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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Federal Review Of Intrastate Branching Applications Can Be Reduced

The Federal review of intrastate domestic bank new branch applications rarely restricts branch actions, produces little new information of supervisory value, and, in the case of State-chartered banks, duplicates State efforts. GAO recommends that laws and policies be changed to alter the Federal review requirement to an exception-based processing system.

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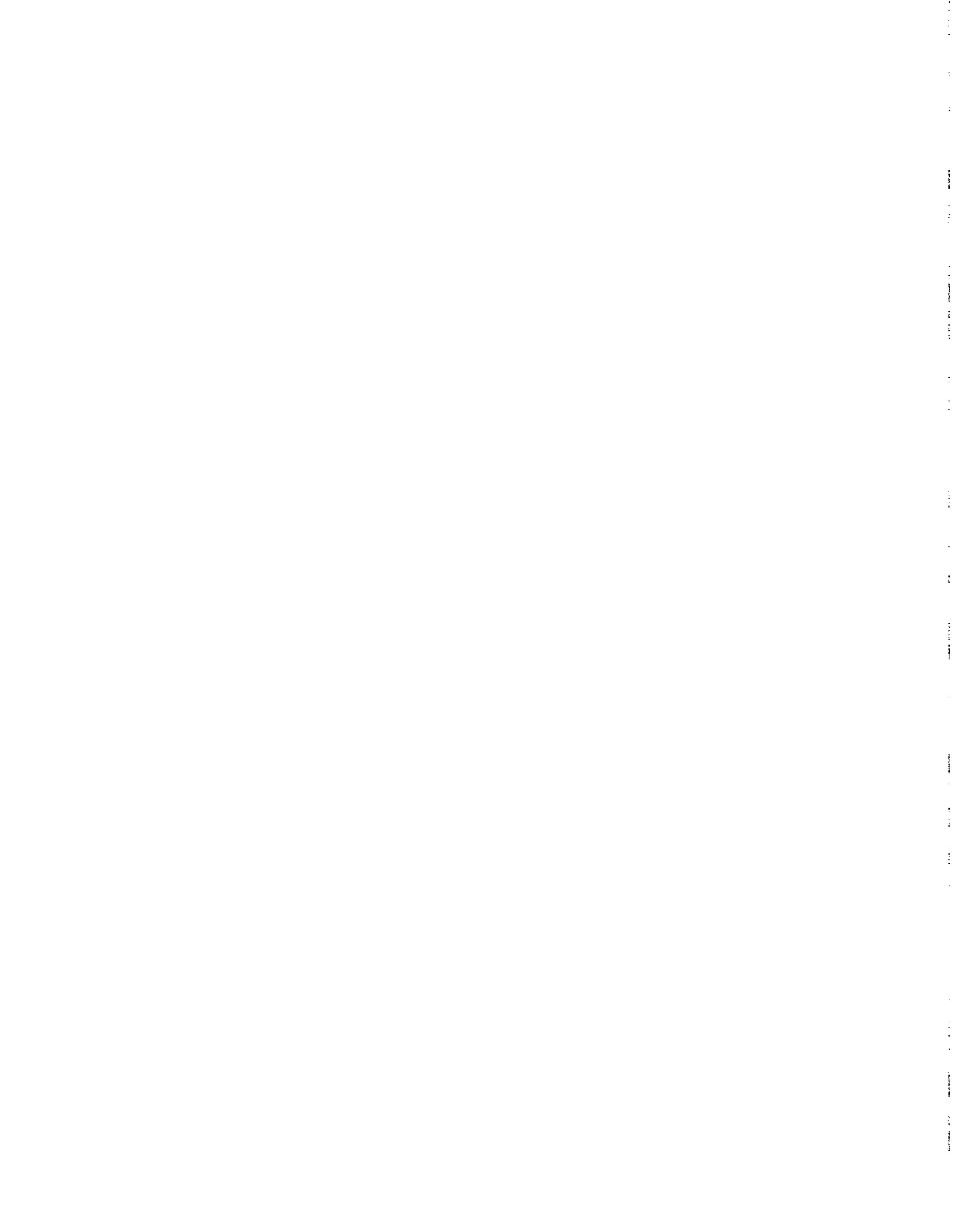

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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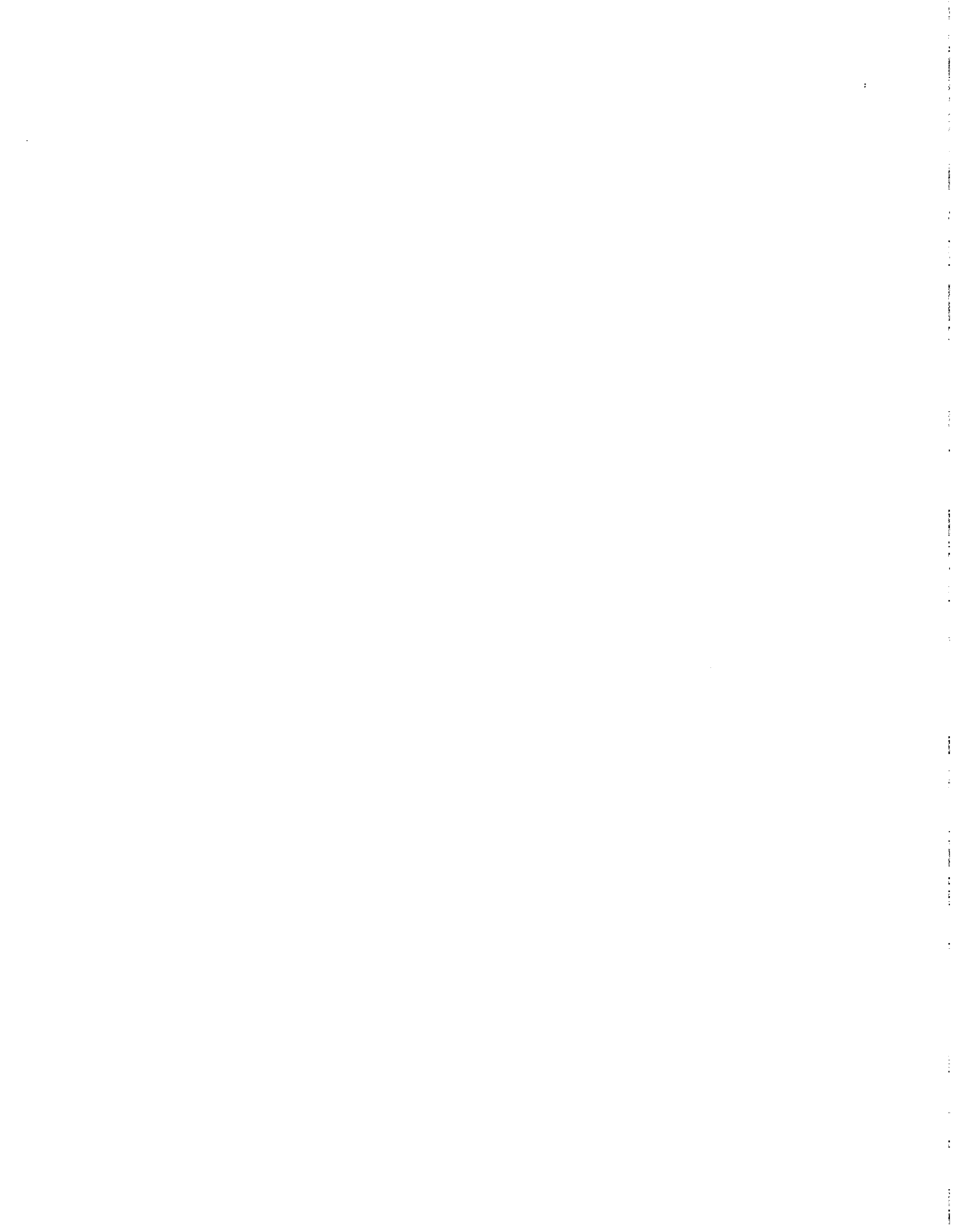
To the President of the Senate and the
Speaker of the House of Representatives

This report describes the processes used by the Federal bank regulators to review commercial banks' applications for branches and makes recommendations for reducing the burden imposed by those processes. The recommendations include changes to existing laws which would minimize and, in some cases, eliminate the Federal review of commercial bank branching.

We conducted this review because branching has been the primary means of bank expansion during the past decade and its regulation presented a high potential for unnecessary regulatory burden. Our review was conducted pursuant to the Federal Banking Agency Audit Act (31 U.S.C. 67).

Copies of this report are being sent to the Secretary of the Treasury; the Comptroller of the Currency; the Chairman, Federal Deposit Insurance Corporation; the Chairman, Board of Governors of the Federal Reserve System; and the Chairman, Federal Financial Institutions Examination Council.

Charles A. Bowsher
Comptroller General
of the United States



COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

FEDERAL REVIEW OF INTRASTATE BRANCHING APPLICATIONS CAN BE REDUCED

D I G E S T

Although the Federal regulation of domestic bank branching was initially related to historical concerns about bank safety and soundness, current Federal reviews of individual branching applications rarely restrict branch actions, produce little new information of supervisory value, and, in the case of State-chartered banks, duplicate State efforts. For these reasons, GAO recommends that the appropriate laws and policies be changed to alter the Federal review requirement to an exception-based processing system.

GAO conducted this review primarily to assess the efficiency and effectiveness of the Federal processes for regulating intrastate branching.

DOMESTIC BRANCHING IN THE U.S. BANKING INDUSTRY

A branch is defined by Federal law as being any office, branch agency, additional office, or any branch place of business located in any State or territory of the United States or in the District of Columbia at which deposits are received, checks paid, or money lent. This definition has been interpreted by court decisions to include unstaffed electronic facilities located away from existing bank facilities. (See p. 5.)

In the 1970s commercial banking expanded throughout the United States primarily by establishing new branches of existing institutions, rather than by establishing new banks. From 1970 to 1980, domestic bank branches in operation increased from 21,810 to 38,736 (78 percent), while the number of domestic banks

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in operation grew only from 13,511 to 14,435 (7 percent) for the same period. (See p. 7.)

THE REGULATION OF BRANCHING IS COMPLEX

The Federal regulators, State governments, and banks are intertwined in the branching process by a mixture of Federal and State laws, many of which were inspired by a historical concern over branching's impact on bank safety and soundness. State laws (to which all banks irrespective of charter must conform) dictate if, how, and where branches may be placed. Federal laws, however, define what constitutes a branch of a bank and also require Federal regulators to approve each federally insured branch, after considering a wide range of issues. Thus the majority of banks must obtain the prior approval of two regulatory agencies before establishing a branch. (See p. 7.)

FEDERAL REGULATORS SHOULD REVIEW STATE BANK INTRASTATE BRANCH APPLICATIONS ON AN EXCEPTION BASIS

Much of the current Federal review effort produces very little. To the extent that these reviews require from applicants information that may not be needed and delay branch investment decisions, an unnecessary burden is being placed on applicant banks. (See p. 38.)

GAO found that:

--94 percent of all State bank applicants were classified by their Federal regulators as "fundamentally sound" or better institutions. (See p. 19.)

--85 percent of all applicants had previous branching experience. (See p. 23.)

--The majority of State bank branching placements are located close to existing bank operations. (See p. 22.)

--Less than 3 percent of these branching actions precipitated strong protests. (See p. 23.)

--Only 31 of 5,786 branch applications were denied by Federal regulators from 1975 through 1980. (See p. 24.)

--Reviews of an applicant bank's capacity to branch rely extensively on data and analyses already in the possession of the regulator. (See p. 32.)

--Reviews of branch impact on the recipient community are difficult and duplicate State efforts. (See p. 36.)

Extensive regulatory reviews by the Federal Deposit Insurance Corporation and the Federal Reserve System should no longer be required for the establishment of each new insured State bank branch. Instead, extensive reviews should be done on an exception basis only.

THE COMPTROLLER OF THE CURRENCY'S REVIEW OF INTRASTATE NATIONAL BANK BRANCH APPLICATIONS SHOULD BE REDUCED

The Office of the Comptroller of the Currency (OCC) performs extensive reviews of each national bank branch application. These reviews are for the purpose of assuring that applicant national banks have the capability to expand without either endangering their safety and soundness or adversely affecting the receiving communities. GAO questions the need for extensive reviews of each application because:

--OCC restricted only 29 of the 577 (5.0 percent) branch applications considered in 1980. (See p. 49.)

--Only 30 out of 577 (5.2 percent) national bank branch applications were strongly protested in 1980. (See p. 53.)

--OCC depends heavily on existing examination-generated analyses for its conclusions and recommendations. (See p. 54.)

GAO believes that a more exception-oriented application review approach should be used by OCC.

THE FEDERAL ROLE IN REGULATING THE INTRASTATE ESTABLISHMENT OF INDIVIDUAL BANK REMOTE ELECTRONIC TERMINALS SHOULD BE FURTHER REDUCED

Federal bank regulatory agencies treat commercial bank remote service facilities as they do staffed branches, because courts have ruled that such facilities are branches as defined by the McFadden Act. Therefore, banks must receive Federal agency approval to establish remote service facilities even when the State involved does not consider those facilities to be branches. (See p. 64.)

GAO believes the Federal review of remote service facilities is no longer necessary for State banks and should be further reduced for national banks because such facilities represent minor actions. (See pp. 71 to 74.) This would also insure regulatory consistency. (See p. 75.)

RECOMMENDATIONS TO THE CONGRESS

GAO recommends that the Congress amend the Federal Reserve Act and the Federal Deposit Insurance Act to replace the requirement for a broad review of each branch application with a notification process, wherein applicant banks notify the respective Federal agency of their desire to branch. (See p. 44.)

GAO also recommends that the Congress amend the McFadden Act and the Federal Deposit Insurance Act to differentiate between staffed branches and remote service facilities. (See p. 81.)

RECOMMENDATIONS TO THE COMPTROLLER OF THE CURRENCY

GAO recommends that the Comptroller of the Currency:

--Establish an exception-oriented new branch application processing system with explicit calendar day processing time requirements for routine branch applications. Extensions beyond this time frame should be exceptions, which would necessitate an OCC action to initiate. (See p. 63.)

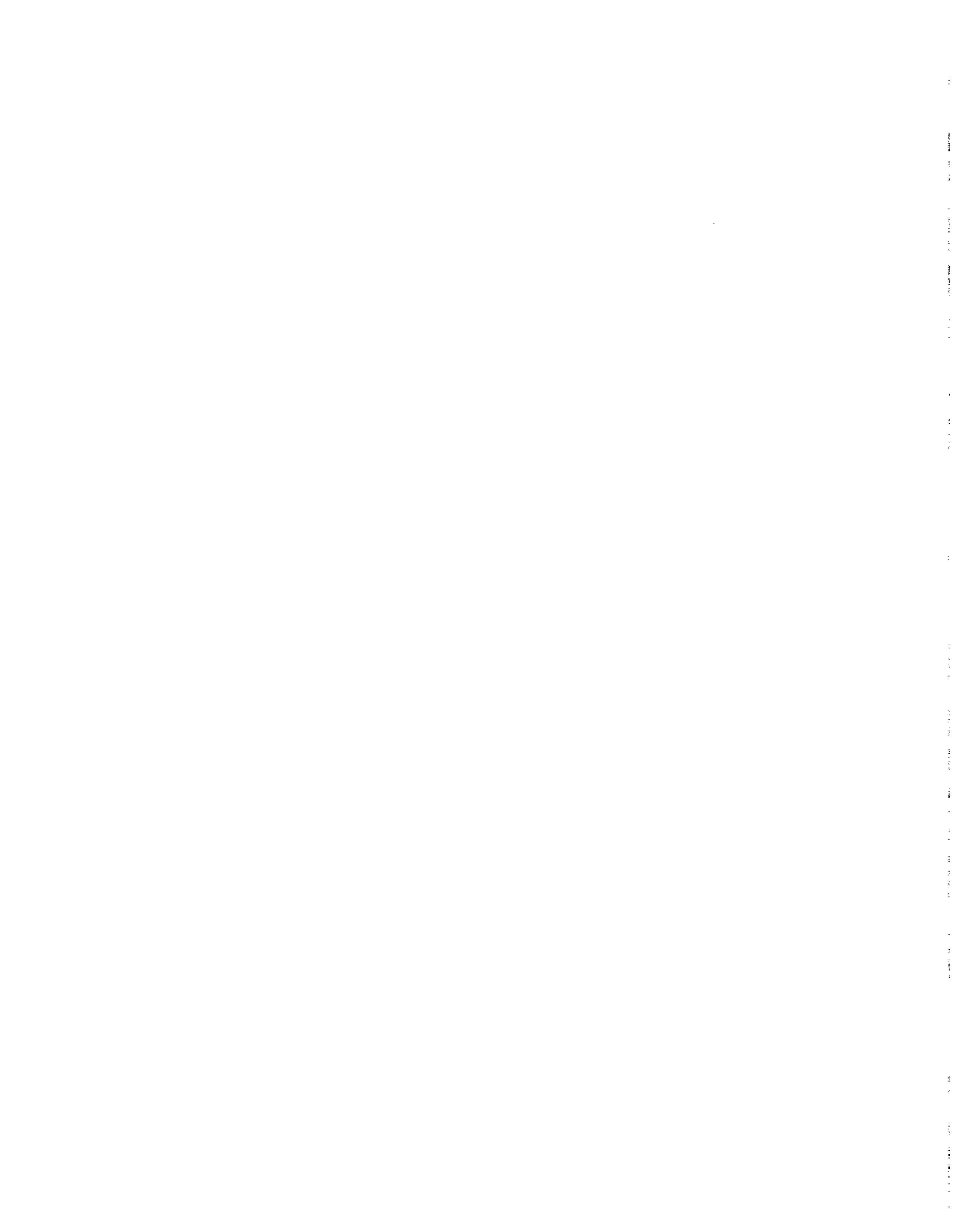
--For national banks operating in States requiring the review of branch applications for their community convenience and needs impact, establish structured bank application reporting formats based on OCC's interpretation of individual State law requirements. (See p. 63.)

AGENCY COMMENTS

The Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve System agreed with GAO's conclusion that their roles in intrastate branching could be reduced. They all did not agree with GAO's recommendations for doing so.

The Comptroller of the Currency agreed with GAO's recommendations to him (see p. 64) and with its suggested modification to the McFadden Act (see p. 82). The Federal Reserve and the Federal Deposit Insurance Corporation did not agree that legislative actions were needed to streamline their branching processes. GAO continues to believe that legislative change is needed to achieve the optimum level of deregulation. See p. 44.)

On the basis of concerns expressed by the Corporation about GAO's proposed changes to the Federal Deposit Insurance Act, some language changes were made. (See p. 45 and app. V.)



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ABBREVIATIONS

ATM	Automated teller machine
CBCT	Customer-bank communications terminal
CRA	Community Reinvestment Act
EFT	Electronic funds transfer
FDIC	Federal Deposit Insurance Corporation
FRS	Federal Reserve System
GAO	General Accounting Office
IBAA	Independent Bankers Association of America
OCC	Office of the Comptroller of the Currency
RSU	Remote service unit

CHAPTER 1

INTRODUCTION

The regulation of commercial bank branching has long been an issue fundamental to the maintenance and growth of the U.S. commercial banking industry. The Federal Government, State governments, and banks are intertwined in the process by a mixture of Federal and State laws. The establishment of a new branch bank, although a relatively straightforward business decision, is a complicated process. State laws (to which all banks irrespective of charter must conform) dictate if, how, and where branches may be placed. Yet, Federal law defines what constitutes a branch of a bank, and Federal regulators must approve the establishment of any new bank branch by any bank with Federal deposit insurance. Thus, the majority of banks must obtain the prior approval of two regulatory agencies before establishing a branch.

This report addresses two aspects of the branching issue:

(1) It evaluates the need for the continued Federal review of applications for new bank branches. (See ch. 2 and 3.)

(2) It describes an inconsistency in Federal and State regulation of unstaffed banking facilities, called remote service units, automated teller machines, or customer-bank communications terminals. (See ch. 4.)

SAFETY AND SOUNDNESS CONCERNS PROMPTED BRANCHING REGULATION

Although the banking environment in the 1920s and early 1930s emphasized the negative aspects of branching on bank safety and soundness, subsequent studies have asserted that branching does not have a significantly negative impact on system safety and soundness. Problem institutions are normally characterized by bad lending policies and/or practices.

Commercial banks play an important role in our economy. They are the custodians of the deposits used in part to meet the financial needs of individuals, private businesses, and industry through loans and investments. The failure of a bank can affect depositors and borrowers in their immediate markets and, depending on the size of the involved financial institution, may reach beyond that market. To maintain public confidence in the banking system, Government regulation has long been viewed as a

necessary mechanism to insure the safety and soundness of individual institutions and to achieve other national policy objectives, such as credit allocation or consumer protection. One regulated area has been the creation of new branches.

