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Branch Banking in Colorado - A Proposal for Reform

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NOTE

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Introduction

WITHIN the United States there are 14,000 unit banks — banks operated within a single structure — of which 85 percent have less than $25 million in deposits.[1] There are 7,700 communities with only a single unit bank and 1,800 towns with only two unit banks.[2] Excluding branches, 75 percent of the country's chartered banks are in one-bank or two-bank communities. Only one out of 10 of these unit banks serves over 5,000 people, and half serve populations of less than 1,000. In contrast, the nation's commercial banks permitted to have branches are located in 29,300 structures with each location serving an average of 6,700 people.

With the sole exception of Wyoming,[3] all of the states and the District of Columbia have legislated with respect to branch banking. Regulatory schemes vary widely, permitting state-wide branching,[4] allowing branches within the county where the main office is located and in counties contiguous to that county,[5] authorizing branches only in the county in which the head office is located,[6] and prohibiting the operation of

[1] Rose, *Are Those 11,400 Banks Really Necessary?*, FORTUNE, Nov. 1970, at 113.

[2] Bratter, *The Role of Branch Banking in Area Development*, 1 MERGERS AND ACQUISITIONS (THE JOURNAL OF CORPORATE VENTURE) 87, 88 (1966).

[3] E. HALAAS, THE BANKING STRUCTURE IN COLORADO 22 (1969).

[4] Such states include: Alas., Ariz., Cal., Conn., Del., D.C., Hawaii, Idaho, Me., Md., Nev., N.C., Ore., R.I., S.C., Utah, and Wash. E. HALAAS, *supra* note 3, at 22. South Dakota has changed its law to allow all present branches to continue, but new branches must be the result of a merger with an established facility. *See* South Dakota Section, POLK'S BANK DIRECTORY (1971).

[5] Those states which allow branches in the county where the main office is located and all counties contiguous to that county are: Miss. (100 mile limit), Mich. (25 mile limit), N.M. (100 mile limit), Ohio, Penn., and Wis. (25 mile limit). New York and New Jersey allow expansion within prescribed banking "districts," and Louisiana banks may branch in contiguous counties or "parishes." Those states which refer to branches as "offices" and allow them in the head office county and contiguous counties are: Ark., Iowa, and N.D. Gup, *A Review of State Laws on Branch Banking*, 88 BANKING L.J. 675, 682 (1971).

[6] States which allow branching within the county where the main office is located include: Ala., Ind., Ky., Mass., Tenn., Utah, and Va. E. HALAAS, *supra* note 3, at 22. New Hampshire allows branches to exist in the same city as the head office (plus 30 miles), and Georgia limits its branches to the same city. Gup, *supra* note 5, at 682.

branch banking completely.[7] The Colorado scheme[8] fits most reasonably in the final category of complete prohibition.[9]

This diversity in the regulation of state banking is evidence of the continuing controversy over the values and dangers of branch banking. The purpose of this note is to analyze present restrictions on branch banking in light of their origins and appropriateness in today's banking environment. The approach taken gives general consideration to the traditional arguments which both justify and refute the need for branch banking regulations. Since the federal government sought to provide a balance in the dual federal-state banking law through the McFadden Act,[10] member banks of the national banking system may not exceed any branch banking restriction created by state law.[11] Consequently, state law will be the primary focus of this note, with specific consideration being given to the Colorado restrictions.

I. COLORADO BANKS AND BRANCH BANKING LAW

Branch banking has always been prohibited in Colorado.[12] In 1911 the Colorado legislature passed the present branch banking statute which provides that "every bank shall be conducted at a single place of business and no branch thereof shall be maintained elsewhere."[13] In 1969, the legislature enacted an exception to this restriction by authorizing banks, after approval by the State Banking Board, to operate one detached facility for receipt of deposits, cashing of checks, and delivery of cash within 2,000 feet of their main office.[14] These limitations apply solely to commercial banks and impose no restrictions on savings and loan associations.

Significantly, the application of the statutory prohibition against branch banking has been limited by the Colorado Supreme Court which has required the presence of the unitary type of operation characteristic of a branch bank for the restric-

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[7] Those states which absolutely prohibit branching are: Colo., Fla., Ill., Kan., Minn., Mo., Mont., Neb., Okla., Tex., W. Va. E. HALAAS, *supra* note 3, at 22.

