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Statement by

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Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions, Supervision, and Regulation

of the

Committee on Banking, Finance and Urban Affairs

House of Representatives

April 24, 1985

I appreciate the opportunity to appear before this Subcommittee to review with you the issues involved in interstate and regional banking. These issues are inextricably related to the "nonbank bank" question we discussed last week, and to the still broader question of the appropriate direction and structure of our banking system.

In sum, the Federal Reserve Board believes the time has come for Congress, as part of more comprehensive banking legislation, to authorize some interstate banking. The approach should take account of the desirability of transitional arrangements over a period of years before moving to more general interstate banking; the need to avoid undue concentration of banking resources and to maintain a climate in which small institutions can flourish; and the desirability of retaining a role for states in the evolution of the banking structure within a state.

The basic Federal branch banking law, the McFadden Act of 1927, has not been amended in any substantive manner since 1933. The law effectively prohibits national banks from branching interstate by limiting each national bank to branching only within its home state, subject within that state to any branching restrictions imposed by that state on state-chartered banks. The Douglas amendment to the Bank Holding Company Act of 1956 prohibits interstate expansion by means of a bank holding company acquiring banks in another state unless such acquisitions are explicitly authorized by that state.

In spite of the statutory McFadden and Douglas prohibitions, de facto there has been a large and increasing amount of interstate banking in recent years. Some of that has taken place through avenues specifically permitted by law.

According to a study by the Federal Reserve Bank of Atlanta, U. S. bank holding companies in 1982 had 202 loan production offices and 143 internationally oriented Edge Act

Corporations operating outside the parent's home state; foreign banking organizations had another 254 banking offices outside their home state. There are probably more today. More important are the variety of finance companies, mortgage companies, industrial banks and other offices with at least partial banking capabilities operated interstate by bank holding companies. The Atlanta study counted some 5,500 such offices operating outside the holding company's home state and many more exist now.

Technological advances are also providing large opportunities for banks to expand geographically without brick and mortar offices. By joining ATM networks, banks in some cases have been able to reach out to existing or new customers over state lines. Looking ahead, banking through home computers would be difficult to confine within a state's boundary. But even without exotic technology, the relative speed and simplicity of communications and transportation today makes it much easier, particularly on the deposit side, to conduct banking at a distance. Large businesses routinely "sweep" deposits into "concentration accounts" at selected banks. The combinations of print and broadcast advertising, 800 number telephone lines, deposit brokerage, and efficient clearing mechanisms mean that the day of rather insulated local deposit markets are gone. On the loan side, nationwide credit cards are available to customers throughout the country.

The substantial number of "nonbank bank" applications by bank holding companies, stretching the fabric of existing law, is one indication of the strength and depth of some banks' desires to operate over a wider geographic area. The pressures toward interstate operations arise from a number of sources. Competition from non-depository businesses that can and do provide financial services -- including money market accounts and other bank-like services -- through interstate networks is strong and pervasive. Thrift institutions, which have no statutory bar to interstate branching, offer interstate facilities in a significant number of cases. Moreover, banks in slower growing areas naturally want to participate in more rapidly expanding regions. Florida alone, for instance, has attracted about 20 percent of all nonbank bank applications by bank holding companies.

A number of relatively large banks that nevertheless rank well below the largest money center institutions in size apparently feel, with some urgency, that a stronger competitive position in national and international markets requires a larger size than can reasonably be attained within the boundaries of a single state. Some of the largest banks, conversely, urgently wish to attain a wider and more stable base of "retail" deposits and to expand their consumer lending. At the other end of the spectrum, there are small banks concerned about their ability to compete effectively without being able to combine with others in a natural market area that may extend over state boundaries.

Resistance to interstate banking for a variety of reasons -- including a desire of many banks to continue as independent institutions -- clearly remains strong. But the pressures for change are apparent in initiatives by a number of states toward more interstate banking. The growing number of regional interstate banking arrangements is the most important reflection of that change in attitude. Today 14 states have enacted laws permitting reciprocal entry by bank affiliates of bank holding companies headquartered in states within a designated region; 12 more states are actively considering such arrangements. Four states allow entry from any other state, three without and one with reciprocity. These liberalized approaches toward interstate banking over recent years suggest a significant change in thinking since the MacFadden Act and the Douglas amendment were enacted.*

Substantive Issues in Interstate Banking

Against this background, the Federal Reserve Board believes the time has come to review and clarify national

*Attached are a chart showing interstate banking regions and a table listing the status of interstate banking legislation in the 50 states and the District of Columbia.

policy toward interstate banking, recognizing the economic and competitive pressures driving toward liberalization of present restrictions, while also protecting the safety and efficiency of the banking system, preventing undue concentration of economic resources, and assuring benefits to the users of banking services.

