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INTERSTATE BANKING
Douglas Ginsburg
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# TABLE OF CONTENTS

ACKNOWLEDGEMENTS

ABSTRACT

## I. CONTEXT OF THE STUDY

### A. THE CURRENT LEGAL POSITION

1. The dual banking system: state and national banks
   (a) Origins
   (b) Regulatory competition
       (i) Entry
       (ii) Examination
       (iii) Powers
       (iv) Other
   (c) Increasing regulatory uniformity
       (i) Reserve requirements
       (ii) Branching authority

2. The triple banking system: BHCs
   (a) BHCs and regulation
   (b) Diversification under 1970 Amendments

3. The state-by-state banking system
   (a) The role of federal law
   (b) The case for the state-by-state banking system

### B. THE CURRENT BUSINESS REALITY

1. Reasons for interstate efforts
   (a) Growing and contracting markets
   (b) Geographical risk diversification
   (c) Economies of scale
   (d) Technological opportunities: computing and communicating

Page

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACKNOWLEDGEMENTS</td>
<td>1</td>
</tr>
<tr>
<td>ABSTRACT</td>
<td>5</td>
</tr>
<tr>
<td>I. CONTEXT OF THE STUDY</td>
<td>5</td>
</tr>
<tr>
<td>A. THE CURRENT LEGAL POSITION</td>
<td>5</td>
</tr>
<tr>
<td>1. The dual banking system: state and national banks</td>
<td>5</td>
</tr>
<tr>
<td>(a) Origins</td>
<td>5</td>
</tr>
<tr>
<td>(b) Regulatory competition</td>
<td>7</td>
</tr>
<tr>
<td>(i) Entry</td>
<td>8</td>
</tr>
<tr>
<td>(ii) Examination</td>
<td>12</td>
</tr>
<tr>
<td>(iii) Powers</td>
<td>12</td>
</tr>
<tr>
<td>(iv) Other</td>
<td>15</td>
</tr>
<tr>
<td>(c) Increasing regulatory uniformity</td>
<td>15</td>
</tr>
<tr>
<td>(i) Reserve requirements</td>
<td>16</td>
</tr>
<tr>
<td>(ii) Branching authority</td>
<td>18</td>
</tr>
<tr>
<td>2. The triple banking system: BHCs</td>
<td>23</td>
</tr>
<tr>
<td>(a) BHCs and regulation</td>
<td>23</td>
</tr>
<tr>
<td>(b) Diversification under 1970 Amendments</td>
<td>29</td>
</tr>
<tr>
<td>3. The state-by-state banking system</td>
<td>36</td>
</tr>
<tr>
<td>(a) The role of federal law</td>
<td>36</td>
</tr>
<tr>
<td>(b) The case for the state-by-state banking system</td>
<td>41</td>
</tr>
<tr>
<td>B. THE CURRENT BUSINESS REALITY</td>
<td>48</td>
</tr>
<tr>
<td>1. Reasons for interstate efforts</td>
<td>48</td>
</tr>
<tr>
<td>(a) Growing and contracting markets</td>
<td>49</td>
</tr>
<tr>
<td>(b) Geographical risk diversification</td>
<td>52</td>
</tr>
<tr>
<td>(c) Economies of scale</td>
<td>54</td>
</tr>
<tr>
<td>(d) Technological opportunities: computing and communicating</td>
<td>57</td>
</tr>
</tbody>
</table>
2. Interstate banking today
   (a) Commercial banking interstate
      (i) Loan production offices (LPOs) and call programs
      (ii) Cash management services
      (iii) Edge Act corporations
   (b) Retail banking interstate
      (i) Credit cards
      (ii) Retail LPOs
      (iii) Deposit-taking
      (iv) ATM networks
   (c) Non-bank subsidiaries interstate
      (i) Extending credit
         (aa) Consumer finance companies
         (bb) Mortgage banks
         (cc) Factors
         (dd) Commercial finance and leasing companies
      (ii) Deposit-taking
      (iii) Trust and fiduciary services
   (d) Data processing interstate
   (e) Perspectives on interstate banking
   (f) Notes on the significance of deposit-taking

C. THE CURRENT LEGAL POSITION RECONSIDERED
   1. Implications of the current system
      (a) The branch definition problem
      (b) Concentration and competition
      (c) The premises of state-by-state banking
   2. The state of the debate
      (a) State legislation
      (b) Problems of reciprocity
      (c) The presidential report

II. THE CRITERIA FOR DECISION

A. CONSUMER WELFARE
   1. Depositors
   2. Retail borrowers
   3. Commercial borrowers

B. PRODUCER WELFARE
   1. Shareholders
   2. Employees
ABSTRACT

Commercial banks are unique among major American industries in that they may not generally operate, directly through branch offices or by affiliation with a commonly owned bank, in more than one state. Banking enterprises, which include both banks and bank holding companies (BHCs), may not, that is, engage in "the business of banking" in more than one state. A bank chartered by and located in State A may not open a branch in State B, nor may a BHC that owns a bank in State A acquire a controlling interest in or receive a charter for a bank in State B. Of course, the bank or BHC with bank(s) located in State A may lawfully deal with residents of State B, making them loans, taking their deposits, etc. As a practical matter, however, not having a bank or branch location in State B will often be a significant disadvantage in seeking the business of residents of State B. Whether it is significant depends upon the particular service, since the bank or BHC of State A can offer some services conveniently by mail or telephone and others through an office in State B that is not a bank or branch—i.e., that is not engaged, as a matter of law, in "the business of banking" in State B.

Even this cursory statement of the state-by-state regulatory regime for banking raises a host of questions. What is "the business of banking" subject to this regime?
What is a "bank"? A "branch"? Why does the regulatory regime confine a banking organization's banks and branches to a single state? And most important, what are the costs and benefits of its doing so? Would a broader geographical reach for banking organizations--whether nationwide or something short of that--be preferable?

This article considers the appropriate geographical limitations, if any, to be placed on enterprises engaged in the business of banking. Each of the questions put in the prior paragraph must be addressed to some extent in order to conduct this inquiry fully, and the last two of them will be dealt with extensively here. The article will develop, and then apply, the criteria for judging one geographical configuration for the banking industry "preferable" to another.

Accordingly, after establishing more fully in Part I both the legal and business backgrounds against which this inquiry proceeds, I shall specify in Part II a set of welfare criteria for the analysis of alternative policies respecting geographical limitations. Part III will address questions of the extent and means of interstate banking indicated by the criteria. There I will discuss such issues of means as interstate branching versus multi-state BHCs, and acquisitions versus de novo (new) entry, as well as issues of extent, such as full service branches versus automated teller machines, and the limits that should be placed on the geographic reach of banking organizations. This effort will entail both application of the criteria
developed in Part II and an analysis of the political considerations that may constrain the extent and direction of change 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.

On the basis of the criteria developed and the 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, in any state on the same terms as local banks and BHCs; it will probably be necessary, however, as the political price of any geographical liberalization, to allow the various 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 the acquisition of an existing bank, or only by chartering a de novo bank, so long as it applies the same limitation to intrastate geographical market extensions by BHCs located within the state. Second, a bank that is located within a metropolitan area that includes part of more than one state should be able to branch throughout its metropolitan area regardless of the state boundary. Third, banks should be permitted to open "wholesale" branches in major financial centers to serve commercial customers.

* "Should" here and elsewhere in the text is not meant as an absolute prescription or an expression of personal preference. It is merely shorthand for the implications of the criteria developed in Part II. Other options, criteria or weightings could lead to other implications.
All of the analysis and the conclusions about interstate market penetration by banking organizations to which it leads are made subject to familiar standards respecting bank solvency and community needs, and a preference for the most pro-competitive form of entry practically available in the particular circumstances.
I. CONTEXT OF THE STUDY

A. The Current Legal Position

1. The dual banking system: state and national banks.

In every state, express authority, in the form of a charter, is required for entry into the business of banking.\(^4\)\(^/\) The charter may be granted by the state, acting through a banking commissioner or a collegial agency, or it may be granted by the federal government, acting through the Comptroller of the Currency.\(^5\)\(^/\) In either case, the resulting state or national bank will thereafter be supervised primarily by the chartering authority, which is known as its "primary regulator." An existing bank may, however, convert from one type of charter to the other—from state to national bank status or vice versa—with the permission only of the regulator to whose regime it seeks admission,\(^6\)\(^/\) and its primary regulator will thereafter be the new, rather than the original, chartering authority.

(a) Origins: The dual banking systems dates from 1863, when Congress enacted the National Bank Act.\(^7\)\(^/\) Until then, commercial banks had been chartered by the state governments,\(^8\)\(^/\) with the temporary exceptions of the congressionally chartered Bank of North America (1781-1785) and the bitterly controversial First (1791-1811) and Second
(1816-36) Banks of the United States. When President Jackson vetoed the 1832 bill to recharter the Second Bank, the states had regained their exclusive province.

The federal government re-entered the commercial bank-chartering field in 1863 in response to the problems it had encountered in financing the Civil War. Under the National Bank Act, charters were made available only upon the purchase (and deposit) of a substantial volume of United States bonds, in return for which the bank received national bank notes, i.e., a national currency. National banks were given special privileges, such as that of serving as a depository of government funds, while the bank notes issued by state banks were subjected to a 2% tax. In this way the federal government intended to drive the state banks out of existence, subject all banking to its regulation, establish a uniform currency, and support the market for its debt. In 1865, when this combination of carrots and sticks still proved inadequate to attract many of the state banks to national charters, Congress raised the tax on state bank notes to 10%. The constitutionality of the tax was upheld by the Supreme Court in 1869, through 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.

Even after the Supreme Court's decision, some state banks persisted, but the great majority converted to national charters. Indeed, about 85% of all banks with 88% of all
bank deposits were national in 1870.\textsuperscript{16} Nonetheless, the survival and later resurgence of state banks was made possible by the then already increasingly general shift, among both national and state banks, to the use of checking deposits instead of bank notes as money.\textsuperscript{17} Thus freed of the problem created by the tax on their notes, many states' bank charters were again more attractive than national ones since state regulation was generally less stringent. In fact, the decline in state bank deposits had ceased in 1867, and state and national bank deposits were about equal again in 1871;\textsuperscript{18} state banks outnumbered national banks again by 1890.\textsuperscript{19}

There have been no other frontal assaults on the existence of state banks since 1865. Today there are more state than national banks in every state except Pennsylvania,\textsuperscript{20} although national banks hold 55% of all commercial bank deposits.\textsuperscript{21}

(b) Regulatory competition. Depending upon its precise form, interstate banking would have more or less of an impact on the dual banking system and particularly on the continued vitality of the state banking regimes. Because of the competitive check on regulators that it provides—each regulator is restrained from "excessive" regulation by the ability of banks to switch charters and therefore regulators—banks have venerated the dual system as their "Magna Carta";\textsuperscript{22} they have fought to preserve its vitality against proposals for federal preemption of bank regulation,\textsuperscript{23} and would
presumably be equally opposed to a system of exclusive state regulation. Indeed, since regulatory competition is the essence of the dual banking system, I pause here to examine more particularly how and where it operates.

(i) **Entry.** Entry into banking is controlled and limited primarily for two reasons.\(^{24}\) The first is consumer (particularly depositor) protection, for banks and bankers are foremost the custodians—in Brandeis' phrase—of other people's money;\(^{25}\) the opportunities for fraud and the equally severe consequences of mismanagement caution against completely free entry to an even greater extent than in many other entry-regulated fields. Notice, however, that this concern 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.\(^{26}\)

The second reason for control over entry is to limit competition in the industry. A highly competitive industry is characterized by a rate of firm failure and withdrawal that is regarded as unacceptable in banking due to: (1) the financial impact of bank failure on uninsured depositors; (2) the disruption of established consumer and commercial borrowing relationships implied by a bank's closing; and (3) the infectious and self-fulfilling character of a loss of public confidence in the solvency of banks.\(^{27}\) In order to limit competition, the number and the location of banks chartered in a given area must be controlled.\(^{28}\)
These 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 various trades and professions may be based upon both these grounds, although it is more often justified solely as a means of consumer protection from fraud and incompetence.\textsuperscript{29/} Entry into broadcasting is regulated in part on the ground that the rigors of competition will lead to a degradation of service to the public.\textsuperscript{30/}

The unique element in the control of bank entry is competition among regulators to grant charters. Under the dual banking system both the relevant state and the national government may charter a bank at any particular location; if one chartering authority will not grant a charter for a new bank, perhaps the other will. True, both the state regulator and the national Comptroller have considered whether the community of application "needs" (will sustain) another bank, as well as the related question whether the existing banks can withstand the competition of another bank,\textsuperscript{31/} but the two chartering authorities may apply these standards somewhat differently, with one inclined to a more pro-competitive, pro-entry view of the market.\textsuperscript{32/}
Each has some incentive to be the more liberal, however. 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 to introduce an additional competitor to the market notwithstanding the state regulator's preference to the contrary. Worse from the state's point of view, the new competitor will be a national bank, supervised by the Comptroller rather than the state. At the same level of resulting competition, then, the state regulator could have had one additional constituent—with which to justify a larger staff and budget—and through which to pursue his or her or the state's policies respecting such matters as bank reinvestment in home mortgages, local enterprises, and municipal debt, and, in states that allow branching, the number and location of branch offices the bank should be allowed to have.

The incentive for both the state regulator and the Comptroller to be liberal in chartering new banks is limited and offset by their concern with avoiding bank failures. Generally, a failed bank is no longer merely liquidated, with all the adverse consequences mentioned earlier. Instead, the Federal Deposit Insurance Corporation (FDIC), which insures the first $100,000 of most accounts in state and national commercial banks, induces another bank or group of banks in the area 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,\textsuperscript{37} which still entails some adverse effects: the loss of a competitor in the market; the disruption of many banking relationships; usually the loss of some employment; and almost always a complete loss to the shareholders of the failed bank; as well as a marginal threat to 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 bank failure, or a number of smaller ones close in time, can be embarrassing as well as protracted.\textsuperscript{38}

At the point of entry control, then, there are conflicting forces at work. Entry control was adopted by the legislatures in part to limit entry, but regulatory competition between the Comptroller at the national level and his counterpart at the state level tends to encourage a more permissive administration of entry policy. At the same time, the legislatures' decision to control entry is reinforced by its actual and potential oversight, \textit{post hoc}, when there are significant bank failures.

This is not to suggest that many bank failures arise from banking markets becoming overly competitive. There have in fact been relatively few bank failures in recent decades, and most of them have been caused by fraud or mismanagement.\textsuperscript{39} Studies of entry policy and of the concentration ratios in banking markets suggest that both state and national bank regulators have limited entry and bank
competition, notwithstanding regulatory competition, at least to a degree sufficient to avoid failures and the ensuing legislative disapprobation.\textsuperscript{40/}

(ii) Examination. For the same reason--avoiding the legislature's sanction 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.\textsuperscript{41/} Virtually every aspect of a bank's operations conceivably relevant to solvency may be examined, including the quality of management personnel, security and control systems, liability management procedures, and asset quality.\textsuperscript{42/} While the adequacy of some examination staffs and procedures have been criticized,\textsuperscript{43/} and scrutinized by legislatures investigating bank failures, there is little evidence that a state regulator or a Comptroller has even implicitly held out the prospect of lax examination to make a state or national bank charter, respectively, more attractive to banks.\textsuperscript{44/}

(iii) Powers. On the other hand, there is evidence of vigorous competition between the Comptroller and the regulators of state banks, including some state legislatures, to make their respective charters more attractive by interpreting broadly the statutory powers that such a charter generally authorizes any bank to exercise, and by administering liberally any statutory grants of discretion to the regulators to confer special powers upon their banks. Thus, the Comptroller has interpreted the National Bank Act to authorize
national banks to offer travel agency services, establish and operate mutual funds, open loan production offices, and so on. Although each of these interpretations was later rejected by the courts, others--most importantly, those authorizing financially related data processing services and personal property leasing--have survived judicial review, if only after substantial qualification in their breadth.

Some state regulators have also been very aggressive in interpreting the charter powers provisions of their organic statutes, and in a majority of the states the legislatures have assured state banks of at least competitive equality with national banks by providing in statutes that, in addition to their enumerated powers, state banks may exercise any powers allowed or later to be allowed to national banks.

Evidence of regulatory competition by means of the liberal exercise of discretion is somewhat harder to come by. Discretionary grants of special powers involve such matters as applications to open branches (in states that allow branching) and to acquire other banks. Although there is some impressionistic evidence of regulatory competition in these areas, the decisions have not been rigorously studied to determine whether liberalization by one regulator has led the other to follow suit. This may reflect the difficult methodological problem of establishing a causal relationship between two factors in the midst of what are
inevitably complex situations, especially in light of the relatively small amount of data; it would be almost impossible to demonstrate a statistically significant increase in the number of state bank branch application approvals, for instance, lagged after a similar increase for national banks in the same state, that might not also be explained by other factors applicable to both state and national banks within that state. Nonetheless, it is fairly inferable in principle that, other things begin equal, a state or national bank regulator with a significantly tighter policy on branch applications or the grant 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.

An example is provided by the recent attempt of the Marine Midland Bank, which was chartered by New York, to be acquired by the Hong Kong and Shanghai Banking Corporation (HKSB). Because HKSB would become a BHC by reason of the acquisition, Federal Reserve Board (hereinafter Fed or FRB) approval of the acquisition was needed, and it was obtained. New York Banking Commissioner Siebert, however, then indicated that she would not approve HKSB's acquisition of control of Marine Midland Bank, 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. Since, in the wake of Marine Midland's case, Comptroller Heimann made a lengthy
statement dealing indulgently with foreign acquisitions in general, other state banks—both in New York and elsewhere—trying to be acquired by foreign banks may be able to induce their regulator's approval more readily in the future with the implicit or explicit threat to convert to a national bank charter.

(iv) Other. There are many ways in which the national and the several state banking statutes and regulatory systems can and do differ, and these confer competitive advantages and disadvantages upon their constituent banks. An example of some competitive significance is the disparate treatment of the banks' limit on loans to any one borrower. This lending limit is generally expressed as a percentage of capital, which is itself variously defined, but the result is to establish a maximum size loan with respect to any given bank, and that maximum may, in a particular state, differ depending upon whether the bank holds a national or state charter. Accordingly, the lending limit and other such differences that will turn on the choice of a charter are de facto terms of competition between the two banking systems. Even taken all together, however, these differences are not as important as would be any significant disparity between the national and state regimes in granting general and special powers to banks, as discussed above.

(c) Increasing regulatory uniformity. In recent years, Congress has passed a number of banking laws applicable
with equal force to national and virtually all state banks.62/
As a formal matter, the predicate for asserting jurisdiction
over state banks has generally63/ been that, with few exceptions,
their deposits are insured by the FDIC.64/ In most states,
banks are required by statute, as are national banks, or by
regulatory policy to insure their deposits with the FDIC;65/
in three states, however, including such a major banking
center as Texas, deposit insurance is not required,66/ but
it is simply a business necessity for state-chartered banks
to obtain FDIC insurance in order to compete with insured
national banks for deposits.67/ Since FDIC insurance is a
practical necessity, Congress can apply regulation uniformly
by conditioning insured status upon compliance with the
desired norm.

While the states remain free to impose even more stringent
conditions upon state-chartered banks, they would do so to
their competitive detriment. It thus remains likely that
whether federal standards are made applicable to all banks,
or to all insured banks, they will be a uniform feature of
bank regulation across the two systems.

(i) Reserve requirements. By far the most significant
extension of uniform regulation came in 1980 and 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.68/ Member banks are required
to subscribe 6% of their capital for stock in their regional
Federal Reserve Bank. Until recently, 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 one instrument through which the Fed could exercise monetary policy, for its adjustment of the reserve requirements would affect the amount of their lendable funds and thus the overall money supply. Non-member state banks, in contrast, were required by the states to hold reserves only for the purpose of meeting their liquidity needs. Typically, therefore, they have been allowed to meet reserve requirements with Treasury bills, which are readily marketable and earn interest for the bank.

Both the capital subscription and the reserve requirement have acted as an implicit and often substantial tax on member banks. The effect of the tax was offset, but to an extent that varied greatly with the size of the bank, by the Fed's provision of a large number of subsidized services, such as check processing and coin and currency services for which no charge was made at all. Still the economic significance of the implicit tax was so great, even after the offset for Fed services was taken into account, that a large number of banks withdrew from Fed membership during the 1970s. Since a national bank had to be a Fed member, this entailed some national banks switching to state charters, and it implied as well that some new and extant state banks were probably deterred from seeking a national charter.
When the Fed convinced Congress that the exodus of members was so severe that its ability to control monetary policy was jeopardized, Congress made the Fed's reserve requirements essentially universal, by extending them, on a phased-in schedule, to all insured banks[^75] (as well as, for related reasons, to other depository institutions offering transaction accounts).[^76] In addition, Congress directed the Fed to charge a compensatory price to members and non-members alike for all of its services.[^77] Consequently, while member banks are still somewhat 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 non-members, thus removing a relative disadvantage long associated with a national bank charter.

(ii) Branching authority. Something like regulatory uniformity was achieved in 1933 with respect to the branching powers of state and national banks by a quite different route. Federal law incorporated state law provisions governing branching. Prior to 1927, national banks were prohibited from opening branch banks by the National Bank Act, as interpreted by the early comptrollers.[^78] Meanwhile, some states had been authorizing branch banking with increasing liberality. State-chartered banks in these states were able to follow their customers to the newly burgeoning suburbs and generally to gain a competitive advantage over national
banks in making themselves convenient to the public. At the same time, branching policy varied greatly among the states: at one extreme were the so-called "unit bank" states, which did not allow any branching; at the other extreme were those that allowed statewide branching, subject only to the usual prudential considerations; and in between were those that authorized branching subject to some limitations. These limitations were principally geographical, such as those authorizing only home or contiguous county branching; numerical, such as those limiting the number of new branches opened per year to one or two; or explicitly anti-competitive, such as those protecting a bank from the competition of branch banks in its home office community.

Notwithstanding the limitations of the National Bank Act, some national banks managed to take advantage of the branching powers open to their state bank competitors. Shortly after its enactment, the National Bank Act had been amended by Congress to induce more state banks to convert to national charters by the addition of a provision allowing state banks with branches to retain their branches after conversion to national bank status. Pursuant to the Consolidation Act of 1918, moreover, a national bank with branches retained at its conversion from state bank 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 consolidating with it. Indeed, the national bank could cause a state bank to be chartered, to open branches, and then to consolidate with itself. It is some measure of the competitive disadvantage felt by national banks that by 1926 they had acquired 121 branches by this circuitous route. 85/

In 1927, Congress ameliorated this national bank disadvantage through passage of the McFadden Act, 86/ which authorized national banks to open a limited number of branches in their home communities. 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. The inadequacy of this home community solution soon became apparent, and Congress returned to the question of national bank branching. In 1932, the Senate passed a bill authorizing national banks to branch throughout the state in which they were located and to branch interstate within 50 miles of their home office; 87/ but the House did not accede. Under the Senate's approach, national banks would have been at a distinct advantage in every state that did not meet their competition by authorizing statewide branching for state banks, and even in states that did authorize such branching, interstate compacts would be required if state banks were to be allowed to branch into neighboring states in parity with national banks.

In 1933, Congress returned to the branching issue amidst the emergency atmosphere created by widespread bank
failures and the President's declaration of a "Bank Holiday."\(^{86}\) The branching issue was resolved by a compromise that enabled national banks to branch throughout their home state if state banks were authorized to do so:

... 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.\(^{89}\)

As the Supreme Court has stated, whereas "National Banks have been national favorites" with respect to some subjects,\(^{90}\) in 1933 the Congress adopted a policy of "competitive equality"\(^{91}\) between national banks and state banks with respect to branching.

