes.

Finally, concern about market concentration suggests the superiority of nationwide banking, since that could best serve to deconcentrate local and regional markets and would have only unimportant concentrating effects at the national level. With respect to asset aggregation, however, nationwide banking has the most potential for creating an undue concentration of resources, whereas regional interstate banking could be designed to preclude that adverse affect.

While the implications of the standard criteria are thus not unmixed, their combined force overwhelmingly suggests the superiority of nationwide and regional interstate banking over metropolitan area interstate banking. As between nationwide and regional interstate banking, moreover, the choice is only somewhat less clear. Nationwide banking would serve more relevant interests better, and such problems as it might occasion—increasing the need for supervisory coordination and the potential for an undue concentration of resources—are eminently solvable. The supervisory problem is minor at worst, and in any event it will have to be met in large part simply in order to cope with the expanding overseas activities of banks and the new branching authority of Edge Act corporations. Regional or nationwide banking will add little further complexity to the problem. Similarly, the drawback of an undue concentration of resources emerging from nationwide banking seems both speculative and susceptible to remedy if it should arise. Accordingly, one may conclude with confidence that banking enterprises should be allowed to operate nationwide, as are virtually all other types of enterprises.

8. Note on Phasing-In.—It does not follow from this conclusion that banking enterprises should be allowed to operate nationwide at once. While consumer welfare is disserved, pro tanto, by delay in the transition from state-by-state to nationwide banking, all of the other criteria counsel an incremental approach.

Supervisory considerations are perhaps the clearest in this regard. Interstate banking offices—which branches or BHC subsidiary banks—would still have to be approved individually by the ap-
propriate regulators. They would almost certainly administer the approval process in the conventional manner to assure themselves at least that each interstate expansion is consistent with the ability of each applicant to support a new banking office with capital and management. They will probably continue to apply a "community needs" test, as well, in order to shield incumbent banks from a degree of new competitive entry that would threaten their viability. Indeed, they should probably be inclined to allow even less rapid interstate growth than the conventional criteria for intrastate expansion would allow, in order gradually to gain experience with such problems of soundness supervision as may arise, and to monitor the impact of interstate operations on the banks' amenability to policy guidance.

A precipitous move from state-by-state to nationwide banking would also raise intertwined concerns about equitable regulation, producer welfare, and the undue concentration of resources. First, a new inequity of regulation could arise if banks are suddenly allowed to expand interstate to the degree that the standards generally applicable to intrastate expansion applications—community needs, and capital and managerial adequacy—would indicate. The banks most capable of supporting extensive nationwide expansion programs are not only the large money center banks of the Northeast, but also the major banks that have benefited from the economic growth of the South and West, especially in California, Florida, Georgia, and Texas. Regulators would have little or no reason to deny their many applications solely on the basis of the criteria applicable to intrastate applications. Nor would the special supervisory considerations mentioned above as counseling caution in the interstate context much affect these large banks. Surely, the soundness implications of interstate expansion would be minimal where they are concerned; each interstate addition to their operations would be insignificant in relation to their overall operations—particularly if they enter new markets de novo or by toehold acquisitions. A bank's amenability to policy guidance, moreover, could not be truly tested until its deposit-taking operations were reasonably well-diversified among the states; for a small bank, this point might be reached after one or two offices have been opened in a second state, whereas for these large banks, it might not be

664. On the problem of discriminatory administration, see text accompanying notes 769-771 infra.
reached until perhaps hundreds of new offices had been opened—enough to shift the "center of gravity" of the bank's core deposit and loan portfolio bases and relieve it of dependence on a single state.

Accordingly, since there would be no supervisory reason to restrain them, a relatively small number of banks could, if allowed to, dominate the de novo and toehold opportunities for growth in the more desirable markets for interstate entry. For example, the BankAmerica BHC, with assets of $111.6 billion and more than 1,100 bank branches in California, might be ready, willing, and able to open as many new direct branches or BHC subsidiary banks in an Arizona market as that market could support. If it is allowed to establish that many offices in the market, however, there may be few opportunities over the next several years for other out-of-state banks to participate in the market. It would be more equitable, better serve producer welfare, and in many cases also be more pro-competitive, to assure that at least some of these opportunities are made available to the banks that have been most disadvantaged under the state-by-state banking system, regardless of whether they are able to exploit them immediately.

It would also be inequitable to subject banks in the markets that first attract interstate entrants to unlimited new competition too precipitously. It may safely be assumed that regulators will not allow so many new entrants into these markets as to jeopardize the safety and soundness of the incumbent banks. As a matter of equity, however, incumbent banks in desirable markets should be given some opportunity to adapt gradually to the demands of a more competitive marketplace, so that they have at least a fair chance to prosper, not just to survive, under the spur of competition. The management of an intensely regulated industry is not immediately suited to deal with the problems of a competitive market. Nor can the management of the Sleepy Hollow Bank fairly be expected to compete profitably with several branches of money center banks suddenly opening around it.

Finally, it would be inequitable to deprive the banks in the most desirable markets of their own opportunities to expand into markets in other states; if they are preoccupied with an onslaught of competition in their home markets, however, that becomes a

668. Cf. Gaskins & Voytko, supra note 665, at 27 (discussing means to encourage industries to respond more quickly to deregulation).
more likely result. To return to the previous example, even the major banks in Arizona, and certainly the lesser ones, may have their hands quite full trying to compete profitably with several money center banks suddenly admitted to the market, whereas their gradual entry may have been something that the Arizona banks could have dealt with while at the same time managing their own entry into desirable markets in, say, California.

The case for a gradual phasing-in of nationwide banking in order to spread the benefits and burdens of a restructured marketplace thus seems to be a strong one; the nice question is how to do it. One means would be to establish a schedule by which banks or BHCs would be allowed to enter increasingly broad geographical areas. For example, the McFadden Act Report proposed a "phased liberalization of the Douglas Amendment," perhaps allowing regional BHC expansion at first.\footnote{McFadden Act Report, supra note 410, at 18.} Similarly, the Association of Bank Holding Companies has proposed that BHCs be allowed to acquire other BHCs in contiguous states.\footnote{See Association of BHCs Outlines Why It Supports Limited Interstate Banking, Am. Banker, July 16, 1980, at 4, col. 1 (adoption of policy on interstate banking by Association of Bank Holding Companies on June 7, 1980).} Seemingly neutral on its face, this approach is on inspection most inequitable, and indeed capricious.

One need only consider the vastly disparate and disproportionate new opportunities contiguous state expansion presents to banks in such states as California and Nevada. California is contiguous to Arizona, Nevada, and Oregon, each of which has had above-median economic growth in recent years, and each of which permits statewide banking, but the combined population of which is only 5.5 million persons.\footnote{Statistical Abstract, supra note 643, at 14 (1978 preliminary population data).} Meanwhile, Nevada is contiguous to California, Arizona, Utah, Oregon, and Idaho—which constitute an area with rapid economic growth, statewide banking organizations, and a combined population of 29.3 million.\footnote{Statistical Abstract, supra note 643, at 14 (1978 preliminary population data).} The smaller BHCs in Nevada would thus seem to be faced with better opportunities for interstate growth by acquisition than their neighbors in California; the Nevada BHCs could enter all the same states as the Californians, and two more.

Under this proposal, the limitations that would be placed on the "corner" states of Florida, Maine, and Washington, and the non-contiguous states of Alaska and Hawaii, are even more obvi
ous, and just as arbitrary. Indeed, they seem to be completely unrelated to any consistent and relevant criteria except a preference for limiting each BHC to its own "region" of the country. One might as well limit each BHC to the states on either side of their home state in an alphabetic list of states.

A more reasonable and surely a more equitable way in which to phase in nationwide banking would be to establish a maximum number of interstate banking offices that a bank or BHC could open or acquire each year, without limitations as to place except the usual standard of "community need." This numerical limitation, or perhaps separate limitations for de novo and acquired offices, would constrain those banking organizations that would be qualified, so far as soundness is concerned, to open a larger number of new offices. Within the numerical limitation, however, it would enable them to seek their best opportunities, by their own lights and not that of a regulatory scheme with an arbitrary passion for contiguous states.

The only difficulty with this approach is in determining the appropriate number of new offices a bank could open or acquire each year. If banks have too limited a presence in a particular market, they may not be able to compete effectively there. For example, a New York bank limited to opening just a few interstate offices per year could not hope for many years to be a meaningful competitor for retail deposits in California, where there are over four thousand bank branches, of which 1,119 belong to the Bank of America alone. On the other hand, if the number of permissible interstate offices opened or acquired each year is set too high, a small number of large banks will dominate the most desirable interstate opportunities, as described above.

While there is much room for debate over an appropriate number, it would seem reasonable to limit each bank or BHC to opening or acquiring a maximum of somewhere between 50 and 100 banking offices per year. Regardless of whether this is the appropriate range, however, the point is to allow meaningful interstate market entry without enabling a few banks to corner the opportunities to do so.

672. Id.
673. See note 29 supra and accompanying text.
674. [1979] FDIC ANN. REP. 145 (Table 103).
676. See text accompanying note 667 supra.
677. An exception might be made to facilitate the interstate acquisition of a failing bank with more than the maximum number of branch locations.
B. **Functional Limitations on Interstate Banking: ATMs Only?**

The National Commission on Electronic Funds Transfers (NCEFT) recommended that Congress enact legislation removing electronic banking facilities from the definition of a “branch” in the McFadden Act. The Commission believed that banks and other financial institutions should be allowed to establish or share in the use of ATM networks nationwide, provided that they accept deposits only through terminals located in their home state or interstate-metropolitan area. The President’s recent report to Congress on the McFadden Act renews the suggestion that “EFT terminals ought to be subject to less onerous geographic restrictions than those imposed on brick-and-mortar branches.” It recommends that terminals be permitted within a bank’s “natural market area” without regard to state policy on electronic branching and presumably without regard to state boundaries; in other words, each bank would be able to deploy electronic terminals throughout its SMSA or, in the case of banks not in any SMSA, perhaps throughout their home county.

While the President’s McFadden study is not entirely clear on the point, the NCEFT report unequivocally proposed to treat electronic branching more liberally than brick-and-mortar branching in two distinct respects. First, electronic terminals would be relieved of the procedural burdens associated with branching. Having been removed from the McFadden Act definition of a branch, that is, they could be established (or shared) at will, without prior application and approval or separate capitalization, as would be required for a brick-and-mortar branch. Second, they could be established (or shared) where brick-and-mortar branches could not be established by the same bank, viz. statewide, even in unit and limited-branching states, interstate in SMSAs, and nationwide for all purposes except deposit-taking. Thus, the NCEFT envisioned a situation in which banks could give their retail customers elec-

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679. Id. at 45.

680. See McFADDEN ACT REPORT, supra note 410, at 19.

681. Id.

682. National Comm’n on Electronic Funds Transfers, supra note 678, at 47. The Commission would have retained a “negative” approval process, under which an application would be automatically granted in a short time if no regulatory action were taken, with respect to deposit-taking terminals only.

683. Id. at 45.
tronic access at an unlimited number of convenient locations within the bank's market area and home state, and enable customers to perform other transactions—most importantly to debit their accounts, either by withdrawing cash from an ATM or making payment for a purchase at a POS terminal—from anywhere in the country.

The justification for not applying the procedural burdens associated with brick-and-mortar branching to electronic facilities is rather strong. First, it would often if not generally be prohibitively expensive to file a conventional branch application for each ATM. Economic studies and the production of data to demonstrate community need for a particular terminal at a particular location would probably cost a bank more than having the terminal would be worth to it. In addition, each application would be subject to a public hearing at which competitors could object to the terminal's deployment, thereby increasing the cost and delay involved in establishing it. Second, even if the procedures were not preclusive, they would not be productive. A bank does not risk substantial capital in establishing an ATM, and may invest little or nothing to share another's ATM on a transaction-fee basis. Thus, if it errs in locating or sharing an ATM at a particular place, it can relocate the machine or withdraw from the sharing arrangement at a trivial cost. Third, the deployment of the ATM is not as substantial a competitive threat as a brick-and-mortar branch would be to nearby competitors. The machine can neither open accounts nor approve loans, although it can offer deposit and withdrawal services accessing deposits and preapproved lines of credit. An ATM is thus not a full-scale competitor to the brick-and-mortar locations around it, and should not be burdened procedurally as though it were.

The justification for treating ATMs more liberally than brick-and-mortar branches with respect to geographical locations is not clear, however. It is relevant that, for the reasons just given, ATMs do not pose the same competitive threat to host-area banks as would a brick-and-mortar branch. Thus, removing all geographical limitations on the establishment of ATMs would not have nearly the same effect on the structure of the banking industry as would removing all such restrictions on brick-and-mortar branches. It would have some adverse effects, however, and these may or may not outweigh the potential advantages; moreover, a complete

684. Id. at 46. Indeed, the OCC allows national banks to use abbreviated procedures for the approval of a deposit-taking ATM. See 41 Fed. Reg. 48,333 (1976).
analysis must consider also the alternative to which the proposal is being compared.

The proposal to allow banks to establish or share ATMs where they cannot branch can be evaluated on two comparative bases. Compared to the present state-by-state banking system it is probably an opportunity for improvement; compared to nationwide banking through brick-and-mortar banks or branches, however, it is clearly a limitation and an inferior option.

First, as to consumer welfare, retail depositors would clearly be benefited by interstate ATMs, even if banks could not obtain a brick-and-mortar presence interstate; indeed, the welfare of retail depositors must be the primary justification for the proposal. Depositors would be given more convenient access to their accounts, making the process of depositing or withdrawing funds less costly and time consuming for them. In addition, retail depositors in interstate SMSAs would benefit from enhanced competition among banks for their depository business. Within an interstate SMSA, that is, a depositor in one state would be more willing to open an account at a bank in the other state if that depositor could access the account from terminals conveniently located in his home state. Since it would be necessary for the depositor to visit the out-of-state bank only once, \textit{viz.} to establish the account relationship, the present barriers to interstate competition within the SMSA would be lowered substantially by the ATMs. Accordingly, actual competition for retail deposits would be enhanced, to the benefit of retail depositors.

Retail borrowers in the host state, on the other hand, could be prejudiced by the use of ATMs beyond a bank’s brick-and-mortar reach. Since ATMs cannot be used to establish a lending relationship, but can be used to gather deposits, they facilitate the flow of capital from the areas within which they are allowed to take deposits to the areas within which the bank is able to make loans. Retail borrowers within the bank’s brick-and-mortar branching area, and commercial borrowers in whatever area(s) the bank reaches them, would thus benefit at the expense of retail borrowers in the areas from which the bank is taking funds through ATMs.

Of course, as a matter of policy, the bank could decide or be required to re-lend those deposits in the areas from which they came, by means that are not dependent upon having a brick-and-mortar presence in order to make loans. Deposits gathered through ATMs in state $A$ by a bank in state $B$ could be re-lent to residents of state $A$ through the issuance of bank credit cards or, to the ex-
tent allowed under the affiliate-transaction regulations,\textsuperscript{685} through consumer finance or other nonbank lending offices of the BHC located in state A. In the absence of a legal norm, however, there is little reason to expect this congruence between interstate deposit-taking and lending areas.\textsuperscript{686}

Allowing ATMs that access banks across state lines while prohibiting interstate brick-and-mortar branching does only little to redress the inequities of the current regulatory regime. As between banks in growing markets and those in declining markets, there would be some redress, but only for some banks. In particular, those banks whose physical presence is limited now to the inner-city area of an interstate SMSA would gain some access to more desirable suburban markets, unrestricted by the limitations of state law or state boundaries. For example, banks in Philadelphia could have deposit-taking ATMs in three suburban counties in New Jersey.\textsuperscript{687} As between banks in declining and those in growing regions of the country, however, opportunities would not be meaningfully equalized. The ability of a bank in Pittsburgh to take deposits statewide, or of a bank in Philadelphia to take deposits both statewide and interstate within its SMSA, does not put those banks on an equal competitive footing with the banks of the South and West, which would also have statewide ATM authority. Even the ability to take deposits at ATMs nationwide would not give the Pennsylvania banks in this example an equal chance to compete for the core deposits of Florida or California residents because of the severe limitation inherent in having only an electronic terminal presence within a market.

The same limitation makes the proposal for less restricted interstate ATM authority relatively innocuous in its implications for soundness supervision, policy guidance, and the undue concentration of resources. An ATM outside the area in which a bank can have offices is not a significant enough marketplace force to raise such concerns.