[8] COLO. REV. STAT. ANN. § 14-3-1 (Supp. 1969), *amending* COLO. REV. STAT. ANN. § 14-3-1 (1963).

[9] It should be noted that a recent amendment to the Colorado statute permits the establishment of branches within 2,000 feet of a parent bank. COLO. REV. STAT. ANN. § 14-3-1 (Supp. 1969).

[10] 12 U.S.C. §§ 24, 29, 34a, 36, 51, 52, 57, 72, 76, 81, 82, 84, 161, 321, 342, 371, 501, 521, 591, 593 (1970).

[11] McFadden Act, 12 U.S.C. § 36(c) (1970).

[12] Ch. 19, § 68, [1877] Colo. Sess. Laws 166.

[13] COLO. REV. STAT. ANN. § 14-3-1 (Supp. 1969), *amending* COLO. REV. STAT. ANN. § 14-3-1 (1963).

[14] COLO. REV. STAT. ANN. § 14-3-1 (Supp. 1969).

tion to apply.[15] This judicial requirement of unitary operation departed from the view held by the Colorado State Bank Commissioner who had argued that chain banking — the operation of several banks owned by a holding company — was with within the interdiction of branch banking.[16] The effect of the court's decision was to limit the statute to commercial banks maintaining "extensions" which are an integral part of the main office's operation — the essence of a unitary type of operation. All other methods used by banking institutions are not subject to the statutory prohibition.[17]

The prohibition of branching raises issues with respect to the adequacy of service for Colorado citizens which should be kept in mind in an evaluation of the appropriateness of Colorado's anti-branching statute. Colorado has 80 one-bank towns, with an average population of 1,800, which are not near larger metropolitan communities. These small town banks are available to serve 20 percent of the state's population, constitute 37 percent of the state's banks, and account for only 9 percent of the total state bank deposits.[18] It is interesting to note that the unit banks, presently serving a significant segment of Colorado's population, have a disproportionately small percentage of Colorado's total bank assets.

II. Historical Rationales for Branch Banking Prohibitions

The reasons for branch banking prohibitions are varied and conflicting. One fact, however, does seem clear: branch banking restrictions are an almost unique American phenomenon. English law permits completely uninhibited branching of banks,[19] as do the laws of most other countries.[20] To account for America's singular treatment of the banking industry, it is necessary to understand a number of factors in early American banking history.

During the early part of the nineteenth century, most of the branch banks in the Eastern States were replaced by smaller, independent banks in response to restrictive legisla-

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[15] Peoples Bank v. Banking Board, 164 Colo. 565, 571, 436 P.2d 681 (1968), *citing* First Nat'l Bank v. First Bank Stock Corp., 306 F.2d 937, 943 (9th Cir. 1962).

[16] Goldy v. Crane, 167 Colo. 44, 47, 445 P.2d 212, 213 (1968).

[17] Group and chain banks are owned by the same person or group, but avoid the "unitary type of operation" by operating each bank as an individual entity with its own officers and directors and by not intermingling funds or services with their affiliate members. E. Halaas, *supra* note 3, at 21, 24, 103, 105.

[18] *Id.* at 100.

[19] Halleck, *Freedom in Banking*, 31 Banking L.J. 870, 871 (1914).

[20] E. Halaas, *supra* note 3, at 18.

tion.[21] This legislation was not aimed at branch banking per se, but rather at the issuance of so-called "wild cat" currency. This problem was resolved when the Bank Act of 1865 drove circulating notes of state banks out of existence by the imposition of a 10 percent tax.[22] After this Act, most state banks were converted into individual national banks.