Branching once thought to be threatening

The regulation of individual branching decisions first became an issue of concern in the early 1920s. A "new" system and theory of banking--branch banking--had been introduced in several States and was actively being engaged in by some State banks. This situation was viewed with alarm by both the Comptroller of the Currency and the Federal Reserve System, as national banks could not engage in the same expansion. The Comptroller of the Currency viewed branch banking as an entirely undesirable phenomenon threatening both the national bank and Federal Reserve Systems. In his 1924 annual report, he recited the following "points" relating to branch banking:

> " First, That branch banking is opposed to public policy as being in its essence monopolistic.
>
> Second, That branch banking is absentee banking, and is conducted for the sole purpose of earning dividends for the stockholders rather than of service to the community.
>
> Third, That with the development of large chains of branch banks the responsibility for the mobilization and transfer of funds would rest with individuals whose prime motive would be personal profit. The resources of banks are, in a large measure, the trust funds of a community, and the conditions which justify the transfer of funds from one community to another should be passed upon and the action controlled by disinterested governmental authority, removed from the influence of personal profit. This is the function of the Federal reserve banks.
>
> Fourth, Branch banking is particularly inconsistent with the American idea of local self-government and Federal coordination. The banking system of the United States as at present constituted is closely analogous to the governmental structure. Under the Federal reserve system local independent units are coordinated, while branch banking proposes that they should be consolidated.
>
> Fifth, As a direct result of absentee control the human element and moral responsibility of the creditor would necessarily be largely eliminated. Absentee control must obviously be exerted through employees governed by rigid rules, operating under the most limited discretion. Under such conditions a bank would eventually degenerate into a glorified pawnshop from which collateral had excluded character as an element in credit."

The Comptroller recommended that branching be restricted so that "neither National nor State member banks may, under any circumstances establish branches beyond the limits of the city of the parent institution." The Federal Reserve Board also passed a strong antibranching resolution, calling for limitations similar to those proposed by the Comptroller and expressly requiring "that as a condition of membership, they (banks) will establish no branches except with the permission of the Federal Reserve Board."

Antibranching sentiment was still present in the early 1930s when the Congress adjusted the Federal Government's role to include Federal deposit insurance. The Comptroller stated in his 1934 annual report:

> "* * * great caution should be exercised in the future in the establishment of either State or National banks, or branches of either, in order to prevent a repetition of the failures of a few years ago."

Branching no longer considered a safety and soundness threat

Subsequent studies have asserted that branching does not have a significantly negative impact on safety and soundness. In 1976, as a part of the "Compendium of Issues Relating to Branching by Financial Institutions," prepared by the Subcommittee on Financial Institutions of the Senate Committee on Banking, Housing and Urban Affairs, a Federal Deposit Insurance Corporation (FDIC) economist presented a study of bank failures entitled "Branch Banking and the Safety and Soundness of Commercial Banks" which concluded that branching activities and opportunities *per se* do not account for the recent experience of bank failures.

In January 1981, as a part of the Report of the President entitled "Geographic Restrictions on Commercial Banking in the United States," several other FDIC economists presented a study of failed and problem banks entitled "Multioffice Banking and the Safety and Soundness of Commercial Banks." The study stated that on balance, the evidence indicates that neither multioffice banking authority nor multibank organizational structure had an appreciable negative impact on bank closings in either the 1960s or the 1970s. The study also concluded that the problem bank list does not suggest that multioffice banking authority or organizational structure have increased substantially the risks to bank safety and soundness.

Problem institutions normally have fundamental management problems ranging well beyond branching actions. Our 1977 study entitled "Federal Supervision of State and National Banks" (OCG-77-1; Jan. 31, 1977), sampled problem banks and found that most of the problems cited by examiners were in lending areas such as classified loans or law violations. Branching was not identified as a problem.

COMMERCIAL BANK BRANCHING REGULATION IS COMPLEX

Commercial bank branching regulation is complicated by the large number of applicable Federal and State laws and the large number of regulators involved in the process.

A mixture of State and Federal laws complicate the branching process

Commercial bank branching is regulated by a wide variety of Federal and State laws. Several Federal laws require Federal evaluation of the proposed branch's impact on applicant bank solvency, market competition, applicant bank credit policies, and the physical environment. The specific Federal laws involved and their objectives are as follows:

LAW	BRANCHING REGULATORY OBJECTIVES
1. The McFadden Act of 1927 (as amended)	1. a. Insure national bank solvency. b. Assess national bank branch competitive and community impact.
2. The Federal Deposit Insurance Act (as amended)	2. a. Insure State nonmember bank solvency. b. Assess State nonmember bank branch competitive and community impact.
3. The Federal Reserve Act (as amended)	3. a. Insure State member bank solvency. b. Assess State member bank branch competitive and community impact.
4. The Community Reinvestment Act of 1977	4. Assess branch applicant's efforts to meet the credit needs of its community.
5. The National Environmental Policy Act of 1969	5. Assess branch bank's site impact on the environment.

6. The National Historic Preservation Act of 1966	6. Assess branch bank's site impact on the historical or architectural environment.
7. The Depository Institutions Management Interlock Act	7. Prohibit, with certain exceptions, management officials of one depository institution from serving as management officials of another depository institution.

McFadden Act links national bank branching to State law

The McFadden Act of 1927 (as amended) is the primary Federal law directing the Federal regulation of bank branch creation. Section 7(f) of the McFadden Act defines the term branch to include:

> "* * * any branch office, branch agency, additional office, or any branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received or checks paid or money lent." (emphasis added)

In addition to defining the term branch, the McFadden Act, as amended by the Banking Act of 1933, restricts national bank branching to anywhere in a State as authorized by that State for its own State-chartered banks. This link to State law makes State law the dominating force in the regulation of commercial bank branching activity. State laws have taken a generally conservative approach toward branching, with less than half of the States currently allowing statewide branching. Interstate branching has also been effectively prohibited.

State laws vary as to treatment of branching

States have taken a wide range of approaches toward branching, ranging from allowing extensive statewide branching to prohibiting branching. Although this variation makes any classification of State laws somewhat arbitrary, the Federal Reserve classifies State laws into three broad categories: statewide, limited, and unit. As of the end of 1980, State laws were distributed within these categories as follows:

CLASSIFICATION OF STATE BRANCHING LAWS - 12/31/80

Statewide	Limited	Unit
Alaska	Alabama	Colorado
Arizona	Arkansas a/	Illinois a/
California	Georgia a/	Kansas a/
Connecticut a/	Indiana a/	Missouri
Delaware	Iowa	Montana
Florida	Kentucky a/	Nebraska a/
Hawaii	Louisiana a/	North Dakota
Idaho	Massachusetts	Oklahoma a/
Maine	Michigan	Texas
Maryland	Minnesota	West Virginia a/
Nevada	Mississippi a/	Wyoming
New Hampshire a/	New Mexico	
New Jersey a/	Ohio	
New York a/	Pennsylvania	
North Carolina	Tennessee	
Oregon a/	Wisconsin	
Rhode Island		
South Carolina		
South Dakota a/		
Utah a/		
Vermont		
Virginia a/		
Washington a/		

a/State has some form of home office protection.

As shown in the above classification, a majority of States still do not permit statewide branching. In addition, a number of States categorized as statewide still provide some restrictions in the form of home office protection provisions. For example, the State of New York's statute states that if a State or national bank has a head office in a community with a population of less than 50,000, no bank outside that community may establish a branch within the community.

The relationship between Federal law and State law in the branching area could best be characterized as inconsistent. State law determines where branches may be located and, in the case of State-chartered banks, State approval is needed before any branch may be established. National bank branches must also conform to State laws, although State approval is not required. However, Federal law, not State law, determines what is to be defined as a branch. Consequently, although a unit banking State may allow only limited facilities, such as a teller's window with no loanmaking capacity, these facilities

are treated as branches under Federal law. As a result, Federal regulators recognize no unit bank States. Federally insured banks in all States must get Federal approval for establishing any facility receiving deposits, paying checks, or lending money, regardless of whether or not State law recognizes the facility as a branch.

A large number of regulators are involved in the process

Three Federal agencies and 50 State banking regulatory agencies are involved in the branch approval process. For the 4,425 national banks in operation in 1980, the Office of the Comptroller of the Currency (OCC) approves branch applications, consistent with the applicable State law. National banks, however, do not apply to States for approval. Within OCC, considerable authority is delegated to field offices for approvals.

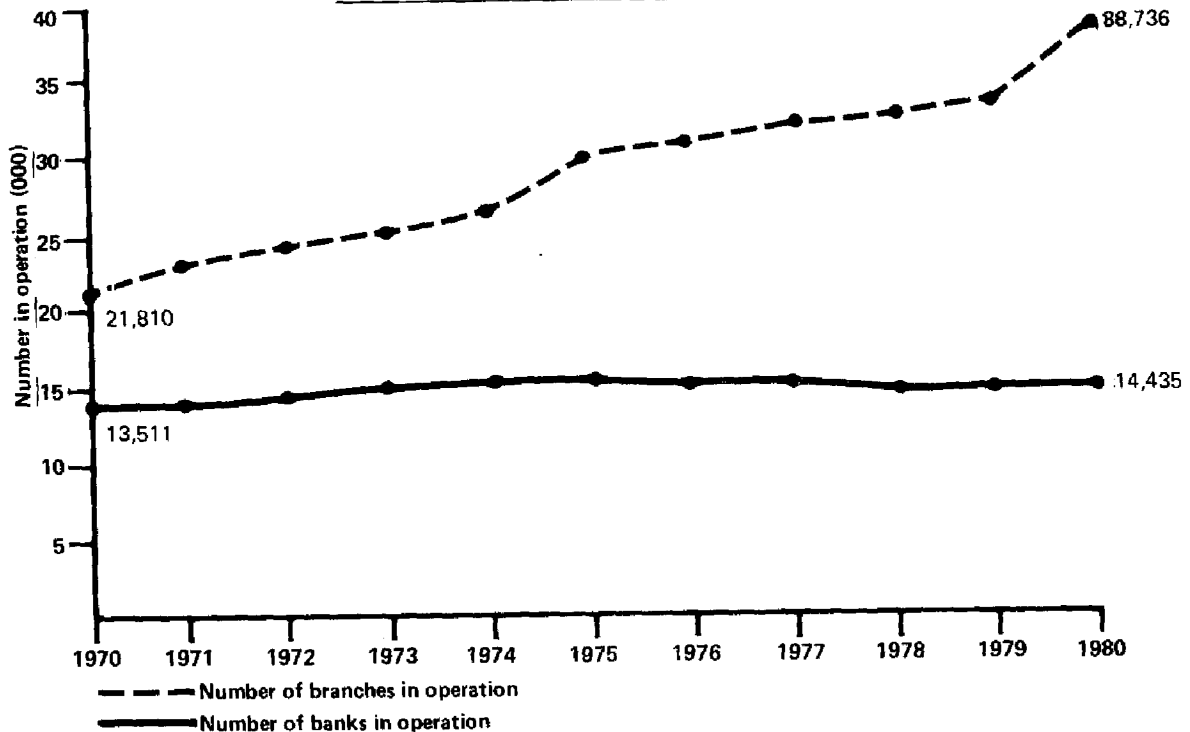
For the 997 State banks which are members of the Federal Reserve System, each branch must be approved by the applicable State agency and the Federal Reserve. Within the Federal Reserve, significant authority for approving most branches has been given to each of the Federal Reserve banks.

For the 9,001 State banks insured by the Federal Deposit Insurance Corporation which are not members of the Federal Reserve System, each branch must be approved by the applicable State agency and the FDIC. As with the other Federal regulators, FDIC regional offices exercise considerable authority for approving most branch applications.

BRANCHING HAS BEEN THE PRIMARY METHOD OF DIRECT COMMERCIAL BANK EXPANSION IN THE 1970s

In the 1970s, commercial banking expanded throughout the United States primarily by establishing new branches of existing institutions, rather than by establishing new banks. In addition, the number and percentage of banks engaged in branching rose significantly in the 1970s. Branch closings have also remained low relative to openings. The following graph shows the growth in branches in operation compared to banks in operation from December 31, 1970, to December 31, 1980.

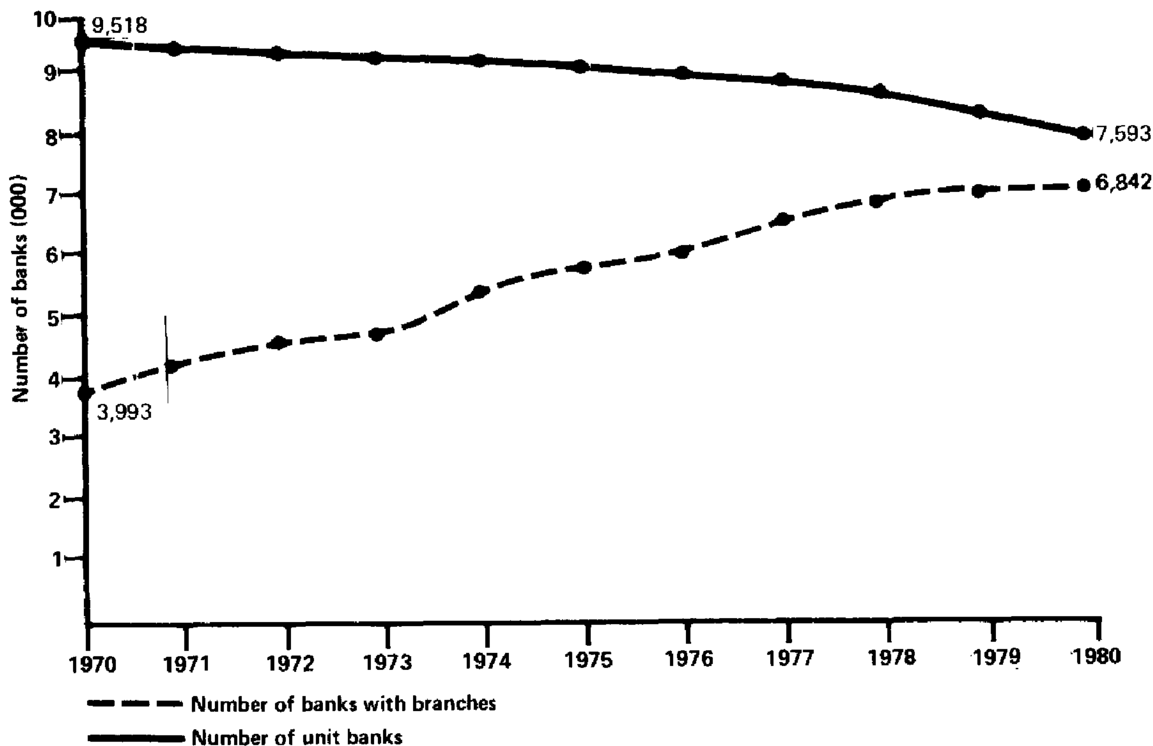
COMPARISON OF GROWTH IN COMMERCIAL BANK BRANCHES IN OPERATION TO BANKS IN OPERATION DECEMBER 31, 1970, TO DECEMBER 31, 1980



In the last 10 years, the number of branches in operation has grown by 16,926 (78 percent) while the number of banks has grown by only 924 (7 percent). Branch growth has been particularly strong for State nonmember banks from 1970 to 1980. (See app. I.) The increase in the number of banks in operation was caused by a 16.4-percent increase in State nonmember banks. (See app. I.)

The Federal definition of a branch may include facilities not recognized as branches under State law (see pp. 6 and 7). As a result, even unit banking States have branches, according to Federal law. Using the Federal definition from 1975 to 1980, the number of branches in operation increased in nearly every State.

From 1970 to 1980, the number of banks operating branches has increased significantly relative to unit banks. The following graph shows the increase in banks with branches and the decrease in unit banks from December 31, 1970, to December 31, 1980.



As shown above, the number of banks operating branches has increased 71 percent over the past 10 years, while the number of unit banks has decreased 20 percent. The largest portion of the increase was experienced by State nonmember banks (117 percent).

From 1975 to 1980, branch closings have remained low relative to openings. The following chart shows branch openings compared to closings for December 31, 1975, to December 31, 1980.

Calendar year	Branches opened	Branches closed	Percent of closings to openings
1975	1,599	152	9.5
1976	1,221	202	16.5
1977	1,873	241	12.8
1978	1,772	232	13.1
1979	2,039	206	10.1
1980	2,050	210	10.2
6-year total	10,554	1,243	11.7

THE FEDERAL COMMERCIAL BANK NEW BRANCH APPLICATION PROCESS--A COMPOSITE

The Federal new branch application process requires the consideration of a wide range of information by a variety of reviewers. Although these processes differ slightly by regulator, they are similar enough to construct a composite.

The application process is normally initiated by a phone or written inquiry to the regulator's field office by a bank wanting to establish a new branch. For insured State banks, this inquiry would be directed to the applicable State banking authority or to both the Federal and State authorities. In response to the inquiry, the regulator will normally send out a package of application forms and instructions for the bank to use in formally filing an application. At this point, the regulator may, if requested by the bank, counsel the bank as to its chances for gaining successful approval. Regulators differ on the extent to which they will provide this counseling to the applicant.

After the bank fills out the application and compiles any additional information requested, such as a Community Reinvestment Act statement, the data are sent to the applicable State and/or Federal regulator's field office. State banks may elect to file with both the Federal and State regulators simultaneously.

Upon receipt of the initial information from an applicant bank, the Federal regulator makes a review of the submission for accuracy and completeness. If problems are identified,

corrections or a full resubmission may be sought from the applicant. After the regulator has been satisfied that the application is complete, the application is formally accepted for filing and the applicant bank is so notified. Upon acceptance, the regulator establishes an application file, portions of which may be requested by any interested party. The applicant bank must then advertise its intent to establish the branch two times within a prescribed time period in a newspaper serving the area where the proposed branch is to be located and in a newspaper serving the home office area.

An application investigation is initiated by an examiner in the regulator's field office. These investigations address the bank's capability to expand, the impact of the branch on the receiving market, and the applicant bank's compliance with a wide range of laws and policies. An onsite visit to the location may be made. Potential bank competitors are normally notified.

Upon completion of the investigation, if there have been no protests, an approval decision or denial recommendation is generally made at the field office level by the regional director. Agency headquarters may have to make the final determination for some applications. If approval is granted, a time limit is normally established within which the branch must be established, generally 12 to 18 months unless extended. Any extension of time or any subsequent relocations of the branch also require regulator approval. Approvals may also contain additional conditions deemed necessary by the regulator. For State-chartered banks, State approval must be obtained before a Federal approval can become effective. If a denial is recommended at the field office level, the applicant is normally notified and has the opportunity to meet with agency officials to discuss the application. If the problem is not resolved, the application is referred to the agency headquarters, where a final decision is made. At headquarters, these decisions are normally reviewed at several levels before a final determination is made.

If an application is protested within the allowed time, normally 15 to 30 days, a copy of portions of the completed investigation report is sent to the applicant and the protestors. A decision is made by the regulator as to whether a meeting is necessary. If the regulator believes a meeting is necessary, a formal hearing or informal meeting will be held for the parties involved. The results of the hearings or meetings are considered and a decision is made by either the regional director or agency headquarters. Protestors and applicants are notified and the application file is closed.

UNMANNED REMOTE ELECTRONIC SERVICE FACILITIES PRESENT SPECIAL CHALLENGES

The advent of electronic funds transfer (EFT) technology in recent years has increased the opportunities for financial institutions to better serve financial markets. Remote electronic banking terminals are now capable of offering customer services such as cash withdrawals, account deposits, transfers from savings to checking accounts, account balance inquiries, the payment of installment and mortgage loans, and the accessing of preauthorized lines of credit.

The resulting problem presented to banking regulators by EFT has been that of deciding whether electronic banking terminals should or should not be treated as brick-and-mortar branches for the purpose of regulating banking structures. However, the impact of a recent court case, Independent Bankers Association of America vs. Smith, 1/ has been to define, for purposes of the National Banking Act, EFT terminals as branches. Prior to that decision, the banking regulators had adopted a more liberal policy overall for multioffice banking through EFT than would be apparent from branching statutes only.

So far, electronic banking has not rendered the geographic restrictions placed on banking by State statutes and the McFadden Act ineffective. For example, the great majority of EFT terminals currently are placed at brick-and-mortar branch sites. However, EFT placement raises other issues related to the McFadden Act, such as the erosion of the traditional isolation of the facilities of deposit institutions from each other. This is because of the growing tendency of depository institutions to share their electronic banking facilities. As noted in a recent study, cooperative arrangements between institutions which have been highly restricted in terms of geographic expansion (commercial banks) and those which have been less restricted (credit unions and savings and loan associations) could make restrictions progressively less meaningful overall.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our review was to assess the efficiency and effectiveness of the Federal processes for regulating intrastate branching.

1/402 F. Supp. 207 (D.D.C. 1975), aff'd, 534 F. 2d 921 (D.C. Cir.) Cert. Den. 97 S. Ct. 166, 429 U.S. 862, 50 L. Ed. 2d 141 (1976).

