Interstate Branching, the Riegle-Neal Amendments Act of 1997 and the Future of the Dual Banking System

Jason L. Booth
J.D. Candidate Harvard Law School

Submitted in Satisfaction of the Written Work Requirement
April 20, 1998
# TABLE OF CONTENTS

I. Introduction ................................................................................................................................. 1

II. The Dual Banking System ........................................................................................................... 3
    A. Origins and History of the Dual Banking System ................................................................. 3
    B. The Dual Charter Dynamic .................................................................................................... 4
    C. The Future of the Dual Charter .............................................................................................. 10

III. Interstate Expansion and the Continued Viability of the State Charter ................................. 11
    A. History of Interstate Expansion ........................................................................................... 11
    B. Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 ............................ 14
    C. The Threat to State Charters under the IBBEA .................................................................. 17
    D. The Nationwide Cooperative Agreement ............................................................................. 21

IV. The Riegle-Neal Amendments Act of 1997 ............................................................................ 24
    A. Operation of the Riegle-Neal Amendments Act ................................................................. 24
    B. The Amendments Debate ..................................................................................................... 27
        1. The Arguments For .......................................................................................................... 27
        2. The Arguments Against ................................................................................................. 32

V. The Interstate Branching Regulatory Regime Post Riegle-Neal Amendments ..................... 40
    A. The IBBEA as Amended and the Second Banking Directive ............................................... 41
        1. The Second Banking Directive ....................................................................................... 41
        2. The IBBEA as Amended vs. the Second Banking Directive .......................................... 43
            a. Permission to Branch ................................................................................................. 43
            b. Powers ....................................................................................................................... 43
            c. Supervision ............................................................................................................... 45
            d. Applicable Law .......................................................................................................... 47
    B. Recent and Future Trends of Interstate Activity in the United States ................................. 48
        1. Early Interstate Branching Trends .................................................................................... 48
        2. Recent and Future Trends in Interstate Branching ......................................................... 50
        3. The Future of the State Charter and the Dual Banking System .................................... 51
            a. National Charter Benefits ......................................................................................... 51
            b. State Charter Viability .............................................................................................. 52
I. INTRODUCTION

The presence of a choice between state or federal authorities in the bank chartering process in the United States (commonly referred to as the "dual banking system") is widely heralded as a necessary component in maintaining the strength and ingenuity of the American banking system. The system enjoys the support of regulators and legislators at both the state and federal level. Indeed, the extent of this support is so overwhelming that the dual banking system has been labeled the "sacred cow" of American banking. While the dual banking system is immune from direct legislative attack, it is viable only so long as the choice between the two competing charters is preserved; that is, the innovation and regulatory dynamic evident in the current system will only be achieved when banks have the realistic ability to change charters. If a regulatory scheme arises that has the indirect effect of creating a preferred charter, then the dual banking system is seriously diluted and its widely-touted benefits will vanish. This paper is an examination of one such situation and the response undertaken to address the matter.

In 1994 President Clinton signed the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. The IBBEA had the direct effect of liberalizing geographic restrictions on bank expansion. In the banking industry, many believed that the IBBEA also had the indirect effect of creating a regime in which the national charter would become the preferred charter of most banks. Therefore, it was widely perceived that as originally enacted, the IBBEA threatened the existence of the dual banking system. To deal with the threat and to preserve the state charter, Congress passed the Riegle-Neal Amendments Act of 1997.


This paper is a critical assessment of the Riegle-Neal Amendments and an examination of the current regulatory regime governing interstate branching. In Part I, I examine the history of the dual banking system and consider the arguments both for and against maintaining a dual charter option. Despite the increased influence of federal authority over state-chartered banks that has reduced justifications for maintaining the state charter, I argue that significant benefits stem from the dual banking system and, more explicitly, result from the presence of a state charter option. Therefore, regulators and legislators at both state and federal levels should maintain and protect the dual banking system by guarding against the creation of a preferred charter.

In Part II, I examine the possibility that the recent liberalizations of geographic restrictions on bank expansion created a regulatory environment in which the national charter would become the preferred charter of banks. After a brief history of interstate banking and branching regulation and a review of the IBBEA’s provisions and operation, I determine that the liberalizations did create an impetus on state banks to convert to a national charter. This threat if left unattended would result in a banking system structure in which only the smallest, most insignificant banks would choose to retain a state charter. In Part II, I also examine actions undertaken by various state actors designed to preserve the state charter. I argue that these measures, while incomplete and ultimately ineffective in remedying the problem, created the framework for the Riegle-Neal Amendments.

In Part III, I explore the Riegle-Neal Amendments, the Congressional action enacted to address the IBBEA’s threat to state charters. This section outlines the provisions and operation of the Riegle-Neal Amendments. Detailing arguments advanced by both proponents and opponents of the legislation, I conclude that for the state charter to remain a viable option in a regime of permissive interstate activity, the Amendments’ provisions must be in place.

Part IV is an examination of interstate banking and branching laws after the Riegle-Neal Amendments. In this section, I explore the regulatory and legislative regime that currently governs banks engaged in interstate branching. Considering the similarity between the regulation
of interstate branching activities in the United States and cross-border banking in the European Economic Community, I focus some attention on the EEC banking regulation under the Second Banking Directive. Finally, I will discuss some basic trends that can be expected to develop in the U.S. as banks begin to engage in interstate branching. Specifically, I consider future bank charter choices and the continued viability of the dual banking system.

II. THE DUAL BANKING SYSTEM

A. Origins and History of the Dual Banking System

The United States banking system operates in a manner commonly referred to as "dual banking." In the United States any person desiring to open a bank must initially seek authorization from a proper authority. The "dual banking" designation succinctly identifies a unique and unintended feature of American banking -- the presence of dual chartering authorities.

Although both federal and state governments exercised regulatory power over banks since the founding of the United States, early on the federal government chartered and regulated only two banks, while the states chartered and regulated many banks. In 1832, agrarian interests and state bank proponents, championed by President Andrew Jackson, prevented the rechartering of the Second Bank of the United States and for the next 30 years states acted as the sole chartering authority. During this time many states enacted "free banking" laws which permitted any person to obtain a bank charter upon the satisfaction of specified conditions. The "free banking" laws greatly facilitated the chartering of new banks.

The accident of dual banking has its origin in the National Bank Act of 1863 which was modeled after the "free banking" laws developed at the state level. By empowering the federal

---

4 The two federally chartered banks were the First Bank of the United States (1791-1811) and Second Bank of the United States (1816-36). For a detailed history of the dual banking system, see Arthur E. Wilmarth, Jr., The Expansion of State Bank Powers, the Federal Response, and the Case for Preserving the Dual Banking System. 58 FORDHAM L. REV. 1133, 1152-1160 (1990).

5 Michigan passed the first "free banking" act in 1837 followed by New York in 1838. See, A. Wilmarth, Jr., supra note 4, at 1152.
government to serve as a chartering authority in the same manner as states, the NBA became the fountainhead of the dual banking system. To be sure, the purpose of the NBA was not to create a system of dual authority, instead, Congress expected state banks to voluntarily convert to national charters to issue newly-authorized national bank notes. However, the expected mass exodus from the state charter did not occur. After most state banks failed to convert voluntarily to a national charter, Congress imposed a ten percent tax on state bank notes in an attempt to drive state banks out of business. In an early demonstration of their flexibility and tenacity to survive, state banks successfully avoided extinction by shifting their revenue base away from circulating notes to a deposit-based business by adopting the use of checking accounts.

B. The Dual Charter Dynamic

Although clearly unintended, the dual banking system is widely heralded as essential to maintaining the strength of the American banking system and both state and federal actors have strained to protect it. Those desiring to maintain and foster the dual banking norm take recourse to a number of arguments. These arguments range from extolling the virtues of community-sized banks; to asserting the primacy of a state’s interest in the regulation and control of financial institutions operating within its borders; to acclaiming state banking systems’ role as laboratories

---


7 A. WilmARTH, Jr., supra note 4, at 1153.

8 See, Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533, 549 (1869)(upholding the tax on state note).

9 A. WilmARTH, Jr., supra note 4, at 1154.

10 It should be noted that some of these arguments are more directly in favor of smaller community banks rather than specifically in favor of maintaining a state charter option; however, as an overwhelming number of such banks are chartered by state authority, the arguments are presented here. For instance in 1993, there were approximately 11,300 commercial banks with roughly 8,000 of these institutions holding state charters. See, CONFERENCE OF STATE BANK SUPERVISORS, THE STATE OF THE STATE BANKING SYSTEM 7-8 & figs. 1-3 (1994)
of innovation; to pointing out the beneficial regulatory dynamic created by the presence of a choice between regulators.  

Parroting Jacksonian concerns regarding the concentration of financial resources, supporters of dual banking often point to its role in maintaining a decentralized banking system.  Recognizing the benefit of a diversified banking structure, Federal Reserve Board Chairman Alan Greenspan has noted that “having a large number of community-sized banks . . . is a major contribution to the stability of the banking system and the well-being of the macroeconomy.” Smaller banks -- overwhelmingly chartered by states -- are a major source of capital for small businesses lacking access to securities markets and perhaps not otherwise best served by supra-regional banks headquartered far beyond the immediate community. The elimination of these banks would result in a less optimal credit allocation within local economies that could have an adverse effect on the nation’s economy as a whole.

The importance of banking activities to a state’s economic policy favors a system in which those who are most affected by the institutions are able to exert some authority and control over those institutions. If a state lacks the ability to supervise and regulate banks through the use of its chartering authority, the state loses the ability to affect public policy and economic development through banking law and regulation. Local control is desirable especially when

---


12 A. Wilmarth, Jr., supra note 4, at 1154 (discussing congressional debates surrounding the McFadden Act of 1933 and the Douglas Amendment of 1956).


14 Id.

15 Letter from Governor Terry E. Branstad, Governor of the State of Iowa to Representative Marge Roukema, Chairwoman, House Subcommittee on Financial Institutions and Consumer Credit dated April 23, 1997.
one considers a state’s significant interest in maintaining the safety and soundness of its financial institutions as tools of economic policy. The benefits of local control are also evident when one considers the close proximity to the regulated institutions and superior knowledge of the communities in which the banks operate that is available through state regulation.\textsuperscript{16} Under a system of dual charter authority, regulatory oversight is enhanced in that state and federal regulators serve different governments. In seeking to protect different interests, the regulators bring different perspectives and viewpoints to the bank regulatory process.\textsuperscript{17} In this manner, state regulation tends to be more personalized and tailored to specific institutions and can evaluate local needs and conditions without having to decide whether an activity is appropriate for the entire country.\textsuperscript{18}

The impressive record of banking innovations sparked by the competitive dynamic evident in the dual banking system provides further support for maintaining a state charter option. The presence of a choice between a state or federal regulator creates an incentive for the regulators to permit banks within their charge to engage in new activities or offer innovative products. The ability to create new products and offer novel services permits banks to better serve consumers’ needs and communities’ interests. Furthermore, as much of this innovation occurs first at a state level, the new product or service does not destabilize the entire U.S. banking system. In this manner, state systems act as “laboratories” for the entire national banking system. While those products that prove disadvantageous have only a limited adverse impact, successful innovations can be incorporated by federal authorities and by other states in the regulation of their own institutions.

\textsuperscript{16} C. Johnson, supra note 11, at 362.

\textsuperscript{17} Bank Regulatory Consolidation, April 30, 1996: Hearings of the House Banking Committee, 103rd Cong., 1st Sess. (1996)(statement of Committee Chairman Rep. Jim Leach (R-la)).

