

SUBJECT: Prohibiting interstate branch banking

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 6 ayes — Marchant, Carona, Elkins, Grusendorf, Patterson, Romo

0 nays

3 absent — Giddings, Gutierrez, Hudson

WITNESSES: For — Cleve T. Breedlove, David R. Seim, J. Pat Hickman, and Karen Neeley, Independent Bankers Association of Texas; Bernie Francies, Business Control Systems, Inc.; Durwood Tucker, Texas Farm Bureau; Charles Carter, Independent Cattlemens Association of Texas; Robert Howden and Christine Mitchell, National Federal of Independent Business/Texas; Shayne Woodard, Texas Association of Builders.

Against — Fredrick M. (Rick) Smith, Community Bank of Waco and the Texas Bankers Association; Harvey R. Mitchell and Lee Rona McKinney, Bank One, Texas; John M. Heasley, Texas Bankers Association; Jerry Killingsworth; Robert H. Sewell, Equitable Bank and Texas Bankers Association; Gene D. Wyatt; Tom Daniels, Comerica Bank Dallas; Merriman Morton, Texas Commerce Bank, Austin

BACKGROUND: *Interstate banking* refers to the operations of bank holding companies that own or operates banking subsidiaries in more than one state. Each subsidiary bank must have its own capital and board of directors and management, comply with separate regulatory reporting requirements and be separately examined. Each bank is taxed separately and legally treated as a separate corporate entity.

Under *interstate branching* a bank may consolidate existing bank operations as branches in various states. The branches are offices of the parent bank and share the parent bank's board of directors and management.

Texas has allowed interstate banking since 1986 and unlimited intrastate branch banking (banks engaging in business at more than one Texas location) since 1988. Texas does not permit interstate branch banking.

Out-of-state bank holding companies may acquire Texas banks, but the Texas subsidiary banks must be chartered in Texas and governed by a board with a majority of Texans.

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 allows nationwide interstate banking beginning September 29, 1995, regardless of state law, and interstate branching beginning June 1, 1997.

The act allows states to either opt-in or opt-out of federal interstate branching provisions. If a state chooses not to participate in interstate branching, it must pass a law to opt-out by June 1, 1997. (Whether a state may opt-in once it has opted-out is unclear since the law is silent on the subject.) Once a state opts-in to interstate branching, it cannot later opt-out. If a state does not affirmatively opt-in or opt-out by June 1, 1997, the state's national banks will be allowed to branch in and out of the state, but its state-chartered banks will not be allowed to branch outside of the state.

The Riegle-Neal Act provides that no one bank may have more than 10 percent of insured deposits nationwide nor more than 30 percent of insured deposits in any state with branches. States, however, may waive the 30 percent concentration limit.

Generally, each Texas bank charter files one report, examined by federal regulators for compliance with the Community Reinvestment Act, based on its statewide operations. The Riegle-Neal Act requires separate Community Reinvestment Act (CRA) evaluations for each state in which an interstate bank has a branch — one for each Metropolitan Statistical Area (MSA) with a population of at least 250,000 in which a bank branch is located and one for all areas outside the MSAs. (Texas has 11 MSAs this size.)

Any branch of an out-of-state national or out-of-state bank is subject to state law with respect to intrastate branching, consumer protection, fair lending and community reinvestment as if it were a branch of an in-state bank, unless federal law specifically preempts state law or the state laws are discriminatory. Branches of out-of-state banks are subject to all the same state laws as in-state banks.

DIGEST: CSHB 889 would prohibit a national bank with its main office in Texas or a Texas-chartered bank from merging with a national bank with its main office outside Texas or a bank chartered in another state. It would prohibit an out-of-state bank from establishing a branch bank in Texas and a Texas bank from establishing a branch bank in another state.

CSHB 889 would take effect immediately if approved by a two-thirds vote of the membership of each house.

SUPPORTERS SAY: CSHB 889 would prevent federal law from superseding Texas state law on interstate branch banking. It would allow Texas to maintain state control over its banking laws and regulate how interstate banks may operate here. Texas should opt-out of interstate branch banking to maintain local control and accountability of the banking community, keep Texas deposits from being siphoned off to other regions, assure that small business and agriculture receive needed loans and keep the state's independent and community banks alive.

