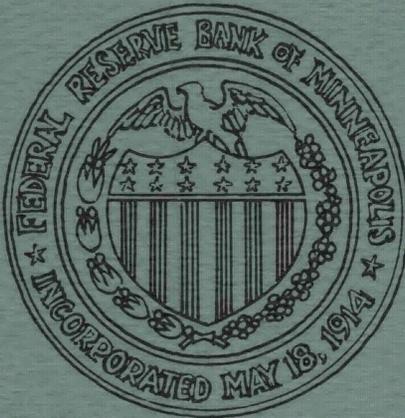
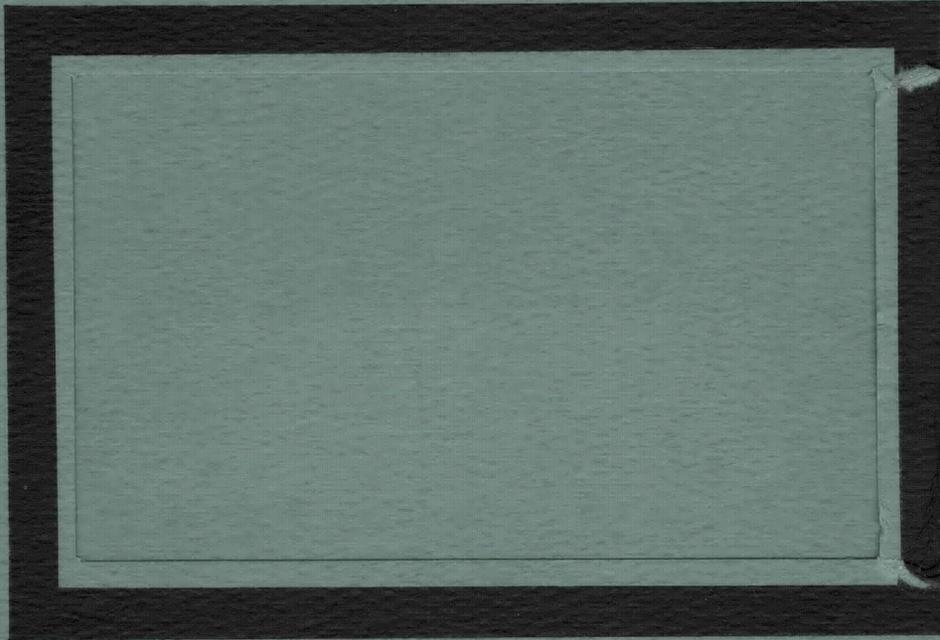


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Changing Minnesota's Banking Structure:
A Decision Framework

by

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CHANGING MINNESOTA'S BANKING STRUCTURE: A DECISION FRAMEWORK

Paul F. Jessup and Richard W. Stolz

This paper summarizes how various changes in legislative and regulatory policy will likely affect Minnesota's banking structure.

The Minnesota Legislature has recently considered 2 branch-banking bills and a bill to permit banks to use consumer banking facilities at nonbank locations. None of these bills was enacted. Meanwhile federal regulatory agencies are permitting financial institutions to use technological innovations and to offer new services. Examples include: NOW accounts, a type of savings account against which one can basically write checks (currently limited to Massachusetts and New Hampshire); electronic funds transfer systems (EFTS) for savings and loan associations; and proposed EFTS capabilities for national banks.

Changes in law and technology are associated with changes in how financial services are defined and delivered. These changes will likely have a profound effect on banking structure.

Minnesota has a dual heritage of independent banking and holding-company banking. Many of the state's independent (nonaffiliate) banks, although generally small in deposit size, are responsive to local banking needs. Also, 2 of the nation's largest multibank holding companies are headquartered in the state. These companies, with affiliate banks in major cities throughout the state, have extensive financial, human, and technical resources capable of providing a broad array of financial services to diverse customers.

These traditions of independent banking and holding-company banking affect most proposals that are likely to change Minnesota's banking structure. Seldom do proponents present information about

alternatives to their specific proposals, and seldom do opponents present constructive alternatives. Instead proposals such as branch banking are debated without careful documentation of probable structural outcomes or of hypothesized public benefits. This adversary approach can easily result in a stalemate or in piecemeal legislation concerning changes in banking structure.