\textsuperscript{18} H. Mandanis Schooner, supra note 11, at 362.
The function of state banking systems as innovative laboratories is not mere theory, but has been well documented throughout the last 130 years. Early on, state banking systems originated free banking laws and checking accounts; concepts that were subsequently adopted by federal banking authorities. Other state innovations include branch banking, real estate lending, trust services, reserve requirements and deposit insurance. Like the free banking laws and checking accounts, each of these concepts proved so successful that federal regulators incorporated them into the federal banking laws. States have also introduced the concept of negotiable order of withdrawal ("NOW") accounts which has led to a campaign to remove national deposit interest rate controls and allow bank and nonbank institutions to compete on common ground. More recently, states have been at the forefront in utilizing the rapid expansion of technology by permitting banks to create interstate electronic funds transfer ("EFT") systems through the establishment of networks of automated teller machines ("ATMs"). Indeed, even the federal liberalization of bank interstate activities that now threatens the state charter have at its roots, state authorization of interstate acquisitions by bank holding companies.

Because banks are free to convert between national and state charters without approval, both federal and state bank regulators have an incentive to be flexible and innovative in the

---


20 See A. Wilmeth, Jr. supra note 4, at 1156.

21 In the 1970s, several New England states and New York authorized state-chartered savings banks to offer NOW accounts. NOW accounts are savings accounts which allow the customer to withdraw funds by means of a negotiable instrument such as a check. See, A. Wilmeth, Jr., supra note 4, at 1157; A. Greenspan, supra note 13.

22 Interstate shared EFT systems enable customers of a participating bank to obtain access to their accounts by using ATMs located at other participating institutions in the same state or in different states. See, A. Wilmeth, Jr., supra note 4, at 1157.

23 Id.
regulation of their charters in order to retain their constituents. 24 The ability to change charters with relative ease allows banks to escape from arbitrary, inflexible or outdated regulation and provides a motive for regulators to remain responsive to the banks under their charge. Regulators recognize that “[t]he decision on what kind of charter a bank wants is purely a business decision, and banks are free to choose whichever regulator they think will give them the best deal for whatever reason.” 25 In this manner, the federal and state banking agencies “can be viewed as firms producing different brands of regulation and engaged in a species of competition for market shares.” 26

Countering champions of the dual banking system, opponents of the regime question the necessity and value of maintaining a dual chartering option. Specifically, opponents would eliminate the state charter option in favor of the nationalization of U.S. banking law. 27 These commentators employ a number of arguments in attempting to prove their claim that the dual chartering system is neither valuable nor wise. First, these opponents assert that the much heralded regulatory competition dynamic is illusory. Pointing to the federal ability to preempt state law and the federal government’s role as deposit insurer which compels substantial federal oversight of state banks, dual banking opponents argue that real open market competition of the sort likely to make a difference is just not present. 28 Although banking law has become increasingly federalized in recent years and the freedom of states to regulate their banks have been


curtailed, there is still evidence that a state charter option supplies a needed check on federal regulation and presents a barrier to the creation of a “banking czar.”\(^{29}\)

Opponents also assert that current system of overlapping regulation is inefficient and unwise. The regulatory overlap creates additional costs without corresponding benefits.\(^{30}\) Furthermore, it is unwise given the presence of FDIC insurance, through which losses from state bank failures are not borne by the regulator or the state, but rather by the deposit insurance fund, which opponents contend creates a disincentive for state regulators to preserve the safety and soundness of state banks.\(^{31}\) The recent efforts by various federal regulators and state regulators to reduce the extent of dual regulation and oversight and increase reliance on the reports of another reduce the impact of this inefficiency argument.\(^{32}\) The argument also ignores the other obvious interests states and banking regulators have in maintaining rigorous oversight of its chartered institutions, including indirect economic, professional and reputational related concerns.\(^{33}\)

Opponents respond that regardless the incentives, a system of regulatory competition leads to laxity and “encourages regulators to neglect safety and soundness concerns in order to build their regulated constituencies.”\(^{34}\) To dual banking opponents, the argument is the logical extension of the competitive dynamic evident in the system. For dual banking opponents, the enormous losses stemming from the S&L failures of the 1980s and early 1990s demonstrate the dangers of leaving safety and soundness regulation within the sole discretion of state regulators.

---

\(^{29}\) See, A. Wilmarth, Jr. supra note 4; See also, C. Johnson, supra note 11.

\(^{30}\) H. Butler & J. Macey, supra note 28.

\(^{31}\) A. Wilmarth, Jr., supra note 4, at 1152-55.

\(^{32}\) See, Nationwide State/Federal Supervisory Agreement, adopted by Conference of State Bank Supervisors, Federal Reserve Board and Federal Deposit Insurance Corporation. (on file with the author.)[hereinafter State/Federal Agreement].

\(^{33}\) A. Wilmarth, Jr., supra note 4, at 1152-55.

\(^{34}\) See, H. Mandanis Schooner, supra note 11.
Like the federal deposit argument, this ignores the other motivations that state authorities have in maintaining the safety and soundness of their chartered institutions. While it is sensible that state regulators may act to maintain their regulatory sway, it is unsupported that this type of “turf protection” has resulted in the destabilization of state banking systems. Furthermore, the Federal Deposit Insurance Corporation Improvement Act of 1991, with its focus on maintaining banks’ safety and soundness, significantly curtailed the ability of state regulators to engage in a regulatory “race to the bottom.”  

The current regime prohibits insured state banks from engaging in activities not otherwise permitted a national bank unless “the activity would pose no significant risk to the appropriate deposit insurance fund” and the state bank is in compliance with applicable capital standards. In restricting the ability of state regulators to authorize activities far beyond those authorized to national banks, the FDICIA provisions mitigate dual banking opponents’ “competition in laxity” concern.

C. Future of Dual Charter

While the dual banking system has been attacked by some academics as the redundant and inefficient remains of a historical accident that should no longer be maintained, the importance of banking institutions to states’ economic policies, the traditional and recent operation of state systems as vehicles of innovation and their function as a check on the formation of an inflexible “banking czar,” compel the conclusion that the dual banking system -- and the state charter specifically -- continues to serve a vital role in maintaining the strength of the U.S. banking system. Regardless of the relative merits of the arguments in the dual banking debate, the political viability of the current system is unimpeachable. State banking supervisors and state legislatures jealously protect their autonomy over state-chartered institutions and rail against any encroachment by federal authority. As a bedrock principle, the dual banking system has been

---


36 Id.
labeled the “sacred cow” of American banking and it is immune from direct legislative attack. To be sure nearly every piece of major banking legislation in the last century has been passed with an eye toward maintaining the dual banking system.

That “the banking industry continues to hail the dual banking system as an integral part of the U.S. banking industry, entitled to the same deference as mom, baseball and apple pie,” does not mean that the dual banking system will confront no challenges in the future. To have a viable dual banking system, the choice between chartering authorities must be a realistic choice such that all banks can easily convert their charters; that is, the innovation and regulatory dynamic of the current system can only be maintained if both large and small banks can afford to forfeit one charter in favor of another without incurring prohibitive real economic costs.

Therefore, for the system to survive there must be a rough equality between the two charters. If, through regulatory or legislative change, a system arises that implicitly creates a preferred charter of a majority of banks, the dual banking system will fall into disrepair.

In Part III, I examine one example of such a threat, the recently effective Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. First, I explore the history of interstate expansion by banks, specifically examining the IBBEA’s provisions and its threat, either real or perceived, to the dual banking system. Then, I examine initial measures that state regulators undertook to preserve the state charter option and maintain the dual banking system.

III. INTERSTATE EXPANSION AND THE CONTINUED VIABILITY OF THE STATE CHARTER

A. History of Interstate Expansion

President Clinton signed the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 on September 29, 1994. At the heart of this landmark piece of legislation is the

---

37 G. Miller, supra note 1.

38 H. Mandanis Schooner, supra note 11 at 264.

39 IBBEA, supra note 2.

40 Id.
elimination of the geographic restrictions historically placed on banks. Some commentators have contended that these restrictions were based in part on the fear of excessive concentration of financial power and the aspirations of community control over economic development.\(^{41}\) Others have retorted that, wrapped in the guise of consumer protection, these artificial barriers were nothing more than statutory measures designed to protect regulators’ turf and an effort to preserve local bank monopolies or oligopolies.\(^{42}\) Regardless of their source, the IBBEA erased the barriers and left in its wake a regime of permissive interstate banking and branching. In order to understand exactly what changed and to better understand the risk to the state charter posed by the legislation, a brief background of the evolution of interstate banking and branching is needed.\(^{43}\)

Starting in the early 1900s, states began to grant intrastate branching powers to their state-chartered institutions.\(^{44}\) Responding to the large numbers of subsequent charter conversions by national banks, the Office of the Comptroller of the Currency (“OCC”) attempted to restore a competitive balance by authorizing national banks to branch, but the effort was struck down by the Supreme Court in First National Bank in St. Louis v. State of Missouri.\(^{45}\) The Supreme Court’s action prompted Congress to pass the McFadden Act in 1927 which authorized national banks to open branches in its local community if the law of the state in which the national bank operated permitted such action for state-chartered banks.\(^{46}\) The initial


\(^{43}\) For a detailed history of interstate banking and branching and the IBBEA see, Mark D. Rollinger, Interstate Banking and Branching under the Riegle-Neal Act of 1994. 33 HARV. J. LEGIS. 183 (1996); See also, P. Mulloy & C. Lasker, supra note 41.

\(^{44}\) M. Rollinger supra note 43, at 190-191.

federal forays into easing geographic limitations on national banks therefore was limited to intrastate branching and then only to the extent authorized by state law.

Banks first attempted to branch across state lines through the use of bank holding companies (BHCs) in the 1940s and 1950s. In 1956, the Douglas Amendment of the Bank Holding Company Act of 1956 partially closed this avenue of interstate branching to banks by prohibiting the interstate acquisition of a bank by a BHC, unless the law of a state where such acquisition was to occur explicitly authorized such action. Therefore, as with intrastate branching, state law controlled the extent of interstate branching by banks. Motivated by a desire to attract new investment capital, states gradually began to allow the acquisition of its banking institutions. Subsequently, a majority of states authorized nationwide interstate banking.

Responding to concerns regarding the competitiveness of U.S. banks, efforts to further liberalize the limitations on geographic expansion began to take place in the late 1980s. Early proposals to do so either were not acted upon or failed. However, in 1993 the bill that would become the IBBEA was introduced and ultimately erased many of the historic restrictions on the interstate activities of banks.

46 12 U.S.C. §36 (1994); The National Banking Act of 1933 further expanded national banks branching rights to extend throughout the entire state, if state banks were permitted to do so. P. Mulloy and C. Lasker, supra note 41.


48 Maine was the first bank to authorize out-of-state bank holding companies to acquire Maine banks, subject to a requirement of reciprocity and a requirement that the acquiring bank be located within the same region of the country. The regional restriction was upheld by the Supreme Court in Northeast Bancorp v. Board of Governors of the Federal Reserve System, 472 U.S. 159 (1985). See, P. Mulloy & C. Lasker, supra note 41, at 258; M. Rollinger, supra note 43, at 193-194.


B. **Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994**

The goal of the IBBEA is to allow banks to operate on a nationwide basis. To attain this goal, the IBBEA contains provisions addressing the interstate banking\(^{51}\), agency authority\(^{52}\) and interstate branching\(^{53}\) powers of banks. With respect to the dual banking system and for purposes of this paper, the interstate branching provisions are more significant than either the interstate banking or agency provisions. First, the branching liberalizations affect a greater number of states than did the liberalization of interstate banking.\(^{54}\) Second, because operating a branch is more efficient than using either a BHC or agency bank, branching is likely to become the preferred method in conducting interstate operations.