We pursued this objective by reviewing the branch application approval activities of the three Federal regulators involved: the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve System. We also reviewed selected information provided voluntarily by the 50 State banking regulatory agencies. The review was conducted in accordance with GAO's "Standards for Audit of Governmental Programs, Activities, and Functions."

We interviewed various Federal regulatory officials and reviewed the entire 1979 and 1980 inventories of 1,750 completed new branch and branch relocation files at four locations for each Federal regulator: San Francisco, Richmond, Chicago, and New York. We selected these regions because they each have a substantial volume of activity, and they represent a cross section of the different types of intrastate branching environments in operation throughout the United States. For example, Federal regulators in Chicago operate in Illinois within a unit bank environment, while regulators in San Francisco operate in California in a statewide branching environment. Our individual file analyses used a standardized data collection instrument. In addition, we supplemented our field audit work by collecting selected workload and procedural data from all field locations at each Federal agency.

At headquarters, we interviewed application review officials and reviewed each of the 80 new branch denials made by the Federal regulators during 1978, 1979, and 1980. At the State level, we interviewed officials from the Conference of State Bank Supervisors, and we contacted and received selected workload and procedural data from all 50 State banking regulatory agencies.

Our efforts to obtain information on the burden of Federal regulation on applicant banks were limited by several factors. First, none of the regulators had developed any burden estimates for their information requirements, as they were exempt from developing these estimates when their forms were under development. Second, information requirements may differ at each field office, making nationwide inferences difficult without extensive stratifications of any sample used. For example, each Federal Reserve bank makes its own decision as to how much and in what form an applicant bank will provide its data. Although OCC uses a nationwide application form, individual regions may supplement or delete information from the form at their discretion. In addition to regional differences, FDIC was in the process of implementing a change in its form during the course of our audit.

Because of these limitations, we used a case study approach based on the completed application files we reviewed and visits to 17 banks in the San Francisco and New York areas. At the 17 banks, we interviewed the executives responsible for complying with Federal and State branching regulatory information requirements. Although it was impractical for us to verify the statements we received, we used a standard interview format and inquired about any problems experienced in understanding specific questions.

CHAPTER 2

FEDERAL REGULATORS SHOULD REVIEW STATE BANK INTRASTATE BRANCH APPLICATIONS ON AN EXCEPTION BASIS

Extensive Federal regulatory reviews should no longer be required for the establishment of each new insured State bank branch (defined here as a staffed branch; electronic, unstaffed branches are discussed in ch. 4). Instead, extensive reviews should be done on an exception basis only. An exception-oriented notification system should be established wherein an applicant bank simply notifies the regulator of its intent to establish a branch, complies with existing public comment regulations, and then within a set period commences establishment of the branch, unless otherwise notified by the regulator. Regulators should continue to have the power to deny the branch, but they should be required to perform extensive reviews of only those institutions already identified by existing supervisory information or CRA protests as having problems. An exception-oriented notification system would reduce applicant burden while maintaining the Federal regulatory objectives of insuring applicant institution safety and soundness and protecting recipient communities from any adverse impacts associated with the branching decision.

Much of the current Federal review effort produces very little, as State banks' branching actions do not normally threaten either the applicant institution's safety and soundness or the recipient community's economic health. Specifically, we concluded that:

- State bank branch proposals are conservative in nature in that applicants are normally sound financial institutions, with previous branching experience, seeking to branch into areas they are already familiar with.

- Few branch proposals draw strong competitor protests at the Federal level.

- Federal regulators normally do not restrict State bank branch proposals.

- Federal individual application reviews do not generate significant, new analyses of an applicant bank's capacity to expand, and they duplicate State banking agencies' reviews of a proposal's impact on the recipient community.

To the extent that these reviews require information from applicants that may not be needed and delay branch investment decisions, an unnecessary burden is being placed on applicant banks. This burden will vary from minimal to extensive depending on the bank's previous branching experience and the nature of the proposal.

Although the FDIC and the Federal Reserve have made efforts to streamline their existing branch application processes, we believe that the statutory requirements for a broad review of each application should be modified. We believe a notification process, which would allow the regulation of this activity to be put on an exception basis, should be established by law.

FEDERAL STATUTES CALL FOR BROAD EVALUATIONS OF EACH STATE BANK NEW BRANCH APPLICATION

Federal statutes call for the Federal Reserve and the Federal Deposit Insurance Corporation to conduct broad assessments of each new branch proposal. These evaluations are to address a wide range of factors, including the capacity of the institution to expand, the competitive impact of the branch, the impact of the branch on community convenience and needs, the environmental impact of the branch, and the identification and elimination of abusive insider relationships.

Broad Federal Deposit Insurance Corporation application reviews are required by the Federal Deposit Insurance Act of 1933

FDIC's current branch application review process is primarily the product of its efforts to assure compliance with the Federal Deposit Insurance Act of 1933, as amended (12 U.S.C. 1828(d)). This act requires FDIC to evaluate each State nonmember bank and mutual savings bank branch application in relation to six factors prescribed in section 6 of the act.

--The financial history and condition of the bank.

--The adequacy of the bank's capital structure.

--The future earnings prospects of the bank.

--The general character of the bank's management.

--The convenience and needs of the community to be served by the bank.

--The consistency of the bank's corporate powers with the purpose of the act.

To implement this act, FDIC developed a policy statement addressing each factor and calling for the consideration of a broad range of issues. In several areas, the consideration of one factor overlaps another. For example, the consideration of an applicant bank's capital position is to include a review of the applicant's asset quality, earnings capacity, volume of risk assets, and management.

Federal Reserve branch application reviews originate primarily from the Federal Reserve Act

The Federal Reserve Board has delegated the authority for the review and approval or recommendation of denial of most State member bank branch applications to the Federal Reserve banks. The Board's publication "Rules Regarding Delegation of Authority" establishes the factors the banks are to consider when reviewing branch applications. The factors, which parallel those applied by the FDIC, are:

--The bank's capitalization in relation to the character and condition of its assets and to its deposit liabilities and other corporate responsibilities, including the volume of its risk assets and of its marginal and inferior quality assets, all considered in relation to the strength of its management.

--The ability of bank's management to cope successfully with existing or foreseeable problems, and to staff the proposed branch without any significant deterioration in the overall management situation.

--The convenience and needs of the community.

--The competitive situation (either actual or potential).

--The prospects for profitable operations of the proposed branch within a reasonable time and the ability of the bank to sustain the operational losses of the proposed branch until it becomes profitable.

--The reasonableness of the bank's investment in bank premises after the expenditure for the proposed branch.

Other areas not explicitly addressed in the Rules of Delegated Authority, but considered in varying degrees by individual Federal Reserve banks, include State historic preservation compliance, environmental impacts, management interlock issues, and insider transactions associated with the branch proposal.

Two sections of the Federal Reserve Act provide basis for many of the application review factors used. Section 9, paragraph 4, of the act states that the Federal Reserve Board must consider the financial condition of the applicant bank and the general character of its management in assessing applications for both branches and Federal Reserve membership. Under section 9, paragraph 3, State member banks are also subject to the same terms and conditions and the same limitations and restrictions as are applicable to the establishment of branches by national banks, which are regulated by OCC. In its interpretation of the legislative history of the Banking Acts of 1933 and 1935, OCC developed review factors for its branch approval process. (See ch. 3, p. 48.) The Board adopted similar assessment factors.

FDIC and Federal Reserve consider other statutes

The reviews performed by the Federal Reserve and the FDIC include assessments required by four other laws. The Community Reinvestment Act (Title VIII of the Housing and Community Development Act of 1977, 12 U.S.C. 2901 et seq.) requires the regulators to take their assessments of State banks' records of meeting community credit needs into account when evaluating branch applications. The National Environmental Policy Act of 1969 (42 U.S.C. 4321 et seq.) requires the regulators to make an initial determination that a branch does or does not significantly affect the environment. The National Historic Preservation Act of 1966 (16 U.S.C. 470 et seq.) requires the regulators to determine if a branch action significantly affects any sites, buildings, or structures that are eligible for inclusion in the National Register of Historic Places. The Depository Institution Management Interlocks Act (12 U.S.C. 3201 et seq.) requires the regulators to prohibit, with certain exceptions, management officials of one depository institution from serving as management officials of another depository institution.

STATE BANK BRANCHING ACTIVITY HAS GENERALLY BEEN CONSERVATIVE

The primary Federal regulatory role is to guard against unsound State bank branching decisions. However, State bank branching activity has generally been conservative. Applicant institutions are rarely problem banks, are normally experienced branchers, and seldom locate in areas distant from their existing operations. In addition, State bank branch proposals are seldom formally protested at the Federal level.

Applicant institutions are rarely problem banks

Institutions applying for branches are rarely problem banks. Ninety-four percent of the applications we reviewed in four FDIC offices and four Federal Reserve banks were from banks which were judged by the regulator to be "fundamentally sound institutions" or better.

Both Federal regulators identify the applicant bank's capability to expand as their primary area of concern in reviewing individual branch application proposals. This capability is reflected by the overall condition of the applicant institution. One of the systems used by regulators to reflect a bank's overall condition is the Uniform Interagency Bank Rating System, which rates individual banks on five factors--capital adequacy, asset quality, management, earnings, and liquidity (CAMEL).

Adopted in May 1978 by the FDIC, Federal Reserve, and OCC, this system is designed to provide the agencies a basis for making comparable judgments about federally insured banks. Under the system, each bank is rated on each CAMEL factor and also receives a composite rating. A summary or composite rating is predicated upon the evaluations of the specific performance dimensions. The composite rating is based upon a scale of 1 through 5 in ascending order of supervisory concern. The five composite ratings are defined and distinguished in appendix II. Banks receiving either composite 1 or composite 2 ratings are judged to be "fundamentally sound."

We reviewed all of the 431 branch applications considered by FDIC and the Federal Reserve in 1980 by their New York, Chicago, Richmond, and San Francisco offices. We found that problem institutions rarely seek additional branches. The distribution of the composite CAMEL ratings for the 431 applicant banks was as follows:

Distribution of Applicant Bank CAMEL Ratings

CAMEL rating	Number of applicant banks
1	90
2	318
3	23
4	0
5	0
Total	431

As shown on the previous chart, no bank with a composite 4 or 5 rating applied, and only 23 (5.3 percent) of the applicants had composite 3 ratings. Application review officials attributed this situation to the continual communication process between the regulator and the banks. Banks with problems know they have problems and also know, in advance, what the regulator's disposition toward expansion will be.

State bank branching activities have been geographically conservative

Current State bank branching actions have been geographically very conservative. Many State banks are located in States with extensive geographic limitations on branch placements. State banks in statewide branching States are also being conservative in the placement of their branches, normally staying close to areas with which they are familiar.

The geographic placement of a branch in relation to the bank's existing operations is one factor considered by Federal regulators in assessing the risk involved in an individual branching decision. The farther away the location is from existing operations, the more potential management and communication problems the branch faces.

Many State banks are located in States with restrictive branching laws

Most State banks are located in States which significantly restrict the geographic placement of branches or facilities. Using the categorization developed by the Board of Governors of the Federal Reserve, as of December 31, 1980, we find the following distribution of federally insured State banks in operation. (See app. III for a State-by-State breakdown.)

Category	Number of States	Number of State member banks	Number of State non-member banks	Total State banks
Statewide branching States	a/ 24	264	1,397	1,661
Limited branching States	16	397	3,913	4,310
Unit banking States	11	336	3,691	4,027
Total	a/ 51	997	9,001	9,998

a/Includes District of Columbia.

As shown on the previous chart, only 17 percent (1,661 of 9,998) of the federally insured State banks are located in statewide branching States. The remaining banks are located within States where State laws significantly restrict the location of bank branches. Unit States are the most restrictive. For example, in Texas, banks are limited to one drive-in facility between 500 and 2,000 feet from the main office. Limited branching States also impose significant geographic restrictions on branching. For example, in Iowa a bank may open offices in its home office county or a contiguous county, but no office may be established in a city or town where a bank or bank office already exists. Eight statewide branching States also have some form of home office protection requirements, which also limit the geographic placement of branches. For example, New York allows banks to branch anywhere in the State, except into a city or village (population of 50,000 or less) where another bank, trust company, or national bank already exists.

Forty-four percent of the 1980 branching proposals considered were from restrictive branching States

With 83 percent of the federally insured State banks located in States which restrict branching, a significant number of the Federal regulatory branch approvals involve actions in limited branching environments. Using the same classification category as before, the 1980 Federal branching actions are distributed as follows:

Branching classification	State member and nonmember bank application actions	
	#	%
1. Statewide States	545	56
2. Limited branching States	319	32
3. Unit banking States	117	12
Total	981	100

As shown above, 436 of the 981 Federal branch actions (44 percent) were actions in States which significantly restrict the geographic placement of branches or facilities. In addition, of the 545 actions in statewide States, 204 (37 percent) were in States, such as New York, which have home office protection laws. The statewide numbers are also affected by a mid-1980 change in Florida law, which allows Florida banks to branch

statewide, but through merger only. Florida actions accounted for 137 of the 545 (25 percent) actions occurring in statewide branching States.

Branch locations in statewide States are normally close to existing operations

State banks in statewide branching States are also generally being conservative geographically in their branching placements. We reviewed all of the branch and/or facility placements for State nonmember banks listed by FDIC for calendar years 1979 and 1980 for the four largest (in terms of 1980 numbers) statewide branching States: California, Florida, New York, and Connecticut. We found that most branches or facilities are being located in the same county as the bank's home office.

State	Year	Total listed	Total located within home office county		Total located outside home office county	
			#	%	#	%
California	1979	96	69	71.9	27	28.1
	1980	103	78	75.7	25	24.3
New York	1979	25	14	56.0	11	44.0
	1980	41	20	48.8	21	51.2
Florida	1979	78	78	100.0	0	0
	1980	105	104	99.0	1	1
Connecticut	1979	31	24	77.4	7	22.6
	1980	31	26	83.9	5	16.1
Totals		510	413	81.0	97	19.0

As shown above, even with statewide opportunities, State banks are generally remaining close to their home office operations. In addition, even in those States where a significant portion of the placements are outside the home office county, banks may still be locating close to their other existing offices (such as other branches), as opposed to locating in areas they may be unfamiliar with. For example, of the 25 State nonmember bank branch placements in California in 1980 which were located outside the home office county of the bank, 20 were located within 10 miles of an existing branch.

State bank branching activities are dominated by banks with previous branching experience

One of the application factors assessed by Federal evaluators is bank management's capability to successfully manage the expansion. One element within this capability is management's previous experience with branching. Previous experience may help management avoid problem situations.

Our review of all the 1979 and 1980 branch application actions taken by the Federal regulators in their San Francisco, New York, Richmond, and Chicago offices indicates that most applicants have previous branching experience. Eighty-four percent of the application actions we reviewed were from applicants with previous experience.

Number of branches in operation at time of application	San Francisco		New York		Richmond		Chicago	
	1979	1980	1979	1980	1979	1980	1979	1980
0	30	24	0	8	12	10	24	26
1-5	75	69	17	23	25	19	40	19
6-15	43	47	21	33	5	6	9	9
16-25	7	10	11	5	2	5	1	2
Over 25	49	49	24	29	23	21	4	3
Data not available	15	10	7	2	0	0	1	2
Total	219	209	80	100	67	61	79	61

As shown above, most of the banks in these areas had previous experience in branching. In 1980, of the 431 branch applicants, 363 (84.2 percent) had previous branching experience; in 1979, 379 of 445 (85.2 percent) applicants had previous experience.

State bank branching actions have rarely been formally protested at the Federal level

State bank branching actions are rarely formally protested at the Federal level, although competing bank managements may

give unfavorable oral comments to regulators, who call the banks seeking comment on a branch proposal.

Both FDIC and the Federal Reserve allow competing institutions, or any interested party, the opportunity to protest any specific branch application, in writing, within a specific time frame. The regulator may then either hold a formal or informal proceeding, if desired by the regulator and the parties involved, to allow for the presentation and exchange of information. The information presented during these meetings will be considered by the regulator in the final approval or disapproval decision.

Protests leading to a formal or informal proceeding were rare in 1979 and 1980. The following chart shows the number of applications where protests led to formal or informal proceedings during 1979 and 1980 and the reason for the protest.

Calendar year	Number of applications where protests led to a proceeding	Reason for protest: Adverse competition	Reason for protest: Community reinvestment
1979	27	22	5
1980	24	18	6
Total	51	40	11

As shown above, the number of applications formally protested for 1979 and 1980 has been small, relative to the total number of applications considered, 27 of 1165 (2.3 percent) in 1979 and 24 of 981 (2.5 percent) in 1980. Bank competitors were responsible for nearly all of the protests, including three involving the Community Reinvestment Act (CRA).

FEDERAL REGULATORS RARELY RESTRICT STATE BANK BRANCHES

Although the Federal regulators may act to restrict any State bank branch application they have a problem with, FDIC and Federal Reserve reviews of new branch applications rarely result in restrictions being placed on branching actions. Outright denials of branches are extremely rare, as are supervisory-encouraged application withdrawals or branch approvals conditioned on the correction of a supervisory concern. In addition, when restrictions have been used, the substantive issues addressed were either originally identified by the regulator before the application was submitted, or by a CRA protest, which was subsequently investigated by specialists who were not a part of the normal branch review structure. State regulatory agencies also rarely restrict bank branches.

Formal branch application denials are rare

When a proposed branch expansion would adversely affect either the applicant institution or the community into which it will be placed, Federal regulators may deny the branch. A denial simply prohibits the institution from establishing the proposed facility. Federal regulators denied less than 1 percent of all the applications considered from 1975 to 1980. The denials primarily addressed bank capacity issues. In addition, agency reviewers did not always agree about denials. The denial rates for all State bank branch applications, 1975 through 1980, are shown on the following chart.

Calendar year	Regulator	Applications considered (note a)	Applications approved	Applications denied	Percent denied
1975	FDIC	629	623	6	.9
	FRS	135	135	0	0
1976	FDIC	743	740	3	.4
	FRS	140	140	0	0
1977	FDIC	890	885	5	.5
	FRS	137	137	0	0
1978	FDIC	842	832	10	1.2
	FRS	106	106	0	0
1979	FDIC	967	964	3	.3
	FRS	198	198	0	0
1980	FDIC	842	838	4	.5
	FRS	139	139	0	0
Total - CY1975-1980	FDIC	4,913	4,882	31	.6
	FRS	855	855	0	0
Total		5,768	5,737	31	.5

a/FDIC data includes mutual savings banks.

During this period, FDIC denied only 31 of 4,913 applications it considered, while the Federal Reserve denied none of the 855 applications it considered. The last branch denial by the Federal Reserve was in February 1971, over 10 years ago. A Federal Reserve official stated, however, that in some instances States have denied applications prior to Board actions.

Denials primarily involve bank capacity issues

Of the few branch denials which were made, most were because the regulator questioned the bank's ability to expand. The 17 applications denied (all by FDIC) from 1978 through 1980 were distributed as follows:

Reason for denial		Number denied
1. Bank capacity problem (includes capital earnings, liquidity, financial condition, management)		12
2. Convenience and needs problem		5
a. Threatened new bank	2	
b. Threatened existing banks	0	
c. Community Reinvestment Act noncompliance	3	
Total		17

The specific factors cited in bank capacity related denials normally reflect regulator dissatisfaction with the overall operations of the bank, as these factors significantly influence each other. For example, a bank with a poor financial history and condition usually does not have outstanding management, strong capital, and high earnings. If it did, it would not be in poor financial condition.

Agency reviewers do not always agree about denials

The decision to deny a branch involves a high degree of regulator judgment, which has sometimes been mixed. In 7 of the 17 denials made from 1978 to 1980, significant internal disagreements were present within the regulatory agency as to whether the branch should be denied or upon which factors the denial should be based. The following cases illustrate the nature and extent of these disagreements.

Case 1

Denial based on "unfavorable findings on the factors of Financial History and Condition of the Bank, the Adequacy of its Capital Structure, and its Future Earnings Prospects."

Approximately 1 month after the bank's application had been accepted for filing, the regional office initiated a branch investigation. An examiner spent 3 days investigating the application, specifically reviewing the bank's financial history and condition, capital structure, and future earnings prospects. The examiner's subsequent Report of Investigation recommended the branch be approved, specifically rendering favorable evaluations of the bank's financial history and condition, capital structure, and future earnings prospects.

After reviewing the Report of Investigation, the Regional Director also recommended approval of the branch application. In the region's summary report to headquarters, the director noted that although earnings and capital were low, these conditions were due to a one-time, extraordinary event. The Director also noted that the region had recently completed an examination of the institution and that management "is well regarded."

The Director of the regulator's headquarters division, responsible for evaluating all branch applications not approved at the regions under delegated authority, reviewed the regional office's report and concurred in the region's findings. He noted that

> "while the volume of classifications continues high, they are concentrated in the substandard category and the condition of the bank is not so severe as to preclude approval of this application."

These favorable findings were subsequently reversed by a higher review group, whose judgment was concurred in by the Board of Directors. The application was denied on the basis of the factors of financial history and condition, adequacy of capital structure, and future earnings prospects.

