

The Midwest prepares for interstate banking

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Although interstate banking is not yet a nationwide reality and remains prohibited by the McFadden Act and the Douglas Amendment to the Bank Holding Company Act of 1956, many have already begun to hail its arrival. A variety of banking and related services are currently available on a multistate basis. For instance, a growing list of nonbanking activities permitted by section 4(c)(8) of the Bank Holding Company Act of 1956—such as equity financing, securities brokerage services, and futures commission merchant activities—may be offered by bank holding companies without geographical limitation. Banks may also expand across state lines via loan production offices, Edge Act corporations, and electronic funds transfer (EFT) networks. In addition, the Garn-St Germain Depository Institutions Act of 1982 provides opportunities for banking organizations to purchase failing financial institutions across state lines.

A question important to midwestern banking organizations and consumers in need of financial services is whether the region is a net supplier of such services to the rest of the country or a net importer of these services from out-of-state institutions. The geographic source of financial services becomes an increasingly important issue as banking regulations are relaxed and as nationwide competition among banks and nonbank financial institutions increases. Consumers benefit, both in the availability and price of services, when competition is keen.

This article analyzes Seventh District financial services to determine whether the District is a net importer or exporter of financial services. After analyzing current interstate banking activity coming from, or directed toward, the five Seventh District states, it is concluded that, although the District is a net supplier of inter-

state financial services, a great potential lies largely untapped.

Examination of these activities is based primarily on numbers of office locations for the various services, not the dollar volume of activity generated from these offices or their assets. The bank-related activities of nonbanking firms will not be examined here.¹

Permissible interstate activities

Bank holding companies are currently permitted, under Section 4(c)(8) of the Bank Holding Company Act of 1956 as amended and Regulation Y, to engage in a broad scope of nonbanking activities (Table 1). The offering of these services is not subject to the geographical limitations of banking; e.g., a bank holding company located in Chicago may provide trust services through an office in Phoenix, Miami, or Anchorage.

The number of bank holding companies headquartered in Seventh District states, along with the number of their 4(c)(8) subsidiaries and offices is shown in Table 2. As of year-end 1981, Illinois, with 70 offices, led the District states in number of 4(c)(8) interstate subsidiaries. Bank holding companies headquartered in only three other states—New York, California, and Pennsylvania—have established more of these subsidiaries.

Even so, District states are net receivers of 4(c)(8) services with 368 offices located inside their boundaries, as opposed to 124 offices

¹An interstate comparison based on total assets would be valuable; however, the difficulty in obtaining asset breakdowns by type of activity precludes such a comparison here.

For an analysis of nonbank competition, see "Competition in Financial Services: The Impact of Nonbank Entry," by Harvey Rosenblum and Diane Siegel, Federal Reserve Bank of Chicago, *Staff Study 83-1* and "Banks and Nonbanks: A Run for the Money," *Economic Perspectives*, July/August 1983, and Harvey Rosenblum and Christine Pavel, "Financial Services in Transition: The Impact of Nonbank Entry," *Staff Memoranda 84-1*. All of these publications are available from the Chicago Fed's Public Information Department.

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Table 1

**Permissible nonbank activities for bank holding companies under Section 4(c)(8)
of the Bank Holding Company Act and Regulation Y
(December, 1983)**

Activities permitted by regulation

1. Extensions of credit²
 - Mortgage banking
 - Finance companies: consumer, sales, and commercial
 - Credit cards
 - Factoring
2. Industrial bank, Morris Plan bank, industrial loan company
3. Servicing loans and other extensions of credit²
4. Trust company²
5. Investment or financial advising²
6. Full-payout leasing of personal or real property²
7. Investments in community welfare projects²
8. Providing bookkeeping or data processing services²
9. Acting as insurance agent or broker primarily in connection with credit extensions²
10. Underwriting credit life and accident and health insurance
11. Providing courier services²
12. Management consulting to all depository institutions
13. Sale at retail of money orders with a face value of not more than \$1000, travelers checks and savings bonds^{1, 2}
14. Performing appraisals of real estate¹
15. Issuance and sale of travelers checks
16. Providing securities brokerage services and related securities credit activities¹
17. Arranging commercial real estate equity financing¹
18. Underwriting and dealing in government obligations and money market instruments¹
19. Foreign exchange advisory and transactional services¹
20. Acting as a futures commission merchant¹

