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Interstate Banking and Branch Banking in Texas: An Overview of the Constitutional and Statutory Provisions.

Kimberly Cauthorn

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Interstate Banking and Branch Banking in Texas: An Overview of the Constitutional and Statutory Provisions

Kimberly Cauthorn

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I. INTRODUCTION

Historically, Texans have been distrustful of the financial power possessed by banking institutions.¹ While Texans have learned to accept the banking business, most have continued to fear the power of large corporations and have opposed most attempts by banks to consolidate financial power.² The depressed oil-services industry and overbuilt Texas real estate markets, particularly in Houston and Dallas, have burdened Texas banks³ with an increasing number of nonperforming loans.⁴ Attempting to boost the weakened Texas economy by assisting Texas banks in obtaining much-needed capital,⁵ Texas lawmakers have enacted legislation allowing inter-

1. See TEX. CONST. art. XVI, § 16, interp. commentary (Vernon 1955). The development of the Texas commercial banking system represents the conflict between frontier distrust of financial institutions (and the subsequent fear of concentrated financial power) versus the need to continually adapt to meet the evolving banking needs of a growing economy. See *id.*

2. See Op. Tex. Att'y Gen. No. JM-498, at 2269 (1986) (resentment of banking business subsided, but distrust and fear of corporations did not subside before 1904); see also *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 1, at 3 (Aug. 13, 1986) (testimony of Texas Senator O.H. Harris, before Texas Senate Economic Development Committee) (noting 1985 regional banking bill's defeat).

3. Unless otherwise noted, "bank" means a bank in the general sense.

4. See, e.g., S.J. OF TEX., 69th Leg., 2d Called Sess. 53 (1986) (Governor Mark White urging joint session of Congress that Texas cannot have strong economy without strong banking system); J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 50-52 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (noting weakened financial condition of Texas banks). "Declining oil prices, depressed agricultural markets, and overbuilt residential and commercial construction markets have combined to produce a serious recession in the Texas economy." J. Hazleton, Interstate Banking Implications for Texas 2 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee).

5. See J. Hazleton, Interstate Banking Implications for Texas 2 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (due to Texas' weakened economic condition, many Texas banks approaching capitalization limits and need massive infusions of new capital to survive).

state banking.⁶ Additionally, Texas voters recently rejected a long-standing constitutional prohibition against branch banking in Texas.⁷

Numerous events have led to Texas' recent liberalization of its banking laws. Most significantly, the Texas Legislature slowly retracted the statutory prohibitions against branch banking by increasing the allowable distance between banks and their drive-in/walk-up facilities.⁸ This legislative action resulted in a Texas Attorney General opinion which stated that free-standing facilities, more than 20,000 feet from the main bank building, violated the constitutional prohibition against branch banking.⁹ Correspondingly, federal legislation has granted greater competitive advantages to savings and loan institutions.¹⁰ Financial service institutions, such as "nonbank" financial institutions,¹¹ banking-related subsidiaries,¹² loan

6. See TEX. REV. CIV. STAT. ANN. arts. 342-102, 342-404, 342-912, 342-914, 342-916 (Vernon Supp. 1987) (effective Jan. 1, 1987).

7. Compare TEX. CONST. art. XVI, § 16(a) (1904, amended 1986) (bank may only engage in business at one place) with TEX. CONST. art. XVI, § 16(d)-(f) (allowing bank to branch if accomplished through purchase of failed bank or if limited to three branches within city or county). The constitutional amendment was approved by voters November 4, 1986. See TEX. CONST. art. XVI, § 16 (d)-(f).

8. See, e.g., TEX. REV. CIV. STAT. ANN. art. 342-903, § 1 (Vernon Supp. 1987) (allowing limited branch banking according to constitutional amendment passed 1986); Act of June 12, 1985, ch. 484, §§ 1-2, 1985 Tex. Gen. Laws 2054 (extending distance between central building and connecting facility to 20,000 feet in larger cities and counties); Act of June 17, 1983, ch. 374, § 1, 1983 Tex. Gen. Laws 2043-44 (extending distance between central building and connecting facility to 10,500 feet).

9. See Op. Tex. Att'y Gen. No. JM-498, at 2288 (1986); see also J. Sexton, Interstate Banking and Branch Banking 12-13 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (prospective dismantling of customer convenience facilities another reason branch banking law needed).

10. See Deposit Institutions Deregulation & Monetary Control Act of 1980, 12 U.S.C. §§ 3501-09, 3521-24 (1982) (savings and loan institutions perform same functions and provide essentially same services to consumers as commercial banks).

11. The Bank Holding Company Act regulates bank holding companies' acquisitions of bank subsidiaries. See *id.* § 1842(a). It also limits bank holding companies' activities and interests in areas which are unrelated to banking. See *id.* § 1843(a). A "bank" is defined as an institution organized under state or federal law meeting both parts of the two-pronged "bank" test. A bank "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans." *Id.* § 1841(c). "Nonbank" financial institutions avoid regulation under the Bank Holding Company Act because they do not meet both prongs of the "bank" test. See Lobell, *Nonbank Banks: Controversy Over a New Form of Consumer Bank*, 39 BUS. LAW 1193, 1193 (1984). Such limited service banks may expand across state lines because they do not constitute banks for purposes of the Bank Holding Company Act (BHCA) and, therefore, are not subject to the BHCA prohibition on interstate expansion. See 12 U.S.C. § 1842(d) (1982); see also Conner & Murphy, *Recent Developments in Banking Laws*, 22 T.B.A. SEC. CORP., BANK & BUS. LAW 13 (1985).

12. See 12 U.S.C. § 1843(c)(8) (1982); see also Douglas, *State Banking Regulation and Deregulation — Geography*, reprinted in STATE BANKING REGULATION AND DEREGULATION 17 (P. Wallison ed. 1985). Bank holding companies may directly or indirectly engage in activi-

production offices,¹³ and even automated teller machines,¹⁴ have infiltrated financial markets once exclusively reserved for commercial banks.¹⁵ Currently, a majority of states have enacted various forms of either interstate banking¹⁶ or branch banking, or combinations of both.¹⁷

The recent amendment to the Texas Constitution allowing branch banking in Texas,¹⁸ its enabling legislation,¹⁹ and the newly-enacted interstate banking statute²⁰ will significantly impact Texas multibank holding companies.²¹ Branch banking often offers a more efficient operating structure, thereby affording multibank holding companies greater competitive advan-

ties deemed to be closely related to banking. These activities are not subject to the Douglas Amendment's prohibition against interstate expansion. *See id.*

13. *See* 12 C.F.R. § 7.7380(b) (1984) (bank employee or agent may originate loans at location other than main bank location).

14. *See* 1 W. SCHLICHTING, T. RICE & J. COOPER, *BANKING LAW* § 8.02[2], at 8-3 (1986). The automated teller machine (ATM) is the electronic fund transfer system (EFT) that is most widely used. An ATM is defined as "an unmanned system of electronic terminals that takes deposits, disburses cash, and transfers funds from one account to another without needing to process paper for collection." *Id.*; *see also* HOUSE STUDY GROUP, *SPECIAL LEGISLATIVE REPORT NO. 123*, at 17 (Jan. 30, 1986) (ATMs and other technological innovations make physical location of deposit accounts less important).

15. *See* Merchner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, col. 4 (proponents argue branch banking will provide more efficient structure for regulated financial industry and, therefore, will be better able to compete against unregulated competitors); *see also* *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 2, at 14 (Aug. 13, 1986) (testimony of Franklin Raines, general partner, Lazard Freres, before Texas Senate Economic Development Committee) (noting many businesses becoming involved in financial services industry).

16. *See, e.g.*, J. Sexton, *Presentation of Paper Concerning Both Interstate Banking and Branch Banking*, exhibit 3 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee); HOUSE STUDY GROUP, *SPECIAL LEGISLATIVE REPORT NO. 123*, at 22 (Jan. 30, 1986); *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 1, at 8-9 (Aug. 15, 1986) (testimony of R. Bruce LaBoon, Vice-Chairman of General Counsel, Texas Commerce Bancshares, before Texas Senate Economic Development Committee). The following states have enacted interstate banking laws: Alaska, Alabama, Arizona, Connecticut, District of Columbia, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Louisiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Virginia, West Virginia, Washington, and Wisconsin. *See id.*

17. *See* Op. Tex. Att'y Gen. No. JM-498, at 2268 (1986) (twenty-one states permit limited branch banking, eighteen states permit statewide branch banking).

18. *See* TEX. CONST. art. XVI, § 16 (1904, amended 1986).

19. *See* TEX. REV. CIV. STAT. ANN. art. 342-903, §§ 1-4 (Vernon Supp. 1987).

20. *See id.* at arts. 342-102, 342-404, 342-912, 342-914, 342-916.

21. *See* Harris & Glasgow, *Bill Analysis—S.B. 11*, 24 T.B.A. SEC. CORP., *BANK & BUS. LAW* 8-9 (1986) (changes to Texas Banking Code of 1943 primarily affect bank holding companies). Frank W. Anderson, a bank analyst with the Dallas investment banking firm of Weber, Hall, Sale and Associates remarked that Texas could advance from the "most anti-

tages over the unregulated financial service industries.²² Removing interstate barriers will also give Texas multibank holding companies the opportunity to expand into other states.²³ While Texas multibank holding companies were formed primarily to circumvent the constitutional and statutory branch banking prohibitions, such holding companies, even though apparently having many of the same features as a branch banking system,²⁴ will need substantial time in order to implement a branch banking system.²⁵ Since the constitutional and statutory amendments, two major Texas multibank holding companies have announced an agreement to consolidate operations.²⁶ Furthermore, another Texas multibank holding company has announced an agreement to consolidate its operations with a foreign (out-of-state) multibank holding company.²⁷ Allied Bancshares, Inc., plans to combine its twenty Harris County banks into a single commercial bank.²⁸ These consolidations represent the first attempts to reap the opportunities that the new Texas legislation offers regarding bank expansion.

quoted banking laws to the most progressive in one push." *American Banker*, Aug. 7, 1986, at 3, col. 2.

22. See J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 13 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (services provided through branch banking system less costly than provided through unit banking system). In a unit banking system, a multibank holding company owns subsidiary banks, which are separate legal entities with their own board of directors and management. These subsidiary banks have no operational relationship to each other, but they are indirectly controlled by the parent holding company. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 18 (Jan. 30, 1986); see also J. Hazleton, Interstate Banking Implications for Texas 10 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (branch banking improves customer convenience and creates more competitive banking system).

23. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 39 (Jan. 30, 1986). Diversification protects commercial banks because it decreases loan concentration. If loans are made in various economic sectors, then the collapse of one sector will have less effect on other sectors. Furthermore, greater diversification allows a commercial bank to make more speculative loans that may benefit the community. For example, banks may be more willing to grant loans to struggling farmers. See *id.*

24. See *Grandview Bank & Trust v. Board of Governors of Fed. Reserve Sys.*, 550 F.2d 415, 419-20 (8th Cir.) (operation of multibank subsidiaries not considered branch banking), *cert. denied*, 434 U.S. 821 (1977).

25. See Merkner, *Texas Banks: Branching Out or Out on a Limb?*, *San Antonio Express-News*, Nov. 2, 1986, at 10-K, cols. 2-3 (may take three to five years for holding companies to fully implement branch banking system).

26. See *American Banker*, Jan. 6, 1987, at 2, col. 2 (on December 16, 1986, RepublicBank Corporation announced acquisition of InterFirst Corporation in \$580 million "stock swap").

27. See Shearson Lehman Bros., News Release (Dec. 15, 1986) (on Dec. 15, 1986, Chemical New York Corporation, with assets of \$56 billion, and Texas Commerce Bancshares, with assets of \$18.9 billion, announced merger agreement).

28. See *Wall St. J.*, Feb. 23, 1987, at 9, col. 2 (Allied's banks combined to increase financial strength and provide better services to consumers).

This comment will present an overview of the new interstate banking law in Texas and the recent constitutional amendment permitting branch banking. After discussing the trends leading to these developments, particular attention will be focused upon the effects of the new legislation and the constitutional amendment on Texas multibank holding companies. Finally, possible economic advantages and disadvantages of branch banking and interstate banking in Texas will be examined.

