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BANKING STRUCTURE AND STATEWIDE BRANCHING: THE POTENTIAL FOR VIRGINIA

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In Virginia, as in most states, legislation historically has provided the impetus for change in the structure of the banking industry. The most recent development was prompted by the passage of the Buck-Holland Bill¹ in 1962. Following the implementation of that Act, which initiated the transition from a unit banking to a limited branch banking system, the identity, market structure, and competitive nature of the State banking industry underwent rapid changes that reflected industry response to relaxed statutory requirements.² The primary effects of the statute were increases in the number of bank offices, the concentration of bank deposits held by the largest banking organizations, and the concentration of the number of bank offices operated by the largest banking organizations.³ As of the mid-1970's, however, this process of change seems to have stabilized, apparently signaling the completion of the banking industry's reaction to the 1962 legislative liberalization of banking regulation.⁴

There is now a movement to enact another significant legislative amendment to the Banking Code for the purpose of further liberalizing the branching provisions to allow de novo branching,⁵ establishing new offices by parent banks, on either a statewide basis or on an extended basis.⁶ This Article will describe Virginia's existing

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1. Act of March 30, 1962, chs. 371, 404 (1962) Va. Acts of Assembly 512, 565. This Act amended sections 6-26 and 6-27 of the Virginia Code of 1950 and added sections 6-27.1 and 6-27.2. All now are incorporated in sections 6.1-4, 6.1-39, and 6.1-40 of the Virginia Banking Act, VA. CODE ANN. §§ 6.1-3 to -125 (Repl. Vol. 1973 & Cum. Supp. 1976).

For an analysis of this Act and its subsequent effects, see Ileo & Parcell, *Evolution of the Virginia Banking Structure 1962-1974: The Effects of the Buck-Holland Bill*, 16 WM. & MARY L. REV. 567 (1975).

2. "As enacted, the Buck-Holland Bill permitted a bank to establish branches in the city, town, or county in which its main office was located, in contiguous cities, and five miles into counties contiguous with the city in which its main office was located." Ileo & Parcell, *supra* note 1, at 571. The statute also provides for statewide branching via merger. See VA. CODE ANN. § 6.1-39(b) (Repl. Vol. 1973 & Cum. Supp. 1976).

3. See Ileo & Parcell, *supra* note 1, at 572-82.

4. *Id.*

5. A de novo branch is distinguished from a branch established by merger, in which an existing facility subsequently is operated as an office of the parent bank.

6. See note 2 *supra*.

banking structure and discuss the implications of a liberalized branching framework.

PRESENT BRANCHING PROVISIONS

The present branching provisions for Virginia state-chartered banks⁷ are found in section 6.1-39 of the Virginia Banking Act, which authorizes the establishment of branches in cities contiguous to the county or city in which the parent bank is located and in counties contiguous to the city in which the parent bank is located, provided that the branches are not more than five miles outside the city limits.⁸ Branching via merger is permitted statewide. These provisions were adopted in 1962 in the Buck-Holland Bill,⁹ which liberalized the State's branching laws and provided for the development of the banking structure to its present form. Since 1962, a series of mergers, holding company acquisitions, and de novo branches has permitted the rapid growth of the larger banking organizations (the holding companies) and has led to a greater concentration of banking resources.¹⁰

The table below lists the total number of banks, banking offices, and deposits in Virginia at the end of 1975 and the corresponding portions of each statistic held by the four largest, eight largest, and all thirteen bank holding companies. As this table indicates, the number of banking offices and deposits are somewhat dominated by the larger holding companies, although the number of banks is not.

1975 Virginia Banking Structure

	No. of Banks	No. of Offices	Deposits (\$000,000)
Total State	289	1,460	\$13,721
Four Largest Holding Companies (Percent of Total)	68 (24%)	59 (41%)	5,948 (43%)
Eight Largest Holding Companies (Percent of Total)	101 (35%)	930 (64%)	9,411 (69%)
Thirteen Holding Companies (Percent of Total)	119 (41%)	1,050 (72%)	10,552 (77%)

Source: Federal Reserve Bank of Richmond.

7. Branching provisions pertinent to national banks are found in the McFadden Act, 12 U.S.C. § 36 (1970), which established the so-called "dual banking system" and determined that state branching laws would provide the legal basis for branching of both state and national banks.

8. VA. CODE ANN. §§ 6.1-3 to -125 (Repl. Vol. 1973 & Cum. Supp. 1976).

9. See note 1 *supra*.

10. See Ileo & Parcell, *supra* note 1, at 572-82.

MOVEMENT FOR STATEWIDE BRANCHING

Virginia is characterized as a statewide branching state in some respects because branching via merger and holding company expansion are permitted statewide. However, because a merged bank cannot establish additional branch offices¹¹ and because expansion via the holding company concept is not possible or practical in many areas,¹² the claim that Virginia is a statewide branching state has to be carefully qualified. There remain significant restrictions on the ability of the larger organizations to continue their expansion into new areas. In addition many of the smaller banks have been denied the opportunity to branch from one contiguous county to another, though the arbitrarily defined geographic boundary often separates two economically integrated areas.¹³

Many bankers favor statewide branching because the present law discriminates in favor of savings and loan associations, the major competitors of banks. Virginia S & L's currently are permitted to

11. The Virginia Banking Act uses the location of the parent bank (*i.e.*, the office at which the principal functions of the bank are conducted) as the point from which to determine geographic contiguity. See note 8 *supra* & accompanying text.