Minnesota's Current Banking Structure

Minnesota's current banking structure is the base from which proposed changes will occur. This current structure is characterized by exceptional size disparity and by barriers to entry of new firms.^{1/}

Two large multibank holding companies, First Bank System and Northwest Bancorporation, control 51 percent of commercial bank deposits in Minnesota (year-end 1974).^{2/} The remainder is diffused among more than 600 other banking organizations--no one of which controls as much as 3 percent of the total.^{3/} This basic size disparity has persisted for at least 3 decades.

Within Minnesota there are exceptionally few large banks to serve as nuclei of new systems capable of developing, in the foreseeable

^{1/}Paul F. Jessup, Minnesota's Exceptional Banking Structure: Research and Policy Perspectives, Research Report, Federal Reserve Bank of Minneapolis, March 1975.

^{2/}Multibank holding companies control 2 or more banks. Until 1970, such multibank holding companies were distinguished by law from holding companies that controlled only 1 bank. The 1970 amendments to the Bank Holding Company Act eliminated this distinction and specified more fully what constitutes "control" of a bank or banks.

^{3/}Noncorporate ("chain") control of sets of banks is possible. A recent review demonstrates that most chain systems control several small banks, and only 2 chain systems control bank deposits in the range of \$70-\$90 million. "Summary Results of Ministudies of Minnesota's Banking Structure," Federal Reserve Bank of Minneapolis, December 18, 1974, p. 2.

future, anywhere near the size and geographical diversity of the 2 large holding companies.

Out-of-state banking organizations cannot branch, acquire banks, or establish banks in Minnesota. Principal barriers to such entry are Minnesota laws and the Bank Holding Company Act, which is federal legislation that prohibits entry by out-of-state bank holding companies unless a state explicitly permits such entry.^{4/}

Banking Structure and Public Policy

Economic theory suggests a relationship between the structure of an industry and the economic conduct and performance of that industry.^{5/} Basically the theory predicts that industries characterized by: (1) high concentration; (2) substantial size disparity among firms; and (3) high barriers to entry by new firms perform less satisfactorily in terms of prices and output than do industries not having these characteristics.

Concentration is generally measured by using a concentration ratio, such as the proportion of assets, sales, or--in the case of banking--deposits accounted for by the largest firms in the relevant market.

Size disparity refers to the size distribution of firms in the relevant market. For example, in 1 market the 4 largest firms may

^{4/}Because of a grandfather clause in the Bank Holding Company Act, some bank holding companies own banks in more than 1 state. These companies, however, cannot acquire additional banks outside their domicile state unless an outside state explicitly permits such entry.

^{5/}Edward S. Mason, "Price and Production Policies of Large-Scale Enterprise," The American Economic Review, Supplement, March 1939, pp. 61-74. Joe S. Bain, Industrial Organization, Second Edition, John Wiley & Sons, Inc., New York, 1968. F. M. Scherer, Industrial Market Structure and Economic Performance, Rand McNally College Publishing Company, Chicago, 1970.

account for 40 percent of sales (a 4-firm concentration ratio of 40), with each of the 4 firms accounting for 10 percent. In another market the 4-firm concentration ratio is also 40, but with the largest firm accounting for 25 percent and the next 3 firms each accounting for 5 percent of sales.

Barriers to entry refers to the handicaps that new firms face in entering an established market. Barriers can take many forms, such as: absolute plant size necessary to produce efficiently (economies of scale); capital requirements; consumer loyalty to established brands (product differentiation); or legal and regulatory barriers. In banking, laws and regulations are probably the major barrier to entry.