Activities permitted by order

1. Issuance and sale of travelers checks^{2, 6}
2. Buying and selling gold and silver bullion and silver coin^{2, 4}
3. Issuing money orders and general-purpose variable denominated payment instruments^{1, 2, 4}
4. Futures commission merchant to cover gold and silver bullion and coins^{1, 2, 6}
5. Underwriting certain federal, state and municipal securities^{1, 2, 6}
6. Check verification^{1, 2, 4}
7. Financial advice to consumers^{1, 2}
8. Issuance of small denomination debt instruments¹
9. Arranging for equity financing of real estate⁶
10. Acting as futures commissions merchant⁶
11. Discount brokerage

emanating from bank holding companies located in District states. Although the District states house approximately 23 percent of the nation's bank holding companies, their 4(c)(8) activities account for only about 11 percent of the nation's 4(c)(8) interstate subsidiaries, and only 2 percent of the number of interstate offices.

Bank holding companies and their nonbank subsidiaries may also participate in interstate expansion via loan production offices and Edge Act corporations. Eleven of the 13 Edge Act cor-

porations in the Seventh District are located in Chicago; Detroit and Milwaukee have one each. Twenty interstate Edges emanating from District states are found in California, Massachusetts, Minnesota, and New York.

Loan production office (LPO) distribution is shown in Table 3. The twenty-six interstate LPOs are located in four of the five District states. There is no LPO activity in Wisconsin. Banks from Illinois and Michigan have originated 32 LPOs in 14 states outside their home states. In this activity, the Seventh District (that is, Illinois

Table 1 (cont.)

Activities permitted by order (cont.)

12. Operating a distressed savings and loan association
13. Operating an Article XII Investment Co.
14. Executing foreign banking unsolicited purchases and sales of securities
15. Engaging in commercial banking activities abroad through a limited purpose Delaware bank
16. Performing appraisal of real estate and real estate advisor and real estate brokerage on nonresidential properties
17. Operating a Pool Reserve Plan for loss reserves of banks for loans to small businesses
18. Operating a thrift institution in Rhode Island
19. Operating a guaranty savings bank in New Hampshire
20. Offering information and transactional services for foreign exchange services.

Activities denied by the Board

1. Insurance premium funding (combined sales of mutual funds and insurance)
2. Underwriting life insurance not related to credit extension
3. Sales of level-term credit life insurance
4. Real estate brokerage (residential)
5. Armored car
6. Land development
7. Real estate syndication
8. General management consulting
9. Property management
10. Computer output microfilm service
11. Underwriting mortgage guaranty insurance³
12. Operating a savings and loan association^{1, 5}
13. Operating a travel agency^{1, 2}
14. Underwriting property and casualty insurance¹
15. Underwriting home loan life mortgage insurance¹
16. Investment note issue with transactional characteristics
17. Real estate advisory services

¹Added to list since January 1, 1975.

²Activities permissible to national banks.

³Board orders found these activities closely related to banking but denied proposed acquisitions as part of its "go slow" policy.

⁴To be decided on a case-by-case basis.

⁵Operating a thrift institution has been permitted by order in Rhode Island, New Hampshire, California, and Illinois.

⁶Subsequently permitted by regulation.

SOURCE: Board of Governors of the Federal Reserve System

and Michigan) appears to be a net provider of loan services to other parts of the country.

Table 4 lists the states whose banks and holding companies have established interstate offices in District states, whether through 4(c)(8) activity, LPOs, or Edge Act corporations. New York, Massachusetts, Minnesota, and California are the predominant states establishing a presence in the Midwest.

