Structural Changes in the Banking Industry in the Last Decade

Professor Lissa L. Broome
Director, Center for Banking and Finance
UNC School of Law

I. Time Period (Jan. 1, 1996 to Jan. 1, 2006)
   
   A. In honor of publication of Volume 10 of North Carolina Banking Institute Journal

II. Number of significant changes, but I will focus on structural changes in the location of operations for bank holding companies and their banks, and changes in the activities that may be undertaken by bank holding companies and bank subsidiaries

   A. Other significant changes, but not discussed here, include:

      1. USA PATRIOT Act of 1999, especially provisions in Title III relating to anti-money laundering and customer identification procedures
      2. Consumer issues
         a) State anti-predatory lending legislation
         b) Payday lending
         c) Arbitration agreements in consumer credit contracts and availability of class relief

III. Structural Changes in the Geographic Scope of Banking

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

      1. Repealed Douglas Amendment to the Bank Holding Company Act (BHCA) to permit interstate banking—acquisition of a bank in any state by a bank holding company (BHC) regardless of state law
         a) Interstate banking already occurring in many states under the Douglas Amendment to the BHCA that required state statutory authorization and pursuant to state regional reciprocal interstate banking statutes.
         b) State “age” requirements for the acquired bank (of up to 5 years) will be honored.
            (1) A shell bank formed for an acquisition shall be deemed to have been in existence for as long as the bank to be acquired by the shell
            (2) SC has a five-year age requirement
2. Riegle-Neal set trigger date of June 1, 1997, to permit interstate bank mergers (and hence interstate branching)

   a) States could opt out of interstate bank mergers by enacting a state law between September 29, 1994 and June 1, 1997. Only two states did so (Montana and Texas) and both states’ laws have since expired

   b) States could opt in to interstate bank mergers before the June 1, 1997 trigger date by enacting a state statute.

      (1) NC enacted an opt-in statute in 1995.

   c) An interstate acquisition of a branch of a bank is only permitted if state law permits an interstate branch acquisition

      (1) Only 18 states permit an out-of-state bank to establish a de novo branch, and 14 of those condition de novo branching on reciprocal home state laws.

      (2) NC law allows acquisition of a branch in NC by an out-of-state bank if the home state of the out-of-state bank has a reciprocal statute permitting a NC bank to acquire a branch in that state. NC law also permits an out-of-state bank to establish a de novo branch in NC.

      (3) SC does not have an affirmative authorization for an out-of-state bank to acquire an in-state branch

3. 10% nationwide deposit cap

   a) If BHCs and banks allowed to expand into new markets, traditional antitrust analysis would find no lessening of competition by a merger that replaces Bank A with Bank B. (In an in-market merger, Bank A and Bank B are competing against each other and their merger reduces the number of banks in the market and the competition in the market).

   b) The 10% nationwide deposit cap seems designed to deal with this issue by reaffirming one of themes present throughout our country’s history with respect to banking law that “big is bad.” Nationwide deposit share may not by acquisition exceed 10%.

B. Examination of resulting changes in structure of banking industry

1. Result: fewer banks, but given local flavor of banking still many more than in most countries. Some of reduction in the overall bank numbers came from mergers within multi-bank holding companies, and some from mergers between holding companies holding banks in different states.

   a) Number of FDIC-insured commercial banks as of December 31

      (1) 1986 -- 14,210
      (2) 1995 -- 9,942
b) Ratio of in-market mergers to all mergers was 50% or above for 1994 through 1996, but declined to 40% and 36.7% respectively for 1997 and 1998 once interstate branching became fully operational. Pilloff, at 13 (Table 15). The percentage of in-market mergers returned to above 50% for 1999 through 2003, and exceeded 60% in 1999, 2001, and 2003. Id.

c) As of September 30, 2005, there were 107 total state or federally chartered banks, savings banks, and savings and loans in North Carolina, which includes

- 70 state chartered banks
- 18 state savings banks
- 1 state savings and loan

2. Largest mergers

a) For the top 20 mergers based on asset size of the target bank from the period 1994 to 2003, NationsBank Corporation (now Bank of America) or First Union (now Wachovia) was the acquirer in 6 mergers. Pilloff, at 9 (Table 7). Two other mergers in the top 20 involved Fleet Financial as the acquirer, an institution which itself was acquired by Bank of America in 2004. Id.