With respect to interstate banking, as of September 29, 1995, the IBBEA repeals the Douglas Amendment and allows the aggregation of separate banks from different states under a single BHC.\(^{55}\) Banks wishing to engage in interstate banking are subject to a number of limitations including adequate capitalization, competent management and an adequate Community Reinvestment Act record.\(^{56}\) In addition, various concentration and age limits apply to control the amount or type of interstate acquisition. The impact of this portion of the IBBEA is minimal considering that every state but Hawaii already expressly invited some form of out-of-state acquisition by BHCs.\(^{57}\) However, the interstate banking provision does eradicate the

\(^{51}\) Interstate banking is the aggregation of separate banks from different states under a single BHC.

\(^{52}\) Agency authority concerns the power to act as an agent for a banking affiliate.

\(^{53}\) Interstate branching involves the merger of an in-state bank with an out-of-state bank or de novo branching across state lines.

\(^{54}\) See, E. Kane, supra note 42.

\(^{55}\) IBBEA, supra note 2, §101.

\(^{56}\) IBBEA, supra note 2, §101(a) (amending Bank Holding Company Act §3(d)(2)(A) and (B); 12 U.S.C. §2901 (1994).

\(^{57}\) E. Kane, supra note 42.
regional restrictions that were imposed by fifteen states. The IBBEA agency powers permit any
bank subsidiary of a BHC to receive deposits, close and service loans as well as perform various
other enumerated functions without being considered legally as a branch of the affiliate.\textsuperscript{58}
Effective September 29, 1995, the agency authority provision like the interstate banking
provisions was not optional.

Turning to the interstate branching provisions of the IBBEA, as an initial matter, it is
important to comprehend the relevance of “home state” and “host state” concepts. The IBBEA
employs the “home state” and “host state” terms to characterize a bank’s relation to a particular
state. Under the IBBEA, the “home state” of a national bank is the state in which its main office
is located and the “home state” of a state bank is the state that charters the bank.\textsuperscript{59} A “host
state” is any state, other than a bank’s “home state” in which a bank maintains a branch office.\textsuperscript{60}
The home-host state concept is vital in the determination of the applicable law, permitted
powers and regulation, examination and enforcement of interstate banks and their branches.

Whereas the interstate banking and agency authority provisions of the IBBEA went into
effect immediately, Congress delayed the effective date interstate branching until June 1, 1997 or
at such earlier time as a state opted to adopt the IBBEA’s interstate branching provisions.\textsuperscript{61}
Furthermore, unlike the mandatory provisions regarding interstate banking, states were permitted
an opportunity to opt-out of the new rules regarding interstate branching.\textsuperscript{62} Restrictions

\textsuperscript{58} Id.

\textsuperscript{59} IBBEA, supra note 2, §101(c) (amending Bank Holding Company Act §2(o)(4)).

\textsuperscript{60} Id.

\textsuperscript{61} IBBEA, supra note 2, §102. Many states, partly to overcome incentives of state-chartered
banks to convert to a national charter (notably Michigan California, New York and New Jersey)
enacted early opt-in legislation. Further spurring opt-in legislation was substantial uncertainty
regarding the ability of a state to opt-in once it passed opt-out legislation. See, E. Kane, supra
note 42. By May 15, 1997, 25 states plus the District of Columbia had opted in early. \textit{All But
16, No. 5 at 5.

\textsuperscript{62} IBBEA, supra note 2, §102. Despite efforts in a number of states to pass opt-out legislation,
only Texas and Montana ultimately implemented such legislation. Opt-out legislation was
concerning capital adequacy, competent management, CRA performance, and concentration and age limits on a bank's ability to branch track those of the interstate banking provisions.\textsuperscript{63}

Under the IBBEA, a national bank branch is subject to host state laws regarding community reinvestment, consumer protection, fair lending and intrastate branching to the same extent that such laws apply to a host-state chartered branch.\textsuperscript{64} However, these host-state "carve-outs" are not applicable to a national bank to the extent that federal law preempts the host state law or in the event the OCC determines that host state law has a discriminating effect on the national bank branch in comparison to state-chartered branches.\textsuperscript{65} Under the IBBEA, to the extent host state law is applicable to a national bank branch only the OCC has the authority to enforce those laws.\textsuperscript{66} Furthermore, the national bank is subject only to examination by relevant federal authority.

As for state-chartered banks that operate an interstate branch, the original provisions of the IBBEA required out-of-state state-chartered branches to observe the "applicable state laws" of the host states into which they branched.\textsuperscript{67} Therefore, branches of banks chartered by another state could not engage in an activity within the host state that was not also permitted a host-state chartered bank, regardless of the banking powers that were permitted it under the laws of the bank's chartering state. As for regulation, enforcement and examination of the out-of-state state-chartered branch, the IBBEA empowered host state banking supervisors to examine branches of out-of-state banks to assure compliance with host state laws including those governing banking.

passed by the Colorado state legislature only to be vetoed by Colorado Governor Roy Romer. In both Texas and Montana the opt-out legislation contains a sunset provision (for instance Texas opt-out statute automatically expires September 2, 1999). See, M. Rollinger, supra note 43, at 250-254.

\textsuperscript{63} IBBEA, supra note 2, §102.


\textsuperscript{65} Id.

\textsuperscript{66} Id.

community reinvestment, fair lending, consumer protection and permissive activities in order to assure the operation of the out-of-state, state-chartered branch in safe and sound manner.\(^{68}\) To facilitate this oversight, the IBBEA explicitly permitted states to enter into cooperative agreements regarding the supervision of state banks operating interstate branches.\(^{69}\)

C. The Threat to State Charters under the IBBEA

The original provisions of the IBBEA led the Chairman of the Federal Reserve Board, Alan Greenspan, to comment that "the dual banking system . . . despite its advantages and achievements, is under attack. This attack is neither particularly intentional nor particularly coordinated, but rather consists of the unintended consequences of statutory and regulatory changes aimed at achieving broader policy objectives."\(^{70}\) The specific threat that Chairman Greenspan was identifying consisted of a differential in the permitted activities of a national bank host-state branch vis-a-vis a host-state branch chartered under state authority (the "power differential")\(^{71}\) and the less onerous regulatory burden borne by national banks in an interstate context. Indeed, the perceived advantages of a national charter seemed so clear that many concluded that it would soon become the preferred charter of banks, thereby destroying the viability of the state charter and the basis for the American dual banking system.\(^{72}\)

Perhaps the greatest factor in creating an incentive to convert to a national charter was the noted advantage in the powers a national bank branch could exercise within a host state compared to those permitted a state-chartered branch. Under the IBBEA, regardless of the powers allowed

\(^{68}\) IBBEA, supra note 2, §105; See, P. Mulloy & C. Lasker, supra note 41, at 259-264.

\(^{69}\) IBBEA, supra note 2, §105.

\(^{70}\) A. Greenspan, supra note 13.

\(^{71}\) The term "power differential" is used to refer to the ability of a nationally-chartered branch to engage in a wider array of activities in a host-state than permitted an out-of-state, state-chartered branch.

\(^{72}\) W. Isaac, supra note 19.
under its home-state laws, an out-of-state state-chartered branch could not engage in any activity that was otherwise not permitted to a host-state chartered bank. Conversely, a nationally-chartered branch enjoyed the benefits of federal preemption; therefore, as long as the activity was authorized by federal banking authorities, the national bank could engage in that activity throughout the country.

The incentive to convert to a national charter to take advantage of this power differential is evident in considering the following hypothetical example. Suppose there are two banks in State A, State Bank and National Bank, that are authorized to engage in the same array of activities. Specifically, let us suppose that both State Bank and National Bank, by operation of state and federal law are permitted to engage in activity X. Seeking to take advantage of the IBBEA’s relaxation on interstate branching restrictions, both State Bank and National Bank determine to establish a branch in State B. An examination of State B’s banking laws uncovers that State B-chartered banks are restricted to a more limited array of activities than found under State A’s laws. Notably, State B’s laws do not permit its banks to engage in activity X.

The National Bank’s branch within State B could engage in any activity permitted under federal law as determined by the OCC. That is, National Bank’s branch would be able to engage in activity X regardless of State B’s laws restricting such. Conversely, State B’s laws would act to restrict the activities of State Bank’s branch. Specifically, while State Bank in State A was permitted to engage in activity X, State Bank’s branch in State B would be denied that same ability. Therefore, if the ability to offer service X in State B was valuable (i.e. gave a bank a competitive edge), State Bank would undoubtedly switch to a national charter before establishing its State B branch.

Up to this point the perceived power differential has been discussed in terms of theoretical possibility. If federal and state laws are generally equal, the impact of the power differential will only be minimal. However, an examination of the powers of federal and state banks demonstrates that the power differential could be quite large, especially considering the extension of national bank powers under recent OCC authorization and Supreme Court decisions.
Since December of 1995, national banks have been empowered to engage in nationwide trust activity.\textsuperscript{73} In 1995 the Supreme Court upheld the OCC’s authorization to national banks to sell annuities, both fixed and variable.\textsuperscript{74} In 1996, the Supreme Court ruled that § 92 of the NBA was a federal law that specifically relates to the business of insurance, thereby allowing it to preempt state law.\textsuperscript{75} Since the Barnett decision a qualifying national bank has been permitted to sell insurance.\textsuperscript{76} The OCC’s November 1996 changes to its Part V rule allowing operating subsidiaries of national banks to engage in activities currently not permitted to the banks themselves (notably certain securities activities) creates the possibility for an even greater disparity in permitted powers between national and state banks.\textsuperscript{77} With a state-chartered branch operating in a host-state only able to engage in an activity if it was authorized by both home and host state banking laws, Chairman Greenspan noted that the IBBEA combined with the Operating Subsidiary Rule “served to tip the balance in favor of national banks.”\textsuperscript{78}

In an effort to respond to the expanding powers of national banks, states have increasingly enacted “wild card” statutes that allow their chartered institutions to engage in the same powers and activities as national banks. Given the widespread enactment of these parity statutes, one might expect the power differential to only be present in those few states that lacked such legislation. While this is a theoretical possibility, a study of the actual operation of these statutes has demonstrated that “wild card” legislation infrequently provides parity to state


\textsuperscript{76} A qualifying national bank is one that has a branch in a town of 5,000 inhabitants or less.


\textsuperscript{78} Id.
banks. A number of factors have been pointed to as the reason for the non-functioning of these acts, for our purposes it is enough to realize that despite “wild card” statutes, the 50 states have been unable to keep pace with the OCC in the authorization of new powers. Therefore, “wild card” statutes cannot be expected to adequately solve the power differential threat created by the IBBEA.

Another significant advantage for banks chartered under federal law involved the area of examination and enforcement. Under the IBBEA, a national bank branch operating in a host state is subject only to the examination and regulation of federal authority. The IBBEA left it to the individual states to work out a suitable way to supervise state-chartered branches. Therefore, the exact nature of host-state examination and enforcement of out-of-state, state-chartered branches was still to be determined with the possibility that examination and enforcement would vary greatly among the states. Specifically, it was unclear if host-state banking supervisors would insist on surprise inspections or demand the ability to initiate examinations on its own. The national charter offered an additional benefit in having an expansion-friendly OCC perform the role of the enforcer of any applicable host-state laws. For banks looking to branch interstate, it did not require a heroic stretch of imagination to envision a more favorable application of host-state laws by the OCC than by the host-state supervisor.

---

79 C. Johnson, supra note 11.

80 One major factor is that these statutes frequently are not self-executing and require additional authorization either by the state banking department or the state legislature. Of the 39 wild card statutes passed by 1995, 33 of these required additional authorization. Many times one or both of these actors have demonstrated hesitation in responding to OCC’s expansion of powers for national banks. See, C. Johnson, supra note 11, at 369.