Case 2

Denial based on convenience and needs factor, specifically relating to the applicant's performance in serving the credit needs of the community as specified in the Community Reinvestment Act.

Approximately 6 months prior to the filing of the branch application, several community groups had alleged the bank had failed to adequately serve its existing

communities. The regulator investigated the bank's lending practices and policies. The investigation "found no evidence that the bank was engaged in discriminatory lending policies."

Shortly after the branch application was filed, a community group filed a formal objection against the proposal. The regional office initiated a branch investigation which rendered a favorable finding on the convenience and needs factor, found no evidence of discriminatory practices, and noted that the bank was making efforts to serve the communities where it was located. The examiner recommended approval of the branch, as did the Region.

In addition, a special assessment of the bank's compliance with the CRA was made. The resulting report concluded that "there are no apparent violations of the Community Reinvestment Act" and the bank "appears to be in compliance with the requirements of the Act." On the basis of this additional assessment and the other previous studies, the Director of the regulator's headquarter's division also recommended approval of the application.

The FDIC Board of Directors subsequently denied the application on the basis of the applicant's record with respect to serving the credit needs of the community as specified in the Community Reinvestment Act. The Comptroller of the Currency (a member of the Board) dissented from the majority opinion.

Applications are rarely withdrawn for supervisory reasons

As with outright denials, supervisory-encouraged withdrawals are also rare. In 1979 and 1980, supervisory-encouraged withdrawals represented less than 3 percent of the branch applications approved.

Supervisory-encouraged withdrawals are those instances, after the application has been formally accepted but before the approval or denial decision, where the regulator makes it apparent to the applicant that a denial is imminent and the applicant withdraws the application. Withdrawals are really indirect denials.

The following chart shows, for 1979 and 1980, the number of State bank branch application withdrawals nationwide at the Federal level and the reasons for the withdrawals.

Withdrawal reason	1979	1980
1. Location problem	9	15
2. Denied or withdrawn at State level	13	7
3. Adverse economic conditions	1	6
4. Change in bank management	4	1
5. Supervisory encouraged	4	6
6. No reason given	9	7
Total	40	42

As shown above (item 5), most withdrawals are for reasons other than direct Federal regulator pressure. Adding the instances where no reasons for withdrawal were given to the supervisory-related withdrawals, the total still represents a very small number relative to the total number of applications approved for calendar years 1979 and 1980; 1.1 percent and 1.3 percent, respectively. Adding these types of withdrawals to the total outright denials also represents a very small percentage of the 1979 and 1980 applications considered; 1.5 percent and 1.7 percent, respectively.

Conditional approvals are rare

Rather than deny or encourage the withdrawal of an application, the regulator may choose to attach conditions to the approval which the regulator believes must be corrected. In some instances, these approaches may be more desirable than outright denial. Approvals conditioned on the correction of significant supervisory problems were rare in 1980.

For calendar year 1980, the following chart shows the distribution of all Federal conditional approvals (other than the overall time limitation placed on all approvals) by reason.

Condition addressed	Number of approvals
1. Addition of capital to support expansion	45
2. Completion of State historic preservation requirements	3
3. Submission of fixed asset plan upon move from temporary to permanent facility	7
4. Disclosure of insider transaction	2
5. Investment in bank premises	2
6. Compliance with the Community Reinvestment Act	4
Total	63

As indicated in the above chart, additions of capital (item 1) account for the majority (71 percent) of the conditions placed on 1980 approvals. The 10 conditional approvals relating to either the completion of State historic preservation requirements or the submission of future fixed asset plans (items 2 and 3) are merely time-oriented requirements and do not address problems or require any corrective action on the part of the applicant bank. The 53 other conditional approvals represent 5 percent of the total number of approvals made in 1980 by Federal regulators.

Supervisory-related delays are unusual

In addition to either denying or conditionally approving an application, the regulator has the option of delaying the application until the applicant bank makes a correction. Although some regional officials stated that they used this approach, others indicated they would either conditionally approve or deny the application outright, rather than delay it.

To assess the extent to which the delay approach is used at FDIC, we reviewed the 1980 quarterly agings which are performed by FDIC on all applications it processes. These agings require an explanation for all applications where the FDIC has not acted within 90 days after State approval. The reasons for delay cited by FDIC for the 93 completed 1980 branch applications with long processing times were:

Reason for delay	Number of delays (note a)
1. Applicant delay in FDIC filing	33
2. CRA notification or statement error	22
3. State historic preservation office delay	3
4. Change made in proposal by applicant	6
5. Held pending completion of FDIC exam	7
6. State banking agency approval delay	3
7. Applicant delay in providing complete application information	5
8. FDIC delay to obtain supervisory-related correction	17
9. Protest	7
10. Other	8
Total	111

a/More than one reason cited for delay in some instances.

As shown above, most delays are process oriented, where the applicant, for a variety of reasons, is responsible for the delay. In the instances where the delay did lead to the correction of a supervisory concern (item 8), most were concerned with capital and the correction of problems cited in examination reports. The 17 instances cited represent 2 percent of the total FDIC 1980 approvals.

Federal Reserve bank review officials indicated that a delay would be used only in exceptional circumstances, if at all. In our review of 81 applications filed in 1980 with 4 Federal Reserve banks, we identified only 4 instances where this approach was used.

STATE BANKING AGENCIES NORMALLY APPROVE BRANCH OR DETACHED FACILITY APPLICATIONS

Like the Federal banking regulatory agencies, State banking agencies also normally approve most State bank branch or detached facility applications. Outright denials are rare, with withdrawals making up most of the restrictive actions taken. According to annual data collected by the Conference of State Bank Supervisors, State banking agencies denied only 244 (5.2 percent) of 4,734 applications considered from 1977 through 1980. In addition, only 317 (6.7 percent) were withdrawn. See appendix IV for a yearly breakdown.

FEDERAL REVIEWS ARE LIMITED AND DUPLICATIVE

When the regulators receive a branch application they conduct a review or investigation of the proposal. However, the information in an application is not the prime focus of the review. The reviewers depend on information already in the regulator's possession. Often, the Federal reviews duplicate State regulators' reviews. And, we found few instances where denials or conditional approvals were based on information presented in the application.

Branch application reviews of bank capacity depend on existing examination and supervision information

As discussed earlier, Federal regulators are responsible for evaluating the capability of the applicant institution to expand. Specific areas to be addressed include financial history and condition, capital, management, and earnings. The sources of information for these analyses are examination reports, supervisory reports, and correspondence files--information the agency already has in its possession.

Branch investigations are limited reviews primarily conducted within the regulator's office, with rare onsite visits. We found that:

- --The financial history and condition review consists primarily of analyzing examination reports, surveillance system reports, and correspondence files for the bank and copying down the information and analyses.
- --The analysis of capital condition copies existing capital trend analyses from surveillance systems and examination-generated information on asset risk.
- --The management review copies examination report evaluations of the character of management.

Regulatory evaluations of future earnings prospects are also limited. The applicant's earnings history is obtained from existing examination and surveillance analyses and is then compared to the applicant's assertions concerning projected branch profitability and deposit growth. Branch profit estimates are products of branch deposit estimates.

The applicant creates branch deposit estimates by defining the branch's market, identifying the total amount of deposits available in the market, and determining the portion of these deposits which the new branch will successfully compete for. From the deposit figure, which normally forms the basis for the loan estimate, expense and revenue estimates may be derived. Our review of 431 files or applications in 1980 at four locations showed that the deposit estimates of the applicant were challenged by the regulator in only 25 instances (5.8 percent). In 95 instances (25 percent), the application file did not contain enough information to even determine how the applicant derived the estimate.

The regulators perform new analyses in three areas; investment in bank premises, potential management interlocks, and insider transactions associated with the branch. However, these analyses have produced little, and each of these areas would also be examined in the next examination scheduled for the bank.

Other analyses are also limited

Federal regulators also review each application for conformance with the National Environmental Policy Act, the National Historic Preservation Act, and the Community Reinvestment Act. Reviews of compliance with the first two acts center on applicant self-reporting with little analysis actually done by the regulator. In these instances, the regulator acts primarily as a coordinator between applicants and the Council on Environmental Quality and the State historic preservation agencies. According to regulatory officials, very few applications have been denied, withdrawn, conditioned, or delayed because of noncompliance with these laws. CRA reviews are based primarily on the applicant's performance as measured by the latest consumer compliance examination.

Denials and conditional approvals usually based on information not provided in the application

During 1980, 4 State bank branch applications were denied and 53 applications approved with conditions requiring the bank to correct operational problems. Normally, the problems addressed by these restrictions were well known to the regulator before the Federal branch application review. The following chart shows the extent to which Federal regulator restrictions dealt with issues previously identified by their supervision activities.

Federal Regulatory Branch Application Denials and Conditional Approvals in Calendar Year 1980

Condition addressed	Condition indicated by: Previous examination report(s)	Special report/ surveillance	Surveil-lance system	State action	Application investigation
1. Capital maintenance	20	2	5	16	4
2. CRA compliance	1	0	0	1	4
3. Investment in bank premises	0	0	0	0	2
4. Disclosure of insider transaction	0	0	0	0	2
Total	21	2	5	17	12

As shown by the chart, branch regulatory actions normally address conditions which are known to Federal regulators through their other supervisory activities. For example, in one denial, the examination process had categorized the bank as a problem institution and had negotiated a formal agreement with the bank before the branch application was filed. In another instance, a conditional approval based on capital considerations, the previous examinations of the bank had rated the bank's capital position as weak and in need of additional regulator monitoring.

Some issues were previously identified by State banking agencies

In 16 of the 48 capital maintenance cases, Federal regulatory action was also preceded by State actions addressing the same issue. These actions were spread among seven States in different areas of the country. For example, in one instance 30 days before the Federal regulator issued a conditional approval, a midwestern State regulator issued a conditional approval of the application with exactly the same additional capital requirement as the Federal regulator. In another instance, 5 months before the Federal regulator issued a conditional approval, a far west State regulator issued a conditional approval with exactly the same capital requirement imposed by the Federal regulator.

CRA protest-related restrictions required investigations beyond normal branch procedures

In four of the six CRA-related cases, there were no indications in the application files of a previous problem before the branch application. These instances were generated by CRA protests, which required extensive investigative efforts that went beyond the normal branch investigation.

Issues identified solely by branch investigations were minor

Eight other issues unidentified before the branch application involved relatively minor conditions. For example, one condition called for the disclosure of an insider lease transaction in the bank's annual proxy solicitation statement. In another instance, the condition was merely that the bank obtain a waiver from the regulator's headquarters to exceed the investment in premises limitation. No reduction in the proposed investment or additions to capital were suggested.

Reviews of competitive and community impacts are very limited and duplicate State efforts

Federal regulatory reviews of branch competitive and community impacts are limited and inherently difficult. In addition, these reviews duplicate State analyses, which in many cases are more extensive than the Federal reviews.

In addition to assessing the capacity of the applicant to expand, Federal regulators are required to review the competitive impacts of each individual branch proposal. Historically, both the FDIC and the Federal Reserve have been concerned with how the introduction of a branch into a market affects the competitive nature of the market. Specifically, there was concern over

--one bank being allowed to take a dominant position in a particular market; and

--the phenomenon called "overbanking", which was generally believed to be a situation wherein the introduction of a new competitor oversaturated a market, thereby having an adverse impact on existing institutions.

For example, FDIC's 1974 memorandum outlining delegated authority to FDIC Regional Directors specifically addressed "destructive competition" and established the percentage of aggregate deposits controlled in a market as a measure to identify potential anti-competitive situations.

Although the Federal Reserve System had no specific policy guidance in this area, its concern with these factors was evident in its last branch denial (1971). In this case, the Federal Reserve bank cited the lack of demonstrated need for a branch in the community as its reason for denial. In support of the decision, the Federal Reserve bank compared the number of people and deposits per bank in the area to State, national, and other county averages to show that another banking facility was not needed in the community. The decision also contained an analysis entitled "competitive situation or tendency toward monopoly."

Currently, Federal regulators take a different view toward assessing the competitive impact of a new branch proposal. FDIC's 1980 application policy states in part:

"Generally, the Corporation believes that active competition between banks and other financial institutions, when conducted within applicable law and in a safe and sound manner, is in the public interest. Accordingly, applications to establish branches by well managed and adequately capitalized banks with a record of

responsive service to their communities will generally be approved."

However, the FDIC policy also notes that competitive considerations will also include an assessment of whether the applicant is already a dominant bank in a market and has applied for the purpose of saturating that market as well as whether the potential viability of a newly organized bank within a market would be threatened significantly by a proposed branch. Although the Federal Reserve Board has not issued any similar policy guidance, the Federal Reserve banks we visited all took the position that branching is inherently pro-competitive and that competitive considerations are currently being de-emphasized.

Competitive and need reviews are limited and inherently difficult

Our review of the 1980 completed applications in four locations showed that competitive evaluations are limited and inherently difficult. The standard review approach consists of an experienced examiner reading over the competitive information provided in the application and informally comparing the data with his/her personal knowledge of the area. Formal analyses of the competitive data are rare, and onsite visits to proposed locations are rarely performed. Telephone or personal contacts with competitors may be made. In many instances, market data can only be roughly estimated. In our review of 431 files, we found that 25 percent did not contain information on trade area population growth and that only 10 percent contained analyses of trade area deposit growth. Instead, numbers for an entire city or county (of which the trade area constituted only a portion) were sometimes provided. Applicants' assertions regarding their impact on their trade areas were very rarely challenged, except by competitor protests.

Application reviewers in several locations cited several reasons, in addition to regulator de-emphasis, for their informal review approach. Competitive reviews are inherently difficult in that:

--Branch arrangements vary widely, making the consistent application of a specific review methodology difficult.

--Branch proposals are inherently futuristic in nature, relying heavily on assumptions made concerning future events

--The dynamic nature of today's financial markets makes it normally impossible, without extensive research, to determine which institution is competing in which market with which competitor.

The judgmental nature of this evaluation is best illustrated by an example. In reviewing a 1980 application by a small southeastern bank, the review examiner found the convenience and needs of the community factor to be unfavorable. The application was protested by an institution located .1 mile from the proposed branch site. The examiner found that this institution "has been plagued with poor earnings as a result of poor deposit growth." The examiner also found "very little growth anticipated" in the trade area and that "the five existing offices in the general area, as well as an approved/unopened branch of another bank, adequately serve the needs of the community." The examiner recommended disapproval on the basis of potentially destructive competition. Subsequently, after reviewing the same data, a different review examiner recommended approval, noting the protesting bank "should be able to withstand any adverse effect the establishment of the proposed branch may have" and that the new branch would "provide an alternative banking choice to local residents and businesses." The regional director approved the application based on the analysis of the second reviewer.

Federal reviews duplicate State reviews

State banking agencies are normally very active in reviewing the potential competitive and community impact. As described

The costs of regulation do not conveniently appear in a ledger or an annual report. Estimation of the amounts involved often require sophisticated models and complex statistical techniques. Dollar figures for some costs cannot be estimated at all. Nevertheless, regulatory costs may be classified into six categories: administrative and compliance costs, static efficiency costs, dynamic costs, costs imposed on secondary markets, shifted costs, and transfers. Our review concentrated on administrative and compliance costs only.

Administrative and compliance costs consist of the cost of the budgeted activity of the regulatory agency and the costs to the private sector involved in filling out and reporting required information to the regulator. In the regulation of intrastate branching for insured State banks, there are direct Federal administrative and direct and indirect compliance costs.

Direct Federal regulatory administrative costs vary

At the Federal level, administrative costs vary by regulator, by regional office within each regulator, and by year, as the volume of branch applications rises or falls. Relative to other agency costs, the estimated costs of administering the branch application program at FDIC and FRS are small. In 1980, FDIC spent an estimated $700,000 on administering the branch application program. Federal Reserve banks provided cost estimates ranging from $250 to $1,100 per application in 1980, which would place total bank 1980 costs between $39,000 and $174,000.

Direct and indirect compliance costs

The costs for banks to comply with Federal regulatory branch application requirements also vary by application and by regulator. These costs consist of the costs of supplying required information directly to Federal regulators and the indirect costs due to time delays encountered by applicant banks.

Direct Federal compliance costs

Historically, FDIC has used a nationwide branch application form, which addressed each of the statutory factors the agency is required to review. In the fall of 1980, FDIC adopted a new application form, which reduced the reporting requirements for individual banks. However, the 1980 form still requires the applicant bank to provide such information as:

--A full economic justification for the branch, including appropriate demographic and economic data.

--A map disclosing the exact location of all competitors in relation to the branch location.

--A full discussion of the applicant's CRA program.

--Deposit and profit estimates for the branch's first 3 years of operations and a description of the methods used to derive the estimates.

--Listing of examples of energy saving practices engaged in by the institution.

In 1980, when FDIC revised its application form, the agency made no estimates as to the number of hours needed by banks to complete the new form.

The Federal Reserve allows each Federal Reserve bank to determine the type of branch application it uses. Two banks have their own applications which require a wide range of data, including:

--A list of all existing branches and their locations, deposits, and distances and directions from the main office.

--A description of the economic character of the community to be served, including types of dwellings, population, etc.

--An estimate of the branch's deposits and earnings for the first 3 years of operation.

The other 10 banks use the State application combined with additional data requests when appropriate. These applications require a wide range of information, including descriptions of economic conditions, deposit estimates, lease agreements, and maps disclosing the location of competitors in relation to the branch location. The Federal Reserve has no estimate of the time required for banks to comply with its information needs.

Our review of all the 1980 files for completed applications in four regulatory locations identified examples of both minimal and extensive reporting on the part of applicant banks.

Case 1

This case illustrates the extensive reporting effort a bank can make in applying for a branch.

A small, southeastern bank applied for a branch in 1979. In the section of the application discussing convenience and needs of the community to be served, the applicant provided a 26-page discussion which included:

--An 18" x 24" site plan of an entire shopping center drawn up by the developer's architect.

--Population estimates for the State and county from 1960 through 1977.

--Age distribution of the county for 1960, 1970, 1976.

--County income per capita for 1950, 1965, 1969, 1975, and county income per capita as a percentage of State income per capita.

--Family income percentage distributions for the county for 1960 and 1970.

--County wholesale and retail trade statistics for 1967 and 1972.

--County employment, labor force, and unemployment estimates for 1960 and 1970 through 1975.

--County agriculture economic value in 1976.

Case 2

This case illustrates the minimal reporting effort a bank can make in applying for a branch.

A large mid-Atlantic bank applied for a branch in 1980. In the section of the application discussing the convenience and needs of the community to be served, the applicant supplied a 1-1/2-page summation in support of its proposal. In the summation, the applicant used primarily county population and income figures in support of the application.

Indirect Federal compliance costs--
delays in application processing

In addition to the costs of compiling the required application data, applicant banks must also delay their plans until they receive both Federal and State approval. In some instances, these delays are quite lengthy. Our review of all 1980 branch applications processed by Federal regulators in New York, San Francisco, Chicago, and Richmond indicates that the combined Federal and State total application processing time from initial State receipt to final Federal approval normally exceeds 3 months, with times ranging from under 30 days to over 12 months. The additional Federal application processing time required beyond State approval normally exceeds 1 month, with times ranging from 1 day to 6 months. In some cases, these delays are attributable to lengthy application protest proceedings. However, as shown earlier, the number of protest proceedings is relatively small.

In a 1979 FDIC-sponsored report entitled "State and Federal Regulation of Commercial Banks," a recommendation was made that the State Liaison Committee of the Federal Financial Institutions Examination Council undertake the development of a program to reduce and simplify the paperwork and processing times in connection with filing applications for a wide range of activities, including branching. The report recommended the establishment by agreement of maximum processing times for branch approvals.

CONCLUSIONS

Regulating intrastate branching of federally insured, State-chartered banks involves a basic conflict between State and Federal regulatory power. Historically, an applicant State bank required both Federal and State approval to establish a branch. Both Federal and State authorities normally perform similar, broad evaluations of each applicant bank's capacity to expand and the impact of the expansion on the receiving market.

We believe the statutory requirements for an extensive Federal review of each State bank branch application should be eliminated because:

--State bank branching actions are normally low-risk activities characterized by experienced banks in sound financial condition expanding into familiar areas.

--Federal restrictions are rarely imposed on State bank branching proposals.

--Federal reviews of applications are limited and duplicate State efforts.

--To varying degrees, applicant banks supply unnecessary information to obtain individual branch approvals.

State bank branching actions are normally very conservative in nature. Banks with problems rarely even apply for a branch. Applicants are normally experienced branchers who wish to locate in areas close to their existing operations. Their proposals are rarely formally protested by competing institutions.

Federal regulators rarely find it necessary to restrict State bank branching proposals. Outright denials of proposals are extremely rare, as are supervisory-encouraged withdrawals and approvals conditioned on the correction of a supervisory problem. The agencies have other means by which to obtain corrections of supervisory problems.

