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What Happened to the Dual Banking System

-Historical Meaning of Interstate Banking and Branching Reform in the United States (2) -

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CONTENTS (I-III is in Vol. 2, No.2 of this journal)

IV. The Dual Banking System: Historical Development and post-WWII Changes

As discussed in the first part of this article, under the United States dual banking system, both the federal and state governments held rights for chartering, supervision and examination of commercial banks. The dual system often resulted in a competitive, rather than cooperative federalism, which is found in many areas. Banks, for example, might select a particular jurisdiction that would regulate and supervise them, which allowed small unit banks with unsound management to prosper during favorable economic condition and often caused banking crises.

Proponents of the dual system stressed that the dual banking system reduced the possibility of over regulation, but opponents argued that it created competition to relax restrictions between national and state governments.

After the Great Depression, the Banking Act of 1935 established the Federal Deposit Insurance Corporation (FDIC) as a permanent federal agency and made federal control over state-chartered banks dramatically tighter. Also, new regulation for commercial banks added complications to bank supervision, though the federal government had pursued strengthening the banking system by integrating the state and federal bodies.

Table 4. U.S. Commercial Banks by Charter and FRS Membership

Year As of 30-June	Commercial Banks Total	National Charter	% of Total	State Charter Member	% of Total	State Charter Non-member	% of Total	Non-insured among Non-member
1915	27,390	7,597	27.7%	17	0.1%	19,776	72.2%	
1920	30,291	8,024	26.5%	1,374	4.5%	20,893	69.0%	
1925	28,442	8,066	28.4%	1,472	5.2%	18,904	66.5%	
1930	23,677	7,247	30.6%	1,066	4.5%	15,364	64.9%	
1935	15,488	5,425	35.0%	985	6.4%	9,078	58.6%	1,225
1940	14,534	5,164	35.5%	1,234	8.5%	8,136	56.0%	956
1945	14,126	5,015	35.5%	1,822	12.9%	7,289	51.6%	905
1950	14,146	4,971	35.1%	1,911	13.5%	7,264	51.4%	741
1955	13,772	4,753	34.5%	1,846	13.4%	7,173	52.1%	535
1960	13,147	4,542	34.5%	1,672	12.7%	6,933	52.7%	400
1965	13,534	4,803	35.5%	1,430	10.6%	7,301	53.9%	319
1970	13,487	4,638	34.4%	1,166	8.6%	7,683	57.0%	231

Source: U.S. Department of Commerce (1975), pp.1023&1034-35.

Original FDIC legislation required all participating banks to become members of the Federal Reserve System within two years,[1] though the requirement was rescinded in 1939.[2] This resulted in the number of the state-chartered non-member banks surpassing the total number of other commercial banks, yet only a fraction of the banks were non-insured (see Table 4).

The New Deal banking reform ended the era of competition in relaxing chartering policies and bank supervision between national and state governments to attract banks to either jurisdiction. As shown in Figure 3, there were scant new charters for national banks and state member banks between 1935 and 1961. There was less incentive for the federal authorities to integrate many banks into the National Banking System to restore the United States' banking system in this period. For over-banking was still thought to be a significant reason for the avalanche of bank failures.

The Banking Act of 1933 eliminated the $25,000 minimum capital provision[3] and raised it to $50,000, which is what the state banking authorities gradually did, too.[4] The large number of bank failures in the 1930s had eventually forced the banking authorities to end the history of competition in relaxing control over banks between national and state governments.

The federal government ultimately changed the dual banking system not by integrating the banking authorities, but through sharing and overlapping supervisory responsibilities among these supervisors. The Banking Act of 1935 gave federal authorities permanent discretionary authority over bank charters.[5] And to strengthen the capital structure of newly established national banks, the Act required that surplus equal to 20 percent of capital be paid in before a new bank may commence business.[6] Further, an applicant agency also had to meet certain criteria when it applying for Federal Deposit Insurance: adequate capital, good earnings prospects, qualified management and a demonstrated ability to serve the community.[7]

The federal chartering authority, the Comptroller of the Currency, was somehow reluctant to form new banks and consequently, from 1935 to 1961, the average number of

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1 FDIC (1998), p.28.
2 Ibid, p.36.
3 Revised Statute, Sec.5138, 12 U.S.C.A. Sec.51.
4 Bailey (1964) various pages.
5 Robertson (1968), p.128.
6 P.L. 74- 305, Sec. 309 (Title III, Section 309 of the Banking Act of 1935)
7 FDIC (1998), p.37.

new banks annually chartered by the Comptroller of the Currency was 13.7, compared to the average 46.8 banks that the state banking authorities chartered. Among the state new charters during this period, an annual average of only 4.6 banks were members of the Federal Reserve System.[8] If we study the conversion of one banking system to another, between 1950 and 1961, the number of annual average conversion of state banks to national banks was 6.9, compared to 3.6 for the converse. Though the state charter was preferred as an initial one, more existing banks converted from the state charter to the federal than to the reverse in this period.

The trend began to change from 1962 to 1965 (see Figure 3), where the average number of annual new charters for national banks was 128.5, compared to 123.8 for state banks. Also during this period, the average annual number of conversions from state to national banks was 23.5, compared to 8.0 for the converse.[9] The banks felt the national system was more favorable. Indeed, the trend did not continue for long and, the state system's advantage again overwhelmed the national system.