81 IBBEA, supra note 2, §105 permitted (but did not require) states to enter into regulatory compacts on an individual regulatory cooperatives.

82 E. Kane, supra note 42.

83 Id.
D. The Nationwide Cooperative Agreement

State banking supervisors understood, even before the IBBEA was enacted, that the states would either have to develop a system to ensure that state regulation and supervision did not interfere with state-chartered banks' abilities to branch interstate or suffer a mass of charter conversions and loss of regulatory influence.\textsuperscript{84} Indeed it was widely recognized that "state bank regulators [had] a powerful marketplace incentive to get their act together collectively, so that they [wouldn't] lose out to the national bank charter."\textsuperscript{85} Many also advocated efforts to clean up banking laws so that state chartered banks would not have to deal with layers of regulation, taxation and reporting requirements.\textsuperscript{86} The incentive to adapt was so great that spokesman for the CSBS, James R. Watt, declared that "the state system [would] reinvent itself to assure institutions that the state charter [was] still a vital option, possibly even the charter of choice, with many competitive advantages."\textsuperscript{87}

The most elaborate and significant response to the new era of permissive interstate branching was CSBS's formation of the CSBS Interstate Task Force to adopt a set of guidelines for the supervision of multi-state state-chartered banks.\textsuperscript{88} The CSBS Interstate Task Force was composed of four subgroups. There was an Application Subcommittee that developed interagency


\textsuperscript{85} States Face Deadline in Interstate Bank Branching Law that Limits Opt-Out Choice BNA BANKING DAILY, Nov. 4, 1994 (quoting Bert Ely).


\textsuperscript{87} States Face Deadline in Interstate Bank Branching Law that Limits Opt-Out Choice, BNA BANKING DAILY, Nov. 4, 1994.

\textsuperscript{88} H.R. 1306 Hearings, supra note 84 (statement of CSBS).
forms for change in control and change in directors notices as well as biographical and financial reports. The Professional Development Subgroup focused its efforts on examiner training by issuing a policy statement on education and training standards that identified core training necessary for all bank examiners. The Technology Subgroup worked on automated examination issues, loan analysis tools, improved Internet communication and the production of ELVIS, an automated risk-focused analysis tool.

The most important of these groups in the adaptation of state regulation to the new regime of interstate branching was the Examinations Subgroup. The stated objective of this Subgroup was the creation a seamless supervisory web to minimize conflicts and avoid regulatory duplication among the states with respect to a multi-state state-chartered bank. Along these lines, the Examinations Subgroup developed two Agreements designed specifically to address the issue of examination and enforcement of multi-state state-chartered banks. First, the Subgroup drafted the Nationwide State/Federal Agreement, a series of regional state-federal supervisory agreements designed to coordinate the efforts of federal and state banking supervisors. Second, the Subgroup developed the Nationwide Cooperative Agreement as a model to help individual state banking regulators shape their own agreements regarding the shared responsibility of supervision of state-chartered banks with interstate branches. In November 1996, bank supervisors in all 50 states signed both Agreements. The overriding principle behind the Agreements was the determination that a multi-state state-chartered institution should have only one regulatory point of contact at the state level. Under the Agreements, a bank’s home-state supervisor served as the single point of contact for safety and soundness supervision, while host-state supervisor retained backup authority.

---

89 See, State/Federal Agreement, supra note 31

90 Nationwide Cooperative Agreement, developed by Conference of State Bank Supervisors (on file with the author.)[hereinafter Cooperative Agreement].

91 H.R. 1306 Hearings, supra note 84 (statement of CSBS).

92 Id.
The Agreements inadvertently created a third incentive for state banks to convert to a national charter. Under the IBBEA, state banks complained that there was ambiguity as to whether home or host state law applied in a specific context. In an effort to clarify the applicable law, the Agreements asserted that home-state law would apply to multi-state state-chartered branches in almost every area with the exception of the IBBEA host-state law carve-outs relating to intrastate branching, community reinvestment, consumer protection and fair lending. Therefore, home-state laws regarding corporate structure, capital requirements, lending and investment limits would apply to the out-of-state, state-chartered branch. Despite the Agreements' assertion that home-state law controlled all of a state-chartered banks operations regardless of where they were conducted, a large number banking lawyers disagreed with the CSBS's interpretation of the IBBEA. A significant number of bank attorneys believed that under the IBBEA host-state law controlled the operation of the out-of-state state-chartered branch on a substantial number of issues and the Agreements could not operate to change federal law. Rather than spend large amounts of money attempting to accurately define the applicable law, banks looked to take shelter under the relative certainty accorded a national bank branch.

In the end, while the Agreements arguably created a workable scheme for dealing with the examination and enforcement of multi-state state-chartered banks, the Agreements failed to alleviate the state banks' concerns regarding uncertainty as to which laws applied to its interstate branching operations and failed to solve the problematic power differential evident between national and state banks. Therefore, despite the efforts of state banking supervisors to maintain the state charter option, issues regarding branch powers, uncertainty as to applicable laws and to

---

93 Pamela Atkins, Riegle-Neal Clarification Bill Could Go to House Floor May 20, BNA BANKING DAILY, May 15, 1997; H.R. 1306 Hearings, supra note 84 (statement of CSBS).

94 Cooperative Agreement, supra note 90.

95 H.R. 1306 Hearings, supra note 84 (statement of CSBS); Carl Horowitz, Congress Is Set To Clarify Interstate Bank Regulation. Investor's Business Daily, June 2, 1997 at A20.

96 H.R. 1306 Hearings, supra note 84 (statement of CSBS).
a lesser extent branch examination and enforcement, acted individually and in concert to stimulate
a movement among state-chartered institutions to increasingly consider converting to a national
charter. This impetus to convert was only exacerbated to the extent the institution determined to
create a branching presence in a greater number of host states. Chairman Greenspan noted that
"regional and nationwide banks may find that state charters are burdensome . . . [i]f that burden
were to become excessive, banks with interstate operations . . . would likely turn to the national
charter on grounds of simple expediency."97

In light of the Agreements' failure to adequately respond to the IBBEA's threat to the
state charter and facing a potentially significant curtailment of their regulatory power, state
banking officials turned to federal legislation to preserve the state charter and maintain the dual
banking system. In this manner, as the effective date of full interstate branching arrived, a strange
effort began in which various state actors clamored for federal legislation to preempt state
sovereignty. The next section examines the debates and the resulting federal amendments to the
IBBEA that sought to save the state charter.

IV. RIEGLE-NEAL AMENDMENTS ACT OF 1997

A. Operation of the Riegle-Neal Amendments Act

Responding to the concerns of state regulators, particularly those of the CSBS, House
Banking Financial Institutions Subcommittee Chairwoman Marge Roukema (R-NJ) introduced
H.R. 1306; the bill designed by the CSBS that would ultimately become the Riegle-Neal
Amendments Act of 1997.98 Belying their general impact and perceived importance, the
provisions of the bill are quite modest in length. In general, the proposed Riegle-Neal
Amendments dealt with two issues. First, it clarified the extent to which host state law applied
to an out-of-state state-chartered branch in an effort to eradicate the uncertainty surrounding the

97 A. Greenspan, supra note 13.

98 Riegle-Neal Amendments, supra note 3.
issue. Second, it eliminated host states’ ability to restrict the activities of an out-of-state state-chartered branch.

The Riegle-Neal Amendments basically codify the provisions and underlying assumptions of the Cooperative Agreement adopted by the CSBS Interstate Task Force. Specifically, amending subsection §24(j) of the Federal Deposit Insurance Act, the Amendments Act provides that the laws of a host state will apply to an out-of-state state-chartered branch to the same extent that such laws apply to a national bank branch operating in the host state. To the extent that a host state’s law is inapplicable to an out-of-state state-chartered branch because the law does not apply to a national bank branch, the laws of the state-chartered branch’s home state will apply. Therefore the Amendments resolve the debate regarding the applicability of host-state or home-state law by incorporating the CSBS Agreement’s concept of home-state law as controlling.

Considering the Riegle-Neal Amendments’ language that “the laws of the host state shall apply,” this result may not seem evident at first. However, the language is subsequently limited so that host-state law applies to a state-chartered branch only to the extent such host-state law applies to a national bank. Because national banks are not generally subject to the


100 H.R. 1306 Section 2. Subsection 24(j) of the Federal Deposit Insurance Act is amended to read as follows: (j) Activities of Branches of Out-of-State Banks -- (1) Application of Host State Law -- The laws of a host state, including law regarding community reinvestment, consumer protection, fair lending, and the establishment of intrastate branches, shall apply to any branch in the host state of an out-of-state state bank to the same extent as such state laws apply to a branch in the host state of an out-of-state national bank.

101 H.R. 1306 Section 2. Subsection 24(j) of the Federal Deposit Insurance Act is amended to read as follows: (j) Activities of Branches of Out-of-State Banks -- (1) Application of Host State Law -- To the extent host state law is inapplicable to a branch of an out-of-state state bank in such host state pursuant to the preceding sentence, home state law shall apply to such branch.

102 Id.

103 Id.
host-state laws, except the explicit community reinvestment, consumer protection, fair lending and intrastate branching carve-outs, it is clear that the resulting regime is one in which home-state law will govern the majority of the out-of-state, state-chartered branch’s operations.

Addressing the activities of out-of-state state-chartered branches, the Amendments permit a branch to engage in any activity that is permissible under the branch’s home state law, but only if that activity is permitted for either a host-state bank or national bank branch. The provision does not independently authorize any new powers for state banks, rather, a state bank must obtain authorization from its home state before realizing any expansion in its permitted activities. In this manner, the Amendments only create the potential for a level playing field between state-chartered branches and national banks. Under the Amendments then, a home-state can assure its chartered institutions that at a minimum the state charter will authorize the same activities as those permitted a national bank branch.

The bill breezed through a 10-minute House Banking Financial Institutions Subcommittee markup on May 7. Under a suspension of rules H.R. 1306 was passed in the House by a unanimous voice vote on May 21 and forwarded to the Senate. The Senate approved it on June 12 with some alteration. For the most part these alterations were cosmetic changes, however the Senate version does require the OCC to make an annual report regarding state laws that were preempted under its authority. On June 24, the House agreed to the Senate changes,

104 H.R. 1306 Section 2. Subsection 24(j) of the Federal Deposit Insurance Act is amended to read as follows: (j) Activities of Branches of Out-of-State Banks — (2) Activities of Branches — An insured state bank that establishes a branch in a host state may conduct any activity at such branch that is permissible under the laws of the home state of such bank, to the extent that such activity is permissible either for a bank chartered by the host state (subject to the restrictions in this section) or for a branch in the host state of an out-of-state national bank.

105 H.R. 1306 Hearings, supra note 84 (statement of Chairwoman Marge Roukema (R-NJ)).

106 Id.

107 CONG. REC. H3088-3095.

108 CONG. REC. S5637-5367.
again through a unanimous voice vote.\textsuperscript{109} On June 26, 1997, the bill was presented to President Clinton who signed the bill on July 3, 1997 becoming Public Law No. 105-24.\textsuperscript{110}

B. The Amendments Debate

On April 30, 1997 the House Subcommittee on Financial Institutions and Consumer Credit held hearings regarding the Riegle-Neal Amendments.\textsuperscript{111} The record of this hearing details the arguments of both those championing the bill as a necessary measure to preserve the state charter and those opposed the Amendments’ enactment. Considering the lack of debate in the ratification of the bill and the speed by which the legislation was adopted, the arguments both for and against the Amendments, as well as a critical assessment of the debate are presented.

