Banking & Finance

AN EIGHTH DISTRICT PERSPECTIVE

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1985—The Year of Interstate Banking?

Only a few years ago, most bankers were decidedly opposed to the concept of interstate banking. Many analysts point out that despite this opposition, financial services have become available on a nationwide basis. As evidence they cite the national financial networks of some automobile companies, insurance firms, retailers and nonbanking financial institutions. Large banks have also been active in offering interstate financial services. It is estimated that domestic banking organizations today have over 7,000 interstate facilities such as loan production offices and mortgage lending centers. Recent evidence suggests that a growing number of smaller banks have joined the larger institutions to play an active role in the evolution toward wider interstate banking. Much of the debate among bankers as well as legislators now centers on finding the most appropriate banking strategy for achieving this end.

One option being studied widely is the development of regional banking pacts, which empower banks from states of a defined region to acquire or establish banks in other states within the region. One modification to this approach being considered by many state legislatures is a "trigger period" of a number of years after which banks of the region would be open to full nationwide banking. The main rationale for regional banking zones as an intermediate step toward nationwide banking is to permit the smaller regional banks to grow to a size that allows them to compete effectively with the larger money center banks.

In the coming year, legislatures in most Eighth District states will consider some form of regional interstate banking. This issue briefly examines the main arguments for and against interstate banking and provides a state-by-state synopsis of current legislative developments in the District.

Background of the Debate

The McFadden Act, passed in 1927 and amended in 1933, subjects the branching authority of nationally chartered banks to the banking laws of their resident state. With all state laws prohibiting interstate branching, both state- and national-chartered banks have been restricted to single-state branching. The 1956 Bank Holding Company Act eliminated another potential form of interstate banking by barring bank holding companies from acquiring banks in other states. The Douglas Amendment, however, provides one avenue around the act's interstate prohibitions. This amendment gives individual states the right to permit acquisitions of banks in that state by out-of-state companies. This amendment has been cited as justification for the formation of regional banking pacts. In January 1985, however, Citibank challenged the constitutionality of the regional banking zone established by the states of Connecticut and Massachusetts, alleging the pact to be a restriction of interstate commerce. A Supreme Court ruling, expected in early summer, is likely to influence future banking legislation considered by state legislatures.

The Debate

The controversy over wider geographic banking markets exists at a number of levels. Some bankers are opposed to bank expansion beyond county lines. Others can accept intrastate branching but fear banks from neighboring states. Still others propose regional banking pacts, but forbid entry by banks from certain states or from other regions. In each case, the primary argument against the expansion of each bank's offices beyond some arbitrary geographic limit is the allegation that banks from another area (the next county, the next state or New York City) would drain deposits from a local area and leave insufficient funds to meet local credit needs. Supporters of this view suggest this could occur if a non-local bank aggressively bid away deposits from local banks by offering higher interest rates, then used the deposits to fund loans in another area. The net impact would be a reduction in the local availability of loanable funds.

Advocates of interstate banking counter with the observation that many small banks are already very active in redistributing local funds to other regions through routine federal funds sales to larger banks. Banks lend surplus funds to other banks through the federal funds market, often on an overnight

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basis. For example, over the last six quarterly Call Reports, U.S. banks with less than $100 million in assets, on average were net sellers of $17 billion of funds (equivalent to nearly 5 percent of their deposits) to larger banks. Such sales may reflect a lack of local loan demand or the opportunity for higher returns in other regions. Regardless of the cause, the federal funds market functions as a vehicle for redistributing loanable funds from regions of excess supply to areas of excess loan demand.

Proponents of interstate banking point out that, while capital can indeed be drained out of an area, it can also be infused into an area if economically justifiable. Building on the same concepts behind the federal funds market, they argue that a banking organization with a wider geographic scope could more readily supply loanable funds to areas and industries that would use them most productively. The Farm Credit System, for example, functions as a vehicle whereby Wall Street investors provide funds for loans to farmers in rural areas across the country. In 1984, the Farm Credit System sold over $98 billion of debt instruments in major financial markets for this purpose. Thus, farmers and other rural businessmen do not rely solely on local deposits for loanable funds.