Although note issuance was a major factor in prompting anti-branching regulations, there were other difficulties which attended the operation of branch banks. The Second Bank of the United States met with grave difficulties of supervision in the 1860's when "[p]oor roads and transporation systems made it almost impossible for auditors or officers from the head office to check the work in the several branches."[23] Further investigation into this communication problem reveals that many early regulations were predicated upon the reasoning that when the steadying influence of ever-present bank officers was absent, security of deposits was lessened and probability of loss was increased.[24]

That this concern for the safety of deposits was justified is illustrated by a 1910 Colorado case, *Kipp v. Miller*,[25] which dealt with the dissolution of the State Bank of Monta Vista which had operated two highly profitable branches in Creede and Garrison for 10 years. The dissolution caused creditors, who had dealt in good faith with the branches as part of the state bank, to bring suit against the stockholders who had shared in profits from the branches. The defense of an ultra vires act was raised since branches were prohibited, but the shareholders were estopped on the ground that they had acquiesced in a relationship of which they were well aware.[26] "[G]eneral publicity was given to the relations between these branch banks and the State Bank. . . . [L]etterheads of the branches bore the legend that they were associated with the State Bank. . . . [I]ndeed their relations seem to have been a matter of common knowledge."[27]

It is obvious from a reading of *Kipp* that the regulatory system at that time was indifferent to the branching issue, since the branches had been allowed to go unregulated for 10 years and the suit arose only when creditors, following the failure of

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21 G. CARTHINHOUR, BRANCH, GROUP AND CHAIN BANKING 278 (1931).
22 J. CHAPMAN, CONCENTRATION OF BANKING 14 (1934).
23 *Id.* at 94.
24 50 A.L.R. 1340, 1342 (1927).
25 47 Colo. 598, 108 P. 164 (1910).
26 *Id.* at 607, 108 P. at 167.
27 *Id.* at 605-06, 108 P. at 167.

the parent bank, sued to enforce the liability of stockholders. Therefore, the concern for stability, plus the possibility of cumulative failure in such unrestricted situations as that presented in *Kipp,* may be the best explanation for the 1911 statute which regulates Colorado branch banking today. Evidence of this can be found in a letter dated January 16, 1908, from the Assistant Attorney General of Colorado, S. H. Thompson, Jr., to the Colorado State Bank Commissioner, Harry M. Beatty: "It is evident that the purpose of the legislature in prohibiting branch banks was to avoid the dangers which might follow from the temptation to transfer the funds of one branch to another and thus impair the financial conditions of the various branches."[28]

During the late nineteenth century the national banking system, in an effort to afford safe banking facilities, became very inflexible; as a result, money panics occurred in 1873, 1893, and 1907.[29] During these difficult times branch banking was discussed as a means of relieving the problem of small communities without banking facilities; but legislatures did not "contemplate encouraging [the location of banks in] unduly places that could not support unit banking."[30] In 1904, John Hamlin, Attorney General of Illinois, stated that branch banking would promote uncertainty and "increase the liabilities of banks in proportion to capital stock, and encourage an extension of business,"[31] which he considered detrimental to bank safety and against sound public policy.

Another factor which prompted anti-branching legislation was the desire to control the influence of "big money." In 1887 the Comptroller of Currency, William L. Trenholm, voiced the often repeated fear that an extension of branch banking would mean money monopoly.[32] The fear of monopoly has been often forwarded as an explanation for the ban on branching: "[A]merican (and especially rural American) fear of 'foreign' money power, and the desire to keep local banking resources in local hands, are probable explanations for this prohibition."[33]

Perhaps the most emotional advocate of branching prohibitions was the 1907 Bank Commissioner of Wisconsin, Marcus C.

[28] 1907-08 COLO. ATT'Y GEN. ANN. REP. 156.
[29] Halleck, *Our Banking System,* 19 CASE & COM. 414 (1912).
[30] 28 BANKING L.J. 15 (1911).
[31] 21 BANKING L.J. 673, 674 (1904).
[32] J. CHAPMAN, *supra* note 22, at 111.
[33] Kreps, *Modernizing Banking Regulation,* 31 LAW & CONTEMP. PROB., 648, 657 (1967).

Bergh, who described branches as being "foreign to the American principle of free banking and contrary to the spirit and intent of the Wisconsin banking law."[34] This "un-American" characterization has been constantly used by later advocates of anti-branching legislation, but the allegation is never accompanied by a detailed explanation of its basis. Bergh also gave a more practical explanation of the previously mentioned communications problem by pointing out that branches would require the state to employ several examiners at one time to simultaneously examine the main bank and its branches. This point may be a factor often overlooked in attempting to analyze early legislative concerns over the difficulties accompanying branch banking.