The Garn-St Germain Depository Institutions Act of 1982 provides another interstate opportunity. Banks and savings and loan associa-

tions may acquire failing financial institutions across state lines. The Act ranks these acquisitions in order of preference, favoring combinations between the same type of institution in the same state. In considering out-of-state offers, those institutions in adjoining states are to be given priority over those from non-adjacent states. Acquisitions by these favored parties, however, do not always prevail. On January 20, 1984, the Board of Governors approved an application by Citicorp to acquire First Federal Savings and Loan Association of Chicago and its

Table 2
Interstate 4(c)(8) activity of
Seventh District state bank holding companies

Holding company home state	Holding companies with home office in state			Holding companies with interstate 4(c)(8) subsidiaries		
	One- bank	Multi- bank	Total	Holding companies	Subsidiaries	Offices
Illinois	316	7	323	5	24	70
Indiana	66	1	67	3	11	38
Iowa	268	16	284	2	2	3
Michigan	18	24	42	1	3	6
Wisconsin	82	28	110	2	3	7
District state Total	750	76	826	13	43	124
U.S. total	3201	430	3631	139	382	5500
District as a % of U.S. total	23.4	17.7	22.7	9.4	11.3	2.3

SOURCE: Federal Reserve Board data as of December 31, 1981 and the Federal Reserve Bank of Atlanta. 4(c)(8) refers to the section in the Bank Holding Company Act (together with Regulation Y) that permits bank holding companies to engage in nonbank activities.

62 offices statewide under this provision of the Garn Act.²

The most rapidly growing type of interstate expansion is by means of EFT or automated teller machine (ATM) networks. Each of the District states is involved in some form of interstate EFT network. Table 5 lists the EFT networks in each District state and indicates those that are interstate. Note that the majority of EFT services available in the District are provided by networks based in the District.

Often these regional systems will join together to form a national network. For instance, four regional systems in the District have recently

become members of Nationet, a national EFT network tying 3,408 financial institutions in 26 states. In October 1983, when Nationet became a nationwide network, it had a total of 12 member networks; the members from District states include Iowa Transfer System, Des Moines, Iowa; Magic Line, Detroit, Michigan; Electronic Funds Illinois, Inc., Chicago, Illinois; and Tyme Corporation, Browndeer, Wisconsin.³

In addition, the Board of Governors recently granted approval for a joint venture—Money Transfer System, St. Louis, Missouri—to begin operating in Missouri and Kansas.⁴ This organization plans to expand to Iowa, Illinois (which requires an ATM reciprocity agreement), and Kentucky. This data processing network includes a system of shared ATMs and will recruit savings

²See 70 *Federal Reserve Bulletin* 157 (February 1984). Also, for a discussion of Citicorp's acquisition of Fidelity Federal Savings and Loan Association of San Francisco, see 68 *Federal Reserve Bulletin* 656 (October 1982). Although this acquisition was approved prior to the passage of the Garn-St Germain Act, it generally complies with the procedure later finalized.

³Robert M. Garsson, "Nationet Launches 26-State ATM Operation," *American Banker*, October 14, 1983, pp. 1, 15.

⁴69 *Federal Reserve Bulletin* 643 (August 1983).

Table 3

Loan production office activity

LPOs entering the District states

State	Offices	States
Illinois	21	8
Indiana	1	1
Iowa	2	2
Michigan	2	2
Wisconsin	0	0
Total	26	10*

LPO activity originating from District states

State	Organizations	Offices	States entered
Illinois	4	31	13
Michigan	1	1	1
Total	5	32	14

*This figure represents the total number of states outside the Seventh District with an established LPO presence within the District. Due to intradistrict movements and states with an LPO presence in more than one District state, this figure does not represent the sum of the numbers above it.

SOURCE: Federal Reserve Bank of Atlanta survey of the top 200 banking organizations, 1983.

and loan associations as members as well as banks.⁵

State banking laws

The banking laws of each of the Seventh District states are summarized in Table 6. Multi-bank holding companies, intrastate and interstate, are prohibited in Indiana. Only Iowa and

⁵One means of interstate expansion whose legality has not yet been decided is proposed by Dimension Financial Corporation. Dimension proposes to establish 31 "nonbank banks" (i.e., banks that do not issue commercial loans and thus do not fall under the statutory definition of a bank in section (2) of the BHCA) in 25 states nationwide. The application was filed in March 1983 with the Comptroller of the Currency and no ruling has been made to date. An Illinois bank located near the site of a proposed Dimension "bank" and several other banking associations are protesting the application for two reasons. First, they assert that the nationally-chartered "banks" to be acquired by Dimension are subject to the Bank Holding Company Act and violate its interstate banking prohibitions (section 3(d), the so-called Douglas Amendment). It has also been charged that Dimension itself would be a subsidiary of a savings and loan association, causing further legal and regulatory complications.

