The branch banking boom in Illinois: A byproduct of restrictive branching laws

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What’s behind the boom in bank branches across Illinois, particularly in Chicago? The authors explore the history of branch banking within the state and across the nation to help explain this recent trend and discuss its future implications.
The explosion of bank branches

In addition to suppressing banking office growth, Illinois’ once restrictive branching environment also protected small banks, allowing a relatively large number of them to operate in the state. In 1994, Illinois had 994 banks (0.84 banks per 10,000 residents) with an average of $296 million in assets (in 2006 dollars). Nationwide (excluding Illinois), each state had on average 207 banks (0.60 banks per 10,000 residents) with $871 million in assets (in 2006 dollars). Today, though there are fewer banks nationwide, Illinois is still home to more small banks than other states, on average. As of June 2006, Illinois had 650 banks (0.54 banks per 10,000 residents) with $545 million in assets, while other states had on average 145 banks (0.43 banks per 10,000 residents) with $1,858 million in assets.

Because this environment allowed many small banks to exist, Illinois’ banking markets were among the least concentrated in the country (measured at both the city level and state level), and this trend continues today. Using a common measure of market concentration, Illinois was less concentrated than 47 states in 1994.3 Back then, Chicago was the third least concentrated metropolitan area out of 369 metropolitan areas in the U.S. Interestingly, the relaxation of branching restrictions in Illinois did not significantly change the concentration of its banking markets. In 2006, Illinois was less concentrated than 42 states, while Chicago was the sixth least concentrated metropolitan area out of 369 metropolitan areas in the U.S.

Figure 1 shows the change in the total number of banks versus the total number of banking offices from 1935 through 2006; the vertical lines represent major regulatory changes.

These two observations—that Illinois’ banking markets are relatively unconcentrated and that Illinois has experienced higher branch growth—are related. Figure 2 shows this pattern: The trend line illustrates a negative relationship between branch growth and market concentration. This figure plots the percentage growth in banking offices with our measure of market concentration for the largest 15 cities. Chicago is located in the top left-hand corner of the figure, above the line; of these 15 cities, it has experienced the highest branch growth and remains the most competitive market. Interestingly, five of the seven cities plotted above the trend line are located in states that were once unit banking states.

The political economy of bank branching

There are a number of reasons why Illinois and many other states enacted restrictive branching regulations. One objective was to limit the power of banks by constraining their size. Opponents of branch banking thought that if banks became too large they would exert excessive political and economic influence.7 Residents were concerned that if big banks were allowed to branch into small towns, they would siphon deposits out of these towns and use them to make loans to larger clients in financial centers.8 As a result, small businesses and local communities would be without the capital they needed to thrive. Branching restrictions were also intended to make banking safer by shielding banks from excessive competition9 and to protect and enhance state banking regulation fees, which made up a large percentage of many states’ revenues.10

The banks that were the beneficiaries of these regulations were naturally strong supporters of branching restrictions. Bankers in small towns, in particular, lobbied effectively against branch banking, motivated in part by their desire to insulate themselves from competition by larger out-of-state banks.11

Experience has shown that branch banking did not merit many of these early concerns. When states introduced statewide branching, banks’ loan losses and
noninterest expenses decreased significantly, and these savings were largely passed along to consumers in the form of lower loan rates. Branching has been shown also to increase the stability of the banking system by reducing bank failures through diversifying banks’ customer base and increasing competition, forcing less efficient banks to exit.

Deregulation: What changed?
The preceding discussion highlights how regulation of bank branching involved competition among several parties. Disparate interests among the various parties provided an environment that allowed continuance of branching restrictions as barriers to entry, meant to protect the competitive position of small banks. These restrictions did, for a while, enhance small banks’ profits. However, a number of events undermined the value of supporting these restrictions on branching. Lobbies for small banks in Illinois had the political clout for many years to defeat attempts to liberalize the state’s branching laws. Significant changes to the branching laws finally surfaced in the 1980s when the benefits of local monopolies were being challenged by technological advances, such as automatic teller machines (ATMs) and telephone banking. At the same time, high interest rates and increased competition from nonbanks made it more difficult for many banks to maintain profitability. As a result, some faltering banks desired to merge with larger banks but were unable to do so because of branching restrictions. As technological and economic factors threatened the status quo, the net burden of maintaining regulatory restrictions increased until one-time opponents began to support liberalization of branching laws.

One of the most significant changes to branching laws, however, sprang from external forces. In 1987, a court ruling in Mississippi allowed national banks to branch in Illinois and 20 other states. The ruling did not apply to state-chartered banks. Illinois politicians were thus concerned that the state’s current branching restrictions would put state-chartered banks at a disadvantage relative to federally chartered banks. As a result, in 1993, Illinois changed its laws to allow all banks to branch within the state without restriction.

Conclusion
Will this expansive branching trend in Illinois, particularly in Chicago, continue, or will it fall in line with national branch growth rates? This question seems appropriate in light of consumers’ rapid adoption of online banking and electronic payments. Recent contradictory announcements by Chicago banks give no clear indication. Several banks plan to build additional branches in Chicago in hopes of generating new accounts; estimates suggest that more than 90% of new transaction accounts in the U.S. are opened at physical branches.

Conversely, the market may be poised for a slowdown in branch growth, as several financial institutions announced plans to close underperforming branches in the Chicago area. As the Illinois banking market becomes more saturated, banks may decide they can no longer maintain the current number of banking offices.

While the future growth of bank branching in Illinois is unclear, there is one lesson: Though an overarching objective of the original branching restrictions was to prevent large out-of-state banks from competing with smaller banks, ironically, these restrictions have contributed to a great deal more local competition in the long run.

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1 Branch banking is defined as a single legal bank entity operating more than one banking office. See C. E. Cagle, 1941, “Branch, chain, and group banking,” in Banking Studies, Federal Reserve Board, Baltimore, MD: Waverly Press, p. 113. In our article, banking offices include both

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main offices (banks) plus “other” offices (branches) of state and national banks.

Branching statistics in this article are calculated by the authors using Federal Deposit Insurance Corporation (FDIC) data.


Bank branching is governed by both federal and state level laws; laws at either level may affect branching across state lines (interstate branching) and/or branching within a state (intrasate branching). Federal law allows national banks to branch wherever state banks are allowed to branch, but does not grant national banks any additional branching powers.

Concentration is measured using the Herfindahl-Hirschman Index (HHI), calculated from Federal Reserve and FDIC bank data. For further details, see www.usdoj.gov/atr/public/testimony/hhi.htm.


Kroszner and Strahan (1999).

Note, however, a provision in the 1982 Garn–St Germain Act authorized federal banking agencies to arrange interstate acquisitions for failed banks with total assets of $500 million or more.

Kane (1996).

Department of Banking and Consumer Finance v. Clarke, 809 F.2d 266 (5th Cir.) cert. denied, 483 U.S. 1010 (1987).