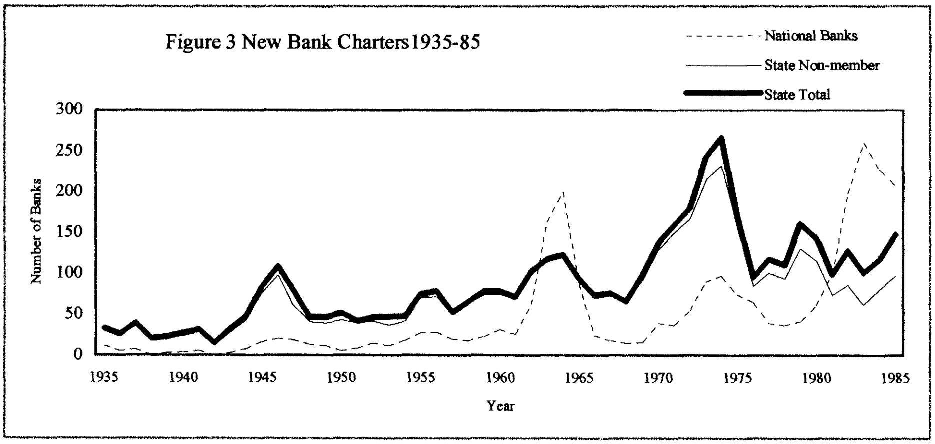

Figure 3 New Bank Charters1935-85

Source: FDIC, *Annual Reports*, 1935-1986.

Looking at FDIC control over banks, on the other hand, more than 90 percent of commercial banks were insured at the program's inception, and by 1955, the number of non-insured banks dropped to less than five percent (see Table 4). Since having federal deposit insurance meant to be regulated and examined by the FDIC, federal control over

[8] FDIC, *Annual Reports*, 1935-1962.
[9] Scott (1979), p.25.

new and existing banks, was, in a sense, completed without state banks having permission to switch to national charters.

Non-member banks, however, increased from 51.6 percent of all commercial banks in 1945 to 57.0 percent by 1970 and to 60.6 percent by 2000.[10] Nevertheless, the Federal Reserve had become the most relevant federal regulator over bank holding companies after the passage of the Bank Holding Company Act (BHCA) of 1956 and its amendment in 1970. The BHCA provided that all bank holding companies register with the Federal Reserve Board. The late 1960s and early 1970s saw the amount of bank holding companies and their assets increase rapidly, with the most important banks in the United States being turned into subsidiaries of bank holding companies.[11] Moreover, the Depository Institutions Deregulation and Monetary Control Act of 1980 phased in uniform reserve requirements for all depository institutions, regardless of chartering agency, and thus, an important motive for choosing state charters eliminated. Consequently, the number of new national charters again began to increase (see Figure 3).

In this way, state and federal competition under the dual banking system changed significantly. By allowing the majority of the commercial banks to elect state charters, federal control had been achieved over almost all commercial banks through deposit insurance and bank holding company regulations. Federal bank regulation, however, was still under the thumb of three separate authorities, which became even more complex by the Financial Institutions Reform, Recovery and Enforcement Act of 1989(FIRREA), which invited savings and loan associations into the FDIC program and established the Office of Thrift Supervision (see Table 5).

The Federal Financial Institutions Examination Council (FFIEC),[12] which was a step toward further coordination, was established March 10, 1979, pursuant to the Financial Institutions Regulatory and Interest Rate Control Act of 1978 and in 1989, the FIRREA established the Appraisal Subcommittee within the Examination Council. The FFIEC consists of representatives from three federal banking authorities, the FRB, FDIC, and OCC, as well as the Office of Thrift Supervision and the National Credit Union Administration. The president of the American Bankers Association once warned that

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[10] FRS, *Annual Reports*, 2000.
[11] FRS, *Federal Reserve Bulletin*, December 1956-1975.
[12] See http://www.ffiec.gov/about.html.

consolidation of these federal agencies into a "super-agency" would bring about a concentration and centralization of financial power unparalleled in the financial history of the United States.[13] Though the supervisory role of states had been gradually on the wane, the jurisdictional tangle of federal agencies on bank supervision had not been lessened. Eventually, all attempts to reforming the banking system resulted in preserving the system's duality, if not the same as it once were (see Table 5).

Table 5. The Dual Banking System of Regulation in the United States.