Another historical argument against branching was that early taxes were structured in such a fashion that if branches replaced unit banks, the local community would lose taxes.[35] Thus, there existed a local incentive to prohibit branches. A further local argument against branches contended that a branch, governed by strict rules and regulations from the main office, would leave few decisions to the manager's discretion. Consequently, it would be difficult for a young man, or a local infant industry, with little capital to secure credit from a branch.[36]

III. THE CURRENT APPLICABILITY OF THE HISTORICAL RATIONALE FOR THE PROHIBITION OF BRANCH BANKING

Based on the foregoing, the historical rationale for the prohibition of branch banking can be separated into five main categories: inadequate communications, lack of stability, management incompetency, lack of local control, and miscellaneous dangers. It is important to examine these historical rationales from the viewpoint of modern banking practices and the present situation in the banking industry.

A. *Communications*

A detailed examination of the change in communications systems since 1911 is not necessary to conclude that the communication problem, a substantial factor in past anti-branching legislation, has long since been solved. Auditors and examiners no longer encounter difficulty in getting to branches. This outdated argument was aptly dismissed in 1966 by George W. Mitchell, a Federal Reserve Board Governor, who "envisions the

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[34] *Branches of Banks & Trust Companies*, 24 BANKING L.J. 166 (1907).

[35] V. WILLIT, CHAIN, GROUP, AND BRANCH BANKING 176 (1930).

[36] *Id.* at 43.

advancement of automation to a point that not only will permit, but will force, profound changes in banking structure."[37] He further points out that computers will soon make it possible to avoid outmoded banking restrictions and that some banks have already done so through the mail service.[38]

B. *Stability*

The stability concern, like the communications issue, has completely changed in its characteristics. It is now well accepted that: "[T]here is little question but that a powerful branch organization offers a greater protection as a repository of funds than does the small independent institution."[39] One-sixth of all banks existing in 1920 failed by 1928.[40] Figures from post World War II to 1966 show that an average of only five banks, or .04 percent of the total number of banks, fail each year.[41] This rate is so low it has prompted Representative Patman, Chairman of House Banking and Currency Committee, to remark that there are not enough bank failures. He indicates that, unlike the situation in 1899, the market today is not sufficiently competitive and that if more competition existed consumers would benefit.[42] He further points out: "When we boast of no bank failures, let's remember that several thousand other business firms may have failed because the banks did not take as many reasonable risks as they might have taken."[43]

C. *Management Competency*

The fear of poor management stems from an apprehension that branches could carry on the same business as the main institution "without being subject to safeguards afforded the establishment and administration of the latter."[44] Today, due mainly to the increase in communication technology, branches may be easily regulated and protected by the head office's "administration" and "safeguards." The fear of not having the president ever-present has therefore been technically relieved. However, there currently exists an argument which charges that the complex managerial hierarchy moves all competent

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[37] Quantius, *Outmoded Aspects of Branch Banking Laws,* 204 COM. & FIN. CHRON. 9, 10 (Dec. 8, 1966).

[38] *Id.*

[39] G. CARTHINHOUR, *supra* note 21, at 308.

[40] V. WILLIT, *supra* note 35, at 108.

[41] Edwards, *Bank Mergers and the Public Interest: a Legal and Economic Analysis of the 1966 Bank Merger Act,* 85 BANKING L.J. 753, 783-84 (1968).

[42] Davis, *Banking Regulation Today: A Banker's View,* 31 LAW & CONTEMP. PROB. 639, 642 (1966).

[43] *Id.*

[44] 50 A.L.R. 1340, 1343 (1927).

managers to the main office, leaving local areas with managers who have no ability to react to local problems. How well-founded is this fear?

D. *Feared Loss of Local Control*

Fear of loss of local control is a bifurcated argument used to justify the prohibition of branch banking. The first aspect of the argument is that the local populace will not be able to effectively influence "absentee" managers who make decisions from the main office. This, it is asserted, will make loans difficult to obtain and subordinate local interests to those of "big city" banks.