Since the policy of competitive equality was extended only to branching, however, regulatory competition has resurfaced to some extent as the Comptroller has taken a narrow view of what constitutes a branch. The McFadden Act rather unhelpfully defines the term "branch" as "any branch bank, branch office, branch agency or any branch place of business" in the United States "at which deposits are received, or checks paid, or money lent."\(^{92}\) The Comptroller has interpreted this language to exclude from the definition of a branch—and thus from the ambit of competitive equality in states where they would be branches and hence either unlawful or subject to prior approval and perhaps to other limitations—a national bank's "loan production office" (LPO), at which bank employees solicit and provide information about loans, and aid customers in making loan applications, which are
forwarded to the bank or a branch for acceptance;\textsuperscript{93/} automated
teller machines (ATMs) placed at remote locations, such as
supermarkets, at which customers may make deposits and
withdraw cash against an account balance or a line of credit;\textsuperscript{94/}
and armored car services, by which a national bank picks up
deposits from and delivers coins and currency to commercial
customers.\textsuperscript{95/}

The courts have disapproved each of these interpreta-
tions, in the interest of competitive equality,\textsuperscript{96/} but
complete equality between a single federal definition and
divergent state law definitions of a "branch" simply cannot
be achieved. For example, while ATMs are characterized as
branches of national banks wherever located, ATMs are not
considered branches under some state laws.\textsuperscript{97/} In those
states, national banks' ATMs are therefore free of the
state's geographical limitations on branching--there are
none applicable to ATMs if ATMs are not branches under state
law--but they are subject to the other provisions of the
National Bank Act burdening branches: the bank must have a
certain minimum amount of capital to support each branch,
and must receive administrative approval prior to its estab-
ishment.\textsuperscript{98/} The Comptroller has taken steps to mitigate
these burdens, but he cannot purport to eliminate them, and
even the steps he has taken, while sensible, are of doubtful
validity.\textsuperscript{99/}
2. The triple banking system: BHCs. The ownership of multiple banks by one or more individuals, known as "chain banking," had its inception in the 1880's. In 1889 New Jersey became the first state to permit one corporation to purchase the stock of another without a special legislative act, and thus gave rise to the bank holding company phenomenon which was originally known as "group banking." The BHC, which has superseded chain banking, is thus distinguished by corporate rather than individual ownership of the stock in the operating banks.

(a) BHCs and regulation. Bank holding companies grew rapidly during the 1920's. This has been attributed to a variety of factors. For example, Fischer emphasizes 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 make it possible for the holding companies to easily obtain the funds necessary to acquire new affiliates." However plausible one might find an explanation that posits a booming market for the shares of companies acquiring weak banks, it is more certainly true, as Fischer has elsewhere acknowledged, that the bank holding company movement was fueled to "largely" by the desire to circumvent branch banking restrictions. Clearly, a BHC with, say, 10 unit banks would be something of a substitute, however imperfect, for a single bank with nine branches. In any event, 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 28 major BHCs owned 511 banks, with approximately another 1,200 branches. By the end of 1979, there were 329 multi-bank holding companies, controlling 2,261 banks and 11,418 branches. Of these multi-bank holding companies, 125 are in unit bank states, and many more are in states with geographically limited branching, in both of which cases the BHC serves as a substitute for branching.

The BHC could also be used to acquire banks in multiple states, where local law did not prohibit the practice. By 1929 there were several multi-state 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 system of 34 branches located in New York City."

In addition to circumventing restrictions on branch banking, the BHC device could be used to aggregate within one enterprise the powers of both a state and a national bank. Indeed, prior to the extension of the Fed's reserve requirements to non-member banks, some BHCs adjusted their portfolio of bank charters with just this in mind. For example, a BHC might maintain one national bank charter, with all of the other banks in the group holding state charters. The national bank would have to be a member of the Fed, and thus be subject to its reserve requirements. At the same time, 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 of the banks in the group. While the same access could be gained by a BHC retaining all state charters and making one of the banks a Fed member, making it a national bank had the added advantage, at no added cost, of picking up for the BHC any powers that a national but not a state bank in the particular state might be able to exercise.

There has been at least some federal regulation of BHCs since the Banking Act of 1933. That Act, however, affected only those companies with majority control of a Fed member bank and that wished to vote their shares to elect the subsidiary bank's directors. Substantively, the Act did little more than limit such companies' intra-corporate transactions: banks were prohibited from lending more than 10% of their capital and surplus to any one affiliate and more than 20% of their capital and surplus to all affiliates combined.\textsuperscript{110/}

The Bank Holding Company Act of 1956 established the first comprehensive federal regulation of BHCs, but it applied only to multi-bank companies, of which there were seemingly fewer than 50.\textsuperscript{111/} The Act made the Fed the principle regulator of BHCs, with power to examine both BHCs and their bank and non-bank subsidiaries.\textsuperscript{112/} Fed approval was required before an organization in control of one bank could acquire more than 5% of the stock or substantially all of the assets of another bank.\textsuperscript{113/}
The Fed was to approve BHC acquisitions of additional banks on the basis of a set of rather vague standards, but it is clear from the background out of which the Act emerged that Congress was principally concerned with the potentially anti-competitive aspects of the BHC movement. It identified these as (1) concentration in the banking industry; and (2) tie-ins "requiring the bank's customers [presumably borrowers] to make use of [affiliated] non-banking enterprises as a condition to doing business with the bank." The Act required multi-bank BHCs to divest themselves of their non-banking businesses with an exception 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 under the standard of the 1956 Act. Almost all multi-bank BHCs had confined their non-banking activities to other financial businesses and insurance.

Pursuant to an amendment offered by Senator Paul Douglas on the floor, Section 3(d) of the 1956 Act also prohibited BHCs from acquiring any interest in an additional bank outside of the state in which its subsidiary banks had the largest total of deposits as of that time "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."\textsuperscript{119} Senator Douglas presented his amendment, which "\textit{grandfathered}," i.e., exempted, the 19 multi-state BHCs then in existence\textsuperscript{120} as 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{121} 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{122} and several states do regulate BHCs or prohibit multi-bank BHCs altogether.\textsuperscript{123}

The 1956 Act did not cover the majority of BHCs in existence when it was passed, since it did not reach one-bank holding companies, of which there were then 117.\textsuperscript{124} By 1970, however, there were 1,352 one-bank holding companies, including parent companies for virtually every major bank in the country.\textsuperscript{125} The one-bank holding company does not, of course, facilitate the circumvention of branch banking restrictions in the way that the multi-bank holding company does, nor does it enable the single enterprise to accumulate the banking powers of both a state and a national bank. It is nonetheless true that the major attractions of the one-bank BHC form involved 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 funds. Second, the one-bank BHC could diversify into lines of business that would be permissible neither to banks under the powers provisions of their charters nor to multi-bank BHCs under the 1956 Act. Third, and relatedly, the BHC could diversify geographically, and indeed open offices across state lines, so long as it was not thereby engaging in the unchartered business of banking within the states that it entered (hereinafter called host states).

The 1970 Amendments to the Bank Holding Company Act finally brought one-bank holding companies, too, under the supervision of the Fed, primarily in order to regulate their diversification into non-banking activities. First, diversification had long been viewed as a potential threat to the solvency of banks because the non-banking 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 even speculative, activities would impair confidence in the solvency of the bank; at its worst, the failure of a non-banking subsidiary could, it was thought, cause a confused public, unaware that the bank is a separate corporate entity, to cause a "run" on the bank and thus needlessly bring about its insolvency.
Second, diversification by banks into non-banking activities had long been viewed suspiciously as a threat to competition in those activities. Here the concern was that the BHC would have access to its subsidiary bank(s) to finance non-banking activities, while at the same time it could cause the bank(s) to deny credit to the non-banking firms with which it competed.\textsuperscript{130} Related concerns had led the Congress to sever commercial banking from investment banking in 1933;\textsuperscript{131} indeed, national and member banks were then prohibited, with minor exceptions not relevant here, from owning "any shares of stock of any corporation,"\textsuperscript{132} and it was certainly thought at the time that this would prevent them from controlling non-banking enterprises. In addition, if the BHC’s non-banking activity was unregulated, as it usually would be, it might provide new opportunities to avoid legal constraints—for example, by transfer pricing.

(b) Diversification under the 1970 Amendments. Ironically perhaps, the 1970 Amendments greatly enhanced the ability of BHCs to engage in non-banking activities at the same time that they extended control over non-banking activities to one-bank holding companies.\textsuperscript{133} As amended, Section 4(c)(8) exempts from the general prohibition upon BHC control of non-banking enterprises "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."\textsuperscript{134} The same section provides that in making its
determination that a particular activity is a proper incident to banking, 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.

The Fed has promulgated Regulation Y implementing Section 4(c)(8) and listing the activities that it considers to be closely related to banking.135/ (See Table I, infra at page 31.) Any BHC may engage in any of the listed activities and in such incidental activities as are necessary thereto. The Board has also established abbreviated procedures for a BHC that proposes to engage de novo in any of the listed activities, such entry--unlike acquisition of a going concern--being considered presumptively pro-competitive.136/ The Board also considers applications to engage in activities not listed in Regulation Y;137/ non-listed activities that BHCs have been permitted to enter by order are set forth below. (See Table II, infra at page 31)138/

As more fully detailed in Part I.B, some BHCs have aggressively exploited the opportunities opened to them under Regulation Y and become, as a result, nationwide or worldwide diversified financial service organizations, albeit somewhat 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 under Regulation Y and the Fed's adjudications under
Section 4(c)(8) 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 were essentially permissible for national banks;" and of those that the Board has denied to BHCs (see Table III infra at page 32) none is permissible for a national bank. Indeed, some of the activities opened to BHCs are expressly limited to financially-related services, or to servicing banks.

Table I

Permitted by regulation

- Extensions of credit
  - Mortgage banking
  - Finance companies: consumer, sales, and commercial
  - Credit cards
  - Factoring
- Industrial bank, Morris Plan bank, industrial loan company
- Servicing loans and other extensions of credit
- Trust company
- Investment or financial advising
- Full-payout leasing of personal and real property
- Investments in community welfare projects
- Providing bookkeeping or data processing services
- Acting as insurance agent or broker, primarily in connection with credit extensions
- Underwriting credit life, accident, and health insurance
- Providing courier services
- Management consulting for unaffiliated banks
- Real estate appraisal
- Selling at retail money orders, travelers checks, and U.S. savings bonds
Table II

Permitted by order

Issuance and sale of travelers checks
Buying and selling gold and silver bullion and service coin
Issuing money orders and general-purpose variable denominated payment instruments
Futures commission merchant to cover gold and silver bullion and coins
Underwriting certain federal, state, and municipal securities.
Providing check verification services

Table III

Denied

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
*Operating a savings and loan association
Operating a travel agency
Underwriting home loan life mortgage insurance
Contract key entry services

* The Board has allowed BHCs to acquire a savings and loan association in Rhode Island and "guaranty savings banks" in New Hampshire, where state law and market conditions made the operation of such institutions more like that of a commercial bank. See Old Colony Co-op Bank, 58 Res. Bull. 417 (1972); Profile Bankshares, Inc., 40 Fed. Reg. 52,318 (1975); see also Notice Requesting Comments on the Acquisition of Thrift Institutions by Banks and Bank Holding Companies, 46 Fed. Reg. 18,067 (Mar. 16, 1981).
To be sure, other BHC activities have been given a somewhat broader scope, or have been defined to include and allow riskier transactions under the Fed's implementing regulations than under the Comptroller's so that a BHC can do more than a national bank under some of the heads listed in Tables I and II. In providing data processing services to others, 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."\(^{141}\) A BHC, however, may not only "process ... data for others of the kinds banks have processed" for themselves and others, and sell the by-products of programs developed therefor. It may also 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."\(^{142}\) With only slight need of interpretation, the scope of the data processing business open to BHCs can be seen far to exceed that permitted to national banks.\(^{143}\)

On the other hand, the full payout leasing business seems to be 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 25% of the original cost of the property.\footnote{144}{Under parallel regulations of the Fed, however, BHCs are limited in the (unguaranteed) residual value risk they can assume to 20% of original cost.\footnote{145}{National banks can thus make some riskier leases than BHCs can make, and can offer lower rental payments on others--by taking more residual value risk--in order to compete away some leases that BHCs could enter into.}

The point here is twofold. First, the BHC cannot invariably, or perhaps even frequently, offer services of a type that a national bank or, depending upon applicable state law, a state bank cannot offer. Yet, second, the BHC can offer its services to an extent that a bank cannot. The BHC's advantage of extent arises in two distinct forms. First, it can operate through non-bank offices without geographical limitation. Second, the BHC may be able to commit more of its total assets--banking and non-banking alike--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 non-bank parent or in non-bank subsidiaries means they can be financed by non-deposit liabilities, such as commercial paper and longer-term debt, of the holding
company. Since the bank’s solvency is not directly implicated by these risks, the bank examiners and regulators will allow a BHC, in pursuit of a higher return on its assets, to maintain a higher level of risk overall 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 and thereby actually to lower its overall level of risk.\textsuperscript{146} This is an advantage 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,\textsuperscript{147} but the earnings of which are said to be counter-cyclical to bank earnings.\textsuperscript{148} Even where overall risk will be lowered by the inclusion of some higher risk assets in the portfolio, however, bank examiners would almost surely prefer to see them carried in some non-bank 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{149} Some BHCs, that is, probably have a lower, and others a higher, level of riskiness than their banks alone would have if the BHC device were not lawful.

Surely the most significant effect of the BHC movement has been in the ability it gives banks, through the non-bank subsidiaries of the BHC, to circumvent regulation. And in this sphere, circumvention of the state-by-state limits on
banking has been the most important, extensive, and dramatic development. Perhaps it was this development that one observer foresaw when he commented on the Bank Holding Company Act of 1956 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." 150/

3. 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 non-banks—from the business of banking within its borders; only because of the supremacy of federal law in general are they unable to exclude banks chartered by the national government and by it given the right to locate in the state. 151/ Until the 1920's, some states allowed the banks of other states to branch into their territory, 152/ and today several states allow foreign banks to open branches if the host state's banks are accorded reciprocal treatment by the foreign country. 153/ No state today allows the banks of a sister state, however, to branch in, even upon the condition of reciprocity. 154/

(a) The role of federal law. While the state-by-state banking system originates in state law, it is now embedded also in federal law; for if State A were to invite banks located in State B to branch into its territory, a bank in
State B would have to comply not only with its home state (B) law but also with federal law before it could accept the host state's (A's) invitation. Assuming that the home state bank is state-chartered, it would have to obtain approval for the extra-territorial branch from its primary regulator, State B, and from its federal regulator—the Fed if it is a member bank, or the FDIC if it is an insured non-member bank. As presently drafted, however, many state branching statutes would seem to preclude a state bank from establishing an extra-territorial branch, at least within the United States. A general prohibition on extra-territorial branching—applicable abroad as well as in the other states—may reflect the felt difficulty of supervising and examining a home state bank with distant branches; but one more typically gets the impression that the state law drafters simply did not consider whether to allow state banks to branch into other states when they imposed geographical limitations on branching.

Even if the home state law did not preclude a host state branch, however, a Fed member bank would, like a national bank, seem to be precluded from interstate branching under the terms of the McFadden Act, which is made applicable to member banks through the Federal Reserve Act. The McFadden Act authorizes the Comptroller, and by incorporation the Fed, 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 banks, and then only "at any point within the State in which [it] is situated."\footnote{160} Thus, only if the bank were an insured non-member state bank might it be able to obtain federal approval for an interstate branch, namely, 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 initially to insured status.\footnote{161} These factors relate to the present soundness and future prospects of the bank and the "convenience and needs" of the community to be served, but impose no explicit geographical restrictions on branching.\footnote{162} Even so, the FDIC might understandably be very reluctant to approve an interstate branch where the result would be to make Fed membership and a national bank charter relatively very unattractive and set off a stampede away from them.\footnote{163} 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 and it is doubtful whether any state could successfully opt out of it, 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 also presumed by federal law to want to exclude from the banking industry within their borders any BHC that controls a bank--state or national--in another state.\footnote{164} This presumption can be overcome by specific
statutory authorization, but the federal decision to put the burden of obtaining legislation upon those in a state who would admit a BHC that controls a bank in another state has probably contributed to the still nearly universal exclusion of out-of-state BHCs from the control of host state banks.\footnote{165} There might be more multi-state BHCs, that is, if federal law had merely granted to the states the right to exclude out-of-state BHCs by positive law, leaving the burden of actually enacting exclusionary legislation to each state legislature. Then the local banks might have moved the exclusion of out-of-state BHCs, and the issue would have been on the legislative and public agenda. By the approach taken in the Douglas Amendment, however, exclusion did not have to achieve a legislative majority in each--or indeed any--state. It is much less likely, however, that consumers or others who might benefit from the competition provided by the admission of out-of-state BHCs would obtain permissive legislation (or even initiate the debate) than it is that banks, being the more organized group with the more intense interest,\footnote{166} could obtain exclusionary legislation. The Douglas Amendment's allocation of the burden of going forward has therefore probably determined the outcome in many states, namely, to keep out-of-state BHCs out.

There is some evidence of the Douglas Amendment's independent role in confining BHCs to a single state more completely than the state legislatures would do if the burden of acting were upon them. Prior to 1956, when the
issue of the state's exclusionary authority was admittedly unclear but when multi-state BHCs were a real and growing factor in the environment, eight states had regulated BHCs; three states effectively prohibited them from gaining majority control of even one bank. Yet no state that allowed domestic BHCs seems specifically to have prohibited the entry of out-of-state BHCs. Since 1956, however, only three states have legislated to permit their entry under any circumstances—and in the case of 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, in which the banking subsidiaries of all but the surviving multi-state BHCs grandfathered in 1956 are confined each to a single state, while their non-bank subsidiaries can and do provide 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 to expand across State lines in a way contrary to State policy." Instead of deferring to state policies as they were 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 understand 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 for banks. Dual banking is a scheme for allocating regulatory responsibility (although it may be used, as it is in unit or limited branching states, to reduce further the territory allocated to each bank). 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 alone might charter and regulate banks, as they did from 1836 to 1864, or the national government might pre-empt the chartering and regulatory field while still confining each chartered bank to a single state, much as it licenses broadcasters to operate in and serve a particular local community. 172/ Likewise, dual banking 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. 173/ Perhaps the only other governmental field in which duality and state-by-state "markets" are combined, in fact, may be the dual court systems. 174/
As a scheme of territorial allocation, state-by-state banking is moderately local in orientation; in unit banking states it becomes extremely localized. Accordingly, the advantages that can be claimed for state-by-state banking tend to be the virtues of localism.

First, local institutions may be 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:

His 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. . . .

It is inconceivable that the representative of a non-resident 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.175/

Even where the issue is no longer unit versus branch banking, but statewide versus some broader territory for a bank's operations, there is some force in Dawes' vision of the community banker. States are economically more heterogeneous, in ways relevant to making credit judgments—e.g. agricultural and commercial borrowers have different needs—than his focus on the "small community" implies, but they are not as diverse as still larger regions or as the nation as a whole. The broader a bank's territory, therefore, the more challenging the task of responding to varied local conditions must be.
Second, local institutions may be thought to be less likely to cause a flow of capital from one state to another by borrowing (i.e., taking deposits) in one and lending in the other. When a bank does intermediate 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, in the pursuit of private gain the bank may be allocating capital to its most productive use, to the greater benefit of "society" at large, but that brings 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 non-depositors alike will bear the externalized costs of local economic under-development. For example, opportunities for their children may be few at home and while it may then be efficient as well as necessary to become a labor-exporting area, the effect on family life can rightfully be counted a cost.

Third, state-by-state banking may be thought better able to accommodate the diverse attitudes among the states regarding the appropriate or desirable size of banks and level of market concentration in banking. These are historically issues on which feelings have run high, and the greatest diversity of policies have been adopted at different times and places.
Populist and agrarian sentiment have been very hostile to large size and high concentration in banking.\textsuperscript{177} This has led some states to prohibit both branching and multi-bank BHCs.\textsuperscript{178} Other states have prohibited branching, but allowed multi-bank BHCs,\textsuperscript{179} while still others have set a maximum share of statewide deposits for a single banking organization, above which no new branches or acquisitions will be approved.\textsuperscript{180}

Some states have pursued a policy, more or less consciously, of becoming a major financial center 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{181} Colorado, a unit banking state,\textsuperscript{182} seems now to be on a similar course, perhaps in order to facilitate exploitation of its energy resources and to finance the associated growth that that may support. In any event, it has by statute: authorized electronic banking;\textsuperscript{183} administratively approved loan production offices;\textsuperscript{184} and very liberally granted the applications of major out-of-state BHCs to charter "industrial banks" and finance companies.\textsuperscript{185}

Still another approach to bank market structure was taken for awhile in Alabama and perhaps elsewhere, namely state enterprise. The Alabama Constitution of 1819 provided for the state to establish one wholly-owned bank.\textsuperscript{186} As of 1839, there were seven banks in Alabama, five wholly owned by the state and in two of which she had a 40% interest.\textsuperscript{187}
Even now, the Bank of North Dakota is a state enterprise.\footnote{188}

The national bank side of the dual banking system makes state-by-state control of bank size and market structure somewhat less than complete. The Comptroller can increase banking competition by chartering additional national banks. Or he can allow concentration to rise, subject to the antitrust laws as administered by the Department of Justice and the courts, by approving mergers of state or national banks into a surviving national bank.\footnote{189} Despite the comptroller's potential, however, the states retain by far the 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 at a scale where examination and regulation are still feasible, and below some point at which they would be very difficult if not infeasible. In the context of examination, both the size of a banking organization and the area 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.\footnote{190} As asset size increases, simultaneous examination may strain the manpower of any examination staff.\footnote{191} In addition, as the area over which a bank or BHC operates increases, problems of coordinating the simultaneous examination process 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.

Although less susceptible of proof or disproof, regulators seem to believe that regulation is increasingly difficult to enforce as the size of a banking organization increases. With more potential earnings or costs at stake, a larger entity may rationally be more willing to invest in circumventing a particular regulation. Furthermore, a larger enterprise may expect to spread the fixed costs of circumvention—strategic planning, new product development, lawyering, etc.—over a larger number of transactions, at a lower average cost than a smaller banking company. As a result, some products that a smaller company would have to offer at an unattractive price, and therefore does not develop, the larger company can offer at an attractive price and therefore does develop, although (indeed, because) each would have incurred the same regulatory "R&D" costs.

Each of the virtues claimed for the state-by-state banking system is open to some dispute on either normative or empirical grounds, or both. Responsiveness to local credit needs may be achieved more readily by a regional or national banking enterprise with a substantial devolution of authority internally and yet greater expertise and resources than a community bank could offer. Interstate or inter-regional capital flow may be in the long run national interest,
even if it has adverse short-run consequences for capital exporting areas. As for the diversity of banking market structures that the states may wish to pursue, one would need to know much more about the political process in each state before reposing any confidence in the idea that the present—and diminishing—diversity of banking structures reflect current community sentiments, and not the reified vestiges of ancient political struggles, perhaps corruptly conducted. Finally, the extreme paucity of empirical literature concerning the problems of bank examination, and the impressionistic nature of the perception that large banking organizations are more difficult to regulate, rather than easier to regulate by virtue of their smaller number, makes evaluation of these claims difficult indeed.

Thorough investigation and evaluation of these claims is no longer necessary, however, in order to compare the state-by-state banking system as it exists in practice today with alternative approaches allowing some form of interstate banking. The magnitude of interstate banking conducted today within the regulatory framework for state-by-state banking moots the claimed virtues of localism. The needs of commerce and the incentives facing bankers will not lead banking enterprises to shrink back within their own home state's border voluntarily in the future, either. But the state-by-state regulatory system is not adequate 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, on the one hand, to persevere with the state-by-state framework and hope for the best, or perhaps even require banks and BHCs to recede to within their home state borders or, on the other hand, 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 in section B of this Part I. 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 posed in the paragraph above.

B. The Current Business Reality

1. Reasons for interstate efforts. Most of the largest banks in the nation have made substantial and 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 the BHC device in order to open non-bank offices in multiple states; as will be seen in section 2 below, however, some interstate offices are those of the banks themselves.

Almost all of this activity has occurred, at an accelerating rate moreover, during the last 15 years. 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 contemplates 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 the New York-based banks have acted as the lead banks in arranging nationwide syndicates of banks to participate in financings that are too large for them to undertake alone. In recent years, the growth of regional banks has also enabled them to take lead bank positions in this market.