II. FACTORS LEADING TO THE RECENT CONSTITUTIONAL AND STATUTORY AMENDMENTS TO ALLOW BRANCH BANKING AND INTERSTATE BANKING IN TEXAS

A. Attorney General Opinion JM-498: The Branch Banking Catalyst

Prior to November 4, 1986, Texas was the only state to constitutionally prohibit branch banking.²⁹ In fact, the Texas constitutions of 1845, 1861, and 1866 expressly prohibited a state banking system.³⁰ The Texas Constitution of 1869 briefly removed this prohibition, but it was soon reinstated in Texas' present constitution, which was adopted in 1876.³¹ Subsequently, the constitution was amended in 1904 so as to create a state banking system; however, the amendment still expressly prohibited branch banking.³² Various attempts were made thereafter to permit branch banking in Texas, but none were successful.³³ In 1967, even a vote for a legislative study on the

29. See TEX. CONST. art. XVI, § 16 (1876); see also Harris & Glasgow, *Bill Analysis—S.J.R. 4, 24 T.B.A. SEC. CORP., BANK & BUS. LAW* 16 (1986). Branch banking is defined as "a banking corporation conducting business at more than one location." *Id.*; see also TEX. CONST. art. XVI, § 16(b) (in 1980, Texas voters amended branch banking prohibition to allow use of ATMs by commercial banks).

30. See, e.g., TEX. CONST. art. VII, § 30 (1866); TEX. CONST. art. VII, § 30 (1861); TEX. CONST. art. VII, § 30 (1845) (constitutions prohibited creation of corporations with "banking or discounting privileges"); cf. *Burleson v. Davis*, 141 S.W. 559, 561 (Tex. Civ. App.—Austin 1911, writ ref'd n.r.e.) (opinion reflects court's fear regarding concentration of financial power).

31. See TEX. CONST. art. XVI, § 16 (1876) (retained language of 1845 constitution); see also Op. Tex. Att'y Gen. No. JM-498, at 2269 (Reconstruction Constitution did not contain state banking system prohibition).

32. See TEX. CONST. art. XVI, § 16 (1876, amended 1904); see also J. GRANT & L. CRUM, *THE DEVELOPMENT OF STATE-CHARTERED BANKING IN TEXAS FROM PREDECESSOR SYSTEMS UNTIL 1970*, at 41-42 (1978) (Governor Lanham proposed constitutional amendment permitting state chartered banking, but prohibiting branch banking). As Texas' agricultural, as well as commercial and industrial activities expanded, there developed a corresponding need for an organized state banking system. See TEX. CONST. art. XVI, § 16, interp. commentary (Vernon 1955).

33. See J. GRANT & L. CRUM, *THE DEVELOPMENT OF STATE-CHARTERED BANKING IN TEXAS FROM PREDECESSOR SYSTEMS UNTIL 1970*, at 265-67 (1978) (discussing attempted branch banking bills introduced during legislative sessions since 1929).

issue of branch banking in Texas was overwhelmingly defeated.³⁴ This general aversion towards branch banking stems from a long-standing popular distrust of corporations.³⁵ During the 28th Texas Legislature, when a great deal of anti-trust sentiment existed, a regulation was proposed which sought to restrict a corporation from establishing and maintaining more than one place of business.³⁶ Similar sentiment was reflected when the branch banking prohibition was enacted with the intent to prevent bank monopolies.³⁷

The Texas statute prohibiting branch banking, enacted pursuant to the constitutional prohibition of branch banking, has been frequently amended, thereby testing the limits of the statutory restriction.³⁸ In 1983, a statutory amendment significantly expanded the definition of "banking house" by broadening the definition of the central bank's connecting facilities.³⁹ This amendment increased the allowable number of connecting facilities to two, excluding any connecting facility located within five hundred feet of the central bank.⁴⁰ This amendment also extended the allowable distance between

34. See J. GRANT & L. CRUM, *THE DEVELOPMENT OF STATE-CHARTERED BANKING IN TEXAS FROM PREDECESSOR SYSTEMS UNTIL 1970*, at 267 (1978) (request for legislative study on branch banking defeated in Texas House by vote of 114 to 5) (citing Walter Johnson, "President's Address," *Texas Bankers Record* June 1967 at 8). See generally *id.* at 265-67 (discussing Texas branch banking controversy).

35. See Op. Tex. Att'y Gen. No. JM-498, at 2269 (resentment of banking business subsided, but distrust and fear of corporations remained prior to 1904).

36. See *id.* at 2270. Governor Lanham, in his February 5, 1903, Executive Message, suggested the "one office" prohibition as a way to prevent monopolies and other acts in restraint of trade. See *id.*

37. See *id.* (analogy drawn between banking institutions and other corporate forms).

38. See TEX. REV. CIV. STAT. ANN. art. 342-903 (amended 1957, 1959, 1963, 1971, 1975, 1981, 1983, 1985, 1986). The original language of the Texas branch banking statute stated: "No state, national or private bank shall engage in business in more than one place, maintain any branch office, or cash checks or receive deposits except in its own banking house." *Id.* See generally Op. Tex. Att'y Gen. No. JM-498, at 2270-73 (1986) (statutory amendments expanded and redefined "banking house"). The constitutional branch banking prohibition was amended in 1980 to allow the utilization of automated teller machines (ATMs). See TEX. CONST. art. XVI, § 16(b) (ATMs first exception to proscription against "engaging in business at more than one place").

39. Compare Act of June 15, 1981, ch. 611, § 1, 1981 Tex. Gen. Laws 2410 (first amendment to designate connecting facility as "drive-in/walk-up facility," defined as "a facility offering banking services solely to persons who remain outside of the facility during the transaction of business with the bank") with Act of June 17, 1983, ch. 374, § 1, 1983 Tex. Gen. Laws 2042 (drive-in/walk-up facility is "facility offering banking services solely to persons who remain outside of the facility or in a secured teller lobby during the transaction of business with the bank") (emphasis added).

40. See Act of June 17, 1983, ch. 374, § 1, 1983 Tex. Gen. Laws 2042; see also Act of May 13, 1957, ch. 220, § 1, 1955 Tex. Gen. Laws 448. The connected facility must be "physically connected" by passageway or hallway, closed circuit television, pneumatic tube, or other physically-connected delivery device. See Op. Tex. Att'y Gen. No. JM-498, at 2270 (1986).

the central bank and its connecting facilities from 3,500 feet to 10,500 feet.⁴¹ In 1985 another amendment was enacted which expanded the definition of the central bank's connecting facilities so as to include office buildings,⁴² and which extended the distance between the central bank and its connecting facilities to 20,000 feet.⁴³

The constitutionality of the 1985 amendment was questioned by State Senator Chet Brooks.⁴⁴ In response, Texas Attorney General Jim Mattox issued an advisory opinion declaring that the 1985 amendment violated the constitution's prohibition against branch banking.⁴⁵ Attorney General Mattox initially determined that the bank services offered at connecting facilities constituted "banking" within the meaning of the Texas Constitution.⁴⁶ The Attorney General then asserted that the type of physical connection and the distance between the central building and the facility allowed by the amendment violated the constitutional prohibition against corporations engaging in business at multiple locations.⁴⁷ Attorney General Mattox therefore concluded that the 1985 statutory amendment to the branch banking statute was an impermissible attempt to alter the effect of article XVI of the Texas Constitution.⁴⁸ Intensive lobbying efforts were soon initiated so that the

41. See Act of June 17, 1983, ch. 374, § 1, 1983 Tex. Gen. Laws 2042 (distance extended to nearly two miles).

42. See Act of June 12, 1985, ch. 484, § 1, 1985 Tex. Gen. Laws 2053-54 (drive-in/walk-up facility defined as "a facility offering banking services solely to persons who remain outside of the facility or in a building having a secured teller lobby during the transaction of business with the bank") (emphasis added); see also Op. Tex. Att'y Gen. No. JM-498, at 2287 (1986) ("drive-in/walk-up facility" may fairly be construed as office building).

43. See Op. Tex. Att'y Gen. No. JM-498 (1986).

44. See *id.* at 2266 (letter sent to Texas Attorney General questioning merger of two Dallas state banks and resulting use of bank facilities).

45. See *id.* at 2287-88 (drive-in/walk-up facility 20,000 feet away from central building considered "branch"); see also Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, col. 1 (House-Senate committee investigated issue and suggested putting constitutional amendment on ballot).

46. See Op. Tex. Att'y Gen. No. JM-498, at 2281 (1986) (services typically offered at "drive-in/walk-up facilities" constitute banking). See, e.g., *Kaliski v. Gossett*, 109 S.W.2d 340, 344 (Tex. Civ. App.—San Antonio 1937, writ ref'd n.r.e.) (essential element of bank is legal power to receive deposits); 12 U.S.C. § 36(f) (1982) (branch is branch bank, office, agency, place of business, etc., where deposits received, checks paid, or money lent); TEX. REV. CIV. STAT. ANN. art. 342-903 (1985) (does not specify or limit what services drive-in/walk-up facilities offer); Op. Tex. Att'y Gen. No. WW-22, at 3 (1957) (all possible banking functions need not be exercised to constitute "banking").

47. See Op. Tex. Att'y Gen. No. JM-498, at 2287 (1986) (legislative increases in distance is situation which constitutional prohibition intended to prevent); see also TEX. CONST. art. XVI, § 16(b) (ATMs are exception to proscription against operating at more than one location).

48. See Op. Tex. Att'y Gen. No. JM-498, at 2287 (1986) (Attorney General noted negative consequences of decision, but asserted that true intent of Texas Constitution must govern).

branch banking issue could be placed on the 1986 Special Legislative Session's agenda.⁴⁹ Lobbying for branch banking, Texas Banking Commissioner James L. Sexton warned Texas legislators that the only viable alternative, besides dismantling a number of existing detached banking facilities, would be eliminating the prohibition against branch banking.⁵⁰

B. *Multibank Holding Companies—Increasing in Number and Size*

The Bank Holding Company Act of 1956 (BHCA)⁵¹ defines a bank holding company as any company directly or indirectly controlling a bank.⁵² Because the operation of multiple bank subsidiaries is not considered branch banking,⁵³ multibank holding companies are often formed to circumvent state branch banking restrictions.⁵⁴ Instead of owning branches of the same bank, the multibank holding company owns a controlling interest in several

49. See J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 12-13 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (legislature's "aggressive laws" extended beyond relevant constitutional language); see also Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, cols. 1-2 (legislative efforts regarding constitutional amendment directed by State Sen. O.H. Harris and State Rep. Bruce Gibson).

50. See J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 12-13 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee). Besides the immediate problem of what to do with the existing convenience facilities, Texas Banking Commissioner Sexton believed that Texas' growth, the shifts in population patterns, and greater mobility necessitated a change in Texas' branch banking laws. See *id.*; see also Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, col. 2 (if branch banking amendment passed, existing detached facilities would be allowed, and closures and employee layoffs prevented).

51. 12 U.S.C. §§ 1841-49 (1982) (effective May 9, 1956).

52. See 12 U.S.C. § 1841(a)(1) (1982); see also 4 F. SOLOMON, W. SCHLICHTING, T. RICE, & J. COOPER, *BANKING LAW* § 86.03, at 86-10 (1986) ("company" includes bank). The three principal purposes of the Bank Holding Company Act of 1956 are to limit bank holding company activities to a financial nature, to prevent unsound or unsafe practices, and to guard against an overconcentration of financial resources in too few companies. See *id.* § 86.01, at 86-1.

53. See, e.g., *Grandview Bank & Trust Co. v. Board of Governors of Fed. Reserve Sys.*, 550 F.2d 415, 419-20 (8th Cir.) (Bank Holding Company Act allows many activities similar to branch banking), *cert. denied*, 434 U.S. 821 (1977); *Central Bank v. Smith*, 532 F.2d 37, 39 (7th Cir.) (if banks have interlocking ownership and directorates and owners actively participate in management of subsidiaries, no intent to engage in branch operation), *cert. denied*, 429 U.S. 895 (1976); *First Nat'l Bank v. First Bank Stock Corp.*, 306 F.2d 937, 940 (9th Cir. 1962) (if no showing that subsidiary *state* bank not doing business through instrumentality of subsidiary *national* bank, then not branch banking arrangement).