Extensive research has tested the structure-conduct-performance theory as it applies to banking. Primarily because of measurement problems, these studies provide weak, often inconclusive, support for the theory.^{6/} Two recent studies, using survey data to overcome many past measurement problems, report stronger support for the theory.^{7/}

Neither the theory nor the results of its general testing is sufficiently conclusive to generalize that Minnesota's current banking

^{6/} Excellent literature reviews include: George J. Benston, "The Optimal Banking Structure: Theory and Evidence," Journal of Bank Research, Winter 1973, pp. 220-237; Gary G. Gilbert and William A. Longbrake, "The Effects of Branching by Financial Institutions on Competition, Productive Efficiency and Stability: An Examination of the Evidence," Journal of Bank Research, Autumn 1973, pp. 154-167, and Winter 1974, pp. 298-307; Jack M. Guttentag and Edward S. Herman, "Banking Structure and Performance," The Bulletin, Institute of Finance, New York University, February 1967; Larry R. Mote, "The Perennial Issue: Branch Banking," Business Conditions, Federal Reserve Bank of Chicago, February 1974, pp. 3-23.

^{7/} A. A. Hegstad and J. J. Mingo, Prices, Nonprices and Concentration in Selected Banking Markets, Research Papers in Banking and Financial Economics, Board of Governors of the Federal Reserve System, March 1974. Donald P. Jacobs, Business Loan Costs and Bank Market Structure: An Empirical Estimate of Their Relations, Occasional Paper 115, National Bureau of Economic Research, New York, 1971.

structure results in unsatisfactory banking services for various customers. Moreover, there is little, if any, information that carefully documents the quantity and quality of banking services available to Minnesota residents. Yet, despite such incomplete information, public officials periodically must make legislative, regulatory, or judicial decisions that affect Minnesota's banking structure.

The Federal Reserve System, for example, is responsible for administering the Bank Holding Company Act. In considering whether or not to approve a holding company's proposed acquisition of a bank, the Board of Governors must evaluate, among other items, whether the proposal may have the effect:

"...substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served."

The Act does not provide convenient definitions of such terms as "competition" and "public interest." Therefore, in administering the Act, the Board of Governors typically uses proxies to try to infer actual or potential competition in a relevant market. Principal proxies used by the Board are: concentration, size disparity, and entry barriers.

For example, in recent decisions involving Texas banking, the Board of Governors states its explicit concern about a situation in which the 5 largest banking organizations account for almost 31 percent of total commercial bank deposits in a state.^{8/} Moreover, the Board

^{8/}Federal Reserve Bulletin, January 1974, pp. 43-46. The Board specifically referenced this decision in a subsequent case involving the same multibank holding company, Federal Reserve Bulletin, April 1974, pp. 290-293.

expresses explicit concern about the disparity in which the 5 largest banking organizations control almost 67 percent of all deposits controlled by bank holding companies within a state. These guidelines, using concentration ratios and focusing on size disparities among firms, provide useful benchmarks against which to compare Minnesota's current banking structure.^{9/}

Because of First Bank System's and Northwest Bancorporation's present position in Minnesota banking, the Board of Governors is reluctant to approve additional bank acquisitions by these 2 systems, especially in metropolitan areas in which they already have major affiliates. The series of Board decisions, and the stated reasons for each decision, are matters of public record.

In summary, the relationships and proxy measures of the structure-conduct-performance model are used by public officials having to make practical decisions about proposed changes affecting banking structure. These officials generally realize that the model is subject to differing interpretations and that it is not definitive. Yet despite its imperfections, it seems to provide a useful framework for evaluating proposed changes in banking structure.

Comparing Future Structural Change in Minnesota Banking

This section specifies a broad set of policy actions and their probable effects on Minnesota's future banking structure. Such a predictive

^{9/} For comparison, the 2 largest banking organizations in Minnesota account for 51 percent of total commercial bank deposits in the state, and they control almost 87 percent of all deposits controlled by multibank holding companies within Minnesota (year-end 1974).

framework enables decision makers to compare probable outcomes of alternate actions.

The predictive framework focuses on possible actions initiated by 2 principal categories of agents:

1. The Federal Reserve System.
2. Legislatures (Minnesota or U.S. Congress) and/or regulatory agencies other than the Federal Reserve System.

The set of major policy actions specified for each agent is as follows:

1. Federal Reserve System--
 - a. Continues recent regulatory policies.
 - b. Encourages emergence of competing multibank holding companies.
2. Legislature and/or regulatory agencies other than the Federal Reserve System.
 - a. Permit full-servicing branching, either statewide or in limited areas within Minnesota.
 - b. Permit specific banking transactions via networks of electronic communications terminals.
 - c. Permit controlled entry by out-of-state bank holding companies.
 - d. Permit nonbank intermediaries to have more "banking" powers.