12. Branching by the holding company method often involves inferior economies of scale (*e.g.*, the inability to consolidate record keeping functions and accounts) which militate against this type of organization. See Ileo & Parcell, *supra* note 1, at 576 & n.39.

13. Most of the smaller banks, however, are opposed to further liberalization of the Code's branching provisions. As a result, this issue, like many others in banking, is largely a reflection of the tension between the interests of the large banks and the interests of the small banks. In fact, the first Virginia statute concerning branching of state banks allowed statewide *de novo* branching. Act of Mar. 13, 1912, ch. 173, § 3, (1912) Va. Acts of Assembly 1417. The then unit-bank predominated industry subsequently influenced passage of an amendment in 1928 restricting such branching. Act of Mar. 27, 1928, ch. 507, § 13, (1928) Va. Acts of Assembly 1314. The emergence since the Depression of large banking organizations with the concomitant decline in the predominance of unit banks has supplied the pressure for the removal of branching restrictions. See Klebner, *Recent Changes in the United States' Commercial Banking Structure in Perspective*, 18 ANTITRUST BULL. 759 (1973).

At least one commentator has suggested that anti-branching arguments too often are based on emotion rather than fact. "State legislative battles about liberalized structural rules tend to swirl around several related issues. One is the evil of 'bigness' and 'monopoly.'" Baker, *State Branch Banking Barriers and Future Shock—Will the Walls Come Tumbling Down?*, 91 BANKING L.J. 119, 123 (1974). The proper emphasis is otherwise:

What then are our *affirmative goals* in the financial sector? They are, quite simply, that financial services be available to the public to the extent that the public wants to pay for them; that they be delivered efficiently; and that the public be spared the trauma of widespread institutional failure. . . . To what extent do our state banking laws serve these goals? To what extent do they follow the opposite cause . . . of inconveniencing us to serve a horse-and-buggy interest? *Id.* at 120.

branch throughout the State,¹⁴ thus enjoying a competitive advantage over banks. This advantage has become especially pertinent in recent years and more of a concern to bankers because the S & L's have emerged as greater competitors of banks in many areas.¹⁵

The recent and rapid development of Electronic Funds Transfer Systems (EFTS), which use remote terminals to effect numerous types of account transfers,¹⁶ provides added support for statewide branching. Recent legislation has given banks greater latitude in establishing electronic facilities than in establishing traditional branches,¹⁷ thereby supplementing the technological momentum for statewide branching.

A study performed in 1976 for the Bureau of Banking of the State Corporation Commission recognized the problems created by S & L's and EFTS and recommended that statewide branching be permitted in Virginia.¹⁸ Subsequently, a bill was introduced in the General Assembly¹⁹ which would have permitted statewide branching. The branching provision of this bill, however, was deferred by the House Committee on Corporations, Insurance and Banking pending further study.

A new bill²⁰ containing a provision for statewide branch banking has been filed for consideration in the 1977 session of the Assembly.

14. Although the savings and loan associations must obtain approval from the State Corporation Commission, which must make a finding of "public convenience and necessity", there are no geographic contiguity requirements regarding the establishment of such branches. See VA. CODE ANN. § 6.1-195.48 (Repl. Vol. 1973 & Cum. Supp. 1976).

15. Savings and loan associations have made inroads into the previously exclusive checking account market by offering similar withdrawal services under various names, such as "pre-checking" or "NOW" (Negotiable Order of Withdrawal) accounts. Moreover, the practice of paying interest on such accounts increases the competitive potential of savings and loan associations.

16. For a detailed description of EFTS and its implications, see Parcell, *Bank Expansion and Electronic Banking: Virginia Banking Structure Changes—Past, Present and Future*, 1 WM. & MARY BUS. REV. 33-38 (1976). See also Symposium, *Electronic Funds Transfer*, 35 MD. L. REV. 3-87 (1975); Comment, *Electronic Funds Transfer and Branch Banking—The Application of Old Law to New Technology*, 35 MD. L. REV. 88 (1975).

17. Act of April 6, 1976, ch. 554 (1976) Va. Acts of Assembly 664 codified in VA. CODE ANN. §§ 6.1-39.1, 6.1-39.2. Section 6.1-39.1 allows the establishment of terminals operated with or without bank personnel when they are located at a site where the bank could establish a de novo branch or a branch by merger. Section 6.1-39.2 allows an EFTS terminal where a de novo branch could not be established only if the terminal is one that does not utilize bank personnel to deal with bank customers at the location.