Soundness supervision could be complicated, however, to the extent that ATMs accept deposits in a host state. The host-state


\textsuperscript{686} At present, the Community Reinvestment Act of 1977, § 801, 12 U.S.C. §§ 2901-2905 (Supp. III 1979), does not appear to impose lending obligations in areas from which deposits are taken by ATMs, but it could be amended to so provide.

\textsuperscript{687} Burlington, Camden, and Gloucester Counties of New Jersey are within the Philadelphia SMSA. \textit{Statistical Abstract}, supra note 643, at 942.
banking commissioner might understandably assert his state's interest in examination and soundness-oriented regulation of the bank—such as lending limits, reserve requirements, and liquidity ratios—at its home-state location; obviously, examination of the ATM is not a meaningful alternative, as examination of a branch might be where an out-of-state bank is taking deposits in the host state by that means.

If the out-of-state bank is a national bank, it is not subject to such state examination or regulation even in its home state; and there is no greater need to subject it to examination or regulation in the host state than in its home state. If the interstate ATM is that of a state-chartered bank, however, there would be no constitutional inhibition on the host state asserting visitatorial rights, although the federal law authorizing the interstate ATM could probably, under the Commerce Clause, immunize the state-chartered bank from host-state examination and regulation. Such immunity would put the state-chartered bank in a position of competitive equality, with respect to out-of-state ATMs, with national banks located in its home state. It could also, however, put them at an advantage or disadvantage relative to host-state banks. For example, if the out-of-state banks are subject to less burdensome regulation than host-state banks, they will be able to offer superior terms to depositors; with Regulation Q removed, out-of-state banks with lower regulatory costs could pay more than host-state banks for deposits. As a result, home-state and host-state banks would be brought into competition with one another through interpenetration of each other's markets with ATMs; one would then expect that home-state and host-state regulators would also engage in some of the type of rivalry presently attributable to state and national regulators within a single state. In this way, giving state banks a federal right to take deposits through out-of-state ATMs within interstate SMSAs may induce competition in supervisory laxity between the affected states.

With respect to policy guidance, ATM authority to take deposits interstate could tend to frustrate the policy that local deposits be used to fund local extensions of credit, as already described in the discussion of consumer-welfare implications above.\textsuperscript{688} With respect to the undue concentration of resources, deposit-taking across state lines only in interstate SMSAs should have little effect. Its effect on market concentration, indeed, will probably be beneficial,

\textsuperscript{688} See text accompanying notes 684-686 supra.
since it will introduce new competitors for deposit services into each part of an SMSA now divided into submarkets by one or more state lines. At the same time, there is no reason to fear that deposit-taking in a single interstate SMSA could result in an unduly large aggregation of assets.

Thus, application of the standard criteria indicates that the proposal to extend ATM authority interstate is of little significance except insofar as it would allow deposits to be taken interstate, particularly within an interstate SMSA. Compared with the present state-by-state regime, that would clearly be an advantage to depositors, entailing a potential but probably curable drawback for retail borrowers, and only a very speculative threat to soundness supervision.

Compared with interstate market penetration by whichever means banks choose—ATM or brick-and-mortar—it is clearly a second best choice, however. Since it has already been established in this essay that banking organizations should be allowed to operate full-service facilities nationwide, the question presented here is whether that authority should be limited to providing electronic access services. Clearly, it should not be; consumer and producer welfare, and the public interest in equitable regulation that make nationwide banking desirable, would all be disserved by such a limitation.

The distinction between the geographical reach of ATMs and brick-and-mortar offices is not directed to the correction of an externality; therefore, to the extent that the legal regime induces greater investment in ATMs and lesser investment in brick-and-mortar branches than would have occurred were the two forms of market entry equally available, both consumers and producers will be relatively worse off. In other words, the ability to establish an ATM interstate serves consumers and producers better than a prohibition upon such activity, but less well than would the ability to establish either an ATM or a brick-and-mortar branch at the same location. If the brick-and-mortar branch would have been preferred as a matter of business judgment, then it may be presumed that the bank's customers and shareholders are less well off by being limited to the ATM option. Even more clearly, bank employees are prejudiced by a legal regime that creates noneconomic

incentives for capital-intensive and labor-saving means of expansion.

Such problems as nationwide banking would create for soundness supervision, policy guidance, and avoiding an undue concentration of resources, would be averted by the limitation only because it would prevent effectively achieving the nationwide banking system that should exist. Accordingly, limiting interstate banking—i.e., deposit-taking—to ATMs would entail losses to consumers and producers without offsetting gains, and should be rejected in favor of allowing banks to choose their method for entering interstate markets.

C. Multistate BHCs vs. Interstate Branching

In prior sections it has been established that banking organizations should be allowed to operate nationwide, and that their presence outside of their home states should not be limited to electronic terminals. If a single banking organization is to have a brick-and-mortar presence in more than one state, however, it must be determined whether it should be allowed to choose between direct interstate branching and the incorporation of a separate BHC subsidiary bank in each state that it enters, or be required to enter by one means and not the other. In fact, however, there has never been any reason to require direct branching in an intrastate context, and that option will not be considered here for the interstate context. Accordingly, the present issue is whether to leave banks their choice of form on entering an additional state or require that they incorporate a separate bank in each state under some or all circumstances. Before applying the standard criteria to this question, it seems only appropriate to specify what is logically entailed or implied by the choice of organizational form.

Most clearly, the organization of a separate bank in each new state of entry requires the observance of certain corporate formalities. The separate bank must have directors and officers, for example. If these individuals can be the same persons who are the directors and officers of the sister banks in other states (A), then

690. The laws of one state, Washington, nonetheless have the same effect, since statewide branching is allowed while multibank holding companies are prohibited. See Wash. Rev. Code Ann. §§ 30.04.405, 40.020 (Supp. 1981). This combination is unique. See M.A. Schapiro & Co., Inc., Confinement of Domestic Banking in the United States 10 (Oct. 1978) (map showing state policies on branch banking and BHCs).

the maintenance of a nominally distinct table of organization in the new state (B), is of literally no consequence in this regard. If different individuals must be involved, however—and if that requires some redundant employees—the BHC will incur a cost that could have been avoided with direct branching. Analytically this cost, and any other associated with maintaining separate banks, is in the nature of a barrier to entry into state B. Other formality costs of using the BHC approach may include separate and greater total legal fees, audits, examination fees, and increased state taxes.692

A bank separately organized to operate in state B will require local management, but so too would a branch operating in state B. While it might be thought likely that a locally organized bank, with its own officers, directors, and managers, would be more accountable to local interests, and specifically that it might lend more to local borrowers and generally be more amenable to local policy guidance, this is not a logical necessity.693 The authority of local managers to extend credit or acquiesce in the policy guidance they receive may be just as limited or capacious whether they are bank managers or branch managers; that is a matter of organizational policy respecting the devolution of authority, and not inherent in the table of organization imposed by the legal structuring of the entity as a holding company.

There are two respects in which the choice of form could have meaningful consequences which should be considered in applying the standard criteria. First, a single bank would have a higher lending limit—the maximum amount it could lend to any one borrower—than would any of the separate banks that would be organized in each state under the BHC approach. This follows from the fact that lending limits are set at a percentage of bank capital,694 as defined by the federal regulatory agencies and the states. If the same capital is divided to support two or more banks, each will have less—and a lower lending limit—than would a single

692. For example, Florida imposes a documentary stamp tax, FLA. STAT. ANN. § 201.01 (West Supp. 1981), and an intangible property tax, id. § 199.032, on loans made and held within its jurisdiction. A separately organized BHC bank subsidiary operating in Florida would incur these taxes, whereas a branch of an out-of-state bank may, like an LPO, be able to avoid them by booking the loan to its headquarters office. Cf. Florida Bankers Prepare for Fight to Bar Out-of-State Banks From Soliciting Loans, Wall St. J., May 13, 1980, at 21, col. 1 (loans originating through Florida LPOs exempt from state taxation).

693. See text accompanying notes 179, 413-415, supra.

694. See 12 U.S.C. § 84 (1976); STATE BANKING LAW SERV., supra note 3, at 126-29 (state limits on commercial bank loans to one borrower collected).
bank. If one bank participates in a large loan to its affiliate banks, however, their lending limits can effectively be aggregated, although at the expense of some transaction costs.695

Second, under the BHC approach, neither the parent holding company nor any subsidiary bank stand behind the obligations of the other subsidiary banks in the system. Indeed, that is reflected in the separate corporate organization, lending limit, and reserve calculation described above. In contrast, each branch of a bank can draw upon the assets of, and is exposed to the liabilities of, the whole bank of which it is a part. Depositors and creditors will therefore be doing business with very different entities under the multistate BHC and direct interstate branching approaches. BHC subsidiary banks in each state will be smaller, and geographically less well diversified, but they will also be entirely within the examination capabilities of each of the states that they enter.696

As shown below, the standard criteria slightly favor direct branching, but the maintenance of the dual banking system seems to require that the states generally be allowed to require that an out-of-state BHC or bank enter their borders through a separately organized bank subsidiary. A federal right to enter by direct branch might be appropriate, if all the facts were known, for wholesale banking purposes and probably within interstate SMSAs.

1. Consumer Welfare.—Retail depositors’ interest in bank soundness will not be affected by the choice between allowing interstate branching and requiring multistate BHCs. No significant risk of failure is implied by either choice of form, under the reasonable assumption that regulators will continue to administer entry policies with due regard to soundness. It is true that BHC banks tend to be more highly leveraged than unaffiliated banks in the state-by-state banking system,697 but that has had no adverse affect on their soundness, and indeed, the failure rate of multibank BHC banks is lower.698 Since, in addition, the BHC form promises

695. See, e.g., 12 C.F.R. § 250.250(c) (1978) (procedure by which limitation on extension of credit imposed by 12 U.S.C. § 371c may be avoided).

696. There is a third, but minor, respect in which the choice of form matters. A single bank would have a marginally higher total reserve requirement than would separate banks with the same aggregate volume of deposits because reserves are generally required at an increasing percentage of incremental deposits. See 12 C.F.R. § 204.8 (1981); CSBS PROFILE, supra note 19, at 123-25. Distributing the same total of deposits among separate banks therefore decreases the burden of required reserves imposed upon the banking organization as a whole.


698. “About 0.6 percent of the unit banks and about 0.4 percent of the branch
no greater local orientation in bank lending policies, neither retail borrowers nor retail depositors have a stake in the choice-of-form issue.

Some commercial borrowers would, however, benefit from direct interstate branching because it implies the existence of a larger bank with a higher lending limit. This would mean that, with interstate growth, more banks could compete for larger loans, and that the market in which intermediate and perhaps even large corporations shop for credit would become more competitive. Smaller corporate borrowers, with needs that already fit within the lending limits of a large number of banks, would be unaffected by the choice of form.

All consumers would benefit to the extent that there are scale economies that could be realized in the provision of services to them by a single bank but that would be lost under the BHC approach. For the very large banking organizations that would probably operate in many states, most scale economies could probably be about equally well realized under either form. Whether one has 1,119 branches, as the Bank of America has in California, or 21 subsidiary banks with a total of more than 800 branches, as Western BanCorporation has in 11 states, many of the internal operations of the enterprise could be configured in whatever is the most efficient way. For nationwide and large regional interstate banking organizations, it will usually be of little moment, that is, whether the managerial and technological units supplying operations services—such as advertising, account data processing, loan applications analysis, credit scoring, and so on—are placed within the home office of an interstate bank or in a bank-servicing subsidiary of the BHC.699 or whether the units that they supply with services are labeled branches or banks.

For smaller banking organizations, maintaining separate banks in each of perhaps two or three states may be prohibitive, depending upon the various costs of maintaining formally separate legal entities, itemized above. This is most clearly likely in the interstate SMSAs in which many relatively small banks would want to straddle the state line or lines that divide the metropolitan area among two or three states.700 Indeed, such banks may wish to open just one or a few small offices in a host state; at this modest

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scale, separate organization of a bank in that state may well preclude entry. If so, then consumers will not realize some of the potential benefits of interstate banking within an SMSA.

In summary, consumer welfare is probably only modestly affected by the choice-of-form issue. Some large and intermediate corporate borrowers would probably benefit if already large banks are allowed to enter additional states by direct branching, thus increasing their lending limits as they grow. Some retail consumers would almost certainly be better off with interstate branching in metropolitan areas where the BHC approach would result in fewer interstate entrants to serve them.

2. Producer Welfare.—Bank profitability, and thus the interests of shareholders, will be served to the extent that banking organizations expanding interstate are allowed the choice of form—bank or branch—that is most profitable for them. It might at first seem, by parity of reasoning, that shareholders of host state banks that do not expect to enter interstate markets would be better served by anything that impairs the competitive ability of the out-of-state banks that will be entering their markets; accordingly, they could be made better off if the BHC approach were imposed upon their would-be competitors, since this will lower the entrants’ lending limits and may prevent them from realizing some economies of scale.

The apparent conflict between the interests of shareholders in banks expanding interstate and those faced with their competition in host states is something of an illusion, however, since risk-averse investors, necessarily uncertain of the competitive outcome, will diversify their investments across the conflict. And an investor with a portfolio of shares in interstate and host state banks would be benefited by total industry profitability. Such an investor will be indifferent to whether a marginal dollar of profit is realized by an interstate or a host state bank, and concerned only that both types of banks are able to realize all possible economies and thus maximize their joint profitability. In other words, once it has been determined that there will be interstate banking, and thus increased competition, investors are going to be concerned with productive efficiency. Legal rules that prevent operational efficiency will harm producer interests, as they would harm consumer interests. Thus, to the extent that banks expanding interstate would find it more economical to branch directly than to form a separate bank in each state, diversified bank shareholders are served by having that option.
Bank employees should be close to indifferent to the choice-of-form issue. The opportunities for advancement within their banking organization should not be affected by whether the organization is composed of a single bank with many branches or a BHC with one subsidiary bank per state and branches of those banks where state law allows. The BHC approach might require that a larger number of employees be given officers' titles, and this may be regarded as a dignitary benefit by some.

An increase in the demand for bank employment would provide a more tangible, and probably more highly valued, benefit to bank employees. Since direct branching authority, being pro-competitive, will result in greater interstate (and overall) banking activity, the interests of employees as a group would be served by banks having that option. The employees of particular host state banks that will not be expanding interstate may be worse off, however, since their employers' demand for labor may decline; moreover, they cannot practically diversify their interests, as by working part-time for their present employer and part-time for its new interstate competitors.

In summary, it seems that all bank shareholders (who can diversify) but only some bank employees (who cannot diversify) would be made better off if banks were not required, in expanding interstate, to establish separate BHC subsidiary banks in each state. Their interest is in having the bank(s) on which investment or employment opportunities depend operate as free as possible of legal barriers to the most efficient choice of form.

3. Equity of Regulation.

a. Banks in Different Markets.—One of the inequities of the present state-by-state banking system has been that it confines some banks in declining markets while others have fortuitously enjoyed the benefits of regional growth. In general, the choice-of-form issue will not much affect the degree to which this inequity is eliminated by moving to nationwide banking. Of course, if the organization of a separate bank in each state proves to be a substantial barrier to entry, the redress will be less than complete. In any event, there is one type of market to which direct branching access may be important for a remote bank to compete effectively. The reference is to the wholesale banking markets of the major financial centers such as New York, Chicago, and San Francisco; regional fi-

financial centers, such as Atlanta, Boston, and Dallas might also be included in this group.

At present, out-of-state banks are represented in these wholesale markets by various combinations of commercial LPOs, equipment leasing and data-processing subsidiaries, and Edge Act corporations, which can engage in banking related to international transactions. In order to provide the full range of deposit services to their large corporate customers in these wholesale markets, out-of-state banks would find it more convenient to open direct branches than to incorporate a separate bank. In the context of the wholesale market, moreover, the observance of the formalities, reserve requirements, and lending limits applicable to a separate bank in each state (e.g., New York, Illinois, and California) would not seem to be relevant to public policy.