For brevity each policy action is viewed independently. A more complete analysis would also examine likely interactions among the various policy actions.

AS A RESULT OF THESE POLICY ACTIONS THESE CHANGES IN MINNESOTA'S BANKING STRUCTURE MOST LIKELY WILL OCCUR:

	Concentration of banking resources (2-firm concentration ratio)	Size disparity among state's 10 largest banking organizations	Barriers to entry and/or expansion of banking systems
<p>Federal Reserve System . . . continues recent regulatory policies.</p> <p>. . . encourages emergence of competing multibank holding companies.</p>	<p>↓</p> <p>↓ ↓</p>	<p>↓</p> <p>↓ ↓</p>	<p>No change</p> <p>↓ ↓</p>
<p>Legislature and/or regulatory agencies other than the Federal Reserve System . . . permit full-service branching subject to 20% deposit ceiling: limited statewide</p>	<p>↑ ↑</p>	<p>↓ ↓</p> <p>↓ ↓</p>	<p>↓ ↓</p> <p>↓ ↓</p>
<p>. . . permit specific banking transactions via networks of electronic communications terminals.</p>	<p>↑</p>	<p>No change</p>	<p>↑</p>
<p>. . . permit controlled entry by out-of-state banking systems.</p>	<p>↓</p>	<p>↓</p>	<p>↓ ↓</p>
<p>. . . permit nonbank intermediaries to have "banking" powers.</p>	<p>↓ ↓</p>	<p>↓ ↓</p>	<p>↓ ↓</p>

KEY: Direction of probable change: ↑ increase ↓ decrease

Rate of probable change: ↑↑ rapid ↑ gradual ↓ gradual

The Exhibit summarizes the expected structural outcomes associated with each policy action.^{10/} The analysis focuses on 3 principal dimensions:

1. Concentration of banking resources.
2. Size disparity between banking organizations in the state.
3. Barriers to entry and/or expansion of banking systems.

For each structural measure, the Exhibit schematically summarizes the probable direction and rate of change. Logical extensions of this initial framework include:

1. Specifying "Highly uncertain" as an outcome.
2. Distinguishing between controlled outcomes (principally by legislative and/or regulatory constraints) and less controllable--and presumably less predictable--outcomes.
3. Estimating the magnitude of expected change.
4. Classifying probable outcomes within the time spectrum of short run to long run.

The schematic summary thus provides a basis for comparing estimated outcomes from a broad set of alternate policy actions.

Federal Reserve System Continues Recent Regulatory Policies

This policy action assumes that the Federal Reserve System maintains its expressed concern about the current market position of the 2 multibank holding companies, First Bank System and Northwest Bancorporation. Therefore, the System scrutinizes any applications by these 2

^{10/} For conciseness, most of the following statements use simple future tense to describe outcomes that necessarily involve probability estimates as to their future occurrence.

organizations to acquire existing or de novo banks, especially in metropolitan areas of Minnesota. In this regulatory environment, the 2 largest banking systems in Minnesota will continue to be constrained from acquiring new affiliates in growing banking markets. They will have to rely on the internal growth of their current affiliates, and they may apply to acquire small banks or newly chartered affiliates in rural areas in which they currently have no affiliate banks.

This policy action also assumes that the Federal Reserve System welcomes proposed formation and expansion of other Minnesota-based multibank holding companies but insists that such firms maintain high levels of equity capital. For all practical purposes this regulatory posture precludes many acquisitions by these other multibank holding companies. (Such acquisitions are largely stymied until these firms raise more equity capital--an unlikely action in today's capital markets.)

If the Federal Reserve System continues its recent policies, this implies only gradual change in Minnesota's current banking structure (Exhibit). Over time the market share of the 2 largest systems will gradually decline, and other Minnesota-based multibank holding companies will slowly build their networks of affiliates by acquiring or establishing banks in additional markets within Minnesota.