Apart from the market for large loans, however, the business of banking was traditionally conducted on a relatively localized basis. Retail banking customers, which include households and small businesses, patronized a bank that was within a convenient distance for a personal visit. Deposits and withdrawals were typically accomplished at the bank; even the ability to use the mails for making deposits and automated teller machines (ATMs) for both deposits and withdrawals have not much 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, has generally been carried on by the customer’s visiting the bank.
Retail banking can thus usefully be compared 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.196/

Both retail banks and retail merchandisers may also participate in the wholesale market, which in banking entails not only making large loans but otherwise servicing commercial accounts--with cash management, data processing, and other services. Wholesale customers less frequently need to pay personal visits to banks, and with larger transactions at stake, will shop for a banking service over a larger area. This fact, combined with the large scale required to offer many wholesale services efficiently, has tended to favor large, centrally based banks in the market for wholesale services.

Office location is thus important to business success in both retail, and to a lesser degree, in wholesale banking; it simply matters where a bank is--downtown or suburban, small town or large city--in a way that is not true for, say, an insurance company home office. Moreover, the rate of economic growth, and thus of growth in the demand for banking services, in the geographical market in which a bank is located is probably an important determinant of profitability.197/ There are significant differences in the rate of
growth among various geographical markets and, indeed, some have negative rates. Banks located in markets that are declining, either absolutely or relatively, therefore, have the greatest incentive to look for market opportunities elsewhere.

It is thus understandable that the banks that have been most aggressive in establishing themselves in host state markets seem to have been disproportionately drawn from declining home markets. In 1975, the 13 BHCs whose lead bank was one of the 50 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 13 BHCs are from four states that experienced low growth in bank deposits over the period 1967-77; the other four are from states that had below median growth. Two of the four--North Carolina and Georgia BHCs--moreover, were still regional organizations, having almost all their non-bank offices in the Southeast, except that each had an office in New York City and one had Chicago and Los Angeles corporate service offices.

While it is true that the largest banks would logically 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 north-
eastern banks among the most interstate-oriented BHCs seems still to be disproportionate to size alone. 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 appear to 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. Clearly, it could not explain the interstate motivation of the large California BHCs, for example. 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.\textsuperscript{202/} Risk—both political and economic—may also be diversified across geographical markets, and this benefit 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 non-bank subsidiaries of the BHC.\textsuperscript{203/}

Internationally, "country" risk includes such potential economic and political hazards as adverse regulation, capital controls, exchange rate fluctuations, and, in the extreme, expropriation.\textsuperscript{204/} Economic and political risks are diversified by international operations because national economies expand and contract at differential rates, and experience adverse political developments at different times.
Domestically, political risk is less extreme but it is not unknown. The profits of a bank in New York, for example, depend to some extent upon political decisions made in Albany. Changes in state usury laws, income taxation, and branch banking and bank holding company powers are just a few of the elements in the political environment that can have a profound effect on a bank's prospects. If that same bank's earnings are derived to a significant degree from each of several states, however, it will be exposed to less risk from adverse political developments, since it is less likely that every such state would take unfavorable decisions, especially at the same time.

Domestic economic risk diversification is possible if only because different regions of the country are affected differentially by the business cycle. Each is also subject to special circumstances apart from the general business cycle. Thus, agricultural lending in the Plains states, consumer lending in the manufacturing states of the Midwest, and export financing in California may have very different business cycles of their own. A bank that can serve all three markets can diversify its risk better than a bank serving any one of these three areas.\(^{205}\)

It is true that bank shareholders could individually diversify their portfolios of bank shares to diversify their risk; in the example above, the single shareholder could own the shares of banks located in California, the Midwest, and the Plains states. This is not a complete substitute for
the bank diversifying its risk, however. First, the shareholders taken collectively would probably incur greater transaction costs 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 be 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 surely 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.\textsuperscript{206/}

(c) \textbf{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.\textsuperscript{207/} These studies are of limited value, however, since they examine only selected products or services,\textsuperscript{208/} and not necessarily those with the most sharply declining average costs. They pre-date the effects of widespread computerization on bank
operations, and they "do not fully account for possible capital (or financial) economies."\(^{209}\)

More recent studies, although subject to some of the same data limitations, show the persistence of substantial scale economies over a wide range of output,\(^{210}\) and distinguish between banks with and without computerized operations.\(^{211}\) Even these studies do not reflect advances in technology now in use at larger banks, however. Nor do they attempt to estimate the potential economies of scale available if banks were allowed to operate interstate,\(^{212}\) or examine home office scale economies.\(^{213}\)

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 to avoid having either excess reserves or correspondent balances that do not earn interest, member banks "buy" and "sell" their Federal Reserve Bank 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.\(^{214}\) Typically, the money center bank buys funds from country banks for itself and for resale to other major banks. Indeed, according to Martin Mayer, in the 1960's "[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."\(^{215}\) 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 even great increases in the dollar balances involved; the addition of three zeroes to the end of every number would not require much more manpower.

The provision of expert advice is another service for which one would expect average cost to decline until a very large scale, indeed, is achieved. Banks provide expert advice to their branches, their correspondent banks, and their customers. 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 very 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 at a low marginal cost; hence average cost declines with scale for a considerable time.

So 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 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 means that banks have to increase their scale and thus to realize economies is branching.\textsuperscript{218} Banks have pressed for and in general received from the states increasingly liberal branching laws.\textsuperscript{219} At the same time, they have expanded across state lines through non-bank subsidiaries of their BHCs in order to increase the scale at which they could provide some services. Indeed, many of the activities permitted to non-bank 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 that information—such as servicing loans and other extensions of credit; investment or financial advising; providing bookkeeping or data processing services; and management consulting for unaffiliated banks. In addition, many of the activities that amount to extensions of credit or are related to the extension of credit, such as credit card operations and real estate appraisals, respectively, are themselves information-intensive activities for which one would expect average costs to decline over a wide range of output.\textsuperscript{220}

(d) \textbf{Technological opportunities: computing and communicating}. As just suggested, essential bank operations consist to a very large degree of information gathering, management,
and distribution. Decisions to extend credit, for example, begin with the process of accumulating and analyzing data relevant to the credit-worthiness of the applicant. In the case of a consumer borrower, the information may be relatively brief, 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 it may be analyzed through industry or economy-wide computerized economic models.

Deposit services are also information-intensive. This reflects the fact that money in the modern world has become a datum rather than a tangible item.\textsuperscript{221/}

Today, a bank deposit or withdrawal is little more than a series of book entry adjustments. In the simplest case of a check drawn on one bank and deposited at another in the same city, for example, the depository bank increases the balance in favor of the depositor, and decreases the balance that the drawee bank has on deposit with it; the drawee bank registers on its own books the decreased balance that it has with the depository bank, and makes an offsetting decrease in the balance in the account of the drawer of the check. Extensions of credit are also handled by the adjustment of balances. When a bank lends money, it increases the borrower's account balance by the amount of the loan; the borrower can then draw the loan down by writing checks against the balance.
With the advent of money in the form of bank balances, banking operations became essentially information handling. Accordingly, 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 the unit costs of bank operations. For example, IBM memory technology has fallen in cost from $2.00 per byte in 1964 to about 8 cents per byte in 1977; the cost of 100,000 calculations has fallen from 12 cents to 1 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 re-sell 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 much more sophisticated telecommunications network than they could afford without shared use.

When telecommunications networks are further combined with distributed electronic data processing, in which "smart" terminals do many of the functions previously performed by the central processing unit, the efficient scale of operation for the information-handling aspects of banking may be much further increased (although it may conceivably decrease). 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 computers with ever-increasing capacity less expensive than the generation of machines that they displace.

Indeed, there is evidence suggesting that computers, or more likely computers 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.\textsuperscript{226/} To the extent that the value added by banking services is attributable to such information handling technologies, the efficient scale for banking enterprises can be expected to increase similarly and to tend, in the extreme, toward "natural oligopoly."\textsuperscript{227/} 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.\textsuperscript{228/}

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 next section, banks are already turning their attention to electronic means of penetrating interstate markets: in 1980, several banks announced plans for interstate networks of ATMs.

2. \textit{Interstate banking today}. It has already been noticed that virtually all of the activities in which BHCs are allowed to engage are also permissible activities for national and most state banks.\textsuperscript{229/} Insofar as the BHC
engages in the activity through an office outside of its home state, however, it will generally be exercising an authority that is not open to the bank. Still, 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 non-bank 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 organize activities directly through the bank where that is permissible. With this understanding, the typology of interstate activities used below, which is based in part upon the distinction between bank and non-bank offices, will not be misleading.

(a) Commercial banking interstate. In order to serve commercial customers nationwide, major banks have established three types of presence on an interstate basis. They 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 it will be willing to invest in shopping among banks. As indicated before, the largest corporate borrowers and the banks that serve them operate in international and national markets. Middle-sized corporations typically shop 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. Sales personnel would be dispatched to call directly on potential borrowers and to solicit their business.

At least 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 borrowers within the state. Rhode Island took perhaps the strictest view; it maintained that an out-of-state bank could not lawfully send a "warm body" into the state.\(^{231}\) Connecticut may have taken a slightly less extreme view providing that the representative of an out-of-state bank could not lawfully stay overnight in the state;\(^{232}\) apparently, any hotel room in which he or she might stay would thereby become an unlawful branch of the out-of-state bank.

After experience with call programs, some banks determined that it would be more efficient and more effective to open permanent LPOs from which to base their marketing operations. In 1974, Martin Mayer reported that the First
National Bank of Chicago, the First National Bank of Boston, and the First Pennsylvania Bank all planned to open regional offices throughout the United States over the next few years. But it is not possible to know how many LPOs there are, nor what banks have established them, nor where. Some states prohibit or require approval of LPOs on the ground that they are branches; and some require them to register with the banking regulator of the state; but still others, including California, freely permit them by statute or policy, thus vexing any hope of getting an accurate tally. Whether an LPO is a "branch" within the meaning of the McFadden Act is not clear. The Comptroller has issued an Interpretive Ruling that LPOs are not branches Provided, that the loans are approved and made at the main office or a branch office of the bank . . . ." In litigation challenging this interpretation, there was evidence of record indicating that "the Comptroller has construed the ruling narrowly in letters sent to banks subject to his jurisdiction." Some of these letters clearly must have 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." 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."239/ 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 similar facilities,"240/ 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,241/ 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.242/ 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 time that payments spend in the mail and to maximize the amount of time during which they are earning interest for the corporation.243/ The corporation will therefore maintain a "concentration account" at one bank to which excess balances will be transferred by wire on a daily basis.244/ The bank providing the concentration account will undertake to keep all balances invested in interest-earning assets each day. Consequently, it will almost 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; and indeed, this entire operation may be conducted on a multi-national 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 one or more times each day. In this way, the corporate treasurer can retain control over the decision-making process as situations requiring investment or currency transactions arise. Recently, some banks have offered an improved communication and control capacity by linking their corporate customers directly to the bank's own computer and money market desks through the installation of an on-line computer terminal that has a cathode ray tube used for video display (hereinafter jointly referred to as a CRT), at the customer's premises. In its most sophisticated form to date, the customer's CRT provides continuously current information on the corporation's cash position; is preprogrammed to instruct the bank's computer, on the basis of the information that it receives, 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 non-recurring or irregular transactions, such as payments to suppliers and investing proceeds of loan transactions.245/ 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 the lines linking the bank's computer to the Fed's.

Under current case law, it is not at all clear whether terminals and CRTs installed in corporate offices and linked to bank computers are branches of the bank 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 under the McFadden Act. CBCTs, which include both ATMs and point-of-sale (POS) terminals, were described by the court as follows:

CBCT's are manned or unmanned electronic terminals which, depending upon 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...247/

In the court's view, CBCTs were branches within the Supreme Court's reasoning in the Plant City case, 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 received, or checks paid, or money lent." 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 the 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 his or her 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 was here thinking of 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. 253/

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 little reason in policy for a state to so hold, except in the interstate context. Consider the situation faced by the many small and even some regional banks that are not competitors in the cash management market; indeed, in many states there might be no bank that does offer such sophisticated cash management services as to use CRTs. Concerned about losing balances to money center banks, the banks in such a state 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 do not seem to have asked for official approval of their activities and they have certainly not filed branch applications for each of the CRT units that they have installed.

(iii) Edge Act corporations. Since 1919, the Federal Reserve Board 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.254/ Until the International Banking Act of 1978,255/ any United States citizens could establish an Edge Act corporation, but in fact only domestic banks did so.256/ Some banks, indeed, established several Edge Act corporations in as many states, since they could not branch. These parent banks tended to be very large, however, since each Edge Act corporation has to have at least $2,000,000 of paid-in capital,257/ while their banking activities in the United States were limited to the facilitation of international transactions. Thus, they could issue letters of credit, create bankers acceptances, and make loans to finance imports and exports; accept domestic deposits linked to anticipated payments for these transactions; and accept any deposits from foreign sources. As of 1979, there were only 131 Edge Act corporations.258/

The International Banking Act of 1978 made foreign banks eligible to own Edge Act corporations,259/ as part of a compromise under which the foreign banks lost their de
facto exemption from the McFadden Act. Foreign banks, that is, lost the privilege of adding new, full-service domestic banking facilities outside of a designated "home" state, but were still allowed to open branches in multiple states, state law permitting, if they limited their deposit-taking to such deposits as an Edge Act corporation could accept; lending authority was not similarly restricted, however, so 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, making them more attractive to domestic banks and somewhat 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 Fed to re-regulate them so as better to realize their statutory purposes, especially that of facilitating United States exports. The Fed, has, accordingly, broadened its concept of what is related to an international transaction. 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.

The Fed has also determined that Edge Act corporations may open branch offices, in order to further the Congress'
purpose "to foster the participation by regional and smaller banks throughout the United States in the provision of international banking and financing services." In the absence of branching authority, each location required separate incorporation and therefore capital of $2,000,000; it is now possible for a single Edge Act corporation with that amount of capital to have as many offices as the Fed agrees the parent bank can prudently manage in any community the convenience and needs of which (with respect to international banking and financing) warrant the addition of a new competitor.

In the first 18 months under the new regime for Edge Acts, 11 banks received approval to establish 28 new Edge Act corporation branch offices. In addition, several banks have proposed to consolidate their pre-existing Edge Act corporations into one company with branch offices, and thereby to increase the loan limit, which is 10% of the corporation's capital and surplus, available at each location. For example, the Bank of America has merged its Edge Act corporations in Houston, Chicago, Miami, and New York, and intends to open new branches of the consolidated company in Seattle, Dallas, Minneapolis, Cleveland, St. Louis, Atlanta, and Boston by June 1981. Citibank plans to convert its Los Angeles, San Francisco, Chicago, and Houston 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.\textsuperscript{271/} Other major banks are considering or pursuing similar plans to consolidate and extend their existing Edge Act networks.\textsuperscript{272/}

The Edge Act corporation is now an important element in the pattern of interstate commercial banking. It enables major banks to establish a commercial bank presence in a large number of cities, while giving regional banks access to the locations they consider most important for servicing existing customers' international transactions or acquiring new international business. Thus, a regional bank in, say, Atlanta may wish to open an Edge Act office in Miami because so many of its present and potential customers import and export through that city; at the same time, it may want to establish a presence in the New York market which, as one commentator has noted, 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."\textsuperscript{273/} 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 Fed 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. The inability of banks 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 made efforts to overcome the competitive disadvantage that inheres in lacking a physical presence in a retail market area.

(i) **Credit cards.** The extension of consumer credit interstate 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 either of the chattel purchased with the proceeds of the loan, such as an automobile, or securities, or a savings account passbook. Unsecured personal loans were by no means unknown at banks, but as late as 1974 "most [banks were] still not really comfortable" making them. They were typically made only to established depositors as an accommodation.\(^{274}\)

In the latter part of the 1960's, banks got into the business of issuing credit cards on a large scale. Today, most banks are issuers of either Master Card or VISA or both,\(^{275}\) and there are 35 million of these bank cards outstanding.\(^{276}\) Almost all of the nearly \$6 billion\(^{277}\) in credit extended by means of these cards is unsecured.

Having involved themselves deeply 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 for consumer credit. Bank credit card relationships, unlike personal loans, are typically established on the basis of an impersonal application. The bank dis-
tributes applications by mail and at its premises; completed forms may be mailed or brought to the bank. If the application is approved, the bank establishes a line of credit and mails a card to the new account holder. This can be done with almost the same ease regardless of the distance between the bank and the consumer. Making inquiries of the card applicant's employer, local credit bureau, and credit references is no more expensive, at least when done by mail, regardless of their location. Processing sales drafts and billing customers are equally insensitive to distance; even collection efforts are probably no more difficult over distance, since banks tend to turn delinquent consumer accounts over to outside collection agencies even when the borrower is within their 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, did a mass mailing of undisclosed size to Visa card holders in 25 states. It is reported to have as many as 5.8 million Visa and MasterCard card holders now, and claims to have at least 25,000 in each of 25 states. And in the case of Marquette National Bank of Minneapolis v. First of Omaha Service Corporation, it was stipulated that the First National Bank of Omaha solicited Minnesota residents "on a continuous and systematic basis" to accept its Visa card, and that it did so by "direct mail solicitation, telephone contact and
through Minnesota banks.\textsuperscript{280/} In that same case, the First National Bank of Chicago, an \textit{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.\textsuperscript{281/} Before the advent of the nationwide bank credit card systems, it would have been inconceivable for even 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) \textbf{Retail LPOs.} There is some evidence that banks have established LPOs for the purpose of originating consumer loans. In \textit{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.,"\textsuperscript{282/} 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.\textsuperscript{283/} The case of \textit{Oklahoma v. American National Bank and Trust Company}\textsuperscript{284/} 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.285/ The action was settled, however, in 1979 when the bank agreed to close the LPO for what it says are business reasons.286/

While the number of retail LPOs cannot be known, it is doubtful that there are large numbers of them in operation either within or outside the parent bank's home state. There does not seem to be any litigation, other than the three cases reported above, implicating retail LPOs, and this is probative. 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 state287/ and Maryland National Bank was attempting to cross a state line; neither had the option of branching, therefore. In almost any such situation, the LPO would certainly be challenged by a competing bank or other lender in the host community, if not by the host state itself.288/

Commercially oriented LPOs, on the other hand, are not so likely to engender a legal challenge 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 do not need to 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.\^289/\n
The "branchness" of retail LPOs, like that of commercial LPOs, is unclear. In the American National Bank\^290/ case, an intrastate office of a national bank was held to be a branch at which money was lent, but that result seems indisputable since all steps in making a loan--except approval by a loan officer, which was done by telephone--were handled there, including the disbursement of loan proceeds. Whether a consumer LPO that neither approves loans nor disburses loan proceeds--such as the Comptroller has required--is a branch remains in doubt. There is no basis in the McFadden Act for distinguishing non-approving and non-disbursing consumer LPOs from non-approving and non-disbursing commercial LPOs,\^291/ however, so their legal status will necessarily be resolved together.

(iii) Deposit-taking. There are no legal inhibitions whatever on a bank's soliciting deposits from individuals in other states.\^292/ The constraints are, instead, practical.

The maximum rates of interest payable on various types of deposits in insured banks are set by regulation.\^293/ In recent years, the maximum rates have often been below the rates available to depositors from competing investments, most notably money market funds.\^294/ In addition, they have been kept consistently 1/4% below the rates payable by
insured savings and loan associations. Consequently, virtually all insured banks have paid the maximum rates allowable on each type of account. Unable to engage in effective interest rate competition for deposits, banks have emphasized service competition—for example, by opening convenient branches, maintaining longer banking hours, etc.

Banks with no physical presence in a market are therefore at a substantial disadvantage when they solicit depositors by mail or advertising.

Even when there is price competition among banks to attract deposits, there are substantial drawbacks for a consumer in having a distant bank. First, without a local bank, many individuals would not have a convenient place at which to obtain cash. Second, depositors who anticipate that they may some day want to obtain a bank loan often realize that they will be more likely to succeed in doing so at the bank at which they have maintained a deposit relationship. If that bank is distant, however, they will be less likely to be able to borrow notwithstanding their deposit relationship. This factor will be particularly compelling for those relatively high income depositors that are most likely to have business and personal banking needs sufficient to warrant their cultivating something of a personal, continuing 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 have any hope of succeeding, 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 and Arizonans who convinced a friend to deposit $3,000 or more in the bank. The same offer had been met by competing banks in New York, but was new in Florida, and it attracted deposits of $5 million in the first week.\textsuperscript{297} 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 telephone bill paying, Visa credit, and other features that are not available all together at a single bank in most if any markets.\textsuperscript{298} 

Citibank has indicated that it is considering offering a "credit balance" feature on Visa accounts as a substitute for a conventional bank account.\textsuperscript{299} 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.\textsuperscript{300} The Bank of America is also considering a credit-balence feature on its cards.\textsuperscript{301} 

(iv) **ATM networks.** Several banks have opened or announced plans to open interstate networks of shared-use automated teller machines (**ATMs**).\textsuperscript{302} These are unmanned CBCTs at which the customers of any participating bank can typically make deposits, withdraw cash, transfer sums between accounts, and make loan payments, although customers will
not be able to make deposits at ATMs in a state other than that of their bank in all but one of the interstate systems announced thus far.\textsuperscript{303/} This limitation is apparently being imposed in the hope of avoiding characterization of the ATMs as branches for McFadden Act purposes.\textsuperscript{304/}

An unshared ATM located at a site remote from a bank was held to be a branch, under the McFadden Act, of the bank that established it in the Independent Bankers case discussed above.\textsuperscript{305/} 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.\textsuperscript{306/}

The Independent Bankers case did not deal with networks of shared ATMs programmed to enable card holders to access their account at one bank from a terminal that is established by a second bank, either on its premises or at a remote site. Nor, of course, did it deal with 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 non-bank subsidiary of a BHC, or a "bank service corpo-
ration," which is a type of joint venture among banks,\textsuperscript{307} could do so, as could a computer communications network company unaffiliated with any bank or BHC. Alternatively, the ATM could be characterized as a branch of each of the banks that share its use,\textsuperscript{308} 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 be able to use the ATM for a transaction fee.\textsuperscript{309} In the intrastate context, this ruling reintroduces the potential for competitive inequality that the court of appeals sought to minimize in the \textit{Independent Bankers} case. If home state law, that is, treats each ATM in which a state bank shares use as a branch of that bank, and the Comptroller does not do so with respect to national banks, then national banks, unlike state banks, will be able to share in the use of ATMs without geographical limitation--intrastate and interstate.\textsuperscript{310} 

In the \textit{Independent Bankers} case, 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 them as branches and prohibited branching or limited the geographical area in which a state bank could branch. The McFadden Act policy of competitive equality
suggests also that an intrastate shared ATM should be treated as the branch of each national bank to which it gives access in states where it is treated as a branch of each state bank. Since the McFadden Act must be applied uniformly in states that do and states that do not treat a shared ATM as the branch of each state bank sharing 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 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, but this possibility was foreclosed by the Supreme Court's interpretation of the McFadden Act in Plant City to provide a uniform federal definition of a branch.

The policy of competitive equality also requires that a national bank be allowed to share in the 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 it 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 such out-of-state
branching, an inequality would be created because the Comptroller could not authorize an out-of-state branch. Here the resolution that minimizes 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 into its territory—as all states seem to do—host state law will prevent a state bank from branching in electronically and the McFadden Act should be held similarly to prevent a national bank from branching in electronically. If the 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 in 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 their branching in in this fashion, 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, he could not authorize it. Competitive equality would then be most 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 he 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 the 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 the question whether an ATM is a branch of an out-of-state bank.

Nothing in this analysis of the McFadden Act issue 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 the out-of-state bank: if it can take deposits for the out-of-state bank, it is held to be a branch of that bank; if it cannot, it is not a branch. As a formal matter, the regulators are treating deposit-taking as the essential element of engaging in the business of banking, and therefore of operating a branch bank.

Functionally, an out-of-state bank that could take deposits at a host state ATM would still be at something of a disadvantage in competing for the accounts of host state
residents because it lacks an office in the area; 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 will be to accommodate home state residents who find themselves in the vicinity of the out-of-state ATM. Account holders away from home will much more frequently want to withdraw than to deposit funds anyway, 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, i.e., in their common home state market.