Federal reviews of individual branch applications are limited and duplicate State agency efforts. The Federal regulatory review of bank capacity relies extensively on existing supervisory and examination analyses and generates little new information on the capacity of the bank. The applications themselves provide much information which is little used. Federal reviews of banks' market impact directly duplicate State banking agency reviews of the same issue.

Although Federal agencies have made efforts to reduce applicant bank compliance costs, these costs are still present and are potentially significant for each applicant.

In a sense, the Federal review of federally insured State banks' branch applications has become an exception-oriented process. Yet, the agencies' policies, procedures, and applications maintain the full-scale review concept. The results of that process, however, do not justify its extent nor the burden it places on applicant banks. We believe that the agencies and the applicants would be better served by a notification system wherein the bank would notify the Federal regulator of its intent to establish a branch.

The system we envision would involve a bank submitting a notice of intent to establish a branch. The regulator would base its decision to act on existing supervisory information (problem lists, surveillance data, or examination reports) or outside protests. The Federal regulator could approve the branch merely by allowing a pre-established period to pass without taking action. If for supervisory or Community Reinvestment Act reasons the agency needed additional information, it could delay approval until an investigation was complete and could,

if necessary, deny the application. This would enable the agencies to concentrate on exceptional cases and free most applicants from the Federal application processing burden. We believe that this notification system will also allow regulators to effectively identify the exceptional instances where additional supervisory measures must be taken to ensure compliance with applicable Federal laws, such as the National Environmental Policy Act.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress amend the Federal Reserve Act and the Federal Deposit Insurance Act to replace the requirement for a broad review of each new branch application with a notification process, wherein applicant banks notify the respective Federal agency of their desire to branch. The agency would then respond within a fixed time frame to this notification with the options of either having no objection, denying the branch, or requiring more data. (See app. V for suggested legislative language.)

AGENCY COMMENTS

The Federal Reserve and the Federal Deposit Insurance Corporation generally supported the reduction of the Federal involvement in intrastate branching. (See apps. VII and VIII.) However, neither of them supported our recommendations for specific legislative changes to their branching responsibilities. Both believe that they can accomplish the same end through administrative actions. We disagree. The Corporation also raised issues about the wording of our suggested legislation.

The Federal Reserve said that it had made procedural changes to expedite its processing of branch applications. We believe that these changes are a positive step, but they do not address several points addressed in our proposal. Even with the change in procedure, the Federal Reserve would continue to duplicate State evaluations of the competitive impact of each proposed branch. As we have described, these reviews seldom raise any significant issues, and the Federal Reserve has not restricted any branch proposals for competitive reasons in over a decade. Also, the Federal Reserve's change places no overall time limit on the consideration of all branch proposals. We believe that such a limit is desirable as a means of reinforcing regulatory agency accountability.

The Federal Reserve believes that it can reduce its role in branching administratively. We believe that a change in the Federal Reserve Act (see app. V for suggested language) is necessary to insure the equal treatment of State member and State nonmember banks. The Federal Reserve Act requires that State member banks' applications for branches be treated as are national banks' branch applications. Our proposal for modifying the Federal Reserve Act would insure that all State banks, regardless of Federal Reserve membership status, would receive the same Federal treatment of their branch proposals.

The Federal Deposit Insurance Corporation disagreed with our proposed changes to the Federal Deposit Insurance Act (see app. V.) because our language did not

--adequately distinguish between sound and unsound banks,

--recognize situations where unsafe banks are applying for branches,

--recognize the Corporation's responsibilities under the National Environmental Protection and National Historic Preservation Acts, and

--recognize situations where long extensions might be required for reasons other than requesting additional information.

We believe that the language proposed in our draft report provided adequate flexibility to handle the first three of the above mentioned points; however, we have changed the language to clarify the treatment of unsound banks. We agree with the Corporation that longer processing times than the 120 days we proposed might be needed on rare occasions to accommodate significant or complex protests. We have adjusted the proposed legislative language accordingly. (See app. V.)

We do not agree with the Corporation that any changes need be made with regard to its responsibilities under the National Environmental Protection and National Historic Preservation Acts. The requirements of these acts exist separate and apart from the Federal Deposit Insurance Act and are unaffected by the changes we propose to it. Also, the notice system we envision affords the Corporation sufficient flexibility to satisfy its responsibilities under those acts.

The Corporation indicates that it is exploring ways to streamline the consideration of branch applications through administrative action. We do not believe that the Corporation's general authority to issue regulations is sufficient to alter or obviate what it is required to do under the Federal Deposit Insurance Act. Thus, we firmly believe that significant reductions in the Corporation's role in bank branching can only be accomplished through amending the Federal Deposit Insurance Act as we have proposed.

CHAPTER 3

THE COMPTROLLER OF THE CURRENCY'S REVIEW OF INTRASTATE NATIONAL BANK BRANCH APPLICATIONS SHOULD BE REDUCED

OCC policy requires a broad review of each national bank new branch 1/ application to insure that neither the bank's safety and soundness nor the recipient community are unduly harmed by the new branch. OCC, however, rarely restricts or denies new branch proposals and, in its individual application reviews, relies heavily on information already developed by its examination function and rarely receives strong competition or convenience and needs protests of new branch applications.

Although OCC has taken steps to cut back the resources it spends in processing new branch applications, we believe that an exception-based process should be used by OCC to consider proposed branches. Upon receipt of a completed application, OCC would review its existing examination and supervision data to determine if the application should be denied or conditioned for supervisory or State law reasons. At the end of the public comment period, the application should be considered approved, unless OCC initiates action to either deny or request additional data. Unlike the other Federal regulators, OCC must continue to use an application approach in order to insure national bank compliance with State law.

To the extent that OCC's reviews currently require information from applicants which may not be needed or delay investment decisions due to processing requirements, an unnecessary burden is being placed on applicant banks. This burden varies depending on the nature of the proposal and the bank's previous branching experience.

1/Staffed branches only.

OCC CONDUCTS A BROAD REVIEW OF EACH NATIONAL BANK NEW BRANCH APPLICATION

OCC performs a broad review of each national bank branch application. These reviews address a wide range of considerations focused on the applicant bank's ability to support expansion and the impact of the new branch on the receiving market. The reviews also insure that the proposed branch is consistent with applicable State laws.

The McFadden Act of 1927

The McFadden Act, as amended, provides that a national bank may, with the approval of OCC, establish and operate branches at any point within the State in which it is situated

> "if such establishment and operation are at the time authorized to State banks by the statute law of the State in question * * * and subject to the restriction as to location imposed by the law of the State or State banks."

As a result, Federal law allows State law to determine the location of national bank branches.

OCC policies call for broad reviews of each branch application

OCC's policies call for a broad review of each new branch application made by a national bank. OCC's branch application policy was established in 1976 and subsequently codified in October 1980. The policy calls for OCC to review each branch application for conformance with three broad sets of factors identified as banking factors, market factors, and other factors.

Banking factors deal with assessing the capability of the institution to expand. OCC defines these factors as including the bank's general condition (including the level of criticized assets, law violations, liquidity, and adverse operating trends), capital and earnings performance, and management's ability to handle expansion.

Market factors deal with assessing the potential impact of the branch upon the receiving market. OCC identified five factors it considers in this assessment:

--Economic condition and growth potential of the receiving market.

--Primary service area of the branch.

--Branch location.

--Market population characteristics, such as age, income distribution, and education level.

--Impact on competing financial institutions.

While these factors are considered, OCC's policy also notes that the judgment of the applicant as to the viability of a proposed branch will ordinarily be respected, if, in OCC's opinion, no adverse competitive impacts will occur.

The "other factor" category identified by OCC includes considering the propriety of any insider transaction associated with the branch establishment and protecting newly chartered independent banks for one year by denying any branch that threatens the viability of these institutions.

OCC also considers the branch proposal in relation to four Federal statutes. The Community Reinvestment Act (Title VIII of the Housing and Community Development Act of 1977, 12 U.S.C. 2901 _et seq._) requires the OCC to take its assessment of the national bank's record of meeting community credit needs into account when evaluating branch applications. The National Environmental Policy Act of 1969 (42 U.S.C. 4321, _et seq._) requires the OCC to make an initial determination that the action does or does not significantly affect the environment. The National Historic Preservation Act of 1966 (16 U.S.C. 470 _et seq._) requires OCC to determine if a branch action significantly affects any sites, buildings, or structures that are eligible for inclusion in the National Register of Historic Places. The fourth statute, the Depository Institution Management Interlocks Act (12 U.S.C. 3201 _et seq._), requires OCC to prohibit, with certain exceptions, management officials from one depository institution from serving as management officials of another depository institution.

BRANCH ACTIONS OF NATIONAL BANKS ARE RARELY RESTRICTED

Although OCC's individual application reviews are made to protect both the applicant institutions and recipient communities from unsound banking decisions, these reviews rarely result in restrictions being placed on proposed national bank branching actions. Outright denials are rare, as are supervisory encouraged withdrawals or branch approvals conditioned on the correction of a supervisory concern. The few restrictions made by OCC address either issues previously identified in OCC's ongoing supervision process or external protests.

Branch application denials and withdrawals are rare

When a branch proposal endangers either the applicant institution or the receiving market, OCC may deny the request. The denial may be formal or informal, where the applicant withdraws the proposal under pressure from OCC.

As shown below for 1975 through 1980, most staffed branch applications were approved. In the last 2 years, denials became a rarity as OCC's need to use branch denial as a supervisory tool lessened.

Calendar year	Applications considered	Applications approved	Applications denied	Applications withdrawn	Percent denied
1975	612	530	82	14	13.4
1976	677	600	77	32	11.4
1977	778	703	75	8	9.6
1978	761	709	52	37	6.8
1979	794	789	5	34	.06
1980	577	568	9	18	1.6
Total	4,199	3,899	300	143	7.1

Of the branch denials which were made, most addressed issues concerning the ability of the bank to expand. The 66 applications denied from 1978 through 1980 were distributed as follows:

Reason for denial		Number denied
1. Bank capacity problem (includes capital, earnings, liquidity, management, financial condition)		53
2. Legal problem		6
3. Convenience and needs problem		7
a) Threatened new bank	7	
b) Threatened existing banks	0	
c) Community Reinvestment Act (CRA) noncompliance	0	
Total		66

The specific factors cited in the bank capacity denials normally reflect regulator dissatisfaction with the overall operations of the bank. A significant number of these denials, 22 out of 53 (42 percent), were for subsidiary banks of one holding company with which OCC was involved in a dispute over

the sufficiency of capitalization to support expansion. The dispute was resolved when OCC agreed to modify its capital demands in exchange for additional access to holding company records. Subsequent branch applications for subsidiaries of this holding company have all been approved. In fact, two applications for which a capital-related denial had been drafted were also approved.

Supervisory-related withdrawals are also rare. Of the 15 withdrawals occurring in OCC's San Francisco, New York, Richmond, and Chicago offices during 1979 and 1980, 9 were specifically supervisory related. Other reasons for withdrawals included location problems, change in bank management, and change in regulator.

Conditional approvals and supervisory related delays are also rare

Rather than deny an application outright, OCC may elect to condition its approval on the applicant bank's promise to address an issue of concern to OCC. Normally, upon fulfillment of the condition, OCC will allow the branch to open. Another approach which can be employed is to merely delay the processing of the application until a supervisory issue is addressed by the applicant.

Like outright denials, OCC conditional approvals are rare. In 1980, OCC placed conditions (other than standard time limitations) on 20 of the 568 applications approved (3.5 percent). The issues these conditions addressed were distributed as follows:

Reason	Number
CRA noncompliance	2
Inadequate capital	8
Overinvestment in bank premises	7
Legal issues	1
Site issues	2
Total	20

As shown above, capital and investment in bank premises issues were the main subjects of OCC conditional approvals. These instances normally involved the bank adding equity capital prior to the establishment of the branch. The one legal issue involved compliance with State branching laws, while the two site issues involved shutting down an existing facility before opening a new one on the same site and an annexation problem. No conditional approvals were made on the basis of competitive issues.

According to regional officials, supervisory-related delays are rarely used in the regions we visited. If the applicant is having a problem, OCC would prefer to deny or condition the approval, rather than put a hold on the application.

<u>Major restrictions address either issues previously identified in OCC's ongoing examination and supervision effort or issues raised by external protests</u>

A branch application review is not OCC's only source of analyses concerning the applicant's condition. In meeting its regulatory and supervisory responsibilities, OCC continually gathers and evaluates extensive data on the condition of each national bank, regardless of whether or not the bank is seeking approval for a branch. The foundation of the supervisory process is the examination function, which provides the analysis and evaluation upon which supervisory actions are based. The examination process includes various onsite examinations, special supervisory visitations, and early warning surveillance systems which analyze financial information periodically reported by each bank to the regulator. Acting together, these systems provide a continuing assessment of each bank's condition, including the bank's capital position, financial history and condition, management capability, tendency toward inside dealing, investment in bank premises, earnings history and trends, compliance with laws and regulations, and willingness to serve the legitimate banking needs of the community.

In 1980, OCC's denials and conditional approvals normally addressed issues either previously identified in OCC's ongoing examination and supervision process or raised by external protests. The following chart shows the sources of the information used in supporting the 29 restrictions in 1980.

Source of information	Number of instances
Examination report(s)	12
Special reporting or supervisory agreement	5
CRA protest	2
Trend analyses	1
Legal analyses of State law	4
Application	5
Total	29

As shown above, in 18 instances (62 percent) the issues addressed were identified in other supervision or examination related efforts. For example, in one denial, OCC objected to the bank's equity position, noting that capital was clearly inadequate. This inadequacy had been identified by OCC well before the application, as the OCC summary memo on the decision stated "this Office has brought capital adequacy to management's attention for over a year." In a conditional approval, OCC required the bank to add capital to "bring the bank's capital to a more acceptable level." At the last examination, which preceded the application by 5 months, the bank's capital received a "4" CAMEL rating.

In six instances, OCC's restrictions were based on external protests contesting the application. In four cases, protestors challenged the legality of the branch. These challenges asserted that the branches did not meet State law requirements. Two other instances were results of CRA protests.

The five instances, where the application served as the primary source for the restriction, involved over-investment in bank premises. In these instances, the issue was a relatively minor one as the banks' overall capital positions were adequate.

FEW PROTESTS ARE MADE AGAINST NATIONAL BANK BRANCH APPLICATIONS

Few strong protests are made against national bank branch applications. The protests which are made come from either competitors or community groups.

All national bank branch applications may be subject to protest from any member of the general public. Each branch proposal must be published in newspapers in both the location of the home office and the location of the branch. Comments or protests may be made to OCC by the general public within 21 days after publication. OCC normally also notifies affected bank competitors. Prior to March 1981, strong protests accompanied by a written request for a hearing normally resulted in a public hearing. OCC revised its rules in March 1981. Currently, a request for a formal hearing must specifically explain why an oral presentation, rather than submission of written comments, is necessary.

In 1980, the number of branch applications requiring a formal hearing were small. Of the 577 applications considered, 30 (5.2 percent) resulted in public hearings. The issues raised at these hearings were distributed as follows:

Reason	Number
Noncompliance with CRA	5
Adverse competition to existing institution	20
Adverse competition to new institution	2
Noncompliance with State law	3
Total	30

As shown on the previous chart, most protests requiring a hearing are concerned with the impact of the branch on existing institutions. However, in no instance did a protest involving a competitive issue result in OCC either denying or conditionally approving a 1980 application.

APPLICATIONS ARE NOT THE PRIMARY SOURCES OF INFORMATION USED BY OCC REVIEWERS

OCC new branch application reviews are limited and rely heavily on data generated by OCC's supervision and examination process. The applicant bank's capacity to expand is primarily determined by judgments made concerning the bank's condition during the examination process. Reviews of the market impact of the proposed expansion are also limited.

Branch application reviews of bank capacity are based on existing examination data

The individual branch application review of the bank's capability to expand relies heavily on existing evaluations made by other supervisory components rather than on new analyses made specifically for the new branch decision. Branch investigations are limited reviews primarily conducted within the regulator's office, with rare onsite visits. Even when onsite visits are performed, no new evaluations of management capability or of asset quality are made. As a result, "investigations" of a bank's financial history and condition, capital position, management capabilities, and earnings prospects are primarily summaries of existing examination-based analyses.

Our review of 248 files or applications in 1980 and interviews with reviewers in 4 regions show that:

--The financial history and condition review consists primarily of analyses of existing bank examination and surveillance system reports and correspondence.

--The analysis of capital condition is based on capital trend analyses from surveillance systems and examination-generated information.

--The applicant's past earnings and future earnings prospects are assessed primarily through an analysis of examination report and surveillance system data and the applicant's deposit assertions from the application.

--The applicant's management capability is assessed exclusively through analysis of examination reports.

Even in areas where application data is considered, the considerations are either very limited or produce very limited results. In reviewing applicant deposit and earnings projections, OCC reviewers rarely perform any formal analyses or adjust any data provided. In our review of all of the 248 applications in 1980 in four OCC regions, we found only 10 instances (4 percent) where deposit estimates were adjusted.

In reviewing the applicant's level of investment in bank premises, OCC reviewers calculate the level of investments in bank premises and compare the result with the applicant's equity capital level. If the investment in bank premises level becomes too high, OCC will require additional capital. However, OCC is also continually monitoring this area in both its examination and surveillance processes and consequently has rarely found it necessary to restrict branch applications in order to ensure compliance with bank premises requirements.

Market factor reviews are difficult to perform

OCC's review of market factors is aimed at identifying and prohibiting instances where the introduction of an additional branch might harm the receiving market's community(s) and/or existing financial institutions. OCC defines market factors to include branch location, economic conditions and growth potential of the receiving market, delineation of the primary service area of the branch, population characteristics of the market, and growth of competing financial institutions in the market. The determination of what the primary service area of the branch will be is of particular importance. OCC uses the primary service area concept, which is defined to include "the smallest area from which the bank expects to draw approximately 75 percent of its deposits and should be drawn around a natural customer base." This market must be defined if the rest of OCC's economic population and competitive review is to be done.

At the four OCC regions, we found that applicants' assertions concerning market factors were generally accepted by OCC reviewers with little additional formal analysis. Examples of the limited nature of OCC's market factor review include:

--Applicant bank primary service area delineations were not challenged in any of the 248 files we reviewed.

--Applicants' primary service area population growth statistics were presented in only 150 of the 248 files.

The rare formal analyses completed by OCC were normally in response to competitor protests. Onsite evaluations of applicant data are no longer performed, with applicants providing pictures and maps of the area instead. OCC may contact competitors through the mail or by phone. OCC's decisions on these factors are documented by a series of check marks on their internal decision memorandum. In 1980, no applications were denied or conditioned due to competitive considerations.

OCC officials in each region stated that these factors have been de-emphasized by OCC and that the placement of a new branch into a new market was normally found to be inherently "pro-competitive" by providing another alternative source of services for depositors. OCC reviewers also cited several characteristics of these reviews which make them relatively difficult:

--There are a wide range of different branch arrangements, making the consistent application of a specific review methodology difficult.

--Branch proposals are inherently futuristic, relying heavily on assumptions made about future events.

--The dynamic nature of today's financial markets makes it normally impossible, without extensive research, to determine which institution is competing in which market with which competitor.

Measurement difficulties can cause uncertainty within the regulatory decision process in this area. Two examples illustrate the differences in judgment which can be a part of this analysis. In the first case, an OCC regional office recommended

disapproval of an application because of the potentially adverse impact the proposed branch would have on an existing national bank. The existing bank had not been cooperating with OCC's efforts to correct its liquidity problems. The region feared that the introduction of a new competitor would weaken OCC's supervisory efforts with the problem bank. OCC headquarters, however, did not believe these conditions were sufficient to warrant the denial of the application. In another instance, an OCC region recommended the denial of a branch application to provide "regulatory shelter" for two new banks in the proposed branch's market area. After the State authority had granted charters to two new banks, one of the State's largest national bank's applied to OCC for a branch in the same area. Although the region believed the branch would be operational before the new banks, OCC headquarters approved the branch.

Reviews of other factors are limited

Reviews of other factors include analyses of insider transactions associated with the branching decision, applicant compliance with CRA, environmental and historical considerations, and the applicant's management interlock status. All of these reviews rely extensively on the applicant's self reporting coupled with the OCC regional office's knowledge of the applicant and the area. No onsite review of applicant records is performed. These reviews rarely identify any substantive problem needing corrective action by OCC. In our review of 248 of the applications in 1980 we found:

- --No instances of management interlock problems.
- --No instances of noncompliance with either environmental or historic preservation requirements.
- --No instances of insider transactions identified which needed to be changed.
- --Three instances where CRA violations required substantive OCC action.

BRANCH APPLICATION COSTS VARY BY NATIONAL BANK

OCC's branch application process costs applicant banks time and money. National banks must go through a multiphased process which requires the postponement of investment decisions. In addition, national banks must pay a $900 filing fee for each application filed and spend varying amounts of resources filling out the necessary application forms.