For example, assume that a large Chicago bank establishes a separate wholesale-oriented bank in New York. Providing cash management, lock box, and related deposit services to corporate customers, the New York bank might receive hundreds of millions of dollars in deposits daily, but retain very little of that money on its own books at the end of the day. Funds that were not transferred out of the BHC system to other banks would presumably be transferred to the lead bank in Chicago for aggregation before being invested on behalf of the depositor. Thus, as a practical matter, the deposit-taking bank in New York would be little more than a conduit through which the lead bank in Chicago would offer deposit services to corporations and gather the deposits to itself; whatever name it is called, it would, in effect, be a branch, and would not incur a separate reserve requirement of any magnitude, nor book any loans itself (except to the extent of its required capital).

In the example just given, it may actually be a matter of little moment to the large Chicago bank whether it must organize a separate bank in New York. Doing so would entail more bother than opening a branch, perhaps, but whether it would have substantial drawbacks or would place the out-of-state competitor in wholesale markets at a disadvantage relative to host state banks is unclear.

If there are non-obvious reasons that would indeed make the organization of a separate bank for the purpose of carrying on business in a wholesale market burdensome, then consideration should be given to distinguishing between out-of-state wholesale and retail banking operations. The choice-of-form issue with respect to retail banking could be decided on its separate merits, while banks are given the right to branch directly into specified financial centers for
the purpose of establishing wholesale-oriented branches. Analogous to Edge Act corporations, these branches could be limited to accepting deposits from and making loans to business entities and individuals in connection with business transactions.

b. Grandfathered BHCs.—The regulatory advantage enjoyed by the domestic multistate BHCs grandfathered in 1956 will obviously be eliminated regardless of how the choice-of-form issue is resolved. This is not true of the multistate foreign banks, however.

In the absence of a federal law preventing them from having a multistate presence, foreign banks until 1978 were subject only to host-state law respecting the choice-of-form by which they entered a particular state. Some states allowed foreign banks the option of branching in directly. New York and California, significantly, made direct branching contingent upon reciprocal treatment of their banks in the foreign banks’ home country, but allowed the banks of non-reciprocating countries to obtain a state bank charter—which strongly suggests that a branch is the more desirable form of entry into that wholesale market.

Under the International Banking Act of 1978, a foreign bank operating branches, agencies, or subsidiary banks in more than one state was required to choose a “home state” outside of which it could no longer establish any entity that accepts deposits other than a branch that, by agreement with the Fed, restricts itself to the activities permissible to an Edge Act corporation. Thus a foreign bank that wants to enter a second state for the first time after 1978 is at no advantage, with respect to interstate operations, over a domestic bank; each is limited to full-service banking in one state, may own Edge Act or agreement corporations in other states, and through its BHC may engage nationwide in permissible nonbanking activities. Therefore, there will be no difficulty in applying the same choice-of-form rule to domestic and recent and future foreign-bank arrivals when they seek to expand interstate.

Redressing the advantage now enjoyed by some foreign banks that were able to choose whether to expand interstate by branching or subsidiary banks, chose to branch, and were grandfathered in 1978, is slightly more problematic. The correction of this inequity

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702. See text preceding note 270 supra.
703. See, e.g., MASS. GEN. LAWS ANN. ch. 167, § 37A (West 1971).
704. See CAL. FIN. CODE § 1756 (West Supp. 1981); N.Y. BANKING LAW § 202-a (McKinney 1971); cf. TEX. CONST. art. 16, § 16 (foreign banks prohibited from operating in Texas in any form).
would require either giving domestic banks their choice of form in interstate expansion—at least when they seek to enter states that previously allowed foreign banks that choice—or if domestic banks are limited to the BHC approach, requiring foreign banks either to close or convert to separate banks all of their branches outside of their “home state”. Giving the domestic banks their choice of form would, of course, have the advantage of not disrupting the existing, lawful branch relationships of foreign banks. Thus, while either approach to redressing the inequity would be equally effective, it would perhaps be less costly to give domestic banks their choice of form rather than to require foreign banks to reorganize themselves.

c. Banks and their Nonbank Competitors.—Credit unions do not have to organize separately in order to operate offices interstate. If savings and loan institutions and holding companies are authorized to operate interstate, they too will be able to branch directly rather than having to organize affiliates. Brokerage houses also operate through direct branch offices in multiple states without limitation. So, too, do the retailers, such as Sears, Roebuck, that are contemplating selling small denomination consumer thrift notes at their nationwide chains of stores. In short, all of the non-banks with which banks are now or may soon be competing for deposits are allowed, to the extent that they operate interstate, to choose whether to organize separate entities in particular states or to open direct branches. An inequity of regulation thus exists to the extent that requiring banks to organize separate affiliates in each state would be costly or otherwise inconvenient, and the same burden would not be felt by their competitors. This is undoubtedly a minor consideration, but one that counts against requiring the BHC approach to interstate banking.

4. Soundness Supervision.—Regardless of whether banks are allowed to branch directly interstate or required to form affiliates in each state that they enter, it is desirable that the entire banking organization be examined simultaneously. 706 As previously observed, the difficulties of arranging a coordinated, and especially a simultaneous and uniform approach to examination increases with the number of examining jurisdictions involved.

A BHC with separate bank subsidiaries in each state of operation does not necessarily implicate more jurisdictions, however; if all of the BHC subsidiary banks have national charters, then only the Comptroller will examine them, while the Fed will examine

706. See text accompanying note 194 supra.
the parent BHC. On the other hand, if the subsidiary banks are chartered by the states in which they operate, they will be examined by their state regulators and by the FDIC or by the Fed. These two situations are not altered under the direct branching approach to interstate banking. If the bank that branches interstate is a national bank, it will still be examined by the Comptroller alone. If it is a state bank, then it may be examined by the FDIC or the Fed and by each of the states in which it has deposit-taking branches.

The desirability of simultaneity of examination is greater with respect to a branch banking system than it is with respect to a group of affiliated banks. Limits on and records of interaffiliate transactions make it possible to examine affiliated banks sequentially and yet have substantial confidence in the accuracy and completeness of the picture that emerges. In a branch system, by contrast, overvalued assets may be kept out of the examiner’s view if the branches are not examined simultaneously. Of course, simultaneity in examining branches can be achieved readily if the Comptroller or a single state is the only examining agency. If there are multiple states involved in the examination process, however, either they will coordinate their efforts and examine the banks simultaneously, or the chartering state will examine all of the branches and the various host states will separately decide whether to conduct their own examinations of either the branches in their states or of the entire system.

It seems, therefore, that the potential for duplication, disruption, and expense in supervision is least with a national bank branching interstate, greatest where a state bank branches interstate, and somewhere in between where a BHC organizes separate banks in each state. A national bank branching directly implicates only the Comptroller, while a BHC with banks in each state can be examined simultaneously by the Comptroller examining the national bank subsidiaries, the FDIC examining the nonmember state bank subsidiaries, and the Fed examining the parent and the member state bank subsidiaries. If the states want to duplicate these efforts by examining the state bank subsidiaries (and perhaps the parent BHC),707 they would be free to do so. Examination complexity

707. The Bank Holding Company Act of 1956, § 7, 12 U.S.C. § 1846 (1976) provides that the Act “shall not be construed as preventing any State from exercising such powers and jurisdiction which it now has or may hereafter have with respect to banks, bank holding companies and subsidiaries thereof.” Some states have asserted
and practicality is not, therefore, as much affected by the choice-of-
form, i.e. branch vs. BHC, as it is by the choice of charter(s).

Soundness supervision (and perhaps also policy guidance) may
be made more difficult if banks are allowed freely to choose be-
tween state and national charters in the context of interstate bank-
ing as they are presently allowed to do intrastate. Under the state-
by-state banking system, a multibank BHC may, and typically
does, have both national and state-chartered subsidiary banks. This
enables the BHC to maximize its incidental or nonbanking powers.
When banks are allowed to operate in multiple states, they will
find it advantageous to operate banks with state charters in those
states with liberal policies respecting bank powers. Indeed, since
the acquisition of a state bank charter with broad powers may ena-
ble the BHC to engage in a new line of business nationwide, so
long as all such business is directly or indirectly (i.e., through a
subsidiary of the bank) conducted by or booked to the appropriate
state bank,\footnote{See note 710 infra and accompanying text.} the states will find that they are competing with one
another to attract banks. This competition among many jurisdic-
tions may be much more vigorous than the competition that has
previously obtained between state and national regulators within
each state.

Only a modest amount of imagination is required to envision
how this competition will work, particularly in light of the models
that now exist in the relationships between Citicorp and South Da-
kerja and between the Chase Manhattan and Morgan banks and
Delaware. In the Citicorp and South Dakota case, it will be re-
called, the state was induced to pass legislation enabling an out-of-
state BHC to establish a single national or state bank subsidiary
with one office in the state “at a location which is not likely to at-
tract customers from the general public in the state.”\footnote{S.D. CODIFIED LAWS § 51-16-41 (1980); see text accompanying notes 435-440 supra.} The plan
was to enable Citicorp to obtain a national bank charter and then,
under the provisions of the National Bank Act applying the usury
law of a national bank’s home state to its loan transactions, to solicit
credit card customers throughout the country. South Dakota also
repealed all limitations on interest rates, making it the ideal “base”
state for this operation.

\footnote{See, e.g., MASS. GEN. LAWS ANN. ch. 167A, § 5 (West 1971).}
Suppose, however, that South Dakota's appetite for economic development were not satisfied by the establishment of a card-oriented national bank subsidiary of Citicorp. The state might then amend its banking laws to provide that a state bank in South Dakota may engage in, say, the travel agency business. Citicorp (or any other out-of-state BHC) could then establish a state bank subsidiary primarily for the purpose of entering the travel agency business. The state bank would establish a travel agency subsidiary, and that company would presumably be able to operate interstate without limitation. The Fed would not prevent this activity, pursuant to its view that state-chartered banks are free to exercise their state-granted powers, regardless of the fact that they happen to be subsidiaries of BHCs that are otherwise limited to activities "closely related to banking." 710 The host states of the travel agency would not be able constitutionally to prevent its entry, since it would neither be engaged in the unchartered business of banking nor otherwise triggering a police-power concern. 711 Thus, when the travel agency opens an office adjacent to (or perhaps within) a branch of Citibank in New York, or in any state-bank subsidiary of Citicorp in any state that does not allow banks to operate travel agencies, the National Bank Act and the banking laws of the relevant host state respectively will have been circumvented.

In this example, Citicorp will have been admitted to the travel agency business by South Dakota, presumably in return for some consideration. It would not take long for another state, say North Dakota, to offer the same powers for a lesser consideration to another out-of-state BHC, or to offer its own package of banking powers at an appropriate price. At the limit, North Dakota might give

710. A state's ability to grant nonbanking powers to state banks is not entirely unlimited, since one of the factors to be considered by the FDIC in issuing a certificate for a bank to become insured is "whether or not [the bank's] corporate powers are consistent with the purposes of [the Federal Deposit Insurance Corporation] chapter." 12 U.S.C. § 1816 (1976). While a state bank might be authorized to engage in a wide variety of nonbanking activities that did not constitute "unsafe or unsound practices" such as to warrant the termination of its insurance, see id. § 1818 (1976 & Supp. III 1979), the exercise of such powers by a newly-chartered state bank might be viewed by the FDIC as inconsistent with the purposes of the statute, making it ineligible to become insured under the standard of section 1816. The result would be that newly-chartered state banks given unorthodox powers could not become insured; at the same time, however, existing state banks newly authorized to exercise the unorthodox powers would command still greater economic rents since the potential for new entry is ended. See id. § 1842(e) (1976) (BHC subsidiary banks must be FDIC-insured).

banks the same powers that general business corporations have, viz. to enter any lawful line of business. A BHC that obtains a North Dakota charter for the purpose of conglomeration would then be able to enter, through its North Dakota bank, any business except that of dealing in securities, since federal law prohibits any firm "engaged in the business of issuing, underwriting, selling, or distributing . . . securities" to engage also in the business of taking checking or savings deposits.\(^7\)

Thus, if BHCs are allowed, without more, to expand interstate through subsidiary banks in each state, they will be able to exploit a new form of bank regulatory competition, \textit{i.e.}, that between the states. This possibility could be completely eliminated by either of two means. First, banking organizations could be \textit{required}, when crossing state lines, to do so by direct branching—an option not under consideration here.\(^1\) Second, multistate BHCs could be required to hold all national charters, or at least to do so outside of their present home state. Since this approach would surely foretell the demise of the dual banking system, however, it need not be considered, under the assumption previously made in this essay that a move from state-by-state to interstate banking must occur within the context of the dual banking system.

There are two less drastic, albeit quite imperfect, responses that could be made to limit regulatory competition among the states, and they should be considered in any event, whether a banking organization is required or only allowed to use the BHC approach in going interstate. First, the Fed could be directed to apply the BHC Act’s limitation on permissible activities to state bank subsidiaries of out-of-state BHCs. Citicorp, that is, would not be able to use a South Dakota bank charter to engage in activities (at least outside of South Dakota) that would not be permitted to the BHC under Regulation Y.\(^1\) Second, host-state-bank affiliates


\(^1\) See text accompanying note 690 \textit{supra}. If banks were required to expand across state lines by direct branching, it would be necessary to regulate their choice of a "home" state and to prevent home office relocations across state lines to keep the states from competing for their patronage. \textit{Compare} 12 U.S.C. § 1842(d) (1976) (home state of multistate BHCs designated by law), \textit{with id.} § 3103(o) (Supp. III 1979) (multistate foreign BHCs choose "home" state from among those where it has operations) and \textit{French Bank's Choice of N.Y. Over Calif. Lets It Expand in 2 States}, Am. Banker, Apr. 3, 1981, at 1, col. 2.

\(^1\) If the limitations of Regulation Y did not apply to a state chartered bank subsidiary insofar as it operated at offices within its home state, competitive states could still authorize banks to engage in a variety of nonbanking activities that are
of multistate BHCs could be limited in the powers they can exercise (at least outside the host state) to those that are granted by the BHC's home state to state banks located there, and are permitted to host-state banks. This alternative is less intrusive on state authority and, since equally effective and administrable, preferable on that ground.

Either approach would still create competitive disparities, however, since state banks that are not the subsidiaries of out-of-state BHCs would, presumably, still be able to exercise all state-granted powers (both inside and outside their home state). That disparity may have to be tolerated, however. If it were not, either the states would be able, or competitively driven, to act as havens for the conferral of broad powers that could then be exercised in conjunction with banking subsidiaries in other states that do not allow their own banks to exercise the same power; or federal control over bank powers would have to be extended to all state banks regardless of their affiliation with a BHC, and the dual banking system will have been substantially altered.

In conclusion, the choice-of-form issue does not affect soundness supervision directly, whereas the choice of charters implicit in the dual banking system would, in the interstate context, threaten to induce a competition among states that could ultimately undermine soundness supervision. This would probably happen not through examination laxity, but through increasing liberality in the granting of powers to state banks, until they are essentially unlimited in their ability to engage in risky businesses. Regardless of how the choice-of-form issue is resolved, therefore, and of whether banks are required or simply allowed to form separate affiliates in host states, soundness regulation will require that multistate BHCs be prevented from using a base state bank subsidiary to expand the powers they exercise in other states.

5. Policy Guidance.—The ability of the state and national governments to influence banks with respect to certain public policies would probably be only marginally greater if banks could be required to form a new banking affiliate in expanding interstate.

The implementation of monetary policies will not be affected by whether the Fed is dealing with the management of a BHC or of a single interstate bank when it is doing such things as not currently permissible under Regulation Y and do not require a physical presence outside of the home state in order to reach nationwide markets. Examples would include insurance underwriting, manufacturing, and extractive industries.
influencing the allocation of credit, jawboning against remote disbursement services, and so on. Nor should the ability of states to obtain bank assistance in funding their public debt be affected. Under the implicit chit system, the bank will want to have good relations with the state in order to obtain approvals that are needed to open additional branches, exercise special powers, and so on, without regard to whether the first office that it opens in the state is separately chartered as a bank subsidiary of its BHC or is admitted as a branch of the out-of-state bank. Of course, if the host state is in a position to confer on a BHC subsidiary bank powers that could then be used by the BHC system nationwide, it will be able to obtain greater funding for its public debt because it will have more to offer. It has already been shown that this should not be allowed on supervisory grounds, however, so this method of increasing the demand for a state’s public debt should not be available regardless of whether banks are required or merely allowed to enter by the subsidiary route.