- NationsBank Corporation and BankAmerica Corporation -- 1998 (#1)
- First Union Corporation and Wachovia Corporation (2001) (#7)
- Fleet Financial Group, Inc. and BankBoston Corporation (1999) (#9)
- First Union Corporation and CoreStates Financial Corporation (1998) (#14)
- NationsBank Corporation and Boatmen’s Bancshares, Inc. (1997) (#15)
- FleetBoston Financial Corporation and Summit Bancorp (2001) ($17)
- First Union Corporation and First Fidelity Bancorporation (1996) (#20)

b) Additional large mergers involving North Carolina banks in 2004 and 2005, include

- Wachovia and SouthTrust (2004)
- Bank of America and MBNA (2005)

c) Additional NC mergers of interest


- National Commerce Financial Corporation acquisition of CCB and continued operation in NC d/b/a CCB, even though resulting entity a
national bank (National Bank of Commerce headquartered in Memphis, Tenn), followed by SunTrust acquisition of National Commerce (following SunTrust’s failed bid for Wachovia). SunTrust has changed CCB name to SunTrust.

(3) Southern National Corporation and BB&T Financial Corporation (1995) (#49)

3. Result: Mega-banks

a) Trillion dollar holding companies emerged from this process

(1) Citigroup Inc.-- resulted from 1998 merger of Citicorp and Travelers Group, a combination of banking and insurance that predated the Gramm-Leach-Bliley Act and undoubtedly influenced its passage

(a) Assets of $1.47 trillion as of September 30, 2005

(2) Bank of America Corporation

(a) Assets of $1.26 trillion as of September 30, 2005

(3) JPMorgan Chase & Co. -- Resulted from 2004 merger of J.P. Morgan Chase & Co. with Bank One Corp. The resulting bank abandoned its New York state charter for Bank One’s national charter. JPMorgan Chase Bank is headquartered in Columbus, Ohio.

(a) Assets of $1.20 trillion as of September 30, 2005

(4) The fourth largest holding company, Wachovia, is less than half the size JPMorgan Chase & Co.

(a) Assets of $532 billion as of September 30, 2005

(5) The ninth largest holding company is SunTrust Banks

(a) Assets of $172 billion as of September 30, 2005

(6) BB&T is the 14th largest bank holding company

(a) Assets of $107 billion as of September 30, 2005

b) There are two banks with assets in excess of one trillion dollars: Bank of America, N.A. and JPMorgan Chase Bank, N.A. B of A is the largest with $1.05 trillion in assets.

(1) Citibank is number 3 in bank size, with $704 billion in assets

(2) Wachovia is number 4, with $478 billion in assets
(3) SunTrust is number 7 (and the largest state chartered bank), with $171 billion in assets

(4) Branch Banking and Trust Company is number 14 with $78 billion in assets

c) Geographic reach of franchises. Notwithstanding the tremendous size of these institutions, they do not have nationwide reach

(1) B of A has the greatest nationwide reach with branches in 29 states and the District of Columbia

(2) Wachovia has banking offices in 15 states and the District of Columbia

(3) BB&T has banking offices in 11 states and the District of Columbia
d) Implications for regulators

(1) Too big to fail?

(2) Effect of bank conversion from state to national or national to state on regulatory system
e) Test of 10% deposit cap

(1) B of A has butted up against this in its recent mergers, but has so far avoided a problem by

(a) Benefiting from growth in insured deposits as the result of banks owned by brokerage firms

(b) Advocating for an expansive definition of deposits (to include offshore and trust deposits), and

(c) Lowering interest rates on certain savings accounts and CD deposits and bleeding off deposits to competitors. In B of A’s merger with MBNA (January 1, 2006), the combined deposits of B of A and MBNA were 10.2% when the merger was announced in June 2005. For the third quarter of 2005, Bank of America’s weighted average rate on money market, savings, and NOW accounts was 1.21%, while the comparable rates for Wachovia and SunTrust were 47 and 27 basis points higher, respectively. The deposit percentage was below 10% at the time the FRB approved the merger in December 2005.