Table 4

Holding company activity in Seventh District by state and type of activity

4(c)(8) Activity	Location in District				
	IA	IL	IN	MI	WI
California	X	X	X	X	X
Connecticut		X	X		
Delaware	X	X	X	X	X
Illinois				X	X
Indiana		X		X	
Maryland		X			X
Massachusetts		X			
Minnesota	X	X	X		X
New York		X	X	X	X
Oregon		X		X	
Pennsylvania		X	X		X
Rhode Island		X	X	X	X
Wisconsin		X		X	
LPO					
California		X			
Georgia		X			
Illinois				X	
Kentucky		X	X		
Maryland		X			
Massachusetts				X	
Missouri	X	X			
New Jersey		X			
New York		X			
North Carolina		X			
Ohio		X			
Pennsylvania		X			
Washington		X			
Interstate Edge					
California		X			
Massachusetts		X			
Minnesota					X
New York		X			

SOURCE: Federal Reserve Bank of Atlanta survey of the top 200 banking organizations, 1983.

Illinois allow grandfathered out-of-state bank holding companies to continue expanding within the state. None of the states currently has a reciprocal interstate banking agreement with another state. Illinois's recently enacted law allowing multibank holding companies restricts their expansion to designated regions of the state. These limitations are also imposed on the grandfathered out-of-state holding companies.⁶

⁶Further analysis of the Illinois multibank law may be found in "First Year Experience: Illinois Multibanks Shop Carefully," by Sue E. Gregorash, *Economic Perspectives*, May/June 1983.

Table 5

District participation in EFT networks

State of origin (if interstate)	Network	Interstate (yes/no)	Number of states covered
Illinois			
	The Answer System	No	1
	ATM Network Management Corp.	No	1
	Cash Station	No	1
	Computer Research Co.	No	1
	Easy	No	1
	*Electronic Funds Illinois, Inc.	No	1
	Money Network	No	1
	Shared Network Corp.	No	1
	Yes	No	1
Indiana			
	Access 24	No	1
Ohio	Jeanie	Yes	3
Ohio	The Owl Network	Yes	3
Iowa			
Iowa	*Iowa Transfer System	Yes	3
Michigan			
Michigan	Any Time Teller	Yes	2
Wisconsin	Continet	Yes	3
	*Magic Line	No	1
Wisconsin	*Tyme Corporation	Yes	2
Wisconsin			
	A.O. Smith Data Systems Division	No	1
Wisconsin	Continet	Yes	3
Minnesota	Fast Bank	Yes	5
Wisconsin	*Tyme Corporation	Yes	2

*Member of national EFT network (Nationet).

SOURCE: *EFT Interchange: A Directory of Shared ATM Services*, American Bankers Association, 1982.

These bank holding companies are exercising their opportunities to expand in Iowa and Illinois, as seen in Table 7. General Bancshares Corporation of St. Louis received Board approval in August 1983 to add a fourth bank to its Illinois holdings. Northwest Bancorp in Minneapolis owns 11 banks in Iowa and is the largest bank holding company in that state. Its most recent Iowa acquisition was in 1980.

The only Seventh District bank holding company to own banks outside of its home state to date is Northern Trust Corporation of Chicago. Within the past two years it has begun acquiring banks in Florida pursuant to a grandfather provision in Florida's banking law. At year-end 1983, Northern Trust Corporation owned four banks in Florida.