as of June 30, 2000

Regulatory Agency	Banks (Financial Institutions)	Number	Assets (billions ofdollar)
Comptroller of the Currency (Treasury Dept.) : Supervises and examines national banks that are chartered by the OCC. The Comptroller must approve any merger or acquisition involving national banks and declare a national bank insolvent before its assets can be purchased or liquidated.	National banks	2,413	2,818
Federal Reserve Board : Supervises member banks of the FRS, but usually examines only state chartered banks that have elected to join the FRS. The formation and the acquisitions of bank holding companies must be approved by the Federal Reserve Board, which also monitors and enforces federal law against all foreign banks oprating inside the United States and the foreign ventures of American banks.	State chartered Federal Reserve members	1,000	958
Federal Deposit Insurance Corporation (BIF insured) : Supervises all federally insured banks that have qualified for FDIC insurance coverage of their deposits, but usually examines only state-chartered banks not members of the Federal Reserve System. The FDIC prepares standards for the prudent management of all federally insured banks in an effort to protect federal insurance reserves.	National banks	2,413	2,818
	State chartered Federal Reserve members	1,000	958
	State chartered non-members	5,188	902
	Savings Banks - Mutual and Stock	465	270
State Banking Authorities : State banking boards or commissions supervise and examine all banks chartered by the state where each bank is headquartered and may reserve the power to approve or disapprove of any mergers or acquisitions involving state-chartered banks. When a state bank fails, it must be declared insolvent by the state's banking board or commission and may then be turned over to the FDIC acting as receiver for the disposition of the failed bank's assets and deposits.	State charter Federal Reserve members	1,000	985
	State chartered non-members FDIC insured	5,188	902
FDIC, OTS, and/or State Banking Depts. (SAIF insured)	S&Ls and Savings Banks	1,572	1,117

Source: FDIC, *Statistics on Banking*, 2000. Rose(1997) p.26.

V. Historical Development of Branch Banking and the Impact of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994

[13] A. A. Milligan, ABA president, 23 August 1978 testimony before Senate Committee on Governmental Affairs and Committee on Banking joint hearings on *Consolidated Banking Regulation Act of 1978*, 95th Cong., 2d Sess. (Washington, D.C. Government Printing Office, 1978), 66

A BRIEF HISTORY OF BRANCH BANKING

States during the nineteenth century began to put restrictions on branch banking to prevent unscrupulous bankers from choosing inaccessible office sites, which would deter customers from redeeming circulating banknotes.[14] The political advocates of avoiding an excessive concentration of financial power also supported this restriction. One could also say that restrictions on branching, especially on interstate branching, were intended to protect small, local banks from competition with out-of-state banks and that the public did not, as a rule, trust large banks. Led by the State of California in 1909, the number of state laws on branch banking increased. By 1922, 22 states specifically authorized branch banking, and by 1940, 35 states and the District of Columbia passed legislation allowing branch banking.[15]

For more than a half-century, the National Bank Act had been interpreted to prohibit national banks, with very limited exception, from having branches. But by 1918, the federal government allowed state banks, even though they had branches, to convert to national system or join the Federal Reserve System. But under this system, no new branches could be established.[16] Then, in 1922, by its interpretation of United States general law, the Comptroller of the Currency permitted national banks to establish additional limited-service offices (branches), within their head-office cities where state banks were permitted to run branch offices by a concerned state authority.[17]

The McFadden Act of 1927 allowed national banks to have the same rights as the sate-chartered banks had, that is, to establish branches within cities where their head offices operated. This had a significant impact on the history of the dual banking system because it explicitly gave states the authority to regulate national bank' branching powers, and in effect, essentially blocked national banks from establishing an interstate branches, since no states allowed to do so for state banks, as well.

The Banking Acts of 1933 and 1935 amended the Federal Reserve Act and allowed national and state member banks to establish statewide branches if state laws permitted state banks to do the same. As a result, national banks could set up new branches with

[14] Kane (1996), p.142.
[15] OCC, *Annual Report*, 1922 & 1940.
[16] An Act To provide for the consolidation of national banking associations, c.209, 40 Stat. 1043.
[17] OCC, *Annual Report*, 1922. FRS (1941), p.116.

nearly the same freedom as state banks.

In an effort to control national bank's foreign branches, the Federal Reserve Act of 1913 authorized national banks at least $1,000,000 in capital and surplus to open branches to overseas. In 1916, legislation allowed national banks to invest up to ten percent of their capital and surplus in foreign banking subsidiaries, which were regulated by the Federal Reserve Board.

BANK HOLDING COMPANY ACT OF 1956 AND BHC INTERSTATE BRANCHING ACTIVITIES

Bank Holding Companies (BHCs) were new corporate entities that began forming during the first decade of the 20th Century.[18] BHCs owned or controlled directly or indirectly one or more banks, and the two general BHC types were the multi-bank (MBHC) and the one-bank holding company (OBHC). BHCs were developed by expansion-minded bankers to avoid regulatory restrictions on branching and to take advantage of existing tax loopholes. National banks also used MBHCs to acquire other banks and to evade geographic restrictions on branch banking. BHCs regulation at the federal level was initiated by passage of the Clayton Act in 1914.[19] Given that BHCs were established primarily in states that prohibited branch banking, one could surmise that the McFadden Act's branch banking restrictions spawned the creation of BHCs.