18. Golembe Assoc., Inc., *Report and Recommendations from a Study of the Bureau of Banking of the Commonwealth of Virginia* (February, 1976).

19. H.B. No. 796, offered Feb. 6, 1976 by Delegate Axselle.

20. H.B. No. 1285, prefiled June 19, 1976 by Delegate Axselle.

In addition, the Virginia Bankers Association, after holding a series of member bank meetings around the State, has offered a compromise bill which would permit branching on less than a statewide basis but on a liberalized geographic standard.²¹

Public hearings were held on these bills by a House Subcommittee on Banking. The hearings demonstrated the controversial nature of the branching question; the larger banks supported liberalizing the branching provisions, but many smaller bankers spoke out strongly against it.²² The outcome of these bills in next year's General Assembly is uncertain, but they surely will generate one of the greatest legislative struggles on a banking change in recent memory.

EFFECTS OF STATEWIDE BRANCHING

What would be the probable effects of a change in Virginia's branching law? Would the State's banking structure undergo an identity change and increase in concentration similar to that which occurred after the Buck-Holland Bill in 1962? It is submitted that three types of changes would result from the implementation of statewide or liberalized branching.

First, the major holding companies would undergo a period of consolidation whereby most of their affiliate banks would be merged into the central bank. This is a logical reaction because the present system of multiple banks under common ownership results in obvious diseconomies compared to a single bank with statewide branches. In fact, one Virginia holding company already has undertaken such a consolidation program,²³ presumably after determining that the resulting benefits would outweigh the corresponding inability to establish additional branches in areas where consolidation occurs. Further, two other holding companies have embarked on limited consolidation programs of their member banks.²⁴

21. This proposal would permit a bank to establish branches, in addition to those presently allowed, in counties contiguous to counties in which the main office is located, in counties contiguous to cities in which the main office is located (without the present five-mile restriction), and would permit similar branching privileges from the former main office of a merged bank as are available to a main office. Letter from C. Clarke Cunningham, Jr., President, Virginia Bankers Association to Chief Executive Officers (Sept. 29, 1976).

22. The smaller banks were led in their opposition by Robert Garnett of Marion, who is heading the organization of a Virginia Independent Bankers Association to combat branch banking liberalization.

23. The Bank of Virginia has implemented a program to consolidate its fifteen affiliate banks into five regional banks. See 1974 *Annual Report to Stockholders, Bank of Virginia Company*.

24. These are United Virginia Bankshares, which has consolidated its affiliate banks in

Second, there would be a substantial amount of *de novo* branching. This could be expected to take three forms. The holding companies would use the opportunity to extend their operations into additional areas throughout the state, regional organizations would be able to extend and solidify their positions in their respective service areas, and many smaller banks could extend their operations into neighboring counties.²⁵

Third, a number of smaller, independent banks would probably merge into the larger organizations. However, this factor should be relatively minor because the Buck-Holland Bill of 1962 provided the impetus for the majority of available merging opportunities.

On the other hand, three factors should temper the establishment of new branches. First, the high construction cost of establishing new branches makes *de novo* branching less desirable than it was in the past. Second, the development of EFTS will have a dampening effect on branching in the traditional "bricks and mortar" sense, because remote terminals are much less expensive than traditional branch banks and offer many of the same banking services. Third, a *de novo* branch in a new area, far removed from the city containing the main office, generally will face identity problems in an area traditionally served by local banks.

CONCLUSION

Amendment of the Banking Code to allow statewide or liberalized branch banking would be likely to have some noteworthy consequences. Overall structural changes would be insignificant, aside from the merger of many holding company banks and some independent banks. From a structural standpoint, the merger and holding company activities of the past fifteen years already have created

Northern Virginia, and First Virginia Bankshares, which has consolidated its affiliates in the Hampton Roads area and in the Richmond area.

25. There is the additional possibility of increased competition by new entrants into the industry.

While the cost patterns of unit vs. branch banking remain in dispute, there can be little doubt that the broader the permissible branching territory, the more potential competition can operate to exact desirable performance. Entry is more likely under branch banking than in a regime of unit banking. . . . Present branching policy of many states has the effect of increasing concentration or preventing deconcentration. If instead, noncontiguous *de novo* branching were encouraged, competition in local markets would increase to an even greater extent than is conceivable under existing . . . practices.

Klebner, *supra* note 13, at 784-85 (footnote omitted).

the effects that statewide branching would be expected to generate in the absence of merger and holding company activities. Additional efficiencies would be realized because branch operations are more readily coordinated and organized than are multiple-bank operations. Moreover, overall bank competition would increase, especially on a local market basis,²⁶ and entry would be encouraged.²⁷

Because the desirable consequences emanating from the bank expansion in 1962 could be expected to continue without any significant detrimental consequences such as higher levels of concentration, the net effect of legislative change liberalizing branch banking would be beneficial.

26. A study of the structural adaptation of the New Jersey banking industry to statewide branching evidences such results. The increased competition in local markets led to a decrease in concentration on that level. Baker, *supra* note 13, at 128.

27. See note 25 *supra*.