Research Department
Federal Reserve
Bank of
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Across State Lines

Traditionally, commercial banks in the United States have been able to operate banking offices within only one state—and in some states, they have been restricted to only one office within the state. There have been a few exceptions where banks have retained long-established branches in other states, but in most cases, state boundaries have marked the limit for branching.

Even so, this general prohibition has not prevented the development of some interstate banking activities. The largest banks operate nationally in lending and in limited competition for deposits. With the development of electronic payment systems and remote automatic tellers, the significance of formal prohibitions against the establishment of out-of-state offices will be reduced still more.

The few remaining unit-banking states are now facing growing pressures to allow branching or its equivalent, while other states (such as California and New York) are actively considering laws which would permit entry by out-of-state banking organizations on a reciprocal basis. The needs of business and the development of technology have created a particular form of interstate banking, so that the individual bank is no longer completely bound by state lines.

Nationwide services

Commercial banks compete in national markets in several different ways. Through the Federal Reserve System's wire transfer facilities, banks transfer funds and carry out transactions in Government securities. They buy and sell excess reserves in the Federal-funds market, which is now one of the key national money markets. The restriction on these markets is not distance, but the size of the transaction; for example, a typical minimum for Federal funds is $100,000.

In addition, large banks send the lending officers of their national divisions across the country seeking new customers, and they also establish representative offices in the major financial centers to develop local business. In both these cases, deposits and loans are carried on the books of a bank office located in the state in which the bank is incorporated. Yet, despite this legal requirement, the fact remains that the business was solicited in another state. Hence, for the nation's larger businesses, banking is not restricted by state boundaries, any more than are their other transactions.

Developments in marketing and in electronic technology also permit national-banking facilities to be offered to the ordinary consumer. Credit cards, through the system of national interchange of cards, already provide a form of interstate banking for consumer credit. Future developments could perhaps give consumers—through their plastic cards—direct access to their bank deposits via remote terminals or automatic tellers on a 24-hour basis.

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Many banks began to expand in related financial fields following the amendment of the Bank Holding Company Act in 1970. Although a commercial bank may be restricted by state boundaries in many activities, the parent holding company can serve as a vehicle to expand into other states by forming subsidiaries specializing in banking-related services. In particular, bank holding companies can operate consumer-finance companies, mortgage companies, leasing companies and other approved lines of business in more than one state. Consequently, commercial banks have available another indirect means of interstate operation that nominally would be closed to them.

International banking

Despite the formal barriers to branching, commercial banks are able under long-established Federal legislation (the Edge Act) to establish out-of-state banking subsidiaries to conduct international banking. Edge Act subsidiaries are permitted to make loans and accept deposits only if they result from international trade or finance. Still, they represent an important form of interstate banking competition, especially among the larger banks. These subsidiaries also provide indirect benefits for their parents because (like representative offices) they develop contacts which can stimulate domestic business—even though by law they are limited to the field of international business.

In addition, foreign banks (unlike U.S. banks) have been able to establish multi-state offices. Under existing laws, foreign banks can open branches in several states, assuming they gain the permission of the states concerned, because these offices operate under individual state charters and thus are covered by state rather than Federal banking laws. Foreign banks thus can maintain branches in New York or Illinois or Massachusetts, for example, and conduct a full-scale domestic banking business in each. They can also form banking subsidiaries with state charters. These subsidiaries have the same privileges as other state banks, but, unlike branches of the parent bank, they come under the Bank Holding Company Act which limits their formation to one state.

Foreign bank entry is permitted in only ten states—five of them in the Twelfth District—and in some cases banking powers are quite restricted. But foreign banks can operate in the several states (New York, California and Illinois) containing the nation's key financial markets, and thus they are able to lay the foundations for a larger interstate-bank network. Foreign banks control less than 2 percent of the nation's deposits, partly because of the limited number of states permitting such operations, but they are quite important in certain markets, and account for 14½ percent of all large-bank business loans. Moreover, their share is likely to grow, as other banks follow the example first set by U.S. banks overseas and try to develop similar business here.