The Bank Holding Company Act of 1956[20] was the first comprehensive regulatory statute in the United States that embodied the result of nearly two decades of public discussion. It was also the fruit of studies on the principal issues involved in the design of regulatory legislation for this form of banking organization and control. The Bank Holding Company Act of 1956 was established with three objectives: 1) to define a bank holding company in terms that cover all such companies that need to be regulated,[21] 2) to control holding company expansion within limits that back public interest,[22] and 3) to require divestment of non-banking interests to avoid certain hazards that could

[18] Actually, the first use of the holding company was in a few years before 1900. One of the first-known applications to banking was the Adam Hannah Company in Minnesota in 1900. (Lamb (1961) p.81)
[19] The Banking Act of 1933 also furnished the federal government with the provision of supervisory power over bank holding companies but the power itself was very restricted. (Jessee and Seelig (1977), p. 8)
[20] Section 1 of the Act of May 9, 1956 (Pub. L. No. 511; 70 Stat. 133), effective May 9, 1956.
[21] Section 2(a) of PL 511-70 Stat. 133
[22] Section 3(a) of PL 511-70 Stat. 133

accompany mixed ownership.[23]

The act required any company owning a bank to register as a bank holding company with the Federal Reserve Board, giving the Board primary responsibility for supervising and regulating MBHCs.[24] The act also legislated that a BHC operating in one state may not acquire a bank in a different state unless that state's law expressly authorizes the acquisition.[25] As a result, twelve existing interstate holding companies were grandfathered.[26]

The Douglas Amendment to the 1956 Act[27] (adopted in the 1960s) prohibited banking companies from acquiring banks in more than one state, although Congress allowed the states to decide for themselves whether or not to allow interstate banking. This provision effectively stopped the interstate banking movement, because no states permitted out-of-state acquisitions.

The BHC Act of 1956 definition of a holding company as "an organization with two or more banks," created an opportunity for launch of one-bank holding companies. At this point, banks gave birth to their parent organizations and merged companies offering various financial services that mortgage and finance companies did. Because they did not own two or more banks, but one, OBHCs could circumvent restrictions ruled by the Act. Confronted by this, Congress passed the Bank Holding Company Act of 1970[28] and closed the loophole by revising the Act to cover one-bank holding companies under the law, as well.

The government, however, could not stop banks from further attempts to expand their businesses across state lines. Later, banks found yet another loophole, this time, in the Act of 1970, that defined a bank as an institution accepting demand deposits and making commercial loans. As a result, bankers began to develop "non-bank" banks, for example, institutions that accepted only deposits. Certainly, the bank holding company movement made a profound change in banking industry organization. By 1976, 26 percent of all banks were owned by holding companies, which controlled half of all bank offices and two-thirds of all bank deposits.[29]

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[23] Section 4(c) of PL 511-70 Stat. 133
[24] Section 5(a) & 5(b) of PL 511-70 Stat. 133
[25] Section 3(d) of PL 511-70 Stat. 133
[26] Section 2(a) & 2(c) of PL 511-70 Stat. 133
[27] Section 3(d) of PL 511-70 Stat. 133.12 USC Sec. 1843 (d).
[28] 1970 Amendments to the Bank Holding Company Act of 1956 - P.L. 91-607.
[29] White (2000), p.780.

STATE RESTRICTIONS ON BRANCH BANKING

Table 6 shows that in 1910, only ten states permitted statewide and limited branching (BL plus S) and that eleven states restricted to unit banking (U). At the point,

Table 6. State Interstate Banking Laws Slected Years

	1910	1961	1979	Year Intrastate Branching Deregulated	Year Interstate Branching Deregulated
Alabama	NBL	BL	BL	1981	1987
Alaska	NYS	S	S	Before 1970	1982
Arizona	NYS	S	S	Before 1970	1986
Arkansas	NBL	U	BL	1994	1989
California	S	S	S	Before 1970	1987
Colorado	U	U	U	1991	1988
Connecticut	U	S	S	1980	1983
Delaware	S	S	S	Before 1970	1988
Florida	S	U	BL	1988	1985
Georgia	S	BL	BL	1983	1985
Hawaii	NYS	S	S	1986	-
Idaho	NBL	S	S	Before 1970	1985
Illinois	NBL	U	U	1988	1986
Indiana	NBL	BL	BL	1989	1986
Iowa	NYS	U	BL	-	1991
Kansas	NBL	U	U	1987	1992
Kentucky	NBL	BL	BL	1990	1984
Louisiana	BL	BL	BL	1988	1987
Maine	U	S	S	1975	1978
Maryland	NYS	S	S	Before 1970	1985
Massachusetts	U	BL	BL	1984	1983
Michigan	NBL	U	U	1987	1986
Minnesota	NBL	U	U	1993	1986
Mississippi	U	BL	BL	1986	1988
Missouri	U	U	U	1990	1986
Montana	NBL	BL	U	1990	1993
Nebraska	NBL	U	U	1985	1990
Nevada	U	S	S	Before 1970	1985
New Hampshire	NBL	NBL	NBL	1987	1987
New Jersey	NBL	BL	S	1977	1986
New Mexico	NYS	BL	BL	1997	1989
New York	BL	BL	S	1976	1982
North Carolina	NBL	S	S	Before 1970	1985
North Dakota	NBL	U	U	1987	1991
Ohio	NBL	BL	BL	1979	1985
Oklahoma	NBL	U	U	1988	1987
Oregon	S	S	S	1985	1986
Pennsylvania	U	BL	BL	1982	1986
Rohde Island	S	S	S	Before 1970	1984
South Carolina	NBL	S	S	Before 1970	1986
South Dakota	NBL	S	S	Before 1970	1983
Tennessee	S	BL	BL	1985	1985
Texas	U	U	U	1988	1987
Utah	NBL	S	S	1981	1984
Vermont	NBL	S	S	1970	1988
Virginia	NBL	BL	S	1978	1985
Washington	S	S	S	1985	1987
West Virginia	U	U	U	1987	1988
Wisconsin	U	U	BL	1990	1987
Wyoming	NBL	NBL	U	1988	1987

Key: U: Unit banking (branching prohibited); **BL**: Branching limited geographically within state; S: Statewide branching
NBL: No branching law; **NYS**: Not state yet.