The Riegle-Neal Act is special interest legislation for the nation's largest banks and will lead to consolidation of control of the nation's financial system in a few hands. Riegle-Neal is the first step towards eliminating the dual state-national banking system. It is ironic that the federal government would pass a law that would consolidate the national banking system, just when the emphasis in Washington has shifted to local control on most other issues.

Banks doing business in Texas should be controlled by and accountable to Texans. Interstate banks would be less responsive to local needs. Under Texas law, any bank can come to Texas, and once here can branch statewide. However, the bank must have Texas charter and be managed by a Texas board of directors. Unless Texas opts-out of the Riegle-Neal Act before June 1, 1997, banks operating in Texas would no longer be required to maintain a Texas charter or be governed by Texans.

Interstate branch banks would take the deposits they get from Texas communities and export them to support loans in other states. The Texas House Select Committee on Small Business Access to Capital reported that Texas deposits already are being exported to support loans elsewhere.

Interstate branching would exacerbate this situation. Out-of-state banks such as NationsBank, Bank One, Texas Commerce Bank, First Interstate Bank and Bank of America already control more than 50 percent of the banking deposits in Texas. The select committee found that out-of-state banks make less than 28 percent of small business loans and less than 8 percent of the agricultural loans in Texas. They would reinvest even less in these important sectors of the Texas economy if their Texas operations were no longer required to be managed by a Texas board of directors with ties to the local communities.

Allowing out-of-state institutions to consolidate their already massive national operations through interstate branching will give them a competitive advantage over community-owned banks. As out-of-state banks reduce costs, they could initiate predatory pricing tactics to draw deposits from smaller banks. Smaller independent banks that focus on serving the community rather than skimming deposits to be transferred out-of-state will be severely damaged in the long term.

State banking laws eventually could be preempted by federal law for national interstate banks. This would give national banks a tremendous competitive advantage over Texas-chartered banks. The comptroller of the currency, the regulator of national banks, recently said that national banks would operate under a uniform banking law when operating on an interstate basis. He added that state-chartered institutions would have to comply with banking statutes and regulations in each state where it maintained an interstate branch.

Allowing out-of-state banks to consolidate their operations will cost Texas jobs. The large banks have said they will save as much as \$50 million a year by converting to nationwide branch banking. Savings will be achieved by eliminating local boards of directors, centralizing loan offices and trimming staffs. Branch managers will be accountable only to the bank's out-of-state corporate headquarters, eliminating local accountability.

At least eight other states are considering bills to opt-out of interstate branching, and another six states are seriously studying the issue. Colorado is reported to have already passed opt-out legislation.

Branches located outside a Metropolitan Statistical Area will not have to report individually under the Community Reinvestment Act (CRA). Community banks would continue to be examined for community reinvestment, but competitor branches of an out-of-state bank in a non-MSA would not have to provide adequate information to properly evaluate their local reinvestment performance because all interstate bank branches outside the MSAs would be lumped together. Furthermore, a recent U.S. Justice Department opinion said that regulators have no power to impose penalties or other sanctions for noncompliance with the federal CRA.

Even if interstate branching is inevitable, HB 889 would allow the state time to get proper laws into place on consumer protection, fair lending, community reinvestment and taxes to mitigate its adverse effects. The Legislature could choose to opt-in next session and would only be less than three months behind other states. However, if we fail to opt-out now, there will no incentive for the large bankers to come to the table to agree to needed consumer protection laws.

If the state does not opt-out of interstate branching, it might lose up to \$36 million in the 1998-99 biennium. Texas bank franchise taxes are tied to a bank's domicile. A bank lacking a Texas charter and domiciled outside the state would not be liable for state franchise tax while a Texas-chartered bank would be, another competitive advantage.

**OPPONENTS
SAY:**

The Riegle-Neal Act is an important step to modernize the nation's antiquated banking system. It received nearly unanimous approval in both houses of Congress. The act provides states with new opportunities to influence the operation of interstate banking companies, which Texas will lose out on if the state opts out. Interstate branching will allow banks to be more efficient and ultimately make them more competitive and their products more attractive to the consumer.