As an initial matter, it is important to understand that the debate did not concern the validity and desirability of maintaining the dual banking system in light of the new interstate branching regime. Commentators, both for and against the Amendments, made an almost a verbatim recitation of the benefits of the current dual banking system. With all participants trumpeting the necessity of the dual banking system, any debate regarding the wisdom of maintaining the state charter option in light of a regime of permissive interstate branching would be relegated to the halls of academia.


The CSBS assumed the lead role in both fashioning and advocating passage of the Riegle-Neal Amendments. Joining the CSBS’s effort to enact the legislation were the Independent Bankers Association of America, various state banking associations, the National Governors

\textsuperscript{109} CONG. REC. H4230-4231.

\textsuperscript{110} CONG. REC. D701.

\textsuperscript{111} H.R. 1306 Hearings, supra note 84.
Association and numerous individual governors. At a federal level, the Federal Reserve Board through Chairman Greenspan voiced its support for the measure.

The arguments put forward in favor of the bill’s passage revolved around its necessity in protecting the state charter option for banks planning to engage in interstate branching. The proponents most persuasive arguments enunciated the IBBEA’s threats to the state charter and by implication its threat to the future of the dual banking system. These threats (i.e. the power differential and legal uncertainty faced by an out-of-state state-chartered branch,) have been detailed elsewhere in the paper and will not be repeated ad nauseam. Similarly, with the benefits and dynamic of the dual banking system having been established in Part II, only brief mention of them is made here. In short, proponents argued that the absence of a dual banking system, specifically through the elimination of the state charter as a viable option, due to the power differential and legal uncertainty created by the IBBEA, would result in a less responsive, less innovative, more centralized system of bank regulation in which those most affected by the operation of the financial institutions would have no ability to control those institutions.

Proponents of the Amendments assumed that the failure to provide parity and certainty to state-chartered institutions would result in the demise of the dual banking system. Although there was a clear disadvantage to operating under a state charter in an interstate context, the link between this disadvantage and the continued viability of the dual banking system was considerably less obvious.

Whereas among advocates it was a matter of faith that state banks would convert in mass to a national charter absent enactment of the Riegle-Neal Amendments, an examination of bank charter conversion data reveals conflicting evidence regarding the future of the state charter. Since

112 Id.

113 A. Greenspan, supra note 13.

114 H.R. 1306 Hearings, supra note 84 (statement of CSBS).

115 Id.
the passage of the IBBEA, the national bank share of total bank assets had reversed its decline of the early 1990s and climbed back up to 58% as of September 1996.\textsuperscript{116} Furthermore, the percentage of banks with national charters, already on the rise from recent years, was estimated to reach 50-60%.\textsuperscript{117} Conversely, state charters were said to be increasing in popularity as more and more new banks were opting for a state regulator.\textsuperscript{118} Therefore, empirical evidence of the threat to the state charter and the dual banking system remained inconclusive.

In an effort to demonstrate the threat faced by the state charter, proponents relied heavily on anecdotal evidence and rumors of large state banks contemplating conversion. Governor George Pataki voiced concern that the trend of state banks “flipping” charters was on the rise.\textsuperscript{119} New York Banking Department Head Neil Levin predicted that the state banking department would have to fire 400 employees as the number of state-chartered institutions fell dramatically under the IBBEA.\textsuperscript{120} The decision by Cleveland-based KeyCorp to convert to a national charter was an often cited example of the impetus to switch charters. By August of 1997, Cleveland-based KeyCorp consolidated its 12 state-chartered institutions into one national bank, finding the certainty and convenience of one regulator provided by a national charter to be irresistible.\textsuperscript{121} However, like the empirical studies, the anecdotal evidence was less than unanimous. For example, countering the KeyCorp experience was the decision of Birmingham-based Amsouth

\textsuperscript{116} Stan Wilson, supra note 73.

\textsuperscript{117} Id.

\textsuperscript{118} Christopher Rhoads, By the Numbers: State Charters Said to be Gaining Popularity, AM. BANK., May 10, 1996.

\textsuperscript{119} P. Atkins, supra note 77.

\textsuperscript{120} State Legislators’ Committee Rejects State Bank Regulators’ Call for Preemption, BNA BANKING DAILY, December 16, 1996.

Bancorp to retain its state charter after combining institutions in Alabama, Florida, Georgia and Tennessee.\textsuperscript{122}

While the preemption of state sovereignty should not be based solely upon a supposed or unestablished link of cause and effect, it is no argument that the problem Congress seeks to avoid must manifest itself with absolute certainty before Congress is justified in its actions. Although the lack of empirical evidence demonstrating a mass exodus from state charters weakened the advocates' arguments, the evidence presented, stemming from the common experience and beliefs of state banks and their regulators, adequately established the need for action.

In light of the disadvantages of operating under a state-charter in a multi-state context, it is logical to believe that most state banks engaging in interstate branching would convert to a national charter typically leaving only very small community banks under the control of state authority. A system in which state authorities control and regulate only those institutions with little need for innovation and with relative insignificance within the local economy, is a system in which the touted benefits of the current dual banking regime would rapidly disappear. Indeed, proponents argued that even the small, community-based banks would ultimately find the state charter less desirable if the measure was not passed. State banking supervisors argued that the cost advantage feature of the state charter, in which state examination fees are generally less expensive than that of the OCC, would be eliminated as economies of scale were lost due to the sinking number of state-chartered banks.\textsuperscript{123} The state charter cost advantage is a real reason why it remains an attractive alternative to a federal charter. The loss of the cost savings would result in the increased conversion of even small community-state banks, thereby hastening the demise of the dual banking system and further eroding the ability of states to implement economic policy on a local level.

\textsuperscript{122} Id.

\textsuperscript{123} H.R. 1306 Hearings, supra note 84 (statement of CSBS).
Perhaps most interesting and somewhat ironically, the debate for the Riegle-Neal Amendments passage presented important state actors (governors, state banking regulators and a few state legislators) arguing for federal preemption of state sovereignty -- the antithesis of most state authority. In explaining their position, the advocates claimed the measure was "a very surgical and practical solution to what [was] considered to be a practical problem."124 Pointing to the passage of wild card statutes in 43 states, they downplayed the extent of federal preemption, claiming that the measure would only operate to preempt the laws of those seven states without parity legislation.125 This argument, while facially true, ignored the true operation of most "wild card" statutes. As previously noted they infrequently operated to create parity with a national bank automatically upon a national bank's engaging in an activity; instead a state bank must obtain authorization to engage in the power either from the state banking supervisor or the state legislature.126 Historically this authorization has been infrequently granted, leaving the "wild card" statute a tiger without any teeth.127 Therefore, the extent of federal preemption was much greater than advocates were willing to admit.

In an effort to further ease their queasiness over the preemption of state sovereignty, proponents asserted that the measure in fact protected the state sovereignty in its protection of home-state law.128 While the Amendments Act does protect the ability of home-states to determine the powers and regulation of institutions acting under its authority, such protection comes only through an imposition of another state's sovereignty. The claim therefore that the Amendments enhances state sovereignty ignores the counter-effect on host states and is a bit


125 H.R. 1306 Hearings, supra note 84 (statement of CSBS).

126 See, C. Johnson, supra note 11.

127 Id.

128 H.R. 1306 Hearings, supra note 84 (statement of Chairwoman Marge Roukema (R-NY)).
disingenuous. The more accurate and more persuasive argument is that the Amendments’ effect of halting state charter conversions insures host states some control over its chartered institutions thereby preserving host-state sovereignty in general despite the limited forfeiture to home-states.

2. The Arguments against the Riegle-Neal Amendments Act of 1997

Lining up against the Riegle-Neal Amendments were state legislatures represented by the National Conference of State Legislatures (NCSL) and various consumer groups, notably the Consumer’s Union. Initiall, opponents argued that the Amendments Act was an unnecessary usurpation of state sovereignty enacted to solve a relatively limited problem. Turning the focus of their critique to the operation of the Amendments, opponents found further faults with the proposal. First, demonstrating concern for host-state institutions, opponents asserted that the much ballyhooed parity between out-of-state state-chartered branches and national bank branches came only at the expense of host-state institutions. Opponents also decried those provisions in the Riegle-Neal Amendments that operated to expand the effect of OCC preemption decisions. Consumer advocates opposing the measure argued that the resulting structure of regulation would lead to a race to the bottom in which the interests of consumers would be frequently disregarded. Finally, the NCSL railed against the post-effective alteration of fundamental provisions of the IBBEA under which most states had determined whether or not to permit interstate branching. A recitation and examination of the arguments presented against passage of the Riegle-Neal Amendments follows.

In general, opponents argued that the scope of the problem was limited and did not warrant federal action. Therefore, to the opponents, the CSBS’s arguments claiming that the Amendments Act was only a limited preemption of the laws of those seven states without parity statutes perfectly demonstrated that the scope of the problem did not warrant the extent of

---

129 H.R. 1306 Hearings, supra note 84.

130 H.R. 1306 (statement of Al Knight, Alabama State House of Representative, Chair, NCSL Committee on Commerce and Communications and Bill Schroeder, Colorado State Senate, Vice Chair, NCSL Committee on Commerce and Communications, On Behalf of The National Conference of State Legislatures) [hereinafter statement of NCSL].
action.131 Indeed, two of the seven states (New York and Connecticut) were considering passing “wild card” legislation in light of the perceived problems.132 To the opponents this indicated that to the extent the problem existed the individual states could adequately address the problem. Further downplaying the extent of the problem, the NCSL argued that the bill was addressed to the concerns of those state-chartered institutions choosing to engage in interstate branching.133 The NCSL argued that only 30% of state-chartered institutions had assets of over $100 million and that the vast majority of state chartered institutions has no desire of becoming “a multi-state financial giant operating coast-to-coast.”134

Although, it is undoubtedly true that the many, perhaps even a “vast majority” of state-chartered institutions will not engage in extensive interstate branching, the argument fails to recognize that the dual banking dynamic is only present and can only be assured where the choice of charters is a realistic one for all banks. A system in which state regulation is imposed on only the smallest community banks is a system that has lost much of the ability to serve as a “laboratory” for development, act as a check on the creation of a banking czar and allow states the opportunity to manage their own economic development. Therefore, although comparatively few state-chartered banks may ultimately choose to engage in widespread interstate branching, these banks must be able to maintain their state charter in order for the dual banking system to survive.

Considering its assessment that the IBBEA posed only a limited threat, the NCSL ardently opposed the usurpation of state sovereignty and the corresponding reduction in the ability of states to control banking activity occurring within their borders.135 As demonstrated in

131 Id.


133 *H.R. 1306 Hearings*, supra note 84 (statement of NCSL).

134 Id.

135 Id.
Part II of this paper, the state charter option is desirable given the vested interest state authorities have in determining the powers and regulation of financial institutions operating within the state's borders. Opponents argued that the Amendments' provisions regarding the application of home-state law and powers operated to give home-state laws an extra-territorial effect and resulted in the erosion of host-state control.\footnote{Id.}

Although this argument is facially valid and compelling, it ignores the ability of the multi-state state-chartered branch to simply convert to a national charter, thereby eroding state control over the banks operating within its borders. Considering the advantage of a national charter under the IBBEA, it was inevitable that host-states would lose the ability to control the banks within their borders as out-of-state state-chartered branches increasingly converted to national banks. In fact, under the IBBEA as its own chartered institutions began to branch across state lines, the host-state's institutions would most likely switch to a national charter, further reducing the host state's ability to exercise regulatory control over its banking institutions. The Riegle-Neal Amendments then are best viewed as a simple recognition of this an attempt to preserve the state-charter so that a states can retain regulatory control over the banks that they have chartered.