With respect to the impact of branching on the availability of loans, it should be pointed out that "the smaller the bank, the higher the ratio of sterile assets (cash) and government securities to total resources."[45] Data indicates that banks with deposits of 5 to 10 million dollars hold 35 percent of their assets in liquidity reserves and 51.7 percent in loans and discounts. The banks with 25 to 100 million in deposits hold 28.3 percent in liquidity reserves and loan 54.9 percent. Institutions having more than 100 million in deposits hold 27.6 percent in reserves and loan 55.7 percent, while the very largest banks loan 75 percent of their deposits.[46] Thus it seems clear that instead of making it more difficult for local people to obtain loans, branching would actually have the opposite result.[47]

The argument that community participation in local banks benefits the community is equally unrealistic. A Federal Reserve Board study in 1962 showed that among banks with assets of less than 5 million dollars (the 80 unit banks in single Colorado towns previously mentioned average assets of less than 3.3 million[48]), 20 people or less owned 90 percent of the stock. In most of these banks the controlling interest was held by three stockholders.[49] Needless to say the interests of a small group of stockholders do not always correspond to those of the community.

An example of Coloradans "benefiting" from local autonomy was demonstrated in the 1963 case of *Banking Board v. Holyoke Industrial Bank*.[50] The issue raised was: Did the fact that the community had one bank preclude the need for an-

[45] Rose, *supra* note 1, at 113.
[46] *Id.*
[47] *Id.* at 138.
[48] E. HALAAS, *supra* note 3, at 100.
[49] Bratter, *supra* note 2, at 88.
[50] 152 Colo. 489, 383 P.2d 318 (1963).

other? The Colorado Supreme Court overturned the banking board's denial of a permit for a second bank when the record revealed that the existent bank was a family organization whose procedures included: in addition to a regular service charge, the imposition of a "float charge" of 10 cents per $100 face value for every check deposited which was drawn upon another bank; paying 1 percent on savings accounts up to $10,000 with no additional interest on accounts in excess of that amount; discouraging savings accounts; not handling consumer accounts; limiting loans to $6,000; and making little effort to gain larger loans for customers through correspondent banks.

The question of whose local interest is really being protected by unit banking is summarized by James Saxon, the Comptroller of Currency from 1962 to 1966:

> It is perfectly clear that [restrictive branch banking] laws show little regard for the public interest, that they are designed to protect the selfish interests of the less energetic or competent segments of the industry which cannot abide the prospect of competition. It is unfortunate that such laws do not meet the economic needs of the people and of the industries, but serve instead the determined opposition of parochial interest.[51]

The second aspect of the feared loss of local control argument involves the belief that free competition among banks of all sizes will bring about a money monopoly in the major banking centers and cause a depletion of bank assets at the local level. This argument is based on speculation with respect to what would happen to small unit banks if forced to compete with big money branches. One answer is found in the Hearings of the Committee on Banking and Currency where Mr. Saxon acknowledged that, for many banking services, size confers no advantage. Experience has shown that well-managed, adequately capitalized, aggressive small banks can and do prosper when in competition with the country's largest institutions. "For such banks, which rely upon their own efforts, and not upon public protection against competition, there will always be a place in the banking structure."[52]

Existence of larger banking institutions has not proven to be detrimental to a competitive atmosphere. Studies have shown "that the most competition, and the most aggressive competition, typically occurs among the nation's relatively small number of larger banks."[53] Indeed, these larger banks are competing, or

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[51] J. SAXON, 100TH ANNUAL REPORT OF COMPTROLLER OF THE CURRENCY 147, 150 (1962).

[52] *Hearings on the Conflict of Federal and State Banking Laws Before the House Comm. on Banking and Currency*, 88th Cong., 1st Sess. 374 (1963).

[53] E. HALAAS, *supra* note 3, at 94, *citing* C. KREPS, MONEY, BANKING AND MONETARY POLICY 199 (1962).

are at least willing to compete, with many of the smaller banks throughout the nation. The extent to which these banks are allowed to grow does not have to be regulated differently in various states, since the Bank Holding Company Act[54] and the Bank Merger Act[55] can now be relied upon as effective barriers to excessive concentration of banking at the state level.[56] In any event, to allow Colorado's group and chain banking to expand only through acquisition of established institutions is a less rational alternative than to allow *new* branches to be created as direct and local competitors to existing banks in growing population areas.