One continuing objective of public policy is to assure competition in banking, as in other industries. Ordinarily, we would not expect that competition would be promoted by confining an industry to a single geographic market or a single state. Indeed, we rely on the ability of additional firms to enter markets as a competitive force leading to the best possible products at least cost. Moreover, existing anti-trust law appears to provide considerable protection against local markets becoming non-competitive as the result of entry of larger organizations.

Available empirical studies do not suggest that large states with large banks and statewide branching are experiencing increasing concentration of local markets. The presumption that restrictions on entry into particular markets imply some loss of competitive vigor, unless overridden by other considerations of public policy, suggests that some liberalization of interstate banking is appropriate. That presumption has added force in an environment in which other large financial service firms are able to operate nationwide, exploiting what economies of scale in technology or marketing may be available. In effect, those firms may now be in a position to skim off profitable areas of business from banks committed to providing a full range of banking services.

Historically, a counter-argument to interstate banking has been a strong antipathy to concentration of economic power, particularly in the banking system, and a desire to maintain banking resources in significant measure under control of local banks, knowledgeable about the needs and circumstances of smaller businesses and individuals.

Experience in states with large banks and statewide branching suggests that these are not questions of "either-or." Attachments I and II provide a brief analysis of experience in two of our largest states, one of which has had statewide branching for decades and the other of which has permitted statewide operations only since 1976. In both cases, large numbers of relatively small independent banks remain. In California, a rapidly growing state, new banks are being formed in relatively large numbers; in New York, a state that is growing more slowly, relatively few new banks have been formed, but the number of small independent banks (i.e., under $100 million) has dropped only modestly since statewide branching was permitted. In both states, the competitive environment appears healthy, with the consumer and businessman able to choose between some of the largest banking institutions in the world and small locally oriented banks. Should banks be permitted to expand interstate more freely, we would anticipate similar patterns to prevail.

We are aware that a rush to expand geographically could pose certain risks -- temptations to pay exceptionally high prices and to leverage capital, to spread management thin, and to enter into new types of lending or operations where experience may be limited. We believe these risks can be dealt with through normal supervisory processes, particularly in evaluating financial and managerial factors with respect to applications. In particular, we believe that a banking organization planning sizable expansion programs should be able to demonstrate its ability to maintain fully adequate capital and liquidity positions, to avoid excessive use of good will on its balance sheet, and to provide capable management for acquired institutions. I would also emphasize, in this connection, that the risks -- actual and potential -- from expansion into new banking markets are typically more identifiable, and often less, than those posed by entry into new nonbanking activities where bank management may have little or no experience.

Concentration

Viewed from a national perspective, restrictions on interstate banking have been effective in forestalling large concentrations of domestic banking resources, at least by the standards of other countries. The 10 largest banking organizations control only about 20 percent of all domestic banking assets, and the 100 largest only a little more than half.

Presumably, concentration ratios would tend to rise with interstate banking, quite significantly so if such activity is unrestricted. At the same time, the California and New York experience I referred to earlier suggests the process would stop very far short of the concentration of institutions common in other countries. We would anticipate thousands of independent organizations remaining.

Nevertheless, we believe that a variety of safeguards should be included in legislation liberalizing interstate banking to encourage continuing diversification of banking resources. Taken alone, anti-trust laws -- focused on the market shares of competitors in particular markets -- do not appear fully responsive to that need. Essentially, those laws as applied to banking make little distinction between the overall size of organizations competing in particular markets, but rather focus on the size of their presence in a single market alone. Consequently, those laws might be consistent with considerably greater concentration, measured on a national or regional basis, than would be desirable.

Two kinds of limitations, in our judgment, might be taken to forestall any substantial risk of excessive concentration. The approaches are not mutually exclusive and would be complementary. Both would, at the margin, involve essentially arbitrary judgments, for they would envisage a simple quantitative measure of relative size. But, by responding directly and logically to the concerns about concentration, I believe they would provide a more coherent approach than the present "system" of implicitly relying on an almost total prohibition on interstate acquisition as an indirect means of controlling concentration levels.

The first approach would envisage limitations on the largest banking institutions acquiring other banks. For instance, the very largest holding companies in terms of domestic banking assets (or depository institution assets) -- say the top twenty-five -- might be prohibited from merging with each other. In addition, banks could be prohibited from obtaining through acquisition more than some fixed share of the nationwide total of such assets, although de novo or relatively small acquisitions in other states could be permitted.

The second approach would permit, or even encourage, states to set limitations on the proportion of banking assets (or depository institution assets) within their own borders that could be acquired through acquisitions or mergers of institutions of significant size. Specifically, such acquisitions could be denied if the resultant institution would hold more than, for example, 15 or 20 percent of a state's banking assets. Any such rule should be nondiscriminatory between in-state and out-of-state banking organizations.

Of course, rules implementing these approaches would have to be carefully drawn to avoid anomalous results. The important point is that the national and state-wide concentration limits be fully observed.