Another frequent argument is that interstate banking would lead to increased concentration, allowing the remaining banks to exercise monopoly-like power in dictating the terms of deposit and loan agreements. Such an anticompetitive result would allegedly occur if mergers and acquisitions sharply decreased the number of banks and limited the number of options for borrowers and savers.

States that have allowed statewide branching do not find this to be true. During a period of statewide branching in California, for example, the number of banking organizations increased from 209 in 1975 to 364 in 1982, while the share of deposits at the state's six largest banks fell. This trend has been noted in several other states as well. If small banking organizations have survived statewide banking in California, they also would be likely to survive in the competitive environment of nationwide interstate banking.

Legislation in the Eighth District

In spite of the preceding arguments and evidence, a survey of legislative proposals in Eighth District states suggests that the regional approach will serve as an intermediate step to full-scale nationwide banking. A summary of current proposals in Eighth District states follows.

Arkansas

A regional interstate banking bill has recently been introduced into a legislative committee. The bill calls for reciprocal banking privileges with all southeastern states ranging from Louisiana to Virginia and Washington D.C. The Arkansas Bankers' Association is neutral on the proposal, but the Arkansas Association of Bank Holding Companies has expressed support for the bill.

Illinois

The Illinois Bankers' Association will sponsor legislation to allow regional reciprocal banking with contiguous states. No trigger to full nationwide banking is included. Together with three farm groups, the Independent Community Banks of Illinois has formed the Illinois Coalition for Competitive Banking for the purpose of opposing interstate banking legislation.

Indiana

A bill for reciprocal banking with the four contiguous states recently has been introduced into committee with the support of the Indiana Bankers' Association, the Independent Bankers' Organization and the Indiana League for Economic Development. The bill contains no provisions for moving to full nationwide banking.

Kentucky

In July 1984, the state enacted a bill allowing reciprocal banking with contiguous states. The bill has a two-year trigger, after which the state would be open to banks from any state having reciprocal banking provisions.

Mississippi

No interstate banking legislation is expected in 1985.

Missouri

A minimum of four different interstate banking bills will be introduced in the 1985 state legislature. Three of the four endorse the contiguous state branching concept. Two of these three would set trigger dates for expanding to nationwide banking. The Missouri Bankers' Association plan includes an expansion of bank powers, but does not call for a trigger date. One of the regional bills includes a provision to allow banks from any state to enter immediately on a *de novo* basis if their entry would cause them to pay a yet-to-be-determined amount in state taxes. This provision essentially would allow banks outside of the contiguous state region to "buy their way into the state" ahead of the trigger date. This bill tentatively includes provisions requiring an out-of-region bank to demonstrate how its entry would benefit the state. The fourth bill calls for the immediate adoption of full nationwide banking. The Missouri Independent Bankers' Association opposes any form of interstate banking.

Tennessee

An interstate banking bill supported by the governor and the Tennessee Bankers' Association will be proposed. The bill would allow interstate banking with the eight states contiguous to Tennessee plus West Virginia, South Carolina, Louisiana, Indiana and Florida. The Independent Bankers' division of the TBA has taken a stand opposing the measure.

—Kenneth C. Carraro

EIGHTH DISTRICT BANKING DATA
(dollar amounts in millions)

Small Weekly Reporting Banks[1]

REGION I
(eastern Missouri and southern Illinois)

Selected Assets	Nov 1984	Dec 1984	Jan 1985	Percent Change Jan - Dec 84
U.S. Treasury and Government Agency Securities	$ 659	$ 672	$ 654	14.1%
Other Securities	180	178	181	-20.2
Federal Funds Sold	126	143	112	-12.8
Total Loans and Leases-Gross	1,499	1,499	1,496	12.9
Secured by Real Estate	660	655	646	12.2
Commerical and Industrial	463	455	466	13.2
To individuals	256	271	271	22.1
Selected Liabilities				
Total Deposits	2,407	2,433	2,398	7.1