Processing times vary by region and by applicant

OCC's branch application process is multiphased. Upon receiving an initial inquiry by the applicant bank, an OCC regional office will send the bank the appropriate forms and instructions. With the exception of the Atlanta regional office, no formal prescreening procedures are employed by OCC. Informal prefiling conferences may take place, but they are not a part of OCC's formal process. When the region receives the formal application, a review is made to check its completeness. If it is incomplete, additional information will be required before the region will formally accept the application.

Upon formal application acceptance, the applicant is required to publish its proposed branch action for 2 weeks. A 21-day public comment period follows the last publication.

Simultaneously, at the appropriate OCC regional office, the branch application review is initiated by the Regional Director of Corporate Activities or his/her designate. Upon completion of the review (which in the regions we visited normally took between 4 and 16 hours), and assuming no protests are made, a decision will normally be made by the OCC regional administrator. If a protest is made, or the applicant is a problem institution, the final application decision must be made at OCC headquarters.

OCC's new branch application processing times vary within and among regions. For 1980, OCC's processing times for the four regions we visited were distributed as follows.

Region	Calendar Days From Initial Receipt to Final Approval			
	0-29	30-59	60-90	90+
Richmond	0	33	18	4
Chicago	0	19	44	5
San Francisco	0	62	24	8
New York	0	6	17	17
Total	0	120	103	34

As shown on the previous chart, most applications take 60 or more calendar days to process from initial receipt to final approval.

Applicant bank compliance costs vary

Applicant national banks must pay a filing fee and incur the costs associated with compiling and presenting their branch applications to OCC for approval.

OCC estimated its 1981 costs associated with processing new branch applications at roughly $870,000. These costs were determined through allocating the overall OCC corporate application area budget among the various corporate activities, including mergers, branches, and charters. To cover these costs, OCC charges a filing fee for each type of application. The current branch application fee is $900.

In addition to paying the filing fee, national banks must spend resources accumulating and presenting the data required by OCC's application process. These requirements vary by OCC region. Although OCC's 24-page application is an agencywide form, OCC regions may alter the application to fit their particular States' branching environments. For example, in Illinois, OCC's regional office instructed applicant national banks to delete major portions of the application. In addition to altering the application, OCC regions may also request supplemental information from applicants. Other data which has been requested include:

--Copies of the bank's most recent month end statement of condition.

--Copies of the bank's Community Reinvestment Act statement.

--Copies of the applicable State branching statutes.

--Letters from the applicants asserting compliance with the provisions of Title II of the Financial Institutions Regulatory and Interest Rate Control Act of 1978 relating to management interlocks.

Individual national bank compliance costs vary by bank. Some banks make extensive reporting efforts, while others do not. The following cases illustrate the range of information provided by banks in complying with the branch application process.

Case #1

This case illustrates the extensive reporting a national bank may make in an effort to comply with OCC's application requirements addressing market factors.

> In support of its 1980 application, a large $1.8 billion eastern bank with over 100 branches already in existence submitted an extensive amount of data relating to market factors including:
>
> --An 8" x 10" extensively labeled color photograph of the proposed branch location.
>
> --Sixty-two pages of assorted macro-economic statistics.
>
> --Six pages of 17 3" x 4" snapshots of assorted facilities, including "typical" homes, hospitals, shopping centers, townhouses, and apartment developments.
>
> --An 18" x 18" map identifying the location of 65 financial offices in the branch's area.
>
> --An 18" x 18" map identifying the location of 17 housing developments, 6 employers, 5 shopping centers, and 4 office buildings.
>
> The application was approved with a one-paragraph summary of market factor information.

Case #2

This case illustrates the limited reporting a national bank may make in an effort to comply with OCC's application requirements.

> In support of its 1980 application, a small midwestern bank submitted the application with portions of the economic and demographic data areas left incomplete because the bank asserted that the data was not available. The application was approved with a one-paragraph summary of market factor information.

RECENT OCC BRANCH POLICY PROPOSALS SHOULD BE MADE LESS BURDENSOME

In July 1981, OCC issued for comment a revised branching and Customer-bank Communications Terminal (CBCT) policy. Although the new proposals recognize the need to lessen national bank costs associated with a new branch application, they do not address ways to reduce application processing times. In addition, the proposed treatment of community convenience and needs considerations does not insure that an applicant bank's reporting burden will be reduced.

The proposal changes many of OCC's existing approaches toward individual branch applications. The branch application form is to be substantially reduced and several changes will be made to the current branch policy. The current policy explanation of OCC's consideration of banking factors will be reduced from two pages to one line which simply states that "supervisory" issues will be taken into consideration by OCC.

The policy explanation of market factor considerations will also be substantially reduced. Instead of explicitly defining the nature of market factors, OCC's policy now states that OCC will consider the issue only when required to do so by the State. The market factor portion of the application form, which required an extensive amount of specific economic and demographic data, has been eliminated and replaced by an open-ended essay-type question requiring applicants to justify how their new branch will better serve the convenience and needs of the community. These explanations will have to conform to the applicable State law requirements. In addition, OCC will no longer give any explicit consideration to protecting newly chartered banks.

OCC's branch proposal does not address ways to further reduce OCC's application processing times. As noted earlier, most applications took over 60 calendar days to process at the regions we visited. Little of this calendar time is needed for completing the application analyses. Regional reviewers we interviewed estimated the analyses to take between 4 and 16 hours each for routine applications. The largest identifiable block of processing calendar time is the publication and comment period, which runs 35 calendar days. Although OCC's CBCT proposal establishes a standard processing time for "routine" applications, no standard times were established for routine staffed branch proposals. We believe that such a standard would create a positive incentive for lowering the processing times of these applications. OCC is currently drafting a separate internal procedure change aimed at establishing branch application processing time standards.

OCC's proposed approach toward evaluating the branch's impact on the community's convenience and needs should also be changed. OCC's substitution of an essay question for its previous review approach has reduced the number of pages on OCC's form but may not lead to a lessening of the reporting burden of an applicant bank. As shown earlier, applicant banks responding to the same application form varied widely in the level of information they supplied to OCC in justifying their branch. The unstructured approach advocated by OCC's proposed policy will not necessarily reduce the instances where excessive amounts of information were supplied by applicants.

CONCLUSIONS

The OCC is required by agency policy to perform extensive reviews of each national bank branch application. These reviews are for the purpose of assuring that applicant national banks have the capability to expand without either endangering their safety and soundness or adversely affecting the receiving communities. We believe there is no need for extensive reviews of each application because:

--OCC rarely finds it necessary to restrict or disapprove national bank branch applications for either applicant safety and soundness reasons or community convenience and need reasons.

--In the last few years, few national bank branch applications were strongly protested.

--OCC application reviews rely extensively on existing supervisory analyses, and the applications are not usually the basis for the reviewers' conclusions and recommendations.

To the extent that OCC requires unneeded information on applications, an unnecessary burden is placed on applicant banks.

We believe that a more exception-oriented application review approach should be used by OCC. Most application activity is routine, and the actual review time for a routine application is normally less than 2 days. As a result, we believe most applications could be approved immediately upon the closing of the public comment period, which runs for 21 days after the last date of the public notice publication. Upon receipt of a completed application form, OCC would review its existing supervisory reports to determine if the action should be denied or conditioned.

In July 1981, the OCC published for comment a proposed shorter application review approach, but no explicit processing times were set. The new proposal would reduce the amount of information required from applicant banks, but the extent of the reduction will depend upon State law requirements. For those States requiring the review of each new branch application to determine the branch's community convenience and needs impact, OCC's new essay-type question may not reduce applicant reporting which has historically varied widely.

One of OCC's primary responsibilities is to ensure that national bank branch actions conform with State law. As a result, information must continue to be gathered from applicants to ensure compliance with State law, particularly laws requiring convenience and needs and competitive impact assessments of branching actions.

As OCC regional offices already have the primary responsibility for insuring conformance to State law requirements, we believe OCC regional offices should develop individualized, structured supplements for the applicable States within their jurisdiction. We believe this approach would ease the reporting burden on applicant banks by having the reporting requirements structured, as opposed to having an essay-style question, which places the burden of State law interpretation on the applicant bank. A structured form would further reduce applicant bank reporting burden.

RECOMMENDATIONS TO THE COMPTROLLER OF THE CURRENCY

We recommend that the Comptroller of the Currency:

--Establish an exception-oriented new branch application processing system with explicit calendar-day processing time requirements for routine branch applications. Extensions beyond this time frame should be exceptions, which would necessitate an OCC action to initiate.

--Establish structured bank application reporting formats for national banks operating in States requiring the review of branch applications for their community convenience and needs impact, on the basis of OCC's interpretation of individual State law requirements.

AGENCY COMMENTS

The Comptroller of the Currency agreed with our recommendation that his current branch application review process can be reduced. The Comptroller agreed to consider our suggestions, but he noted that State statutes might limit his options. (See app. IX.)

CHAPTER 4

FEDERAL REGULATION OF INTRASTATE ESTABLISHMENT OF REMOTE ELECTRONIC TERMINALS SHOULD BE FURTHER REDUCED

Federal bank regulatory agencies treat commercial bank remote service facilities 1/ as they do staffed branches because courts have ruled that such facilities are branches as defined by the McFadden Act. Therefore, banks must receive Federal agency approval to establish remote service facilities even when the State involved does not consider those facilities to be branches.

We believe that Federal review of the placement of remote service facilities is no longer necessary because:

--Such facilities represent minor dollar investments and minimal risk to a bank.

--Such facilities have minor, if any, competitive impact.

--Such facilities are normally co-located with banks' staffed branches as a convenience to customers.

--Few applications for such facilities have been denied or conditionally approved.

--Many States have taken steps to deregulate the placement of such facilities.

Therefore, we believe that the Federal Reserve System and the Federal Deposit Insurance Corporation should not review the placements of remote service facilities by State banks. The Comptroller of the Currency should review national banks' remote service facility actions only to ensure that they conform to State law. To accomplish this, the Federal definition of a branch must be amended.

1/Computer terminals which enable customers to receive branch-like services (making deposits, withdrawing cash, paying bills, etc.) without using tellers' services. They are variously referred to in the industry and by the agencies as customer-bank communications terminals (CBCTs), remote service units (RSUs), and automated teller machines (ATMs).

THE CURRENT FEDERAL REGULATION OF REMOTE SERVICE FACILITIES IS BASED ON COURT INTERPRETATIONS OF THE MCFADDEN ACT

The regulatory treatment of remote service facilities has been shaped by the Federal courts which have determined that remote service facilities are branches as defined by the McFadden Act. Therefore, commercial banks must apply for Federal regulator approval to establish remote service facilities.

As noted in the National Commission on Electronic Fund Transfers 1977 report, the courts have used statutes that apply to branches by commercial banks as a basis for determining the legal status of national banks' terminal-based remote service facilities. The Supreme Court concluded in First National Bank in Plant City v. Dickinson, 1/ that it was the Congress' intent that national and State banks compete equally with respect to certain banking functions. National banks are subject to the limitations of State laws in at least three areas: trust powers, interest rates, and branching. The appearance of Electronic Funds Transfer (EFT) terminals was viewed by many as a direct threat to current branching powers, the dual banking system, and the doctrine of competitive equality because these terminals could quickly and radically alter the balance between national and State banks.

The McFadden Act provides that a national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches at any point within the State in which it is situated "if such establishment and operation are at the time authorized to State banks by the statute law of the State in question." But what is a branch? Section 36(f) of the McFadden Act defines the term as follows:

> "The term branch as used in this section shall be held to include any branch bank, branch office, branch agency, additional office, or branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent."

A similar definition was later incorporated into the Federal Deposit Insurance Act. Because EFT terminals did not come into existence until 40 years after the McFadden Act was

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1/396 U.S. 122, rehearing denied, 396 U.S. 1047 (1969).

written, it was unclear prior to the resolution of various cases whether terminals had to be considered branches under the act.

In interpreting the McFadden Act, the Supreme Court ruled that the Federal statutory definition of "branch" included an armored car messenger service and an off-premises receptacle for packages containing cash or checks for deposit. The Supreme Court granted that while State law "comes into play in deciding how, where, and when branch banks (of national banks) may be operated," State law definitions of what constitutes "branch banking" do not control the Federal definition of "branch"; the Federal statutory definition of "branch" must not be given a restrictive meaning that "frustrates Congressional intent" to place national and State banks on a basis of competitive equality with respect to branch banking.

The status of remote service facilities as branches became an issue in 1974 when the Comptroller of the Currency issued a ruling stating that branch applications were not required for EFT terminals, 1/ and some national banks began aggressively deploying terminals in States that did not permit branching. The Independent Bankers Association of America (IBAA) brought suit against the Comptroller, claiming that the terminals were branches under the McFadden Act and that he had exceeded his authority in allowing this deployment.

The IBAA's suit was resolved in October 1976, when the Supreme Court in Independent Bankers Association of America v. Smith 2/ let stand a lower court ruling which held that there is no functional difference between the way a customer makes a deposit in a remote terminal and the way a customer in the Plant City case used a stationary receptacle to make deposits that would be picked up later by an armored car. In short, the lower court had held that a terminal constitutes a branch as defined in the McFadden Act. This determination served to eliminate the competitive advantage in terminal deployment that national banks presumably had gained over State banks following the Comptroller's ruling.

1/Fed. Reg. 44416 (1974).

2/402 F. Supp. 207 (D.D.C. 1975), aff'd, 534 F. 2d 921 (D.C. Cir. 1976), cert. denied, 97 S.C.T. 166, 429 U.S. 862, 50 L Ed. 2d 141 ((1976).

APPLICATION PROCESSES FOR REMOTE SERVICE FACILITIES HAVE BEEN SIMPLIFIED

Although remote service facilities are considered branches under Federal law, the Federal regulatory agencies have attempted to reduce the processes involved for banks applying to establish such facilities. However, the application processes are not always as timely as the agencies' policies dictate.

FDIC requires an application for the first facility

Under guidelines issued in 1979 and reaffirmed in April 1980, banks are required to file modified branch applications for their initial facilities. The application can also request permission to establish or relocate additional facilities at a future date. FDIC's approval of an application is based on the same six statutory factors applied to staffed branch applications. (See ch. 2, p. 17.) However, these factors are not applied to the same extent. For example, the FDIC's guidelines state:

> "* * * with respect to the earnings factor, detailed projections of deposits, income and expenses are not necessary. A determination that operating expenses of the facility will not burden the bank's future earnings will generally suffice * * *."

The banks are required only to notify the FDIC prior to establishing additional facilities or relocating existing ones. These notifications are to include the exact location of the terminal, the costs involved, an opinion on the impact of the facility on the human environment, and a statement as to whether the site is included in or eligible for inclusion in the National Register of Historic Places. In reviewing these notifications, FDIC regions are to consider all of the six statutory factors and the bank's compliance with the Community Reinvestment Act and inform the applicant of any questions or delays within 30 days after the last publication of notice. If the applicant receives no comment from the regulator within 30 days after the end of the public comment period, the bank may establish or relocate the facility.

Federal Reserve System receives a notice when a remote service facility is established

State member banks are required to notify the appropriate Federal Reserve bank 30 days before establishing or using a remote service facility. This notification process has been in effect since August 1975. The notice includes a description of the facility's location, a description of the transactions the facility will handle, and any arrangements or intentions to

share the facility. These notices are reviewed by the Federal Reserve banks which apply the same criteria used for staffed branches, with the exception that remote service facilities are exempt from the Federal Reserve Act (Section 24A) limitations on bank premises investment. If the Federal Reserve bank does not notify the applicant of its objection within 30 days, or by the end of the public comment period (whichever is longer), the applicant may take action to establish or use the facility.

OCC requires an application for a remote service facility

In 1976, the OCC began requiring applications for the establishment of remote service facilities. Before 1976, national banks only had to provide 30 days notice to the Comptroller. (See p. 78.) The information now required for remote service facility applications is less extensive than that required for a staffed branch. In considering such applications, OCC reviewers are to consider all of the factors considered for a staffed branch decision. (See ch. 3, p. 48.) In addition, the applicant must file a public notice and pay an application fee of $500 for each remote service facility application.

Recent actions taken by OCC

In July 1981, the OCC issued for comment a new policy statement containing several proposed changes to OCC's approach toward the establishment of customer-bank communication terminal branches. Major changes include:

--A specific processing timeframe, "10 days after the end of the public comment period" is set up for the approval of "routine" applications.

--A shortened CBCT application form will be used.

--A bank will be allowed to apply on one application "for as many CBCT branches as it proposes to establish within six months," rather than filing a separate application for each branch, as is currently the procedure.

--Only one CBCT application fee ($500) per application will be required, regardless of the number of CBCT approvals requested in the application.

OCC believes these changes will lessen the reporting burden on the applicant banks.

While these actions will result in some national banks saving application fees and some applicants receiving faster processing, the extent of these savings is uncertain. First, in order to save filing fees, the bank must conform to OCC's branching rules. The bank must apply for more than one installation at a time and have these installations operational within 6 months of the filing date. As no time extensions will be granted if the applicant experiences installation problems beyond 6 months, a new application will be required. Second, application forms have historically made up only a portion of the information required by OCC regional offices in processing CBCT proposals.

Streamlined application processes still can delay remote service facility installations

Although the Federal agencies are using streamlined application processes for remote service facilities, the processing of the applications can delay the actual operation of the facilities. For State banks, the FDIC is required to act within 30 days after the close of the public comment period, while the FRS must act within 30 days of the initial receipt of the notice. If the State is required to also approve the facility, some of the Federal processing time will run concurrently with the State's. If the State does not have to approve remote service facilities, the FDIC or the Federal Reserve System still have at least 30 days in which to act. Thus, the applicant must wait for up to 30 days or more to open the facility. There is no comparable 30-day period for national banks' applications.

The following chart demonstrates the delays that the Federal processes can impose. It presents the distribution of the additional Federal processing times required for State banks (from the time an application was approved by the State, when required, to the date of Federal approval) and the processing time required for national banks from date of initial receipt to final approval for all 1980 applications or notifications at four locations. In those instances showing processing times of less than 30 days, Federal and State processing was performed concurrently.

Area/ regulator	Total files reviewed	Calendar day Distribution of processing times				
		0-29	30-59	60-90	90+	Not available
New York						
OCC	37	3	29	4	1	0
FDIC	41	14	8	4	3	12
FRS	13	5	3	1	3	1
San Francisco						
OCC	6	0	5	1	0	0
FDIC	65	64	1	0	0	0
FRS	0	0	0	0	0	0
Richmond						
OCC	10	7	2	1	0	0
FDIC	1	0	1	0	0	0
FRS	0	0	0	0	0	0
Chicago						
OCC	64	21	25	11	7	0
FDIC	19	12	6	1	0	0
FRS	17	0	11	0	3	3
Total	273	126	91	23	17	16

As shown above, Federal processing times vary, and most applications or notifications take over 1 month to process.

REMOTE SERVICE FACILITY INSTALLATIONS ARE RELATIVELY INSIGNIFICANT ACTIONS

Taken individually, remote service facility installations do not present a significant regulatory problem. Their installation costs are low, they are primarily used to serve the needs of existing customers, and they do not appear to be viewed as competitive threats.

Investment costs are relatively small

The costs associated with establishing an individual remote service facility normally include the cost of the unit and the cost of the space needed to install the unit. These facilities

are usually installed on or within leased space so the major initial investment cost is the machine. For example, our detailed review of the 76 OCC CBCT approvals for 1980 in the Richmond and Chicago Regional Offices showed initial investment costs ranging from $11,000 to $118,739, with a median of $54,000.

In several instances, the minor nature of the placement has caused a regulator to approve a proposal, even though the bank faced serious problems. One large bank applying for a remote terminal had "inadequate planning, earnings, and information systems to support the bank." However, the CBCT operation was characterized as "not significant" given the overall bank operations. Denial or conditional approval of the CBCT was "not considered advisable at this time, given our more substantive options." In another instance, a bank applying for a remote terminal had serious supervisory problems including "little evidence of meaningful capital planning" and delinquencies at "immoderate" levels and was "experiencing undesirable trends in many respects." The regulator judged that the proposal "will not significantly impact the condition of the bank or their future planning."

Locations are convenience oriented

In discussing the role of these facilities in 1974, the Comptroller noted that "CBCT's can be used efficiently only when there is an existing base of bank customers large enough to make installation of a CBCT economically feasible." Our review of calendar year 1979 and 1980 remote electronic facility applications or notifications considered by Federal regulators in four locations supports the Comptroller's assertion. In the four locations, we found:

--One hundred and forty-nine of the 156 applications/notifications approved in New York cited the retention of existing customers as a reason for the establishment of the terminal.

--Nineteen of the 21 applications/notifications approved in Richmond were located less than 3 miles from an existing applicant bank facility.

--Fifty-one of the 64 national bank applications/notifications in 1980 approved in Chicago were located less than 3 miles from an existing applicant bank facility.

--Twenty-two of the 30 applications/notifications approved in San Francisco were located 5 miles or less from an existing applicant bank facility.