We would strongly suggest exceptions to these limitations be permitted for failing institutions. Indeed, in light of the remaining strains evident in some sectors of the thrift and banking industries, we would propose that the emergency arrangements for failing institutions in the Garn-St Germain Act be extended. They should be liberalized in two ways: by not requiring that an institution actually be "closed" to qualify for emergency treatment, and by reducing or eliminating the $500 million size cut-off in the Act.

The Dual Banking System

Interstate banking, by its nature, has implications for the dual banking system. Indeed, it is difficult to conceive of a system of interstate branching that would enable state law and supervision to govern the operations of banks in sister states. Consequently, interstate branching could well lead to a massive expansion of the national banking system.

If interstate banking operations are instead generally confined to separately incorporated and chartered components of a holding company, particular states could maintain authority over the in-state operations of the holding company. Moreover, there would be opportunity for a greater degree of local control. For those reasons, a requirement that interstate acquisitions generally take the form of a holding company affiliate appears to fit more naturally our banking traditions, at least over a long transitional period to a fully developed interstate banking environment.

A Possible Policy Approach

Various approaches toward interstate banking have been proposed over the years, ranging from modest changes in existing arrangements to nationwide branching. For instance, possible transitional approaches well short of nationwide banking include:

1) Branching throughout metropolitan areas that extend across state lines, of which there are 35 at present.

2) Expansion into contiguous states.

3) Expansion de novo or by acquisition, into any metropolitan area above a minimum size.

4) Encouragement of reciprocal arrangements among states.

5) Interstate banking limited to de novo operations or small acquisitions (conversely, some have proposed limiting or prohibiting small acquisitions in the interest of maintaining local banks).

6) Regional arrangements.

Each of those approaches (and any others that could be developed) has particular strengths and weaknesses; each could be debated. However, much of the recent thinking in states, and within the banking community, has focused largely on the last of those options -- regional arrangements. As a consequence, we believe it useful to focus on that approach as a point of departure.

An advantage of regional arrangements seen by many is the opportunity for regional organizations to reach a size necessary for an effective national or international presence, and then to become more effective competitors of the largest banking institutions in all phases of banking.

However, the approach suffers from some clear weaknesses. The regions may be defined in a discriminatory way, aimed at encouraging particular combinations of banks and excluding others, without clear and objective rationale. Specifically, some proposals appear to be driven by a desire to exclude New York and California banks, or simply large money center banks. By their nature, sizable regional arrangements would permit combinations of banks long distances (and several states) apart, without permitting even limited operations in some contiguous states. Metropolitan areas might be left, in a banking sense, bifurcated. Viewed as a permanent arrangement, regional compacts would tend to Balkanize banking, with a tendency toward regional concentrations.

Because of these potential weaknesses, we believe a federal framework is required for regional arrangements. For example, such weaknesses can be substantially ameliorated if states entering into such regional arrangements were also required after relatively few years -- say three -- to permit reciprocal entry by banks in any state that has enacted a regional arrangement or otherwise provides for entry of banks of any other states.*

In this approach, any state, if it so chose, could continue entirely to "opt out" of full interstate banking. But, if it chose to enter into a regional arrangement, it would also have to be prepared to consider those arrangements as a transitional approach toward a broader arrangement encompassing all states willing to provide reciprocal privileges.

As suggested above, all interstate acquisitions would be subject to Federal limitations designed to protect against

*Regional arrangements are the subject of a constitutional challenge that is now before the Supreme Court. A federal framework, such as suggested above, could be put in place if the Supreme Court sustains regional arrangements or even if the Court were to find them unconstitutional on grounds of violation of commerce or compact clause requirements. However, if the Court were to find that such arrangements violate the equal protection clause, they could not be permitted even if sanctioned by Federal law. See Attchment III.

undue concentration, and states would be able to limit the proportion of their banking assets acquired by a single banking organization. We would also suggest that it would be appropriate, in the first stages at least, for these interstate operations to be undertaken by means of separately incorporated units of a holding company rather than by direct branches.

The number of states that ultimately might wish to enter into regional (or nationwide) arrangements within this broad framework must, for the time being, remain unknown. Consequently, the possibility would exist that little progress would be made toward interstate banking, even for limited operations within metropolitan areas. Yet, the status quo is hardly satisfactory, and the legitimate pressures toward interstate operations that have impelled "nonbank banks" would continue to seek "unnatural" channels. Consequently, we would suggest that, with due notice, the Congress authorize interstate branching within metropolitan areas and for neighboring areas of contiguous states.

Conclusion

I have on a number of occasions in the past stressed the urgency of Congressional action to guide the orderly evolution of the banking system and to reaffirm certain basic principles that have guided the banking and financial systems, adapting them to present circumstances. Markets will continue to respond and change will take place. The only question is whether that change will take place in a constructive framework of rules established by the Congress after a careful weighing and balancing of the vital public interests that are now before you for review. In my judgment, -- and taking account of both market forces and recent state inititatives -- a comprehensive approach now requires a resolution of the issues involved in interstate expansion.