Source:Savage (1993); Amel (1993); FDIC, *Banking Review* , verious issues.

22 states did not yet have laws concerning branching (NBL). In 1961, eighteen states permitted statewide branching (S), but the number of states prohibiting branches had risen to fifteen (U). In early 1970s, no states permitted interstate banking, except for a dozen bank branches and banking companies grandfathered by the McFadden-Pepper and Glass-Steagall Acts and by the bank Holding Company Act and its subsequent amendment. Besides these exceptions, bank holding companies started interstate financial services by using non-bank firms whose services did not consist of accepting deposits or making direct loans.

In 1975, Maine was the first state to allow any out-of-state holding companies to enter the state and purchase existing banks or to set up new banking affiliates, provided reciprocal privileges were extended to Maine-based bank holding companies.[30] This new permissibility was enacted to attract new capital to develop the state and to create more jobs for residents.[31] In 1979, the number of states permitting statewide branching rose to 21 and branch banking became the new trend, though thirteen states still allowed only unit banking. In 1982, New York, Alaska, and Massachusetts joined the interstate-banking movement on a reciprocal basis, and in 1983, Connecticut and South Dakota followed suit.

By 1986, more than half the states in the United States deregulated interstate branching, and by 1993, all states (with the exception of Hawaii) enacted interstate banking statutes. Conditions for allowing out-of-state entry, however, varied from state to state. The dominant trend of state legislation had been to ease restrictions on branching, which lawmakers had long thought to be indispensable for protecting small unit banks in their states. Consequently, "super-regionals," not money-center banks, took the lead in interstate banking. It looked that fear of concentrated bank power, which had been deeply rooted in American history, seemed to be gradually easing.

Table 7 shows state interstate banking laws as of June 1, 1993. By this time, 21 states allowed nationwide interstate banking with a reciprocal basis and 12 states also nationwide non-reciprocity. Sixteen states allowed regional interstate banking with a reciprocal basis and one state allowed under special conditions. And 17 states set percentage limits on the share of total deposits that out side banking organization held.

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[30] Rose (1997), p. 35.
[31] Ibid.

One could say that most states already allowed interstate banking to some extent by their own laws before Riegle-Neal Act.

Table 6. State Interstate Banking Laws (as of June 1, 1993)

Types of Laws					
National reciprocity: Entry from any other states allowed if reciprocal permission to enter is granted to banks headquartered in the state entered	**National, no reciprocity**: Entry from any other state allowed without a requirment that reciprocal entry privileges be granted to banks in the state entered	**Regional reciprocity**: Entry from any state in the same region allowed if reciprocity is granted to banks headquartered in the state entered	**Special condition**: Entry from other states allowed under special circumstances (2).	**Prohibited**: Entry from out of state still not permitted	**Percentage limits**: States limiting the share of total deposits that outside banking organizations can hold (limit in percent of total bank or total bank and thrift deposits statewide that can be held by interstate banking organizations is shown in paretheses) (1)
California	Alaska	Alabama	**Oklahoma**	Hawaii	**Arkansas (25%)**
Connecticut	Arizona	**Arkansas**			**Colorado (25%)**
Delaware	**Colorado**	District of Columbia			**Iowa (10%)**
Illinois	Idaho	Florida (3)			**Kansas (12%)**
Indiana	Maine	Georgia			**Kentucky (15%)**
Kentucky	Nebada	**Iowa**			**Massachusetts (15%)**
Louisiana	**New Hampshire**	**Kansas**			**Minnesota (30%)**
Massachusetts	New Mexico	Maryland			**Mississippi (19%)**
Michigan	Oregon	**Minnesota**			**Montana (18%)**
Nebraska	**Texas**	**Mississippi**			**Nebraska (14%)**
New Jersey	Utah	Missouri			**New Hampshire (20%)**
New York	Wyoming	**Montana**			**North Dakota (19%)**
North Dakota		North Carolina			**Ohio (20%)**
Ohio		South Carolina			**Oklahoma (11%)**
Pennsylvania		Virginia			**Tennessee (16.5%)**
Rohde Island		Wisconsin			**Texas (25%)**
South Dakota					**West Virginia (20%)**
Tennessee					
Vermont					
Washington					
West Virginia					

Note: (1) All states listed in this column include total statewide bank deposits in figuring the maximum share of deposits that an interstate acquirer is allowed to hold. Certain states (Colorado, Iowa, Kentucky, Minesota, Mississippi, Montana, Nebraska, New Hampshire, North Dakota, Ohio, Oklahoma, Tennessee and West Virginia) also include thrift depsoits. A few of the states including the same states above also inculde credit union deposits in the permissible statewide share.

(2) National entry from states offering reciprocal entry privileges or the entering organization must wait four years to expand its share.