Federal Reserve System Encourages Emergence of Competing Multibank Holding Companies

This policy action assumes that the Federal Reserve System decides not merely to respond to applications by Minnesota-based multibank holding companies. Instead it decides to encourage, within current

legislative guidelines, development of major competing banking systems within Minnesota.

The Federal Reserve System can explicitly communicate to First Bank System and Northwest Bancorporation that, in view of their current relative positions throughout Minnesota, there are unlikely to be net public benefits from their acquiring additional banks, especially in metropolitan areas of the state. The 2 large systems thus will specifically know that, while they are welcome to apply to acquire additional banks, they will be expected to carefully document public benefits of proposed acquisitions.

At the same time the Federal Reserve System can encourage expansion proposals by other Minnesota-based multibank holding companies. Adhering to the guidelines of the Bank Holding Company Act, the Federal Reserve System will carefully review the managerial and resource bases of expanding systems while weighing, perhaps more heavily, the benefits of such systems' entering new markets in Minnesota and reducing size disparity among large systems.

Thus, operating within the provisions of the Bank Holding Company Act, the Federal Reserve System can act positively to affect future changes in Minnesota's exceptional banking structure. As summarized in the Exhibit, this policy action will lead to more rapid structural changes--especially compared to the policy action of continuing recent policies.

Legislature Permits Full-Service Branching

Minnesota can enact legislation that permits full-service branching either statewide or within limited geographical areas of the

state.^{11/} Such legislation can contain provisions such as home-office protection and a timetable specifying a sequential broadening of the geographical areas within which banks can branch.^{12/} Such provisions will affect the probable sequence of structural outcomes.

What if Minnesota passes branching legislation similar to the bill introduced in 1975? This bill, as amended, provided for full-service branching within each of the state's Development Regions.^{13/} It prohibited any bank from acquiring another bank if the combined deposits of the consolidated bank, or parent holding company, would exceed 20 percent of the deposits in the Development Region or the state. It also provided home-office protection for banks in small communities.

First Bank System and Northwest Bancorporation, with comparatively large affiliate banks in at least 10 of the 12 regions, are each well-positioned to consolidate their subsidiary banks into regional branching systems. With the exception of Otto Bremer Foundation's control of banks in 8 regions, no other multibank holding company owns banks in more than 3 regions.

^{11/}Another possibility is that the U.S. Congress passes legislation permitting national banks to branch across state lines.

^{12/}Home-office protection involves legislation that prohibits a banking system from establishing a de novo branch (or affiliate bank) in a municipality in which an existing bank has its home office. Under these conditions, an expansionary banking system can enter such a protected area only by acquiring an existing bank.

State legislation may divide a state into several multicounty banking regions and then specify a timetable by which banks can, for example, branch only within counties for, say, 5 years, then only within the broader banking region for 5 years, after which they are free to branch statewide. Sequential branching (and holding company) legislation of this general type was enacted in New Jersey (1969) and New York (1971).

^{13/}Senate File No. 639. House File No. 763.

Because of the 20 percent deposit limit, the resultant regional branch systems of First Bank System and Northwest Bancorporation cannot expand by merger but will have new opportunities to expand by opening de novo branches. These regional affiliates have access to resources adequate for financing and staffing the opening of de novo branches in strategic locations within their Development Regions, especially in the Twin Cities metropolitan area.^{14/}

First Bank System and Northwest Bancorporation will not be the only beneficiaries of legislation permitting branch banking within Minnesota's Development Regions. Other banks and bank holding companies, none of which approach the 20 percent deposit limitation, will have new legislative flexibility to expand not only de novo but also by acquiring existing banks. These mergers will tend to reduce size disparity among large banking organizations. In practice, however, it is doubtful that these banking organizations will expand rapidly. Many are small closely held organizations that, while likely acquisition candidates, are themselves not likely to acquire banks. Moreover, the larger nonaffiliate banks and bank holding companies have been notably slow to expand via multibank holding companies in recent years. If managerial and financial resources have constrained such past expansion, it is not evident how these constraints will substantially change if Minnesota permits branch banking limited to regions within the state.