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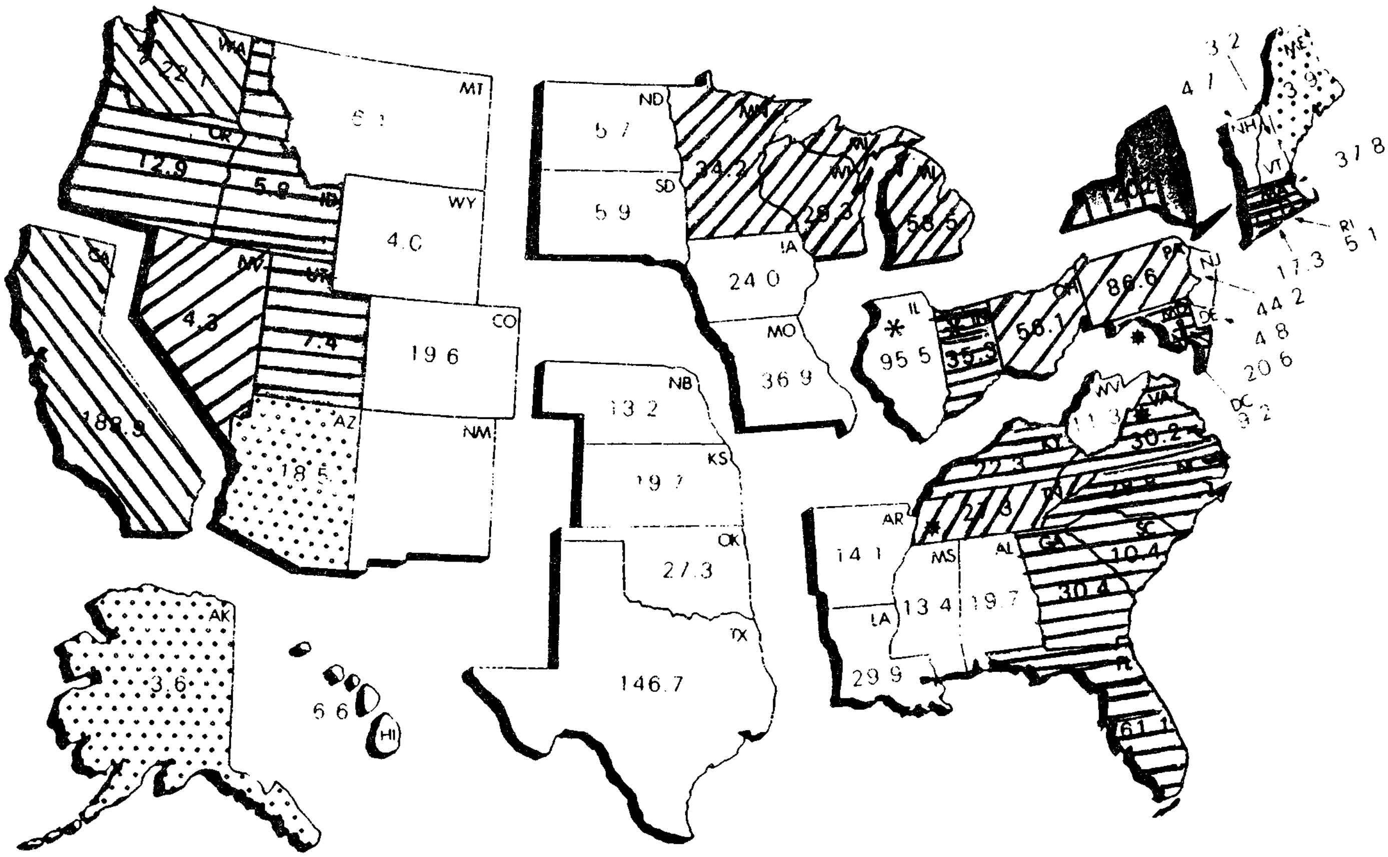
Principal Interstate Banking Regions Being Considered by the States

(As of April 1985)

1984 Year End Commercial Bank Deposits in Billions of Dollars



Passed National Legislation

Passed National Reciprocal Legislation

Passed Regional Reciprocal Legislation

Proposed National

Proposed Regional Reciprocal

Note: This map includes proposed banking regions announced through April 1985. Banking groups and state legislators proposed these regions but they are not definitive. In addition, the laws and proposed laws are not homogeneous. This map does not indicate states with limited purpose, grandfathered or troubled institution laws.

Rhode Island's law provides for reciprocity in New England on July 1, 1984 and reciprocity in the nation to go into effect on July 1, 1986.

In the Southeast Region Florida, Georgia, North Carolina and South Carolina have all passed regional reciprocal laws though the regions differ to some degree.