Significant competitive protests are rare at the Federal level

Remote electronic facility applications and/or notifications are rarely the subject of significant competitive protests at the Federal level. In 1980, only 3 of the 606 (.5 percent) applications/notifications considered by Federal regulators were significantly protested by bank competitors. In each instance, the regulator determined that the protest was without merit.

FEDERAL REGULATORS SELDOM RESTRICT TERMINAL PLACEMENT

The Federal regulators have rarely denied or conditionally approved applications for remote service facilities, nor have many such applications been withdrawn. Those applications which have been denied, withdrawn, or approved with conditions have been so restricted because of issues concerning the entire bank's performance rather than problems associated with specific terminal placement.

Remote service facility denials and withdrawals are rare

Remote service facility applications or notifications are rarely either withdrawn or denied. The denials that have occurred are based on supervisory concerns which go beyond the individual facility placement decision.

As shown on the following chart, most remote service facility applications or notifications for calendar years 1978 to 1980 were approved.

Calendar year	Regulator	Applications/notifications			
		Considered	Approved	Denied	% denied
1978	FDIC	219	219	0	0
	FRS	60	60	0	0
	OCC	323	317	6	1.9
1979	FDIC	467	467	0	0
	FRS	79	79	0	0
	OCC	295	295	0	0
1980	FDIC	219	219	0	0
	FRS	44	44	0	0
	OCC	344	343	1	0.3
1978-80 Total		2,050	2,043	7	0.3

Since 1978, only .3 percent of the remote service facility applications or notifications have been denied. In both years the regulator, OCC, was attempting to correct long-standing problems at the applicant bank.

In the six 1978 denials, OCC was involved in a disagreement with a midwestern holding company over the level of capital to be considered adequate at a number of the company's national banks. During 1978, OCC also denied 22 regular branch applications of banks controlled by this holding company. All were denied on the basis of inadequate capital. These six remote service facility denials were part of this series of denials. The disagreement was subsequently resolved when the Comptroller modified OCC's position regarding capital adequacy in exchange for additional access to holding company records.

In the 1980 denial, OCC's last examination of the applicant bank had identified numerous violations of laws and operational problems. The bank had been identified as a problem institution (composite CAMEL rating of 3). At the time of the application, OCC was considering entering into a formal supervisory agreement with the bank to prompt correction.

Supervisory encouraged withdrawals, (after application or notification receipt but before approval or disapproval) are also rare. Nationwide for 1980, only five applications or notifications were withdrawn after initial filing but before approval or disapproval. All of these withdrawals were by national banks. Of the two 1980 withdrawals at the four OCC locations we visited, one was a supervisory withdrawal and the other was due to the applicant changing its charter.

The few conditional approvals normally address supervisory issues

Rather than deny or encourage the withdrawal of an application, the regulator may choose to attach conditions to the approval. These types of actions are also rare and normally address existing bank conditions warranting supervisory concern rather than issues associated with the individual terminal placement.

For 1980, we identified only seven conditional approvals (conditions other than time limitations placed on all approvals) out of 606 approvals (1.2 percent). These conditions normally addressed existing supervisory concerns either identified by the regulator well before the application or notification or identified by a CRA protest.

STATE LAWS REGARDING REMOTE SERVICE FACILITIES ARE BECOMING LESS RESTRICTIVE

While the Federal regulators must continue to view remote service facilities as branches, many States have either reduced or eliminated government regulatory participation in terminal placement. Conflicting Federal and State approaches have caused applicant banks confusion in several instances.

Many States view remote terminals as being different from branches

Many States have adopted laws which make a distinction between remote service facilities and regular staffed branches or facilities. According to the American Bankers Association's "Analysis of Enacted State EFT Legislation," updated as of February 1981, 21 States have laws which recognize remote service facilities as being different from branches.

The States with laws recognizing a difference between remote service facilities and branches have adopted a variety of regulatory approaches toward individual facility placement actions. As shown in the following chart, some States treat these actions the same as branches while others do not. Many of these States have also neutralized the competitive issue by requiring the mandatory sharing of all remote service facilities.

STATE REMOTE SERVICE FACILITY REGULATORY APPROACHES

State	Advance supervisory approval required?	Geographical coverage	Sharing (note a)
Colorado	30-day prior notice only.	Statewide	Mandatory
Connecticut	Yes.	Statewide	Mandatory
Florida	30-day prior notice only.	Statewide	Optional
Georgia	Yes.	Limited	Optional
Idaho	30-day prior notice only.	Statewide	Mandatory (consistent with anti-trust law)
Illinois	Notice only.	Limited	Mandatory (with exceptions)
Iowa	Yes.	Statewide	Mandatory
Kansas	No. No prior notice required.	Statewide	Mandatory
Maryland	Yes.	Statewide	Optional
Michigan	No. No prior notice required if shared.	Statewide	Mandatory
Minnesota	Yes. 45-day time limit.	Statewide	Mandatory
Montana	Yes.	Limited	Mandatory
Nebraska	Yes.	Silent	Mandatory
North Carolina	30-day prior notice only.	Statewide	Optional
North Dakota	30-day prior notice only.	Silent	Mandatory
Oklahoma	Prior notice only.	Silent	Mandatory
Rhode Island	Yes.	Statewide	Optional
South Dakota	30-day prior notice only.	Statewide	Mandatory
Texas	No prior notice required.	Limited	Mandatory
Washington	Yes.	Statewide	Mandatory
Wisconsin	Yes. 30-day limitation for prior approval.	Statewide	Mandatory

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a/With like institutions.

Fourteen other States have enacted EFT legislation. In six States, statutes are silent as to whether these facilities should receive treatment similar to regular branches. In the eight States with EFT legislation defining unmanned remote service facilities as branches, the State banking departments have issued regulations which treat remote service facility reviews significantly differently than regular branch reviews. Examples of these include:

--Oregon, which considers CBCTs to be branches, requires no prior approval for their establishment.

--Arkansas' regulations require only a 30-day notification prior to establishment or use.

--Utah, which considers CBCTs to be special branches, requires no prior approval for their establishment.

State laws have moved toward limiting regulatory involvement

The trend in State law has been toward further limiting their regulatory involvement in initial terminal placement decisions. From 1976 through 1980, at least four States changed their laws dealing with the regulation of remote service. These changes either liberalized the intrastate placement of terminals and/or limited regulatory involvement in the decision process.

DUAL REGULATION HAS CAUSED INSTANCES OF CONFUSION

The combined Federal and State regulation of remote electronic facilities has caused instances of confusion among applicant banks, particularly in instances where the Federal treatment differs from the State approach. In one instance involving a Michigan State bank, the bank did not notify the Federal regulator concerning the establishment of the facility until after the facility became operational. The bank's approach was consistent with State law, and the bank merely assumed that the Federal approach would be the same. The Federal regulator required the bank to submit a letter explaining its action, publish its proposal in the appropriate newspapers, and provide the regulator the necessary information to process the notification consistent with its policies. In another instance, the State required no prior approval for the facility; and the bank, assuming a similar Federal position, did not notify the Federal regulator. When the Federal regulator discovered this, the bank had to fulfill the normal processing requirement.

DEREGULATION OF REMOTE SERVICE FACILITIES IS NOT SOLELY A STATE PHENOMENON

The deregulation of remote service facilities has been an area of action and study since such facilities became widely used. One Federal financial institution regulator attempted to deregulate remote service facilities; another regulator has done so. A major commission study and a recent Presidential study have called for the deregulation of remote service facilities.

OCC originally ruled remote service facilities were not branches

In 1974, OCC concluded that remote service facilities were not branches and should be regulated "sparingly." Quoting an Annual Report of the Council of Economic Advisors, the Comptroller noted

> "* * * regulation has too often resulted in the protection of the status quo. * * * Industries have been more progressive when the agencies have endeavored to confine regulation to a necessary minimum and have otherwise fostered competition."

The Comptroller also noted that in this new area where technology and consumer response are changing rapidly, sellers and users of these services should be given the widest latitude in determining how, when, and where CBCTs can be used efficiently. Accordingly, the Comptroller required national banks to provide OCC with written notice 30 days before the CBCT was put in operation. The notice was to include information on the location of the CBCT, kinds of transactions performed, description of the manner of operation, purchase price, and distances from the newest banking offices.

Federal Home Loan Bank Board no longer approves remote service facilities

Recently, the Federal Home Loan Bank Board took two steps toward liberalizing "Remote Service Unit" (RSU) placements. First, in early 1981, the Bank Board ended its approval process for RSU actions. Federal savings and loans may now establish RSUs without applying to the Bank Board for permission. According to Bank Board staff, the approval process had restricted savings and loans' attempts to provide RSU services on a competitive basis and imposed unnecessary paperwork costs. RSU activity will now be monitored through the Bank Board's examination process.

Second, in August 1981, the Bank Board amended its regulations by removing geographic restrictions on the establishment and use of remote service units by all federally chartered savings and loan associations and mutual savings banks.

<u>Study groups have recommended the deregulation of remote electronic terminal placements</u>

In its 1977 report, the National Commission on Electronic Fund Transfers found reason to regulate the hardware of electronic banking services--the EFT terminal--differently than the hardware of traditional banking services--the brick-and-mortar branch. The Commission also found reason to regulate different classes of EFT services differently. Thus the traditional "information services" such as check authorization, check guarantee, and file look-up would not require new regulation. But the "funds transfer services" such as various types of debit and credit functions and deposits would require regulation.

The Commission found that the rules governing the deployment of off-premise EFT terminals should be separate and distinct from and less restrictive than the rules regarding the establishment of conventional branches, and that these rules should be no more restrictive than the rules governing that institution's ability to offer EFT services. Regarding EFT services, the Commission recommended that:

--No restrictions be imposed on the availability of the EFT-based credit services of debit overdraft, point-of-sale credit purchase, and cash advance.

--Federally and State-chartered depository institutions should have the power to offer the debit services of cash withdrawal, bill or loan payment, and point-of-sale purchases anywhere in the country through terminal-based EFT systems.

--Federally and State-chartered depository institutions should be free to deploy EFT terminals on a statewide basis for deposit taking.

--Federally and State-chartered depository institutions should be allowed to cross contiguous State lines to deploy deposittaking terminals in "natural market areas" following reciprocal approving legislation by the States.

--The Congress should establish a date after which federally chartered institutions may cross State lines in natural market areas for deposit taking irrespective of State legislation.

A 1981 study, a Report of the President, entitled, "Geographic Restrictions on Commercial Banking in the United States," concluded:

"The Administration believes that the deployment of EFT terminals ought to be subject to less onerous geographic restrictions than those imposed on brick-and-mortar branches, and that this modification of the McFadden Act should be undertaken along with liberalization of the Douglas Amendment in the first phase of geographic deregulation."

While noting that liberalized EFT deployment might raise concerns as to large banks dominating EFT activity, the study contended that most EFT units are currently off-line, self-contained units, which would not necessarily favor big bank development.

CONGRESS HAS ADDRESSED CONSUMER EFT ISSUES

One of the important issues associated with electronic fund transfer systems has always been consumer rights and responsibilities. In November 1978, the Congress enacted the Electronic Fund Transfer Act establishing the basic rights, liabilities, and responsibilities of consumers who use electronic fund transfer services and of financial institutions that offer them. The act directed the Federal Reserve Board to issue implementing regulations. The Board has subsequently issued and amended its implementing regulation, Regulation E. Consequently, Federal standards have been set in this area. In determining bank compliance with Regulation E, Federal agencies have relied on their examination processes.

CONCLUSIONS

Although the courts have ruled that remote service facilities are branches, our evidence indicates there is no need for the FDIC, the Federal Reserve System, and the OCC to continue regulating remote service facilities as branches, even with the streamlined processes they are now using. Remote service facilities have less potential impact than staffed branches because investment is low and competitive impact is minimal. Therefore, we believe they should receive less scrutiny than branches.

In each of the 1980 denials, supervisory withdrawals, or conditional approvals, the regulator had alternative supervisory tools available. Branch denial is only one of a full spectrum of supervisory actions that the Federal regulator can take against a bank including informal actions such as periodic progress reports, special examinations, onsite visits, and formal actions such as written agreements, cease and desist orders, and removal of management. For example, in an area such as noncompliance with the CRA, a regulator may issue a cease and desist order.

In some States, federally insured, State-chartered banks are applying for Federal permission to take an action the State has chosen not to regulate. This inconsistency could be eliminated if the FDIC and Federal Reserve were not required to approve the establishment of remote service facilities. An amendment to the McFadden Act and Federal Deposit Insurance Act definitions of a branch would be needed to enable the FDIC and the Federal Reserve System to discontinue their approval processes. Recognizing these facilities as different than branches would relieve the FDIC and the Federal Reserve from their current approval requirements, which are based on the Federal definition of a branch.

The Comptroller of the Currency has taken steps to streamline his remote service facility application process. However, we believe the process could be streamlined even more if the McFadden Act definition of a branch was modified. This would let the Comptroller match his regulation of such facilities to State regulation. In those States where there is little or no State regulation of State banks' remote service facilities, the Comptroller could reduce his regulation of national banks' facilities.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress amend the McFadden Act and the Federal Deposit Insurance Act to differentiate between staffed branches and remote service facilities. The differentiation should enable the Federal Deposit Insurance Corporation and the Federal Reserve System to stop reviewing State bank applications for remote service units and enable the Comptroller of the Currency to adopt a limited-purpose notification process for national banks' remote service facilities. For suggested legislative language see appendix VI.

AGENCY COMMENTS

The Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve System generally supported our call for reducing the Federal regulation of individual intrastate remote service facility placements. However, each agency had a different reaction to our recommendation.

The Comptroller of the Currency concurred with the need to "effect a statutory change in the definition of a branch" in order to "fully deregulate" the area. (See app. IX.) It is important to point out, however, that we are not advocating complete deregulation. Rather, we are suggesting a form of deregulation which affords national banks' intrastate placements of remote service facilities treatment consistent with that of State banks.

The Federal Reserve cautioned that any change in the definition of a branch, as we propose, "would have to be fashioned in a manner that is consistent with prevailing Federal and State laws concerning the broader terms of interstate branching." (See app. VII.) We did not intend to open up an avenue for interstate branching, nor do we believe that our proposed change to the McFadden Act does so inadvertently. Our proposal maintains the same predominant role of State law in controlling the location of remote service facilities as now exists for branches in general under the McFadden Act.

The Federal Deposit Insurance Corporation believes that, in addition to the changes we propose for the McFadden and Federal Deposit Insurance Acts, changes would also need to be made to the Community Reinvestment, National Environmental Protection, and National Historic Preservation Acts. (See app. VIII.) We disagree. We are suggesting that the Federal Reserve System and the Corporation no longer be involved in the establishment of remote service units by State banks. Therefore, the acts cited by the Corporation would not apply in that no Federal role for such actions would exist.

BANKS AND BANK BRANCHES IN OPERATION: 1970 AND 1980

BRANCHES IN OPERATION BY TYPE OF BANK

Type of bank	Branches in operation 1970	1980	% change
National	12,570	19,792	+57
State member	3,651	4,771	+31
State nonmember	5-589	14,173	+154
Total	21,810	38,736	+78

BANKS IN OPERATION BY TYPE OF BANK

Type of bank	Banks in operation 1970	1980	% change
National	4,621	4,425	-4.2
State member	1 147	997	-13.1
State nonmember	7,743	9,013	+16.4
Total	13,511	14,435	+6.8

DESCRIPTION OF THE FIVE COMPOSITE RATINGS POSSIBLE UNDER THE UNIFORM INTERAGENCY BANK RATING SYSTEM

Composite 1

Banks in this group are sound institutions in almost every respect, and critical findings are basically of a minor nature and can be handled in a routine manner. Such banks are resistant to external economic and financial disturbances and capable of withstanding the vagaries of business and conditions more ably than banks with lower composite ratings.

Composite 2

Banks in this group are also fundamentally sound institutions but may reflect modest weaknesses correctable in the normal course of business. Such banks are stable and also able to withstand business fluctuations quite well; however, areas of weakness could develop into conditions of greater concern. To the extent that the minor adjustments are handled in the normal course of business, the supervisory response is limited.

Composite 3

Banks in this group exhibit a combination of weaknesses ranging from moderately severe to unsatisfactory. Such banks are only nominally resistant to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. Consequently, such banks are vulnerable and require more than normal supervision. Overall strength and financial capacity, however, are still sufficient enough to make failure only a remote possibility.

Composite 4

Banks in this group have an immoderate volume of asset weaknesses, or a combination of other conditions that are less than satisfactory. Unless prompt action is taken to correct these conditions, they could reasonably develop into a situation that could impair future viability. A potential for failure is present but is not pronounced. Banks in this category require close supervisory attention and financial surveillance.

Composite 5

This category is reserved for banks whose conditions are worse than defined under number 4 above. The volume and character of weaknesses are such as to require urgent aid from the shareholders or other sources. Such banks require immediate corrective action and constant supervisory attention. The probability of failure is high for these banks.

DISTRIBUTION OF STATE BANKS

AS OF 12/31/80

Statewide branching States	State member banks	State nonmember banks	Total
Alaska	0	7	7
Arizona	0	21	21
California	8	225	233
Connecticut 1/	2	43	45
Delaware	0	12	12
District of Columbia	0	1	1
Florida	32	321	353
Hawaii	0	7	7
Idaho	4	15	19
Maine	3	24	27
Maryland	5	66	71
Nevada	1	5	6
New Hampshire 1/	4	35	39
New Jersey 1/	15	64	79
New York 1/	43	58	101
North Carolina	1	54	55
Oregon 1/	10	64	74
Rhode Island	0	9	9
South Carolina	6	60	66
South Dakota 1/	27	92	119
Utah 1/	16	48	64
Vermont	1	15	16
Virginia 1/	82	75	157
Washington 1/	4	76	80
Total	264	1,397	1,661

1/State has some form of home office protection law.

DISTRIBUTION OF STATE BANKS

AS OF 12/31/80

Limited branching States	State member banks	State nonmember banks	Total
Alabama	24	195	219
Arkansas 1/	4	188	192
Georgia 1/	9	363	372
Indiana 1/	41	245	286
Iowa	39	513	552
Kentucky 1/	9	257	266
Louisiana 1/	6	211	217
Massachusetts	7	61	68
Michigan	80	169	249
Minnesota	33	523	556
Mississippi 1/	5	135	140
New Mexico	6	43	49
Ohio	86	128	214
Pennsylvania	11	134	145
Tennessee	10	272	282
Wisconsin	27	476	503
Total	397	3,913	4,310

Unit banking states	State member banks	State nonmember banks	Total
Colorado	36	145	181
Illinois 1/	59	787	846
Kansas 1/	22	449	471
Missouri	47	579	626
Montana	44	64	108
Nebraska 1/	9	331	340
North Dakota	3	133	136
Oklahoma 1/	20	291	311
Texas	42	783	825
West Virginia 1/	29	99	128
Wyoming	25	30	55
Total	336	3,691	4,027

1/State has some form of home office protection law.

STATE REGULATOR BRANCH AND/OR DETACHED

FACILITY APPLICATION ACTIVITY

FOR 1977 THROUGH 1980

Year	Applications considered	Applications approved	Applications denied		Applications withdrawn		Percent denied or withdrawn
			#	%	#	%	
1977	1,262	1,115	77	6.1	70	5.6	11.7
1978	a/ 1,198	1,053	65	5.4	80	6.7	12.1
1979	1,230	1,088	63	5.1	79	6.4	11.6
1980	b/ 1,044	917	39	3.7	88	8.4	12.2
Total	4,734	4,173	244	5.2	317	6.7	11.9

a/Data from West Virginia not available.

b/Data from Utah and Vermont not available.

As shown above, State agencies approved over 85 percent of the branch and/or detached facility applications considered between 1977 and 1980. These figures may be conservative in that all withdrawals are counted, although some may be related to reasons other than supervisory pressure.

SUGGESTED LEGISLATIVE LANGUAGE FOR REPORT

CHAPTER 2 RECOMMENDATIONS

I. To amend Section 18(d)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1828(d)(1)) to read as follows:

> "(d)(1)(A) No State member insured bank (except a District bank) shall establish and operate any new domestic branch unless it shall have the prior consent of the Corporation. A State nonmember insured bank desiring to establish any new domestic branch shall, at the time it applies to the appropriate State supervisory authority, give notice of its intent to the Corporation. The Corporation shall afford all interested parties a reasonable opportunity to be heard on the intended branch. The Corporation must, within thirty calendar days of the date of receipt of the notification or until expiration of the public comment period, whichever is longer, disapprove the proposed action in writing or extend the thirty-day period not to exceed an additional ninety days to request additional information from the bank or other interested parties. Unless the bank is so advised by the Corporation, the branch may be established, contingent upon approval of the appropriate State supervisory authority. In considering any proposed branching under this section, the Corporation shall take into account supervisory factors which would affect the safety, soundness of the applicant bank, and the applicant bank's compliance with the Community Reinvestment Act. Where a bank desiring to establish a new branch has been determined to be in an unsound condition, the Corporation may take into account such additional factors as it determines to be necessary in considering such a branch, without regard to the time limitations imposed by this section. If the proposed branch has not been established within 18 months of the original notification date, the applicant bank must notify the Corporation to extend the original decision not to disapprove the branch.