^{14/} Legislation could be designed to limit, at least for awhile, such indirect expansion by specifying, for example, that no bank holding company and its affiliates can establish more than, say, 3 or 5 de novo branches per year in the state. Such a constraint would limit a possible surge of de novo branches by exceptionally large systems and yet would encourage a feasible rate of de novo expansion by medium-sized systems.

Legislation permitting statewide branching in Minnesota will have probable structural outcomes different from those of limited branching (Exhibit). The principal reason is that the comparative locational advantage of First Bank System and Northwest Bancorporation--having affiliate banks in almost all Minnesota's Development Regions and large cities--is less than it would be with limited branching. Other banking organizations can seek to branch anywhere in the state. Therefore, in terms of the Exhibit, statewide branching will contribute to structural outcomes different from those associated with limited-branching legislation like that proposed in 1975.

Legislature Permits Networks of Electronic "Banking" Terminals

Instead of permitting full-service branching, new legislation (or regulation) can permit banks to provide services via networks of electronic communications terminals. Recently the Comptroller of the Currency ruled that national banks can use such terminals exclusively anywhere within 50 miles from the main office or a branch--even if this involves crossing state lines.

The Minnesota Legislature recently passed a bill, subsequently vetoed by the Governor, permitting banks to operate "consumer banking facilities" (CBFs).^{15/} The bill defined CBFs not as full-service branches but in terms of their location, services, and availability to Minnesota's banks and their customers. Also, it imposed some conditions concerning placement, ownership, and advertising of such CBFs. Ownership of a CBF

^{15/}House File No. 929, transmitted to the Senate on May 8, 1975.

was not restricted, but its services were to be "available to any bank on a fair, equitable and nondiscriminatory basis approved by the commissioner of banks, which includes a pricing structure limited to the owner's direct costs, ..."

CBFs are likely to enable Minnesota banks better to service their existing customers who will thus have electronic access to their accounts from a variety of terminals. CBFs also will likely enable Minnesota banks to counter possible competitive inroads by S&Ls that are able to provide similar electronic customer-service terminals away from S&L offices.

Because banks cannot use them to open new accounts, CBFs do not appear to be effective devices for penetrating new geographical areas. To date various banking organizations have little information concerning the costs and expected benefits of establishing or participating in CBF systems. It is likely, however, that First Bank System and Northwest Bancorporation will promptly implement CBF systems in order to service their large base of existing customers. Most of the next-largest banking organizations also are likely to seek to retain their existing customers by providing them access to shared CBF systems. Technically, small banks in Minnesota also will have access to CBFs anywhere in the state. Depending, however, on the expected cost-benefit structure, small banks, with their low initial resource and customer base, may find it infeasible to participate in regional or statewide networks of CBFs. The Exhibit provides a summary of likely structural outcomes if Minnesota were to enact CBF legislation similar to that recently proposed.

Proliferation of CBFs is likely to forestall chartering of banks in Minnesota. The reason is that CBFs will likely be placed in and near shopping areas in order to service consumer banking transactions in these commercial areas. These CBFs will enable existing banks better to serve their customers away from bank premises. However, this availability of CBFs in and near unbanked commercial areas reduces the likelihood that an organizing group will want--or be able to obtain--a charter for a new full-service bank where at least some of the area's banking needs are being met by convenient CBFs. From this view, CBFs can raise barriers to entry of new full-service banks into developing markets.

What if, instead of the proposed bill with its mandatory sharing provision, Minnesota passes legislation that does not require sharing CBF terminals with other banks? The structural outcomes will differ from those summarized in the Exhibit. The 2 large systems have the affiliates and resources to develop quickly extensive CBF networks. Not having "equal access" to these networks, the smaller organizations will face high entry costs to develop or participate in other networks. These entry costs, however, will probably be lower than the costs to develop networks of full-service branches.