Kentucky has a multi-bank holding company law which allows interstate acquisitions with its contiguous states with reciprocal agreements. On July 15, 1986 Kentucky will have a national reciprocal law. Indiana also has a reciprocal law with contiguous states though both states have been proposed as part of the Mid-Atlantic region.

• Maryland, Tennessee, Virginia and Washington, D.C. have been proposed for inclusion in both the Southeast and Mid Atlantic Regions.

* Indiana and Illinois have been proposed for inclusion in both the Central and Mid Atlantic regions.

The laws in Indiana, Maryland and Arizona have been passed by the legislatures but not signed by the governors of those states as of April 18, 1985.

INTERSTATE BANKING LEGISLATION BY STATE

STATE	STATUS OF LEGISLATION	TYPE	REGION (if any)
Alabama	None		
Alaska	Effective	Open Entry	All States
Arizona	Effective October 1, 1986	Open Entry	All States
Arkansas	Defeated	Regional-Reciprocal	SOUTHEAST (14 States & DC) AL, FL, GA, LA, MD, MS, MO, NC, OK, SC, TN, TX, VA, WV, DC
California	Proposed	National-Reciprocal	
Colorado	None		
Connecticut	Effective	Regional-Reciprocal	NEW ENGLAND (5 States) ME, MA, NH, RI, VT
Delaware	None		
District of Columbia	Proposed	Regional-Reciprocal	SOUTHEAST (11 States) AL, FL, GA, LA, MD, MS, NC, SC, TN, VA, WV
Florida	Effective July 1, 1985	Regional-Reciprocal	SOUTHEAST (11 States & DC) AL, AR, GA, LA, MD, MS, NC, SC, TN, VA, WV, DC
Georgia	Effective	Regional-Reciprocal	SOUTHEAST (10 States) AL, FL, GA, KY, LA, MS, NC, SC, TN, VA
Hawaii	None		
Idaho	Effective July 1, 1985	Regional-Reciprocal	WEST (6 States) WA, OR, MT, NV, UT, WY

STATE	STATUS OF LEGISLATION	TYPE	REGION (if any)
Illinois	Proposed	Regional-Reciprocal	MIDWEST/MIDCENTRAL (6 States) IN, IA, KY, MI, MO, WI
Indiana	Awaiting Governor's signature. Effective date January 1, 1986	Regional-Reciprocal	MIDCENTRAL (4 States) IL, KY, MI, OH
Iowa	None		
Kansas	None		
Kentucky	Effective	Regional-Reciprocal (National trigger after 2 years (1987))	MIDCENTRAL (7 States): MO, IL, IN, OH, TN, VA, WV
Louisiana	None		
Maine	Effective	Open Entry	All States
Maryland	Awaiting Governor's signature. Effective date July 1, 1985	Regional-Reciprocal	SOUTHEAST/MIDCENTRAL (contiguous only until 1987; 14 states & DC thereafter) AL, AR, DE, FL, GA, KY, LA, MS, NC, PA, SC, TN, VA, WV, DC
Massachusetts	Effective	Regional-Reciprocal	NEW ENGLAND (5 States) CT, ME, NH, RI, VT
Michigan	Proposed	Regional-Reciprocal	MIDWEST (5 States) IL, IN, MN, OH, WI
Minnesota	Proposed	Regional-Reciprocal	MIDWEST (4 States) IA, ND, SD, WI
Mississippi	None		
Missouri	Proposed	Regional-Reciprocal	MIDWEST-SOUTH (8 States) AR, IL, IA, KS, KY, NE, OK, TN

STATE	STATUS OF LEGISLATION	TYPE	REGION (if any)
Montana	None		
Nebraska	None		
Nevada	Proposed	Regional-Reciprocal (National trigger 1/1/89)	WEST (11 States) AK, AZ, CO, HI, ID, MT, NM OR, UT, WA, WY
New Hampshire	None		
New Jersey	Proposed	Regional-Reciprocal	MIDCENTRAL (5 States & DC) DE, MD, OH, PA, VA, DC
New Mexico	Defeated	Regional-Reciprocal	SOUTHWEST (5 States) AZ, CO, OK, TX, UT
New York	Effective	National-Reciprocal	All States
North Carolina	Effective July 1, 1985	Regional-Reciprocal	SOUTHEAST (12 States & DC) AL, AR, FL, GA, KY, LA, MD, MS, SC, TN, VA, WV, DC
North Dakota	None		
Ohio	Proposed	Regional-Reciprocal (National trigger after 4 years)	MIDCENTRAL/MIDWEST (13 States & DC contiguous States only for 2 years) DE, IL, IN, KY, MD, MI, MO, NJ, PA, TN, VA, WV, WI, DC
Oklahoma	None		
Oregon	Effective July 1, 1986	Regional-Reciprocal	WEST (8 States) AK, AZ, CA, HI, ID, NV, UT, WA
Pennsylvania	None		
Rhode Island	Effective	Regional-Reciprocal (National trigger 6/30/86)	NEW ENGLAND (5 States) CT, ME, MA, NH, VT