(d) Upon consummation of MBNA acquisition, savings account and CD rates may increase and attract deposits that would put B of A in excess of the 10% nationwide cap. That is permissible under Riegle-Neal.
(2) U.S. acquisitions will be curtailed or only be of very small institutions

(3) Result?

(a) Law will be changed or

(b) More growth in foreign countries like the recent stakeout investment in China

4. Relatively little happening in international banking

a) Foreign banks in U.S.

(1) Significant acquisitions. Five of the top 50 mergers from 1994-2003 involved foreign acquirers of U.S. banks, including

(a) Deutsche Bank AG and Bankers Trust Corporation (1996) (#18)

(b) Royal Bank of Canada and Centura Banks, Inc. (2001) (#46)

(2) Foreign banking assets in the U.S. have grown at a rate similar to that of the assets of domestic institutions and have held a relatively constant market share of 4 to 5 percent of total U.S. banking assets. FDIC, at 25.

(3) The largest foreign-owned, FDIC-insured commercial bank or savings institution is HSBC Bank USA, NA. RBC Centura Bank is the 10th largest foreign-owned bank or savings institution. FDIC, at 29.

b) U.S. banks abroad

(1) In 1984, the five U.S. banking organizations with the greatest amounts of international assets held slightly more than half of all international assets reported by U.S. banks. FDIC, at 25, 27

(a) In 2004, the share of international assets held by the top five U.S. banks had increased to 87%.

(b) As of December 31, 2004

(i) Citibank had 42% of all U.S. bank foreign office assets.
(ii) JPMorgan Chase Bank had 34%
(iii) Bank of America had 8% (including Fleet)
(iv) Wachovia had 2% (and was in the 6th spot).

(2) Some stake-out investments like that of B of A in China and Mexico

(a) China is removing restrictions on foreign participation in banking as part of its 2001 accession to the WTO. FDIC, at 28.
5. FDIC article concludes that “international integration of the U.S. banking industry may be following, rather than leading, the wider expansion of global commerce. Indications are that better performance may be more easily attained in the domestic U.S. market, and most U.S. banks remain satisfied with a purely domestic focus. Overseas, a few large institutions continue to dominate the foreign banking activities of U.S.-based banks.” FDIC, at 33.

6. Other depository institutions

   a) Savings banks and savings and loans

       (1) Numbers continue to dwindle. As of September 30, 2005, only 1,315 federal and state savings institutions.

           (a) 339 of these institutions are mutual institutions.

       (2) Similar to community banks

           (a) Pressures on savings banks and smaller, community banks brought about by increasing costs of legal and regulatory compliance, including

               (i) Anti-money laundering

               (ii) Internal controls from Sarbanes-Oxley

   b) Credit unions—many in number (8,903), but far fewer than in previous years

       (1) Challenge to NCUA field of membership regulations in NCUA v. First National Bank & Trust Co., 522 U.S. 479 (1998), immediately followed by passage of Credit Union Membership Enhancement Act of 1998 that permitted multiple groups each with their own common bond to join together in a single credit union.

       (2) Limitations on asset powers and need for additional capital could push some credit unions to convert to mutual savings banks (who could then later convert to stock savings banks)

       (3) Credit unions operate in a manner very similar to community banks, but as non-profit entities are exempt from income taxes. This is a continuing sore spot for bankers.

IV. Changes in Powers of Bank Holding Companies and Banks

A. Passage of the Gramm-Leach-Bliley Act (GLBA) in 1999

   1. Created a new subgroup of bank holding companies, financial holding companies (FHCs), that may engage in financial in nature activities, including securities underwriting, insurance underwriting, insurance agency, and merchant banking

   2. Created financial subsidiaries of banks (to engage in insurance agency and securities underwriting).
3. Added privacy provisions and requirement of annual dissemination of privacy policy by a financial institution to its customers


   a) Significant regulatory loosening of section 20 of the Glass-Steagall in December 1996 to permit BHCs to own securities firms. Section 20 provided that a bank could not be affiliated with a company that is principally engaged in underwriting securities. The Federal Reserve Board interpreted this to mean that if the underwriter received less than 25% of its revenue from underwriting bank-ineligible securities activities, the underwriter was not principally engaged in underwriting securities.