(3) Florida has recently passed a nationwide banking bill.

**States in bold letters are with percentage limits

Sources: Fiancial Structure Section of the Board fo Governors of the Federal Reserve System, Savage (1993), Rose (1997)

THE RIEGLE-NEAL INTERSTATE BANKING AND BRANCHING EFFICIENCY ACT OF 1994

The Riegle-Neal Interstate Banking and Branching Efficiency Act of September 29, 1994[32] set the country on the road to full interstate banking. The act established five categories of interstate banking and branching activity: interstate acquisitions by BHCs, interstate bank mergers, *de novo* interstate bank branching, interstate affiliate banking, and foreign bank interstate branching.

·Interstate Acquisitions

Under the Riegle-Neal Act, the ability of firms to acquire banks across state lines is restricted to "adequately capitalized" and "well-managed" bank holding companies. Within a year of the law's enactment, companies could own a bank anywhere in the U.S., so long as they had Federal Reserve Board approval. This law trumped any existing state law and prohibited states from discriminating against out-of-state firms.

The Act imposed three conditions on interstate acquisitions:[33] 1) by statute, states can protect new banks from acquisition by out-of-state firms for a specified minimum period of time, not to exceed five years;[34] 2) the applicant BHC must not control or control, as a result of the acquisition, more than ten percent of the nationwide insured deposits;[35] and 3) no BHC can acquire another banking firm in a different state if the resulting institution controls at least 30 percent of the insured deposits held in the state involved.[36]

States, however, may waive or alter the third limitation above if so desired. In addition, the market share provisions could be waived with approval from the appropriate regulator under a variety of conditions intended to protect depositors or the banking system.[37] Moreover, the Federal Reserve Board must take into account the applicant's record of meeting the credit needs of its entire community, under federal Community Reinvestment Act (CRA) rules and must consider the applicant's record of compliance with applicable state community reinvestment laws.[38]

As previously noted, before the Riegle-Neal Act, the Douglas Amendment to the Bank Holding Company Act of 1956 prohibited BHCs from expanding across state borders, except when specifically authorized by the states involved in the expansion.[39] Under the BHC Act, states where BHCs were allowed to own banks had been determined solely by

[32] See Table 8.
[33] P.L. 103-328 Sec. 101(a)
[34] P.L. 103-328 Sec. 101(a) '(d) '(1) '(B) PRESEVATION OF STATE AGE LAWS-
[35] P.L. 103-328 Sec. 101(a) '(d) '(2) '(A) NATIONWIDE CONCENTRATION LIMITS
[36] P.L. 103-328 Sec. 101(a) '(d) '(2) '(B) STATEWIDE CONCENTRATION LIMITS OTHER THAN WITH RESPECT TO INITIAL ENTRIES-
[37] P.L. 103-328 Sec. 101(a) '(d) '(2) '(D) EXCEPTIONS TO SUBPARAGRAPH (B)
[38] P.L. 103-328 Sec. 101(a) '(d) '(3) COMMUNITY REINVESTMENT COMPLIANCE
[39] 12 USC section 1842(d).

Table 8. Essential Contents and Summary of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994

Title I-INTERSTATE BANKING AND BRANCHING

Sec. 101 Interstate banking

(a) Section 3(d) of the Bank Holding Company Act of 1956 is amended

-Bank holding companies that are adequately capitalized and managed can acquire a bank anywhere in the United State one year after this law is enacted. However, no banking firm can acquire another banking firm in a different state if the resulting institution controls at least 30 percent of the insured deposits held in the state involved (though a state may waive or alter this limitation if it wishes) or as much as 10 percent of nationwide insured deposits. The states can protect new banks from acquisition by out-of-state firms for up to five years.

Sec. 102 Interstate bank mergers

-Interstate bank holding companies that are adequately capitalized and managed may consolidated their affiliated banks acquired across state lines into branch offices via merger as early as June 1, 1997, unless the states act to outlaw interstate branching activity. An individual state may enact laws permitting interstate branching prior to June 1, 1997, and a host state that contains a branch office of an out-of-state bank can examine and take enforcement action against that branch office.

-If a state elects to prohibit interstate branching, banks headquartered in that state may not engage in interstate mergers.

Sec. 103. State 'opt-in' election to permit interstate branching through de novo branches

-A federally insured bank can branch *de novo* into a state where it has no existing office but only if state law expressly permits *de novo* entry via branching. States can tax branches of out-of-state banks as if they were full-service banks operating in that state.

Sec. 104. Branching by foreign banks

-Foreign-based banks may branch inside the United States on the same basis as domestic banks and are subject to review for their compliance with the CRA if they merge with domestic banks subject to the CRA. Foreign banks without U.S, deposit-taking offices must select a home state or, failing to do so, the Federal Reserve Board will designate their home state for purposes of regulation. National banks are subject to state law in the areas of community support, consumer protection, fair lending and interstate branching.

Sec. 105. Coordination of examination authority

-For those states involved in the interstate banking system, their regulatory agencies will be permitted to set up cooperative agreements to supervise multi-state depository institutions.

Sec. 106. Branch closures

-Federal banking agencies must consult with community organizations before closing a branch office owned by an interstate banking company if the branch is located in a low- or moderate-income area.