54. See Bertini, *A Survey of the State Laws Governing Branching and Other Modes of Bank Expansion in Alabama, Florida, and Georgia*, 35 U. MIAMI L. REV. 1067, 1089 (1981) (expansion-oriented Florida banks no longer need to circumvent branching restrictions due to liberalization of Florida's branch banking laws); see also Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, col. 5 (Texas

separate banks.⁵⁵ While the several banks are separate legal entities, each is operated under a common group banking structure.⁵⁶ However, since each bank is maintained as a separate corporate entity, its services cannot be used interchangeably with the other member banks' services.⁵⁷ Furthermore, the Douglas Amendment⁵⁸ to the federal Bank Holding Company Act prohibits bank holding companies from expanding across state lines, unless the state into which the holding company seeks to expand expressly authorizes interstate banking.⁵⁹ However, a "loophole" in the Act's definition of a bank allows bank holding companies to establish "nonbank" affiliates in other states, even if those states prohibit interstate banking.⁶⁰ Due to this federal loophole and a Texas Attorney General opinion recognizing that multibank holding company operations do not violate the Texas Constitution's branch banking prohibition,⁶¹ multibank holding companies in Texas have quickly increased in size⁶² and strength.⁶³

C. Federal Legislation Favoring Savings and Loan Institutions

The original purpose of savings and loan institutions was to provide private home loans;⁶⁴ however, these institutions, like traditional commercial

multibank holding company system looking more like branch banking system with "facade stripped away").

55. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 18 (Jan. 30, 1986) (each subsidiary in multibank holding company system has separate board of directors and management accountable only to that board of directors, however, ultimate control with holding company, since ownership interest gives it effective control).

56. See *id.*

57. See Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 1-K, col. 2 (disadvantage of unit banking structure—each bank's services cannot be used interchangeably).

58. See 12 U.S.C. § 1842(d) (1982).

59. See *id.*

60. See 12 U.S.C. § 1841(c) (1982).

61. See Op. Tex. Att'y Gen. No. H-606 (1975) (multibank holding company operations do not violate Texas Constitution's branch banking prohibition); see also HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 33 (Jan. 30, 1986) (even though multibank holding companies have quickly expanded, Texas still has many small, independent banks).

62. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 33 (Jan. 30, 1986). In 1978, Texas' ten largest multibank holding companies held 47.5 percent of the state's commercial bank deposits. By the end of 1984, Texas' ten largest multibank holding companies held 60.3 percent of the state's commercial bank deposits. See *id.*

63. See *id.* (by June 30, 1985, Texas' five largest multibank holding companies controlled 305 of over 1900 Texas banks).

64. See Lapidus, *Commercial Banks and Thrift Institutions: The Differing Portfolio Powers*, 92 BANKING L.J. 450, 453-54 (1975) (savings and loans designed to promote savings and to finance private residence purchases); cf. Note, *Interstate Branch Banking: That Someday is*

banks, are providing more profitable and flexible investment programs.⁶⁵ The Depository Institutions Deregulation & Monetary Control Act of 1980⁶⁶ was enacted by Congress in order to enable savings and loan institutions, while still preserving their housing-oriented purpose, to better compete with commercial banks.⁶⁷ By allowing savings and loan institutions to perform similar functions and provide similar services as banks, the Act has blurred the traditional distinction between commercial banks and savings and loan institutions.⁶⁸ Since federally-chartered savings and loan institutions and federally-chartered commercial banks are regulated under different

Today, 21 WASHBURN L.J. 266, 272 (1982) (commercial banks began, and have been maintained, as investing and lending institutions).

65. See Comment, *Northeast Bancorp, Inc. v. Board of Governors: Green Light for Regional Interstate Banking*, 35 AM. U.L. REV. 387, 388 (1986). Over the past decade, other financial institutions have challenged savings and loan institutions to offer a larger variety of financial services. See *id.*

66. See 12 U.S.C. §§ 3501-3509, 3521-3524 (1982).

67. See S.R. REP. NO. 96-368, 96th Cong., 2d Sess. 76, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 236, 238 (Act allows federal savings and loan institutions to make consumer loans and offer interest bearing checking accounts, as long as aggregate amount not more than ten percent of total assets); see also Lapidus, *Commercial Banks and Thrift Institutions: The Differing Portfolio Powers*, 92 BANKING L.J. 450, 454-58 (1975) (before 1980 Act, savings and loan institutions offered savings and time deposit accounts with lending activity limited to various types of real estate loans). Because savings and loan institutions became trapped between low-yield portfolios of long-term mortgage loans and the high-cost source of funds in NOW accounts (interest bearing checking accounts), Congress allowed federally-chartered savings and loan institutions to offer higher-yield corporate, consumer, and nonresidential real estate loans and to invest in higher yield securities and commercial paper. These developments have greatly blurred the distinctions between savings and loan institutions and commercial banks. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 10-11 (Jan. 30, 1986).

68. See S.R. REP. NO. 96-368, 96th Cong., 2d Sess. 76, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 236, 238 (distinction between savings and loan institutions and banks blurred so savings and loan institutions could compete more effectively against commercial banks). The general purpose and effect of the Depository Institutions Deregulation & Monetary Control Act of 1980 is summarized as follows:

The legislation authorizes Federal savings and loan associations to provide consumers with virtually all of their household borrowing needs. Thrifts have historically functioned as depositors and home mortgage lenders. However, the home mortgage borrower has had to go elsewhere to other types of financial institutions to obtain a checking account, make a consumer loan and obtain trust services. The inability to offer the consumer such services has handicapped savings and loan associations in competition with other depository institutions which offer the consumer convenient one-stop financial services across the board. As a result, in period of tight money savings and loan associations suffer from fund outflows even though the rates they pay on deposits are competitive. This legislation gives Federal savings and loans the ability to compete for the savings dollar while remaining housing oriented. They are authorized by the legislation to hold ten percent of their assets in consumer loans, commercial paper, corporate debt securities and banker acceptances. These powers should enable thrifts to become one-stop family financial centers

laws,⁶⁹ federally-chartered savings and loan institutions are not subject to the same interstate banking restrictions as are federally-chartered commercial banks.⁷⁰ In order to increase industry competition and thereby better serve the public, the Federal Home Loan Bank Board, the supervisory agency for all federally-chartered savings and loans, began allowing interstate mergers between savings and loan institutions in limited circumstances.⁷¹ Several mergers and acquisitions of savings and loan institutions have occurred in Texas, thereby giving savings and loan institutions greater advantages over Texas commercial banks, which cannot branch across state lines.⁷²

D. *The Weakening of Interstate Barriers Prohibiting the Expansion of Financial Services*

To avoid the barriers against interstate banking in Texas, expansion-oriented multibank holding companies and other financial institutions have established a variety of financial service facilities in Texas.⁷³ Since many of these facilities do not constitute "banks" according to the Bank Holding Company Act, they are not subject to geographic restrictions.⁷⁴ Further-

making them more competitive and giving them the earnings they need to pay market rates to depositors.

Id. at 248.

69. Compare 12 U.S.C. §§ 21, 221, 531 (1982) (sections regulating banking associations) with 12 U.S.C. §§ 1401, 1421, 1451 (1982) (sections regulating savings and loan associations).

70. See 12 U.S.C. § 37 (1982) (sections 21, 221, and 531 of Title 12 apply only to associations organized to carry on "business of banking"); see also *Springfield Inst. for Sav. v. Worcester Fed. Sav. & Loan Ass'n*, 107 N.E.2d 315, 318 (Mass. 1952) (Federal Home Loan Bank Board need not consider state lines as restriction when deciding whether or not to approve branch application).

71. See 12 C.F.R. § 556.5(a)(3) (1984, amended Sept. 3, 1981) (branch banking allowed where establishment of branch office across state lines by acquisition or merger needed to prevent failure of institution); see also 45 Fed. Reg. 83, 199 (1980) (FHLBB believes branch banking primary means to increase competition and serve public).

72. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 16-17 (Jan. 30, 1986) (as of September, 1985, nine foreign savings and loan institutions operating in Texas); see also Note, *Interstate Branch Banking: That Someday is Today*, 21 WASHBURN L.J. 266, 273 n.58 (1982) (three way merger of savings and loan institutions with 136 offices in California, New York, and Florida resulted in formation of fourth largest savings and loan institution in nation) (citing Wall St. J., Sept. 9, 1981, at 3, col. 1).

73. See Conner & Murphy, *Recent Developments in Banking Laws*, 22 T.B.A. SEC. CORP., BANK & BUS. LAW 13 (1985) (by January, 1985, Chase Manhattan, Chemical Bank, Mellon Bank, First Interstate Bank Corporation, Security Pacific, Union Bank and other large financial institutions had applied with the Comptroller of the Currency to locate limited service banks in Dallas and Houston).

74. See, e.g., 12 U.S.C. § 1843(c)(8) (1982) (bank holding company may directly or indirectly engage in activities deemed to be closely related to banking); 12 C.F.R. 7.7380(b) (1984) (employee or agent of bank may originate loans at location other than location of main bank);

more, technological innovations, such as electronic funds transfer systems, have made it increasingly difficult to use geographic boundaries as a way to control branch banking.⁷⁵

1. Nonbank Financial Institutions

Nonbank financial institutions have evolved due to the loophole in the Bank Holding Company Act. The Act defines a commercial bank as an institution that accepts demand deposits *and* makes commercial loans.⁷⁶ Nonbank financial institutions are distinguished in that such banks either do not make commercial loans *or* do not accept demand deposits.⁷⁷ Commercial bankers argue that since nonbank financial institutions are not within the Act's definition of a commercial bank, the nonbank financial institutions are not subject to the Act's restrictions on interstate bank expansion.⁷⁸ Likewise, the United States Supreme Court has held that the technical definitions of the Bank Holding Company Act must be applied and that it is Congress' responsibility to decide whether or not to bring nonbank financial institutions within the scope of the Act.⁷⁹ While the nonbank financial institutions are economically handicapped by either their inability to accept demand deposits *or* make commercial loans, their avoidance of the interstate expansion restrictions has given such institutions a competitive advantage over multibank structures.⁸⁰ Branch banking will enable commercial banks to com-

cf. HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 17 (Jan. 30, 1986) (ATMs and other technological innovations make physical location of deposit accounts less important).

75. See Note, *Interstate Branch Banking: That Someday is Today*, 21 WASHBURN L.J. 266, 267 n.5 (1982) (statement of Dr. James L. Pierce, Department of Economics, University of California, Berkeley) (citing *Federal Branching Policy: Hearings Before Subcomm. on Financial Institutions of Senate Comm. on Banking, Housing, and Urban Affairs*, 94th Cong., 2d Sess. 411 (1976)); see *id.* at 267 (since EFT systems considered "branches" by state statutory regulation, branch banking restrictions will limit availability of bank service).

76. See 12 U.S.C. § 1841(c) (1982); see also Douglas, *State Banking Regulation and Deregulation — Geography*, reprinted in STATE BANKING REGULATION AND DEREGULATION 327 (P. Wallison ed. 1985) (restrictive geographic and product barriers forcing multibank holding companies and non-banking companies to exploit loophole to make needed services and products available to consumer).

77. See Conner & Wilson, *Recent Developments in Banking Laws*, 21 T.B.A. SEC. CORP., BANK & BUS. LAW 13 (1984) ("nonbank banks" usually do not make commercial loans, but may accept demand deposits).

78. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 13 (Jan. 30, 1986).

79. See Board of Governors of Federal Reserve Sys. v. Dimension Fin. Corp., ___ U.S. ___, ___, 106 S. Ct. 681, 689, 88 L. Ed. 2d 691, 703 (1986); see also HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 14 (Jan. 30, 1986) (Federal Reserve Board strictly bound by technical definitions of Bank Holding Company Act).