It is often argued that economies of scale provide cost benefits which will allow branching institutions to monopolize the industry. This argument is fallacious. Many studies conclude that as the size of a bank increases, costs decline for unit banks but increase for branch banks;[57] and, it has been shown that branching results in higher costs for nearly all bank service.[58] As for the magnitudes of these cost differences, a study by the Commission of Money and Credit conducted on all member banks of the Federal Reserve in 1959 found these differences to be small but consistently higher for branches.[59] Another study of unit and branch banks showed the cost of services for banks with four or more branches to be higher by 9 percent of total operating expenses.[60] This belief in the creation of a monopoly through the use of cost advantages is further contradicted by California statistics which show that for the period 1961-66 the number of branch banks increased 47 percent (California has permitted branches for over 50 years),[61] while the number of unit banks rose 76 percent.[62] Therefore, the fact that monopoly is not created by allowing branch banking is demonstrated by practical experience, as well as by cost studies.

This idea of prohibiting money monopoly advanced by the proponents of anti-branch banking regulations has another and

[54] 12 U.S.C.A. § 1842 (Supp. 1972), *amending* 12 U.S.C.A. § 1842 (1969).

[55] 12 U.S.C. § 1828(c) (1970).

[56] General Bankshares Corp., 53 FED. RES. BULL. 65 (1967); Wells Fargo Bank, 52 FED. RES. BULL. 655 (1966).

[57] D. ALHADEFF, MONOPOLY AND COMPETITION IN BANKING 83, 87-88 (1954).

[58] Edwards, *supra* note 41, at 787.

[59] Benston, *Branch Banking and Economies of Scale,* 20 J. FIN. 312, 328-29 (1965).

[60] *Id.* at 330-31.

[61] Bratter, *supra* note 2, at 93.

[62] *Id.* One variable which enters these figures is that of the banks created to establish viable operations and then sold for a capital gain either as a branch or to a group holding or chain banking company. J. SAXON, *supra* note 51, at 148-49.

often untold aspect. The prohibition of branch banking, ostensibly intended to block a money monopoly, often gives the local unit banker a mild form of local monopoly. The public is not best served by these regulations which protect banks of a particular size; the consumer is more interested in the establishment of a banking system which effectively meets his needs. The protection of perhaps undeserving interest is not a new problem and is summarized by the late Senator Glass of Virginia, a member of the Senate Banking and Currency Committee for over 30 years:

> The appeal of the little bank, so-called, against the "monopolistic" tendencies of branch-banking is misleading when we come to reason about it. The fact is that the little banker is the monopolist. He wants to exclude credit facilities from any other source than his bank. He wants to monopolize the credit accommodations of his community: He does not want any other bank in his state to come there.[63]

A recent Colorado example of this practice of exclusion is found in *Banking Board v. Turner Industrial Bank,*[64] where the main criteria for denial of a new charter by the Banking Board was the existence of another bank in the area. In its decision, the Colorado Supreme Court ruled that the effect of a new charter upon existing institutions should not be an issue when a decision could be based upon advantages to the public and their needs. Despite such recent recognition of public needs, there is a better solution for the regulation of monopoly in the banking industry than absolute branching prohibitions.

E. *Other Factors*

The old fear of issuing notes and wild cat currency no longer exists. Although there is little doubt that an original motive for creating branches was to provide an outlet for notes that could be redeemed only at the main office, thereby keeping the notes in circulation for a longer period of time, the need for such a favorable "float" situation is extinct. Moreover, there are many other collateral issues, such as local taxes and increased requirements for examiners, that must be exposed in order to weigh the merits of branch banking accurately. These issues indicate that motives exist for prohibiting branches which persuade the legislature not to adhere to an objective public benefit analysis.

Political considerations have always contributed input and should be weighed appropriately in any evaluation of the bank-

[63] Bratter, *supra* note 2, at 90.
[64] 165 Colo. 147, 155, 437 P.2d 531, 535 (1968).

ing system. An interesting comment made as far back as 1924 illustrates this point: "While the economic arguments for branch banking would logically lead to nation-wide branch banking as it exists abroad, political considerations render the discussion of such an extension purely theoretical at this time."[65] This idea of branch banking policy being a mixture of both political and economic forces holds true today. It is the political forces outside of the legal system which must be harnessed toward the objective of serving the public benefit rather than being allowed to continue to favor pressure groups. Only after an attitudinal change can the legal regulatory system prescribe efficient laws which avoid circumvention (such as today's allowing group and chain banking) and either prohibit or allow branch banking.