(c) **Non-bank subsidiaries interstate.** It has already been observed that the non-bank subsidiaries of BHCs engage almost entirely in activities that banks themselves engage in, their principal advantage being that they are not subject to limitations on branching as are banks. Accordingly, the nonbank subsidiaries can be seen as vehicles for providing specific bank services to distant and interstate geographic markets.

It is not possible to obtain a complete picture of the degree to which BHCs have penetrated interstate financial markets. The material that follows 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,
their major lines of business have been grouped into four
categories: extending credit; taking deposits; providing
trust services; and data processing.

(i) **Extending credit.** BHCs extend several types of
credit through nonbank subsidiaries, including commercial
credit, consumer credit, and equipment and automobile leas-
ing, which are essentially equivalent to extensions of
credit.

(aa) **Consumer finance companies.** Undoubtedly the
largest number of interstate BHC offices extending credit
are those of their consumer finance company subsidiaries.
Consumer finance companies make direct cash installment
loans and purchase sales finance paper from dealers; a few
of them are credit card issuers as well. Domestic BHCs have
acquired more than 100 consumer finance companies\(^{316}\) with
several thousand offices, including 39 of the 100 largest
non-captive\(^{317}\) finance companies.\(^{318}\) In addition, they
have established more than 850 de novo consumer finance
company offices.\(^{319}\)

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 38\(^{320}\) states and assets of $1.2 billion at the end of
1979.\(^{321}\) The 10 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.\textsuperscript{322}

(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.\textsuperscript{323} In 1979, 76 banks and BHCs accounted for about one-half of the mortgage banking business done by the 196 companies responding to a national survey.\textsuperscript{324}

(cc) **Factors.** Factoring involves the purchase of business accounts receivable; manufacturers, particularly of soft goods, sell their accounts receivable at a discount from face value in order to obtain working capital. According to Glassman and Eisenbeis, "[t]he industry comprises some thirty-five large factoring firms, several smaller factors, and commercial banks."\textsuperscript{325} According to Schotland, banks and BHCs dominate the industry, having obtained a clear majority of the market by 1975; they controlled 19 of the 30 largest factors in 1976.\textsuperscript{326} As of mid-1980, BHCs had been permitted to acquire 12 independent factors, and had notified the Fed of their de novo establishment of 65 others.\textsuperscript{327}

(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 and real property to businesses, but this is more commonly done by BHCs through a specialized leasing subsidiary. As of mid-1980, BHCs had been permitted to acquire 21 leasing firms, and notified the Fed of their de novo establishment of 548 leasing company offices.  

It is impossible to obtain adequate data about the commercial finance industry to determine the significance of banks and BHCs in the commercial finance field. It is known, however, that the Fed has approved 14 BHC acquisitions of commercial finance companies, and been notified of 187 de novo entries into the field by BHCs as of June 1980.  

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." Since then, Manufacturers Hanover Corporation "announced the opening of a full-service commercial financial office" in Chicago, to supplement its commercial finance subsidiary's offices in Atlanta, New York, Charlotte, Los Angeles, and Dallas.  

(ii) Deposit-taking. BHCs may own non-bank depository institutions in the approximately 20 states that have chartered "industrial banks." These institutions, which are also known as industrial loan companies, loan and thrift companies,
and originally as Morris Plan banks, vary greatly from state to state in the powers they may exercise. Their most common elements, 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 something like consumer finance companies that can also take savings deposits. In some states they can issue bank credit cards, like Visa, engage in equipment leasing and commercial lending, and exercise some of the other powers variously available to banks in general.

BHCs may own industrial banks interstate because they are not "banks" within the meaning of the Bank Company Holding Act. That 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,"\textsuperscript{333} i.e., offers checking ("demand deposit") accounts.\textsuperscript{334} Industrial banks are not permitted to offer checking accounts in any states except Rhode Island and Connecticut,\textsuperscript{335} 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,\textsuperscript{336} thus giving depositors a partial substitute for a checking account, and since depositors do not have a legal right to withdraw upon demand, these forms of electronic access may presumably be offered even by
an industrial bank that makes commercial loans without its becoming a "bank" either.

Industrial banks tend to be small institutions. In some industrial banking states there are very few of them;\(^{337}\) in some, such as Florida, where there are three, no new charters will be issued.\(^{338}\) Indeed, New York has legislatively deleted industrial banks from the typology of institutions it will charter.\(^{339}\) In other states, however, the industrial bank business is booming, largely in response to the entry of BHCs. Colorado is perhaps the leading example. In 1971, there were 62 industrial banks chartered in that state;\(^{340}\) in 1980 the number had risen to 131.\(^{341}\) The bank holding companies of Citibank, Manufacturers Hanover, Chemical Bank, and First Pennsylvania Bank had all acquired or applied to acquire one or more industrial banks in Colorado.\(^{342}\) Out-of-state BHCs also own industrial banks in Utah, California, and Massachusetts.\(^{343}\) The Fed has approved 23 BHC acquisitions of industrial banks, and been notified of 79 de novo openings, including an unknown number of intrastate affiliations.\(^{344}\)

Industrial banks are eligible for FDIC insurance, but only a few industrial banks are FDIC-insured;\(^{345}\) some are or must be members of state guaranty funds that insure deposits to a more limited extent that does the FDIC.\(^{346}\) Similarly, industrial banks are eligible for membership in the Federal Reserve System,\(^{347}\) but none has joined. An industrial bank that became a member of the Fed would have
to be FDIC-insured,\textsuperscript{348}\textsuperscript{/} and an insured industrial bank would be subject to Regulation Q governing the maximum interest rates payable on deposits.\textsuperscript{349}\textsuperscript{/} At present, the states either leave industrial bank deposit rates unregulated\textsuperscript{350}\textsuperscript{/} or set them at a slight differential above the Regulation Q rates,\textsuperscript{351}\textsuperscript{/} to offset the drawback for consumers of not being insured and perhaps even to give industrial banks a slight advantage in attracting deposits.

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 has, however, obtained 25 industrial bank charters in California in the last few years in order to be able to offer higher savings rates than banks within California.\textsuperscript{352}\textsuperscript{/} 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.\textsuperscript{353}\textsuperscript{/} 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 regulator of the industrial bank.

Citicorp recently attempted to take deposit-like account balances through a non-depository 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" under Regulation Y, and thus had to be stopped.354/ 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.

(iii) Trust and fiduciary services. 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 commercial banks through separate trust departments, but in some states non-bank trust companies may also be chartered for these specialized purposes.355/ 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 18 trust company acquisitions and had given notification of opening 110 de novo trust companies.\textsuperscript{356} New York, Chicago, and California BHCs have been particularly active in the interstate provision of trust services, largely by following their bank's personal trust customers to Florida, Arizona, and other second home and retirement areas. Out-of-state BHCs now operate five trust companies in Florida alone,\textsuperscript{357} which led that state first to attempt to prohibit the entry of additional out-of-state BHCs into the investment advising, and therefore necessarily into the trust company, business within the state. When that failed,\textsuperscript{358} the Florida Bankers Association managed to procure a federal moratorium or new interstate entry until October 1981.\textsuperscript{359}

(d) \textbf{Data processing interstate.} The precise degree to which banks and BHCs are involved in the provision of data processing services on an interstate basis is impossible to determine. Enough facts are known, however, to infer that it is significant.\textsuperscript{360}

It is useful at this point 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 therefore, 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." It has already been pointed out that the scope of the data processing business open to BHCs under this standard is quite broad. Giving it perhaps the broadest interpretation possible, Citicorp has announced its plans to establish a time shared computer network called Citishare initially serving users in 244 cities throughout the United States and five foreign countries. 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 for the most part. 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 of the outlying banks and thrift institutions with data processing services to maintain their accounts. At the close of each banking day, the customer bank will send information on all its transactions that day to the processing bank, which returns a computer print-out by morning showing the up-dated 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 courier data back and forth on a daily basis has 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{364/}

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{365/}

Thus, BHCs such as Citicorp may soon provide both the internal accounting and the ATM system needed by small banks, and do so by the operation of 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 data processing services will ultimately be responsible for much of the value added by local banks in providing 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 just 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 even very reliable method of measuring interstate banking activity. In addition, the data are fragmentary. Nonetheless, some attempts have been made; all of them are more likely to understate than to overstate the degree of activity.

One method is simply to count BHC offices. For example, in June 1979 when Connecticut enacted a one-year moratorium on the expansion of non-bank BHC activities within the state, during which year the legislature initiated a study of the desirability of limiting BHC activities in the state,\(^366\)/ five out-of-state BHCs were known to have 23 subsidiary company offices in Connecticut.\(^367\)/ These consisted of one data processing service company; seven commercial finance companies engaged variously in equipment financing, personal and real property leasing, and commercial lending; and 15 consumer finance company offices.\(^368\)/ The BHCs extending credit through offices in Connecticut were the holding companies of Citibank (New York); Bank of America and Security Pacific National Bank (California); and Merchants Industrial Bank and Trust (Indiana).\(^369\)/

It is impossible to know whether this seemingly substantial known penetration of the Connecticut consumer and commercial credit markets by out-of-state BHCs is at all typical. Connecticut's close proximity to New York has probably made it unnecessary for the 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 the state, while the Bank of America and Merchants Industrial Bank of Indianapolis have six such offices between them. The New York banks are similarly under-represented in the consumer finance field, probably for the same reason; Citicorp has two offices while the Bank of America and Security Pacific, both of California, have 14 offices between them.

Thus, on the one hand, the New York banks are under-represented but, on the other, because Connecticut is an affluent state, it has attracted twenty consumer and commercial credit extending offices of distant BHCs. Unfortunately, however, 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 in which to locate the existence of bank LPOs or of non-bank subsidiaries in many states.

The American Banker reported in 1975 that 13 large BHCs had 1,642 non-bank subsidiary offices, of which 1,483 were located outside of the BHCs' home states. The number of such interstate BHC offices has increased substantially since 1975, among both the largest BHCs and others. Four of the largest BHCs for which even approximate figures are available increased their non-bank out-of-state offices as shown in the table below:
<table>
<thead>
<tr>
<th>BankAmerica Corp.</th>
<th>1975</th>
<th>1979</th>
</tr>
</thead>
<tbody>
<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 bank holding companies. Clearly, however, the total was even in 1975 a good deal larger than the number attributable to the 13 BHCs that were studied, and the industry total has grown by considerably more since 1975 than the 500 new offices opened by the four firms represented in the table above. Since that time, large BHCs have added a number of commercial credit offices, chartered several industrial banks in Colorado alone; established 27 new Edge Act corporations with a larger number of offices; and established an unknowable number of LPOs.374/

There are still other ways of attempting to assess the degree to which banking has become an interstate industry, but they are at least as imperfect as counting BHC offices. For instance, the Bank of America has 14,436 employees in states other than its home state of California, of whom 1,361 are in New York City alone.375/ At the same time, Citicorp has about 3,000 employees in California.376/ Again, these are crude data.
The Conference of State Bank Supervisors (CSBS) has made conservative estimates for four types of interstate banking operations.\(^{377}\) CSBS estimates: (1) the assets of banks located outside the state in which the lead bank of their holding company is located (i.e., the secondary banks of those multi-state BHCs grandfathered by the 1956 BHC Act) at $23 billion; (2) the banking assets of foreign banks located in states other than their home state (i.e., those grandfathered by the International Banking Act of 1978) at $18.3 billion; (3) the assets of non-bank subsidiaries of BHCs at $38 billion; and the (4) volume of commercial and personal loans made by banks with assets in excess of $1 billion to borrowers in other states at $26 billion.\(^{378}\) The total estimated volume of assets devoted to interstate banking on this basis was $105 billion. If the figure for the assets of non-bank subsidiaries were adjusted from $38 billion to the staff of the Federal Reserve Board's 1978 estimate of $55 billion,\(^{379}\) then the total would be $122 billion. This is approximately 7.17\% of banking industry assets.\(^{380}\) Not only are the quantitative estimates on the low side, but no attempt is even made to factor in the average daily interstate flows of Fed funds and correspondent balances that knit the banking industry together.

(f) **Notes on the significance of deposit-taking.** However measured, then, 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 surely the limitation on their ability to take deposits interstate. The principle exceptions are the international banking deposits taken at Edge Act corporations, the deposits taken by foreign bank branches outside of their "home" states, and the consumer savings deposits taken at industrial banks in perhaps 20 states.\textsuperscript{381/} 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 banking services 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 deposits locally also inhibits an out-of-state BHC's ability to compete for consumer and commercial credit business, albeit to a much lesser extent.

The Depository Institutions Deregulation and Monetary Control Act of 1980\textsuperscript{382/} 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.\textsuperscript{383/} These thrift institutions will now be able to compete with banks for transaction balances of the sort that would have been maintained in bank demand accounts before. The same law provides for the phasing out over 6 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. This will enable banks to compete for some of the balances that would previously have been held in money market funds and in passbook savings accounts at the 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 thoroughgoing 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"—the stable deposit base maintained by individuals for savings and transactional use—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 and money purchased in the money market—Fed funds and correspondent deposits, certificates of deposit, Eurodollars, etc.—will have lessened and, in a perfect market, equilibrated.

Second, the rising cost of bank core deposits will also put non-bank lenders on a more equal footing with banks with respect to 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, that is, but also in comparison to non-bank 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 non-bank subsidiary.

In summary of the last two points, 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 where core deposits are never likely to supply a significant portion of local credit needs. 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.386/ Finally, Citibank's sister corporation in the consumer credit field, Nationwide Finance, obtains funds from the sale of the parent BHC's notes, bonds, and 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 accounts, will equal the cost of their alternative sources of funds, namely purchased funds. If funds from one source cost more, banks would patronize 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 than 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 non-bank affiliate of a distant bank may prefer the local bank for two reasons. First, even if the non-bank 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 non-bank 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, just 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, whether consumer or commercial, in such an arrangement gets the benefit of any "float" because he does not incur interest costs on that portion of his credit line that is unused until the draft is presented for payment.

In addition to convenient access, the second reason for a borrower to prefer bank credit to non-bank credit is price. At present, banks are willing to offer somewhat lower interest rates on loans to depositors, and thus take some business that would otherwise go to non-bank lenders, in partial compensation for the depositor's keeping his balance there. 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 non-depositors. Non-banks 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 charge depositors less than they would charge non-depositors for loans. Then, non-banks will be on a 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 Part I, the legal system affecting the structure of the banking industry was described in terms of
the dual banking system, under which state and national bank regulators compete to construe banking powers liberally; the state-by-state banking system, under which the banking operations of any one company (bank or BHC) are confined to one state; and the triple banking system, under which the importance of BHCs in extending non-bank operations interstate, is given recognition. It was then shown that the motivations driving banks to reach interstate markets through their BHCs are significant and likely to endure, and that some (mostly large) banks have already made significant inroads to interstate and, indeed, nationwide markets for most bank services except deposit-taking.\textsuperscript{388/} In sum, the state-by-state banking system has been redefined in practice to apply only to deposit-taking. Meanwhile, the formal structure of the state-by-state banking system remains in place as though its aptness in the present world were not in doubt.

Both 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 notwithstanding the unchanging legal regime. Admittedly, there is no visible crisis to occasion this reexamination. Banks are not failing in inordinate numbers. The non-bank markets in which BHCs compete are not, 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, i.e., to consider the question of interstate banking to, to which I now turn.
(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[^389] and CBCTs[^390] on the one hand, yet is incapable of selective application to these facilities i.e., in the states where the policy of competitive equality warrants it.

Judicial craftsmanship will not provide a serviceable meaning to the term "branch" as it is used in the McFadden Act, because there is no essential characteristic of "branch-ness." 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 held 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 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. It is for the same reason that cash management CRTs are arguably in danger of being characterized as branches.\textsuperscript{391} Although the problem of defining the term "branch," it must be acknowledged, is a problem of the present regime, it 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 non-bank subsidiary offices whose operations are arguably too integrated with those of the affiliated bank.\textsuperscript{392} Uncertainty about the status of these facilities deters banks from investing
in them, although they may eventually be characterized as non-branches. Perhaps more important, however, is that such uncertainty deters innovation in the provision of banking services. Both consequences disserve the consuming public and foster concentration in the banking industry.

(b) Concentration and competition. As a system of territorial market allocation, state-by-state banking is far from fully successful. As shown above, its greatest success has been in the market for deposit-taking services; its success in dividing this product market geographically spills over, however, to other products 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 less competitive than it would be if territorial markets were not allocated by law. Of course, completely uninhibited competition in banking could be considered an unalloyed benefit to the extent it would have implications for bank failures. Nonetheless, there is good reason to question whether banking markets need to be as concentrated as they are at present 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, relative to small and re-
gional 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.\footnote{395} The costs of legal planning in the design of 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 smaller bank.\footnote{396} 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 non-bank 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
20 in Illinois at what were previously FinanceAmerica
offices, 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 10 or 15 years
ago. Alternatively, prohibiting BHCs from opening additional
non-bank offices interstate, while grandfathering existing
operations, would confer a permanent competitive advantage
on just a few firms; this option, too, has been made un-
attractive by developments taking place within the ostensibly
state-by-state banking system.

(c) The premises of state-by-state banking. The
advantages claimed for state-by-state banking have been
considerably eroded as interstate banking has grown up
within the state-by-state framework. Money center and
regional banks, with the great majority of bank assets, cannot realistically be considered "local" institutions.
These banks themselves lend on regional, national, and
international scales. Commercial and consumer lending,
carried on through the BHC is also, indeed principally,
conducted on a regional or national plane.

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.

In this respect, 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,"\textsuperscript{400} thus giving 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.\textsuperscript{401}

Inter-regional 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 bank loan to a Massachusetts borrower than to a developer in Arizona. 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.

National banks operate 646 branches overseas, under the supervision of the Comptroller.\textsuperscript{402/} Citibank alone has 216 branches and representative offices abroad.\textsuperscript{403/} 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.\textsuperscript{404/} 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 56 branches of 46 foreign banks,\textsuperscript{405/} 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."^406/

The Fed, moreover, reports no special practical difficulties in examining the operations of BHCs with interstate, indeed nationwide, and even overseas offices. It is of course possible that there are serious undetected problems and that the ability of regulators to examine far-flung banking enterprises is an illusion to be revealed in some approaching calamity. That possibility can never be entirely denied, but it seems 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.^407/

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 be relaxed somewhat 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 non-bank offices within the state, at the behest of home state banks and other competitors of the non-bank 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 non-bank subsidiaries of BHCs,\(^{408}\) and to Florida's having passed a statute in 1972 making out-of-state BHCs ineligible to own an investment advisory service, and therefore a trust company, in that state.\(^{409}\)

The Supreme Court held the Florida statute unconstitutional for discriminating unduly against interstate commerce, although it acknowledged the legitimacy of the State's interests in "[d]iscouraging economic concentration and protecting the citizenry against fraud." Regulation, it suggested, might have been a more appropriate means of protecting those interests than an "outright prohibition on entry."\(^{410}\)

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.\(^{411}\) This provision responded 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.\(^{412}\) 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 BT Investments case.\(^{413}\) 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.\(^{414}\)

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.\(^{415}\) 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.\(^{416}\)
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.\(^{417}\) The Delaware law was similarly negotiated by the Chase Manhattan and Morgan banks.\(^{418}\) Under the National Bank Act, a national bank may charge interest at the rate permitted by the state in which it is located.\(^{419}\) Whereas New York limited the interest that banks may charge on credit card purchases to 12%,\(^{420}\) 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.\(^{421}\) In other words, South Dakota and Delaware 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 300 people in South Dakota," even if it fails to move its credit card operations there.\(^{422}\)

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 are more eager to enter the California retail banking market than are California banks to enter that market in New York. In 1980, each state considered virtually identical bills 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 only one in these host states. In essence, 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).

The New 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.

(b) Problems of reciprocity. The divergent views taken by the New York and California banks of what was nominally equal and reciprocal treatment illustrates the inevitable failure of reciprocity as an approach to inter-
state 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 in the New York and California example, is a matter of business rather than law. But there are a multitude of legal problems, too, 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. Would a South Dakota BHC 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? If entry is by means of a state bank charter, soundness supervision will be administered differently, with different rigor, and at different cost to banks in different states; reserve requirements vary, and so on.

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 context of reciprocal treatment of banks internationally, reciprocity "would lead to a crazy quilt of divergent rules,"\textsuperscript{426} 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 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, indeed almost certainly impossible, to reach in light of the disparate attractiveness of various markets and the administrative problems already adverted to. In sum, reciprocity is not a promising means to interstate banking and it is significant that, in the 25 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 in the state-by-state system thus stymied, Congress in 1978 directed the President to study and report in one year on whether there should be any change in the federal law respecting branch banking.\textsuperscript{427} Thus defined, the subject encompasses a variety of alternatives to the McFadden Act--not only pro-
posals for interstate banking, but also those that are consistent with the state-by-state banking system, such as statewide branching for all national (and one would then expect, state) banks.

The Report of the President, which was submitted by the Department of Treasury in January 1981, made three recommendations.428/ 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."429/ Though unable to determine from the evidence examined whether modification of the McFadden Act or relaxation of the Douglas Amendment would be superior, the report suggests 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."430/ Specifically, the report recommends that "Congress enact a phased liberalization of the Douglas Amendment," perhaps initially to allow interstate acquisitions on a regional basis and/or limited to "a specified percentage of local market share."431/ "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.432/
Second, the Administration 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 the liberalization of the Douglas Amendment in the first phase of geographic deregulation." 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.

Finally, the report endorses "[i]nterstate BHC acquisitions to accommodate the 'failing bank' problem." In this, the Administration 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, however. Instead, there is appended to the President's brief (21-page) report a "Compendium of Research on Branch Banking" more than 10 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.

Both 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 here unfruitful. It may in any event be suggested that the precise content of the report is less important than the momentum that presidential endorsement in principle gives to the subject of interstate banking. Issuance of the report accordingly enhances the urgency of identifying the criteria by which the subject should be addressed before decisions are made or attitudes formed on the basis of a less than fully articulated set of standards.
II. THE CRITERIA FOR DECISION

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 paper, 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, multi-bank BHCs, and the like.

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.
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 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.

In Part II, six criteria are introduced and applied to the general question whether banking organizations should in principal be prohibited from operating full-service facilities interstate. Some of these are the conventional criteria of welfare economics; others are peculiar to the institutional setting under consideration. 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 increase. 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.\footnote{440} 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.\footnote{441} 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,\footnote{442} suggests that there is a need for some clarification of the relationship between interstate banking and competition.\footnote{443}

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 principal, consist of the 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. More likely, however, new banks will enter the market, but 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 start-up costs of entry had been incurred, scale and experience would imply 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 the incumbents to price below
marginal cost in the hope that their staying power would be 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 does not necessarily imply increased actual competition, does necessarily imply increased potential competition, and 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 "under-banked" 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 the Philadelphia National Bank case, 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 that compete with banks in only some product lines. Since that case was decided, the cluster of products offered by commercial banks has come to seem less unique, of course. Savings and loan institutions have acquired the power to offer transaction accounts, make consumer loans, and invest in commercial paper; finance companies issue the same credit cards that banks issue and compete on similar terms for much, although not all, consumer loan business. Thus, whatever the continued validity of the proposition that banks offer a
unique cluster of products, close attention to the expected consequences of increased competition from interstate banking requires that the cluster be unbundled and a separate determination made as to how the consumers of 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 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,\(^\text{448}\) they need not worry at all.
Instead, the FDIC joined the Fed and the primary regulators—the Comptroller and the state banking commissioners—in concerning itself with bank safety, since it would feel the impact of most bank depositor losses in the event of bank failure. Depositors with balances in excess of $100,000, which are 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 pay to depositors. Interest rate regulation is now being phased out by congressional directive, however, so that rates of interest paid on deposits in the future will reflect market rates for money, and the FDIC will have to rely on other techniques to assure bank soundness. Unable to control the cost of deposit liabilities, in supervising banks the FDIC will presumably attend even more than it has before 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 lesser quality, or at lower rates, than they used to.