Sec. 109. Prohibition against deposit production offices

-Regulations prohibiting a bank from engaging in interstate branching primarily for the purpose of deposit production must be prepared and uniformly enforced by the federal banking agencies.

Sec. 110. Community Reinvestment Act evaluation of banks with interstate branches (also in Sec.101 (a)(3), Sec.102 Se-sec. 44 (b)(3), Sec.102 Se-sec. 44 (f))

-Branch office established across state lines to take deposits from the public must also create an adequate volume of loans (equal to half or more of the statewide average loan/deposit ratio) to support the local community or they may be closed. Interstate mergers and acquisitions are subject to mandatory review under the terms of the Community Reinvestment Act (CRA) to determine if the banks involved have a record of adequately serving their local communities. Written evaluations of an interstate bank's overall CRA performance and its performance in each state where it branches must be prepared by the appropriate federal agencies.

Source: Public Law. No. 103-328, 108 S. 2338; H.R. Conf. Rep. No. 651, 103d long. 2d. Sess. (1994). Rose (1997), pp.43-44.

state law, which provided, for example, for regional contracts, regional or national reciprocity arrangements, or relatively unrestricted entry from any state.[40] From this point of view, the Riegle-Neal Act for the first time had provided a uniform, national law governing all interstate acquisitions by BHCs.

-Interstate Bank Mergers

Since June 1, 1997, banks with headquarters in two different states had been allowed to seek regulatory approval for merging across state lines. This opportunity, however, had four conditions:[41] 1) by statute, a state may require that a target bank in an interstate merger must have been in existence for at least five years;[42] 2) as in the case with BHC acquisitions, the 30 percent in-state and 10 percent nationwide market-share restrictions apply to interstate mergers, with exceptions for affiliate bank mergers.[43] 3) The responsible federal agency must consider any applicant's record of compliance with the Community Reinvestment Act of 1977 (CRA) and consider any applicant's state community reinvestment laws. The appropriate federal agency must take into account the most recent written evaluation under the CRA of any bank that would be an affiliate of the resulting bank.[44] 4) Any bank to apply for an interstate merger transaction must comply with nondiscriminatory host-state filing and submit a copy of the application to the State bank supervisor.[45]

-*De Novo*[46] Branching

The Riegle-Neal Act allowed states to "opt-out" of interstate branching by passing a law to prohibit it before June 1, 1997.[47] Any state that "opted-out" of interstate branching prevented both state and national banks from branching into or out of its borders. States cannot discriminate against banks from any other state or group of states, allowing some outsiders to come in while excluding the entry of banks from other states. And a state electing to "opt-out" of interstate branching cannot allow its own banks to reach across

[40] See Table 7.
[41] P.L. 103-328 Sec. 102(a)
[42] P.L. 103-328 Sec. 102 'SEC.44 '(a) '(5) PRESEVATION OF STATE AGE LAWS-
[43] P.L. 103-328 Sec. 102 'SEC.44 '(b) '(2) CONCENTRATION LIMITS-
[44] P.L. 103-328 Sec. 102 'SEC.44 '(b) '(3) COMMUNITY REINVESTMENT COMPLIANCE-
[45] P.L. 103-328 Sec. 102 'SEC.44 '(a) '(3) '(B) CERTAIN CONDITIONS ALLOWED-
[46] P.L. 103-328, Sec. 103(a)&(b) says that the term 'de novo branch' means a branch of a national or State bank which (i) is originally established by the national or State bank as a branch; and (ii) does not become a branch of such bank as a result of (I) the acquisition by the bank of an insured depository institution or a branch of an insured depository institution; or (II) the conversion, merger, or consolidation of any such institution or branch.
[47] P.L. 103-328 Sec. 102 'SEC.44 '(a) '(2) STATE ELECTION TO PROHIBIT INTERSTATE MERGER

state lines in order to acquire banks in other states except to "save" a failing bank. Texas[48] and Montana[49] were the only states that took this option and now the option was closed.[50]

States that elected to 'opt-in' to permit interstate branching through *de novo* branches have the power to authorize *de novo* branching across state lines, which would allow a bank to simply open a new branch in another state instead of having to acquire an entire bank.[51] Several states have decided to allow *de novo* branching, though this is usually done on a reciprocal basis.[52] In 1997, the Riegle-Neal Amendments Act was signed into law, ratifying an agreement between the states, the FDIC and the Federal Reserve, which allowed "seamless" supervision for state-chartered banks that branch across state lines.[53]

De novo branches are subject to all laws of the state in which they reside, as well as being subject to Community Reinvestment Act provisions regarding community lending. But, they are not bound by the 10 percent or 30 percent concentration rules.[54] In spite of this limitation, once a *de novo* branch is approved, additional branches or merger may occur within the state. For firms willing to expand statewide, however, it is not as particularly advantageous to set up a *de novo* branch, as it is to merge with an existing bank, since interstate firms cannot set up branch offices primarily for deposits production in the targeted local communities. That is, unless they provide for those communities' lending needs.[55]

-Affiliate Agency

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 substantially increased the powers of affiliated banks. One year after its enactment, any bank subsidiary of a BHC can act as an agent for a bank or a savings association affiliate for receiving deposits, renewing time deposits, closing loans, and receiving payments on loans and other obligations.[56]

TRANSACTIONS-

[48] The Governor signed legislation that prohibits out-of-state banks from branching into Texas until at least September 1999(*FDIC Banking Review*, February 1996, p.25).