The national and state policies aimed at facilitating housing finance would seem to be unaffected by the choice-of-form question. So, too, with the policy that local deposits should be directed in some part to the funding of local credit needs. Indeed, the Community Reinvestment Act now makes that policy applicable to intrastate branches and unit banks alike, and could continue to do so interstate. If a host state wants to supplement CRA, it could do so under a branching approach by adapting the New York model for regulating the safety of foreign branches in that state, *i.e.*, requiring that certain “qualifying local assets” equal at least a set percentage of deposits booked at the branch.

Again, however, the choice of charters may be more important than the choice of form. Under the state-by-state banking system, state banking commissioners do not oversee the credit-allocating policies of national banks. Presumably, they would not be able to do so under an interstate banking regime, regardless of how the national bank entered: whether by branching into the state or, in the case of a BHC subsidiary, by locating in the state. The state banking commissioner does, however, have some potential influence on a national bank’s volume of local lending.

The Community Reinvestment Act directs the Comptroller to take a national bank’s “record of meeting the credit needs of its entire community” into account in passing upon the bank’s applications for new deposit-taking facilities.\(^715\) The Comptroller’s regula-

\(^{715}\) 12 U.S.C. § 2903 (Supp. II 1979); see id. § 2902(1)(A).
tions implementing CRA require national banks to make public certain information about their credit policies, which can then be used by "any interested person" to oppose, or request a hearing upon, the national bank's subsequent applications for deposit facilities. Thus, the host-state banking commissioner's ability to intervene as an "interested person" under CRA enables him to exercise some influence over a national bank's lending policies, although undoubtedly less influence than he can exercise with respect to state banks, over the applications of which he has the power of decision.

In summary, banks will be equally amenable to policy guidance from public officials in host states regardless of how the choice-of-form issue is resolved. National banks entering host states in either form would be more independent of local policy than state banks in their decisions to fund local credit needs, but will nevertheless be subject to some state influence under the CRA.

6. Undue Concentration of Resources.—State policy regarding undue concentrations of resources, in both the market share and the "mere size" senses, is significantly implicated in the choice-of-form question insofar as that policy is implemented through state laws governing branching and the permissibility of multibank BHCs. The states have taken extremely diverse positions on these issues of banking industry structure. Some have prohibited branching, while others allowed limited branching, and still others statewide branching; and in each of these three groups of states, some have allowed multibank BHCs while others have not. Thus, at the extremes, some states, have adhered to true unit banking, disallowing both branching and multibank BHCs, while others have imposed no structural limitations, allowing both statewide branching and multibank companies. The federal government has always deferred to these state decisions because of the importance of concentration policy in both economic development (market concentration) and the maintenance of democratic political processes (mere size). This deference lies close to the heart of the dual banking system; indeed, the proposition that the states would continue to determine the structure of the banking industry within their borders was implicitly subsumed in the earlier assumption

717. See M.A. Schapiro & Co., Inc., supra note 690, at 10; text accompanying notes 182-184 supra.
718. Of course, the states are today subject to federal limitations on their ability to determine banking structure, as found in the Bank Merger Act, the BHC Act, and
that the dual banking system would continue to exist when the state-by-state banking system is replaced by nationwide banking.

States that adhere to unit banking and prohibit multibank BHCs are declining in number. Those that remain are obviously, however, still animated by a distaste for large banking organizations, since a concern with competition alone would not justify either limitation. Indeed, allowing statewide banking organizations could be more conducive to vigorous competition in local banking markets for the same reason that nationwide banking, properly administered, would be pro-competitive in those same markets.

The varying degrees to which the several states are sensitive to the risk of an undue concentration of resources and its centrality to dual banking suggest that the choice-of-form issue in interstate banking should be resolved in such a way as to minimize the intrusion upon state sovereignty over market structure. This clearly counsels in favor of the BHC approach, since only a separate banking subsidiary in any given state, whether state or nationally chartered, could be subjected to the limitations of state law respecting branching and multibank BHCs. To be sure, under the branching approach to interstate banking, the out-of-state bank entering a host state that prohibits or limits branching could be limited to one (or limited) location(s), and thus put into a position of competitive equality with host-state banks. In the eighteen states that prohibit or limit branching but permit multibank BHCs, however, deference to state policy, and thus equal treatment for out-of-state and host-state banks, is impossible under the branching approach. These states, in effect, permit a single banking organization to have multiple locations, while requiring them to operate as separate organizations, separately chartered, under separate names, in different parts of the state. It is simply impossible to apply this scheme to multiple branch locations of a single out-of-state bank. A single branch might be opened consistent with the plan, but no

the antitrust laws, and these qualifications are assumed in the proposition referred to in the text. But see G. Oldfield, Implications of Regulation on Bank Expansion 123-24 (1979) (state branching and BHC law "appears much more powerful than [federal mergers and acquisitions] regulatory policy in influencing the competitive outcomes in local banking markets.").


720. One can only speculate about the possible reasons for this state policy. The states may believe this approach limits the cumulative power—economic or political—that the banking organization can achieve, increases the local responsiveness of its units, or perhaps facilitates its dismemberment should that become necessary.
more. On the other hand, an out-of-state BHC could establish or acquire state or national banks chartered within the host state in complete conformity to the state law on banking structure.

Under the branching approach, state policy on market structure would have to be disregarded, then. An out-of-state bank would be allowed to operate a group of branch banks, in derogation of state policy, and to the competitive detriment of host state banks subject to a unit or limited branching rule but jointly owned by multibank BHCs. Experience reveals that multibank BHCs in unit or limited branching states regard the necessity to maintain separate banks as a distinct disadvantage; for marketing reasons alone perhaps, they have frequently attempted to integrate their operations and present themselves as one entity to the public, thus giving rise to nice questions of "de facto branching." 721 If such unit or limited branching subsidiaries of a multibank BHC were now thrust into competition with an out-of-state bank's statewide group of branches, the host-state banks could justly claim to have been unfairly treated. Indeed, one could reasonably expect that states would simply be disabled, as a practical political matter, from maintaining their prohibition upon statewide branching if out-of-state banks could enter and disregard it. They would either have to allow statewide branching so that local banks could compete with out-of-state banks, or prohibit multibank BHCs, so that out-of-state banks could be held to one location in the same limited branching area as are host-state banks.

In effect, the direct branching approach to interstate expansion is completely inconsistent with continued state control over banking market structures. Either the states must be divested of their authority to determine market structure—including the right to determine what constitutes an undue concentration of resources—or interstate banking must be accomplished through the formation of a separate subsidiary bank in each state.

The first alternative is not unthinkable, of course. In our political federalism, however, the determination of what constitutes an undue concentration of resources is appropriate at both the state and federal levels, because of the relationship of that concept to democratic political processes, which function at both jurisdictional levels. To the extent that a concentration of resources is "undue" because it threatens to have an unwanted influence over the polity,

721. See, e.g., Commercial Nat'l Bank v. Board of Governors, 451 F.2d 86 (8th Cir. 1971).
that is, both the state and national polities must be considered.

Although federal preemption is, by definition, inconsistent with this consideration of state democratic processes, a policy of continued deference to state determinations of the question is not inconsistent with any determination made at the national level. Indeed, it was noted previously that banking enterprises operating in a multistate region of the country, let alone nationwide, might grow large enough to constitute an undue concentration of resources. For that reason, it was suggested that banks approaching a certain size could be required to reorganize themselves into two banks in order to facilitate their division into separate companies upon reaching the maximum permissible size. The BHC approach to interstate banking, if adopted in order to enable the states similarly to determine the maximum size and market concentration that a bank should be allowed within their borders, will only make it easier to remedy any undue concentration that arises at the national level; interstate banking enterprises will already have been organized along state lines. Should it become necessary to require the mitosis of such an enterprise, no physical reorganization of the company would be necessary. It could be required merely to spin-off certain of its bank subsidiaries, thus dividing itself into two or more entities each operating in a set of contiguous states.

7. Summary and Conclusion.—From the foregoing application of the standard criteria to the question whether a bank should be required to form an affiliate for the purpose of entering each new state, rather than be left free to decide whether to enter through such a subsidiary bank or to branch directly into the host state, it appears that the BHC approach is required if the dual banking system is to be preserved. Indeed, little else is at stake.

Considerations of consumer welfare, producer welfare, and the equity of regulation slightly favor allowing banks their choice of form in interstate entry. Considerations of soundness supervision seem slightly to suggest that the BHC approach would be superior. These conflicting indications are dwarfed, however, by the implications of direct interstate branching for the states’ ability to determine for themselves what constitutes an undue concentration of resources.

The direct branching approach was seen to be quite inconsistent with the maintenance of state control over local banking market structures. Divesting the states of this control, while not technically an assault on the dual banking system, substantially weakens its underpinning. Once the states have lost their ability to
determine whether and to what extent to allow branching and multibank BHCs, little justification will remain for the dual banking system, as was clearly recognized in enactment of the McFadden Act and the Douglas Amendment to the BHC Act. Indeed, the benefits of federalism will have been lost and the mixed blessing of regulatory competition, which was wholly unintended in establishing the national bank side of dual banking, will have been retained.

Based on this analysis, the following conclusions may be reached. First, the states should be allowed, if they so choose, to require that out-of-state BHCs enter their territory by means of a separate bank subsidiary operating in that state alone. If a state is indifferent to the matter, then the only reason for federal law to require such separate organization would be to facilitate any later required mitosis of the interstate banking enterprise. If the previously suggested alternative approach to implementing that remedy—requiring a bank approaching the limit size to prepare for its mitosis—is acceptable, however, then there is no reason in federal law to require a BHC to incorporate a separate bank in a state that is indifferent to the choice of form issue. States that allow statewide branching, with or without multibank BHCs, would be unlikely to insist that an out-of-state BHC organize a separate bank within its borders, but there are only twenty-two states (and the District of Columbia and Puerto Rico) that allow statewide branching and even they may have their own reasons, perhaps concerning supervision, to prefer the BHC approach over direct branching in the context of interstate entry. In any event, there is no reason for federal law to oust them of their preference.

Second, the states should be required to accept a direct branch of an out-of-state bank only in those situations where it is the clearly superior alternative, as evaluated by the standard criteria. These include, of course, maintaining the integrity of state policy toward concentrations of resources, as reflected in state laws determining local market structure.

There are two situations in which direct branching may be the superior alternative. The first is in interstate SMSAs. It seems likely that much of the potential consumer welfare gain associated with interstate banking will be in these markets. If, however, the requirement of organizing a separate bank operates as a barrier to entry into the counties of the second or third state within an

722. STATE BANKING LAW SERV., supra note 3, at 85.
SMSA, as it might for small banks, then it should be suspended and direct interstate branching allowed within the SMSA to the extent that the host state allows intrastate branching. If the host state is a unit banking state, the out-of-state bank would be limited to a single branch there; if it allows multiple branches to host state banks, the out-of-state bank should be allowed multiple branches; and if it prohibits branching but allows multibank BHCs, the out-of-state bank should be allowed only one branch location and be required to operate additional banks if it wants multiple locations. This would assure that the consumer and producer welfare potential of interstate banking is realized to an extent that would otherwise be lost, without threatening the states' control over market structure.

The other situation in which states might appropriately be required to accept the direct branches of out-of-state banks arises where a bank seeks to enter a financial center solely in order to participate in the wholesale banking market there. A separately organized bank would act merely as a conduit through which the lead bank would provide deposit services to commercial customers. The wholesale bank would act as a cash management outpost, transferring its funds on a daily basis back to the lead bank in the BHC, and maintaining on its own books only the minimum capital required by its charter, and some offsetting commercial loans.

There does not appear to be any reason in public policy, as reflected in the application of the standard criteria, to require, or to allow the states to require, banks entering a wholesale market to organize a separate affiliate for that purpose. Unless some justification for such a requirement can be adduced, banks should be able to enter wholesale markets through direct branches if they so prefer. The banks' preference for branching suggests that producer costs would be lower, and therefore that consumer welfare would probably be served by allowing it.

It seems only reasonable that, before branching is disallowed as a means of entering wholesale banking markets, at least some public detriment from branching should be identified.


724. Producers will attempt to minimize cost, whether they operate in competitive or noncompetitive markets; the degree to which lower producer costs result in lower consumer prices is, however, a function of competition.
Wholesale branches in financial centers need not affect host state market structure decisions whatsoever. In unit states, the out-of-state banks could be confined to one location. No issue of statewide branching arises under any reasonable interpretation of what constitutes a financial center. Even under a capacious reading of that term, there would be more than one such city only in California, Pennsylvania, and Texas. Since California allows statewide branching, \(^{725}\) however, it would not offend state policy for an out-of-state bank to open direct branches in both Los Angeles and San Francisco. Pennsylvania allows limited branching and prohibits multibank holding companies\(^{726}\) so that a Pennsylvania bank cannot operate in both Philadelphia and Pittsburgh. According equal treatment to out-of-state banks branching directly into these financial centers would require that each such bank choose one of the two cities for its wholesale-oriented branch. Finally, Texas is a unit banking state that allows multibank BHCs.\(^{727}\) If both Dallas and Houston were considered financial centers, and if an out-of-state bank were allowed to branch into both of them, it would arguably be receiving more favorable treatment than a home-state bank located in either city and required to operate through an affiliate bank in the other city. In this limited circumstance, deference to the state’s decisions with respect to market structure would again require limiting the out-of-state bank to a single branch in one of the two Texas financial centers. Unlike the wholesale branch entrant into Pennsylvania, however, it could organize an affiliate bank in the other financial center city.\(^{728}\) Of course, in any financial center, if the out-of-state bank wants to take retail as well as wholesale deposits, it will have to abide by the host state’s market-structure rules and the requirement, if enacted by the host state, that it establish a separate bank in order to effect its entry to the retail market.

8. Notes on the Definition of a Branch.—One of the reasons given in Part I of this Article for examining the question whether interstate banking should be permitted was the difficulty under the state-by-state banking system of determining whether a particular facility is an interstate branch of a bank. If branching were completely unlimited, it was observed, there would be no reason for


\(^{728}\) At the same time, it should not be able to use two subsidiary banks based in different states to establish a branch in each of the Texas cities.
"branch" to be a term of art, since nothing would turn on whether something is characterized as a branch.\textsuperscript{729} Application of the standard criteria to the question whether a banking enterprise should be permitted to branch interstate has since shown that, outside of narrow and exceptional circumstances, direct branching may appropriately be prohibited and the BHC form required by the states to effect interstate entry. Under this approach, therefore, it will still be necessary to define the term "branch" in order to determine whether a bank's presence in a host state that prohibits direct branching is a branch.

It was also established in Part I that banks—especially the largest banks—can and do now operate interstate to a significant extent. They operate physical facilities, such as loan production offices and Edge Act subsidiaries; they provide services that do not depend upon a physical facility, such as cash management for corporations and credit cards for individuals; and they share the ATM networks of other banks to give their customers interstate access to accounts for all purposes except that of making deposits. Through the nonbank affiliates of their BHCs, banks are operating interstate facilities to extend consumer and commercial credit, provide trust services, investment advising, leasing, and data processing; in several states they are also operating industrial banks, a depository thrift type of institution.

In short, it has been shown that banks are able, directly or indirectly, to provide virtually all services other than deposit accounts interstate and indeed nationwide without running afoul of the McFadden Act's definition of a branch.\textsuperscript{730} Instead of asking whether interstate banking should expressly be permitted, therefore, the issue may be more narrowly posed as whether interstate deposit-taking facilities should be permitted. In other words, there has been implicit in all of the foregoing analysis an equation between commercial bank branching and deposit-taking.\textsuperscript{731}

\textsuperscript{729} See text accompanying notes 404-410 supra.

\textsuperscript{730} To be sure, insofar as their services entail "money lent" or "checks paid," they must operate through affiliates, and they do so. Insofar as they want to take deposits, however, they are unable to do so, even through an affiliate.

\textsuperscript{731} If the issue is re-cast in terms of this equation, then the answer derived thus far may easily be translated as well. In translation, it provides that a bank should have federal rights to: (a) take retail deposits throughout its SMSA; (b) take wholesale deposits in financial centers nationwide; (c) take both types of deposits in any host state that does not act legislatively to require separate incorporation of each bank operating therein; and (d) affiliate, through a common BHC, with banks in any state, subject to regulatory approval.
The same equation between deposit-taking and branching appears in the approach taken by most of the states that have considered the status of interstate ATM networks. By prohibiting out-of-state banks that share in the use of host-state ATMs from accepting deposits at those facilities, while allowing them to perform all other services there, the states have implicitly distinguished deposit-taking as the indicium of branching. The significance of deposit-taking has even been made explicit in the responses of some state regulators to the question whether money market funds are engaged in unauthorized banking. Some have equated deposit-taking with banking, while others appear to have gone on to consider whether shares in the funds provide consumers with a close substitute for a bank demand deposit.