IV. WHAT CAN BE GAINED BY ALLOWING BRANCH BANKING?

Since the historical rationales for the prohibition of branch banking are certainly subject to question, the benefits to be derived from a change to allow branch banking should be examined. Also the questions should be asked: What have other states which have changed their banking restrictions gained by the change, and what does a continued prohibition of branch banking cost the public?

A 1961 study conducted by the University of Chicago on Illinois banking practices reveals facts which lead one to question the public benefit derived from a branching prohibition. Illinois is a classic example of a state where unit banking has prevailed in the face of pressures to change it. The study termed Chicago the most "underbanked" city in the nation and labeled the Illinois banking system as not only incomplete and rigid but also unsuccessful in attracting savings or putting out loans at lower rates. Branch banking's value was regarded as "the most powerful method . . . [of] improving the supply of bank services quickly and at the lowest cost to the community."[66]

If branch banking were allowed, service could be increased for the public's benefit to improve on such conditions as found in *Holyoke*. As the Illinois study indicates, the branch prohibition causes unusual charges by other non-bank entities.[67] Not only can services provided by branch banking be less expensive, they can also be much more convenient. This is especially

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[65] C. COLLINS, THE BRANCH BANKING QUESTION 3 (1926).

[66] Bratter, *supra* note 2, at 92.

[67] *Id.*

true for Colorado because of its changing population patterns, a fact which will encourage the banks to open branches in the growing suburbs. The increase in service gained by allowing branches to coexist is summarized by a study conducted by the New York State Banking Department which listed among the beneficial effects of branch banking these positive points: "lower loan rates, higher interest on savings deposits, more liberal loan maturities and loan-value ratios, greater services and banking facilities, larger lending authority and greater convenience for the public."[68]

Another facet of banking which may be improved by the removal of branching prohibitions is the free transfer of funds from one sector of the state to another. Presently, the method used by unit banks to satisfy the needs of their customers with large cash demands is to establish correspondent relations with other banks. This arrangement requires that a substantial amount of the liquidity funds of local banks be deposited with the larger corresponding institution. This in turn causes a local bank's excess liquidity reserves to be removed to the big money centers where they often earn a lower return than possible given other potential uses. The money centers profit from such an arrangement at the expense of the local bank. This situation would definitely be improved if branches could transfer funds internally with "sister" branches without restraint. In the absence of branching restrictions, transfers could be based upon present need rather than upon an automatic funneling of funds to big business and big money centers.

A further advantage of branch banking is the manager's potential freedom in determining local needs, an ability which local unit bank managers lack because of their heavy dependence on the larger correspondent institutions for a final decision on loans.

Not only would the branches achieve more local autonomy and profits, but a local businessman who outgrows a small unit bank's capabilities could continue to do business with a local branch, instead of taking his business to a different region or state. For example, in New Hampshire, where branching is prohibited, bankers are showing concern over many growing corporations transferring their business to larger banks in Boston.[69] The fact that other means exist for promoting competition between large and small institutions, such as the promotion

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[68] *Id.*

[69] Rose, *supra* note 1, at 138.

of group and chain banking, is aptly dismissed by James Saxon who states that the existence of such alternatives is no justification for arbitrarily depriving the public of the benefits to be derived from small unit banks directly competing with larger unit banks and their branches.[70]

The prohibition against branching also produces a vacuum, created by unsatisfied financial demands, which institutions other than commercial banks fill. Loan companies, credit unions, industrial banks, savings and loan associations, private lenders, and various federal agricultural credit agencies are the institutions which are supposedly filling this void at present. These organizations are, however, not equipped to perform as efficiently the full range of services which commercial banks offer.[71] Furthermore, from the public's point of view, these alternatives offer more costly and less efficient operations than commercial banks. James Saxon has warned that unit banks and their opposition to branch banking are directly responsible for the growth of these non-banking institutions, a fact which injures all segments of the commercial banking industry. Saxon also feels that the regulation of branch banking lessens banking efficiency and prevents the growth of banks both large and small which are able to fill the varying needs of society.[72]