[49] In August 1997, the Montana legislature signed the new state law that would forbid interstate branching until September 30, 2001(*FDIC Banking Review*, March 1998, p.38).

[50] P.L. 103-328 Sec. 102(a)

[51] P.L. 103-328, Sec. 103

[52] Savage (1993), p. 1079.

[53] Rose (1997), pp. 47-8.

[54] Rose (1997), p. 48.

[55] P.L. 103-328, Sec. 109 (a) & (b).

[56] P.L. 103-328, Sec.101 (d).

According to the Riegle-Neal Act's Subsection(r) of Section 101(d), a bank acting as an agent will not be considered a branch of the affiliate. Therefore, a bank holding company that separately incorporated banks as its affiliates can designate them as "*de facto*" branch offices, allowing customers from other banking units of the same interstate organization to access their accounts through any bank affiliated with the same BHC.[57] This meant that the Act expanded BHC business flexibility by permitting interstate banking services in a holding company to be offered without any change in corporate structure and to be free from any state limitations or the possibility of state opt-out. In effect, a BHC with many banks within a state can integrate its operations and accommodate its customers' needs by taking advantage of this provision.

In other words, the Riegle-Neal Act substantially decreased the power of state authorities by prohibiting these banks from conducting interstate banking and branching (with minor exceptions). At the same time, interstate affiliate banking provisions of the Riegle Neal Act encouraged merger activity across state lines,[58] though the FDIC Improvement Act of 1991 (FDICIA) originally fostered this.

-Foreign Bank Interstate Branching

Each foreign bank, too, is categorized as a to federal branch or agency or as one on a state level. Foreign banks can also branch throughout the United States to the same extent as domestic banks by way of interstate mergers or *de novo* interstate branching, so long as they have the approval of the Federal Reserve Board and the appropriate national or state bank regulator. This privilege is restricted to well-capitalized foreign banks and requires that they establish a separate subsidiary to allow for capitalization verification. Foreign banks seeking for new interstate activities must comply with Community Reinvestment Act provisions (which many of them could avoid because of their uninsured status) and with all consumer protection legislation.[59]

VI. Conclusion

On September 29, 1994, President Clinton signed into law the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. The Act had finally wiped out

[57] Rose (1997), p.49.
[58] Rose (1997), p.50.
[59] P.L. 103-328, Sec.104.

restrictions on interstate expansion of BHCs by amending the Bank Holding Company Act of 1956. At the same time, the Act removed provisions restricting branching across state lines originally laid down in the McFadden Act of 1927 and Glass-Steagall Act in 1933. This historic legislation would accelerate the ongoing transformation of the U.S. banking system by allowing the creation of banks with extensive interstate branch networks.

Moreover, provisions governing interstate branch operations would have a significant impact on the dual banking system. The legal framework for operations of national-bank interstate branches created by merger could be essentially the same as for home-state branches. By contrast, state bank interstate branches would be subject to the laws and supervision of the each branch is located. State banks may thus be limited in achieving a branch under home state regulation.[60]

The Riegle-Neal Act supersedes the McFadden Act and Douglas Amendment, which let the states largely determine the scope of banks' geographical expansion. This new law, however, generally stands that approach on its head by giving the states certain limited decisions, while authorizing interstate branching and acquisitions as a matter of preeminent federal law. Indeed, even the few states that initially opted out eventually went interstate.[61] Moreover, the federal banking authorities would interpret the new law's ambiguities as applied to both state and national banks and can further dictate interstate expansion as a federal policy. The Interstate Act thus began to transform, nationalize, and consolidate the American banking system.[62]

From this paper's prior arguments, one could conclude that the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 was another step toward a federally dominated banking system, and that weakens powers of state banking authorities, which, collectively, are the other part of the dual banking system. It, however,

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[60] To improve the attractiveness of state charter in an interstate environment, the Riegle-Neal Amendments Act of 1997 was signed by President Clinton into law on July 3, 1997. Before the Amendments Act passed, a testimony at the Senate Banking Committee witnessed, "the OCC ...(is) actively recruiting state chartered banks to convert to national banks... (and) is undermining the dual banking system...the Comptroller blocked a legislative effort in this Committee to fix a technical problem in the Riegle-Neal Interstate Banking law that places state-chartered banks desiring to branch into other states at a distinct disadvantage to nationally chartered banks..." ("Prepared Statement of Chairman D'Amato before Financial Institutions Subcommittee," *Senate Banking Committee News Release*, May 1, 1997). Author adds words in parentheses.

[61] "Texas opened its borders in September 1999, and Montana's will open in October 2001," reported *American Banker*, April 12, 2001, vol. 166 Issue 71, p.4.

[62] See footnote 59.

is too early to conclude the trend towards in a line. The arguments over the amendment of provisions in the Riegle-Neal Act and its establishment were examples of the strike backs from dual banking proponents. Before one could reach a conclusion, some more time and research might be indispensable.

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