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Legislative proposals

The Federal Reserve System is considering a legislative proposal which would bring all foreign banks under national, and not just state, jurisdiction. This proposed legislation would remove the existing interstate advantages enjoyed by foreign banks. The object is not to prevent interstate banking as such, but rather to establish the same ground rules for both foreign and domestic banks, and in the process bring foreign bank operations under Federal Reserve control for monetary policy purposes.

Foreign-bank branches and agencies in the U.S. would be treated as "banks," as their state-chartered subsidiaries already are, and hence would come under the provisions of the Bank Holding Company Act. All future foreign-banking operations would be limited to only one state, but foreign banks would have the option of establishing domestic-bank holding companies for conducting certain nonbanking operations. Nonbank subsidiaries engaged in permissible activities could, of course, operate nationally. Existing branches and agencies may be allowed to maintain their established operations under a "grandfather" clause.

The Bank Holding Company Act, which now forbids interstate banking formations, contains a provision whereby bank acquisitions across state lines would be allowed. Section 3(d) of the Act permits interstate acquisition of banks by holding companies if states give specific permission, and this would apply to domestic as well as foreign banking organizations. Enabling legislation has already been introduced in California and New York which would allow any out-of-state (including foreign) holding company to form or acquire a bank subsidiary with several offices, providing the other state grants reciprocal privileges. The prospect exists of California banks conducting a full-scale banking business in New York City, and vice versa, through holding company operations.

Such legislation would make the law match actual practice. Large banks now compete in wholesale banking nationwide, and the establishment of one or two offices in major out-of-state financial centers would ease the mechanical problems of competing for business. The direct effects on consumer lending would be less significant, because in the absence of branch networks, it is more difficult to build up a consumer-type business. Nevertheless, some competitive benefits would arise to reinforce the pressures building up through the various electronic-payment systems for the nationwide expansion of consumer lending. In international banking, the benefits for domestic banks of having affiliates on both coasts would be obvious. Foreign banks would be able to maintain existing opportunities to compete, while U.S. banks would be able to match their foreign counterparts in gaining broader access to a nationwide market.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 5/29/74	Change from 5/22/74	Change from year ago Dollar	Change from year ago Percent
Loans (gross) adjusted and investments*	82,890	+ 297	+9,314	+ 12.66
Loans gross adjusted—	64,524	+ 200	+8,476	+ 15.12
Securities loans	1,199	− 32	− 565	− 32.03
Commercial and industrial	22,924	− 55	+2,787	+ 13.84
Real estate	19,210	+ 37	+2,983	+ 18.38
Consumer instalment	9,259	+ 18	+ 917	+ 10.99
U.S. Treasury securities	5,232	+ 16	− 550	− 9.51
Other Securities	13,134	+ 81	+1,388	+ 11.82
Deposits (less cash items)—total*	78,540	+ 571	+7,569	+ 10.66
Demand deposits adjusted	21,363	+ 60	+ 936	+ 4.58
U.S. Government deposits	666	+ 200	+ 25	+ 3.90
Time deposits—total*	55,083	+ 86	+6,467	+ 13.30
Savings	17,848	− 26	− 351	− 1.93
Other time I.P.C.	27,304	+ 195	+7,106	+ 35.18
State and political subdivisions	7,325	− 22	− 325	− 4.25
(Large negotiable CD's)	14,175	+ 33	+4,869	+ 52.32

Weekly Averages of Daily Figures	Week ended 5/29/74	Week ended 5/22/74	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	30	34	46
Borrowings	415	258	439
Net free (+) / Net borrowed (−)	− 385	− 224	−393
Federal Funds—Seven Large Banks			
Interbank Federal funds transactions Net purchases (+) / Net sales (−)	+1,316	+1,213	+755
Transactions: U.S. securities dealers Net loans (+) / Net borrowings (−)	+ 287	+ 403	+294

*Includes items not shown separately.

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