STATE	STATUS OF LEGISLATION	TYPE	REGION (if any)
South Carolina	Effective July 1, 1986	Regional-Reciprocal	SOUTHEAST (12 States & DC) AL, AR, FL, GA, KY, LA, MD, MS, NC, TN, VA, WV, DC
South Dakota	Effective	Open Entry 1/	All States
Tennessee	Proposed	Regional-Reciprocal	SOUTHEAST (12 States) NC, GA, AL, MS, LA, AR, KY, VA, IN, FL, WV
Texas	Proposed	Regional-Reciprocal	SOUTHWEST (10 States) AZ, AR, CO, KS, LA, MS, MO, NM, OK, WY
Utah	Effective	Regional-Reciprocal	WEST (11 States) AK, WA, OR, ID, WY, MT CO, NM, AZ, NV, HI
Vermont	None		
Virginia	Effective July 1, 1985	Regional-Reciprocal	SOUTHEAST (12 States & DC) AL, AR, FL, GA, KY, LA, MD, MS, NC, SC, TN, WV, DC
Washington	Proposed	National-Reciprocal	All States
West Virginia	None		
Wisconsin	Proposed	Regional-Reciprocal	MIDWEST (7 States) IL, IN, IA, MI, MN, MO, OH
Wyoming	None		

1/ A South Dakota bank that is acquired by an out-of-state bank holding company may not thereafter open additional branches by merger, consolidation or otherwise, and the out-of-state holding company may not acquire any additional existing banks in South Dakota.

Attachment I

SMALL BANKS IN THE CALIFORNIA BRANCH BANKING ENVIRONMENT

Proposals to reduce barriers to bank geographic expansion, whether on a statewide basis or an interstate basis, raise questions relative to the future of smaller banking institutions. Specifically, can small banks compete with the statewide firms? Will there be incentives for the formation of new banks in markets characterized by a large percentage of total assets being held by a few statewide firms?

The data suggest that, while the large banks in a statewide banking state control a large percentage of state banking assets, this does not mean that smaller banks cannot compete in the state's major banking markets. The California experience, developed over several decades of statewide branch banking, illustrates the possibilities for small banks. Table 1 presents the size distribution of California banks at year-end 1984. As the table indicates, 332 of 435 banks have assets of less than $100 million, and only six institutions have over $5 billion of assets.

Table 1
Number and Asset Size Distribution of California Banks

Asset Size	Number of Banks	Percentage of Total State Banking Assets Held by Firms in Each Size Class
Less than $10 million	17	0.05
$10 million to $25 million	100	0.78
$25 million to $50 million	121	1.93
$50 million to $100 million	94	3.00
$100 million to $250 million	58	3.90
$250 million to $500 million	21	3.35
$500 million to $1 billion	7	2.44
$1 billion to $5 billion	11	10.59
Over $5 billion	6	73.96
	435	100.00

In spite of the dominant asset position of the largest banks, there appears to have been adequate incentives for the formation of new banks in California. Table 2 presents the rate of bank formation in California over the years 1970 through 1983. In these years, 355 new banks were chartered in California. In 1983, California accounted for 16.9 percent of all new banks in the United States. Thus, the existance of statewide branch banking does not appear to have deterred investors in new banks.

Table 2
Bank Chartering in California, 1970 - 1983

Year	Number of New Banks	New Bank Charters in California as a Percentage of All New U.S. Bank Charters
1970	6	3.4
1971	7	3.6
1972	17	7.3
1973	24	7.2
1974	18	5.0
1975	17	6.9
1976	13	8.1
1977	14	9.1
1978	13	8.8
1979	24	11.8
1980	46	22.4
1981	42	21.1
1982	53	16.8
1983	61	16.9

These data suggest that, at least in California, the existence of large statewide banks has not led to the demise of small banks. In addition, the incentives for new bank formation have been maintained.

Attachment II

SMALL BANKS IN THE NEW YORK BRANCH BANKING ENVIRONMENT

The State of New York has had a shorter history of statewide banking than California, and the comparison may be of interest in evaluating the existence of small banks in a state containing many of the nation's largest banking organizations. New York adopted statewide banking in 1976, and therefore has had less than a decade of experience, as compared to the long history of statewide banking in California.

Table 1 presents the asset size distribution for banks in New York as of the end of 1984. As in California, the largest banks hold the overwhelming percentage of total statewide banking assets. Yet, as in California, there are a significant number of smaller institutions; 85 of the 149 banks, or 57 percent of all banks, have assets of less than $100 million.