80. See Douglas, *State Banking Regulation and Deregulation — Geography*, reprinted in

pete with these "nonbank" competitors because it will provide multibank holding companies with a more efficient operating structure.⁸¹

2. Banking-Related Subsidiaries

Another loophole in the Bank Holding Company Act allows commercial banks to establish affiliate banks which can engage in activities closely related to commercial banking.⁸² Since these affiliates are not within the BHCA definition of a commercial bank, they too are exempted from the Douglas Amendment's interstate banking prohibition.⁸³ Therefore, a multibank holding company may establish such affiliates and open offices of the affiliates in other states, thereby effectively providing a number of financial services on an interstate basis.⁸⁴

3. Loan Production Offices

Loan production offices typify a common form of a bank affiliate performing an activity closely related to banking, particularly, originating loans.⁸⁵ Foreign banks and multibank holding companies utilize loan production of-

STATE BANKING REGULATION AND DEREGULATION 329 (P. Wallison ed. 1985) (nonbank financial institutions suffer severe economic handicap).

81. See Interview with Robert E. Orr, Executive Vice-President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987) (stating that Texas commercial banks need to lower operating costs to be competitive with other financial service industries); see also Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, col. 4 (branch banking provides greater customer convenience because services more accessible).

82. See 12 U.S.C. § 1843(c)(8) (1982) (Board of Governors approval still required before engaging in exempted nonbank activity); see also 4 F. SOLOMON, W. SCHLICHTING, T. RICE, & J. COOPER, BANKING LAW § 88.03, at 88-15 (Board of Governors may declare certain nonbank activities as being so closely related to banking, or to managing or controlling banks, as to be properly incident thereto).

83. See Douglas, *State Banking Regulation and Deregulation — Geography*, reprinted in STATE BANKING REGULATION AND DEREGULATION 317 (P. Wallison ed. 1985) (section 4(c)8 subsidiary activities allowed to be conducted on interstate basis without regard to Douglas Amendment); see also Comment, *Northeast Bancorp, Inc. v. Board of Governors: Green Light for Regional Interstate Banking*, 35 AM. U.L. REV. 387, 397 (1986) (bank holding company affiliates' interstate acquisitions not limited by Douglas Amendment).

84. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 15 (Jan. 30, 1986) (most section 4(c)8 subsidiaries offer consumer-finance services). See generally 4 F. SOLOMON, W. SCHLICHTING, T. RICE & J. COOPER, BANKING LAW § 88.03[2], at 88-20, 88-37 (listing activities approved as closely related to banking). The companies operating most of the affiliates are also the companies in the best position to provide full banking services on a multi-state scale. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 15-16 (Jan. 30, 1986) (as of January 30, 1986, two hundred and eighty-nine 4(c)8 subsidiaries were located in Texas).

85. See 12 C.F.R. § 7.7380 (1984) (loan production office originates loans, however, such office does not authorize final loan approval); see also Note, *Interstate Branch Banking: That*

fices to generate loan business in other states, including Texas.⁸⁶

4. Electronic Funds Transfer Systems

Recently, technological innovations such as electronic funds transfer systems (EFTs) have provided a more cost efficient means of commercial bank expansion.⁸⁷ However, since federal case law has determined that EFTs are branches, to comply with state banking laws, states must either relax their branching restrictions or inhibit the expansion of these systems.⁸⁸ Texans amended the constitutional branch banking prohibition by voting to allow commercial banks to operate detached automated teller facilities.⁸⁹ Because of these recent technological innovations, the geographical restrictions on the availability of financial services have been relaxed.⁹⁰

Someday is Today, 21 WASHBURN L.J. 266, 267 (1982) (loan production office more traditional form of bank expansion).

86. See Note, *Branch Banking and the Loan Production Office*, 18 WASHBURN L.J. 46, 46 (1978) (national banks free to establish loan production offices outside state of charter); see also HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 16 (Jan. 30, 1986) (as of 1982, Texas ranked third, behind California and Illinois, in number of loan production offices).

87. See Note, *Interstate Branch Banking: That Someday is Today*, 21 WASHBURN L.J. 266, 267 n.6 (1982) (physical branch buildings expensive means to attract business, but electronic funds transfer systems provide less costly means) (citing *Federal Branching Policy: Hearings Before Subcomm. on Financial Institutions of Senate Comm. on Banking, Housing, and Urban Affairs*, 94 Cong., 2d Sess. 127 (1976) (statement of Ray Livasy, President, Illinois Bankers Association)); see also Comment, *Customer-Bank Communication Terminals Under the McFadden Act*, 47 U. COLO. L. REV. 765, 767 (1976) (customer-bank communication terminals popular because conveniently located and operate twenty-four hours a day). Types of electronic funds transfer systems include automated teller machines (ATMs), customer-bank communication terminals (CBCTs), point of sale terminals (POS), telephone payments, wire transfers, preauthorized payments and deposits, and check guarantees. See generally 1 W. SCHLICHTING, T. RICE & J. COOPER, BANKING LAW §§ 8.01-8.04, at 8-1, -14 (1986) (discussing legal implications of EFTs).

88. See, e.g., *Missouri ex rel. Kostman v. First Nat'l Bank*, 538 F.2d 219, 220 (8th Cir.) (off-premises customer-bank communication terminal that receives deposits constitutes branch bank), *cert. denied*, 428 U.S. 941 (1976); *Colorado ex rel. State Banking Bd. v. First Nat'l Bank*, 540 F.2d 497, 499 (10th Cir. 1976) (receiving deposits, paying checks, or lending money at location separate from main bank location is basis for concluding that separate location constitutes "branch"), *cert. denied*, 429 U.S. 1091 (1977).

89. See TEX. CONST. art. XVI, § 16 (amended 1980); see also Op. Tex. Att'y Gen. No. JM-498, at 2284 (1986) (constitutional amendment necessary because operation of detached automated teller facility would have violated constitutional proscription against banks "engag[ing] in business at more than one place").

90. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 17 (Jan. 30, 1986) (technological advances make it as convenient for consumers to obtain banking services from out-of-state financial institutions as from local financial institutions).

E. *Branch and Interstate Banking in Other States*

1. Branch Banking

Branch banking is defined as a multiple office banking structure in which a bank, as a single legal entity, operates separate and distinct business entities, which are subject to the supervision of the parent bank.⁹¹ State branch banking statutes can generally be placed in three categories: (1) branch banking prohibited, (2) limited branch banking, and (3) statewide branch banking.⁹² Since 1980, four states have removed many previous prohibitions on branch banking so as to allow limited branch banking.⁹³ Three states have removed all prohibitions so as to allow statewide branch banking.⁹⁴ Since Texas has removed its constitutional prohibition on branch banking, limited branch banking is now permitted.⁹⁵

2. Interstate Banking

Interstate banking is defined as a single organization, or group of affiliated organizations, which operates full-service commercial banking facilities through branches or subsidiary banking facilities on a multi-state level.⁹⁶

91. See 12 U.S.C. § 36(f) (1982) ("branch" includes: branch bank, branch office, branch agency, additional office, or branch place of business where deposits received, checks paid, money loaned); see also *Grandview Bank & Trust Co. v. Board of Governors of Fed. Reserve Sys.*, 550 F.2d 415, 419 (8th Cir.) (branch relationship found if unitary operation intended), *cert. denied*, 434 U.S. 821 (1977). Unlike the subsidiary of a multibank holding company, a branch bank is not treated as a separate corporation with a separate board of directors and a separate capital structure. See 1 W. SCHLICHTING, T. RICE & J. COOPER, *BANKING LAW* § 5.02, at 5-3 (1986).

92. See 1 W. SCHLICHTING, T. RICE & J. COOPER, *BANKING LAW* 5.05, at 5-11 (1986) (branch banking statute categories somewhat arbitrary, since exceptions apply in most cases); see also HOUSE STUDY GROUP, *SPECIAL LEGISLATIVE REPORT NO. 123*, at 18 (Jan. 30, 1986) (as of January 30, 1986, ten states, excluding Texas, prohibit branch banking; sixteen states permit limited branch banking; twenty-four states permit statewide branch banking). Even in states which still prohibit banks from operating branch facilities, provisions are usually made for some type of walk-up facility. In those states permitting limited branch banking, banks are usually allowed to operate branch facilities within a certain geographic area. In those states with statewide branch banking, a central bank may operate a branch facility anywhere in the state. See 1 W. SCHLICHTING, T. RICE & J. COOPER, *BANKING LAW* § 5.05, at 5-10 (1986).

93. See J. Hazleton, *Interstate Banking Implications for Texas 1* (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (noting trend towards branch banking and arguing for change in Texas branch banking law).

94. See *id.*

95. See TEX. CONST. art. XVI, § 16(e).

96. See Comment, *Northeast Bancorp., Inc. v. Board of Governors: Green Light for Regional Interstate Banking*, 35 AM. U.L. REV. 387, 396 n.68 (1986) (Connecticut Banking Commission defining interstate banking) (citing REPORT TO THE GENERAL ASSEMBLY OF THE STATE OF CONNECTICUT OF THE FINDINGS AND RECOMMENDATIONS OF THE COMMISSION TO STUDY LEGISLATION TO LIMIT THE CONDUCT OF BUSINESS IN CONNECTICUT BY SUBSID-

There are three generally recognized classifications of interstate banking statutes. These classifications are: (1) nationwide entry, (2) regional entry, and (3) regional entry with a trigger.⁹⁷ Nationwide (or full) entry statutes allow acquisitions and mergers between multibank holding companies located anywhere in the nation.⁹⁸ Regional statutes provide for interstate acquisitions and mergers within a limited geographic region.⁹⁹ Regional entry with a trigger allows limited interstate expansion, with a provision for nationwide expansion at a later date.¹⁰⁰ Variations of each of these forms include requirements of reciprocity or nonreciprocity.¹⁰¹ Other forms of interstate banking statutes include grandfather provisions¹⁰² and failed or failing bank provisions.¹⁰³

IARIES OF BANK HOLDING COMPANIES AND THE IMPACT OF NON-DEPOSITORY INSTITUTIONS ON TRADITIONAL BANKING ACTIVITIES, at 5 (1983)); *see also* HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 22 (Jan. 30, 1986) (interstate banking statutes authorize acquisition of state banks by out-of-state bank holding companies).

97. *See* J. Hazleton, Interstate Banking Implications for Texas 5 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (each of three approaches to interstate banking can be written with or without reciprocity requirement).

98. *See* HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 23 (Jan. 30, 1986) (full interstate banking statutes allow any foreign multibank holding company to acquire domestic institutions).

99. *See id.* at 21 (selective authorization of interstate expansion controversial); *see also* Hoffman & Edge, *State Regulation of Bank Holding Companies and the Future of Interstate Banking: A Tennessee Perspective*, 51 TENN. L. REV. 383, 392 (1984) (regional interstate banking statutes prevent larger financial institutions from acquiring a state's banking concerns, without benefiting the state).

100. *See* J. Hazleton, Interstate Banking Implications for Texas 6 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (regional entry with trigger provides for later transition to nationwide interstate banking).

101. *See id.* (reciprocal means bank from state B may enter state A only if state A's banks may enter state B).

102. *See* Hoffman & Edge, *State Regulation of Bank Holding Companies and the Future of Interstate Banking: A Tennessee Perspective*, 51 TENN. L. REV. 383, 389 (1984) (out-of-state bank holding company's in-state operations may be allowed under state and/or federal grandfather clause provisions). The grandfather provisions relating to the Douglas Amendment have had little impact, since they affect only five bank holding companies, one each in Iowa and Illinois, and three in Florida. *See* Comment, *Northeast Bancorp, Inc. v. Board of Governors: Green Light for Regional Interstate Banking*, 35 AM. U.L. REV. 387, 400 n.95 (1986).