Legislature Permits Controlled Entry by Out-of-State Bank Holding Companies

Minnesota can enact legislation enabling out-of-state banking systems to branch and/or own affiliate banks in Minnesota. Permitting branch entry by out-of-state systems is unlikely unless banks domiciled in Minnesota also have broad branching powers. In contrast, permitting out-of-state bank holding companies to own affiliate banks in Minnesota

is a logical extension of the state's tradition of intrastate holding company operations. Moreover, 3 Minnesota-based bank holding companies, because of grandfather privileges, already own affiliate banks in nearby states.^{16/}

The Bank Holding Company Act prevents bank holding companies from directly acquiring banks in additional states unless a state specifically permits such acquisitions. Even if a state permits entry, any proposed acquisition is subject to regulatory review by the Federal Reserve System. Federal legislation thus is permissive concerning controlled interstate expansion by bank holding companies.

There is precedent for a state to permit out-of-state bank holding companies to acquire banks within its borders. Iowa, for example, enacted legislation (1972) that permits qualified out-of-state bank holding companies to acquire banks in Iowa.^{17/} Reportedly, other states such as California and New York are considering legislation to permit controlled entry by out-of-state systems.^{18/}

What if Minnesota were to pass legislation permitting controlled entry by out-of-state bank holding companies? Some out-of-state bank

^{16/}The Bank Holding Company Act contains a grandfather clause permitting bank holding companies to retain those banks controlled by them in other states prior to passage of the Act.

^{17/}Iowa Code Annotated, Iowa Banking Act of 1969, as amended in 1972, Division XVIII, "Bank Holding Companies," Section 1805, "Out-of-state holding companies."

^{18/}Also, the Foreign Bank Act of 1974, proposed by the Board of Governors of the Federal Reserve System, contains provisions that "would enable foreign banks to establish branches in States where such branches are prohibited or not permitted by State law. Establishment of such branches would, however, be subject to the provisions of the Bank Holding Company Act with respect to multi-State banking operations." Foreign Bank Act of 1974, Summary of Principal Features, Board of Governors of the Federal Reserve System, p. 6.

holding companies will likely analyze probable long-run profit opportunities in Minnesota. If they conclude that Minnesota's banking markets already are all well served such that there are limited profit opportunities from entering such markets, then they will likely decide not to enter Minnesota. Conversely, if their analyses identify markets with unusual profit opportunities, then some out-of-state bank holding companies will likely act quickly to enter such Minnesota markets.

Whether or not out-of-state banking organizations decide to enter Minnesota will provide useful information for future public policy. If Minnesota lowers entry barriers and subsequently finds few, if any, bank holding companies entering Minnesota, this outcome will indicate that Minnesota's banking markets already are highly competitive such that other banking systems choose not to enter.

If out-of-state holding companies decide to enter Minnesota, they can request authorization to: (1) establish new banks; or (2) acquire nonaffiliate banks. By establishing new banks they will immediately add to the number of competing systems in some banking markets within Minnesota. Moreover, if these new banks grow rapidly, this de novo process will, over time, contribute toward reducing the current disparity of concentration among banking systems operating in Minnesota.

In contrast, if out-of-state holding companies decide to enter Minnesota primarily by acquiring nonaffiliate banks, this process will not immediately add to the number of competing systems in banking markets within Minnesota. Instead this process reflects a change in controlling ownership of some banks already in the markets. By deciding to acquire some Minnesota banks, however, these out-of-state holding companies also are likely committing themselves to providing the financial

and managerial resources necessary for their newly acquired affiliates to compete aggressively in Minnesota. Thus, over time, these affiliate banks will probably increase their share of Minnesota banking and thus also contribute toward reducing the current disparity among banking systems in Minnesota.

Whether out-of-state holding companies enter Minnesota de novo or by acquisition is likely to lead toward the structural changes summarized in the Exhibit. Each specific proposed entry could still be controlled by state legislative guidelines and would be controlled under terms of the Bank Holding Company Act. State law, for example, could limit entry by out-of-state holding companies to those domiciled in states that permit reciprocal entry and/or expansion by Minnesota-based bank holding companies. For example, Minnesota officials might initially choose to negotiate reciprocity agreements with nearby states such as Iowa, Michigan, and Wisconsin. Such reciprocity would allow other banking systems to enter Minnesota while simultaneously allowing Minnesota's banking systems, such as First Bank System and Northwest Bancorporation, to enter new banking markets in neighboring states.

Legislature Permits Nonbank Intermediaries To Have More "Banking" Powers

Legislation can be enacted--or possibly reinterpreted--to redefine what constitutes "banking" powers. Such redefinition will substantially change traditional measures of "banking" concentration in Minnesota.