The consequence of equating interstate branching with

732. Delaware, Oregon, and Virginia have expressly permitted reciprocal interstate ATM use-sharing arrangements for other functions but do not permit deposit-taking across state lines. Telephone interviews with Raymond Gawel, Delaware Dep't of Banks Commissioner (July 7, 1981), Gordon Prakken, Oregon Assistant Superintendent of Banks (July 7, 1981), Ralph Jaffe, Virginia First Deputy Commissioner of Financial Institutions (July 8, 1981). In Kentucky, a bank may share the use of an out-of-county ATM only for dispensing of funds. KY. ADM. REGS. tit. 808, § 1:060(11). This is viewed as applicable to out-of-state ATMs as well. Letter from Mark Robinson, Review Examiner, Kentucky Department of Banking & Securities (July 8, 1981) (copy on file in office of Hofstra Law Review).

The Attorney General of Missouri has ruled that banks may enter reciprocal ATM use-sharing arrangements intrastate, notwithstanding the law against branching, so long as the ATMs do not take deposits, and this has been interpreted to allow interstate arrangements that are similarly limited. United Missouri Bank of Kansas City, N.A. and Overland Park State Bank, which is located in Kansas, participate in one such system. Telephone interview with Franke Henthorn, Supervisor of ATMs, United Missouri Bank (July 8, 1981). North Carolina's policy with respect to other functions is unsettled but would clearly prohibit interstate deposit-taking by ATMs. Telephone interview with Kern Freeze, Field Examiner, North Carolina Office of Commissioner of Banks (July 8, 1981).


733. Compare Redden letter, note 518 supra (construing Oregon statute defining "banking business" to include CMA Money Trust described in text accompanying note 517 supra) with Agreement reached between Colorado State Bank Commissioner and Merrill-Lynch in Settlement of People v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., No. C-79745 (Col. Dist. Ct.). The Oregon opinion acknowledges that the "mutual fund shares would have attributes different from the usual commercial bank deposit," but dismisses this fact with the observation that under Oregon law the attributes of a deposit can be varied by agreement. Redden letter, note 518 supra.
deposit-taking simplifies the problem of defining a branch by commuting it to that of defining “deposit-taking.” Indeed, since our concern here is not with distinguishing banks from nonbanks as it would be in determining whether money market funds are banks, for instance, but rather in distinguishing branches from non-branches, we need only to determine when a “deposit” is “taken” without overly complicating the question of what is a deposit.

In ordinary language, a deposit is the delivery to a bank of currency, checks, and similar negotiable items, resulting in a credit to an account holder, who is usually but not necessarily the depositor. This definition of a deposit is tested, however, when new means of effecting a credit are devised. For example, the provision of a payroll computer tape to a bank may be the means by which an employer makes a so-called “direct deposit” to its employee’s account at the bank; no currency or checks are involved, but their electronic replacement nonetheless results in a credit to an account. In essence, the information formerly conveyed by currency and checks has been separated from the paper on which it used to travel and converted into electronic form, i.e. magnetic particles on a computer tape, for greater ease of transmission. Still, it would seem somehow odd to describe a bank’s data processing center, at which it receives such computer tapes, as a “branch” of the bank where, in the words of the McFadden Act, “deposits [are] received”; it would seem odder still if the bank’s computer received the information not through physical delivery of a tape but by transmission from the payor’s computer over ordinary telephone lines. Indeed, the payor’s transmission might not be to the account holder’s bank at all, but to a clearing house’s computer that will distribute the information to the relevant bank, either electronically or by paper print-out, depending on whether it has its own data processing capability. Whether a “branch” is involved in such an automated transaction, and which instrumentality constitutes the “branch”—the computer at the bank where the credited account is held, the clearing house, or the payor’s telephone—cannot, of course, be dismissed because the questions seem odd; they can only be answered, however, by reference to the policy underpinnings that make it important to know whether, where, and when one is dealing with a branch.

In the present context, the question of what is a branch, i.e. of whether something is a deposit-taking facility, will determine not whether or where it can operate but what bank can receive deposits through it. If any of the elements in the electronic payment net-
work of automated clearing houses (ACHs), bank computers, terminals, telephones, etc., is a branch of each bank that is advised through the system of credits to accounts it holds, however, then virtually every bank in the country is a branch of every other bank. They are all tied together through the ACHs, BankWire, Fed Wire, and the data networks that link banks without their own data processing equipment to others with it. As a result, a holder of accounts in any two banks can cause funds to be "wired" from one to the other, i.e., can cause one bank to send a message resulting in a credit to the account at the other.

The point to be made here is not that all banks are branches of each other. Rather, it is that the term "branch," defined in terms of where "deposits [are] received," was not meant to encompass electronically effected credits. It was meant to include only the "deposits" denoted in ordinary language—the physical delivery to a bank of currency, checks, and similar negotiable items. Convenient customer access to facilities that accept such ordinary-language deposits confers a competitive advantage on the bank that receives them, as the courts have understood, but it does so only in the retail market, where convenience is a factor.

A corporate depositor may have accounts at scores or even hundreds of banks around the country from which balances are transferred to a concentration account. Whether the transfer instructions are originated by the corporation's cash management (lead) bank or by its treasurer over a CRT should be of no moment; neither the distant banks nor the CRT are branches of the lead bank. The banks are not branches because their location does not confer a competitive advantage on the lead bank with respect to deposit-taking. It, or the corporation, will have selected them because of the city or federal reserve district in which they are located, of course, as well as because of the price and quality of their cash management and deposit services, but not because they are in a particular part of town. The precise location of a branch bank is an advantage only in the retail market, and it is the "deposits received" in that market to which the definition of a branch should be understood to have been keyed, not only in the McFadden Act, but in ordinary language and thus in all of the state statutes and decisions that use the term without explication.

Thus, interstate deposit-taking, and therefore interstate branching, occurs where a bank takes retail deposits of currency

734. See generally, H. SCOTT, supra note 689.
and checks. They are "taken” where and when a bank receives physical custody of them either directly or through its agent. Therefore, ATMs that take deposits on behalf of a remote bank are branches of that bank; banks that accept deposits for transmittal to another bank, as agent of the other bank rather than agent of the depositor, are branches of that other bank. Likewise, armored cars operated by a bank or group of banks to pick up currency or checks from merchants are branches of the bank or banks they serve, while an armored car operated by an independent company or a group of merchants, not being the agent of a bank, should therefore not be considered a branch of any bank.

In summary, by defining a branch as a place at which a bank or its agent receives retail deposits, most if not all of the ambiguity surrounding the branch definition of the McFadden Act is removed. This would also be true in the intrastate context. Examining the question in the interstate context has served only to make it clearer that the “money lent” and “checks paid” clauses of the McFadden Act definition are irrelevant in light of the nonbank possibilities for performing those functions that were opened up by the 1970 amendments to the BHC Act.

It does not much matter whether an LPO is an unlawful branch of a bank because it is a place where money is lent, that is, if it can be transformed into a commercial or consumer credit subsidiary of the BHC. Likewise, if an ATM established by a bank is a branch because withdrawing cash from one's bank account through the ATM makes it a place where “electronic checks are paid,” then the ATM can be established by a nonbank subsidiary of the BHC, or by a joint venture BSC, established for that purpose. It is only the deposit-taking function that cannot be shifted to a nonbank affiliate, with its unlimited geographical reach, because only deposit-taking, indeed retail deposit taking, is unique to banking.

Why is retail deposit-taking the essential core of banking? Because it is taking retail deposits that raises the public policy concern with soundness supervision, and it is soundness supervision

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735. It could also be operated by a consumer finance subsidiary of the BHC, which could offer a line of credit, issue a Visa card with which to access it at the ATMs, and even arrange for the customer to preauthorize the bank affiliate automatically to pay the Visa bill at the end of the month. Then, little more than a delay in the time at which the cash withdrawal results in a debit to the depositor's account will have been accomplished by characterizing the ATMs of banks as branches because they allow cash withdrawal.
INTERSTATE BANKING

that in turn justifies, however well, both the consumer protective and the anticompetitive aspects of banking regulation, from mandating deposit insurance to entry regulation.736

In fact, it would not be too venturesome to suggest that another form of duality exists in banking beside dual chartering. It is the coexistence of two ideal types: first, retail, localized, less than fully competitive banking markets and banks; and second, wholesale, nationwide, highly competitive banking markets and banks. Only the former institutions, I suggest, were meant to be covered by the restrictions on branching and, as a practical matter, only they are so covered. This is true even though some of the same banks participate in both markets as local retailers and national wholesalers. What is primarily at stake in the interstate branching issue, therefore, is whether to allow banks to become national, or at least multistate, retailers as well.737

D. Interstate Acquisition vs. De Novo Entry

Thus far it has been determined that banks should have a federal right to branch throughout their interstate SMSA, into the wholesale markets in certain financial centers, and into any state that does not legislatively prohibit interstate branch entry; furthermore, it has been shown that BHCs should be able to own and control banks in any state, subject to the limitations of state law concerning market structure. It remains now to be determined whether there should be special legal inhibitions upon a bank’s or BHC’s decision to effect interstate entry de novo or by means of acquisition.

Unless displaced, the antitrust laws will preclude many major interstate acquisitions of banks in concentrated markets. Under the potential competition doctrine of antitrust law, a bank that lawfully could and probably would have entered a concentrated market de

736. The credit allocating aspect of banking regulation is not, however, underpinned by the concern with soundness and may to some degree be inimical to soundness. Credit allocating regulation is probably limited to depository lenders, as opposed to insurance companies and other institutional investors, because they are more easily controlled, having been subjected already in the interest of soundness to the need for prior approval of every step they take.

737. The analogous question, a generation ago, was whether to allow the growth of retail chain stores. Then, as now, the proponents of containment "stress[ed] such matters as their independence, their devotion to the home town, and the size and presumed greed of the huge corporations" seeking to do a nationwide retail business. Comment, Anti-Chain Store Legislation, 30 MICH. L. REV. 274, 274 (1931).
novo or by a so-called "toehold" acquisition—that is, by acquiring an incumbent firm with a small market share that could then be expanded by internal growth—will not be permitted instead to acquire a major participant in the market.\textsuperscript{738} It may reasonably be assumed that the potential competition doctrine will apply to interstate banking with the same, somewhat attenuated, force with which it applies in the intrastate banking context.\textsuperscript{739} Specifically, if out-of-state banks or BHCs are liberally allowed to enter a concentrated market de novo and later expand their presence, the antitrust courts will recognize that fact by analyzing skeptically the necessity for a particular firm to effect its entry by means of an interstate acquisition. On the other hand, regulatory limitations on the ability of a bank to enter or to expand after entry into a concentrated territorial market will be taken to diminish the likelihood that a would-be entrant by acquisition would realistically have entered de novo even if that were the only permissible means of entry.\textsuperscript{740}

The question at hand is therefore whether there are reasons of bank regulatory policy either to limit the ability of banks to enter new (interstate) markets by acquisition beyond the limitation now found in the antitrust laws or, alternatively, to limit their right to enter de novo—i.e., sometimes requiring that entry be by acquisition—notwithstanding the conflict with antitrust policy that implies.

Forbidding or limiting acquisitions would presumably be done in the interest of competition. Many variations on the theme are possible, including, for example, a per se rule against entry by acquisition, the same rule applied only to acquisitions above a certain toehold size, or a shifting of burdens to erect a presumption against entry by acquisition while allowing an acquiror to prove the impracticality of de novo entry or a toehold acquisition. The alternative approach of sometimes requiring that entry be by acquisition, which would presumably be adopted in order to protect existing competitors, might operate like the home-office-protection rule common in intrastate branching laws.\textsuperscript{741} A bank might be al-


\textsuperscript{739} "[T]he application of the doctrine to commercial banking must take into account the unique federal and state regulatory restraints on entry into that line of commerce." United States v. Marine Bancorporation, Inc., 418 U.S. 602, 627 (1974).

\textsuperscript{740} Id. at 636-37.

lowed to enter a new market interstate only by acquisition, or to enter de novo only if efforts to enter by acquisition are unavailing.⁷⁴²

While there are many such possible alternatives to current antitrust policy that could be used to determine whether and when to limit a bank’s ability to enter a new (interstate) market by the means of its choice, only the two polar cases need be taken up here. The analysis of these approaches, under which entry would be allowed either by acquisition only (the “market-protective” approach) or de novo only (the “pro-competitive” approach), is sufficient to identify the relevant interests at stake and to suggest a resolution among them. These polar approaches can better be addressed, however, when the alternative means of bank-market entry have been further detailed.

1. Methods of Market Entry.—There are five distinct ways in which a bank or BHC with operations in one territorial market may, if the relevant regulators approve, obtain a physical presence in a new territorial market. First, the bank may engage in de novo branching, either by opening a brick-and-mortar office or by establishing or sharing in an ATM in the new territory. Second, the bank’s parent BHC may obtain a charter to establish a de novo bank subsidiary in the new territory. Third, the bank may enter the new market by the acquisition of an existing bank, which would then be merged into the acquiring bank, its home and branch offices becoming branches of the acquiring bank. Fourth, the BHC may enter the market by the acquisition of an existing bank, which would remain a subsidiary of the BHC. Finally, the bank may acquire only some of the branches of an existing bank, which would again become branches of the acquiring bank.⁷⁴³ In

⁷⁴² A doctrine giving preference to entry by acquisition can live only in great tension with an exception allowing de novo entry when an acquisition is “unavailable.” Any acquisition is available at a price, and the evidentiary difficulties of determining whether a reasonable price was offered (or demanded) before resort was had to de novo entry are legion. Cf. 5 P. AREEDA & D. TURNER, supra note 738, ¶ 1124d, at 146 (discussing complications involved in toehold mergers).

⁷⁴³ The purchase and sale of bank branches may constitute little more than trafficking in officially created market entry rights. The retail deposit liabilities of a particular branch may be somewhat ephemeral, since a retail depositor’s business could well be lost if he is informed that his account has been transferred to a different, less convenient branch. Commercial deposit accounts, and of course the assets of a particular branch, are more manipulatable. Branches are nonetheless bought and sold, and can be spun off in merger situations. See, e.g., Bankers Trust Agrees to Sell 55 Branches, Wall St. J., Aug. 16, 1979, at 12, col. 2; Sumitomo Wins 19 of 33 Offered BanCal Branches, Am. Banker, July 7, 1977, at 1, col. 4.
sum, therefore, either the bank or its BHC may enter a new market by acquisition of a bank or de novo, while the bank may also enter by acquiring only some of an incumbent bank's branches.

a. De Novo Entry.—For purposes of the present analysis, it is not necessary to distinguish between the two types of de novo market entry; whether a bank enters a new market by branching or its BHC charters a new bank in that market, the fact of competitive significance is the introduction of a single new competitor into the market. A requirement that new entry be de novo is, in theory, and probably in most real markets, pro-competitive for this reason, but in practice the number of new competitors that will be admitted to a given banking market is everywhere limited by entry regulation justified on the ground that too much competition may endanger the solvency of incumbent banks. Consequently, a policy of allowing only de novo market entry may significantly limit the potential competitive significance of interstate banking.

To be sure, several new competitors might still be introduced into each of the presently concentrated metropolitan banking markets, but a per se rule prohibiting entry by acquisition would probably preclude meaningful levels of new entry into many smaller markets and some portions of the larger SMSAs. Beyond the simple numerical limitations that regulators would undoubtedly impose on the number of new competitors in a market, there is sometimes reason to doubt the competitive significance of de novo or toehold entry into moderately concentrated banking markets, i.e., where acquisition of a non-toehold but non-leading firm might have been possible. Simply put, it usually takes longer and may be more expensive to build than to buy a given market share, and if there is a critical minimum share necessary to offer effective competition to other firms, a de novo-only approach, if it does not deter an entrant, may certainly defer the time at which its entry has significant pro-competitive consequences.744

b. Entry by Acquisition.—Market entry by the acquisition of an existing bank may also be accomplished by either of two means, but again the distinction need not detain us. Whether the acquiror is a bank or a BHC, an acquisition does not in itself change market structure. Rather, it merely changes the identity of the owner of the acquired bank. Still, it may prove to be highly pro-competitive if the acquiring bank or BHC is a more aggressive competitor than the acquired bank, i.e., if the acquiror will exploit the acquired

bank's physical presence to introduce price reductions or service improvements in the target market. This is even more likely to occur, moreover, if the acquired bank's market share is not large to begin with. Acquiring banks tend to have more aggressive,745 and probably more capable, managements and greater capital with which to finance the costs of competition. Indeed, it is precisely because the acquiring bank believes that it can exploit the acquired bank's assets—its location, existing customer relationships, and perhaps sleepy competitors—that it will want to acquire the bank and will be willing to pay a price greater than the existing owner's reservation price for the shares.