Examining the competitive status of host-state banks vis-a-vis out-of-state state-chartered branches, opponents of the Amendments asserted that out-of-state state-chartered branches would be able to exercise powers not otherwise permitted a host-state bank.\footnote{Id.} In this manner, an out-of-state state-chartered branch would operate with a competitive advantage over the host state's chartered banks. The opponents therefore asserted that the championed parity created by the Amendments was only between out-of-state state-chartered banks and national banks at the expense of host-state banks.\footnote{Id.}
While under the Amendments host-state chartered banks may indeed face a power differential vis-a-vis out-of-state state-chartered branches, this situation can only arise where a national bank branch could also exercise the power. Therefore, the NCSL’s argument fails to recognize that the potential for a situation in which host-state institutions operated at a competitive disadvantage already existed under the IBBEA. The Amendments do not place host-state banks at any more of a competitive disadvantage than they already face from national banks under the IBBEA. Rather, the Riegle-Neal Amendments simply seeks to eliminate the incentive of state-chartered banks to convert to a national charter to obtain the competitive advantage. Furthermore, market pressures will force state legislatures and banking regulators to respond to any competitive disadvantage faced by its chartered banks or risk losing the bank to a competing state or federal charter.

The NCSL also railed against the expanded effect of OCC preemption decisions under the Riegle-Neal Amendments.\textsuperscript{139} Under the Amendments, preemption of host-state law will additionally result in their non-application to out-of-state state-chartered branches. Considering that states generally abhor the OCC’s power to preempt their laws, the NCSL resistance to the measure seems only natural.

Again, although the NCSL’s argument is potentially valid, it overlooks features of the Amendments Act which considerably lessens the force of the point. First, under both the IBBEA and the Amendments the only host-state law that is applicable to a national bank, and therefore subject to preemption by the OCC, pertain to the community reinvestment, consumer protection, fair lending and intrastate branching. Second, to the extent that these laws are preempted by the OCC, out-of-state state-chartered branches are required to comply with their home state laws regarding such subjects. Therefore, while the Amendments do expand the effect of OCC preemption decisions, this effect is diminished to the extent that the home state banking laws contain similar provisions as those evident in the host state. Furthermore, since the

\textsuperscript{139} Id.
Amendments Act requires the OCC to annually report any decisions to preempt state law, the report may serve as a check on the OCC willingness to preempt a state’s laws.

Opponents of the Amendments, particularly consumer advocates raised concerns that the regime of interstate branching if the Amendments were enacted would lead to a race to the bottom as states clamored to become the banks’ “home state of choice” by passing less restrictive laws, typically to the disadvantage of the consumer.\textsuperscript{140} The Consumers’ Union argued that the Amendments encourages banks to shop for a regulatory environment that was most favorable to the banks and potentially least favorable to consumers.\textsuperscript{141} In this manner state authorities will dampen consumer protection laws in an effort to attract bank charters to the disadvantage of consumers located beyond the authorities’ immediate constituency and to which the lawmakers are not directly accountable.

The Consumers’ Union point is overly simplistic to hold much weight. First, any law that dilutes the consumer protection for a host-state citizens initially and most directly affects home-state citizens -- a constituency to which lawmakers are well attuned. More fundamentally, the argument ignores the plain language and operation of both the IBBEA and the Amendments Act. Regardless of whether the branching institution is a national bank or state-chartered bank, host-state law regarding consumer protection is preserved and applies to all institutions. In the rare event that a host-state’s law regarding consumer protection is preempted, then the state-chartered branch must comply with the consumer protection laws of its home state. Furthermore, the idea that banks will move its home state simply to take advantage of an additional power or to avoid the effect of a consumer protection law, ignores the reality that bank chartering decisions take into account a number of factors. Indeed, the presence of a number of

\textsuperscript{140} H.R. 1306 Hearings, supra note 84 (statement of Michelle Meir, Government Affairs Counsel, Consumers’ Union) [herein after statement of Consumers’ Union].

\textsuperscript{141} Id.
state charters in New York, a state with relatively comprehensive consumer protection laws, weighs against the idea that institutions will immediately run to the lowest denominated state.\textsuperscript{142}

Finally, opponents of the Amendments cried foul in the alteration of the IBBEA’s basic provisions under which the majority of state legislatures had voted to permit interstate branching.\textsuperscript{143} The original provisions of the IBBEA provided that branches of an out-of-state state-chartered bank would enjoy only the same powers as a host-state chartered bank.\textsuperscript{144} Taking issue with proponents’ assertions that the power differential evident in the IBBEA was inadvertent and unintended, the NCSL claimed that it was the clear and intended operation of the IBBEA and it was with this understanding that state legislators cast their votes to permit interstate branching.\textsuperscript{145} Rep. Bruce Vento (D-MN), one of the IBBEA’s original drafters, also sought to make it clear that this effect of the IBBEA was no accident but rather the conscious act of the IBBEA drafters.\textsuperscript{146} According to the NCSL, a subsequent and fundamental alteration of the basic provisions regarding interstate branching enacted under the guise of clarification should not be tolerated.\textsuperscript{147} The fact that the opportunity to opt out of the IBBEA interstate branching provisions for all practical purposes had passed, further fueled the NCSL’s arguments.\textsuperscript{148}

There is some question or dispute as to the understanding of states with respect to applicable law and the ability of host states to regulate the activities of out-of-state state-chartered branches. Some testimony suggests that the Amendments Act only clarifies a basic assumption of the IBBEA and that the decision to opt into the branching liberalizations would

\textsuperscript{142} Id. (statement of CSBS).

\textsuperscript{143} Id. (statement of NCSL).

\textsuperscript{144} IBBEA, supra note 2, §105; See, P. Mulloy & C. Lasker, supra note 41, at 259-264.

\textsuperscript{145} \textit{H.R. 1306 Hearings}, supra note 84 (statement of NCSL).

\textsuperscript{146} Id. (statements of Rep. Bruce Vento (D-Mn)).

\textsuperscript{147} Id. (statement of NCSL).

\textsuperscript{148} The IBBEA opt-out deadline was May 31, 1997, see IBBEA, supra note 2.
not be altered. The NCSL testimony indicates, however, that the reduction in the amount of control exercised by host-states over out-of-state state-chartered institutions under the Amendments may have resulted in a larger number of states opting out of the IBBEA interstate branching provisions.

Regardless of whether or not states would revisit and ultimately reverse their original decisions regarding interstate branching, it was clear that the NCSL wanted to preserve the IBBEA's deference to state law as being the proper decision maker. Therefore, to better address the threat faced by the state charter and its contentions with the Amendments Act, the NCSL advanced a number of alternative proposals. The following section discusses these proposals and ultimately concludes that they were either impractical or did not adequately address the underlying problem.

First, the NCSL felt that state legislatures that opted to permit interstate branching should have to power to reconsider their decisions in light of the Amendments Act. Therefore, the NCSL advocated adding a provision to the Amendments that would permit individual states to enact legislation restoring the application of host-state laws to the activities of out-of-state state-chartered branches. Under the proposal, states would have one year in which to pass legislation opting to have the original provisions of the IBBEA control.

Although the proposal may best comport to the original intent of the IBBEA by allowing states to determine the nature of interstate branching, its practical effect would delay the implementation of interstate banking for a year. Considering that most states had readily opted to permit interstate branching under the IBBEA substantially well in advance of the original Amendments Act.

---

149 H.R. 1306 Hearings, supra note 84 (statement of Margarita Prentice, Member Washington State Senate).

150 Id. (statement of NCSL).


152 H.R. 1306 Hearings, supra note 84 (statement of NCSL).
deadline, it is not clear what postponing the effective date would further accomplish other than an increased delay in the implementation of full interstate branching. Furthermore, the proposal could result in a patchwork of resulting regimes as some states opted out of the Amendments while other states determined to follow the Amendments. Therefore, the NCSL opt-out proposal, created the possibility that the branch operations of one state-chartered bank would be governed by host-state law under the IBBEA, while a second branch of the bank located in another state would be subject to home-state law under the Amendments. Clearly, such a possibility would not address state-chartered banks’ concerns regarding applicable law and did nothing to offer the banks certainty as to regulation. The NCSL’s proposal was therefore properly rejected.

The NCSL also advocated requiring out-of-state state-chartered branches to obtain the written approval of the host-state banking supervisor before being able to exercise any extended powers under the Amendments Act. Like the opt-out proposal, this requirement is adopted would clearly fail to address the underlying problems of the IBBEA. First, the alternative proposal would not adequately address the power differential which could still develop to the extent that a host-state banking supervisor refused to sign off on the power. This withholding of authorization seems quite likely considering the host-state supervisor’s allegiance to its host-state banks. Furthermore, the alternative proposal did nothing to address the banks underlying concerns regarding certainty and would have created more regulatory burden for branching institutions. Like the opt-out proposal, this NCSL proposal was properly discarded.

Although opponents of the Riegle-Neal Amendments developed a number of arguments that arguably deserved more attention than they received in the legislative debates, ultimately one must reach the conclusion that the provisions of the Riegle-Neal Amendments must be in place for the state charter to survive. Perhaps the most valid argument against the Amendments Act enactment concerns not its result but its process. It is quite likely that if left to the states, a

153 Id.
similar solution would have been achieved especially considering the large number of state actors advocating the Amendments’ passage.

However, relying on state action to solve the IBBEA threat would be deficient in two ways. First, the timing of the debate and discussion of possible solutions occurred only a short time before the IBBEA provisions went into effect, thereby necessitating quick resolution. A response that hinged on the ability of the 48 states to coordinate and collectively agree, could not be relied upon to reach a solution in timely fashion, regardless of the states’ motivations to do so. Second, despite proponent’s assertions to the contrary, the Amendments were more than a mere clarification of existing law, they were a fundamental alteration.\textsuperscript{154} Specifically, the preemption of host-state laws in controlling the permissible activities of state-chartered branches altered the original operation of the IBBEA. As with the Cooperative Agreement’s assertion that home-state law applied, the states’ ability to credibly resolve the power differential was circumscribed by its inability to alter federal law. Therefore, not only were the substantive operation of the Amendments necessary to save the state charter, but also the enactment of those provisions had to come from federal authority.

V. THE INTERSTATE BRANCHING REGULATORY REGIME POST RIEGLE-NEAL AMENDMENTS ACT OF 1997

This section explores interstate branching regime and activities since the enactment of the Riegle-Neal Amendments Act of 1997.\textsuperscript{155} Specifically, the section draws a comparison between the current interstate branching regime in the United States and European Economic Community regime governing cross-border branching under the Second Banking Directive.\textsuperscript{156} The section

\textsuperscript{154} Indeed, a Senate manager’s amendment altered the name of the bill from the Riegle-Neal Clarification Act of 1997 to the Riegle-Neal Amendments Act of 1997 to indicate that its provisions substantively altered to operation of the IBBEA.

\textsuperscript{155} IBBEA, supra note 2.

then discusses recent branching trends and makes predictions regarding the future nature of
interstate branching in the United States. The focus here will particularly concern the future of
the state charter and by implication the dual banking system.
A. The IBBEA as Amended and the Second Banking Directive

The current regulatory structure governing interstate branching by United States banks
bears a strong resemblance to the cross-border branching regime in force in the European
Economic Community. The ability to compare the two regulatory systems will be helpful in
understanding the current United States interstate branching regime. Therefore, a brief discussion
of EEC banking regulation with respect to cross-border branching is outlined below followed by a
comparison of the current United State regime.