"(B) In addition, no State nonmember insured bank (except a District bank) shall move its main office or any branch from one location to another without the prior written consent of the Corporation. The factors to be considered in granting or withholding the consent of the Corporation regarding such moves shall be the supervisory factors mentioned in subparagraph A of this subsection."

II. To amend Section 9 of the Federal Reserve Act (12 U.S.C. 321, para. 3) to read as follows:

" . . . provided, however, that nothing herein contained shall prevent any State member bank from establishing and operating branches in the United States or any dependency or insular possession thereof or in any foreign country, on the same terms and conditions and restrictions as are applicable to the establishment of branches by State nonmember insured banks except that approval of the Board of Governors of the Federal Reserve System, instead of the Federal Deposit Insurance Corporation, shall be obtained before any State member bank may hereafter establish any branch and before any State bank hereafter admitted to membership may retain any branch established after February 25, 1927, beyond the limits of the city, town, or village in which the parent bank is situated. The approval of the Board shall likewise be obtained before any State member bank may establish any new branch within the limits of any such city, town, or village (except within the District of Columbia)."

Section 9 of the Federal Reserve Act (12 U.S.C. 322) is further amended to read as follows:

"In acting upon such membership applications the Board of Governors of the Federal Reserve System shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this Act."

SUGGESTED LEGISLATIVE LANGUAGE FOR REPORT

CHAPTER 4 RECOMMENDATIONS

I. To amend Section 3(O) of the Federal Deposit Insurance Act (12 U.S.C. 813(O)) to read as follows:

"(O) The term "domestic branch" includes any branch bank, branch, office, branch agency, additional office, or any branch place of business located in any State of the United States or in any Territory of the United States, Puerto Rico, Guam, American Samoa, or the Virgin Islands at which deposits are received or checks paid or money lent; and the term "foreign branch" means any office or place of business located outside the United States, its territories, Puerto Rico, Guam, American Samoa, or the Virgin Islands, at which banking operations are conducted. Except that neither the term "domestic branch" nor "foreign branch" shall include a remote service facility."

Section 3 of the Federal Deposit Insurance Act is further amended by adding the following definitions:

"(t) The term "remote service facility" means an unattended electronic information processing device, other than an ordinary telephone instrument, located separate and apart from a bank, branch, or detached facility, and through which account holders may engage in banking transactions, by means of either the instant transmission (on-line) of electronic impulses to or from the bank or its data processing agent or the recording of electronic impulses or other indicia of a banking transaction for delayed transmission (off-line) to the bank or its data processing agent.

"(u) The term "banking transaction" means a cash withdrawal, deposit, account transfer payment from a bank account, disbursement under a preauthorized credit agreement, or loan payment."

II. To amend Section 7(f) of the McFadden Act (12 U.S.C. 36(f))to read as follows:

"(f) The term "branch" as used in this section shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received or checks paid, or money lent. Except that the term "branch" shall not be held to include a remote service facility."

Section 7 of the McFadden Act (12 U.S.C. 36) is further amended by adding the following definitions:

"(i) The term "remote service facility" means an unattended electronic information processing device other than an ordinary telephone instrument, located separate and apart from a bank, branch, or detached facility, and through which account holders may engage in banking transactions by means of either the instant transmission (on-line) of electronic impulses to and from the bank or its data processing agent or the recording of electronic impulses or other indicia of a banking transaction for delayed transmission (off-line) to the bank or its data processing agent.

"(j) The term "banking transaction" means a cash transfer payment from a bank account, disbursement under a preauthorized credit agreement, or loan payment."

III. To amend Section 7(c) of the McFadden Act (12 U.S.C. 36(c)) to read as follows:

"A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches and remote service facilities: (1) Within the limits of the city, town, or village in which said association is situated, if such establishment and operation are at the time expressly authorized to State banks by the law of the State in question; and (2) at any point within the State in which said association is situated, if such establishment and operation are at the time

authorized to State banks by the statute law of the State in question by language specifically granting such authority affirmatively and not merely by implication or recognition, and subject to the restrictions as to location imposed by the law of the State on State banks. In any State in which State banks are permitted by statute law to maintain branches or remote service facilities within county or greater limits, if no bank is located and doing business in the place where the proposed agency is to be located, any national banking association situated in such State may, with the approval of the Comptroller of the Currency, establish and operate, without regard to the capital requirements of this section, a seasonal agency in any resort community within the limits of the county in which the main office of such association is located, for the purpose of receiving and paying out deposits, issuing and cashing checks and drafts, and doing business incident thereto: Provided, That any permit issued under this sentence shall be revoked upon the opening of a State or national bank in such community. Except as provided in the immediately preceding sentence, no such association shall establish a branch or remote service facility outside of the city, town, or village in which it is situated unless it has a combined capital stock and surplus equal to the combined amount of capital stock and surplus, if any, required by the law of the State in which such association is situated for the establishment of such branches or remote service facilities by State banks, or, if the law of such State requires only a minimum capital stock for the establishment of such branches or remote service facilities by State banks, unless such association has not less than an equal amount of capital stock."

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

November 30, 1981

Mr. William J. Anderson
General Government Division
United States Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

The Board appreciates the opportunity to respond to the GAO draft report entitled "Federal Review of Intrastate Branching Applications Can Be Reduced." The report reviews the regulatory procedures associated with intrastate branch applications and makes two principal recommendations to Congress to amend existing banking legislation.

First, the GAO recommends that the Federal Reserve and the Federal Deposit Insurance Acts be amended with the goal of replacing the detailed submission and review of branch applications with a more simplified and less burdensome pre-notification requirement. The report suggests that such a pre-notification would be sufficient unless the regulatory agency required additional information due to supervisory or compliance concerns. Second, the GAO recommends amendment of the McFadden and Federal Deposit Insurance Acts to differentiate between staffed branches and remote service units. The GAO believes that this change would give Federal agencies the option, in light of state law, of not requiring an application or notification from a bank seeking to establish a remote service facility. The GAO report takes the position that regulators do not now have this option since Federal courts have held remote service units to be branches.

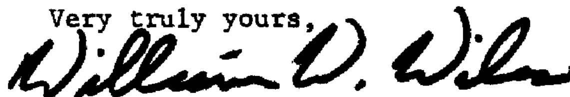
The Board generally agrees with the GAO's objectives of reducing, where appropriate, the regulatory burden associated with branch applications and the potential for duplication between Federal and State application requirements. Recently, the Board has taken steps to achieve these goals. Specifically, the Board has revised its application procedures for remote service units and intrastate branches to require a simple pre-notification letter and evidence of publication for CRA purposes in lieu of a formal and comprehensive application package. Under these new procedures, if the bank does not hear from the Federal Reserve within a fixed time period, it

Mr. William J. Anderson -2-

may proceed to establish the branch or remote service unit. The Board has made these changes under existing authority granted to it by the Federal Reserve Act and believes that they go a long way to reducing burden for the bank as well as for the Federal Reserve System itself.

The Board generally welcomes greater flexibility to simplify and reduce regulatory and reporting burden consistent with its statutory responsibilities for compliance and safety and soundness. The changes outlined above demonstrate the Board's commitment to this end. However, any legislative change in the definition of branches to exclude remote service units from the definition raises potential questions of interstate branching and deposit-taking. Obviously, given the broad public policy issues involved, any change in the definition of branches designed simply to give Federal agencies greater flexibility to reduce burden associated with intrastate branching would have to be fashioned in a manner that is consistent with prevailing Federal and State laws concerning the broader issue of interstate banking.

Very truly yours,



William W. Wiles
Secretary of the Board

Comptroller of the Currency
Administrator of National Banks

Washington, D. C. 20219

December 10, 1981

Mr. William J. Anderson
Director
General Government Division
U. S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

We appreciate the opportunity to comment on your November 4, 1981 draft of a proposed GAO report entitled "Federal Review of Intrastate Branching Applications Can Be Reduced."

In the report, GAO recommends that laws and policies be changed to alter the Federal review requirement to an exception-based processing system.

The Office of the Comptroller of the Currency (OCC) agrees with the draft report's recommendation that the review conducted by the OCC can be reduced. As you are aware, through our Corporate Applications Review and Evaluation (CARE) Program, the OCC currently is conducting a review of all policies, procedures and forms relating to corporate application filings, including branch and CBCT filings. As noted in the draft report, we published proposed amendments to our policies and regulations governing branches and CBCTs on July 30, 1981. In our view, these proposed revisions will significantly deregulate the branch approval process, and contribute to a reduction in an applicant's financial and resource burden.

The proposed policy amendments reflect the OCC's view that establishment of a branch is a legitimate business decision of the applicant, requiring minimal involvement of the OCC, except to the extent that legality, internal supervisory concerns or Community Reinvestment Act (CRA) performance must be addressed. Little emphasis will be placed on an appraisal of economic and competitive conditions except where required by state law.

The application forms have been revised (now still in draft form) to reflect the proposed policy changes. For domestic branches, the OCC will no longer request market area, demographic, and competitive data. For CBCT's, the OCC will no longer request data on the technical aspects of a terminal.

In studying this phase of the CARE program, our staff considered ways of further deregulation and simplification of our processes. However, the staff continually met with obstacles founded in applicable statutes. We believe that, given the current statutory restraints, we have developed the most workable revisions possible.

We understand that certain points addressed by us with your auditors will be incorporated or clarified in GAO's final report. In addition to the points in the draft report which have been clarified, we notice that the draft report also states that the unstructured approach advocated by the OCC's proposed policy and draft application forms will not necessarily reduce the instances when excessive amounts of information are supplied by applicants. Although the draft report elsewhere recognized that the proposed policy and forms revisions will result in reduced information requirements, it suggests that we have not gone far enough. We have considered this in our continuing re-draft of application forms, and will adjust some items to provide for a more structured approach. However, we believe that current restraints contained in applicable statutes give little flexibility in certain areas, such as in responding to "convenience and needs" factors and community reinvestment performance.

In conjunction with this suggestion, the draft report further states that OCC regional offices should develop individualized structured application supplements, which would address the specific state's legal requirements. This suggestion has merit. However, we anticipate that the number of cases in which the applicant may submit excessive information will be few, thus not warranting development of individualized supplements at this time. If after gaining experience with the revised forms, it is apparent that the number of cases in which excessive information is submitted is unacceptable, we can revise the form to include the suggested supplements.

The draft report recommends that the OCC establish an exception-oriented new branch application processing system with explicit calendar day processing time requirements for routine branch applications. The OCC's proposed policy revisions will provide a process whereby routine CBCT applications generally will be approved "automatically" ten days after the end of the public comment period. At this point, we have not suggested a similar process for domestic branches. However, as stated earlier, we drafted internal procedures that will require the regional office to decide routine domestic branch applications by the 10th day after the end of the comment period.

The draft report states that Federal review of the placement of remote service facilities is no longer necessary because:

- they represent minor dollar investments
- they have minor, if any, competitive impact
- they are normally collocated with staffed branches
- few applications have been denied or conditionally approved
- many states have deregulated their placement

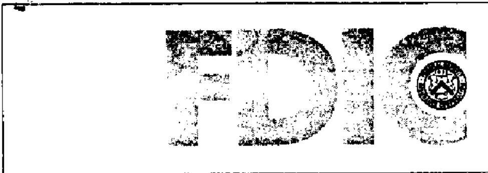
We concur with this opinion. We also agree that in order to fully deregulate this area, Congress must effect a statutory change in the definition of a branch to remove CBCTs, or to at least not require prior approval of the OCC for their establishment.

We, of course, would be willing to elaborate on any of our comments with you or your staff.

Very truly yours,

Charles E. Lord
Acting Comptroller of the Currency

APPENDIX IX



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF DIRECTOR • DIVISION OF BANK SUPERVISION

December 9, 1981

Mr. William J. Anderson
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

Chairman Isaac asked that I respond to your request for comments on the draft report entitled "Federal Review of Intrastate Branching Applications Can Be Reduced."

The recommendation that the Federal Deposit Insurance Act (FDI Act) and the McFadden Act be amended to exclude remote service facilities from the definition of "domestic branch" and "foreign branch" is well founded and has our support. However, the objective of the recommendation -- elimination of the Federal role in the intrastate establishment of remote service facilities -- cannot be met, in our opinion, without corresponding changes in the Community Reinvestment Act (CRA), National Historic Preservation Act (NHPA), and the National Environmental Policy Act (NEPA).

GAO also recommends that Federal review of State bank branch applications be done on an exception basis and suggests an amendment to the FDI Act that would ". . . replace the requirement for a broad review of each branch application with a notification process, wherein applicant banks notify the respective Federal agency of their desire to branch. The agency would then respond within a fixed time frame to this notification with the options of either having no objection, denying the branch or requiring more data."

The recommendation is based on findings that most branch proposals have little bearing on the applicant's safety and soundness or the economic health of the community to be served; that Federal disapproval of branch proposals are rare; that the Federal review process duplicates that of the States; and, that the process seldom discloses anything of substance which was not previously known to the Federal agency. Thus, existing branch review procedures are seen as causing unnecessary delays on applicant banks and imposing nonproductive administrative burdens on both the bank and the Federal agency. The proposed amendment to the FDI Act requires a bank to give FDIC a "notice of intent" to establish a branch; eliminates the need for prior written consent; establishes a maximum time period of 120 days within which the proposed branch may be disapproved; and replaces the six statutory factors which the Corporation must

currently consider on branch applications with ". . . the Corporation shall take into account supervisory factors which would affect the safety, soundness of the applicant bank, and the applicant bank's compliance with the Community Reinvestment Act. . . ."

We are in substantial agreement with the premises upon which GAO's recommendation is based. Most banks which apply for branches are fundamentally sound institutions and Federal disapprovals are therefore infrequent. However, banks which are not fundamentally sound or are otherwise of supervisory concern also apply for branches. In such instances, the present approval process affords the opportunity to restrain an unwarranted expansion of a bank or to help bring about other needed corrective actions, and provides the flexibility to deal with the particular circumstances of a given situation. The "no objection" process advocated by GAO does not make an adequate distinction between sound and unsound banks. Making such distinctions is the essence of bank supervision. When unsound conditions are in evidence, a "no objection" type of consent is not appropriate nor should agency action be restricted by arbitrary time constraints. Moreover, the language of the proposed amendment appears to give the authority to disapprove a branch action only when establishment of the branch ". . . would affect the safety, soundness of the applicant bank . . ." Thus, a bank which is already in an unsafe or unsound condition could not be restrained from opening a new branch, unless it could be shown that the new branch would further reduce its safety and soundness. Such a modification of our existing authority would be totally unacceptable.

The proposed amendment includes compliance with CRA as a factor to be considered. However, our responsibilities under NHPA or NEPA are not addressed. We also question whether our consideration of protests to a branch action is adequately provided for. The language "The Corporation must, within thirty calendar days of the date of receipt of the notification or until expiration of the public comment period, whichever is longer, disapprove the proposed action in writing or extend the thirty-day period not to exceed an additional ninety days to request additional information from the bank . . ." indicates that FDIC extend the time period only if additional information is requested from the bank. It sometimes happens that the Corporation finds it necessary to hear the views of a protesting party and the need for additional information from the bank cannot be established until the protestor is heard. An adequate opportunity to consider the views of protestors must be provided regardless of whether the bank is asked to provide additional information.

We believe that the objective of reducing Corporation review of most branch applications can be accomplished without amendment to the FDI Act. Our authority to promulgate regulations necessary to carry out the provision of the Act provides the means, in most instances, to respond to a changing environment. Moreover, we have found that new legislation frequently does not provide the flexibility needed to carry out our supervisory responsibilities. Thus, we are inclined to favor a revision of our regulations over Congressional action until and unless it is demonstrated that the former

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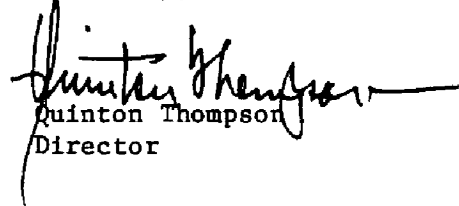
cannot produce the desired results. Accordingly, we intend to explore the possibility of revising our existing regulations and policies on branch applications in order to determine whether alternate approval procedures can be established for sound and unsound banks. A process by which applications from banks with a Uniform Bank Rating of 1 or 2 would receive the minimal review possible while those with a rating of 3, 4 or 5 would receive a more intensive scrutiny is envisioned.

The Corporation is committed to simplification of procedures for all statutory applications. We have recently revised all of our application forms with a view toward reducing the information required from the bank to that which is essential to our statutory responsibilities and is not already available from our internal sources. Arrangements have been made with a number of State banking departments for the utilization of common application forms and concurrent processing of requests. We have developed an application procedure for remote service facilities whereby formal approval of only the first such installation is required with all subsequent installations handled on a notification basis. Regional Directors have been given wide authority to approve applications at the local level and we are continuously looking for ways to expand these powers.

In view of our substantial accomplishments in this area, we are confident that further measures can be taken to streamline the branch approval process. If this cannot be accomplished, we would then be pleased to discuss new legislative language with GAO.

Sincerely,



Quinton Thompson
Director

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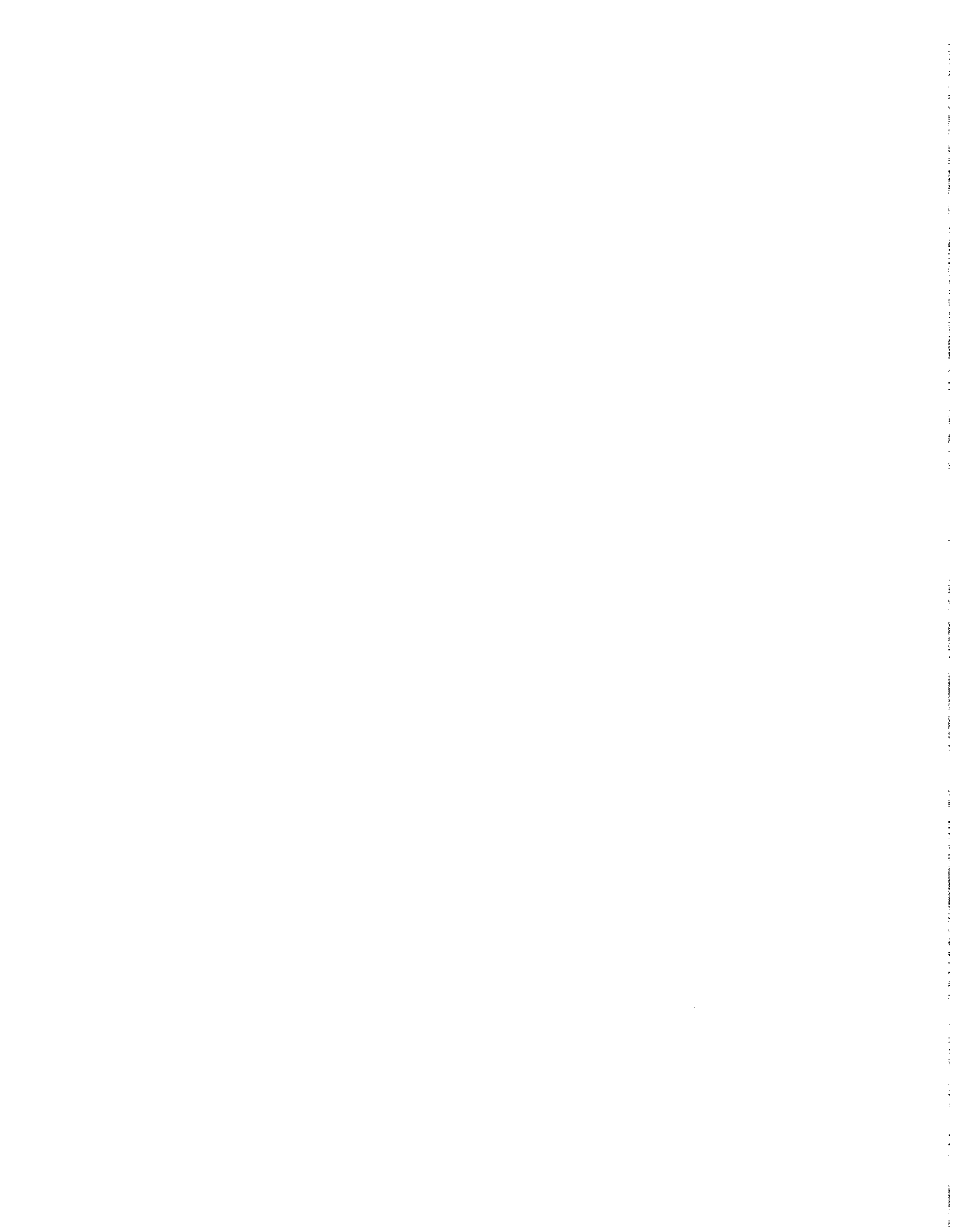

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