Legislated changes in banking powers can be enacted at the federal and/or state level. The U.S. Treasury Department, for example, recently drafted proposed legislation that would enable savings and loan

associations and mutual savings banks to offer third-party payments services very similar to checking accounts traditionally offered by commercial banks. This proposed legislation also would broaden the lending and investing opportunities of nonbank financial intermediaries, thus adding to the areas in which they can directly compete with banks.

Even within current legislative guidelines, regulatory rulings and court decisions can redefine banking powers. For example, the Federal Home Loan Bank Board, through a series of interpretive rulings, has been broadening the powers of savings and loan associations to offer new types of third-party payments services. Similarly, regulatory authorities in Massachusetts and New Hampshire transformed traditional banking definitions when they authorized mutual savings banks in their states to offer NOW accounts. These accounts are basically savings accounts against which account holders can write negotiable orders of withdrawal that are functionally similar to checks.^{19/}

In Minnesota there are only 3 banks with deposits exceeding \$100 million (year-end 1974) that are not affiliated with the 2 large multibank holding companies. There also are 6 savings and loan associations and 1 mutual savings bank in this size category. Such nonbank intermediaries already compete with banks in product areas such as savings accounts and mortgage lending. If these nonbank intermediaries were to acquire additional "banking" powers, then measures of banking concentration will have to recognize explicitly these new competitive dimensions. The distinction between banks and nonbanks will become increasingly blurred.

^{19/}William A. Longbrake and Sandra B. Cohan, "The NOW Account Experiment," Journal of Bank Research, Summer 1974, pp. 71-85.

Allowing nonbank intermediaries to acquire more banking powers will contribute to the structural changes outlined in the Exhibit. "Banking" markets will be broadly defined, and there will generally be more large competing systems within such product markets. Therefore, in evaluating various policy actions that will likely change the structure of Minnesota's banking markets, public officials can explicitly include actions that will directly broaden--or at least not impede the broadening of--"banking" powers of nonbank financial intermediaries.

Conclusion

State legislatures periodically consider bills that may change state banking structures. Sponsors and opponents typically focus on specific provisions of such bills, without considering options that may better achieve public-policy goals.

This paper builds on the assumption that legislative and regulatory changes should be examined as to their probable effects on: (1) concentration; (2) size disparity; and (3) entry barriers. Using these criteria, the paper specifies expected outcomes from various policy actions, thus demonstrating the differential impact of alternate actions.

Public officials can evaluate expected outcomes against public-policy goals. For example, broadening the "banking" powers of nonbank intermediaries will achieve rapid changes in the 3 structural measures whereas CBF legislation will not (Exhibit). If a principal goal is to reduce barriers to bank entry, then public officials may want to examine carefully the total benefits and costs of permitting controlled entry by out-of-state bank holding companies, possibly on a

reciprocity basis with nearby states. If the costs of permitting out-of-state entry are judged to exceed the benefits, then public officials can consider branching alternatives, such as setting a cap on the total deposits that any banking organization can acquire through merger and then permit branching, possibly limiting the number of de novo branches that any banking organization can open during a specified time period.

Although this paper focuses on Minnesota's banking structure, the broad perspective and initial results may be applicable to other states in the Ninth Federal Reserve District.

Public commissions have conducted comprehensive studies of banking laws in several states. These study commissions typically include public members as well as members associated with the industry. For example, Maine recently enacted an omnibus banking package recommended by a governor's advisory committee composed largely of consumer representatives. The package includes provisions for: statewide branching, electronic fund transfers, out-of-state holding company entry on a reciprocal basis, and increased powers for nonbank financial intermediaries.^{20/}

In view of Minnesota's exceptional current structure, the pace of technological and regulatory change in the financial-services industry, and the recent impasses in the legislature, Minnesota may similarly want to examine the probable benefits and costs of a comprehensive public review of its financial-services industry. For similar reasons, other states in the District may also decide to establish public study commissions, possibly on an interstate basis.

^{20/}American Banker, June 20, 1975, pp. 1, 24.