REGION II
(Arkansas, northern Mississippi, western Tennessee)

Selected Assets	Nov 1984	Dec 1984	Jan 1985	Percent Change Jan - Dec 84
U.S. Treasury and Government Agency Securities	$ 358	$ 360	$ 362	5.9%
Other Securities	198	201	203	-11.5
Federal Funds Sold	49	57	55	-5.0
Total Loans and Leases-Gross	1,403	1,410	1,405	8.0
Secured by Real Estate	510	512	512	30.9
Commercial and Industrial	539	544	543	0.9
To individuals	269	270	272	22.2
Selected Liabilities				
Total Deposits	1,938	1,965	1,987	2.7

REGION III
(western Kentucky and southern Indiana)

Selected Assets	Nov 1984	Dec 1984	Jan 1985	Percent-Change Jan - Dec 84
U.S. Treasury and Government Agency Securities	$ 486	$ 474	$ 462	-0.4%
Other Securities	229	233	239	-0.9
Federal Funds Sold	149	168	162	-18.8
Total Loans and Leases-Gross	1,155	1,177	1,177	16.2
Secured by Real Estate	439	444	446	12.7
Commercial and Industrial	343	356	351	12.7
To individuals	281	283	284	19.4
Selected Liabilities				
Total Deposits	1,926	1,933	1,947	4.5

[1]A sample of commercial banks with total assets less than $300 million.

EIGHTH DISTRICT BANKING DATA

(dollar amounts in millions)

Large Weekly Reporting Banks[2]

Selected Assets	Nov 1984	Dec 1984	Jan 1985	Percent Change Jan - Dec 84
Total Loans	$13,369	$13,633	$13,917	12.9%
Secured by Real Estate	2,852	2,864	2,952	11.7
To Financial Institutions	1,054	1,134	1,074	21.8
Agricultural	130	129	134	21.7
Commercial and Industrial	5,122	5,164	5,171	12.4
To Individuals	2,681	2,742	2,808	11.0
All Others	1,530	1,600	1,778	13.4
Total Investments	3,226	3,241	3,287	−2.1
U.S. Treasury and Government Agency Securities maturing in:				
1 year or less	806	842	966	23.5
1 through 5 years	664	611	563	−38.7
over 5 years	423	421	377	4.1
Securities of State and Political Subdivisions	1,332	1,367	1,380	10.7
Selected Liabilities				
Total Deposits	$16,915	$17,309	$17,263	7.0%
Demand Deposits	5,085	5,245	5,177	−2.8
Other Transaction Balances[3]	1,275	1,326	1,388	5.4
Total Non-transaction balances	10,558	10,740	10,699	12.7
MMDAs	2,021	2,066	2,119	9.4
Time Deposits of $100,000 or more	3,677	3,818	3,734	17.0

Selected Eighth District Interest Rates[4]

	Nov 1984	Dec 1984	Jan 1985	Year Ago Jan 1984
Super NOW Accounts	7.16%	6.86%	6.68%	7.32%
Money Market Accounts	8.21	7.75	7.54	8.25
Time certificates and time deposits less than $100,000:				
92 through 182 days	8.98	8.49	8.28	9.13
over 1 year but less than 2½ years	9.63	9.27	9.19	9.68
2½ years and over	9.87	9.50	9.41	9.73

[2]Large banks are those with total assets greater than $750 million. Historical data have been revised to incorporate adjustment factors that offset the cumulative effects of mergers and other changes involving weekly reporting banks during 1984. These adjustment factors, which are computed each year, are used to construct consistent time series for which year-to-year growth rates can be calculated. Adjustment factors are available upon request from the Statistics Section of the Research and Public Information Department.

[3]Includes NOW, Super NOW, ATS and accounts permitting telephone or pre-authorized transfers.

[4]Average interest rates paid on new deposits by a sample of large and small commercial banks.