Market entry by acquisition is thought to be particularly pro-competitive if the acquisition gives the acquiring bank only a toehold position in the market.746 The acquiring bank will then use its managerial and financial resources to build the acquired bank into a more substantial competitive force in the market. As it gains market share through internal growth, the market will become less concentrated, whereas the purchase of and the same internal growth of a bank that already has a large share of the market would tend to make the market more concentrated.

The number of pro-competitive market entries that can be accomplished by toehold or other acquisitions is limited by three factors, however. First, there must be potential buyers outside the market that are financially and legally qualified to enter by acquisition. In the intrastate context, such potential buyers may be very few or nonexistent; there may be no banking organization in a particular state that is not disqualified on antitrust grounds, either because it is already an actual competitor in the local market, or, if the market is concentrated and de novo entry would have been lawful, because it is a potential competitor. This constraint will be substantially, indeed probably completely, relaxed with nationwide banking because it would create a large number of potential buyers, including many that would not have entered a concentrated market de novo and thus may lawfully enter by acquiring a non-toehold incumbent.747

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745. See Mingo, supra note 697, at 413.
746. But cf. 5 P. Areeda & D. Turner, supra note 738, ¶ 1124b, at 141 (toehold merger may not improve acquired firm); Rhoades, The Impact of Foothold Acquisitions on Bank Market Structure, 22 Antitrust Bull. 119 (1977) (study of all acquisitions during 1966-72 of banks with deposits of less than $10 million by BHCs not previously in the acquired bank's SMSA found that there is no significant relationship between foothold acquisitions and changes in market structure).
747. For a glimpse of the types of evidentiary problems raised by the necessity,
Second, there may be very few potential sellers, especially in a concentrated market. Indeed, in the most concentrated markets where the antitrust laws would most strongly suggest the desirability of a new entrant’s acquiring a toehold rather than a major firm, there may be the fewest potential toeholds available for acquisition. In a market with a three-firm concentration ratio in excess of 80%, for example, there may be only two or three firms with market shares small enough for a potential competitor lawfully to acquire them.

Third, these few possible toeholds may not be for sale at an agreeable price. More precisely, each toehold may be able to earn monopoly rents by reason of oligopoly pricing in the local market for bank services; in addition, it has market power in the local market for control of banks, due to restrictions on entry. Thus, each toehold will insist upon receiving substantially all of the economic rents associated with its market position.

A toehold acquisition may still take place if one of two circumstances obtain. First, if the acquiror believes that it can operate the bank more efficiently, *i.e.*, at lower cost than the old management, it may hope to realize greater earnings from the same market share and continued oligopoly pricing. It would then be willing to buy the bank at a price between the capitalized value of expected monopoly profits under the old and new managements, assuming that the return on investment to be expected at that price is still higher than that on any alternative investment. Second, if the acquiror believes it has a superior ability to compete, *i.e.*, to operate at lower cost than the other banks in the market, it may hope to realize greater earnings by lowering prices toward competitive levels and increasing its market share. Only in the latter event will a toehold acquisition in an oligopoly market actually result in post-acquisition price reductions to consumers.

c. Hybrid Entry.—Market entry accomplished by the acquisition of some of the existing branches of an incumbent bank can logically be distinguished from the acquisition of the entire incumbent bank; such a partial acquisition has aspects of both de novo and acquired entry. With respect to the acquired branches, only the identity of the bank to which they are attached is changed. Looking at the market as a whole, however, an added competitor has been introduced into the market through those changes in branch

*under the potential competition doctrine, to determine that an acquiror was not a potential de novo entrant, see United States v. Falstaff Brewing Corp., 410 U.S. 526, 533-36 (1973).*
ownership. Thus, while the number of banking offices in the market, and the public convenience, may be unaffected by the transaction, the results may nonetheless be pro-competitive if, as expected, the acquiring bank competes more aggressively at the acquired locations than did the selling bank. Again, however, the number of opportunities for effecting market entry through such a partial acquisition is limited by the number of interested sellers—this time of branches. Even fewer banks would normally be interested in such a partial sale than in a complete sale, however, since the seller would face the new competition of the buyer as a result.

Indeed, it would be impractical to prohibit the acquisition of a bank on the ground that the acquiring firm might have made a partial acquisition of branches from the same or another seller; that will too rarely be a realistic alternative even to justify an inquiry into whether it might have been accomplished in a particular market by a particular acquiror at a particular time and at an agreeable price. Consequently, as a practical matter the distinction between the acquisition of a toehold bank and a partial acquisition of the branches of another bank can be disregarded; only the former possibility will be considered here.

2. The Criteria Applied.—In this section, the standard criteria are applied to the two polar alternatives to a conventional antitrust approach to regulating the means by which a banking organization may enter a new (interstate) market. To reiterate, these alternatives are, on the one hand, to allow entry de novo or by toehold acquisition only (variously called the de novo-only or “small-start” approach below), or, on the other, to allow entry by acquisition-only, subject to the limitations of antitrust law.

a. Consumer Welfare.—Although consumer welfare is generally enhanced by producer competition, it is not clear whether the small-start or the acquisition-only approach would result in greater competition. Opportunities for interstate market entry could be quite limited under the small-start approach.

De novo opportunities would arise only as target markets experience such growth as would warrant the addition of new banks or branches to the market. This determination would presumably be made on the basis of the same criteria now employed to determine whether an incumbent bank shall be allowed to open an additional branch or a new bank to be established in the market. Under the small-start approach, toehold acquisitions could be made without the same constraints, but as suggested above, the number
of potential toehold acquisitions is severely limited in many markets and may be most limited in precisely the most concentrated markets where the benefits from enhanced competition are potentially the greatest.

Allowing entry by the acquisition-only approach would not change the number of competitors in any particular local banking market. As noted above, however, it could substitute more aggressive competitors for less aggressive competitors or complacent oligopolists in markets where acquisitions occurred, which might in some instances ultimately result in increased market concentration. Assume, for example, an oligopolistic market with only four firms of any consequence, all enjoying the benefits of a quiet life, in which one serves as the price leader and the others as price followers. The acquisition of one such bank by an aggressive competitor could well enable it to acquire a dominant market share when it turns from cooperating to competing with the other three banks in the market. Ideally, all of the banks in such a market would be acquired by aggressive out-of-state competitors. In practice, however, only one or two may be acquired by such firms, with the result that the market becomes more rather than less concentrated as they gain market share at the expense of the others. Eventually they may be able to resume oligopoly pricing and end the flurry of competition, leaving consumers no better off than before the acquisitions. It is simply impossible to predict with any confidence, therefore, whether the small-start or the acquisition-only approach would in general better serve consumer welfare across the myriad markets involved.

b. Producer Welfare.—Under the acquisition-only approach, the shareholders of banks in target markets would be able to sell their shares to out-of-state banking organizations at prices that reflect their bank's ability, if any, to earn economic rents due to the limitations on de novo entry into their market. Under the small-start approach, on the other hand, the shareholders will not only lose this opportunity, but at the same time may be subjected to added competition that results in competing away their present rents.

Still, it is not clear whether shareholders in target markets would be better or worse off under the small-start approach. Their advantage from the small-start approach could, ironically, be the greater protection that it might give them from new market entrants. If aggressive competitors could enter the market through a non-toehold acquisition (as would be possible under the potential
competition doctrine once interstate banking has vastly increased the number of potential competitors perceived to be waiting in the wings\textsuperscript{748}, they could pose a much more substantial competitive threat to any banks that are not acquired by similarly competitive firms. Consequently, the effect of this policy choice on shareholder interests cannot be identified with certainty, although initially it may seem more likely that the acquisition-only approach would better serve the interests of shareholders in target markets.

The interests of all bank shareholders as a group may also be served better by the acquisition-only approach than the small-start approach. Under the latter approach, such new entry as occurs in target markets will either be net additions to the number of competitors or a substitution of toehold owners likely to be more aggressive. If competition is enhanced by either means, all banks in the market may find it difficult to earn more than competitive rates of return. Under the acquisition-only approach however, entry—by toehold or on a larger scale—can occur \textit{only} by the substitution of one owner for another, presumably as a result of their mutual agreement to the terms of an acquisition. Of course, it does not follow that because the parties to the agreement both improve their position that other banks competing in the market with the buyer will be better off by reason of the transaction. Still, one would expect the shareholders of each incumbent bank in a target market to be better off when they are given the nearly exclusive right to sell access to that market by selling their bank—even if it is sold subject to the competition of those who buy other banks in the same market—than they are when they cannot sell their shares to an out-of-state bank or BHC and are subjected to the possibility of those firms becoming net new entrants to the market.

Again, however, one cannot be sure which approach will better serve shareholder interests in practice. The point can be illustrated by the example of a diversified bank stockholder, who owns equal shares in an aggressive out-of-state acquiror bank and a sleepy target bank in an oligopolistic market with cartel pricing. Under the acquisition-only approach, the aggressive acquiror could acquire the target bank at a price equal to or greater than its capitalized monopoly profits, discounted by the probability that some other aggressor would acquire some other sleeper and subject the

\textsuperscript{748} See 5 P. AREEDA & D. TURNER, \textit{supra} note 738, ¶ 1123b, at 124 (suggesting that potential competition doctrine should not preclude a merger "where the universe of potential entrants exceeds three to six firms.").
target to competitive pressure on earnings. The stockholder would thus receive a price somewhere between the capitalized values of monopoly and competitive earnings per share. Under the small-start approach, on the other hand, unless it is a mere toehold the incumbent bank could not be acquired by the aggressor, but its share value will be discounted to reflect the possibility that the aggressor will obtain de novo entry rights and, having entered, compete away the monopoly profits of the target bank.

While there is no way, a priori, to determine which of these two probabilistic discounting procedures will more adversely affect the value of the target-market bank, experience suggests that the de novo discount will be the lesser, i.e. that a de novo or pro-competitive approach may actually be better for incumbent shareholders. First, the regulators who control entry will be expected to limit the adverse impact of entry on incumbent banks in the interest of bank solvency; conservatism among bank regulators will surely induce them to limit de novo entry so that the incumbent and new banks alike will earn more than merely competitive returns on investment. Under the acquisition-only approach, however, regulators would be hard-put to disapprove an acquisition on the ground that the acquiring bank would be too aggressive a competitor for the other incumbent banks to withstand and no pretext may be available otherwise to disqualify the acquiror. Yet consumers, legislators, and perhaps the managers and even shareholders of the other incumbent banks would be angry or embarrassed if the true ground were given. Thus, allowing de novo entry only may make it easier for regulators to avoid introducing into a market what is, from the incumbent shareholders' perspective, "too much" competition. More banks may be allowed into the market de novo, that is, but with less cumulative competitive potential than a smaller number of acquiring banks would have.

Second, there is almost surely less of an immediate competitive threat to incumbent banks when even an aggressive competitor is forced to enter de novo or by toehold acquisition. Building the number of locations and customer relationships—i.e. market share—that might otherwise have been acquired at the outset under the acquisition-only approach simply takes time, even with aggressive pricing and marketing strategies. This factor defers some-

what the full effect of de novo competition on the value of incumbent banks, and thus reduces the present value of the adverse impact from new competition.

Consequently, while the acquisition-only approach might seem initially to be in the interest of incumbent bank owners, the matter is far from clear. A general conclusion may not be possible, moreover, since regulatory attitudes toward de novo entry may vary across target markets. Furthermore, there may be some target markets in which some of the incumbent banks would not be attractive acquisition targets for aggressive banks while others would be; in that case, the interests of target-market banks in this question may therefore be irreconcilably divergent. The attractive acquisition target’s shareholders would actually gain from being acquired—not just suffer less of a loss than they would under the acquisition-only approach—while banks that are not acquired would lose more from the competition of acquiring banks than they would from that of de novo entrants.

The position of incumbent bank employees in target markets does not seem to be any different from that of the shareholders in the banks by which they are employed. Their interests, too, seem less than fully determinate. Of course, under either the acquisition-only or the small-start approach, employees could be held harmless by the inclusion of a labor protective provision in the regime, if the potential for adverse effects were thought to be significant. Under the small-start approach, they would then have a preferential claim to employment by new entrants in their market if they are discharged by the incumbent banks as a result of the increased competition. Under the acquisition-only approach, they would have preferential hiring rights at banks with increased market shares, or perhaps at all banks, as positions arose, after one or more acquisitions were made in a particular market. The theory would be that the market had become more competitive and market shares, and thus the demand for labor, somewhat less stable as a result.

c. Equity of Regulation.—Whether the public interest in equitable regulation would be better served by the acquisition-only or the small-start approach is a very difficult question indeed, and one that arises in principle whenever a change in the law is considered. Of course, the inequity now favoring banks in desirable markets and BHCs with the advantages of grandfathered multistate, full-service banks, can be corrected only to the extent

750. See text accompanying notes 496-498 supra.
that out-of-state banks or BHCs are allowed to enter host state markets. More is involved, however.

If the small-start approach is not administered so as drastically to limit the rate at which de novo entry occurs in target markets, the advent of significant new competition will destroy the incumbent banks' shareholders' capitalized expectation of receiving economic rents. This could create a new inequity. To the extent that the present shareholders are not the original incorporators and owners of the bank but subsequent purchasers, they may be presumed to have paid a price that yields only a competitive return on their investment. Consequently, any diminution in the value of that investment due to an unanticipated change in the law will cause them to suffer a windfall loss.

The key to determining one's own view about the equity of such gains and losses as are associated with changes in law depends upon whether one views the change, or the probability of change, as being beyond the range of risks assumed by investors. Clearly, legal change is always a possibility, and at least a relatively sophisticated population such as that of shareholders may be viewed as assuming the risks of legal change when they invest in an enterprise that is actually subject to extensive public regulation.

If acquisition is the only means by which an out-of-state bank may enter a target market, the problem of windfalls will be quite different. A bank newly subjected to the increased competition of an out-of-state acquiror will experience a windfall loss of the same general type as a bank subjected to de novo entry in its market. The shareholders of the bank that is sold to the entrant-by-acquisition, however, may well have realized a windfall gain. Having invested in their bank under the state-by-state banking regime, they may or may not have paid a price that reflected the possibility of a future change to interstate banking; the empirical question is completely unanswerable. It is clear that at some point investments are made in anticipation that a legal change will occur, i.e., that it has some priceable probability of occurring. Indeed, this has probably been the case with respect to the change to interstate banking at least since 1980, when bank stock analysts began to identify the banks they thought would be premium acquisition targets under interstate banking. With respect to earlier investors, one can only decide whether it is reasonable, as suggested above, to assume that this was the type of legal risk they willingly incurred.

Unfortunately, there is no neater solution to the problem of regulating equitably and yet reserving the right to alter regulations
from time to time. One could assert that all such changes have been discounted to probabilities by all affected parties and investments priced accordingly; if a substantial discount rate is used, moreover, investors need only be blessed with foresight spanning a dozen years or less. The present value of changes that might occur any further into the future would be too slim for most analysts to incur the transaction costs—extensive modelling and calculations—and therefore should certainly not serve to defeat or defer a change in the law.

Although analytically consistent and defensible, this view of the world is clearly unrealistic when carried to its logical conclusion, viz. that the probabilities of all possible legal changes worth anticipating have been actually discounted by investors in the market for shares. Perhaps it is just because this view is not widely held that significant legal changes are so frequently introduced in a series of gradual steps. Such an incremental approach to legal change lessens the windfall gains and losses to affected bystanders by spreading them over a period of years and thereby lowering their present value.