Table 1
Number and Asset Size Distribution of New York Banks

Asset Size	Number of Banks	Percentage of Total State Banking Assets Held by Firms in Each Size Class
Less than $10 million	11	0.02
$10 million to $25 million	17	0.09
$25 million to $50 million	28	0.29
$50 million to $100 million	29	0.60
$100 million to $250 million	23	1.09
$250 million to $500 million	9	0.95
$500 million to $1 billion	7	1.28
$1 billion to $5 billion	12	6.20
Over $5 billion	13	89.46
	149	100.00

Table 2 presents the record of new bank charters in New York for the period 1970 - 1983. Although the bank formation rate in New York was substantially lower than in California, the difference can probably be explained by the differences in growth rates between the two states. Like the California

Table 2
Bank Chartering in New York, 1970 - 1983

Year	Number of New Banks	New Bank Charters in New York as a Percentage of All New U.S. Bank Charters
1970	2	1.1
1971	4	2.1
1972	4	1.7
1973	3	0.9
1974	6	1.7
1975	4	1.6
1976	1	0.6
1977	5	3.3
1978	2	1.4
1979	1	0.5
1980	2	1.0
1981	2	1.0
1982	1	0.3
1983	3	0.8

experience, however, the New York data do suggest that small banks survive the expansion of branch banking and that new banks will be formed regardless of the degree of statewide dominance of the largest organizations.

Attachment III

Litigation Involving Regional
Reciprocal Statutes

The Board has issued seven orders approving interstate acquisitions of banks by bank holding companies pursuant to regional interstate banking statutes. Six of the orders involve New England acquisitions pursuant to statutes enacted by Connecticut, Massachusetts and Rhode Island[1/] and one

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1. Bank of New England Corporation/CBT Corporation, 70 Fed. Res. Bull. 374 (March 26, 1984), approving the merger of the fourth largest Massachusetts bank holding company and the largest bank holding company in Connecticut.

2. Hartford National Corporation/Arltru Bancorp, 70 Fed. Res. Bull. 353 (March 26, 1984), approving the acquisition by the second largest Connecticut bank holding company of the eighth largest bank holding company in Massachusetts.

3. Bank of Boston Corporation/Colonial Bancorp, 70 Fed. Res. Bull. 524 (May 18, 1984), approving the acquisition by the largest bank holding company in New England of the fourth largest bank holding company in Connecticut.

4. Bank of Boston Corporation/RIHT Financial Corporation, 70 Fed. Res. Bull. 737 (Aug. 20, 1984), approving Bank of Boston's acquisition of the second largest bank holding company in Rhode Island.

5. Fleet Financial Group, Inc., 70 Fed. Res. Bull. 834 (October 4, 1984), approving the acquisition by the largest bank holding company in Rhode Island of *de novo* banks in Boston and Hartford.

6. Hartford National Corporation, 71 Fed. Res. Bull. 43 (November 19, 1984), approving the acquisition by the second largest bank holding company in Connecticut of a *de novo* bank in Providence.

order involves the southeast region, the merger of Florida and Georgia bank holding companies.[2/]

Each of the applications for Board approval to acquire a bank across state lines pursuant to regional interstate statutes was protested before the Board[3/] on the basis that the regional interstate statutes violate the Commerce, Compact and Equal Protection Clauses of the United States Constitution. The Board addressed each of these issues and made detailed findings in a lengthy Appendix to its first two approval orders involving regional interstate statutes.[4/]

With respect to the Commerce Clause issue, the Board determined that absent the authorization of Congress in the Douglas Amendment of the Bank Holding Company Act, 12 U.S.C. 1842(d), the regional interstate statutes impose a burden of the type found by the courts to violate the Commerce Clause. The Board then considered the authorization by Congress in the Douglas Amendment and found that the Douglas Amendment does not appear on its face to show an intent by Congress to authorize

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2/ <u>SunTrust Banks, Inc./SunBanks, Inc,/Trust Company of Georgia</u>, 71 Fed. Res. Bull. 176 (January 8, 1985), approving the merger of second largest Florida bank holding company and the third largest bank holding company in Georgia.

3/ Citicorp, New York, New York, protested each application, and it has sought judicial review of each of the Board's approval orders. Northeast Bancorp, Stamford, Connecticut, challenged the first two Board orders.

4/ See the first two cases listed in note 1.

discriminatory restrictions of the type involved in regional interstate arrangements and that the provision's scant legislative history offered little guidance. Despite its doubts about the authorization of discriminatory state action in the Douglas Amendment, the Board decided it should hold state statutes authorizing interstate banking arrangements unconstitutional only upon clear and unequivocal evidence. Applying this test and based upon judicial guidance contained in Iowa Independent Bankers Association v. Board of Governors, 511 F.2d 1288 (D.C. Cir. 1975), the Board concluded that "while the issue is not free from doubt, there is no clear and unequivocal basis for a determination that [the Massachusetts and Connecticut statutes] are inconsistent with the Commerce Clause. . . ." Bank of New England Corporation, 70 Fed. Res. Bull. 374, 377 (1984); Hartford National Corporation, 70 Fed. Res. Bull. 353, 354 (1984).