If bank failures increase, the FDIC will have to raise its insurance premium, \(^452\) and insured banks will have to recover the added cost from their depositors. But increased failure seems unlikely. The federal 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. \(^453\)

In conclusion, depositors may benefit from the potential and such actual competition as is introduced by the relaxation of interstate 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. \(^454\)

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 credit-worthiness 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{455/} Heggestad and Mingo found that consumer 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{456/} They found that the average SMSA has the equivalent of 4.5 equal size banks; rural counties average the equivalent of only 2.2 equal size banks.\textsuperscript{457/} Thus, the inconsistent results of the various studies of bank prices and their relation to 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.\textsuperscript{458/} 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.459/

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; then one would expect that competition among them would result in lower prices to all borrowers, including large commercial borrowers.

Small and intermediate-sized 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 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 implied by 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; if not, it would be because bank rents have been dissipated through price competition for loans and service competition for deposits. 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.

It thus seems at first anomolous that a leading bank stock analyst believes interstate banking will increase bank
profits. 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. 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. 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 could be retained by producers under a condition of less than perfect competition, then it does seem plausible that interstate banking will benefit bank shareholders as a group.

2. Employees. Employees are positioned 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 cannot diversify away their dependence on a single enterprise 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 incum-
bent bank contracts, then some of that bank's 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.\textsuperscript{467} Provision was therefore made to protect the interests 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 output.\textsuperscript{468} If interstate banking is similarly likely to result in increased competition that in turn works to the detriment of some employees 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 inter-state banking.

In summary, the implications of interstate banking for producer 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 enterprises, while others lose their jobs; overall employment in the industry will probably increase, however, holding constant the rate of bank technological innovation.
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 compliance 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 them and their competitors.469/ 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.470/

The key element in making regulation equitable, of course, is deciding which cases are alike and which different.

1. 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 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 multi-state banks and BHCs.** Until the International Banking Act of 1978, foreign banks were not subject to the state-by-state banking 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.471/

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 multi-bank holding companies or branching, respectively. Operations established in other states prior to 1978, however, were grandfathered. The 65 foreign banks with multi-state operations 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 multi-state BHCs then in existence were also grandfathered. These BHCs compete in 24 states with banks and BHCs that are limited to banking in only one state. Whatever the advantages of multi-state 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 21 banks in the 11 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. 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 multi-state advantage will only be enhanced, moreover, if it implements a plan now
under consideration to establish an on-line regional point-of-sale (POS) system; holders of debit cards issued by any of the BHC's subsidiary banks could use this payment system throughout the 11-state region. 477/

The inequity of regulation inherent in requiring some banks to compete with others that have grandfathered multi-state operations could be resolved either by extending the reach of all banks, or by requiring the division of the multi-state banking organizations into separate entities, separately controlled, in each state. Multi-state 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 multi-state they had not failed to comply with the law as it then was. It is not 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 would only suggest that there are significant economies from interstate operation, the grandfathering of which conferred a permanent competitive disadvantage on others. The inequity of regulation is obvious.

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 multi-state 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 turns upon an immutable status, this is the essence of inequitable regulation.

3. Banks and their non-bank competitors. An increasing variety of non-bank institutions compete with banks for deposits. In most local markets, savings and loan institutions and credit unions are the principal non-bank competitors. Historically, savings and loans have been limited to taking savings passbook and time deposits, but they have offered accounts accessed by "remote service units," which are off-premise ATMs, since 1974,478/ and were authorized in 1980 to offer NOW accounts starting in 1981.479/ Credit unions, which have offered transaction accounts called "share draft" accounts since 1977,480/ have also been able to offer NOW accounts as of 1981.481/

Some savings and loans institutions and credit unions do in fact operate interstate at present, but not to an appreciable extent.482/ This is not a limitation of statute law, however. The Federal Home Loan Bank Board could, so
far as legislation is concerned, 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.\footnote{483} 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.\footnote{484} Equity of regulation requires that S&Ls and banks be treated alike in this respect, however, absent a strong countervailing reason for the distinction. Thus far, none has been offered, and any resulting disparity in regulation can be viewed more as the product of regulatory competition and different statutes than of a considered judgment.

Nationally chartered credit unions are operating interstate today. 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 65 branch offices located in 10 states and several additional places overseas.\footnote{485}
The brokerage house of Merrill, Lynch, Pierce, Fenner and Smith, Inc. (hereinafter Merrill) has demonstrated the ability of stockbrokers to compete for deposit business through a network of nationwide offices. Merrill, 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{486/}

CMA consists of a money market fund with a transaction account feature linked to a securities trading account at Merrill. 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. Merrill 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 Merrill'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 of for transactional purposes.\textsuperscript{487/}

At least two states have maintained that CMA is unchartered banking, and begun or threatened to begin litigation to prevent its operation. Oregon prohibits it on this
ground.\textsuperscript{488/} The state of Colorado settled its suit upon Merrill's undertaking not to allow customers to access their balances with drafts of $200 or less, thereby limiting the competitive impact of CMA on local banks.\textsuperscript{489/} Merrill 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 Merrill 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.

CMA is already of some competitive significance--there is $4 billion in the component money market fund\textsuperscript{490/} and it represents a potential competitive force of unknown dimensions. There is no barrier to other brokerage houses entering the competition for what are essentially transaction balances, and from exploiting their advantages over banks in being able to operate nationwide and to operate a money market fund.\textsuperscript{491/} 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, 24 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 and withdrawals to the broker's account at a bank that does share in a network.
Merrill, and perhaps other brokerage houses, 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. Merrill also sells $100,000 insured certificates of deposit (CDs) issued by about 20 banks and savings and loans, for example.\textsuperscript{492} 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, on the one hand, and vertical integration by banks themselves, on the other, but rather arises in a legal environment that leaves most banks no adequate alternative to using an agent in trying to reach depositors in other states.

Finally, ever since Sears, Roebuck announced that it was contemplating selling small-denomination notes to the public,\textsuperscript{493} banks have been facing the possibility that major retailers would 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, and pay interest to customers who have a positive balance during a month, while charging 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 thousands of locations across the nation.

If plans such as these were 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. Even if the soundness-oriented regulations or their equivalents are extended to retailers taking deposits, moreover, they will still enjoy the advantages of interstate operations.

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 as well, 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. Nonetheless, there is 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.

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 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 in the very short run period necessary to train examiners. Furthermore, the availability of examiners or examination procedures could be considered a constraint on the rate at which interstate banking is allowed.

Experience to date with grandfathered foreign banks and multi-state BHCs suggests that interstate banking by additional domestic banking enterprises will raise no new types of problems that have not already been encountered and dealt with successfully by both state and national supervisors. That experience also suggests the feasibility of coordination 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.\(^{497/}\)

Direct interstate branching is at least somewhat more likely than multi-state BHCs to alter the present distribution of supervisory authority.\(^{498/}\) Where a bank chartered in State A opens a branch in State B, both States A and B have a clear interest in the examination process. State A cannot risk allowing the branch in State B to serve as a warehouse for overvalued assets, such as delinquent loans, nor as a haven for imprudent or impermissible transactions. State 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 B is taking deposits from residents of State 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 A, host state 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 taking 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,\textsuperscript{499} 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.\textsuperscript{500} If federal examination is, as often asserted, equal to the best state examination process and superior to many states' processes,\textsuperscript{501} 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.\textsuperscript{502/} 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,\textsuperscript{503/} to the "administrative guidance" exercised by the Ministry of Finance in Japan.\textsuperscript{504/} 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.\textsuperscript{505/}
In the United States, policy guidance is used both for the fiscal and monetary purposes instanced above, and for the purposes of allocating credit to the housing market in general and to local credit markets in particular. Before turning to 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 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.\footnote{506}{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.\footnote{507}{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.\footnote{508}{Since 1933, a long list of exceptions to 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 so on. Many of these exceptioned 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, however, is even more clearly 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 requirements, 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; 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 the state banking commissioner.

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.
2. **Implementing monetary policy.** Monetary policy is implemented by the Fed in three different ways. The first, and by far the most significant now, is open market operations, in which the Fed buys and sells United States Treasury obligations. 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. 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.

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.\footnote{514} In fact, however,
some of the largest banks are particularly aggressive in
exploiting the discount window, borrowing every dollar that
they can at below-market rates.\footnote{515} The Fed has traditionally
jawboned excessive users of its discount window facility,
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 two successive weeks or during four weeks in
a quarter were charged a higher rate than were others.\footnote{516}

Jawboning is a familiar, and perhaps an effective, Fed
 technique for pursuing monetary and related policies. It
has been used in attempts to reduce float by chiding banks
against remote disbursement practices;\footnote{517} 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.\footnote{518}

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 itself providing subsidies to individual renters and homeowners, non-profit housing developers, and public housing authorities, and to creating government mortgage insurance programs, the federal government has encouraged banks and other depository institutions to provide credit to housing markets.519/

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.520/ In their capacity as investors in government obligations, however, the banks play a major role in funding government-insured and agency debts incurred in order to finance housing, including the obligations of the Federal Home Loan Banks, the Federal National Mortgage Association, the Government National 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 the Congress directed that the Regulation Q maxima on interest rates paid to account-holders be phased out, it also directed the President, through an inter-agency 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 rates of interest for deposits during periods of high interest rates. The Congress was here concerned that in the absence of interest rate controls, the institutions providing long-term, fixed-rate financing to housing buyers would experience both depressed or negative earnings and a shortage of funds as savers transferred money from thrift institutions to money market funds and other higher rate alternatives.

Interstate banking would thus run contrary to established national policy if it either diverted bank investments from housing or housing-backed obligations, or if it exacerbated the problems experienced particularly by thrift institutions during periods of substantial dis-intermediation; 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 rela-
tion 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.\textsuperscript{522/} 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,\textsuperscript{523/} and the various linked deposit schemes found in
some of the states.\textsuperscript{524/} The CRA policy is expressed in
congressional findings that: \textsuperscript{525/}

\begin{enumerate}
\item regulated financial institutions are required
by law to demonstrate that their deposit facili-
ties serve the convenience and needs of the com-
\item the convenience and needs of communities
include the need for credit services as well as
deposit services; and
\item regulated financial institutions have con-
tinuing and affirmative obligations to help meet
the credit needs of the local communities in which
they are chartered.
\end{enumerate}

The purpose of the Act is to enlist each of the federal
financial supervisory agencies in encouraging their regula-
tees 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" and to "take such record into account in its evaluation of an application for a deposit facility" by that institution.\textsuperscript{526} CRA compliance records are therefore made explicitly 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,\textsuperscript{527} 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.\textsuperscript{528}

Under the linked state deposit schemes of some states, the state's demand deposit account business is placed with banks that have a superior performance in meeting selected local credit needs, typically those involving housing finance. In the Colorado program established by Colorado State Treasurer Sam Brown, for instance, banks first bid purely on price for the State's business. Their 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.\footnote{529}

The economic wisdom of credit allocation efforts such as CRA and linked state deposit programs is arguable,\footnote{530} but there is no doubt that they represent national and state governmental policy decisions properly and openly taken and within the lawful authority of those jurisdictions. Accordingly, the implications of interstate banking for the pursuit of such policies must be taken into account, and to the degree that an interstate banking proposal would frustrate their achievement, that must be considered a drawback of the proposal.

5. **The significance of foreign ownership.** In the 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 political control over banking in United States policy. 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{531} Other than a brief moratorium on such acquisitions,\footnote{532} 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{533}
New York Banking Commissioner Muriel 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."

Most important, she said, is that pre-disposition towards meeting domestic credit needs:

"...[F]oreign ties also 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."

"...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."

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.537/

It should be clear enough that if the bank were making its investment decisions in order to maximize its return on assets, it 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 was 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.538/ The Comptroller, too, has spoken to 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.\(^{539}\) 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."\(^{540}\) 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.\(^{541}\)

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."\(^{542}\) 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."\(^{543}\)
It is doubtful that the Comptroller considers CRA completely adequate to allay the New York Commissioner's concerns, particularly regarding the market for New York municipal bonds. His decision should 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.\textsuperscript{544/}

Retaliatory pressures exerted abroad could harm United States banks, and to some extent the national interest, far more than could even several additional foreign acquisitions of domestic banks.

Thus, the United States' unique openness to foreign bank acquisitions is not inconsistent with its 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 multi-state 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 multi-state BHCs, moreover, showed that they were not significantly different from host state banks of similar size in their loan-to-deposit ratios. From this it may reasonably be inferred that multi-state BHC banks, too, held less public debt than independent banks, but probably no more or less than one-state banks. It cannot be determined from available sources, however, whether the multi-state BHC banks, like BHC banks generally, held 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 multi-state 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 banking would give a BHC, 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 multi-state BHCs and banks are more independent of each individual state in which they operate, the market for each such 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.

(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.
Nonetheless, the Fed has shown, as mentioned before, that it can use price discrimination to deter overuse of the discount window, as it did during the 1980 credit restraint program.\footnote{550/}

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 100 domestic and 200 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{551/} 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 51 bank regulatory jurisdictions in the United States had primary responsibility, on average, for only 100 banking enterprises, and additionally concerned itself secondarily with 200 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, as now, there would be an average 300 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 location 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 the 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 requirements 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.\(^{553}\)
(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 banks' 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 multi-state 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 affect 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 competitive economic markets. These two concerns are taken up serially 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 are applied to bank mergers and BHC acquisitions of banks, first by the appropriate bank regulatory agency. 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." 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.

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, 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. 558/ 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. 559/ Through a few well-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 560/ and the potential competition doctrine, 561/ 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%. 562/

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 anti-competitive 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 possi-
bility. 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, neither market seems to be at all concentrated, however, but more important, neither would be much affected by interstate banking. Cash management services and consumer credit cards have become national competition 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 equal, even with interstate banking.563/ 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 of a single BHC in passing upon holding company applications to enter non-bank activities. 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. 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.\textsuperscript{567/}

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.\textsuperscript{568/}

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. Noting that the firms involved were respectively the "largest U.S. Banking organization 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. 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.

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 conglomerate abroad would lead to their effective conglomerate 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.

The relevance of "mere size" to BHCs remains obscure, but it is possible to speculate about why the 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. The undue concentration
criterion was added to the BHC Act at the same time that the limitations on the non-banking activities of BHCs were liberalized.\textsuperscript{572} It is plausible that the 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, the 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 competitive by effectively channeling BHC acquisitions toward smaller "toeholds," (firms with small market shares) 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{573} The 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 one turns to consider liberalization of the geographical limitation placed on banking itself through the relaxation of the state-by-state system. Specifically, there are three potentially adverse effects to be expected from the emergence of "megabanks," i.e., very large banks or BHCs with very large aggregate bank assets.574/

(a) Political influence. It is reasonable to believe that megabanks would acquire substantial political influence at the national level,575/ 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 thousands of state residents and important lenders to the state and its political subdivisions, a large bank's voice is 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 the 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 legislature.

(b) Credit judgments. Insofar as interstate banking encouraged or allowed the emergence of a few megabanks,
there would necessarily be many fewer smaller banks. Whether a large bank expanded by acquisition or by internal growth, that is, there is a relatively fixed market for banking services at any given moment and the existence of megabanks implies the existence of fewer banks.

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 syndicated loan to a major corporation. If the same 100 banks were consolidated into, say, 20 nationwide banking enterprises, there would be only 20 and not 100 independent credit judgments making the market. In other markets for the sale of fungible commodities, such as steel, 20 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 that 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 20 lenders rather than 100.

(c) Failure intolerable. While it may be assumed that a megabank is no more likely to fail than any other well-
supervised large bank, it remains possible that a failure will occur. In that event, it is very unlikely that another bank or consortium would be able to assume the failed megabank's liabilities and take over its management. At the same time, confidence in the banking system would surely be impaired, perhaps gravely, if such a major institution were declared insolvent and liquidated in whole or in large part.\textsuperscript{578/}

The alternative certain to be tried in these circumstances would be some form of government ownership.\textsuperscript{579/} There is already 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; any losses it sustains are to be replaced by additional funds from the FDIC.\textsuperscript{580/} 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 a heretofore unprecedented element of state enterprise, with the probable inefficiency and potential for corruption that experience has shown to be associated with it.

In addition, if a megabank ever did encounter severe difficulties, for which FDIC management would not be a desirable solution, it would 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 into doubt. Once the corporation became precarious, however, it was not 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 state loans and federal loan guarantees to the extent of $1.5 billion.\textsuperscript{581/}

Certainly the impending failure of a megabank would occasion at least as much, if not more, solicitude from bank regulators and others answerable for the orderly workings of the economy, as did Chrysler. The widespread disruption of depositor and, even more, 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{582/}

4. \textbf{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 enter-
prises 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 would be at least conceivable that one or 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 solvable. 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 obtaining a new bank charter. This approach, which could entail significant efficiency losses by preventing some of 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 above a specified size. Fed 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 undue concentrations of resources in the sense under discussion here, since a state would rarely, if ever, be the relevant geographical market for an antitrust analysis of banking.

Five states already deny both acquisitions and new branch applications to banking organizations that hold more than a set percentage of statewide deposits. 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 be 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 inapposite, 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. If the national market is relevant only for certain products not including deposit services, 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{587} 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 banking enterprises above a ceiling size. The added objective here would be to avoid creating inefficient incentives for bank managers. Merely limiting the further growth of 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 be a problem to the extent that managerial compensation, status, or perquisites depended upon the size of the enterprise.\textsuperscript{588} 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.\textsuperscript{589} 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 to mitigate considerably 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, 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, or indeed many, 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 sets
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.\textsuperscript{590/}

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, then 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 it is very unlikely that the efficiency losses encountered to safeguard against an undue concentration of resources would outweigh the drawbacks present in the state-by-state banking.

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 liable to cause a problem of undue concentration. That problem could be solved through one or another approach to placing a
ceiling size on bank organizations, and the 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 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; produce welfare; the equity of regulation; amenability to safety and soundness supervision; amenability to policy guidance; and avoiding the undue concentration of resources.

1. Summary. 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. The losses experienced by some present employees could be averted or mitigated through a labor-protective approach, moreover.
Third, interstate banking would unequivocally increase the equity of regulation. It would lower the legal barriers by which some banks are adventitiously fenced into declining markets, while others benefit fortuitously 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 11 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 non-banking 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 and brokerage houses, and money market funds; they may soon be joined by interstate savings and loan institutions, at least in some markets.

Fourth, interstate banking will not impair the quality of safety and soundness supervision. 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 implicated in soundness supervision by interstate operations cannot coordinate their efforts adequately, federal pre-emption 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. If interstate banking results in substantial consolidation within the industry, the smaller number of resulting organizations will be probably 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 either to contribute to its frustration. If interstate banking does increase the inter-regional flow of funds, however, beyond the levels desired by capital-exporting jurisdictions, those areas would be better able to limit 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 as discussed above, that problem could be met without great difficulty, especially if it has been properly anticipated when interstate banking is first authorized. 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. 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 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 under-developed states, namely 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 from another state.

Third, even if the banks in both 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 discrimination against outlanders under what is nominally reciprocity between two states.\textsuperscript{591}

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 16 countries operated branches in New York as of the end of 1979.\textsuperscript{592} In the great majority of cases, however, there was no question about their countries' offering reciprocal treatment to New York banks, since New York banks had established branches in those countries before their banks branched into New York. Meanwhile, some of the banks most likely to have benefited both themselves and New York residents by branching there, including the banks of Canada, have been precluded from doing so by New York's reciprocity requirement.\textsuperscript{593}

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 under which
the criteria used here indicate that interstate banking
should be permitted. 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 amended to permit inter-
state banking to the geographical extent most consistent
with the criteria used above. In addition, the particular
means by which interstate banking is conducted--subsidiary
bank vs. branch banking vs. ATMs--should also be evaluated
according to those criteria. Part III of this essay accord-
ingly turns to the appropriate extent and means of inter-
state banking.
III. ISSUES OF EXTENT AND MEANS

Having determined that the general question whether banking organizations should be allowed to operate full-service facilities in more than one state should be answered in the affirmative, 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 whether bricks-and-mortar branches are to be treated differently from ATMs.

It is logically very difficult to separate questions of geographical extent from those of the means by which it 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 to consider seriously limiting the ATMs of a regional inter-
state 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 different types of geographical areas within which interstate banking could plausibly be permitted. These are: the country as a whole; a multi-state 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 (Standard Metropolitan Statistical Area, or 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 consumer welfare will be better served the larger is the geographical area from within which banks
may enter a particular local market. 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, each bank would immediately have scores of potential competitors in the wings of its market. With regional interstate banking, each 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.594/ Those in interstate SMSAs would face only little added potential competition, i.e., from the banks located in the out-of-state counties of their own SMSA.595/

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 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, however. 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 interstate banking regions would be sufficiently large to exhaust the available economies of scale, or whether, on the contrary, only nationwide banking could do so. The latter possibility seems doubtful under present technological circumstances, although it may fast be coming true. The geographical area of the 11 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 multi-state banks and BHCs, interstate 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.
The preceding two points do not apply with equal force to all banks, of course. Some banks will be able to realize scale economies, for instance, while others—perhaps because they are less well-managed—will lose market share to them; in a more competitive environment, they will clearly be worse off for their poor management. 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 personalized 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 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.

Problem and failing banks would have more potential buyers, who could be expected to bid up the price of their shares, the larger the area within which acquisitions were
allowed. Even in 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. 597/ Indeed, the Federal Financial Institutions Examination Council, which is composed of representatives of the three federal banking agencies, and the Federal Home Loan Bank Board, and the National Credit Union Administration, has since requested that the Congress pass legislation enabling failing banks (and thrifts and credit unions) to be merged interstate in order to avoid a market-concentrating consolidation with a local competitor. 598/

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. 599/ 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."\(^600\) One result, the analysts believe, will be to:

\[\ldots\] 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 removal of geographic restrictions will be in the best interest of the small bank's stockholders as it will increase the number of potential buyers.\(^601\)

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 interest 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, which is a county-wide banking state, could branch throughout Connecticut because one county of that state is in their SMSA and Connecticut allows statewide branching.\textsuperscript{602} Under a regional approach enabling Illinois banks or BHCs to enter contiguous states, an Illinois BHC could hold one unit bank in Illinois and several banks throughout Missouri.\textsuperscript{603}

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.\textsuperscript{604} 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.\textsuperscript{605} 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,\textsuperscript{606} whereas California banks would have access to six additional states, including several with above-median economic growth, such as Arizona and Colorado.\textsuperscript{607} 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.\textsuperscript{608}

The disparity between domestic banks and foreign banks that established branches or subsidiaries in multiple states prior to the International Banking Act of 1978 would be
eliminated only if interstate banking were allowed nationwide. 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 multi-state 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 multi-state domestic BHCs 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. 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 would
presumably have to be admitted to a similarly large or
populous area to be given a truly equal opportunity.

Finally, the non-bank institutions with which banks
must compete now or in the future for retail deposits oper-
ate nationwide. Brokerage houses, money market funds, and
retailers are completely unlimited with respect to locations.
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 re-
specting 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 multi-state BHCs could perhaps be devised but only the nationwide approach could eliminate the disparity now favoring grandfathered multi-state foreign banks and non-bank 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 non-member banks in the system. In addition, assume that the national bank has a significant branch operation in London, that the BHC has substantial non-bank 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. Simultaneous 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 non-member 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 non-bank 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 a simultaneous 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 does 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.\textsuperscript{612/} Still, there would be a larger number of complex organizations requiring examination under interstate banking.

From the point of view of examination simplicity, then, 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;\textsuperscript{613/} 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.\(^{614}\) 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 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;\(^{615}\) in the absence of empirical data, it has seemed more likely than not 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. While there might be only little room for improvement in the banking system's present ability to intermediate housing (and other) funds inter-regionally, such room as there is would better be occupied by nationwide than by regional, and necessarily than by metropolitan, interstate banks, for obvious reasons.
Likewise, with 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{617/} succeed in keeping more deposits invested in local loans.