103. *See* Comment, *Northeast Bancorp, Inc. v. Board of Governors: Green Light for Regional Interstate Banking*, 35 AM. U.L. REV. 387, 400-01 (1986) (failed or failing bank provision allows state's banking superintendent to permit foreign multibank holding companies to acquire troubled banks within state); *see also* HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 21 (Jan. 30, 1986) (failed or failing bank provisions enacted in response to increased bank failures). Texas Banking Commissioner Sexton advised against adopting a *failing* bank provision for Texas. Commissioner Sexton argued that factors used to determine if a bank is failing, such as the public's attitude, projected losses, and Federal Deposit Insurance Corporation assistance are too unmanageable. *See* J. Sexton, Presentation of

Since banking institutions view interstate banking as a means to compete more effectively with other sectors of the financial industry, increased lobbying efforts have been undertaken and have resulted in several states passing some form of legislation to allow interstate banking.¹⁰⁴ Recently, much interstate banking legislation at the state level has taken the form of "nationwide nonreciprocal" or "regional entry with a trigger".¹⁰⁵ For example, Arizona's interstate banking law, like Texas' law, permits full interstate banking.¹⁰⁶ Since Arizona's law became effective on October 1, 1986, many of the state's largest multibank holding companies have agreed to be acquired by foreign multibank holding companies.¹⁰⁷ Maine, which also permits full interstate banking, requires the foreign multibank holding company applicant to explain in detail how it will bring new capital to Maine.¹⁰⁸ This requirement is to ensure that Maine will benefit from its expansive, interstate

Paper Concerning Both Interstate Banking and Branch Banking 7-8 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee).

104. See e.g., HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 1 (Jan. 30, 1986) (bankers contend that recent changes in banking industry render ban on interstate banking anachronistic); Comment, *Northeast Bancorp, Inc. v. Board of Governors: Green Light for Regional Interstate Banking*, 35 AM. U.L. REV. 387, 399 (1986) (state and local commercial banks attempting to increase ability to compete by lobbying for interstate banking laws); J. Hazleton, *Interstate Banking Implications for Texas 2* (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (interstate banking laws enacted in response to deregulation and new technology).

105. See J. Hazleton, *Interstate Banking Implications for Texas 4* (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (initial approach to interstate banking legislation was regional in scope); see also J. Sexton, *Presentation of Paper Concerning Both Interstate Banking and Branch Banking 9* (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (nationwide nonreciprocal interstate banking is optimal problem-solver). Full interstate banking is more advantageous to those states attempting to use interstate banking as a means for improving the capital structure of their banks. A less-restrictive interstate banking law has more impact on capital formation because more foreign multibank holding companies are allowed access to the state's financial markets. See J. Hazleton, *Interstate Banking Implications for Texas 6* (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee).

106. Compare ARIZ. REV. STAT. ANN. §§ 6-321 to 6-327 (West Supp. 1986) with TEX. REV. CIV. STAT. arts. 342-102, 342-404, 342-912, 342-914, 342-916 (Vernon Supp. 1986).

107. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 54 (Jan. 30, 1986) (even prior to Arizona's new interstate banking law becoming effective, its third, fourth, and fifth largest commercial banks had agreed to be acquired by foreign banks); see also Wall St. J., Jan. 9, 1987, at 24, col. 3 (Union Bancorp of Los Angeles completed its acquisition of United Bancorp of Arizona for \$335 million; Union Bancorp has \$9.5 billion in assets, United Bancorp has \$2.5 billion in assets).

108. See ME. REV. STAT. ANN. tit. 9-B, § 1013(4) (West Supp. 1986) (among other factors, application for acquisition of Maine bank by foreign financial institution must include list of consumer and business services to be offered).

banking policy.¹⁰⁹

While Arizona and Texas are both fast-growing states with attractive banking markets,¹¹⁰ Texas' recent oil-related economic problems have diminished the attractiveness of Texas commercial banks.¹¹¹ Texas' neighboring states are likewise experiencing general transition in their economies and, more specifically, in their banking laws.¹¹² As a result, Oklahoma and Louisiana recently passed interstate banking bills allowing Texas banking institutions to merge with or acquire banks in their respective states.¹¹³ States in the southeastern United States may open their financial markets to include Texas multibank holding companies. However, this region presently prohibits Texas banking institutions from merging with, or acquiring banks in, its states.¹¹⁴ Texas multibank holding companies, aided by the new constitu-

109. See Hoffman & Edge, *State Regulation of Bank Holding Companies and the Future of Interstate Banking: A Tennessee Perspective*, 51 TENN. L. REV. 383, 390-91 (1984) (Maine provision ensures that Maine consumers will benefit from interstate bank expansion).

110. See, e.g., HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 54 (Jan. 30, 1986) (based on Arizona's experience, some analysts predict Texas to become dominated by foreign multibank holding companies); Wall St. J., Sept. 1, 1986, at 42, col. 2 (noting that nation's largest bank holding companies planning to move into Arizona); American Banker, Sept. 26, 1986, at 39, col. 4 (despite its economic problems, Texas remains one of nation's fastest growing states).

111. To date, the only interstate banking activity in Texas has been the announcement of the merger between Chemical Bank New York Corporation and Texas Commerce Bancshares. This merger is expected to be completed during the second quarter of 1987. See Shearson Lehman Bros., News Release (Dec. 15, 1986); see also American Banker, Sept. 16, 1986, at 6, col. 2 (Judah S. Kraushaar, bank analyst with Merrill Lynch, not expecting many interstate acquisitions of Texas banks in near future).

112. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 49 (Jan. 30, 1986) (some of Texas' bordering states only recently have allowed multibank holding companies).

113. See LA. REV. STAT. ANN. § 6:533 (West Supp. 1987) ("regional with a trigger"); N.M. STAT. ANN. § 58-5-11 (1986) (failed bank provision only); OKLA. STAT. ANN. tit. 6, § 505C (West Supp. 1987) (failed or failing bank provision only); see also HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 49-50 (Jan. 30, 1986). Arkansas authorized multibank holding companies only four years ago and is still distrustful of Texas banks. See *id.* at 50. Likewise, Oklahoma authorized multibank holding companies four years ago and is also suffering from depressed energy and agricultural industries. See *id.* at 49. Louisiana banks are also suffering from nonperforming energy and agriculture loans. Independent bankers in New Mexico are strongly opposed to more stringent interstate banking laws. See *id.* at 50.

114. See American Banker, Sept. 26, 1986, at 1, col. 4 (large southeastern multibank holding companies may lobby their legislatures this year to make it easier for them to acquire Texas banks); see also *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 1, at 9 (Aug. 15, 1986) (testimony of R. Bruce LaBoon, Vice Chairman of General Counsel, Texas Commerce Bancshares, before Texas Senate Economic Development Committee) (since Texas has adopted nonreciprocal nationwide interstate banking law, Texas could be included within the southeast region, if such region decided to open to Texas bank holding companies). The following states are included within the south-

tional amendment permitting limited branch banking and the new legislation allowing full interstate banking, are well-equipped to compete with foreign bank holding companies and to establish themselves as a stronger force in the national banking industry.¹¹⁵

III. THE FUTURE OF MULTIBANK HOLDING COMPANIES IN TEXAS

A. *Formation and Regulation of Multibank Holding Companies in Texas*

1. The Bank Holding Company Act of 1956

In the Bank Holding Company Act of 1956 (BHCA), Congress defined a bank holding company as a corporation, partnership, business trust, or association that controls a bank.¹¹⁶ The Act was passed in order to provide a measure of state control over the intra- and interstate expansion of bank holding companies through banking institutions.¹¹⁷ Therefore, the Act does not govern expansion by other means, such as nonbank financial institutions.¹¹⁸ The Act's purpose is threefold: (1) to restrict a bank holding company's activities only to those of a financial nature, (2) to prevent undue concentration of banking control by a few companies, and (3) to prevent unsafe and unsound banking practices.¹¹⁹ According to the Act's regulatory

east region: Alabama, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, South Carolina, Tennessee, Virginia, West Virginia, District of Columbia. *See* LA. REV. STAT. ANN. § 6:532(17) (West Supp. 1987).

115. *See* American Banker, Aug. 7, 1986, at 3, col. 2 (Texas now has some of most progressive banking laws in country). *See generally* J. Hazleton, Interstate Banking Implications for Texas 9-10 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (discussing possible impact of interstate and branch banking on Texas' economic development).

116. *See* 12 U.S.C. § 1841(a)(1) (1982) (defining bank holding company); *see also* 4 F. SOLOMON, W. SCHLICHTING, T. RICE & J. COOPER, BANKING LAW § 86.01, at 86-2 (1986) (defining bank holding company and noting that "bank" is institution that both accepts demand deposits and makes commercial loans).

117. *See* 4 F. SOLOMON, W. SCHLICHTING, T. RICE & J. COOPER, BANKING LAW § 86.03, at 86-11, -12 (1986) (fundamental purpose of BHCA to prohibit interstate expansion of bank holding companies by creation of banking institutions without specific state authorization).

118. *See* Board of Governors of Federal Reserve Sys. v. Dimension Fin. Corp., ___ U.S. ___, 106 S. Ct. 681, 688, 88 L. Ed. 2d 691, 702 (1986) (nonbanks not functionally equivalent to commercial banks, therefore, not subject to regulation by Federal Reserve Board); *see also* 4 F. SOLOMON, W. SCHLICHTING, T. RICE, & J. COOPER, BANKING LAW § 86.03, at 86-11, -12 (1986) (noting that Supreme Court held that Federal Reserve Board must look beyond literal language of BHCA to congressional intent).

119. *See* Nealley v. Brown, 284 A.2d 480, 487 (Me. 1971) (bank holding company regulations solely matter of federal law); *see also* 4 F. SOLOMON, W. SCHLICHTING, T. RICE & J. COOPER, BANKING LAW § 86.02, at 86-3 (1986) (noting three purposes of Bank Holding Company Act). The Bank Holding Company Act provides that the Board of Governors shall not approve any acquisition which will result in monopolization of any part of the banking busi-

framework, the Board of Governors of the Federal Reserve System must approve formations of *all* bank holding companies,¹²⁰ all acquisitions by bank holding companies of banks involving over five percent of the target bank's voting stock,¹²¹ and all mergers between bank holding companies.¹²² Additionally, the Act provides the Board of Governors with specific guidelines for determining whether to approve such formations, acquisitions, or mergers.¹²³

Congress, however, did not intend for the Bank Holding Company Act to grant the Federal Reserve's Board of Governors complete regulatory power over bank holding companies.¹²⁴ Rather, the Act allows a state to impose more stringent regulations on bank holding companies, as long as such state action does not contravene the federal law.¹²⁵ The Douglas Amendment to the BHCA prohibits the Board of Governors from approving a bank holding company's acquisition of a commercial bank or a bank holding company in another state, unless the acquisition is expressly authorized by the state where the target commercial bank or bank holding company is located.¹²⁶

ness, unless such effect is clearly outweighed by the needs and convenience of the community. See 12 U.S.C. § 1842(c) (1982).

120. See 12 U.S.C. § 1842(a)(1) (1982). Once the Board of Governors approves the formation of a bank holding company, the bank holding company files a registration statement with its Federal Reserve bank explaining the relationship between the holding company and its subsidiaries. Each year it is required to file an annual report of its operations with the Board of Governors. In addition, the Board of Governors is authorized to examine the holding company and any of its subsidiaries. See 12 U.S.C. §§ 1844(a), 1844(c) (1982); see also 4 F. SOLOMON, W. SCHLICHTING, T. RICE & J. COOPER, *BANKING LAW* § 86.02[2], at 86-5, -9 (1986).

121. See 12 U.S.C. § 1842(a)(3) (1982); see also 4 F. SOLOMON, W. SCHLICHTING, T. RICE, & J. COOPER, *BANKING LAW* § 87.02[8], at 87-7, -8 (1986) (acquisition of less than five percent of bank's voting stock does not require prior approval of Board of Governors).

122. See 12 U.S.C. § 1842(a)(5) (1982); see also 4 F. SOLOMON, W. SCHLICHTING, T. RICE & J. COOPER, *BANKING LAW* § 87.03[1], at 87-11 (1986) (prior Board of Governors approval required before two or more bank holding companies may merge or consolidate).

123. See 12 U.S.C. § 1842(c)(1) & (2) (1982) (anticompetitive effects must be clearly outweighed in public interest by probable effect on convenience and needs of community served). See generally 4 F. SOLOMON, W. SCHLICHTING, T. RICE J. COOPER, *BANKING LAW* § 87.03[3], at 87-15, -25 (1986) (economic factors such as anticompetitiveness, financial unsoundness, and managerial resources are grounds for denying applications for formation and expansion of bank holding companies).

