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Statement No. 99

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Statement of the Shadow Financial Regulatory Committee

on

Proposals to Permit Banks to Branch  
on an Interstate Basis

September 20, 1993

Under present law, interstate banking can be carried on only in a multibank holding company format. Hearings were recently held on three bills that would relax existing interstate branching restrictions. As previously stated (Statement No. 63, National Banking, December 10, 1990), the Shadow Financial Regulatory Committee believes that the prohibitions on interstate branching pose a barrier to the flow of funds within the country. Furthermore, they restrict institutions from adopting efficient forms of operation and pose unnecessary risks to the taxpayer.

Interstate branching has long been advocated on efficiency grounds. More permissive branching policies will enable banks with interstate branches to collect funds from surplus areas and direct them to deficit areas where they have the highest valued uses. Also, there is evidence that branching is often a less costly operational form than a multibank holding company.

Opponents of interstate branching believe that prohibiting this liberalization will increase the funds available in local communities and promote greater bank responsiveness to local customer needs. The validity of this view rests in part on the belief that deposit markets are essentially

compartmentalized and local in character and the chief mechanism by which funds are transferred from these local areas is through lenders reallocating funds internally within their organizations.

Deposit markets are no longer compartmentalized and local, however, largely because other effective means exist for collecting customer funds and transferring them to other markets. Interstate branching restrictions can no longer be justified as a mechanism to channel funds forcibly to local borrowers. Instead, they only act to increase the costs of banking services and competitively disadvantage many banks relative to other suppliers of services.

There are also important safety and soundness reasons for preferring that institutions have the option of branching interstate. Geographically diversified institutions tend to be better able to withstand economic downturns, especially when these events are confined to local or regional areas which constitute only a portion of the markets in which they do business.

The experience with failed commercial banks suggests that the Douglas Amendment now subjects the Bank Insurance Fund to unnecessary risks. For example, the cross-guarantee provisions in FIRREA subordinate the FDIC's claims to those of depositors and other creditors when bank holding company subsidiaries experience financial difficulties. This subordination would not occur if the same losses occurred within branches of a single institution.

Given the net benefits, and since 49 states have now authorized interstate banking through bank holding companies and savings and loans can branch interstate, the Committee believes there is no basis for maintaining the prohibitions on interstate branching.

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It is the Committee's policy that members abstain from participation on policy statements in which they have a direct personal or professional involvement in the matter that is the subject of the statement. Accordingly, Richard C. Aspinwall abstained from voting on this statement.