1. The Second Banking Directive

Adopted on December 15, 1989 and in force in the majority of Member States since
January 1993, the Second Banking Directive endeavors to create an internal market for banking
services among all the Member States of the European Economic Community.\footnote{157} The Directive
therefore attempts to facilitate the provision of cross-border banking services and branching
between and among Member States by allowing a single banking license to automatically enable
institutions chartered in one Member State to supply banking services throughout
the European Union.\footnote{158}

To delineate the rights and obligations of the branching institutions, the Directive contains
a home and host state concept. According to the Directive’s provisions a “Home Member State”
is a Member State in which the bank has been licensed.\footnote{159} A “Host Member State” means the

\footnote{157} Id.; For a general discussion of the Second Banking Directive see Craig M. Scheer, \textit{Note: The
Second Banking Directive and Deposit Insurance in the European Union: Implications for U.S.

\footnote{158} Second Banking Directive, supra note 156, pmbl., art. 24, at 1, 12.

\footnote{159} Id.
Member State in which a bank licensed by another Member State carries out activities or operates a branch.\textsuperscript{160}

Operating under a principle of "mutual recognition," the Second Banking Directive requires that each Home Member State's banking license to be valid throughout the Community. This principle of Home Member State recognition is limited within the Directive to an enumerated list of activities or powers included within the Annex to the Directive. To engage in an activity within a Host Member State, the contemplated activity must first be authorized by the bank's Home Member State and second must be included within the list of enumerated powers set forth in the Annex to the Second Directive.\textsuperscript{161} Based on the "universal banking" model and therefore not distinguishing between commercial and investment banking, the Annex acts as the outer boundary of Home Member State banks' activities within the Host Member State absent greater authorization of powers by the Host Member State.\textsuperscript{162}

With respect to the allocation of supervisory duties, the Second Banking Directive operates on the principle of "home country control."\textsuperscript{163} Under this principle, both a bank and its Host Member State branches are generally supervised by its Home Member State authorities. Host Member States retain primary responsibility for the supervision of liquidity of bank branches and exclusive responsibility for implementation of monetary policy provided that the measures are not discriminatory.\textsuperscript{164} Furthermore, Host Member State branches are required to comply with Host Member State laws that have been "adopted in the interest of the general good."\textsuperscript{165} Considering that European Union banks are subjected to common supervisory

\textsuperscript{160} Id.

\textsuperscript{161} Second Banking Directive, supra note 156, art. 18(2), at 9; C. Sheer, supra note 154, at 190.

\textsuperscript{162} C. Sheer, supra note 157, at 190.

\textsuperscript{163} Second Banking Directive, supra note 156, art. 18(2).

\textsuperscript{164} Id.

\textsuperscript{165} Id.
standards, similar capital requirements, limitations on non-financial services investments and exposure limits, as well as the close contact between European Union supervisors through a supervisory committee, reliance on home state supervision is not that objectionable.

2. **IBBEA as Amended vs. Second Banking Directive**

The brief outline of the regulation of cross-border branching by European Community banks under the Second Banking Directive demonstrates that the regulation of interstate banking in the United States and of cross-border branching is the European Community is roughly analogous. Therefore the Second Banking Directive provides a base of comparison in considering the current regulatory regime of interstate branching under the IBBEA since the enactment of the Riegle-Neal Amendments Act.

a. **Permission to Branch**

Like those banks wishing to engaging in cross-border branching under the Second Banking Directive, United States banks must meet initial base requirements before its supervisory authority will permit the bank to operate an interstate branch. For instance, the IBBEA contains restrictions concerning capital adequacy, competent management, CRA performance, and concentration and age limits on a bank’s ability to branch.\(^{166}\)

b. **Powers**

Although the process of determining the powers of an EEC cross-border branch and those of an out-of-state branch in the United States proceeds along incongruent lines of analysis, certain principles evident under the Second Banking Directive are present in the current United States regulatory regime. EEC cross-border branches must first find authorization to engage in the activity under its Home Member State’s law. Then, the EEC branch must determine that the activity is authorized under the Annex or Host Member State law. Therefore, absent further authorization by the Host Member State, the Annex act as the outer boundary delineating the permissible activities of the cross-border branch. It is possible then that a cross-border branch of

\(^{166}\) IBBEA, supra note 2, §102.
an EEC bank can engage in a greater expanse of powers than Host Member State banks in the event the Host Member State's authorized banking powers are less inclusive than that found under the Annex. Therefore, in general one would expect to see Member State's laws move toward a convergence of permitted powers that at a minimum includes those powers set forth in the Annex or risk forcing their institutions to compete with cross-border branches on an uneven playing field.

In the United States, the determination of permitted powers in an interstate context proceeds along two lines of analysis depending on whether the branching bank is chartered under federal or state authority. If branch in question is an out-of-state national branch, then the inquiry is straightforward; namely the branch is authorized to engage in any power that is available under federal law. For an out-of-state state-chartered branch the determination of permissible activities is a bit more complex, but roughly analogous to the inquiry of EEC banks under the Second Banking Directive. First, the out-of-state state-chartered branch’s home-state must authorize the power. Then, the out-of-state state-chartered branch must determine if the activity is permitted by either federal law or the host-state’s banking laws.

Under the IBBEA as amended, the regulatory structure with respect to state-chartered institutions is quite similar to that of the Second Banking Directive. For instance, United States federal law plays the same role as that performed by Annex to the Second Banking Directive. That is, under the United States regime, absent further authorization by host-state law, federal banking law acts as the outer boundary in determining the permissible activities of the out-of-state state-chartered branch. Furthermore, like in the EEC, the potential exists in the United States for host-state chartered banks to operate at a competitive disadvantage vis-a-vis out-of-state branches. Therefore, U.S. banks can expect to see state laws move toward a convergence of permitted powers that at a minimum includes the same powers permitted a national bank. This convergence seems quite likely to occur as states recognize that for their chartered institutions to effectively compete, state banking powers must keep pace with national bank powers. In such a
regime, the wild card statute is likely assume a greater importance and one would expect to see a greater use of the legislation to provide parity to state banks.

Even more than the cross-border branching regime of the Second Banking Directive, the current US regime governing interstate branching encourages state law to develop beyond federal law. In the EEC, there is little incentive for a Member State to expand its authorized powers beyond those set out in the Second Banking Directive because a cross-border branch can only engage in the activities beyond those set out in the Annex only if the Host Member State also authorizes it. Therefore, the Member State does not stand to capture any regulatory constituency by expanding the authorized powers.\textsuperscript{167} In the United States the opposite is true. In the event that both home and host states’ laws authorize powers beyond those permitted national banks, the state banks can operate at a competitive advantage vis-a-vis the national bank. In such a case, state charters could become more attractive to existing national banks and conversions to a state charter could begin to increase the regulatory sway of states. Although the potential competitive advantages of a state charter may not be completely realized considering federal laws regarding deposit insurance and the willingness of the OCC to expand national bank powers, the possibility exists and could spur state banks into new areas of activities more quickly than under the old system.\textsuperscript{168}

c. \textit{Supervision}

As noted the allocation of supervisory duties under the Second Banking Directive operated on the “home country control.” Therefore, Home Member State authorities are generally responsible for the supervision of both a Home Member State bank and its Host Member State branches with Host Member States retaining only residual supervisory

\textsuperscript{167} Furthermore, the list of enumerated powers set forth in the Annex is already quite expansive, certainly much more expansive than those permitted United States banks.

\textsuperscript{168} The Federal Deposit Insurance Corporation (FDIC) prohibits insured state banks from engaging in activities not otherwise permitted a national bank unless “the activity would pose no significant risk to the appropriate deposit insurance fund” and the state bank is in compliance with applicable capital standards.
responsibilities. Under common EEC law, European Union banks are subjected to common supervisory standards, similar capital requirements, limitations on non-financial services investments and exposure limits, therefore reliance on Home Member State supervision will approximate that of a Host Member State supervisory regime. The close contact between European Union supervisors through a supervisory committee also tends to make reliance on home state supervision more palpable.

In the United States, as with the determination of powers, the determination of proper supervisory authority depends on whether the out-of-state branch is chartered under federal or state authority. If the matter involves an out-of-state national bank branch supervisory duties fall to the OCC. State authorities lack any supervisory obligations or rights over the national bank branch. Supervisory issues regarding an out-of-state state-chartered branch is much more complicated. The Riegle-Neal Amendments did not alter the supervisory structure of the IBBEA under which it was left to the states to determine regulatory responsibilities through cooperative compacts. Therefore, under the current system, supervision of state chartered banks depends on a series of regional supervisory compacts enacted by individual state supervisors following the model set out by the Cooperative Agreement.\(^{169}\)

Under the Cooperative Agreement, the home-state regulator is responsible for the supervision, examination, application and enforcement of out-of-state, state-chartered branches.\(^{170}\) Host states retain the right to participate in the examination of state-chartered branches operating within its borders and can request a home-state regulator to conduct examinations to check compliance with host-state laws.\(^{171}\) Furthermore, host-state regulators can refer complaints to home-state regulator and under “appropriate circumstances” host-state

\(^{169}\) Cooperative Agreement, supra note 90.

\(^{170}\) Id. at §4.1.

\(^{171}\) Id. at §4.2.
supervisors are permitted to investigate disputes with state-chartered branches and even examine the branches independently during "emergencies."\(^{172}\)

d. **Applicable Law**

The greatest difference between cross-border branching under the Second Banking Directive and interstate branching under the current United States regulatory regime deals with the laws with which branches must comply. In both the United States and the EEC branches generally must comply with home state law, subject to certain host state "carve-outs." In the EEC, Host Member State branches are required to comply with Host Member State laws that have been "adopted in the interest of the general good."\(^{173}\) A 1997 Communication was developed to establish the criteria to determine the "general good." Generally, the Host Member State provision (1) must not be discriminatory, (2) must not impose higher requirements than those of a Harmonization Directive covering the subject, (3) must have a general good objective that (4) is not already safeguarded in the country of origin, (5) must be capable of guaranteeing that the objective will be met, and (6) must not go beyond what is necessary to achieve the objective pursued.\(^{174}\) In general these requirements are quite strict and set a high standard that must be met before a Host Member State's law can be labeled "for the general good," and applied to cross-border branches operating within the Host Member State.

In the United States, the default rule concerning applicable law is that for national banks, federal law applies and for out-of-state state-chartered branches, home-state law applies. Like the Second Banking Directive, the current regulatory regime in the United States preserves a role for host state law. However, in the United States regime host state laws play a greater role in that they apply to a greater extent to the out-of-state branches operating within their borders. Both the IBBEA and the Amendments Act explicitly reserve host-state laws regarding consumer

\(^{172}\) Id. at §§ 4.3 and 5.2.

\(^{173}\) Second Banking Directive, supra note 156, art. 18(2).

\(^{174}\) C. Sheer, supra note 157, at 213.
protection, community reinvestment, fair lending and intrastate branching.\textsuperscript{175} Absent federal law preemption or an OCC determination that the measure is discriminating, the host state provisions regarding the “Big Four” will apply to out-of-state branches of both national and state chartered banks.\textsuperscript{176} In the event of preemption or a finding of discriminative effect, the host-state law is not applicable to either branch forms, however out-of-state state-chartered branches must comply with the laws of their home state as to the subject.

B. Recent and Future Trends of Interstate Activity in the United States

To this point the paper has explored the initial regulatory structure governing interstate branching under the IBBEA and delineated the current regulatory structure under the IBBEA as amended by the Riegle-Neal Amendments Act of 1997. In the next section, I detail bank interstate branching trends in the last few years prior to the enactment of the Riegle-Neal Amendments and then make some predictions regarding the future nature of interstate branching by banks. Finally, I conclude with an examination of the relative strength of both the national and state charter in light of the Amendment to determine if the dual banking paradigm is safe.