124. See 12 U.S.C. § 1846 (1982); see also Note, *Jurisdiction Over State Banks: Does the Bank Holding Company Act Preempt State Regulation?*, 36 OHIO ST. L.J. 114, 127 (1975) (Congress did not intend to preempt state authority regarding regulation of bank holding companies).

125. See 12 U.S.C. § 1846 (1982); see also *Northeast Bancorp, Inc. v. Board of Governors of Fed. Reserve Sys.*, — U.S. —, —, 105 S. Ct. 2545, 2553, 86 L. Ed. 2d 112, 124 (1985) (underlying purpose of Douglas Amendment to Bank Holding Company Act was to retain community-based, local control over banking).

126. See 12 U.S.C. § 1842(d) (1982) (prohibiting Federal Reserve Board from approving application permitting bank holding company or its subsidiary from directly or indirectly ac-

The new Texas interstate banking law expressly authorizes such acquisitions.¹²⁷

2. The New Texas Legislation—Its Effect on Formation, Management, and Supervision of Multibank Holding Companies

Sections (e) and (f) of the amendment to the Texas Constitution, permitting limited branch banking in Texas, will significantly affect domestic multibank holding companies' choices regarding the desirability of maintaining their existing operational structures.¹²⁸ Section (e) allows the legislature to permit limited branch banking within the same county or city.¹²⁹ Section (f) protects existing multibank holding company operational structures insofar as a subsidiary bank need not be considered a "branch" of a parent bank even though it shares common ownership, accounting, administrative systems, or shares a similar name.¹³⁰ Section 1(b)(2) of the enabling legislation to the constitutional amendment allows a bank to conduct business from one primary facility and from up to three branch office facilities.¹³¹ Section 1(b)(4) recognizes the legitimacy of the controversial detached facilities and does not include them in the permitted number of branches.¹³² Section 1(c)

quiring interest in bank outside holding company's home state); *see also* 4 F. SOLOMON, W. SCHLICHTING, T. RICE & J. COOPER, *BANKING LAW* § 87.03[2], at 87-12 (1986) (authorizing language of state statute must be express, not implied). The Douglas Amendment was enacted because Congress and the banking industry originally believed interstate banking would be unresponsive to the American public's needs; however, the amendment reserved to the individual states the right to authorize interstate banking. *See* 102 CONG. REC. 6750 (1956).

127. *See* TEX. REV. CIV. STAT. ANN. art. 342-914 (Vernon Supp. 1987); *id.* art. 342-916; *see also* Harris & Glasgow, *Bill Analysis—S.B. 11*, 24 T.B.A. SEC. CORP., BANK & BUS. LAW 9 (1986) (section 4 gives Texas Banking Commissioner jurisdiction over foreign multibank holding companies and section 5 expressly authorizes foreign multibank holding companies to acquire Texas commercial banks or multibank holding companies).

128. *See* J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 13 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (branch banking system less costly); *see also* Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987) (multibank holding companies might maintain subsidiary banks in one market area and convert certain subsidiary banks into branches in other market areas).

129. *See* TEX. CONST. art. XVI, § 16(e); *see also* Harris & Glasgow, *Bill Analysis—S.J.R. 4*, 24 T.B.A. SEC. CORP., BANK & BUS. LAW 16 (1986) (allowing limited branch banking within same county or city, subject to statutory limitations).

130. *See* TEX. CONST. art. XVI, § 16(f); *see also* Harris & Glasgow, *Bill Analysis—S.J.R. 4*, 24 T.B.A. SEC. CORP., BANK & BUS. LAW 1, 16 (1986) (even combination of listed factors not enough to consider bank to be branch).

131. *See* TEX. REV. CIV. STAT. ANN. art. 342-903, § 1(b)(2) (Vernon Supp. 1987) (three branch office facilities must be 5,000 feet from principal bank building).

132. *See* TEX. REV. CIV. STAT. ANN. art. 342-903, § 1(b)(4) (Vernon Supp. 1987) (grandfathers all existing remote facilities). These existing facilities will not be considered in

allows multibank holding companies to convert commercial banks within the same county or city into branches of another commercial bank within the same county or city.¹³³

Statutory recognition of the detached facility is the most immediate benefit for multibank holding companies because these facilities are now legitimate branches and will not have to be dismantled.¹³⁴ Inasmuch as a branch banking system eliminates layers of management, these new developments offer multibank holding companies greater flexibility in terms of operational structure and, accordingly, will increase internal efficiency.¹³⁵ For example, a multibank holding company system works best when all geographic and economic markets are performing well.¹³⁶ However, in times of economic hardship, a branch banking system allows the parent organization to use its aggregate profits where they are most needed in order to relieve local economic pressures.¹³⁷ On the other hand, since certain market areas are less

calculating the permitted number of branches. See TEX. REV. CIV. STAT. ANN. art. 342-903, § 1(c); see also Bulletin of Texas Bankers Association No. 86-4 (Aug. 28, 1986).

133. See TEX. REV. CIV. STAT. ANN. art. 342-903, § 1(c) (Vernon Supp. 1987); see also Bulletin of Texas Bankers Association No. 86-4 (Aug. 28, 1986) (any branch of converted bank created after July 15, 1986, will count toward number of permitted branches).

134. See J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 12-13 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (noting Attorney General opinion recalled relevant language of Texas Constitution prohibiting branch banking); see also Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, col. 2 (primary benefit of constitutional amendment — ratification of existing detached facilities).

135. See *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 1, at 4 (Aug. 13, 1986) (testimony of R. Bruce LaBoon, Vice Chairman of General Counsel, Texas Commerce Bancshares, before Texas Senate Economic Development Committee) (branch banking provides greater consumer convenience); see also *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 2, at 32 (Aug. 13, 1986) (testimony of James Cochran, Chief Economist to the Senior Vice-President of Texas Commerce Bancshares, before Texas Senate Economic Development Committee) (financial institutions must become more complicated and sophisticated because Texas becoming more economically diversified). In a branch banking system, the branch managers of each branch bank report to managers at the central bank, and the entire operation is directly controlled by the central bank's board of directors. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 18 (Jan. 30, 1986).

136. See J. Sexton, Interstate Banking and Branch Banking 13 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (need for diversification strong argument for branch banking). Texas Banking Commissioner Sexton argued:

The need for diversification also presents a strong argument for branching. Unit banking works best when all economic cylinders are firing and all geographic areas are doing accordingly well. In a state with widespread branching, local problems are simply swallowed by the parent organization, using profits made elsewhere.

Id.

137. See *id.*

conducive to branch banking, the multibank holding company may elect to retain some of its subsidiaries as unit banks,¹³⁸ rather than convert them into branches.¹³⁹

The newly-enacted legislation, which permits ownership of Texas banks or bank holding companies by foreign bank holding companies, authorizes nationwide interstate banking without reciprocity.¹⁴⁰ Article 342-102 was amended to define "Texas bank holding company,"¹⁴¹ "out-of-state bank holding company,"¹⁴² "control,"¹⁴³ and "capital adequacy guidelines."¹⁴⁴ Article 342-404 requires that a majority of the board of directors of a Texas commercial bank be Texas residents.¹⁴⁵ The amendment to article 342-404 additionally requires that if the bank is owned by a foreign multibank holding company, none of the Texas residents on the board of directors, nor their spouses, who are employees or officers of the bank, its affiliates, or the foreign multibank holding company, may be considered Texas resident directors.¹⁴⁶ These new statutory requirements insure that only multibank holding companies may acquire control of, or merge with, a Texas commercial bank or multibank holding company.¹⁴⁷ Furthermore, these requirements insure that a foreign multibank holding company may not control twenty-five percent or more of the total banking deposits in Texas.¹⁴⁸ Finally, these requirements suggest that certain capital adequacy guidelines be followed.¹⁴⁹ By requiring that the majority of the board of directors of any

138. See Note, *Interstate Branch Banking: That Someday is Today*, 21 WASHBURN L.J. 266, 268 n.14 (1982) (unit bank is single commercial bank that operates out of only one office).

139. National Bancshares Corporation of Texas owns subsidiary banks located in five different geographic market areas. However, each area will be treated differently, according to its size, the number of NBC subsidiaries located there, and the economic climate. See Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987).

140. See TEX. REV. CIV. STAT. ANN. arts. 342-102, 342-404, 342-912, 342-914, 342-916 (Vernon Supp. 1987).

141. See *id.* art. 342-102 (must have principal executive office in Texas).

142. See *id.* (any bank holding company not Texas bank holding company).

143. See *id.* (ability to directly or indirectly vote at least twenty-five percent of any class of voting stock or ability to control election of majority of board of directors).

144. See *id.* (guidelines relating to capitalization requirements of acquired institution).

145. See *id.* art. 342-404, § 1 ("[a] State bank shall have not less than five (5) nor more than twenty-five (25) directors, the majority of whom shall be residents of the State of Texas").

146. See *id.* § 2; see also *id.* art. 342-912, § 4(3)(A) (same restriction applies to national banks in Texas owned by foreign bank holding company). "If the bank is owned or controlled, directly or indirectly, by a foreign bank holding company, directors who are employees or officers or spouses of employees or officers of the bank or foreign bank holding company, or an affiliate of the bank or foreign bank holding company shall not be counted as residents of the State of Texas for the purpose of Section 1 of this article." *Id.* 342-404, § 2.

147. See Bulletin of Texas Bankers Association No. 86-4 (Aug. 28, 1986).

148. See *id.*

149. See Bulletin of Texas Bankers Association No. 86-4 (Aug. 28, 1986); see also TEX.

Texas bank be Texas residents, this new legislation seeks to insure that Texas, not other states, will benefit most from allowing interstate bank expansion.¹⁵⁰

B. *Acquisitions by Multibank Holding Companies*

1. The New Texas Legislation—Its Effect on Acquisitions by Texas Multibank Holding Companies

Section (d) of the constitutional amendment permits *statewide* branch banking if a state or national bank in Texas acquires a failed state or national bank in Texas.¹⁵¹ Section 2(a) of the enabling legislation allows the failed bank to be considered a branch of the acquiring bank, even though it is located in a different county.¹⁵² However, the “branch” may only be operated in the existing facilities previously owned by the failed bank.¹⁵³ In order to protect the failed bank’s creditors and depositors, the acquisition must be deemed necessary by the Texas Banking Commissioner, and the terms of the acquisition must be acceptable to any federal agencies, such as the Federal Deposit Insurance Corporation (FDIC) involved.¹⁵⁴ The failed bank provision was included in the legislation primarily for practical reasons because a record number of Texas bank failures necessitated an alternative to federal regulatory intervention.¹⁵⁵

REV. CIV. STAT. ANN. art. 342-912, § 6 (Vernon Supp. 1987). The Texas Banking Commissioner is encouraged to give priority to certain factors when reviewing a bank’s compliance with the Community Reinvestment Act of 1977. *See id.* art. 342-912, § 6.

150. *See* J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 11 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (requiring that majority of board of directors of Texas bank be Texas residents relieves anxiety over possibility of deposit outflow to other financial markets); *see also* *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 2, at 42 (Aug. 13, 1986) (testimony of Carol Barger, Director of Southwest Office of Consumers Union, before Texas Senate Economic Development Committee) (provision that majority of board of directors of Texas bank be Texas residents included to assure that board will do what is best for Texas economy when making investment decisions).

151. *See* TEX. CONST. art. XVI, § 16(d).

152. *See* TEX. REV. CIV. STAT. ANN. art. 342-903, § 2(a) (Vernon Supp. 1987).

153. *See id.* § 2(b).

154. *See id.* § 2(a)(1)-(3). The Texas Banking Commissioner must determine that, “(1) the bank proposed to be acquired is a failed bank; (2) the acquisition is necessary to protect the financial interests of the acquired bank’s depositors and creditors; and (3) the terms of the acquisition are acceptable to each federal agency having jurisdiction over the transaction.” *Id.*

155. *See* Wall St. J., Jan. 9, 1987, at 4, col. 2 (twenty-six Texas banks failed in 1986, highest number in any state); *see also* J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 3 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (Texas economy not strong enough to support sterile financial institutions).