Since the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980, the Garn-St Germain Act, and prior and subsequent de jure and de facto deregulation of the banking industry, banks and thrift institutions are becoming more direct competitors. In general, savings and loan associations are subject to less restrictive state branching and expansion laws than are banks. In Seventh District states, savings and loan associations may branch statewide. Table 8 shows the interstate expansion of savings and loan associations affecting the Seventh District. As banks and savings and loan institutions begin to compete more and more for the same customers, some form of parity should be established regarding their respective expansion powers.

Table 6**Impediments to expansion: state banking laws**

<u>State</u>	<u>Out-of-state entry permitted</u>	<u>Reciprocity</u>	<u>Branching</u>	<u>Intrastate bank holding company expansion permitted</u>
Illinois	Only permits expansion of grandfathered companies ¹	None ²	No branching; limited service facilities only	Within a designated region or contiguous region
Indiana	None	None	Limited	No multibank holding companies permitted
Iowa	Only through expansion of grandfathered companies ¹	None	Full-service facilities permitted within county of head office or in a contiguous county	Statewide; subject to size limit of 8 percent of total state deposits
Michigan	None	None	Same or adjacent county as head office if within 25 miles; home office protection	Statewide
Wisconsin	None	None	Same or adjacent county as head office if within 25 miles; home office protection	Statewide

¹Iowa and Illinois allow expansion by companies with bank or trust company subsidiaries grandfathered by the 1956 Bank Holding Company Act. The Illinois multibank holding company law, effective January 1, 1982, grandfathered an additional out-of-state holding company.

²Illinois law requires a reciprocity agreement for its interstate ATM network participants.

Table 7**Interstate bank activity
(August 31, 1983)***

<u>Out-of-state banking organizations having bank subsidiaries in District states</u>	<u>Number of organizations</u>	<u>Number of banks</u>	<u>Number of branch offices</u>
Illinois	1	4	4
Iowa	1	11	50
Wisconsin	3	6	22
District state banking organizations with banking activity outside home state			
Illinois	1	4	NA

*Branch office data as of December 31, 1981.

SOURCE: Board of Governors of the Federal Reserve System.

Table 8
Interstate savings and loan activity
involving Seventh District states (March 1983)

Name of institution	Home state	Coverage
1. Empire of America Federal Savings Association	Michigan	MI, FL, NY, TX
2. Home Savings of America, Federal Savings and Loan	California	CA, FL, IL, MO, TX
3. Bay Savings Bank	Michigan	MI, VA
4. Union Federal Savings and Loan of Evansville	Indiana	IN, KY

SOURCE: Federal Home Loan Bank Board.

