Trade Groups Choose Sides

Regulation in the banking industry focuses on three specific goals: (1) to ensure stability in financial markets; (2) to prevent undue concentration of market power; and (3) to guard against sharp or unfair dealing.[1] The McFadden Act and the Douglas Amendment were intended at least in part to address these aims. The prohibitions on interstate banking were based on the belief that restricting the geographic scope of banking organizations would ensure sound and competitive banking practices. McFadden and Douglas served to erect a "fence" around each state, protecting banks within its boundaries from the rigors of outside competition. By locking competitors out, Congress sought to assure a large number of relatively small banks, thus ensuring a competitive market environment.

Competitive conditions in financial markets have changed considerably since McFadden and Douglas. Although the issues involved in the interstate banking debate are roughly the same, the market realities of the day are not. The relaxation of interstate restrictions on branching and interstate banking have become controversial issues with bankers. Some say that the existing regulatory framework is outmoded. Many are also concerned with the deregulation of product lines to place all financial institutions on an equal footing. Can regulations that restrict only some of our financial institutions serve their intended purpose in a rapidly changing financial world? This article briefly outlines how several banking industry groups have positioned themselves on the interstate debate.

Some within the banking industry believe that product deregulation alone will produce parity with the nonbank institutions. Competing with the money market funds, Sears Roebuck, and other financial service companies, they believe, depends on the array of financial products they may offer, and not necessarily on the ability to accept deposits across state lines. The new product offerings made possible through deregulation would not be limited by state boundaries and, hence, would place banks on more equal footing with other types of financial service suppliers.

Supervision is another critical issue in the interstate banking scenario. If federal legislation liberalizes McFadden or Douglas, some observers worry, state banking agencies could see their authority preempted. A state supervisory agency tempers the scope of privilege granted by federal law to the particular needs of its state. Therefore, some regulators and

[1]Charles F. Haywood, "Regulation, Structure and Technological Change in the Consumer Financial Services Industry." **The Costs and Benefits of Public Regulation of Consumer Financial Services,** (Cambridge: Abt Associates, Inc., 1979).

Banking industry interest groups will have a substantial influence on the evolution of legislation regarding interstate banking. The major trade groups often disagree, but their positions apparently overlap enough to point toward some sort of compromise.

some of the regulated are likely to oppose any modifications to the existing legal framework that would lessen the states' ability to regulate their own financial marketplace.

There is considerable concern over excessive concentration of financial resources. Many feel that, in the absence of the protection afforded by McFadden and Douglas, small banks would face unfair competition from large out-of-state banks. Some charge that a large money center or regional bank might not be concerned with their community and that its development would suffer as a result. In this view, the local banker who is more attuned to the community's credit needs would be more likely to make the kinds of loans required.

Conversely, others within the banking industry view the fence not as restraining outside competitors but as restraining the geographic scope of their own activities. Those desiring to expand their playing field view McFadden as a regulatory straitjacket restraining their ability to compete. Those who favor unrestricted branching reject the anti-competitive argument and reason that large interstate banks that are unresponsive to the needs of a local community will not attract customers and, hence, will not be a real competitive force within the market. Consequently, an unresponsive large bank is destined to be unsuccessful. An interstate bank that succeeds by responding to local needs would be creating more competition—not less. These voices would argue that the well managed community bank is in no danger of suffering substantial deposit and loan loss to large interstate banks. An efficiently operated bank that has been serving a community for years and is knowledgeable about its credit needs will easily maintain an adequate customer base.

Those in favor of relaxing geographic restrictions assert that a certain amount of consolidation in the industry is desirable. Banks that are operating inefficiently will come under increased competitive pressure to improve efficiency or leave the industry. Competition is purported to be in the public interest, promoting efficiency and assuring the lowest cost of goods and services to the consumer.

Opinion on interstate banking is as varied as it is abundant. The positions of interest groups whose constituencies would be affected by a move to interstate banking vary, predictably, according to what constituents expect to lose or gain. To pinpoint the key issues, this article reviews the policy stands of some of the most influential lobbying groups in the financial services industry.

American Bankers Association

Perhaps the most influential of the bank lobbies is the American Bankers Association. The ABA has about 13,600 banks and trust companies in its membership, accounting for 91 percent of all commercial banks in the United States. The ABA's situation is rather sensitive when it comes to policy because of the composition of its membership. The association serves small and large banks alike. Conflicts are frequent, encouraging compromise.