While economic theory tells us that unsuccessful businesses must be allowed to fail in

The interstate banking law provides the Texas Banking Commissioner with greater police powers over *entrusted* acquisitions.¹⁵⁶ Foreign and domestic multibank holding companies seeking to acquire direct or indirect control of a commercial bank or another multibank holding company in Texas must submit to the Texas Banking Commissioner a copy of their application to the Board of Governors of the Federal Reserve System.¹⁵⁷ A Texas state bank seeking to acquire another Texas state bank, including a Texas state bank controlled by either a foreign or domestic multibank holding company, must submit an acquisition application to the Texas Banking Commissioner.¹⁵⁸ Likewise, a Texas national bank seeking to acquire another Texas national bank, including a Texas national bank controlled by a multibank holding company, must also submit an acquisition application to the Texas Banking Commissioner who, in turn, must advise the Board of Governors regarding any views or recommendations the Commissioner may have concerning the application.¹⁵⁹ Additionally, in determining whether a commercial bank has complied with the provisions of the Community Reinvestment Act,¹⁶⁰ the Texas Banking Commissioner is encouraged to give priority to such factors as extension of credit to low-income housing projects, investments in general residential mortgage loans or small business and farm loans, investments in government projects, and availability of banking serv-

order for the market to work, that does not mean that the state should be indifferent to the consequences of such failures. Administration of a failed bank's assets by the FDIC will not encourage economic development in Texas. The FDIC is a loan collector and not a loan maker. Therefore, any encouragement that the state can provide for the acquisition of troubled or failing banks by other banks or other financial institutions would be a net benefit to economic recovery.

Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development, 69th Leg. tape 2, at 3 (Aug. 13, 1986) (testimony of Franklin Raines, General Partner of Lazard Freres, before the Texas Senate Economic Development Committee). Already, the failed bank provision is being utilized to enable failed banks to participate in Texas' economic recovery, as demonstrated by the following scenario: Three Texas banks were closed by the FDIC on January 29, 1987, and reopened as branches on the following day. Montgomery County Bank, The Woodlands, reopened as a branch of Texas Commerce Bank, Houston; two offices of Bear Creek National Bank reopened as branches of Jersey Village Bank, Houston; and LaPryor State Bank reopened as a branch of Zavala County Bank, Crystal City. *See Wall St. J.*, Jan. 30, 1987, at 12, cols. 3-6.

156. *See* TEX. REV. CIV. STAT. ANN. art. 342-912, §§ 1, 2, 3, 6 (Vernon Supp. 1987).

157. *See id.* § 1; *see also* 12 U.S.C. § 1842 (1982) (explaining that prior approval of Board of Governors necessary, noting procedures for approval, listing factors governing approval, asserting limitation on interstate expansion).

158. *See* TEX. REV. CIV. STAT. ANN. art. 342-912, § 2 (Vernon Supp. 1987); *see also* 12 U.S.C. § 1842(b) (1982) (detailing procedure upon receiving application for approval).

159. *See* TEX. REV. CIV. STAT. ANN. art. 342-912, § 3 (Vernon Supp. 1987) (Texas Banking Commissioner authorized to request hearing with Board of Governors to present evidence as to why application for acquisition of national bank should be denied).

160. 12 U.S.C. §§ 2902-05 (1982).

ices to all sectors of the community.¹⁶¹ These amendments to the Texas Banking Code were added as a further protective device to insure that a commercial bank will continue to serve its community after it is acquired by another commercial bank or multibank holding company, whether foreign or domestic.¹⁶²

2. The New Texas Legislation—Its Effect on Acquisitions by Foreign Multibank Holding Companies

The drafters of Texas' interstate banking legislation were primarily concerned with encouraging economic growth without risking the autonomy of Texas banking institutions.¹⁶³ A foreign multibank holding company seeking to acquire ownership of a commercial bank or multibank holding company in Texas must present additional information to the Texas Banking Commissioner.¹⁶⁴ In addition to an acquisition application, the foreign multibank holding company must present evidence of its authority under article 342-916 to attempt the acquisition.¹⁶⁵ The foreign multibank holding company must further demonstrate that after the acquisition, the holding company and the acquired domestic bank will meet the applicable capital

161. *See id.* § 6 (Texas Banking Commissioner is "encouraged," not required to give priority to factors listed).

162. *See* Community Reinvestment Act of 1977, 12 U.S.C. §§ 2902-05 (1982) (requires bank supervisory agencies to examine bank's record of meeting credit needs of customers and community); *see also* *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 1, at 3-4 (Aug. 13, 1986) (testimony of R. Bruce LaBoon, Vice Chairman of General Counsel, Texas Commerce Bancshares, before Texas Senate Economic Development Committee) (explaining purpose of Community Reinvestment Act of 1977).

163. *See* *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 2, at 2-3 (Aug. 13, 1986) (testimony of Franklin Raines, General Partner of Lazard Freres, before Texas Senate Economic Development Committee). Mr. Raines stated:

The legislation now before this committee provides a unique opportunity to fundamentally improve the near-term and long-term economic outlook for the state of Texas while preserving the local orientation that we have found so important in other places So I think it entirely appropriate that the Committee is considering ways to maintain a local orientation, requiring a separate Texas subsidiary, purchases of existing institutions rather than de novo charters, maintenance of certain local asset to local liability ratios for some period of time as well as requiring purchases of local and state government obligations and even requiring some commitment to economic and community development initiatives of importance to the state. All seem to me to improve the chances of maintaining the local orientedness [sic.] so important to the state.

Id.

164. *See* TEX. REV. CIV. STAT. ANN. art. 342-912, § 4 (Vernon Supp. 1987) (requiring application and filings by out-of-state bank holding company seeking acquisition).

165. *See id.* § 4.

adequacy guidelines.¹⁶⁶ In addition, the foreign multibank holding company must abide by the statutory "Texas resident director" requirement and by the statutory requirements that it not own or control any financial institutions in Texas not defined as a bank under the Bank Holding Company Act. Nor may the foreign multibank holding company own or control any institutions in Texas whose deposits are insured by the Federal Savings and Loan Insurance Corporation.¹⁶⁷ If the Texas Banking Commissioner determines that the application and evidence requirements have not been satisfied, he must accordingly advise the Board of Governors of the Federal Reserve System, present evidence before the Board and, if necessary, take appropriate action under the federal statutes.¹⁶⁸ As with Texas multibank holding companies, the Texas Banking Commissioner is encouraged to utilize the criteria listed in article 342-912, section (6), when reviewing the foreign multibank holding company's application.¹⁶⁹ In order to regulate the relationship between the Texas Banking Commissioner and the foreign multibank holding company, the Commissioner is given jurisdiction over the foreign multibank holding company, and the holding company may be held civilly liable to the State of Texas for any violations of article 342-912.¹⁷⁰

The crux of the Texas interstate banking legislation is embodied in article 342-916, which expressly authorizes foreign multibank holding companies to acquire a commercial bank or multibank holding company in Texas.¹⁷¹ However, the importance of the article lies in the limitations it imposes on interstate acquisitions.¹⁷² Prior to September 1, 2001, foreign multibank

166. *See id.* § 4(2).

167. *See id.* § 4(3)(A) & (B); *see also id.* § 4(4) (providing for any additional agreements commissioner may require).

168. *See id.* § 5 (application by foreign bank holding company will not be approved if not authorized under Article 16, cannot meet capital adequacy guidelines, or has not entered into agreements required under section 4).

169. *See id.* § 6.

170. *See id.* art. 342-914 (granting supervision over both Texas and foreign bank holding companies to Texas Banking Commissioner).

171. *See id.* art. 342-916, § 1.

172. *See, e.g.,* HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 35 (Jan. 30, 1986) (to reduce potential for concentration through interstate expansion, banks can be prohibited from obtaining more than certain percentage of banking assets in region); J. Hazleton, Interstate Banking Implications for Texas 6 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (noting that numerous provisions usually attached to interstate banking legislation); J. Sexton, Interstate Banking and Branch Banking 11 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (suggested list of possible conditions incorporated into Texas interstate banking law). "The interstate [banking] bill provides nationwide interstate banking without reciprocity. In doing so, however, the bill contains a number of limitations on the abilities of out-of-state [bank] holding companies to enter the Texas market and acquire or merge with Texas bank holding companies." *Hearings on Tex. S.B. 10 and S.B. 11 Before the*

holding companies may only acquire Texas commercial banks in existence as of July 15, 1986.¹⁷³ If a foreign multibank holding company controls a non-bank financial institution or savings and loan institution in Texas, it is prohibited from further acquiring any Texas bank within Texas.¹⁷⁴ Since the Texas Legislature has liberalized banking practices, Texas multibank holding companies should take advantage of the new opportunities for expansion and seek to help rejuvenate the slumping Texas economy.

IV. POSSIBLE EFFECTS OF BRANCH BANKING AND INTERSTATE BANKING ON TEXAS MULTIBANK HOLDING COMPANIES

A. Branch Banking

1. Advantages

Most Texas bankers endorsed the constitutional amendment to permit limited branch banking in Texas.¹⁷⁵ Branch banking's primary advantage is the greater convenience it offers to bank customers.¹⁷⁶ A branch banking system fosters competition by providing a more efficient operational structure through which financial institutions may offer their services.¹⁷⁷ The

Senate Comm. on Economic Development, 69th Leg. tape 1, at 4 (Aug. 13, 1986) (testimony of R. Bruce LaBoon, Vice Chairman of General Counsel, Texas Commerce Bancshares, before Texas Senate Economic Development Committee).

173. See TEX. REV. CIV. STAT. ANN. art. 342-916, § 2 (Vernon Supp. 1987).

174. See *id.* § 3; see also *id.* § 4 (foreign acquisition must not result in control of twenty-five percent or more of total banking deposits in Texas).

175. See Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, col. 6 (only opposition to constitutional amendment came from group of independent bankers in East Texas).

176. See *id.* at 1-K, col. 1 (noting branch banking offers increased customer convenience); see also J. Hazleton, *Interstate Banking Implications for Texas 10* (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (arguing that liberalization of branching restrictions would improve convenience); Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987) (stressing convenience of branch banking).

177. See, e.g., Note, *Interstate Branch Banking: That Someday is Today*, 21 WASHBURN L.J. 266, 281 (1982) (branch banking restrictions may actually impede competition); Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, at 10-K, cols. 4 & 5 (branch banking will put Texas financial institutions on more equal footing with non-bank competitors because provides efficient structure for regulated financial industries); J. Hazleton, *Interstate Banking Implications for Texas 10* (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (branch banking creates more competitive banking system); *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 1, at 4 (Aug. 13, 1986) (testimony of R. Bruce LaBoon, Vice Chairman of General Counsel, Texas Commerce Bancshares, before Texas Senate Economic Development Committee) (branch banking will promote greater competition in banking industry than Texas banks have previously enjoyed); Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of

delivery of services to banking customers is improved because the structure of a branch banking system makes these services more available.¹⁷⁸ Texas' limited branch banking structure should also provide greater flexibility to multibank holding companies.¹⁷⁹ Such holding companies may retain some subsidiaries as unit banks while converting others into branches, therefore realizing the benefits of lower operating costs.¹⁸⁰ Furthermore, permitting statewide branch banking so that Texas banks can acquire failed domestic banks will help preserve the integrity of Texas' banking system.¹⁸¹

Texas, in San Antonio, Texas (Jan. 20, 1987) (branch banking is way for smaller banks to protect themselves against larger, out-of-state banks because expansion becomes possible through branch banking system, enabling smaller banks to become larger and stronger).

178. See J. Sexton, *Interstate Banking and Branch Banking* 13 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (branch banking system less costly; as a result, retail cost of bank services is lower).

179. See TEX. REV. CIV. STAT. ANN. art. 342-903, § 1(c) (Vernon Supp. 1987) ("A bank holding company owning more than one bank in a county or city *may* convert the bank or banks into branches") (emphasis added); see also Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987). For independent banks which are not part of a multibank holding company system, it will be much cheaper to build a branch than to build a new bank. Also, multibank holding companies may acquire willing independent banks and convert them into branches. Furthermore, there are opportunities to take over physical facilities of failed savings and loan branches. National Bancshares Corporation of Texas hopes to accomplish four objectives in converting to a branch banking system: (1) improve the management reporting structure, (2) lower overall cost of operations, (3) improve the delivery of products and services to its customers and (4) expand its market share in major services and products. See Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987).