In the context of the choice between the acquisition-only and small-start approaches to interstate entry into bank markets, windfalls could be lessened and the change to interstate banking probably made more equitable by adopting whichever approach is more susceptible to gradual introduction. Unfortunately, there does not seem to be any reasonable way to phase in the right of a bank or BHC to make interstate acquisitions. Gradually expanding the geographical area within which acquisitions can be made is not very responsive to the windfall problem, although it is not completely inapposite. If, as discussed above, banks were permitted first to make acquisitions in contiguous states, for example, and gradually given a wider scope, shareholders would find themselves gradually and increasingly affected by the expansion of the geographical range within which banks compete. Some banks would immediately and suddenly become the objects of merger and tender offers, however, while others would with equal suddenness be put in a position to make an attractive acquisition; some banks, moreover, would not be significantly affected either way at first. There does not seem to be any way to even out these effects other than to ena-

752. See text accompanying notes 669-670 supra.
ble all banks and BHCs to reach nationwide simultaneously, as seen before. That, however, would be the surest way to maximize the windfall effects of the legal change to interstate banking; those effects could at least be mitigated if the policy decision were made now but became effective at a later date, so that it had a lesser effect on present share values.

The small-start approach to interstate banking is somewhat more susceptible to gradual introduction. First, de novo banks and branches could be established only as the rate of growth in target markets warranted their introduction. If the Comptroller and the state chartering authority maintained a constant ratio in a particular market between the number of banks and the average volume of deposits per bank, for example, new banks could be opened or allowed to branch in—de novo or by toehold acquisition—without any diminution in the deposit business of the average incumbent bank.

The formula just suggested is hardly exhaustive of the possibilities for mitigating the windfall effects of moving to interstate banking under the small-start approach. That approach has an inherently greater capacity to be introduced gradually because it involves a smaller marginal unit of change, viz. the opening of a new bank or branch or the change in ownership of a toehold bank. The change in ownership and management of a larger bank must be complete and simultaneous throughout the bank and its branches, regardless of how large a factor it is in the local market. Compared to the acquisition of a major bank in a given market, the introduction of a new banking office or new ownership of a toehold bank is clearly a more discrete intervention in market structure and investor equities. The cumulative effect on the value of existing bank stocks, therefore, could be introduced through a larger number of smaller steps—each constituting the opening of a new banking office or a small acquisition—than is practical under the acquisition-only approach. Thus, de novo and even toehold entry is seen to be more susceptible to an equitable transition, and on this criterion is to be favored.

d. Undue Concentration of Resources.—The acquisition-only and small-start approaches could not be more clearly divergent in their effects on the potential for undue concentrations of resources. By limiting interstate bank expansion to acquisitions, the former approach exacerbates the problem of undue concentrations, in both senses of the term, at the regional and national levels. While the antitrust laws could be left in place to deal with the problem of
market concentration, the drawbacks of undue asset aggregation will necessarily arrive sooner if interstate expansion occurs by acquisition rather than de novo or by toehold acquisition. At the other extreme, de novo entry has the minimum adverse effect on asset aggregation that is possible, consistent with allowing existing firms to enter new markets. At the same time, it has a most beneficent effect on market concentration—at least in the structure-performance theory of the industrial organization.\textsuperscript{753} At any rate, local market deconcentration is its inherent characteristic and its advantage. Accordingly, the undue concentration criterion favors the small-start approach.\textsuperscript{754}

3. A Mixed National Strategy.—From this review of the standard criteria that seem to be affected by the choice between interstate acquisitions or de novo and toehold entry, neither of the polar options really seems very attractive. Neither seems likely to unleash fully all the competition that could potentially be of benefit to consumers. Yet each seems to have uncertain and perhaps mixed effects on producers. The acquisition-only strategy is less susceptible to an equitable phasing in, however, and is surely less desirable on the criterion of avoiding undue concentrations of resources. This mix of advantages and disadvantages for the two approaches, although perhaps favoring the small-start approach on the basis of the last two criteria, also suggest alternative blends of the two, the first of which is here called the “mixed national strategy.”

The mixed national strategy would allow banks and BHCs to enter new markets by either means, acquisition or de novo; the states could not require that entry be accomplished exclusively by either one or the other approach. It would also, however, require that a bank or BHC use the more pro-competitive alternative if both are available in a particular market. That is, if the market is not “overbanked” by some objective ratio, such as that of population or deposits to banks,\textsuperscript{755} the de novo approach to entry would


\textsuperscript{754} Neither soundness supervision nor policy guidance are meaningfully implicated in the choice between the acquisition-only and small-start approaches, and accordingly those criteria are not separately treated in the text.

\textsuperscript{755} Both of the ratios mentioned in the text are commonly used by regulators to determine whether a new bank or branch application should be granted. \textit{See}, e.g., In re United Savings Bank, Conway—Application to Establish a Branch Office at 45
presumptively be favored; it would still, of course, be open to a bank or BHC to demonstrate that a toehold or indeed a larger acquisition is in fact innocuous or perhaps even more pro-competitive in the precise circumstances. This showing might have to encompass more than simple market share and concentration ratio data, however, to succeed.

The mixed national strategy is nothing more dramatic than a variation on the potential competition theme of current antitrust law. The only difference is that whereas the potential competition doctrine operates only to preclude non-toehold acquisitions in concentrated markets, the mixed national strategy’s pursuit of the more pro-competitive alternative could actually operate to favor a major acquisition in a concentrated market. In the less concentrated and presumably more competitive banking markets, of course, there would be little reason to be concerned with the effect of any particular acquisition. Even in some of those markets, however, if a trend toward concentration is apparent, the strategy’s preference for the more pro-competitive form of entry would have a prophylactic effect for the future. Alternatively, concern with the competitive vitality of a bank, although it is not actually failing, may lead to the conclusion that its acquisition would be pro-competitive, where the likely result would be to strengthen the bank with capital or improved management; in these circumstances, de novo entry may be less pro-competitive than entry by acquisition.

The mixed national strategy departs only modestly from the acquisition-only and small-start strategies. Because it allows either means of entry but always favors the alternative that is more pro-competitive in the circumstances, it is likely to serve consumer interests better than either of the other, polar approaches. The impact on producers as a whole remains indeterminate, although it is probably less favorable than the acquisition-only approach. If the mixed national strategy tends more to foster competitive markets, consumers and some producers will probably gain more at the expense of other producers. Since the mixed national strategy allows

Federal Street, Greenfield, Mass., Decision of the Commissioner of Banks (July 6, 1979); CSBS PROFILE, supra note 19, at 203 (people per banking office, by state). Ratios of population or deposits to banks, rather than banking offices should be used lest the regulatory structure invite strategic branching whereby incumbent banks keep a market just enough “over-branched” to shield themselves from new entry. See Baker, supra note 609, at 30-31; E. Kohn & C. Carlo, The Competitive Impact of New Branches 2 n.4 (N.Y. Bank Dep’t, 1969).
some acquisitions (i.e. where they would be neutral or pro-competitive) without by any means promoting them, however, it does not increase the risk of fostering any unduly large aggregations of assets; at the same time, it does assure the maximum degree of local market competition—not merely statistical deconcentration—that interstate banking could bring about.

Absent any rigorous means by which to compare the expected burdens on some producers with the expected benefits to other producers and to consumers—a felicific calculus—it is not possible to determine whether the mixed national strategy is “superior” to the small-start approach, i.e. whether the burdens to some would outweigh the benefits to others. It is only this observer’s estimate that the mixed national strategy would be superior in this non-Pareto sense.\(^7\)

4. A Mixed Federal Strategy.—Another approach emerging from this review of the acquisition vs. de novo or toehold entry issue would be to allow the states alone to determine, as they now do to a large extent,\(^7\) whether the means of entry into their markets will be limited as to method. Banks would have a federal right to enter every state by one means or the other, that is, but the states could specify by statute which one. Yet another variation, closer to the mixed national strategy and to the present mix of state and federal law affecting bank market structure, would be to require banks to enter new states by the more pro-competitive means except where the state passes a statute requiring one means or the other. Since these two approaches are analytically similar, I will discuss only the latter, more complex, variation. Because of the role it assigns to the states, I will call it a “mixed federal strategy.”

The probable difference in operation between the mixed national and the mixed federal strategies is that under the latter approach some states would probably act to prohibit interstate entry de novo, while others would probably prohibit entry by acquisition, in each case in order to limit competition below the level im-

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756. Pareto superiority describes a move that makes at least one person better off while making no one worse off. So long as one person is made worse off, it is impossible to determine whether his loss of utility is less than or greater than the gain to others. See Posner, The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication, 8 HOFSTRA L. REV. 487, 488-89 (1980). There are few, if any, proposals for a change in public policy that would meet the test of Pareto superiority.

757. But see note 718 supra.
plied by the mixed national approach. It is predictable, that is, that some states will want to protect their home-state banks from some of the potential competition inherent in interstate banking and further increased by the mixed national strategy; yet owing to the different market conditions among them, they will probably disagree on whether requiring entry de novo or requiring entry by acquisition would do more to limit the impact of new competition and support the market for shares in home-state banks, and on which course would expose non-acquired banks to even greater competition.

Whatever a particular state's view, such states will be trying to trade off some consumer welfare, by limiting the potential for market deconcentration, in order to favor incumbent producers, although they may disagree about the means. This hardly seems like an unacceptable trade-off for a state to make, however, from the point of view of the national interest. Control over local-bank market concentration, as we have seen, has long been vested in the states, and they take quite diverse views of the matter even now. This would be just another aspect of state control over the competitiveness of banking markets. If the consumers within any particular state object to the trade-off being made, moreover, they could organize themselves politically to prevent it. Admittedly, this is not easy to do, but it is a possibility that will prevent legislators from truly oppressing consumers in the intended service of producer welfare.758

5. Conclusion to Part III.—Of the two polar and two mixed approaches to the acquisition vs. de novo entry issue examined here, the mixed national strategy is only probably, and even then only slightly, to be preferred on the standard criteria to the mixed federal strategy; either mixed strategy is superior to either of the polar approaches, however.

758. It is unlikely, for example, that the public would tolerate a state policy that required out-of-state BHCs not only to enter the state by acquisition, but to expand thereafter only by acquisition while banks controlled by home-state BHCs were allowed to branch—a disparity that would probably be unconstitutional, in any event, under Lewis v. BT Investments Managers, Inc., 447 U.S. 27 (1980). At the same time, if an out-of-state BHC cannot branch into the state, complete equality of treatment between out-of-state and in-state BHCs would require that both be required to accomplish any further expansion by acquisition only. To terminate the ability of incumbent BHC subsidiary banks to branch, however, in order to assure perfect equality with out-of-state BHCs is almost certainly more than the Constitution, or sound public policy, would require. It should be enough that the out-of-state BHC must acquire its first location by acquisition, so long as it can branch on equal terms with in-state BHC banks thereafter.
The mixed national strategy does preclude the enactment of state laws that would require that entry be made exclusively by one means or the other, but that does not seem like a significant intrusion upon the states' historic primacy in the area of banking market structures under the state-by-state and dual banking systems. Although the states would be required to allow entry de novo or by acquisition, once having entered the out-of-state bank would be fully subject to state law respecting market structure.

There is no reason to think that entry would occur at an excessive rate under the mixed national strategy. "Over-banked" markets could still be protected administratively from undue levels of new entry, as they are now by both the state and national chartering agencies. Indeed, the mixed national strategy has the virtue that an out-of-state bank could still enter by acquisition a market that could not support an additional bank. Under the mixed federal strategy, on the other hand, if a particular state made either entry by acquisition or de novo unlawful, consumers would be harmed thereby to the extent that some pro-competitive entries would be blocked, or perhaps more often transmuted into less pro-competitive acquisitions. Although it is therefore a second-best solution, the mixed federal strategy may be the best solution that is politically acceptable.

At present, few states now categorically limit the means of intrastate geographical market extensions. It is likely, however, that many more would want to limit the means of interstate entry to their markets. The consumers whose interests are harmed by such limitations are neither organized nor influential on issues such as this, even where they are organized around other, related issues. Furthermore, banks that do plan to expand interstate would probably support any limitation on out-of-state entry into their markets, and banks that hope to be acquired would support a limitation on de novo entry. These would probably be the smaller banks dispersed throughout each state in suburbs and small towns. They would therefore be numerous and the constituents of many congressmen and state legislators.

Reciprocally, banks that want to expand interstate would oppose the states' having any right to erect any limitation on the

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759. For example, some states have "home office protection" laws that would prevent one bank from branching into the headquarters community of another bank although it would be permissible for that bank to acquire the other and operate it as a branch. See, e.g., N.Y. BANKING LAW § 105(1) (McKinney Supp. 1980-1981).
means of entry used. They would prefer to retain the flexibility to enter as their business judgment dictates and especially the ability to use the threat of de novo entry in bargaining over the terms of an acquisition. These would tend to be the larger banks, which are few in number, and whose home offices are concentrated in the downtown sections of major cities. They are thus the constituents of few legislators; indeed many would be distant outlanders with no present political connections to the states that they would wish to enter.

From this analysis, the prognosis is that a mixed national strategy would not be politically acceptable enough to become federal law. Experience under the Douglas Amendment tends to confirm this view. For twenty-five years the states have had the opportunity to invite out-of-state banks into their markets, either unilaterally or conditioned upon reciprocity. In fact, only three states, two relatively underdeveloped and one with a declining economy, have acted to do so, and in each case with significant qualifications. Reciprocal banking bills have recently begun to be introduced in state legislatures, but none has even come close to passing and only the New York Banking Department's bill and a bill introduced in the California legislature at the request of Citicorp have even received committee hearings. The California bill was opposed by the California Bankers Association, which views access to the New York market as an undesirable trade for access to their own state.

If the opponents of interstate-banking entry could be that uniformly successful at the state level, there is little reason to doubt

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760. The states and the qualifications are respectively Maine, which requires reciprocity; and South Dakota and Delaware, which have not opened their retail banking markets to out-of-state BHCs, but merely afforded them a base state from which to extend consumer credit and minimize their taxes. See notes 434-440 supra and accompanying text.


that they could persuade their congressional delegations likewise to insist that the states be allowed to protect home-state banks from any extra measure of out-of-state competition entering their markets. In some states, that may dictate requiring that entry be de novo, in others that it be by acquisition. In all such states, however, it will require that the federal law governing and fostering interstate banking allow the states the means to control entry to their local banking markets.

IV. Standards and Procedures for Interstate Entry

This part of the Article deals with the standards that should be applied to a bank’s application to branch de novo interstate and for a BHC’s application to acquire a bank interstate, as well as the procedures appropriate to each type of application.

A. Standards for Interstate Branching De Novo

It has been proposed herein that both state and national banks be authorized, subject to application, to open retail branches (1) within their interstate metropolitan areas, and (2) in any states that allow entry by branching, i.e., that do not enact legislation to require that entry be accomplished through a separate bank subsidiary of the BHC. It has also been proposed (3) that state and national banks be authorized to open wholesale branches in major financial centers to be designated as such for this purpose.

Intrastate (retail) branching by both state and national banks is everywhere subject to the prior approval of their primary regulator, either the state banking commissioner or the Comptroller. Approval of an intrastate branch typically depends upon (1) the adequacy of the bank’s capital; (2) the earnings prospects for the branch; (3) the public convenience and needs of the community to be served by it; and (4) the bank’s ability to manage the additional branch. 764

Professor Kenneth Scott has convincingly argued that bank regulators need not be concerned with the “profitability of a particular location,” i.e. its earnings prospects. As he pointed out:

A bank simply closes down a branch that does not become profitable; rather than attempting to second-guess the bank’s profitability estimate, the Comptroller [or presumably a state

commissioner] could merely ascertain whether the bank could afford the cost of an error.\textsuperscript{765}

Be that as it may, however, there is surely no reason to apply more stringent standards to an application for an interstate branch than are already applied for an intrastate branch. Indeed, the regulator may be at an even greater relative disadvantage, compared to bank management, in assessing the suitability of a distant, out-of-state branch location, due to differences in local economies as well as the difficulty of studying a distant community. This does not imply, however, that a lesser standard should be applied to interstate branch applications. Indeed, any more liberal standard for interstate branching than intrastate branching could induce banks to place a relatively greater emphasis on interstate expansion than the economics, rather than the law, of the subject would warrant.