The Board also found there was no basis to hold that the regional interstate statutes clearly and unequivocally violate the Compact Clause. The Board applied the standard ennunciated by the Supreme Court in United States Steel Corp. v. Multistate Tax Commission, 434 U.S. 452, 470 (1978), that an agreement among the states does not establish a compact in violation of the Compact Clause unless it enhances state power at the expense of federal supremacy. The Board read the Douglas Amendment as conferring on the states authority to regulate entry of out-of-state bank holding companies without impinging on the federal interest in such regulation as that concept has been articulated in the Supreme Court's Compact Clause cases.

Finally, the Board concluded the regional interstate statutes do not clearly and unequivocally violate the Equal Protection Clause. Under the traditional case law of the Supreme Court applicable at the time of the Board's decision, which upheld state economic legislation if it was rationally related to a legitimate state purpose, the Board found regional interstate statutes to be rationally related to legitimate state purposes in establishing a banking system responsive to local and regional needs, including responsiveness to local credit needs, avoiding undue concentration of banking resources and providing an opportunity for an experiment with limited interstate banking.

Each of the Board's approval orders has been challenged in the United States Court of Appeals for the Second Circuit. The Court of Appeals has stayed consummation of the interstate acquisitions and mergers on two occasions -- to allow the Court of Appeals to hear the case and, even after the Court of Appeals rendered its decision upholding the Connecticut and Massachusetts statutes as constitutional, to permit Supreme Court review. As a consequence of these stays by the Court of Appeals none of the interstate transactions approved in the Board's seven orders, including the de novo acquisitions, has been consummated.

The decision of the Court of Appeals,[5] filed August 1, 1984, upheld the constitutionality of the Connecticut and Massachusetts regional interstate statutes and affirmed the Board's approval orders. The Court found that the Douglas Amendment constituted a renunciation of federal interest in regulating the interstate acquisition of banks by bank holding companies. In deciding that the states have the authority to lift selectively the ban on interstate acquisitions of banks imposed by Congress in the Douglas Amendment and thereby to create interstate banking regions, the Court noted that nothing in the language or legislative history of the Douglas Amendment supports the contention that an individual state must permit acquisitions by all out-of-state bank holding companies if the state permits acquisitions by any.

The Supreme Court was requested to review the decision of the Court of Appeals, and in January 1985 the Supreme Court agreed to hear the case.[6] The State of New York, New York State Bankers Association and both United States Senators and certain members of the House of Representatives from New York filed briefs with the Court opposing regional interstate statutes as unconstitutional. The State of Massachusetts

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5/ Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System, 740 F. 2d. 203 (2d Cir. 1984).

6/ Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System, No. 84-363 (argued April 15, 1985).

joined with the bank holding companies of Massachusetts and Connecticut that were parties to the challenged acquisitions in filing briefs in support of the regional statutes. The case was argued before the Supreme Court on April 15, 1985.

The issues originally placed before the Court involved the Commerce Clause and Compact Clause of the Constitution, and centered, as they had before the Board and the Court of Appeals, on an interpretation of the Douglas Amendment and whether that Amendment provided an "unmistakably clear"[7/] authorization by Congress to permit the states to discriminate and burden commerce through regional interstate statutes.

The Supreme Court decision, with four justices dissenting, on March 26, 1985, in the case of Metropolitan Life Ins. Co. v. Ward, No. 83-1274, prompted the petitioning parties to raise an argument under the Equal Protection Clause not originally raised before the Supreme Court although, as noted above, it was raised before the Board. The Metropolitan decision held that state legislation that taxes out-of-state insurance companies at a higher rate than in-state companies in order to promote in-state business at the expense of out-of-state competitors was unconstitutionally

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7/ South-Central Timber Development v. Wunnicke 104 S.Ct. 2237, 2242 (1984) -- requiring that federal legislation authorizing a departure from normally applicable Commerce Clause standards must be "unmistakably clear" -- was decided after the Board issued its first interstate order but employing the standard used by the Board.

discriminatory. The Court held that this statute did not advance interests rationally related to legitimate state purposes under the Equal Protection Clause. This case thus raises a question as to whether regional interstate statutes which apply different rules to different groups of out-of-state banks, depending on geographic location, violate the Equal Protection Clause.

A decision by the Supreme Court that the regional statutes are unconstitutional on Commerce Clause or Compact Clause grounds could be remedied by an amendment to the Bank Holding Company Act showing the intent of Congress to permit regional interstate compacts, since the Congress has the authority to sanction by federal statute state laws burdening commerce or creating a compact. Congress does not appear to have the authority to sanction violations of the Equal Protection Clause should the Court decide that regional statutes are unconstitutional on that basis.

The past practice of the Court indicates that a decision is likely to be issued in June or July, 1985.