Although a powerful voice for the banking industry, the ABA has not taken a firm position on interstate banking to date. It has long supported McFadden and Douglas and probably will continue to do so. The ABA came out in favor of

"An interstate bank that succeeds by responding to local needs would be creating more competition—not less."

the Regulators Bill, which provided for interstate acquisitions in emergencies. It supported measures which first would exhaust all intrastate possibilities, and then would explore those in contiguous states before going nationwide in search of a purchaser.

The ABA's general position is that deregulation of products and services represents a first step toward an improved banking environment. Relaxation of geographic restrictions may then be indicated.

Independent Bankers Association of America

The Independent Bankers Association of America is a bank lobby with a less general membership than the ABA. The IBAA's membership consists of about 7,300 small and medium sized banks. One of the IBAA's stated purposes is to oppose concentration of banking credit powers in chains, branch systems, or holding

company combines of banks. As we might expect, this goal has led the IBAA to oppose interstate banking.

In 1980, the IBAA favored legislation to prohibit the takeover of nonbank depository institutions by banks or bank holding companies except when a troubled institution is involved. Failure to limit the power to acquire nonbank institutions would, according to IBAA, result in a potentially uncontrollable consolidation movement. The association also expressed fear that allowing banks to acquire S&Ls would undermine state branching laws, because banks would capitalize on the broad branching powers granted S&Ls and circumvent state laws.

Following the release of the Carter report, "Geographic Restrictions on Commercial Banking in the United States," the IBAA came out against any of the recommended modifications of McFadden and Douglas. Any such changes, the IBAA argued, would lead to a "substantial" increase in banking concentration, giving a vast amount of economic power to fewer and fewer banks. Centralization of decision-making over banking would also increase, interfering with the states' role in managing their own banking affairs. The IBAA supports the role of state banking authorities in supervising the financial system. According to the IBAA, policies geared to local needs can be produced only at the state level.

The IBAA asserts that small banks can survive and profit in a turbulent financial marketplace unless that marketplace is weighted against them. The McFadden Act and the Douglas Amendment, according to the association, represent "fundamental safeguards of the nation's decentralized network of independent unit banks." It is the IBAA's contention that changes in the interstate banking laws would hurt the nation's depository institutions and the small communities served by them.

Association of Bank Holding Companies

The Association of Bank Holding Companies is comprised of 179 holding companies registered with the Federal Reserve Board under the Bank Holding Company Act of 1956. The position of ABHC on interstate banking is reflected rather concisely in a draft bill referred to as the "Regional Banking Deregulation Act." This proposal would amend the Douglas Amendment to permit a bank holding company to acquire other bank holding companies in contiguous states. Proponents claim this piece of legislation represents the best solution to the interstate banking question for several reasons:

(1) A gradual approach to interstate banking would allow all banks to develop their banking skills before competing nationwide.

(2) Identifying market areas in terms of state boundaries would provide clearly defined markets.

(3) The contiguous state approach would allow banks to expand within a region having similar financial needs, permitting bankers to do full service business in their "natural" market areas.

Specifically, the bill calls for gradual relaxation of restrictions on bank holding company acquisitions across state lines, subject to certain safeguards.[2] First, mergers would be allowed only between bank holding companies, protecting banks that do not desire holding company affiliation from forced acquiescence. Second, acquisitions would be permitted only into states contiguous to the acquiring company's home state. Moving the head office into another state would be prohibited under the act, eliminating the fear of "leap-frogging" into still other states. Finally, the ABHC bill would limit the number of acquisitions for the first five years. Holding companies over $500 million in assets would be allowed only one merger per state. Companies smaller than $500 million, on the other hand, would not be restricted in the number of holding companies they could acquire.

The ABHC argues that this approach would fulfill the objectives of the Carter study on interstate banking, while at the same time protecting the integrity of the dual banking system and guarding against undue concentration of banking credit power. Community bankers would be safe under this plan. By resisting bank holding company affiliation, they would be protected from acquisition by an out-of-state holding company. As far as any new competitive threat is concerned, the community banker would remain safe because de novo entry is prohibited under the ABHC proposal. State bank supervisors could also rest easy because the "Regional Banking Deregulation Act" would preserve the state supervisor's regulatory authority. A bank affiliated with a holding company would

---

[2] "*Special Report* Commercial Banking Review: Geographic Expansion," from **United States Banker,** March 1981.

remain a state bank after acquisition by an out-of-state holding company, and would remain subject to laws of the state in which it is located.