1. Early Interstate Branching Trends

Cautious hesitation best describes the initial interstate branching forays by most banks. Despite the historic liberalizations of the IBBEA, relatively few banks have rushed to take advantage of its branching provisions to consolidate their interstate activities. By April 1996, 19 states had opted to permit interstate branching before the IBBEA deadline, however only seven applications to open branches had been recorded as of 1996.\textsuperscript{177}

Furthermore, with noted exceptions, most of the branching activity that has taken place consists of smaller community banks located close to state borders establishing a branch just across the border. For example, commenting on the recent decision of 1st Source Bank, a bank


\textsuperscript{176} Id.

\textsuperscript{177} Bill McConnell, News Analysis: After Long Fight for Branching Power, Banks Seem in No Hurry to Use It, AM. BANK., April 3, 1996, at 1.
headquartered in South Bend, Indiana, to open a branch in Michigan, the corporate marketing
director stated that “it was natural to branch across the state border where people read the same
newspapers and watch the same TV shows.”\textsuperscript{178} Although the Quad City Bank and Trust Co.,
headquartered in Bettendorf, Iowa recently turned its bank in Moline, Illinois (located right
across the Mississippi river) into a branch operation, Steve Moser, the deputy superintendent of
the Iowa Division of Banking claimed that few Iowa state banks seemed interested in engaging in
interstate branching.\textsuperscript{179}

The IBBEA’s branching liberalizations were predicted to have a far greater impact on the
operations of multi-state BHCs as they would increasingly consolidate their operations under a
single charter, with considerable cost savings to sprawling operation, therefore one would expect
to see large BHCs taking immediate advantage of the IBBEA. Countering this expectation, initial
trends demonstrate a disuse of the IBBEA interstate branching provisions. Indeed, by April,
1996 despite early opt-in legislation authorizing interstate branching in 19 states, the OCC had
received only four applications by banks seeking to open an interstate branch.\textsuperscript{180}

Although NationsBank, headquartered in Charlotte, North Carolina, combined its multi-
state operations under one charter through the use of the IBBEA’s interstate branching
provisions, many more large banks are pursuing the “agency alternative” rather than interstate
branching.\textsuperscript{181} For example, BankAmerica merged its Idaho and Washington operations, but even
though it had operations five of the six western states that enacted early opt-in legislation, bank
officials decided to offer agency services rather than use the interstate branch option.\textsuperscript{182} Under
the “agency alternative” the bank can authorize agents to take deposits, accept mortgage

\textsuperscript{178} Laura Pavlenko Lutton, \textit{In Midwest, Interstate Doesn’t Mean Going Far}, AM. BANK.,

\textsuperscript{179} Id.

\textsuperscript{180} B. McConnell, supra note 177.

\textsuperscript{181} Id.

\textsuperscript{182} Id.
payments and carry out other customer transactions. Although the cost savings of an agency operation is not as evident as that of a branch, the alternative does facilitate customer service benefits.

2. Recent and Future Trends in Interstate Branching

Despite the initial reluctance of banks to engage in widespread interstate branching bank industry officials and analysts contend that it is only a matter of time before interstate branching operations become widespread. Therefore, the agency alternative is best viewed as an initial step toward interstate operations and consolidation rather than as the ultimate choice of banks. Indeed, recent evidence indicates that the number of bank charters a large multi-state bank is operating with is on the decline. Therefore, it appears that banks are warming to the ability to operate on a branch basis. Furthermore, as the banking industry becomes more and more consolidated and competition requires banks to provide more cost-effective services, the branch, with its ability to present back-office efficiencies will undoubtedly become the preferred method of conducting interstate activities.

In this manner the BHC form as commonly conceived is likely to vanish. Considering the BHC’s principle purpose was to allow interstate ownership of banks, under the new permissive branching regime the form’s value will fade. The demise of the BHC form seems inevitable especially as regulators allow a wider range of uses for operating subsidiaries. However, it is important to note that the BHC will still be of some use to certain types of banking operations for the immediate future, at least for the next 3 years. For instance, Chase Manhattan Bank still operates in BHC because it owns the Texas Commerce Bank in Houston which can’t be made a branch considering that state’s opt out legislation and as a state-chartered bank it still needs the BHC form to operate its “Section 20” securities affiliate.  

---

3. The Future of the State Charter and Dual Banking System

The resulting structure governing interstate branching under the IBBEA after the Riegle-Neal Amendments presents a model in which the future of the dual banking system in general, and the state charter specifically, is promising. Although operating an interstate branch under a national charter presents some advantages, state charters are not without their own particular charms. The competing charters recognize a rough equality but with unique advantages that differ in their attractiveness to different banks. Therefore, the IBBEA as amended by the 1997 Riegle-Neal Amendments preserves a rough parity so that no one charter is clearly preferable to the other.

a. National Charter Benefits

First, the most salient benefit offered an out-of-state bank by the federal charter concerns examination and enforcement issues. It is clear that the procedure for an out-of-state national branch is less uncertain and generally less complicated than that for an out-of-state state-chartered branch. A nationally chartered bank is subject to the regulatory oversight of only one regulator, the OCC. Furthermore, the examination and enforcement under a national charter is quite certain.

Although the out-of-state state state-chartered branch examination procedure under the Cooperative Agreement deals with the problems of interstate branch examination and enforcement of state-chartered banks in a logical way, there are several deficiencies with the current system. First, the cooperative agreements are voluntary in nature and individual states can withdraw from their structures with 90 day’s notice. Second, there are substantial questions regarding the ability of a states to enforce the agreements absent action by individual state legislatures. Indeed, it is widely recognized that “[t]he whole system [of state cooperative agreements] is going to have to rely on the good will of commissioners to operate effectively.”

Despite incentives to cooperate, having the cooperative agreements' effectiveness turn on the abilities of diverse regulators to "get along" means that the operation of the supervisory structure can not be assured. Compounding this, there is always the possibility that individual regulators may act selfishly to protect their autonomy. In this manner, bickering among state regulators can bring the whole compact system crashing down.

Second, the national charter alternative may still present some benefits with respect to powers. It is important to keep in mind that the Riegle-Neal Amendments did not authorize new powers for state-chartered banks. Rather, state-chartered institutions must initially find authorization to conduct a power in its home-state's banking laws. If states are too slow to expand the powers to keep pace with OCC decisions or if the expansion of powers leaves state-chartered banks subject to regulation by other state authority, the banks may opt for the national charter. Considering the uncertain effect "wild card" statutes in expanding the powers of state banks in the past, state-chartered institutions may find they still operate at a competitive disadvantage vis-a-vis a national bank. To the extent that this power differential is widespread or pertain to beneficial activities, one would expect the national charter to prevail among banks.

The effect of preemption decisions may also lead to increased conversions under the Riegle-Neal Amendments. If a particular host-state law is preempted, a national bank no longer must comply with its provisions, however if the state-chartered branch's home state contains a similar provision to that of the host-state, the state-bank branch must still comply with that home-state law despite ability of national banks to avoid it. If the OCC continues to preempt host-state law for national banks, there is still a risk that national charters may become the charter of choice among banks.

b. State Charter Viability

Despite the foregoing factors possibly giving rise to a preference for a national charter, several features of the current system seemingly provide for a regime in which the states will continue exercise charter authority. These features consist of incentives for state banking law to
adopt and evolve in step with national banks, the increased oversight of OCC preemption
decision, and several regulatory advantages accorded a state charter.

First, considering the states’ incentives to maintain their regulatory authority, it is logical
to believe states will be increasingly aware of and respond to any competitive disadvantages its
institutions may confront. Under the Riegle-Neal Amendments Act of 1997, national bank
powers are the minimum powers available to a state-chartered bank operating across state lines,
as long as these powers are authorized by the chartering state. Indeed, a state-chartered bank can
exercise powers beyond those of a national bank in any state where that power is authorized by
both the bank’s home state and its host state. However, it is important to consider that given the
provisions of the Federal Deposit Insurance Act, the reality of state banks obtaining powers far
exceeding that of national banks seems remote.185 Nevertheless, it seems plausible that states
will increasingly utilize their wild card statutes to create parity between state and national banks
and in some cases permit greater powers to the state-chartered institutions.

Second, OCC preemption, while creating the possibility for national charter preference is
subjected to increased Congressional scrutiny. Under the Riegle-Neal Amendments, the OCC
must make an annual report to Congress regarding its preemption decisions. To some extent, this
increased oversight may temper the OCC’s willingness to preempt state laws or risk an
unfavorable Congressional response. With the OCC’s preemption powers subject to possible
Congressional check, the potential that such decisions would give rise to a national charter
preference, while not impossible, is somewhat reduced.

State regulation in general offers substantial benefits to a bank that insures its continued
viability. State examination fees, on average, are about half as much as those paid by national

185 The Federal Deposit Insurance Corporation (FDIC) prohibits insured state banks from
engaging in activities not otherwise permitted a national bank unless “the activity would pose no
significant risk to the appropriate deposit insurance fund” and the state bank is in compliance
with applicable capital standards. The FDIC has issued regulations concerning permissible state
bank powers. For a summary of this regulation see, State Bank Powers: FDIC Sets Boundaries
20, 1993).
banks. States can offer its banks these lower fees due to lower overhead as state banking regulators often rely on FDIC or FRB to conduct examinations. For instance, a national bank with $10 billion in assets national bank will pay roughly $1.4M per year to OCC to cover basic supervision costs.\textsuperscript{186} Comparatively, state bank fees for a similar sized institution would vary but typically be around $600,000.\textsuperscript{187}

It is important to note that recent federal proposals may have the effect of reducing this cost savings feature of the state charter. For instance, some have suggested charging states for federal examinations, but no official action has yet been taken. Furthermore, recognizing the cost disparity in supervisory fees and the incentive it creates for banks to opt for a state charter, the OCC has reduced its fees. These proposed cuts are estimated to save national banks $10 million annually in fees and $30 million annually through a 6\% reduction in supervisory assessments.\textsuperscript{188} However, the OCC has not moved to using the FDIC and FRB “free” examinations in its own supervision of national banks and the recent agreements between these federal regulators and state authorities will act to further reduce the regulatory burden to which a state chartered institutions is subject.\textsuperscript{189} In sum, there still remains a significant cost advantage to maintaining a state charter.

States offer a further advantage in providing close proximity to bank regulators. "State departments are on the ground. They know the bank, they know the management, they know the local community and they know the trends that are afoot in the state's economy."\textsuperscript{190} This


\textsuperscript{187} Id.


\textsuperscript{189} Id.

\textsuperscript{190} James B. Watt, \textit{The Dual Banking System Now More Than Ever, Address at the Annual Meeting and Conference of the Conference of State Bank Supervisors} (April 15-18, 1994).
proximity provides state banks with greater access to policy- and decision-makers. Because state supervisors know the banks’ local markets better, they are capable of better responding to the state banks’ developing needs. Indeed, there is widespread belief that state regulators offer greater responsiveness, streamlined examinations, speedier applications and quicker decisions that available under federal regulation. In this manner state regulation is more personalized and better suited to specific institutions. Furthermore, state regulation can offer an evaluation of local needs and conditions without need to decide matters on a nationwide basis. Perhaps because of the need for the OCC’s to consider the impact of its decisions on a larger scale, there is a perception among bank managers that the OCC is more rigorous in its examination practices than that of state regulators.

In short, under the current regime, the national and state charter present a variety of benefits. In evaluating these benefits, different banks and bank managers will consider the benefits of varying importance. With no one charter presenting a clear advantage over the other, banks’ abilities to choose between roughly analogous but still unique charters has been preserved. In an effort to attract and retain banks, federal and state regulators will continue to compete with one another to offer their banks expanded services, more efficient and responsive service and less costly regulation. In sum, the dual banking dynamic will continue to operate and serve the United States banking system in an environment of permissive interstate activities in the same way it has over the last 130 years.