In sum, political control over banking will probably not be greatly affected by the decision that must be made among nationwide, regional, or metropolitan interstate banking authority. 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. 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 these markets to additional potential and actual competitors, that is, could do much to deconcentrate them—and much needs to be done.\textsuperscript{618/} 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, and could increase by more, the larger the geographical area over which banking enterprises are allowed to operate if the largest banks are best able to exploit the opportunity in 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 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. The local and regional markets that the largest banks enter de novo or by a so-called "toehold" acquisition (that is, of a firm with a small market share) 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 product 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, 621/ and only a few signs that the money center banks may be able to obtain a significant share of the nationwide total of cards outstanding. 622/ 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 geographical ranges within which interstate banking might take place—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 competi-
tion, 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 of this sort, whereas regional and nationwide banking could create complications that would require some 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 non-bank 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 limitation 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 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. It will in any event 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 the conclusion just reached that banking enterprises should be allowed to operate nationwide at once. While consumer welfare is disserved 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—whether branches or BHC subsidiary banks—would still have to be approved individually by the appropriate 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.\textsuperscript{623/}

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.\textsuperscript{624/} The banks most capable of supporting extensive nationwide expan-
sion 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 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\(^6\) and more than 1,100 branches in California,\(^6\) 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.\(^6\) 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 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 re-structured 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.\textsuperscript{628}\textsuperscript{/} Similarly, the Association of Bank Holding Companies has proposed that BHCs be allowed to acquire other BHCs in contiguous states.\textsuperscript{629}\textsuperscript{/} Seemingly neutral on its face, this approach is on inspection most inequitable, 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 5.7 million persons.  

Meanwhile, Nevada is contiguous to California, Arizona, Utah, Oregon, and Idaho—which constitutes an area with rapid economic growth, statewide banking organizations, and a combined population of 29.9 million. 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.

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 obvious, 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."632/ 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 to be a meaningful competitor for retail deposits in California for many years, where there are over 4,000 bank branches,633/ of which 1,119 belong to the Bank of America alone.634/ 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.635/

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.\textsuperscript{636/} 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.

B. Functional Limitations on Interstate Banking: ATMs Only?

The National Commission on Electronic Funds Transfers (NCEFT) recommended that the Congress enact legislation removing electronic banking facilities from the definition of a "branch" in the McFadden Act.\textsuperscript{637/} 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.\textsuperscript{638/} 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."\textsuperscript{639/} 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.\textsuperscript{640} Second, they could be established (or shared) where brick-and-mortar branches could not be established by the same bank, namely statewide, even in unit and limited-branching states, interstate in SMSAs, and nationwide for all purposes except deposit-taking.\textsuperscript{641} Thus, the NCEFT envisioned a situation in which banks could give their retail customers electronic 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.\textsuperscript{642} 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 pre-approved 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 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, regarding 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 inter-state 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—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 extent allowed under the affiliate transaction regulations, through consumer finance or other non-bank lending offices of the EHC 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.
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 and banks 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 inter-state 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. Between banks in declining and banks 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 restrict-ed 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 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 a 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 inter-penetration 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 a 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. 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, since it will introduce new competitors for deposit services into each part of an SMSA now divided effectively into two (or three) submarkets by a state line(s). 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.

Since the distinction between the geographical reach of ATMs and brick-and-mortar offices is not directed to the correction of an externality, both consumers and producers will be relatively worse off to the extent that the legal regime induces greater investment in ATMs and lesser investment in brick-and-mortar branches than would otherwise have occurred were the two forms of market entry made equally available to banks.\(^646\) 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 judgement, 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 non-economic 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 concentrations 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. Multi-state 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,\textsuperscript{647} 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.\textsuperscript{648} 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 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. 649/

A bank separately organized to operate in State B will have to have 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. 650/ 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, and it is these that should be considered in the application of 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 necessarily from the fact that lending limits are set at a percentage of bank capital, 651/ as variously 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 bank. If one bank participates a large loan to its affiliate banks, however, their lending limits can effectively be aggregated, although at the expense of some transaction costs.\textsuperscript{652/}

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 be doing business with very different entities under the multi-state BHC and direct interstate branching approaches, therefore. 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.\textsuperscript{653/}

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 multi-state 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, but that has had no adverse affect on their soundness, and indeed, the failure rate of multi-bank BHC banks is lower. Since, in addition, the BHC form promises 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 organi-
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 Ban-Corporation 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, nor 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. Indeed, such banks may wish to open just one or a few small offices in a host state; at this modest scale, separate organization of a bank in that state may well prove a sufficient barrier to 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, and thus to increase 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 their 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.658/

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 freely as possible of legal barriers to the most efficient choice of form for them.

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 financial centers, such as Atlanta, Boston, and Dallas might well 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; it would, in effect, be a branch by whatever name it is called, 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, the 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 multi-state BHCs grandfathered in 1956 will obviously be eliminated regardless of how the choice-of-form issue is resolved. This is not true of the multi-state foreign banks, however.

In the absence of a federal law preventing them from having a multi-state 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--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.\textsuperscript{662} 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 non-banking 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.

It is slightly more problematic to redress 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. The correction of this inequity 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 non-bank 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 taking "credit balances" 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. To the extent that requiring banks to organize separate affiliates in each state would be costly or otherwise inconvenient, therefore, 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.663/ As previously observed, the difficulties of arranging a coordinated, simultaneous, and especially a 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 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 is liable to be examined by the FDIC or the Fed and by each of the states in which it has deposit-taking branches.

The need for simultaneity of examination is greater with a branch banking system than it is with a group of affiliated banks. Limits on and records of inter-affiliate 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 simul-
taneously, 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 the 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 non-member 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), they would be free to do so.

Examination complexity 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 between state and national charters in the context of interstate banking as they are presently allowed to do intrastate. Under the state-by-state banking system, a multi-bank BHC may, and typically does, have both national and state-chartered subsidiary banks. This enables the BHC
to maximize its incidental or non-banking 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 enable 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, the states will find that they are competing with one another to attract banks to their borders. This competition among many jurisdictions 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 model that now exists in the relationship between Citicorp and South Dakota. There, it will be recalled, 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 attract customers from the general public in the state." 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.

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."667/ 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.668/ 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, a North Dakota might give banks the same powers that general business corporations have, namely 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. 669/

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, i.e., that between the states. This possibility could be completely eliminated by either of two means. First, banking organizations could be required, when crossing state lines, to do so by direct branching--an option that is not under consideration here. 670/ Second, multi-state 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 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.\(^\text{671}\) Second, host state bank affiliates of multi-state 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 the 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 multi-state 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 can 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 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, to a like degree without regard to whether the first office that it opens in the state is separately chartered as a bank subsidiary of its BHC or 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 avenue to increasing the demand for a state's public debt should not be open to it 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 whether the national bank is located in their own state (although a subsidiary of an out-of-state BHC) or the national bank has branched into their 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. The Comptroller's regulations 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.\textsuperscript{673} Thus, the host state banking commissioner's threat to intervene 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 have somewhat greater independence of local policy than state banks in their decisions to fund local credit needs, but even with respect to that policy will 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 multi-bank 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 multi-bank BHCs while others have not.\textsuperscript{674} Thus, at the extremes, some states have adhered to true unit
banking, disallowing both branching and multi-bank BHCs, while others have imposed no structural limitations, allowing both statewide branching and multi-bank 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). They lie, therefore, 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\footnote{675} was implicitly subsumed in our earlier assumption 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 multi-bank BHCs are declining in number, but those that remain are obviously still animated by a distaste for large banking organizations, since a concern with competition alone would not justify either limitation; allowing statewide banking organizations can be more conducive to vigorous competition in local banking markets for the same reason that nationwide banking, properly administered, is 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 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 multi-bank 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 location or limited locations, and thus put into a position of competitive equality with host state banks. In the 18 states that prohibit or limit branching but permit multi-bank 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 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 multi-bank BHCs. Experience reveals that multi-bank 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." If such unit or limited branching subsidiaries of a multi-bank 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 multi-bank 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 former 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, that is, both the state and national polities must be considered.

Although federal pre-emption 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, in our previous discussion of undue concentrations of resources, it was noted that banking enterprises operating in a multi-state 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 limit size could be required to reorganize themselves into two banks in order to facilitate their division into separate companies when the maximum permissible size is reached. 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 will be necessary. It can be required merely to spin-off certain of its bank subsidiaries, and thus to divide 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 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 multi-bank BHCs, there will be little justification left to 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.

The following conclusions may be reached on the basis of this analysis. 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 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 multi-bank BHCs, would be unlikely to insist that an out-of-state BHC organize a separate bank within its borders, but there are only 22 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 strucutre.

There are two such situations in which direct branching may be superior. 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 necessity to organize a separate bank is a substantial barrier to entry into the counties of the second or third state within an SMSA, as it might be for small banks, then it should be suspended and direct inter-state 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 multi-bank BHCs, the out-of-state bank should be allowed only one branch location and required to operate additional banks if it wants multiple locations. This would assure that the consumer and producer welfare potential of interstate banking is captured 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 the 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 that is their preferred method of doing business. The banks' preference for branching is probative that producer costs would be lower, and therefore probably that consumer welfare is served by allowing it;\textsuperscript{681} some public detriment should be anticipated before it is disallowed.

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,\textsuperscript{682} 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 multi-bank holding companies,\textsuperscript{683} 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 multi-bank BHCs.\textsuperscript{684} If both Dallas and Houston were considered financial centers, and 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.\textsuperscript{685} 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 essay 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 bank. If branching were completely unlimited, it was observed, there would be no reason for "branch" to be a term of art, since nothing would turn on whether something is characterized as a branch.\textsuperscript{686} 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 with prohibitory legislation 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 non-bank 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 McPadden Act's definition of a branch. Instead of asking whether interstate banking should expressly be permitted, therefore, the issue might well have been 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. 688/

The same equation between deposit-taking and branching appears in the approach taken by every state to consider 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. 689/

The consequence of equating interstate branching with 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 non-banks, 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 what it is—the computer at the bank where the credited account is held, the clearing house, or the payor's telephone—can not, of course, be dismissed because the question seems odd; it 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 network 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, though. 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 does confer 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, occur where a bank takes *retail* deposits of currency 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, moreover. 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 non-bank 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 non-bank subsidiary of the BHC, or by a joint venture BSC, established for that purpose. Only the deposit-taking function cannot thus be shifted to a non-bank 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 that in turn justifies, however well, both the consumer protective and the anti-competitive aspects of banking regulation, from mandating deposit insurance to entry regulation.

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 when it is realized that some of the same banks participate in both markets, as
local retailers and national wholesalers. At stake in the interstate branching issue is primarily whether to allow banks to become national, or at least multi-state, retailers as well. 693/

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, 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 to be determined now 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 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 to acquire instead a major participant in the market. 694/ 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 con-
text. 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 give recognition to 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.

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 a buyer to prove that de novo entry or a toehold acquisition were impractical. The alternative approach, of sometimes requiring that entry be by acquisi-
tion, which would presumably be adopted in order to protect existing competitors, might operate like the home office protection rule common in intrastate branching laws; a bank might be allowed to enter a new market interstate only by acquisition, or to enter de novo only if efforts to enter by acquisition are unavailing.

While there are many such possible alternatives to reliance solely on the antitrust laws 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.699/

In 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 metropol-
itan 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.700/

(b) Entry by acquisition. Market entry by the acquisi-
tion of an existing bank may also be accomplished by either of two means, but again the distinction need not detain us. Whether the buyer 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 buyer will exploit the
acquired bank's physical presence there to introduce price reductions or service improvements to the target market. This is frequently the case, moreover, if the acquired bank's market share is not too high to begin with. Acquiring banks tend to have more aggressive,\textsuperscript{701} 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 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.\textsuperscript{702} 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 purchase 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 con-
text, 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--but is
nonetheless capable of undertaking a market entry by acquisi-
tion. This constraint will be substantially, indeed probably
completely, relaxed with nationwide banking, of course,
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.703/

Second, there may be very few potential sellers, espe-
cially in a concentrated market. Indeed, in the most con-
centrated 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 small
enough market shares that a potential competitor could
lawfully 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 buyer 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 buyer 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 ownership.\textsuperscript{704} 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 buyer at a particular time and 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 acquisition only 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 of which are enjoying the benefits of a quiet life, in which one of them 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 in the longer run. 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 entrants to the market competing away their economic rents. 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\(^{705}\)), 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 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 acquiring bank and a sleepy target bank in an oligopol-
istic market with cartel pricing. Under the acquisition-only approach, the aggressive buyer 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 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, there may be some reason in experience actually to think 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. \(^{706}\)

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 buyer. 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 somewhat 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 other 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 the 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, therefore. Of course, under either the acquisition-only or the small start approach, employees could be held almost harmless by the inclusion of a labor protective provision in the regime, if the potential for adverse effects were thought to be significant.707/ 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 multi-state, full-service banks can be corrected only to the extent 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 them 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 buyer 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 acquisi-
tion 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 a probabilistic 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 people even to bother with 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—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 enable 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, moreover. That approach has an inherently greater capacity to be introduced gradually because it involves a smaller marginal unit of change, namely 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 market structure-conduct-performance theory of the industrial organization.\textsuperscript{710} At any rate, local market deconcentration is its inherent characteristic and its advantage. Accordingly, the undue concentration criterion favors the small start approach.\textsuperscript{711}
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 last two criteria, also suggests 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 "over-banked" by some objective ratio, such as that of population or deposits to banks,\(^712\)/ the *de novo* approach to entry would 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 there is a trend toward concentration in evidence, 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 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 while it does assure the maximum degree of local market competition—not merely statistical deconcentration—that interstate banking could bring about.

In the absence of any rigorous means by which to compare the expected burdens on some producers with the expected benefits to other producers and to consumers, it is not possible to make a felicific calculus that will 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 guess that the mixed national strategy would be superior in this non-Pareto sense.713/  

4. A mixed federal strategy. Another alternative 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 extent714/ whether
the means of entry into their markets will be limited as to method. 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. Because of the role it assigns to the states, I will call this 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 implied 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. That 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.715/

5. Conclusion. Of the two polar and two mixed approaches to the acquisition vs. de novo entry issue examined, 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.

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 acqui-
sition, once having entered, the out-of-state bank would be fully subject to state law respecting market structure. Nor is there any 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 that many more would want to limit the means of interstate entry to their markets, however.

First, the consumers whose interests are disserved by such a limitation are neither organized nor influential on issues such as this, even where they are organized around other, related issues. Second, banks that do not plan to expand interstate would probably support any limitation they
could place on out-of-state entry into their markets. Of course, 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 would like to expand interstate would oppose the states having any right to erect any limitation on the 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. In contrast to those supporting a limitation on the means of entry, 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 25 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.717/ Reciprocal banking bills have recently begun to be introduced in a few state legislatures,718/ but none has 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.719/ 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.720/

If the opponents of interstate banking entry could be that uniformly successful at the state level, there is little reason to doubt 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 essay 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., do not enact legislation to require that entry be accomplished through a separate bank subsidiary of the BHC. It has also been proposed that state and national banks be authorized to open wholesale branches in (3) 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 the bank's primary regulator. 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.721/

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{722/}

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." 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.

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 national bank'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, in
the section that follows, further to specify procedures for interstate wholesale branching.

B. Procedures for Interstate Retail Branching De Novo

Regardless of their merits, the reasons that justify 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.724/

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 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 10 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.725/ 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 branching 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.

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 will be the primary regulator with respect to national banks branching inter-state. 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.726/

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. The host state banking commissioner 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 (state or national) charter 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 principal 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 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 whose supervision 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 whose control has passed to an out-of-state BHC to which the regulator has legitimate, non-discriminatory 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 outweighed by other considerations within the Fed's mandate. The 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 buyers 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.729/ 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. 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 other issues may be appropriate and in-
evitable, 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 irrepres-
sible 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 non-discriminatory 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 wildcard 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 regulation 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 non-bank 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.
To non-lawyer readers:

These notes may look unfamiliar to you because they are in the form used by legal researchers. Since most of them relate to legal materials, the reader desiring to obtain a source may need to use a law library. In that case the use of legal form will prove helpful.

The following information will serve as an aid in reading the notes:

1. Underlined titles are journal or other periodical articles, essays in collection, and congressional hearings.
2. Book titles are not underlined.
3. Citations conform to A Uniform System of Citation (1980), which may be obtained from the Harvard Law Review.

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 in size or importance to the nation's economy, hence this article's exclusive focus on commercial banking. The commercial banking considerations raised may or may not apply with equal force to the thrifts; a separate analysis would be required in order to make that determination.
Within commercial banking, there are some exceptional cases of interstate branching and affiliation that were "grandfathered" when prohibitory legislation was enacted. See pages 138-39, infra.

"Control" is defined in this context as the ownership, control, or power, direct or indirect, to vote 25% 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).

See American Bankers Ass'n, State Bank. L. Serv. 3 (rev. 1978).


See generally B. Hammond, Banks and Politics in America from the Revolution to the Civil War (1957); Klebaner, State-

The Bank of North America was chartered by the Continental Congress, but doubt about this authority led the directors almost immediately to seek additional charters also from the several states in which the bank operated. B. Hammond, supra note 8, at 51. Regarding the Banks of the United States, see generally id.; P. Studenski & H. Krooss, Financial History of the United States 60-63, 103-07 (2d ed. 1963); J. Hurst, A Legal History of Money in the United States, 1774-1970 passim. (1973). The controversy over the banks is bracketed by Secy. Hamilton's Treasury Report on a National Bank (1790), in 5 American State Papers (1832), and Pres. Jackson's Veto Message (Recharter of the Second Bank of the United States), 8 Cong. Deb. App. 73 (1832). The political context leading to the demise of the Second Bank, and thereby the withdrawal of the national government from bank chartering until the Civil War, is recounted in R. Hofstadter, The American Political Tradition 56-63 (Vintage ed. 1948).

As a contemporary observer noted, "The 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. The North's Empty Purse, 67 Am. Hist. Rev. 1, 8-14 (1961). Earlier that year, Secretary of the Treasury Salmon P. Chase had already been so frustrated by the reluctance of the New York banks to lend the government $150 million in specie that he had threatened to "put out paper until it takes $1,000 to buy a breakfast." A. Hart, Salmon Portland Chase 223 (1899).

11 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. Studenski & Krooss, supra note 9, at 154.

12 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 10, at 10.

13 Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533 (1869).

14 Hammond, supra note 10, at 10-11.

15 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 (1941).
16  Id.


18  Id.

19  Banking Studies, supra note 15, at 418 (Table 2).

20  Computed from Federal Deposit Insurance Corp. (FDIC) 1978 Ann. Rep. Table 103, at 126-33; reprinted at Conference of State Bank Supervisors, Profile of State-Chartered Banking 197-98 (1979) [hereinafter CSBS Profile].


23  E.g., Federal Bank Commission Act--1976: Hearings on S. 2298 Before the Senate Comm. on Banking, Housing and Urban Affairs,

24 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).

25 L. Brandeis, Other People's Money and How the Bankers Use It (1914).

26 See, e.g., 12 U.S.C. §§1814, 1816 (Comptroller to certify to FDIC that he has considered, inter alia, the "general character of [the] management" of each newly chartered national bank); N.Y. Bank. Law §24(1) ("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 the
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. 2 at 22 (1965); cf. 47 C.F.R. §73.24 (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. Communications L.J. 173 (1980).

See, e.g., Comm'n on Money and Credit, Money and Credit: Their Influence on Jobs, Prices and Growth 157-8 (1961); Greenbaum, Competition and Efficiency in the Banking System--Empirical Research and its Policy Implications, 75 J. Pol. Econ. 461, 476-77 (1967); but see Tussing, The Case for Bank Failure, 10 J. Law & Econ. 129 (1967).

Peltzman, Entry in Commercial Banking, 8 J. Law & 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).

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 radio 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.)


The 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." 45 Fed. Reg. 68,603 (Oct. 15, 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.

It is clear, for instance, that Comptroller Saxon had a more pro-competitive bias than his predecessors, his successors, and his state counterparts. Thus, the average number of new national banks chartered annually by him during the five years 1962-66 increased to 448% of the average for the 1957-61, see G. Fischer, American Banking Structure 212 (Table 5.3) (1968) [hereinafter Fischer (1968)] ; it was 427% of the average chartered by Comptroller Camp during the period 1967-71. See Scott, supra note 6, at 24 (Table 1). Meanwhile, the annual average number of banks converting
from state to national charters increased from 9 in 1957-61 to 23 in 1962-66, thereafter decreasing to 13 in 1966-71, while the annual average number of banks dropping national for state charters increased from 4 to 8 and then increased again to 22 over the three quinquennia. See data 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, there is some evidence of this. Four of the 13 national banks merged into state banks in 1966 had been chartered in 1962 or 1963; one of the eight national banks converting to a state charter, and two of the 18 merged into state banks, in 1965 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 Calif. Supt. of Banks, Ann. Rep. 12 (1964), noting decline in number of new state banks chartered and "sharp increase" in number of new national banks; id. (1965), at 13, noting continued decline in new state banks chartered and increase in new national banks chartered.


34 12 U.S.C. §1821 (a) (1).

35 As of December 31, 1979, 14,364 (97%) of all commercial banks, accounting, as of June 30, 1979 for 98.4% of all commercial bank assets, were FDIC insured. Computed from FDIC 1979 Ann. Rep., Tables 101, 106.

36 In the period 1975-79, the FDIC arranged purchase and assumption transactions in 42 of the 52 instances of insured bank failure. FDIC 1979 Ann. Rep. 205-06 (Table 124).

In the period 1960-74, 67 insured banks failed; only 10 (14.9%) were attributed to factors that did not involve turpitude or self-dealing by the management. G. Hill, Why 67 Insured Banks Failed--1960 to 1974 (FDIC publ.), reprinted in Majority Staff of Sen. Comm. on Banking, Housing, and Urban Affairs, Chartering of National Banks: 1970-77 74 (1980) [hereinafter 1980 Senate staff study].

Other regulatory controls, such as minimum capital requirements and asset examination, also operate to prevent bank failures. Entry control itself cannot, therefore, be said to account for the failure rate; rather the point is that sufficiently unrestricted entry would almost certainly cause some banks to fail (or at least to withdraw) due to competition, notwithstanding the existence of these other controls. The FDIC does not, however, attribute any of the 67 bank failures in the 1960-74 period to the rigors of competition. See Hill, supra note 39, at 1. This is not surprising, since the average banking market is highly concentrated, having numbers-equivalents of 4.5 banks in the average SMSA and 2.2 in the average rural county. Heggestad & Mingo, The Competitive Condition of U.S. Banking Markets and the Impact of Structural Reform, 32. J. Fin. 649 (1977). The OCC is criticized for limiting new charters, particularly in concentrated markets, during the 1970s in the 1980 Senate staff study, supra note 39.
Board of Governors of the Federal Reserve System, Manual of Examination Procedures iii (undated looseleaf publication) (examination is concerned primarily with appraisal, audit with verification).


The Subcomm. on Commerce, Consumer and Monetary Affairs of the House Comm. on Gov't 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. 94-1669, supra note 37, at 7.
Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972) (interpretive ruling invalid).


12 C.F.R. §7.3500; see National Retailers Corp. of Ariz. v. Valley Nat'l Bank, 411 F. Supp. 308 (D. Ariz. 1976), 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).

12 C.F.R. §7.3400 (1979); 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 a loan secured by the leased property).

E.g., the New York Banking Dep't 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 Goldman, Atty. for the Dep't (Jan. 5, 1980).

At least 34 states have such so-called "wild card" provisions in some form. State Bank. L. Serv., supra note 4, at 122; see Am. Bank. Ass'n, Model State Bank Code §2.103(4) (1950).

See Miller, supra, note 32, at 2 FDIC Task Force 511; Conflict of Federal and State Banking Laws: Hearings Before the House Comm. on Banking and Currency, 88th Cong., 1st Sess. 242-43
(1963) (statement of Floyd W. Kramer, Member, Colorado Banking Board).

Scott, supra note 6, 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 state member banks to national charters.