      (1) This FRB interpretation permitted the first wave of BHC acquisitions of securities firms. For instance, First Union acquired Wheat First Butcher, NationsBank acquired Montgomery Securities, and Wachovia purchased Interstate/Johnson Lane.

   b) After GLBA, FHCs or financial subsidiaries may underwrite bank-ineligible securities without limit.

   c) The two-way street (with securities firms also owning banks) has not come about except to the extent that some brokerages own a bank to serve as an FDIC-insured place to deposit uninvested customer funds

   d) Enron fall-out caused some to question whether banking and securities belong together after all.

5. GLBA undid 1982 amendments to BHCA and permitted FHCs to underwrite insurance and annuities and act as insurance agents

   a) Financial subsidiaries of banks may act as insurance agents without the place of 5,000 restriction set forth in 12 U.S.C. § 92 for national banks, or any restrictions under state law for state banks

   b) Insurance agency powers have been widely utilized

   c) Insurance underwriting authority has not been utilized much (perhaps because of lower ROE on insurance)

      (1) Citigroup has spun off Travelers

      (2) MetLife owns a bank

      (3) State Farm Bank is a savings bank and State Farm operates it as a grandfathered unitary savings and loan holding company

6. GLBA granted authority for FHCs to make merchant banking investments (investments in nonpublic companies)
7. GLBA has not so far turned out to be an additional source for new “financial in nature” activities
   a) FRB approval of finder (also allowed for national banks under OCC interpretation)

b) Flap over real estate agency and real estate management. Proposal to consider real estate agency and real estate management as financial in nature was made in 2001, and has still not been acted upon because of annual appropriations measures that have prevented Treasury from considering this proposal.

   (1) State banks in well over half the states, including North Carolina, are permitted to act as real estate agents, but few have elected to enter this business.

8. GLBA broadened holding company activities from “closely related to banking” to “financial in nature,” but limited commercial activities of holding companies by closing the unitary thrift company loophole
   a) Other “loopholes” remain
      (1) Grandfathered unitaries
      (2) Nonbanks under 1841(c), including industrial loan companies
         (a) Wal-Mart has an application pending to establish an ILC in Utah with the Utah Division of Financial Institutions and the FDIC

B. Preemption for national banks

1. Barnett Bank of Marion County, N.A. v. Nelson, 417 U.S. 215 (1996), held that the National Bank Act could be used to preempt state laws that “prevent or significantly interfere with the national bank’s exercise of its powers.”

2. Promulgation by OCC of new regulations re preemption (12 CFR §§ 7.4007(b), 7.4008(d), 7.4009(b), 34.4(a)) (preempting state laws that “obstruct, impair, or condition” a national bank’s ability to exercise its federally authorized powers under the National Bank Act).

   a) Subject to limited exceptions, the OCC provided by regulation in 2004 that its visitorial powers over national banks is exclusive and includes enforcing compliance with any applicable federal or state laws. 12 USC § 484, 12 CFR § 7.4000.


4. The OCC set forth new guidelines on predatory lending and promulgated regulations to police predatory lending that prohibit
a) A national bank from making a consumer loan “based predominantly on the bank’s realization of the foreclosure or liquidation value of the borrower’s collateral without regard to the borrower’s ability to repay the loan according to its terms,” 12 C.F.R. § 34.3(b);

b) A national bank from engaging in “unfair or deceptive practices” within the meaning of the FTC Act.

5. Extension of National Bank Act preemption of state laws to national bank operating subsidiaries, 12 C.F.R. § 5.34(f).


6. Why now and not in 1863?

a) Relatively recent authorization of interstate activities

b) State laws regulating predatory lending activities

c) Exportation of interest rates and fees from home state to citizens of other states. See Smiley v. Citibank (South Dakota), N.A., 517 U.S. 735 (1996) (fees are part of the interest that may be exported).

7. FDIC proposed rulemaking to allow state bank’s home state law to govern the interstate activities of state banks and their operating subsidiaries to the same extent that the National Bank Act governs a national bank’s interstate business (to the extent the NBA preemption has been found by a federal court in by a written OCC determination that state law is not applicable to a national bank). 70 Fed. Reg. 60019 (proposed Oct.14, 2005) (to be codified at 12 C.F.R. pts. 331 & 362).
Bibliography