Interstate wholesale branching into financial centers should even more clearly be removed from regulatory oversight, so long as the branching bank is profitable enough that, in Professor Scott's phrase, it "could afford the cost of an error."\textsuperscript{766} Wholesale markets—meaning those for banking services provided to businesses, such as cash management, commercial loans, and demand deposit accounts—are already quite competitive and, insofar as large corporate customers are concerned, are intensely competitive. The introduction of still more competitors with branches in a particular financial center is not likely to have measurable, adverse effects on incumbent competitors. Indeed, the small retail-oriented banks that might conceivably need protection from additional competition will be virtually unaffected by the introduction of wholesale branches to a financial center. Thus, the "convenience and needs" standard, and any other criterion that might otherwise be used to temper competition in banking markets, should not be applied to wholesale-branch applications.

\textsuperscript{765} Scott, supra note 764, at 285. The Comptroller has recently revised his policy toward the chartering of new national banks in a manner philosophically close to that espoused by Professor Scott for the consideration of branching applications. Specifically, the Comptroller's new policy "represents a shift in emphasis from the appraisal of economic and competitive conditions in the community to be served to the appraisal of the organizing group and its operating plan. ... The shift in emphasis is consistent with the [Comptroller's] view that the convenience and needs of communities for banking services are best served by a high degree of competition and ... that qualified persons should have the maximum opportunity to organize and operate a national bank." 45 Fed. Reg. 68,603 (1980).

\textsuperscript{766} Scott, supra note 764, at 285.
Ideally, banking regulators would be able to develop objective standards upon which banks could rely in making wholesale-branch decisions without awaiting prior approval. For example, regulators might relate all of the capital and operating expenses reasonably projected for a wholesale branch in its first year of operation to the bank's capital and surplus in order to enable banks to determine for themselves whether they have the capacity and therefore the right to open a wholesale branch; thereafter, they might simply be required to notify the regulator of their intention, as national banks now do when they are about to share the use of another entity's ATMs. In this way, virtually free entry into and exit from wholesale banking markets could be assured for all banks capable of undertaking the risks of participation in such markets, and only for such banks. As a result, it is not necessary further to specify procedures for interstate wholesale branching.

B. Procedures for Interstate Retail Branching De Novo

Regardless of their merits, the justifications for requiring banks to secure the prior approval of their primary regulator before opening a retail branch apply equally in the interstate and intrastate contexts. Whether the bank holds a state or national charter, therefore, it should not be allowed to branch interstate without the approval of its primary regulator so long as that approval is required for intrastate branches.

Whether the approval of the host-state banking commissioner should be required before an out-of-state bank branches into a host state is a much harder question. The obvious danger is that host-state commissioners will discriminate against outlanders by withholding their approvals or granting them only with respect to less desirable locations or less formidable competitors. Such subtler forms of discrimination would probably defy detection and would certainly prove a challenge to effective judicial review in an area noted for judicial deference to administrative discretion.

On the other hand, if the approval of the host-state banking commissioner is not required, the host state will lack control over two important aspects of its own banking market structure. First, the host state will lack control over the number of banks operating


768. See Camp v. Pitts, 411 U.S. 138 (1973); Scott, supra note 764, at 264-68.
in its territory. Second, it will not be able to control or direct the impact of out-of-state banks' locational decisions on host-state banks. Consider, by way of example, a market with ten unit banks. The market may be easily able to accommodate the addition of an eleventh bank, in the form of an interstate retail branch of a distant money center bank. Certain of the incumbent banks may not be able to withstand such competition, however, if the out-of-state branch is located directly across the street from them.

The states lack these controls on market structure to the same extent, under the dual banking system, when a national bank charter or branch application is sought for a location within the host state. The Comptroller, as primary regulator, will pass upon the application and thereby determine whether a new national bank or branch will open in a given market and at what location within it. This provides some competitive incentive for state banking commissioners to approve applications. As observed earlier, if they deny a charter application, there is some probability that the Comptroller will approve essentially the same application, the only difference being that the Comptroller rather than the state commissioner will then have jurisdiction over the bank.⁷⁶⁹ Even so, no major problems have arisen from this shared control over entry.

In the interstate context, the incentives for regulatory competition are somewhat different, and would be much stronger. If the approval of a bank's primary regulator alone were required to establish a branch in a host state, that is, there would be no reason to expect such approval to be withheld out of solicitude for the host-state banks with which the branch would be in competition. Indeed, state banking commissioners might allow virtually unlimited out-of-state branching, subject only to the bank's ability to "afford the cost of an error." So, too, with the Comptroller's attitude toward interstate branches by national banks. Whatever the merits of regulatory competition between state and national regulators in the intrastate context, therefore, nothing can be said to redeem the expected competition between host and home state regulators in the interstate context: each state would be tempted to approve its regulatees' forays into other states, while defending their home markets against the incursions of banks from other states.

⁷⁶⁹. See text accompanying note 32 supra. A similar, but undoubtedly more attenuated, competitive force may affect a primary regulator's branching decisions as well, since a bank that is denied important branch applications may convert its charter (state or national) to join a more obliging regulatory system. Cf. text accompanying note 570 supra (charter conversion to obtain regulatory approval of acquisition).
From this analysis, it seems that the two elements one would want to see in the procedures for interstate retail branching would be (1) assurance to host-state regulators that they will not be inundated by the branches of out-of-state banks in their markets; and (2) assurance to home-state regulators (and the Comptroller) that their regulatees will not be discriminatorily denied or hampered in their efforts to enter host-state markets. These two potentially conflicting goals could both be served if a bank applying for interstate branching authority were required to secure the approval of a regulator, in addition to that of its primary regulator, whose mandate and vision extend beyond the welfare of the host state or host-state banks. This could only be a federal regulator; and it must be someone other than the Comptroller, since he or she will be the primary regulator with respect to national banks branching interstate, and the point here is to require approval from someone who will balance the interests of the host state with those of the primary regulatory jurisdiction, whether it is a state or the Comptroller.

The situation is quite analogous to that in which a BHC proposes to acquire a state bank. The BHC is regulated by the Fed, although its subsidiary banks have the same primary regulator, be it the Comptroller or a state, that they would have if they were independent of a holding company. A BHC's application to acquire a bank subsidiary is submitted to the Fed, which solicits the "views and recommendations" of the bank's primary regulator. If the primary regulator "disapproves the application," the Fed so notifies the applicant and holds a hearing on the application. The Fed's final decision on the application is to be made on the basis of the record of such hearing.770

In that situation, the state's interest in whether a BHC, or a particular BHC, will control one of its charters is accommodated, without giving the state the power to decide the matter by itself. Nor is the decision vested in a regulatory authority that is any way in competition with the state banking commissioner (or the Comptroller where he is the primary regulator).

A similar reconciliation of interests could be achieved if the Fed, or FDIC, (or indeed a new agency) were given authority, in addition to the bank's primary regulator, to approve or disapprove interstate retail branches.771 The host-state banking commissioner


771. As between the two federal agencies, the FDIC may be the preferable decisionmaker. While it is an interested party in bank solvency, as the bank's insurer, there is no reason to think it will be more (unduly) conservative in approach-
could have an advisory role in the federal agency’s proceedings to assure that any adverse impact that the interstate branch might have on the host state’s local banking market is weighed in the decisional balance.

C. Standards for Interstate Bank Acquisitions

Under this proposal for interstate banking, a banking organization may be prohibited from branching directly into a host state and required, instead, to operate a separate banking subsidiary in the state if it is to enter at all. Further, the host state may specify that the entering BHC must acquire an existing bank or, alternatively, must obtain a de novo charter (state or national) for a bank located in that state. In either case, there is nothing in the interstate context to justify departure from the present standards by which a BHC’s application to acquire an existing or de novo bank is judged. The BHC Act predicates the Fed’s approval of an acquisition application upon its competitive consequences, the financial and managerial resources of the banks involved, and the public convenience and needs. These factors are equally relevant regardless of whether the acquiring BHC has its principle banking subsidiary in the state of application or another state.

Doubtless, the application of these factors in the interstate context may be somewhat different in practice. For example, the financial and managerial resources of the BHC may be stretched more by a long-distance interstate acquisition than by the same acquisition intrastate. Compliance with an additional set of regulations will be required, for example. Communication and coordination will make greater demands on the management of the BHC in the interstate context, at least insofar as significant distances are involved. These would require at most relatively minor variations in the way that the standards of the BHC Act are now applied, however. The Fed has substantial experience with the Act’s standards, and it should be no great task to apply them in the interstate context, with such slight adaptation as experience proves necessary.

D. Procedures for Interstate Bank Acquisitions

Since the Fed is responsible for regulation of BHCs generally, it must have the same power to disapprove an interstate acquisition
as it has over an intrastate acquisition. Otherwise, the BHC that would not be allowed to make an intrastate acquisition due to inadequacy of its capital or management would be able to consummate an interstate acquisition notwithstanding the same defects.

The more difficult question is whether the approval of the primary regulator of the bank to be acquired should be necessary before the acquisition is permitted. Where the bank to be acquired holds a national charter and the primary regulator is the Comptroller, there is no reason to fear that approval would discriminatorily be withheld, i.e., that interstate acquisitions would be disfavored relative to intrastate acquisitions.

When the bank to be acquired is state chartered, however, there is at least some possibility that the host-state banking commissioner will discriminate against BHCs that are based in another state. The commissioner, after all, will know and often be on good terms with the management of local BHCs, while the management of an out-of-state BHC may be entirely unfamiliar to him. He may understandably, therefore, prefer to see local rather than out-of-state BHCs acquiring independent banks the supervision of which is his responsibility.

On the other hand, if the approval of a target bank’s primary regulator is not required, at least in the case of a state-bank acquisition, that regulator could find himself responsible for the supervision of a bank the control of which has passed to an out-of-state BHC to which the regulator has legitimate, nondiscriminatory objections. Under the BHC Act, the banking commissioner will have been able to present these objections at the Fed’s hearing on the application. Nonetheless, it is at least conceivable that such objections will be overweighed by other considerations within the Fed’s mandate. Fed approval of the acquisition will then result in the state commissioner having to supervise—as to both soundness and state policy guidance—a bank whose control has passed to out-of-state managers over his objection. State policy guidance especially may be impeded, since it is more dependent upon informal relationships (backed up by the chit system, to be sure). Insofar as

a hostile regulatory relationship then obtains, neither the bank nor the public will be well served.

In light of this drawback, the approval of the target bank's primary regulator should probably be required before an interstate acquisition can take place. The possibility of a state banking commissioner discriminating against out-of-state acquirors should not be intolerably great. It is important, however, that when a state commissioner disallows an acquisition by an out-of-state BHC, that does not preclude conversion to a national charter and post-conversion acquisition. If it appears that a state commissioner is discriminating, moreover, banks seeking to be acquired will convert to national charters before the acquisition application is filed by the BHC. In this way, state banking commissioners will be "disciplined" by the dual character of the banking system, even in its interstate manifestation. Regulatory competition can be relied upon in this context, that is, to minimize the risk of discrimination against out-of-state interests.

V. SUMMARY AND SOME CONCLUDING OBSERVATIONS ON FEDERALISM IN BANK REGULATION

Part I of this paper described the state-by-state and dual bank regulatory structures within which the development of de facto interstate banking has arisen. In Part II of the paper, I suggested and applied a set of criteria by which to determine whether to give de jure recognition to interstate banking, while Parts III and IV considered issues of extent and means, standards and procedures, under the same criteria, to derive ideas about the alternatives and an articulated proposal.

Throughout the analysis I have attempted to analyze the problems associated with interstate banking, and the legal recognition thereof, in isolation from other issues to which they could have been related. Thus, I have taken as given and legitimate such other elements in the policy environment as regulatory control over entry into banking, state autonomy over the structure of local banking markets, and the continued existence of the dual banking system, to name but a few. Each of these elements could equally have been drawn into question and therefore into the analysis, but it seemed wiser to isolate the interstate banking issue in this initial foray into the subject. As the policy debate on interstate banking proceeds, as it is sure to do over the next several years, linkage to

773. See text accompanying notes 56-60 supra.
other issues may be appropriate and inevitable; but simplicity is the order of the day for now, as we build our understanding of the issue and the stakes. Nonetheless, I shall venture a few remarks on the irrepressible relationship between interstate banking and the dual banking system.

This paper has shown that a virtually complete system for interstate banking, including nationwide BHCs and limited interstate branching by banks, can rationally coexist with the dual banking system. Of course, the proposal made here does imply a shift of power to the national government, since it entails a federal right for a bank or BHC to enter a new state subject only to entry regulations imposed equally upon local institutions and outlanders. This nondiscriminatory entry right is little more, however, than the application of the Commerce Clause of the Constitution to the business of banking; it does nothing to divest the states of their regulatory authority over those banking organizations that avail themselves of the right to enter their borders. The dual banking system could, and I think would, persist and thrive under these conditions.

The more difficult question is what the future portends for dual banking if there is no such change in federal law to facilitate interstate banking. Extrapolation from developments thus far leads me to doubt the viability of dual banking without interstate banking.

I have already described the imaginative means by which banks and BHCs have contrived to enter out-of-state markets with both liability and particularly with credit products, and the reasons to think that this trend will continue. From another point of view, the interstate market penetration of banks and BHCs can be seen as a fragmentation of the business of banking. First, because a “bank” cannot branch or affiliate through a BHC with another bank across state lines, an incentive has been created to break the idea of a bank down into its constituent elements, and to devise means by which to offer the associated products interstate. In this way virtually all of a bank’s services other than deposit-taking can reach new markets. Second, interstate bank deposit-taking itself may soon be a reality, too, as the money-market funds have demonstrated the willingness of consumers to maintain balances at distant institutions accessed by mail, telephone, or wire, and to do so even without the benefit of deposit insurance. In the absence of bank-interest-rate regulation, the funds will lose their advantage, and banks will compete for balances at market rates—presumably in a
nationwide market. Third, shared interstate ATMs, if they are or become lawful, will enable a bank to give distant retail customers access to cash withdrawals.

Under these circumstances, the attachment of a particular bank to its home state will be substantially more attenuated than at present. This is not to say that banks will become disembodied ideas representing electronic networks of computers and ATMs with their seat arbitrarily "located" wherever economic and regulatory forces suggest that they should call home. But it is not so far-fetched to suggest at least some movement in that direction, abetted by a new regulatory competition among the states.

We have already seen Citicorp relocating some of its retail operations in South Dakota, and the Chase Manhattan and Morgan banks undertaking a similar move to Delaware, in each case through a new national-bank subsidiary. In return for jobs and taxes, these jurisdictions have traded local entry rights and powers, but in each case their real purpose is to serve as a base state for nationwide retail banking: the national charter enables the banks to extend credit to residents of other states at their new "home" state interest rates, and newly provided state laws make these interest rates unlimited. This development represents a new regulatory competition among the states that will only increase in the future, while the opportunity for banks to exploit competition between the state and federal governments will decrease; indeed at least 34 states have already passed "some form of wild card statutes" to assure "that state banks have any powers which national banks have by statute or which the Comptroller says they have," thus at least limiting state-federal competition in a majority of the states. As state and federal powers come more and more into congruence in any one place, however, disparities among places will increasingly be the focus of the banks' strategic attentions.

If, instead of leaving the states to compete for the transient allegiance of large banks, interstate banking were authorized in some manner akin to that proposed here, banking organizations would avail themselves of the opportunity to establish a retail presence in target markets, so long as such a presence remains a competitive advantage. In so doing, they would subject themselves to the regu-

774. See text accompanying notes 435-440 supra.
lation of the host state in dealing with its residents, and in this manner, the role of state law—both in chartering banks and regulating their transactions—would be enhanced. Of course, should the time come when a retail presence is not worth the regulatory candle, and banks indeed become invisible, if not abstract, respondents at the other end of a telephone or computer network, then there will be no room for a meaningful regulatory regime that is not coextensive with the banking enterprises' scope of operation. This has been the consistent lesson of modern history as new technologies have assumed a scale that transcends geographic legal regimes.  

Either bank regulation will become unenforceable, as banks choose their jurisdiction the way nonbank corporations choose their chartering state, or it will be centralized in the national government.

Accordingly, I submit that a move to interstate banking, accomplished through federal law, will strengthen the dual banking system, whereas rigid retention of the state-by-state regulatory system will encourage artifice and device in the short run and an artificially accelerated shift of banking to new technologies that in the long run will transcend and confound state regulation, and thus either trivialize or displace altogether the dual banking system.