Interstate branch banking would allow banks to geographically diversify risk to the Federal Deposit Insurance Corporation (FDIC) and would lower costs. The banking system has seen its share of the financial market decline from 40 percent in 1974 to about 24 percent. Competitors, such as securities firms, insurance companies, mutual funds, money market funds

and savings and loans have no geographic constraints. The Riegle-Neal Act is an attempt to help banks compete with other institutions.

Texas already allows interstate banking and unlimited intrastate branching. HB 889 would only serve to stifle the banking industry and economic development, costing the state jobs. Interstate branching will make Texas stronger financially. It will save the banks millions of dollars, which they could loan throughout the state.

If Texas opts out of branch banking, it will send a negative signal to major financial institutions just as the economy is resurging and businesses are looking for a strong capital lending base to keep the state moving forward. Texas may lose business as large businesses and banks that provide financial services related to the North American Free Trade Agreement (NAFTA) move to states like California and Arizona that have friendlier banking laws.

If the state opts-out, national banks headquartered in Texas may be forced to relocate to another state in order to be able to branch, and Texas state-chartered banks will not be able to branch out-of-state.

The Riegle-Neal Act will allow the state to control the operation of interstate branches if the state does not opt-out. Interstate banks would have to comply with Texas community reinvestment, fair lending, consumer protection, intrastate branching and antitrust laws.

The federal act substantially expands federal Community Reinvestment Act (CRA) requirements for interstate branches and provides greater accountability in community reinvestment. Today the Texas subsidiary bank of an out-of-state bank holding company is only required to file one CRA report based on its statewide operations. If Texas opts-in to interstate branching, CRA reports would be required for 11 Metropolitan Statistical Areas (MSA) and one for areas outside the MSAs.

The federal act prohibits interstate companies from using branches for collecting deposits only. Banks would be required to maintain loan-to-deposit ratios of at least 50 percent of the state average loan-to-deposit ratio, which is now about 60 percent. This means that an interstate branch

would have to maintain a loan-to-deposit ratio of at least a 30 percent to continue operating in Texas. If Texas opts-out of inter-state branching, the Riegle-Neal CRA and loan-to-deposit provisions would not apply to Texas interstate banks.

Opting in would actually increase state bank tax revenues. The Texas Bankers Association supports legislation to tax interstate branches based on recommendations of the Multistate Tax Commission. These new tax laws would increase the tax burden of interstate banks, but leave the tax burden of Texas-based banks the same or reduced.

Interstate branching is no threat to the independent and community banks in Texas. Texas has de facto interstate branching today, and small community banks are thriving, as they have since interstate banking was introduced in Texas in the mid-1980s. The five largest banks control about 35 percent of the state's federally insured deposits, but the other banks control 42 percent of the deposits, up from 28 percent in 1988. Because all banks would operate under uniform guidelines, branch banks could not make loans that would undercut the existing banks in rural communities.

Only two other states are seriously considering opting-out of branch banking, while as many as 18 states are may opt-in early. State and national banks headquartered in Texas would not be able to branch interstate. Texans would lose the job opportunities from large banking subsidiary operations such as data processing.

Opting out is likely to be a permanent decision, despite arguments to the contrary. The Riegle-Neal Act is ambiguous and ultimately will be interpreted by the courts. Texas cannot afford to lock in permanently as an opt-out state.

NOTES:

In addition to opting out of inter-state branch banking, HB 889 as filed would have amended the Banking Code provisions pertaining to compliance with the 1977 Community Reinvestment Act and would have repealed provisions of the code dealing with branch banking and bank holding companies.

Related banking bills include: HB 1543 by Marchant, revising the Banking Code of 1943; HB 2627 by Craddick, taxing banks based on their where business is conducted, rather than where the banking corporation is domiciled; HB 1289 by Patterson, requiring all banks, savings and loans institutions and credit unions and holding companies with deposits of \$300 million and offices in more than one county to submit financial reports (bank "call" reports) to the Texas Finance Commission; and HB 2857 by Raymond, requiring that at least 2 percent of all loans made by a bank and bank branch be made in rural communities.