Conference of State Bank Supervisors

The Conference of State Bank Supervisors serves state officials responsible for the supervision of state-chartered banks. The CSBS defines as its goal the maintenance of a strong, decentralized dual banking system and improvement in the efficiency and effectiveness of state banking departments. In the CSBS's view, the McFadden Act and the Douglas Amendment are fundamental safeguards of state-federal checks and balances.

The important issue in the interstate banking debate, according to the CSBS, is not whether banking services may be offered on an interstate basis; interstate banking services are already available. What concerns the CSBS is preemption of a state's authority to determine who may operate within its boundaries and to what extent. Dismantling the present legal framework would jeopardize the state banking department's control in banking matters, the group fears, and result in undue concentration of financial resources. This, in turn, would restrict competition. Michael Edwards, chairman and president of the CSBS, has said that "in the name of progress (the deregulators) would turn the clock back to 1929 and in the process tell us to forget the current structure with its tremendous versatility and flexibility."[3]

The CSBS believes the states—not the federal government—are the vehicles for orderly, effective change. State banking departments work to provide optimum financial services while preserving individual economic freedom, the association argues. Changes in laws protecting the state's role in banking matters ultimately would corrupt the financial system, it says, and result in an excessively concentrated banking industry operating to the detriment of many states. The CSBS asserts that interstate services will expand without changes in current laws and that, therefore, such changes are unwarranted.

Conclusion

Debate over interstate banking will continue. Whether we have full-scale nationwide branching, regional branching, or we simply continue under the same guidelines will be determined in part by the political strength of opposing interest groups. The power and influence of these groups will be tested. However, the number of opposing viewpoints assures us that every proposal will be thoroughly contested before emerging as a finished piece of legislation. Indeed, the very existence of these groups helps ensure that a compromise acceptable to all parties is achieved. The process of congressional debate—with input from all of these groups—serves the best interest of the banking industry as well as the nation.

—Charles R. Haywood

---

[1]Since this article was written, both IBAA and CSBS have adopted positions favoring expanded bank and bank holding company powers and development of reciprocal services arrangements, while maintaining their commitments to state determination in banking matters (see **U. S. Banker**, March 1983). Though not an endorsement of the ABHC Bill discussed above, this development does, perhaps, indicate a trend toward agreement on the fundamental issues.

[3]"Interview with Lawrence Kreider, executive VP-economist, and Michael Edwards, president, of the Conference of State Bank Supervisors," **United Sates Banker,** September 1982.

REFERENCES

Information about the positions of these groups was taken from a variety of sources. The documents consulted are listed below:

Independent Bankers Association of America

IBAA statement before the Senate Committee on Banking, Housing and Urban Affairs concerning major banking and consumer protection laws, May 6, 1981; Oral statement by Robert McCormick, former president, before the House Subcommittee on Financial Institutions, Regulation, and Insurance regarding the Garn-Regan Bill, September 22, 1982; Remarks by Kenneth Guenther, executive director, before the Independent Bankers Division of the Tennessee Bankers Association, May 11, 1982; Statement of IBAA before the Subcommitee on Monopolies of the House Committee on the judiciary concerning the structure of the financial services industry, July 8, 1981.

Association of Bank Holding Companies

"*Special Report* Commercial Banking Review: Geographic Expansion," from **United States Banker**, March 1981; "Interstate Banking: The Contiguous State Approach," Background Paper-Association of Reserve City Bankers, July 1981; "Deregulating Interstate Banking: ABHC Cites Strong Support from Members," **American Banker,** March 6, 1981.

Conference of State Bank Supervisors

"Interview with Lawrence Kreider, executive VP-economist, and Michael Edwards, president, CSBS," **United States Banker,** September 1981; "Interstate Banking: Salvation or Suicide?" **The Supervisor,** November 1980; Press releases of CSBS, 1981-1982.

American Bankers Association

Testimony of Llewellyn Jenkins on behalf of ABA on S.1720 and S.1721 before the Senate Committee on Banking, Housing and Urban Affairs, October 20, 1981; Testimony of Lee E. Gunderson on behalf of ABA on S.2532 and S.2532 before the Senate Committee on Banking, Housing and Urban Affairs, May 27, 1982.