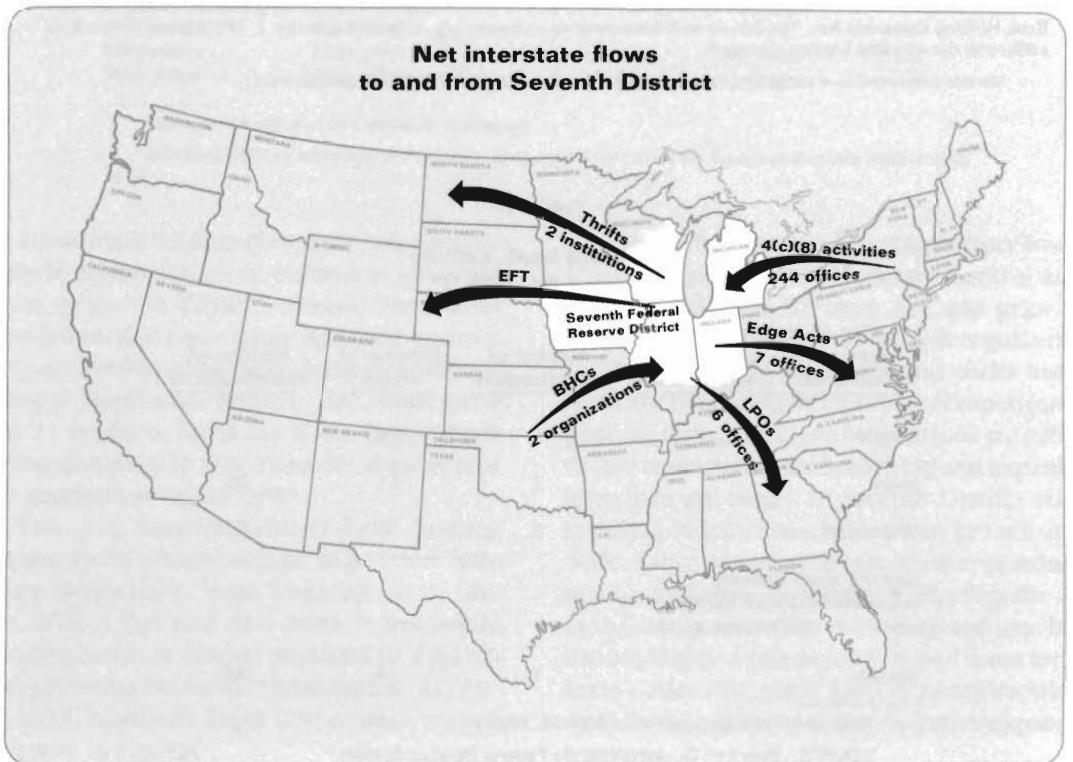
Summary

On the whole, the Seventh District states are net exporters of interstate banking services, except for 4(c)(8) activities. The District is well covered with EFT networks, and the services of four of these networks are available nation-

wide. Out-of-state bank holding companies own more subsidiary banks inside Seventh District states than Seventh District bank holding companies own in the rest of the nation, primarily due to acquisitions prior to the Douglas Amendment and the grandfather provisions of Iowa and Illinois law. Most of the bank holding companies with a nationwide presence have offices in Seventh District states. As with international banking offices, many of these offices have been established as a convenience to the banks' current customers and not for the purpose of

usurping market share from local banks.

Although the District is a net supplier of interstate services, potential still exists for expansion. The Seventh District states house almost one-quarter of the nation's bank holding companies, yet it does not provide a proportionate share of most interstate financial services. Fur-



ther, it would seem that bank holding companies in financial centers such as Chicago and, to a lesser extent, Detroit, would be among the nation's leading innovators in interstate activity. A possible explanation for this relative inactivity is the restrictive state banking laws in Indiana and Illinois that limit multibank holding company expansion and thus encourage one-bank holding company formations, accounting for the District's disproportionately large share of holding companies. Many of these one-bank holding companies are small and have not yet diversified into nonbanking activities even on a local basis, much less an interstate one.

Unlike New England, neither the District nor the Midwest has established any regional cohesion, as is demonstrated currently by the absence of reciprocity agreements in this area. In fact, the limiting intrastate multibank holding company laws of Illinois and Indiana tend to discourage intra-regional support.

Future

Barring any blanket authority at the national level for interstate acquisitions, development will probably continue in the same areas of EFT, §(c)(8) activities, loan production offices, and expansion by grandfathered bank holding companies. Now that some of the larger bank holding companies have established themselves in major

metropolitan markets across the country, they may seek to establish offices in smaller, regional markets, and, conversely, regional bank holding companies may establish themselves in metropolitan areas. For instance, First Union Corporation of Charlotte, N.C., recently opened an office in Chicago. Its purpose is not so much to compete for Chicago business as it is to enhance its image in its home region, the Southeast. NCNB National Bank of North Carolina, also in Charlotte, and Wachovia Financial Corporation, Winston-Salem, N.C., had previously established Chicago offices.⁷

Some banks and holding companies have entered into contractual agreements to combine should it ever become permissible by state or federal law. Such a case exists in the Seventh District, where First Bank System, Inc., Minneapolis, has announced an agreement to acquire Banks of Iowa, Inc., Cedar Rapids, and its 11 subsidiary banks. Other banks may be actively developing their correspondent network and enhancing services and computer hardware/software compatibility with their respondent banks in hopes of cultivating potential marriage partners. In most services, the Seventh District appears to be among the leaders in interstate banking activity.

⁷Steven L. Strahler, "Outsiders Grasp for Chicago's Businesses," *Crain's Chicago Business*, October 17, 1983, p. 29.