An outgrowth of this dilemma has been the increase in holding companies and chain banks. There is no doubt that many bankers regard the multi-bank holding company or privately controlled chain bank as merely a technique to circumvent branching restrictions, with no other purposes or advantages.[73] However, there are important differences between these alternatives and branch banking, especially concerning their capital structures. Holding companies are basically a series of unit banks with independent cash supplies; there is no free flow of currency between the members of the company or chain. The result requires holding company and chain banks to reside in populous areas where they can profitably survive. Smaller communities, consequently, are deprived of the ready access of a local bank. On the other hand, branches can be structured to be as small as necessary and thereby operate successfully in suburban areas where unit banks, though owned by a holding com-

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[70] *Hearings, supra* note 52, at 556.

[71] Saxon, *Non-Branch Banking Policy — A Formula for Stagnation,* 197 COM. & FIN. CHRON. 1701, 1730 (April 25, 1963).

[72] *Id.* at 1701.

[73] Mascia, *Banking Competition, Structure, and Regulation in New York State,* 212 COM. & FIN. CHRON. 149, 159 (July 16, 1970).

pany, could not operate profitably.[74] Therefore, the prohibition of branches not only deprives some areas of local banking, but also encourages group and chain banking.

It can also be argued that economic growth is a benefit derived from branching. Those states which have the most fragmented banking — which include Colorado, even though group and chain banking account for one-third of all banks and two-thirds of all deposits[75] — appear to show less economic progress than those maintaining a favorable environment for banking growth through branching.[76] This fact alone does not indicate which phenomenon is the causative agent, but this may be inferred from observing which states fragment banking by prohibiting branching.

Most states which prohibit branches have predictable homogeneous economies which do not demand a funds flow system necessary to satisfy diversified business population and seasonal needs of varying areas. Most agricultural states are dominated by stable businesses whose financial needs are not growing quickly enough to lobby for more progressive regulatory systems. An example of this type of economy is Iowa, which is noted for its predictable corn-hog cycle economy. Conversely, California's free branching system reflects the population's and industry's needs in an ever-changing environment. There, various demands on resources do not allow money to be restricted to predictable agricultural seasons, and therefore dictate a more flexible funds flow which is provided by a branching system. The statistics verify the progressive nature of branch banking. Five of the six states which had the greatest increase in per capita income from 1957 to 1967 showed increases in their banking concentration. The six states with the lowest increase in per capita income during the same period all had decreases in banking concentration.[77] Though admittedly either characteristic need not be dependent upon the other, these figures add credibility to the arguments for branching when discussing the future of Colorado's growing economy.

SUMMARY

Colorado needs more flexibility in its laws regarding branch banking. The historical problems upon which today's laws are based have become either obsolete through time or controlled by new laws. There remain no valid reasons (other than Saxon's

[74] D. ALHADEFF, *supra* note 57, 232.

[75] *See* Colorado Section, POLK'S BANK DICTIONARY (1971).

[76] Rose, *supra* note 1, at 142.

[77] *Id.*

selfish interests explanation[78]) for such restrictive laws to exist under the guise of protecting the public. The public deserves branch banking service. The economic needs of Coloradans, coupled with the presently inefficient laws, are allowing the less favorable alternatives to branch banking to fill the void created by the present prohibition. These laws, when combined with Colorado's unique control of commercial banks which allow savings and loan associations to go unregulated, aggravate this situation and point toward the need for immediate legislative action on the subject of branch banking.

Moreover, the present statutory restrictions, if arbitrarily continued, could be stripped of their foundation by changes in the national banking system. The desire of the national system for less stringent restrictions is explained by the former Comptroller of Currency, James Saxon, who, when discussing the branching restrictions, remarked, "To withhold entirely any means for reaching our national goals [of efficiency] is to court the peril of failure — a failure we cannot afford in today's world."[79] It is therefore strongly urged that before the national banking system is changed to eliminate the state's restrictions, thus weakening the dual banking, Colorado's present laws be updated to coincide with other states' modern concept of what benefits the public.

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[78] J. SAXON, *supra* note 51.

[79] *Hearings, supra* note 52, at 375.