Hearings Before the Commerce, Consumer, and Monetary Affairs Subcomm. of the Comm. on Gov't Operations, 96th Cong., 1st
Sess. (Aug. 1, 1979). In 1980, the OCC also issued 14 staff
depository institutions eligible for
federal deposit insurance, to offer accounts accessible by
negotiable orders of withdrawal (NOW accounts); Title IX of
the 1980 Act imposed a moratorium on the federal regulatory
approvals required for foreign acquisitions of all banks
"organized under the laws of any State or of the United
States"; and Title V thereof preempted certain state usury
ceilings applicable to FDIC-insured state banks. The Community
Re-investment Act of 1977 [hereinafter CRA] applies to both
state and national FDIC-insured banks, 12 U.S.C. §2902(2),
as does the Change in Bank Control Act, 12 U.S.C. §1817(j).

For exceptions, wherein federal regulation purports to
govern state non-insured banks that are merely eligible for
FDIC insurance, see Consumer Checking Equity Act, supra note
62, and the Monetary Control Act, Title I of the 1980 Act,
which extends reserve requirements to such institutions.
The first cited statute, insofar as it authorizes FDIC-
eligible but non-insured 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 pre-empt state prohibitory law, that is, with respect to entities lacking federal deposit insurance.

64 See supra. note 35.


66 12 C.F.R. Part 346, App. A.

67 Thus, the deposits of 1,422 of the 1,427 commercial banks in Texas are FDIC-insured. FDIC 1979 Ann. Rep. 150 (Table 103).

68 Act of December 23, 1913, Ch. 6, 38 Stat. 251, §2 (par. 3).

69 Id.; see 12 U.S.C. §§282,323.

70 Federal Reserve Act, supra note 68, at §19 (b), repealed and superceded by 1980 Act, §103.

71 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.

72 E.g., Fla. Stat. §663.582(1).


75 1980 Act, §103, supra note 62.

76 The extension of NOW account authority to federal savings and loan associations and mutual savings banks, 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. The monetary control policies that justified a reserve requirement for commercial banks thereafter applied equally to these other types of depository institutions.


81 E.g., Mass. Gen. Laws Ann. ch. 172, §11 (maximum of one branch office per year outside home county.)

82 E.g., N.Y. Bank. Law §105(1) (bank may not branch into city of less than 50,000 population where principal office of another bank is located).

83 Act of March 3, 1865, ch. 78, 13 Stat. 484, §7 (proviso).


The decision invalidating the LPO interpretation was reversed for laches, however. Independent Bankers Ass'n of America v. Heimann, 627 F.2d 486 (D.C. Cir. 1980), reversing No. 78-0811 (D.D.C. Mar. 29, 1979).


The court in Independent Bankers, supra note 94, 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.

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.; Letter No. 153, supra note 94. This view is disputed infra at note 309.
100 G. Cartinhoour, supra note 79, at 82; M. Jessee & S. Seelig, Bank Holding Companies and the Public Interest 5 (1977).


102 Fischer, supra note 32, at 95.

103 G. Fischer, Bank Holding Companies 25 (1961) [hereinafter Fischer (1961)].

104 See id., at 30-32.


106 Id.

107 Id.


110 Act of June 16, 1933, ch. 89. 48 Stat. 162 (1933).


112 §5(c), 12 U.S.C. §1844(c).


114 Section 3(c), 12 U.S.C. §1842(c) incorporates the substance of §§1 and 2 of the Sherman Act and §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."

116 Id., at 5.

117 §4(c)(8).


119 12 U.S.C. §1842(d)(1), as amended. As originally enacted, the 1956 Act's ban on interstate acquisitions was interpreted to create an exception "when the assets of a bank are acquired by a bank which is a subsidiary of a holding company."

120 Golembe (1979), supra note 111, at 33.

121 102 Cong. Rec. 6860 (April 24, 1956).


123 E.g., N.Y. Bank. Law §§1 et seq. (comprehensive regulation); Ill. Rev. Stat. ch. 16 1/2, §73 (multi-bank holding companies prohibited).


126 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 four 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)(v).


132 12 U.S.C. §24(Seventh); see id., §335.

133 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 . . . ." (Emphasis added.) The
tortuous legislative history by which this provision was amended is related in Investment Company Institute v. Board of Governors of the Federal Reserve System, 606 F.2d 1004, 1018-20 (D.C. Cir. 1979). The court there reasons 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). The Supreme Court noted but did not resolve the matter in reversing the case just cited. See ___ U.S. ___, 101 S.Ct. 973, 990-91 (1981).


135 12 C.F.R. §225.4.

136 Id., §225.4(b).

137 Id., §225.4(a).

Id., 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 and associated text supra.

Data processing, courier, and management consulting services are so limited. See 12 C.F.R. §§225.4(a)(8), (11), (12).

12 C.F.R. §7.3500(a).

12 C.F.R. §225.123(e). But cf. National Courier Ass'n. v. Board of Governors of the Federal Reserve System, 516 F.2d 1229 (D.C. Cir. 1975) (non-financially 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 (June 16, 1980); 46 Fed. Reg. 34071 (June 30, 1981).

See text at page 91, 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). The Board is considering an amendment to Regulation Y that would allow BHCs to provide to others "data processing and transmission services, information or
facilities, or access to such services, information or facilities, wherein the data to be processed or furnished are financial, banking or economic related." 45 Fed. Reg. 75221 (Nov. 5, 1980); see 46 Fed. Reg. 37905 (July 23, 1981).

144 12 C.F.R. §7.3400(b)(2). The bank may rely on the residual value of the property to a greater extent if the excess is guaranteed by a manufacturer, lessee, or third party with adequate resources.

145 12 C.F.R. §225.4 (a)(6)(i)(d). With respect to a lease of seven years or less, up to 60% 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).


Regarding geographical risk diversification through non-bank subsidiaries, see page 52 infra.


See Van Reed v. People's National Bank of Lebanon, 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).

See, e.g., Ore. Laws 1920, §6212, Ore. Code Ann. §§22-107, 22-1301 et seq. When the McFadden Act was passed in 1927, national banks with interstate branches were grandfathered. Fischer (1968), supra note 32, at 64n.163. One such, the Bank of California, N.A., has branches in three states to the present day. See 1 Moody's Bank & Fin. Manual 932 (1980).

E.g., N.Y. Bank. L. §202-a.

Curiously, however, several states provide specific authorization for their banks to branch into other states. See, e.g., N.Y. Bank. L. §105(3).


158 Haw. Rev. Stat. §403-54 (out-of-state branches permitted "in other countries or in dependencies in insular possessions of the United States").

159 12 U.S.C. §321 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. . . ."


163 *Cf.* West Helena Savings & Loan Ass'n. v. Federal Home Loan Bank Board, 553 F.2d 1175 (8th Cir. 1977), which holds that
the FSLIC may not deny coverage to state-chartered S&L's based upon its own determination of insufficient community need because of the "needless friction" with the states such re-examination would cause.

164 See text at supra, note 119.

165 Iowa enacted special legislation in 1972 to enable Northwest BanCorporation to acquire two Iowa banks in addition to the four it already owned. Iowa Code Ann. §524.1805; see Iowa Independent Bankers v. Board of Governors of the Federal Reserve System, 511 F.2d 1288, cert. denied, 423 U.S. 875 (1975). Maine 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. Rev. Stat. Ann., tit. 9-B, §1013.2. 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.C.L. §51-16-41 (1980). The origins of this statute are described at page 114, infra.

Kentucky, South Carolina, and Washington. See Fischer (1961), supra note 103, at 76 (Table 11).

See id., at Appendix E and sources there cited.

See supra note 165.

Of the 19 multi-state BHCs grandfathered in 1956, 16 were domestic and three were foreign. The four largest companies, their home states and number of states of operation, were Transamerica Corporation (California and 10 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 12 multi-state BHCs, of which seven are domestic and five foreign companies. The reduction in the number of multi-state companies was accomplished by various corporate reorganizations motivated, it seems, primarily by "[a] desire to avoid supervision as multi-bank holding companies, rather than any considerations relating to interstate banking . . . ." Golembe (1979), supra note 111, at 33-34 & 34n.1.

102 Cong. Rec. 6860 (1956).
172 47 C.F.R. §73.30(a)(1).


174 Thus, for example, the federal courts may apply state law, usually that of their situs, 28 U.S.C. §1332 (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.

The international context provides other examples where multiple authorities compete to provide access to markets. Familiar examples include not only those countries that provide "havens" for banks operating in world markets, such as the Bahamas and the Grand Cayman Islands, but also the countries that provide a "flag of convenience" to ships, most notably Liberia and Panama.
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 The Manchester School of Econ. and Soc. Stud. 139, 177-78 (1954). Reduced opportuniites for labor in capital exporting areas may be offset if the capital is applied to lowering the cost of things that are imported into the area or result in increased wage costs in capital importing areas that compete in third markets; the diminution of labor opportuniites is aggravated if the capital export raises the cost of imports or reduces costs in competing areas. Id., at 190.

Baker, Chartering, Branching, and the Concentration Problem, in Federal Reserve Bank of Boston, Policies for a More Competitive Financial System 21, 27 (1972); contra id., at 41 (discussion by Ross M. Robertson); cf. id., at 51 (discussion by Leonard Lapidus).
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 Bank. L. Serv., supra note 4, at 98, 337-39.

E.g., Texas, Colorado.

See, e.g., Mo. Rev. Stat. §362.915 (Vernon), which prohibits a BHC from gaining control over a bank where the BHC will thereby control banks with more than 13% of state total bank deposits.


In November 1980, however, Colorado voters, in a referendum, defeated a proposal to allow branch banking. Denver Post, Nov. 5, 1980, at 29; American Banker, Nov. 6, 1980, at 1, col. 3.


Thus, 29 of the 105 industrial banks operating at the end of 1978 had been chartered in the period 1975-78. Tabulated from Colo. Div. Bank., Statements of Condition of State Banks and Industrial Banks as of December 31, 1978.

 Ala. Const. of 1819, Art. 6, § 1; see Skinner's Ala. Const. Annot. §247 (1938).


 N.D. Cent. Code §6-09-01.


 V. Willit, Chain, Group and Branch Banking 56, 111 (1930); OCC, Ann. Rep. 9 (1923).

 See Miller The Manpower Cost of Bank Examination, supra note 42, 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, and Bank. 500, 502 (1977).
192 See, e.g., Burns Asks Halt on BHC Growth, American Banker (Sept. 25, 1978).

193 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. and 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.")

194 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 Dept., Fed. Res. Bank of S.F.), finds that in rural areas and smaller towns in a statewide 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.\"

195 See 167 infra.

196 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.

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) (growth patterns of population, employment, and personal income, by state, closely associated with bank deposit growth).

See id.


See Mellon, supra note 197, at 13.

Bank Holding Company Map Series, supra note 19.

See text at supra notes 146 to 149.


Cf. Mingo, *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").


Edwards & Scott, *supra* note 208, 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. Rev. 258 (1972).

210 See Longbrake & Haslem, Productive Efficiency in Commercial Banking, 7 J. Money, Credit & Bank. 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 & Bank. 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).


212 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.

213 Economies of reporting, accounting, legal counsel, and other overhead or home office costs can not 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 Subomm. 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).


216 According to Lawrence & Lougee, Determinants of Correspondent Banking Relationships, 2 J. Money, Credit & Bank. 358, 359 (1970), provision of investment advice is one of the more important services that correspondent banks provide to their "country" bank respondents. See also Subcomm. on Domestic Finance of the H. Comm. on Bank. & Currency, 88th Cong., 2d Sess., Report on the Correspondent Banking System 4 (Subcomm. Print 1964).

217 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 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); K. Smith, Portfolio Management 42 (1971).

218 The leading studies of the 1960's concluded that the additional costs of bank branching were offset by the economies of scale. See F. Ball & N. Murphy, Costs in Commercial Banking: A Quantitative Analysis of Bank Behavior and its Relation to Bank Regulation (Research Rep. No. 41, Federal Reserve Bank
of Boston, 1968); Benston, Branch Banking and Economies of Scale, 20 J. Finance 312 (1965).

219 See State Bank. L. Serv., supra note 4, at 89.

220 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.

221 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: Whence It Came, Where It Went 118-19 (1975), it was a small matter to eliminate the paper itself and deal in bank balances.


225 At the same time, small computers and smart terminals decrease the unit costs of computation at a lower level of output and could, in principle, some day lower the optimal scale of computer operations.

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, Asst. Atty. Gen., Antitrust Div., U.S. Dept. of Justice to William B. Brandt, Nebraska Bankers Assn. (March 7, 1977) (hereinafter NETS letter).

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 227; but cf. R. Posner, Economic Analysis of Law 205 (2d ed. 1977).

See p. 30 and text at supra note 52.

With minor exceptions, member and non-member 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 (member banks), 1828(j)(1) (non-member insured banks).

In telephone interviews, representatives of the Conn. Div. of Banking embraced the view expressed in the text in 1978 but disavowed it in 1981.

M. Mayer, supra note 215, at 259.

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

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 America 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. Financial Code §1780. The State Banking Dept. has proposed to license offices instead of persons. See Cal. Sen. Bill No. 285 (1981).
236 12 C.F.R. §7.7380 (emphasis is original).


238 Id.


240 Id.


242 Examples are lock boxes, remote disbursements, multilateral netting for affiliate payments, and foreign exchange dealing. See generally Bonocore, Making Cash Management More Marketable, 163 The Bankers Mag. 49 (Nov.-Dec. 1980).

243 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, 163 Bankers Mag. 62, 63 (1980), 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.
244 See Wittebort, supra note 243, at 191.


247 Id., at 924.


250 534 F.2d, at 941.

251 See U.C.C. §3-104(2)(b).

252 534 F.2d, at 944.

253 An alternative interpretation of the McFadden Act's definition of a "branch," which would exclude the corporate CRT from its ambit is offered at pages 271-79, infra.


257 12 U.S.C. §618. Only three banks with assets under one billion dollars had opened Edges under the pre-IBA regime. Abrams, supra note 52-1, at 9; see Cobb, A Shot in the Arm for Edge Act Corporations, 97 Bank. L.J. 236 (1980).

258 Abrams, supra note 203, at 9.


260 See Note, supra note 256, at 292.

261 12 U.S.C. §3103

262 International Banking Act of 1978, §3(b), amending 12 U.S.C. §611a (declaration of policy); id. §§3(d), (e), amending 12 U.S.C. §615 (deleting limitation on liabilities and 10%
reserve requirement in favor of such conditions as the Fed may prescribe); cf. 12 C.F.R. §211.4(d) (member bank reserve requirements applied to Edge Act corporations).


265 12 C.F.R. §211.4(e)(4)(v).

266 Id., §211.4(c).


268 See 12 C.F.R. §§211.4(c), (a)(1).


270 Id.; Wall St. J., July 31, 1980, at p. 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.


276 *Id.* Of these, more than 23 million represent active accounts.

277 *Id.* (dollar volume).

OCC Opinion on Application to Charter Citibank (South Dakota), N.A., Nov. 19, 1980, at p.3.


No. 78-0811, slip. op. at 2n.3 (D.D.C. Mar. 29, 1979), reversed on other grounds, 627 F.2d 486 (D.C. Cir. 1980).

See text at supra notes 239, 240, 237.


According to the State, "the matter was settled in light of the pleadings, the District of D.C.'s order [in IBAA v. Heimann, supra] to the Comptroller to rescind the [LPO] Interpretive Ruling, and its eventual rescission." Letter from Don C. Brown, Deputy Att'y Gen. 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).


288 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 5 Del. Code Ann. §§2101 et seq. (small loan law); Okla. Stat. Ann. tit. 14a, §3-504 (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.

289 Machalaba, Legal Fight is Starting Over Offices Used by Big Banks to Obtain Consumer Loans, Wall St. J., June 2, 1978, at p.6, col.2, reports only the three cases discussed above. Adverse opinions of the Attorney General of Arkansas (June 4, 1969), and the Georgia Supt. of Banks (Dec. 3, 1968), concerning LPOs are noted respectively at 1 CCH Fed. Bank L. Rep. ¶3169.294 & ¶3169.757. Consumer LPOs have also been used in attempts to overcome intrastate geographical restric-


291 See text at supra note 92.

292 A national bank, for example, may "transact" its business only at its main and authorized branch places of business, 12 U.S.C. §81, and any place at which it "receives" deposits is a branch, 12 U.S.C. §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. See Bigelow v. Virginia, 421 U.S. 809, 825-26 & n.10 (1975).

293 See 12 C.F.R. §217.7 (Reg. Q governing member banks); id. §329.6 (insured nonmember banks).
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 to temporarily available investment funds, however.


See Letter from Todd Hoffman, Chase Manhattan Bank, N.A. to the author, April 17, 1980, describing "Chase Full Benefit Banking."
299 See Rose, supra note 278.

300 See note supra 293. Regarding the closely related credit card product since offered by Citicorp Financial, Inc., a non-bank subsidiary of the BHC, see p. 90, infra.


303 See FG Electronically Links Area Banks, Washington Star, Sept. 6, 1980, at B-5, col. 1, which reports that Financial General Bankshares, Inc., a grandfathered multi-state BHC with subsidiary banks in Maryland, Virginia, and the District of Columbia, has established a non-bank 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.
See, e.g., id.

See text at supra note 246.

Insured state and state member banks must apply to the FDIC and the FRB, respectively, however. See, e.g., 12 U.S.C. §321 (member banks).


any facility that performs the traditional bank functions of receiving or disbursing 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.)

In Independent Bankers, however, the court was distinguishing a proprietary ATM from a mailbox and a telephone, to which the Comptroller had analogized the ATM as just another means of access to a bank account. The court rejoined that in those cases "no place or facility established (i.e., owned or rented) by a bank is involved." Id., at 941. It
supported its distinction with the Supreme Court's phrase in
the armored car case (Plant City) describing a branch as "a
bank facility apart from (the bank's) chartered place of
business." Id. at 941 n.72 (emphasis added by the court of
appeals).

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 of appeals' 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 the Supreme Court in Plant City, 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.

310 OCC Letter No. 153, supra note 308, 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 source cited in supra note 302, on the ground that the distant ATM is not a branch of Girard, then it must likewise be able to overcome Pennsylvania's contiguous county branching limitation by arranging for shared use of ATMs established by banks in non-contiguous counties of Pennsylvania. If the competitive advantage forbidden to national banks by the McFadden Act is measured only relative to host area banks (whether in New Jersey or distant Pennsylvania counties) and not relative to home area state banks (in Philadelphia), then the results must be the same intrastate as interstate, for the Philadelphia bank sharing a distant ATM occupies the same competitive relationship to host area banks regardless of whether the host area in question is New Jersey or Pittsburgh.

311 See text at supra note 160.

312 South Dakota law allows banks to agree with out-of-state banks to share access to their ATMs. S.D. Compiled Laws Ann. §51-20A-7. 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.
Again, however, it does not regard nor regulate an ATM as a branch bank. Id., §7-16-1(1).

313 See text at and source cited in note 303.

314 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.

315 See page 30 and text at supra note 52.


317 "Captive" finance companies are those whose principal activity is financing the purchase of its affiliate(s)' goods.

318 Tabulated from 100 Largest Independent or Affiliated Finance Companies, Am. Banker, June 20, 1980, at 24 (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.
319 BEQ, supra note 316, reports that the Fed has received 857 notifications of BHC de novo consumer finance offices since March 31, 1973. 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 the it did not distinguish among types of finance companies (e.g., consumer, commercial).

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 i (1978).


321 American Banker, supra note 318, at 22.

322 Nine companies reporting financial data had just under $3 billion in receivables, id., and I estimate that Citicorp's Nationwide Finance has more than $1 billion in receivables.

323 BEQ, supra note 316.

324 Mortgage Bankers Ass'n of America, Financial Statements and Operating Ratios for the Mortgage Banking Industry (1980)
reports data from which it can be calculated that reporting banks and BHCs closed 48.8% and serviced 50.9% of the mortgage loans closed and serviced by all reporting companies. The average reporting bank or BHC affiliate closed and serviced about 15% more mortgage loans than the average reporting S & L or other depository and their affiliates, and about twice as many as the average reporting independent mortgage banking company.

325 See source cited at supra note 138, at 238.


327 BEQ, supra note 316.

328 Id. Current information on the market share of non-bank 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 & Quantitative Anal. 577, 580 (1975).
329 BEQ, supra note 316.

330 American Banker, Dec. 21, 1979, at 1, 12. Continental Illinois Corporation 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., but the acquisition was not consummated.

331 American Banker, Mar. 10, 1980 at 15.


333 BHCA §2(c), 12 U.S.C. §1841(c).


337 See Booth, supra note 332, 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 Minn. Comm'r of Banks, Dec. 29, 1980.

338 Telephone interview with Mr. Ed Stripling, Fla. Dept. of Banking and Finance, Nov. 15, 1979.


344 BEQ, supra note 316. In the period 1971-78, BHCs opened or acquired 75 industrial banks, of which 31 were outside their home states. See Golembe (1979), supra note 111, at 96.
345 See 12 U.S.C. §§1815(a) (state non-member banks eligible); §1813(a)-(b) (definitions of state bank, state non-member bank); Letter from William Via, FDIC, to the author, Dec. 11, 1980.

346 See, e.g., Colo. Industrial Bank Savings Guaranty Act, Colo. Rev. Stat. §11-22-201 et seq. (bank must either be a member of state guaranty corporation or insured by FDIC); cf. Minn. Stat. Ann. §53.10 ("industrial loan and thrift companies" that sell "certificates of indebtedness" must obtain insurance thereof acceptable to the Commissioner of Banks).


349 See 12 C.F.R. §329.6. Industrial banks were subjected to the reserve requirements of Fed. Regulation D by the 1980 Act. See 12 C.F.R. §204.1(c)(i).

350 E.g. Utah.

351 See, e.g., Cal. Financial Code §18315; Memorandum from H.J. Desz, Spec. Admin'r, Industrial Loan Law, Cal. Dep't. of Corps., to All Industrial Loan Cos. Issuing Investment Certificates,


See text at supra note 297.


BEQ, supra note 316.

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.


361 12 C.F.R. §225.123(e).

362 See text at supra note 143.


365 See Citicorp Selling New ATM/Debit Card to Correspondents Across the Nation, American Banker, May 21, 1980 at 1, col. 3.


368 Id.

369 Id.

370 Id.

371 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. Conn. Bankers Ass'n v. Board of Governors of the Federal Reserve System, 627 F.2d 245 (D.C. Cir. 1980).

American Banker Reprint Service, Bank Holding Company Map Series (1976) reprints profiles and maps showing the offices of these BHCs. The material was originally published in the American Banker on Oct. 23 and 29, Nov. 5, 13, and 20, Dec. 4, 12, 22 and 29, 1975, Jan. 6, 13, and 21, and Feb. 9, 1976.

1975 data are from Bank Holding Company Map Series, supra note 95-1; 1979 data are from Janssen, Expanding U.S. Banks Hope Law Will Allow National Competition, Wall St. J., June 21, 1979, at 1, col. 6, except that for Security Pacific Corp., which is from a telephone interview with Arch D. Hardeman, Sr. Vice-Pres.


Telephone interview with Ms. Bernice Riordan, Sr. Public Info. Officer, News Relations Dep't, Bank of America, June 18, 1981; Janssen, supra note 373.

Telephone interview with Charles Klensch, Press Info. Officer, Public Affairs Dep't., Citicorp (data as of Nov. 1, 1980).

Id.

Glassman & Eisenbeis, Bank Holding Companies and Concentration of Banking and Financial Resources, in BHC Compendium, supra note 124, at 231.

Calculation based on all commercial banking institutions' total assets of $1,702.7 billion as of the end of 1980. 67 Fed. Res. Bull. A17 (March, 1981). The same $122 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.

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), and thereby to take deposits in any number of states.
382 1980 Act, supra note 62.


385 The total cost of core deposits consists of the interest paid to depositors, plus the processing costs incurred, less any transaction fees received.


387 See brochures distributed by Citicorp Person-to-Person Financial Services, Inc., One Market Tower, 3033 S. Parker Rd., Denver, Colo.

388 Some smaller BHCs do participate in interstate markets, including taking deposits interstate. For example, Financial Services Corp. of the Midwest 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).


See text at supra notes 245-253.

cf. Connecticut Bankers Assn. v. Board of Governors of the Federal Reserve System 627 F.2d 245 (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 non-bank subsidiary would not be used as a de facto branch of bank subsidiary).


