The Dodd-Frank Act Will Open All States To Interstate De Novo Branching

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One section, covering half a page in the 2,300 page Conference Committee Report for the Dodd-Frank Wall Street Reform and Consumer Protection Act, will remove the key political compromise of the 1994 Riegle-Neal Interstate Banking and Branching Efficiency Act. Section 613 will allow national or state banks from any state to branch into any other state as if they were chartered in that state.

The section has attracted little fanfare and apparently little political opposition. When enacted, Section 613 will eliminate the required "opt-in" election by each state to permit interstate branching through de novo branches. A majority of states did not opt-in. In those states, including California, the acquisition of either an existing bank or a branch of a bank in that state was the price of admission.

There are several reasons for this proposed change, which removes the compromise reached in 1994 (and effective in 1997) on the issue of interstate branching. One is that the legislation initially proposed by the Treasury is a long overdue leveling of the interstate branch playing field between commercial banks and OTS-regulated thrifts, which have had the authority to branch nationwide since 1992. Since the Dodd-Frank Act will dismantle the OTS and place thrifts under OCC jurisdiction but preserve thrifts' interstate branching authority, this has symmetry appeal. Similar legislation proposed in the House of Representatives in 2006 was supported by the Federal Reserve.

Also, news reports have tagged this new nationwide de novo branching authority as a "Big Gift for Big Banks." This might be traced to the fact that the provision was introduced in the House bill by a congressman from North Carolina, a state which a very big bank calls home. Others, including some state regulators and trade associations, have observed that most big banks that desired interstate branches and would pay handsomely in acquisitions have done so, and therefore this change is overdue and not that significant. Finally, there is the theory that certain regulators would be pleased to have more competition in some states to help pare down the excessive number of community

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Whatever the basis and motivation for this change, state statutes such as California Financial Code Section 3824, which states that it is "an express prohibition against interstate branching through de novo establishment of California branches pursuant to Section 5155 of the Revised Statutes (12 U.S.C. Sec. 36) or Section 18(d) of the Federal Deposit Insurance Act (12 U.S.C. Sec. 1828(d)," will become moot and will need to be revised. The FDI Act and the companion Section 36(g) of the National Bank Act are amended by Section 613 to remove the Reigle-Neal opt-in requirement and permit de novo interstate banking if "the law of the State in which the branch is located, or is to be located, would permit establishment of the branch, if the bank were a State bank chartered by such State." Today, most banks can open branches throughout their own states.

Accordingly, the enactment of Section 613 of the Dodd-Frank Act will mean that a California state bank and a national bank with California as its home state could open a new branch in more than 20 states that now either prohibit de novo interstate branching or require that California offer de novo branch entry "reciprocity" to its banks (which California does not). Key, of course, is whether the California bank's own state and/or federal regulator has any supervisory objection to the opening of the proposed branch in another state, which would include consideration of the bank's capital, management and community reinvestment compliance.

The removal of the Riegle-Neal "opt-in" barrier to de novo interstate branching in many states will dash the hopes of banks to sell for high multiples or perhaps at least sell a branch for a healthy premium. It also will likely move to the history book footnotes the variety of ways banks found to enter other states without doing a whole bank acquisition and merger. These included buying shell charter skeleton banks from two merging banks for premiums that have exceeded $1 million; structuring a branch acquisition so as to strip most all of the unwanted assets and deposits at closing as well as then relocating and closing the acquired branch; and even entering a state by outbidding a nearby community bank for a single-branch small-town failing bank, immediately opening a second branch in the desired metropolitan city far away and then selling the acquired branch back to the nearby community bank.

It remains to be seen if there will be an influx of banks into California by outsiders that have been previously unwilling to buy their way in. Likewise, there may be larger California banks that will promptly establish branches in desirable markets in several other states, such as New York, Florida or Illinois. There may also be many community banks that simply wish to establish branches across their state borders in contiguous states.

Section 613 of the Dodd-Frank Act will become effective immediately upon enactment.

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