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 4.5 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. The Competitive Condition of U.S. Banking Markets

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>3-banks</th>
<th>5-banks</th>
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<tbody>
<tr>
<td>Unit bank states</td>
<td>22.5%</td>
<td>49.4%</td>
<td>60.2%</td>
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<tr>
<td>Limited branching</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>states</td>
<td>29.9%</td>
<td>62.5%</td>
<td>76.3%</td>
</tr>
<tr>
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<td></td>
<td></td>
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<tr>
<td>states</td>
<td>34.0%</td>
<td>67.5%</td>
<td>80.3%</td>
</tr>
</tbody>
</table>


395 See text at note 257.

396 Cf. supra note 193.

397 Bank Holding Company Map Series, supra note 372, indicates that in 1975 FinanceAmerica had 20 offices in Illinois.

398 At the end of 1980, the 100 largest BCHs controlled commercial bank assets of $1,137 billion, or an average of more than

399 For example, United Jersey Bank (Hackensack), a subsidiary of the 97th largest BHC, has a branch in the British West Indies. 1 Moody's Bank & Finance Manual 1503 (1980).


401 The overnight market in Fed funds began to grow in the mid-1960's 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." Stigum, supra note 214, at 285.


404 N.Y. Banking Dept., Statement of Condition of the Banks, Trust Cos., & Private Banker of the State of N.Y. at the


406 M. Stigum, supra note 214, at 144. Indeed, perhaps because New York's reputation is so good, when American Express Company's subsidiary American Express Int'l Banking Corp. 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.

407 See OCC Ann. Rep. 40 (1978); Bennett, Curb on Foreign Banks Studied, New York Times, May 2, 1980 at D1, col.3, which reports that when New York authorities took possession of the New York branch of a 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."


409 See text at supra note 358.

The provision relating to BHC offices soliciting loans for affiliated banks was §97, amending Fla. Rev. Stat. §659.52, renumbering it §663.821, at subsec. 2(b).


See source cited at supra note 412.


429 Id., at 17.

430 Id.

431 Id., at 18.

432 Id. at 19.
433 Id.

434 Id., at 20.


437 The Council, which was established by the Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No.95-630, §1004, 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.

438 McFadden Act Report, supra note 428, at 12-16.

439 See Parts III & IV, infra.

440 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 non-depositors for unrestrained competition in banking to be clearly efficient.
See, e.g., Letter from Thomas F. Bolger, Pres., Independent Bankers Assn. of America, to Hon. Bob S. Bergland, U.S. Secy. of Agriculture (July 22, 1980) (associating "the disappearance of small unit banks [with] liberalization in bank branching limitations under state laws," and cautioning against interstate branching in the interest of maintaining "an adequate supply of credit to farmers.") For a more balanced view of the likely effects of interstate banking, see J. Guttentag, Branch Banking, Interstate Branching, and Loan Production Offices: Analysis of the Issues (Univ. of Miami Law & Econ. Center, 1979); Edwards, Interstate Banking: The Debate Begins, 163 Bankers Mag. 64 (Sept.-Oct. 1980); and C. Felsenfeld, Banking, Buisness, and Barbicans (undated monograph by a vice-president of Citibank).


As Professor Bernard Shull has wisely observed: "It is sometimes argued that geographic market extension by large banking organizations is inevitably pro-competitive; sometimes 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."


1980 Act, supra note 62, at Title IV.


12 C.F.R. §330.2


12 C.F.R. §217 (FRB Regulation Q); id., at §329 (parallel FDIC regulation of interest rates paid by insured non-member banks). Through the differential that enables thrift institutions to pay 1/4% 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.


453 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 BHC’s.

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. FDIC Ann. Reps. 1960-79. 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 be cause they have the authority to allow statewide banking. See generally E. Kohn and 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 test at notes 98-0 et seq.; the only effect that the relaxation of territorial market boundaries should have is to insure that a fully competitive interest rate is paid in all markets.

Rhoades, supra note 442, 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 and Rhoades, Multi-Market Interdependence and Local Market Competition in Banking, 60 Rev. Econ. & Stat. 523 (1978). 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.


Heggestad & Mingo, supra note 394.

Id.

See Rhoades, Nonbank Thrift Institutions as Determinants of Performance in Banking Markets, 32 J. Econ. & Bus. 66 (1980); but cf. Heggestad & Mingo, supra note 394 (demand deposit account charges lower where thrifts could offer such accounts).

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

Non-depository creditors include both trade creditors and financial creditors such as sellers of Fed funds.


A sub-competitive return would be tolerated only while specialized physical capital that has been dedicated to the banking business is allowed to wear out.


Of course, these non-banks 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.

See note supra 463. In addition, banks might remain in the industry at sub-competitive 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.


470 The cycle of regulation, creative response, and loophole-closing is well-illustrated in the history of Regulation Q. For the most recent and perhaps shortest rounds, compare Latest 'Advantage' From Chase Draws Regulators' Interest, Wall St. J. Feb. 26, 1981, at 40, col.3 (bank interpreted lawful $10 maximum value of premium per account per deposit up to $5,000 to enable it to solicit customers to open multiple accounts and receive up to $800 for a 30-month deposit), with 46 Fed. Reg. 15,131 (Feb. 26, 1981), amending 12 C.F.R. §1204.109(a) to prohibit such solicitation and compare Bank of California Complies With Fed Request To Hold Off on London Accounts, BNA Wash. Financial Rep. May 18, 1981, at A-8, with 46 Fed. Reg. 27,090 (Regulation Q extended to cover deposits of less than $100,000 payable outside the U.S.).

471 Golembe (1979), supra note 111, at 101, 110-14 (Table 5-2).

472 12 U.S.C. §3103(a). Compilations of state laws excluding and allowing entry by foreign banks appear at McFadden Act Report, supra note 428, App.A to Ch.8; see also id., at 211 (Table 8-2).

See Golembe (1979), supra note 25-2, at 110-14 (Table 5-2).

Id., at 66 (Table 41).

Address by Lisa E. Smith, Asst. Vice-Pres., Western Bancorporation, Before the Electronic Funds Transfer Ass'n: Debit Card I (Sept. 8, 1980); see Hollie, Coast Bank Going Interstate, N.Y. Times, Apr. 9, 1981, at D-1, col.2 (profile of Western Bancorp., which has since changed its name to First Interstate Bank).

Address, supra note 476.


1980 Act, supra note 62 at §303.


Perpetual Savings and Loan Ass'n is perhaps the most extensive such interstate institution, having 11 offices in the District of Columbia and five in Maryland.


The sole exception is Financial General Corporation, a grandfathered BHC with a bank in each of the three metropolitan Washington D.C. jurisdictions and a network of 77 offices and 59 ATMs. Even it would be at some disadvantage relative to a co-extensive 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, Washington Star, Sept. 6, 1980, at B-5, col.1.


491 Dean Witter Reynolds, Inc., and Shearson Loeb Rhoades, Inc. have each announced their intention to offer products similar to Merrill'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.


See text at supra notes 402-406.

E.g., 12 U.S.C. §338 (state member banks), §196 (national banks).

See, e.g., Golembe (1979), supra note 111, at 80, 138 (both multi-state BHCs and bank regulators report no special or insurmountable problems of supervision).

See N.Y. Banking Law §202-b(2) (foreign branch must hold qualifying assets equal to 108% of liabilities); Stigum, supra note 214, at 144.


See text at supra note 23.

See Comptroller General of the United States, Report to the Congress on Federal Examinations of Financial Institutions:
Issues That Need to beResolved 10-11 (1981); CSBS, Profile of State-Chartered Banking, *supra* note 20, at 49-52.


503 The three largest nationalized banks in France hold 55% of all commercial bank assets in that country. Weiss, *National Policies on Foreign Acquisitions of Banks*, 164 Bankers Magazine 25, 29 (Table 4) (Jan.-Feb. 1981).

504 *See* J. White, Banking Law 1033 (1976).

505 *See, e.g.*, H.R. Rep. No. 94-1669, *supra* note 37, 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 ostensible 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.
506 See supra note 10.


508 Id.


510 Consider, for example, the 10 largest banks in Texas, each of which had domestic deposits in excess of $750 million in 1978, and nine 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. Calculated from Sheshunoff & Co., The Banks of Your State 1980, at 10-11.
Conventional scholarship examining bank portfolios of municipal bonds does not attempt to measure the importance of non-economic and non-tax factors such as the chit system discussed here. See, e.g., Hendershott & Koch, The Demand for Tax-Exempt Securities by Financial Institutions, 35 J. Finance 717 (1980), and sources there cited.


513 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).

514 See 12 C.F.R. §201.3(a); but cf. id., at §201.3(b)(1)-(2), (extended seasonal and other extended credit); FRB Press Release, Operations of the Federal Reserve Discount Window Under the Monetary Control Act of 1980 (Sept. 9, 1980).
See Stigum, supra note 214, at 201.

See FRB Announcement of Monetary and Credit Actions, and Implementing Regulations (Mar. 14, 1980), reprinted at BNA Wash. Financial Rep. No.12, at T-1,3 (Mar. 24, 1980); 12 C.F.R. §201.3(b)(2) (rate above basic discount rate charged for "other extended credit").


See P. Samuelson, Economics 326n.6 (10th ed. 1976)

See Gallaudet, Construction Mortgage and Real Estate Warehousing Loans, in The Bankers' Handbook 703, 711-12 (W. Baughn & C. Walker, eds., 1978). While the average commercial bank invests a small percentage of its assets in long-term residential mortgages loans, there are major exceptions. In general, commercial banks in California have emphasized such loans.

See text at supra notes 508, 509, and 505.


See text at infra note 529.


Compare Hearings on H.R. 212, supra note 518, at 88 (statement of Prof. Lester Thurow), with id., at 187-88 (statement of Prof. Yale Brozen).

1980 Act, supra note 62, at §902 (moratorium from Mar. 31 to July 1, 1980).

See Rep. by the Comptroller General, supra note 531, at 2-4 - 2-5.

Marine Midland Report, supra note 531, at 23.

Id., at 25.

Id., at 27.

Id., at 28.
538 See text at supra notes 55-59.

539 See Heimann statement, supra note 531.

540 Id., at 20.

541 Id., at 20-21.

542 Id. at 21.

543 Opinion of the Comptroller of the Currency on Application of Marine Midland Bank, Buffalo, N.Y., to Convert From a Banking Institution Chartered Under the N.Y. Banking Law to a National Banking Ass'n. 11-12 (Jan. 28, 1980).

544 See National Treatment Study, supra note 426, at 13-35.


547 See sources cited in Curry, The Performance of Bank Holding Companies, in BHC Compendium, supra note 124, at 95, 99n.5.
Golembe (1979), supra note 111, at 84. The data show some tendency for the multi-state BHC banks to have higher loan-to-deposit ratios than peer group independent banks, but that is true regardless of whether the BHC is multi-state or one-state. See sources cited in Curry, supra note 547, at 99n. 7.

See sources cited at supra note 516.

See Stigum, supra note 214, at 138.

See text at note 323.

See Stigum, supra note 214 at 144.

See 12 U.S.C. §§1828(c)(2),(5) (bank mergers); id., §1842(c) (BHC acquisitions).

12 U.S.C. §§1828(c)(5)(B), 1842(c)(2). 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. Federal Res. Board, ___ F.2d ___, 49 L.W. 2584 (5th Cir., Feb. 25, 1981).
12 U.S.C. §§1828(c)(6)-(8), 1849(b)-(f).

See supra note 394.


U.S. Dept. of Justice, Dep't of Justice Merger Guidelines (1968), reprinted in 1 CCH Trade Reg. Rep. ¶4510.


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.

1979 State Concentration Ratios

<table>
<thead>
<tr>
<th>State</th>
<th>3-firm</th>
<th>5-firm</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>

Source: McFadden Act Report, supra note 428, at 46-47. States, of course, are not relevant geographical markets for any banking products, but multi-state regions would be relevant markets for some wholesale banking products.


Id.
But see Mercantile Texas Corp. v. Board of Governors of the
Federal Reserve System, ___F.2d___, 49 L.W. 2584 (5th
Cir., Feb. 25, 1980).


Id., at 519.

The FRB may also have been concerned that the bank would
acquire an undue influence over the co-venturer's non-banking
domestic operations, which are not "closely related to
banking," but it did not say so.

See note 29-2 and accompanying text, supra.


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.

See Salamon & Siegfried, Economic Power and Political
Influence: The Impact of Industry Structure on Public


Cf. Glassman & Eisenbeis, supra note 138. at 215 (government may be reluctant to permit failure to occur).


582 Such concerns may have been implied when "the regulators [who arranged $500 million in credit for First Pennsylvania Bank] said their decision to aid the ailing bank was influenced by the major role it plays in Philadelphia banking." First Pennsylvania Bank Gets Assistance of $500 Million From FDIC, 22 Banks, Wall St. J., Apr. 29, 1980, at 3, col.2.

583 See Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161,1173 (1981).


585 Moreover, this proposal would prevent a bank with more than 25% of one market from entering another by toehold acquisition—again apparently reflecting a concern with size and perhaps political influence, but certainly having little to do with competitive markets.
See State Bank. L. Serv., supra note 4, 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. Id.

See Dep't of Justice Merger Guidelines, supra note 560.


See G. Fischer, American Banking Structure 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").

Discrimination could be minimized to the extent that entry were 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.

593 Id. See N.Y. Banking Law §202-a.

594 Intrastate SMSAs with high three-bank concentration ratios, using mid-1974 data, include Elmira, N.Y. (100%); Honolulu, Hi. (75.5%); Pittsburgh, Pa. (82.6%); and San Francisco-Oakland, Ca. (79.6%). Carter H. Golembe Assocs., Inc., Some Thoughts on Interstate Banking 38-39 (Dec. 1, 1975).

595 Intrastate 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, TN. - AR. - MS. (79.6%). Id.

596 See text at supra note 476.


600  Id., at 4.

601  Id. at 2.


605  See Statistical Abstract, supra note 602, at 942.


608  Johnson, supra note 606, at 37.

609  See text at supra notes 471-473.
610 See text at supra notes 475-477.

611 The companies and their states of operation are listed in Golembe (1979), supra note 111, at 66-67.

612 See text at supra note 266.

613 See U.S.C. §3301 (Financial Institutions Examination Council to prescribe uniform principles and standards for federal supervisory agencies); but cf. Comptroller General, Report, supra note 500.

614 See text at supra note 551.

615 See text preceding supra note 547.

616 See text preceding supra note 552.


618 See supra notes 394, 594, and 595.

619 Of course, many smaller banks as well, especially in inter-state 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.
See text preceding supra note 563.

Master Card has 11,666 member institutions, Visa 11,646. American 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 227, at 67.

Citicorp's 5.8 million cardholders, see text at supra note 278, represent 4.8% of all Visa cards and MasterCards outstanding as of Sept. 30, 1980. See American Banker, Feb. 3, 1981, at 3 (Domestic U.S. Bank Card Statistics).

On the problem of discriminatory administration, see pp.315-17, infra.


American Banker, Apr. 21, 1981, at 1, col. 3 (data as of Dec. 31, 1980).

627 CF. Gaskins & Voytko, supra note 624, at 27.

628 Supra note 428, at 18.

629 See Ass'n of Bank Holding Companies, Policy on Interstate Banking by Bank Holding Companies as Approved June 6, 1980; See American Banker, July 16, 1980, at 4, col. 1.


631 Id.

632 See supra note 31 and accompanying text.


635 See text at note 626.

636 An exception might be made to facilitate the interstate acquisition of a failing bank with more than the maximum number of branch locations.

637 National Comm'n on Electronic Fund Transfers, EFT and the Public Interest 31-33 (1977).
638 Id., at 45.

639 See McFadden Act Report, supra note 428, at 19.

640 National Comm. on Electronic Fund Transfers, supra note 637, at 47. The Commission would have retained, with respect to deposit-taking terminals only, a "negative" approval process, under which an application would be automatically granted in a short time if no regulatory action were taken.

641 Id., at 45.

642 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 (Nov. 3, 1976).

643 12 U.S.C. §§37lc (member banks); 1828(j) (insured banks).

644 At present, the Community Reinvestment Act, 12 U.S.C. §§2901 et seq., does not appear to impose lending obligations in areas from which deposits are taken by ATMs, but it could be amended to so provide.

645 Burlington, Camden, and Gloucester counties of New Jersey are within the Philadelphia SMSA. Statistical Abstract of the U.S. 942 (1979 ed.).

The laws of one state, Washington, nonetheless have the same effect, since statewide branching is allowed while multi-bank holding companies are prohibited. See Wash. Rev. Code §§30.40.020, 30.04.405. That 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).


For example, Florida imposes a documentary stamp tax, Fla. Stat. 201.01, and an intangible property tax, id. §199.12, 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 (banks originating loans through Florida LPOs avoid taxes).
See pages 42 and 108, supra.

See 12 U.S.C. §84; State Bank. L. Serv., supra note 4, at 126-29 (state limits on commercial bank loans to one borrower).

See e.g., 12 C.F.R. 250.250(c) (procedure by which the limitation of 12 U.S.C. §371c on extensions of credit to affiliates may be avoided).

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; CSBS Profile, supra note 20, 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.


"About 0.6 percent of the unit banks and about 0.4 percent of the branch banks failed in the 1970s. An even smaller percentage of multi-bank holding company banks failed (0.1)." McFadden Act Report, supra note 428, at 122.
656  See 1843(c)(1)(C).


658  But cf. page 134, supra.

659  See text preceding supra note 263.


663  See text at supra note 190.

664  Section 7 of the BHC Act of 1956, 12 U.S.C. §1846, 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 the right to examine BHCs and their subsidiaries other than national banks. See e.g., Mass. Gen. Laws Ann. ch. 167A, §5.
See note 667 and accompanying text, infra.

S.D. Compiled Laws Ann. §51-16-41; see text at notes 417 to 422.

A state's ability to grant non-banking 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 Act]." 12 U.S.C. §1816. While a state bank might be authorized to engage in a wide variety of non-banking activities that did not constitute "unsafe or unsound practices" such as to warrant the termination of its insurance under 12 U.S.C. §1818, 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 §1816, supra. The results would be that newly chartered state banks intending to exercise 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 no new banks could enter the newly expanded business of banking. See also 12 U.S.C. §1842(e) (BHC subsidiary banks must be FDIC-insured).


See text at supra note 647. 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. Compare 12 U.S.C. §1842(d)(1) (home state of multi-state BHCs designated by law), with 12 U.S.C. §3103(c) (multi-state foreign BHCs choose "home" state from among those were it has operations), and French Bank's Choice of N.Y. Over Calif. Lets It Expand in 2 States, American Banker, Apr. 3, 1981, at 1, col. 2.

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 non-banking activities that are 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.
12 U.S.C. §2903; see id. §2902(1)(A).


See sources cited at supra note 647; text at supra notes 178 to 180.

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 the antitrust laws, and these qualifications are assumed in the proposition referred to in the text.

See sources cited at supra note 647.

One can only speculate on the possible reasons for this state policy. The states may believe this approach limits the cumulative power--economical or political--that the banking organization can achieve, increases the local responsiveness of its units, or perhaps facilitates its dismemberment should that become necessary.

State Bank L. Serv., supra note 4, at 85.

Puerto Rico, for example, has allowed mainland banks to establish direct "wholesale branches" in return for acquiring, rehabilitating, and reselling a failing retail bank. See Cont. Illinois Operating Puerto Rico Branch, American Banker, Dec. 19, 1980, at 3, col. 3.

Producers will attempt to minimize cost, whether they operate in competitive or non-competitive markets; the degree to which lower producer costs result in lower consumer prices is, however, a function of competition.


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.

See text at pages 104-06, supra.

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 interstate, however, they are unable to do so in most states, even through an affiliate.

688 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.

689 Compare Redden letter, supra note 488 (construing the Oregon statute defining the "banking business" to include the CMA Money Trust described in the text at supra note 487) with the Agreement reached in Colorado, supra note 489. The Oregon opinion acknowledges that the "mutual fund shares would have attributes different from the usual commercial bank deposits," but dismisses this fact with the observation that under Oregon law the attributes of a deposit can be varied by agreement.

690 See generally, H. Scott, New Payment Systems, supra note 646.
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 pre-authorize 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.

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.

The analogous question, a generation ago, was whether to allow the growth of retail chain stores. Then, as now, the proponents of containment "stressed 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. See Comment, Anti-Chain Store Legislation, 30 Mich. L. Rev. 274 (1931).

United States v. Marine Bancorporation, 418 U.S. 602, 627 (1974) ("the 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").

Id., at 636-37.

See e.g., N.Y. Bank. Law §105(1).

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. Areeda & Turner, supra note 694, at ¶1124d.

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 or assumed by a new bank at the old location. 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 United States v. First Nat'l State Bancorp., 499 F.
Supp. 793, 804 & nn. 8586 (D.N.J. 1980); Bankers Trust Agrees
2; Sumitomo Wins 19 of 33 Offered BanCal Branches, American
Banker, July 7, 1977, at 1, col. 4.

700 United States v. Marine Bancorporation, 418 U.S. 602, at

701 See Mingo, supra note 654.

702 But cf. Areeda & Turner, supra note 694, at ¶1124b.

703 For a glimpse of the types of evidentiary problems raised by
the necessity, under the potential competition doctrine, to
determine that a buyer was not a potential de novo entrant,
see United States v. Falstaff Brewing Corp., 410 U.S. 526,

704 But cf. note 699, supra.

705 See Areeda & Turner, supra note 694, at ¶1123b suggesting
that the potential competition doctrine should not preclude
a merger "where the universe of potential entrants exceeds
three to six firms."

706 See text at notes 37 to 40; Rhoades, A Comparative
Investigation of Risk and Rates of Return in Commercial
Banking and Manufacturing Industries, 25 Antitrust Bull.,
589 (1980).

707 See text at pages 134-35, supra.

708 See Graetz, Implementing a Progressive Consumption Tax, 92

709 See text at supra notes 628, 629.

710 See F. Scherer, Industrial Market Structure and Economic
Performance 4 (2d ed. 1980); cf. Miller, Measures of
Monopoly Power and Concentration: Their Economic Significance,

711 Neither soundness supervision nor policy guidance are meaning-
fully implicated in the choice between the acquisition-only
and small start approaches, and accordingly those criteria
are not separately treated in the text.

712 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. See e.g., In re: United Savings Bank, Conway - Application to Establish a Branch Office at 45 Federal Street, Greenfield, Mass., Decision of the Commissioner of Banks (July 6, 1979); CSBS Profile, supra note 20, at 203 (people per banking office, by state). Ratios of population or deposits to banks, rather than banking offices should be used lest the 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 576, at 30-31; E. Kohn & C. Carlo, The Competitive Impact of New Branches 2n.4 (N.Y. Bank. Dept., 1969).

713 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.

714 But see supra note 675.

715 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, Inc., ___U.S.____, 100 S. Ct. 2009 (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.

716 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. Bank. Law §105(1).

717 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 and text at notes 416 to 422.


Scott, supra note 721, 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 (Oct. 15, 1980), amending 12 C.F.R. Part 5.


See Camp v. Pitts, 411 U.S. 138 (1973); Scott, supra note 721, at 264-68.

See text at note 33. 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 at supra note 534, (charter conversion to get regulatory approval of acquisition).


727 As between the two federal agencies, the FDIC may be the preferable decision-maker. While it is, as the bank's insurer, an interested party in bank solvency, there is no reason to think it will be more (unduly) conservative in approaching interstate branch applications than it is in the intrastate context. The Fed, on the other hand, would have an incentive to discriminate in favor of member banks' interstate applications.

728 In practice, the Fed does not even consider applications to acquire a bank -- state or apparently national -- over the objection of the state banking commissioner where state law requires it. 37 Fed. Reg. 5084 (1972). For an example of state law purporting to require state approval for a BHC's acquisition of a national bank, see N.Y. Bank Law §§141(1), 142. See also Note, Foreign Holding Company Acquisition of American Banks: Legislative Restrictions and Regulatory Policy, 17 Harv. J. Legis. 555, 589-93 (1980).

729 See text at supra notes 55 to 59.
See text at supra notes 417 to 422.