180. See Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987) (not all banks in multibank holding company system branch-oriented due to market area's location, economy, or other factors). National Bancshares Corporation has no intention of "gutting the team," but it recognizes the need to lower its operating costs in order to compete with other financial service industries. Therefore, subsidiary bank presidents may be brought into the holding company and given a position in the branching structure itself. Others may be relocated to subsidiaries that will remain independent. Above all, National Bancshares Corporation wishes to avoid losing good personnel to strong independent banks in areas like San Antonio. See *id.*; see also *American Banker*, Jan. 6, 1987, at 23, col. 2-3 (Gerald W. Fronterhouse, Chairman and Chief Executive Officer of RepublicBank, estimates that RepublicBank's consolidation with Interfirst could save resulting bank holding company ten million dollars annually).

181. See J. Sexton, *Presentation of Paper Concerning Both Interstate Banking and Branch Banking* 14 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (endorsing failed bank provision as assurance to communities with failed banks that they will continue to receive banking services). In 1986, Texas experienced a record twenty-six bank failures. See *Wall St. J.*, Jan. 9, 1987, at 4, col. 2. However, implementation of the failed bank provision has already enabled a number of failed banks in

2. Disadvantages

Texas' financial institutions will need substantial time in order to convert to a branch banking system.¹⁸² Texas multibank holding companies must try to create more efficient operating structures without becoming massive, sterile systems.¹⁸³ Unfortunately, many individuals will lose their jobs as the multibank holding companies streamline operations and eliminate needless layers of management.¹⁸⁴ One apparent disadvantage will be surplus banking facilities; the holding companies will consequently have to find ways to afford many of their large, subsidiary bank properties.¹⁸⁵ Another disadvantage is, as some representatives of independent banks and commentators have argued, that branch banking will cause increased concentrations of financial assets in fewer banks.¹⁸⁶ These arguments, however, are based on studies which were conducted in states allowing statewide, rather than lim-

Texas to reopen as branches of other banking institutions. *See* Wall St. J., Jan. 30, 1987, at 12, cols. 3-6.

182. *See* Merkner, *Texas Banks: Branching Out or Out on a Limb?*, San Antonio Express-News, Nov. 2, 1986, at 10-K, col. 2-3 (quoting Texas Research League's estimates that commercial banks and multibank holding companies would take three to five years to fully implement branch banking).

183. *See* Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987) (criticizing Citibank's formalized system). Most large financial institutions use formalized systems to determine eligibility for loans and other services. If a consumer is unable to meet the requirements, he will be turned away. On the other hand, smaller banks' lending requirements are not as formalized; consequently, they can be more flexible in helping their customers obtain loans and other services. *See id.*

184. *See id.* (disadvantage of implementing branch banking system is suffering it will cause within bank's personnel); *see also* American Banker, Jan. 6, 1987, at 23, col. 2 (RepublicBank/Interfirst consolidation entails trimming 3,000 workers from payroll; acquisition of Crocker National Corporation by Wells Fargo Corporation of San Francisco eliminated 8,000 jobs).

185. *See* Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987). In order to afford existing facilities, banks may lease space to companies in banking-related services, such as hazard and liability insurance, title insurance, underwriting of investment securities, and discount brokerage. For example, the bank would enter into a partnership with an insurance agent and bring him into the bank building. In return, the bank receives rental payments and income from the sale of insurance policies. *See id.*; *see also* American Banker, Jan. 6, 1987, at 23, col. 1 (RepublicBank and InterFirst will be forced to merge many of their banks and eliminate overlapping operations).

186. *See* Note, *Interstate Branch Banking: That Someday is Today*, 21 WASHBURN L.J. 266, 279 nn.110 & 111 (1982) (highly concentrated states are statewide branching states and least concentrated states tend to be those prohibiting branch banking); *see also* HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 32 (Jan. 30, 1986) (states switching to statewide banking report shift in banking structure toward fewer banks controlling larger percentage of assets) (citing McMahan, *Interstate Banking: The Down Side*, LYCEUM, Summer 1985, at 17-24).

ited, branch banking.¹⁸⁷ Moreover, in California, the largest branch banking state, the number of banks has increased, while the share of total deposits held by the five largest multibank holding companies has decreased.¹⁸⁸

B. *Interstate Banking*

1. Advantages

a. Economic Development

The recent decline in oil prices and the overbuilt real estate market have weakened the Texas banking industry.¹⁸⁹ Recognizing that large infusions of capital were needed in order for many banks to survive, Texas Banking Commissioner James Sexton and others urged the passage of the interstate banking bill during the 1986 Special Legislative Session.¹⁹⁰ Because of Texas' depressed economy, these capital infusions needed to come from foreign banking institutions through interstate expansion.¹⁹¹ The initial capital investment required to purchase a commercial bank represents new funds

187. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 32 (Jan. 30, 1986).

188. See J. Hazleton, *Interstate Banking Implications for Texas* 9 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (California is largest statewide branch banking state). Between 1980 and 1984, the number of banks in California increased by 208, while the share of total deposits held by the five largest multibank holding companies decreased from 73.7 to 69.9 percent. Likewise, in New York, another statewide branch banking state, the number of banks increased by 84 between 1980 and 1984. See *id.*

189. See *American Banker*, Aug. 26, 1986, at 1, col. 4 (Texas' interstate banking law passed as emergency legislation to help ailing banks obtain more capital). Banking institutions needing access to new capital cannot expect that capital to come from Texas banks as they presently exist, given the current economic condition in Texas. See *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 1, at 10 (Aug. 13, 1986) (testimony of R. Bruce LaBoon, Vice Chairman of General Counsel, Texas Commerce Bancshares, before Texas Senate Economic Development Committee).

190. See, e.g., J. Hazleton, *Interstate Banking Implications for Texas* 9 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (interstate banking will result in stronger Texas banking system); J. Sexton, *Presentation of Paper Concerning Both Interstate Banking and Branch Banking* 9 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (full interstate banking optimal problem-solver for Texas); *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 2, at 17, 18, 25, 31 (Aug. 13, 1986) (testimony of Don Adams, representing Independent Bankers Association of Texas, Bookman Peters, President of Texas Bankers Association, L.L. Bowman, Commissioner of Texas Savings and Loan Department, James Cochrane, representing Association of Bank Holding Companies of Texas, before Texas Senate Economic Development Committee) (supporting interstate banking legislation).

191. See J. Hazleton, *Interstate Banking Implications for Texas* 2 (July 31, 1987) (unpublished manuscript available from Texas Senate Economic Development Committee) (low profits and depressed bank stock prices make needed capital difficult to obtain within Texas).

that can be used to help diversify Texas' economy away from its heavy dependence on oil and gas and other energy-related industries.¹⁹² The Texas interstate banking law limits potential capital outflows from Texas financial markets by requiring that the majority of an acquired bank's directors be Texas residents and not be serving as officers or employees of the commercial bank, the multibank holding company, or any of its affiliates.¹⁹³

b. Financial Concentration and Competition

The need for Texas banks to compete more actively with deregulated financial industries far outweighs the fear of competition from large, foreign banks moving into Texas.¹⁹⁴ In reality, market pressures generated by large, foreign multibank holding companies are no greater than those pressures generated by large, Texas multibank holding companies.¹⁹⁵ To prevent an undue concentration of economic resources in foreign multibank holding companies, the Texas interstate banking law limits to less than twenty-five percent the total banking deposits that a foreign multibank holding company may directly or indirectly control.¹⁹⁶ Nonetheless, due to the state's weakened economy, Texas banks have not experienced increased acquisition and merger attempts by foreign multibank holding companies.¹⁹⁷

192. See *id.* at 3 (unpublished manuscript available from Texas Senate Economic Development Committee) (Texas needs infusions of capital for new industry and expansion of existing industry); see also Hoffman & Edge, *State Regulation of Bank Holding Companies and the Future of Interstate Banking: A Tennessee Perspective*, 51 TENN. L. REV. 383, 391 (1984) (out-of-state bank holding company typically brings in new capital when acquisition made).

193. See TEX. REV. CIV. STAT. ANN. art. 342-404, § 1 (Vernon Supp. 1987); see also J. Sexton, *Interstate Banking and Branch Banking* 11 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (provision needed to relieve anxiety expressed over possible outflow of deposits).

194. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 53 (Jan. 30, 1986) (full interstate banking advocates argue that needs of consumers and businesses in national economy cannot be met by banks that are geographically restricted); see also Hoffman & Edge, *State Regulation of Bank Holding Companies and the Future of Interstate Banking: A Tennessee Perspective*, 51 TENN. L. REV. 383, 389 (1984) (interstate banking laws are response to deregulation of banking industry).

195. Cf. Hoffman & Edge, *State Regulation of Bank Holding Companies and the Future of Interstate Banking: A Tennessee Perspective*, 51 TENN. L. REV. 383, 397 (1984).

196. See TEX. REV. CIV. STAT. ANN. art. 342-916, § 4 (Vernon Supp. 1987); see also J. Sexton, *Interstate Banking and Branch Banking* 11-12 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (statutory provision necessary to avoid undue concentration of economic resources).

197. See N.Y. Times, Aug. 25, 1986, § D, at 1 (divided opinion as to how quickly alliances will be formed between out-of-state bank holding companies and Texas banks); see also *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 2, at 19 (Aug. 13, 1986) (testimony of Bookman Peters, President Texas Bankers Association, before Texas Senate Economic Development Committee) (interstate expan-

c. Increased Consumer Services

Large, foreign multibank holding companies generally offer a wider range of financial services.¹⁹⁸ In addition, larger, foreign financial institutions are able to attract new customers because they have the financial ability to loan larger amounts of money.¹⁹⁹ Therefore, acquisition of a Texas commercial bank by a foreign multibank holding company translates into increased customer satisfaction and higher earnings for the target bank.²⁰⁰ Furthermore, the Texas interstate banking statute encourages the Texas Banking Commissioner to weigh certain factors when determining whether the domestic commercial bank will continue to serve its community after its acquisition by a foreign multibank holding company.²⁰¹

d. Greater Operational Efficiency

When a foreign multibank holding company acquires a Texas commercial bank, the domestic bank's local orientation can be maintained.²⁰² The board of directors of the acquired bank will continue to draw its members from the

sion will be slow process, but option to go into interstate banking very reassuring to funding sources, capital acquisition, and investments).

198. See Hoffman & Edge, *State Regulation of Bank Holding Companies and the Future of Interstate Banking: A Tennessee Perspective*, 51 TENN. L. REV. 383, 391 (1984) (out-of-state bank may provide financial services otherwise unavailable); see also HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 31 (Jan. 30, 1986) (smaller, separate banks cannot offer as many services as larger, combined banks). Interstate banking provides financial institutions with the necessary tools to best serve the consumer. Banks must be efficient, of sufficient size, offer innovative technology and products, and be subject to the financial market's competitive forces. See J. Hazleton, *Interstate Banking Implications for Texas* 7 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee).

199. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 31 (Jan. 30, 1986) (larger banks have higher lending limits).

200. See *id.* Larger banks have the ability to raise funds at lower rates and are therefore able to charge lower interest on loans. With higher lending limits, larger size, greater resources and more offices, combined banks' earnings would increase. See *id.*

201. See TEX. REV. CIV. STAT. ANN. art. 342-912, § 6 (Vernon Supp. 1987) (priority of criteria in determining compliance of applicant); see also HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 45 (Jan. 30, 1986) (such requirements based upon recognition that competition alone insufficient to insure that community credit needs will be met).

202. See J. Hazleton, *Interstate Banking Implications for Texas* 6 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (interstate banking laws drafted to meet local needs and concerns); see also *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 2, at 3 (Aug. 13, 1986) (testimony of Franklin Raines, General Partner of Lazard Freres, before Texas Senate Economic Development Committee) (local orientation good business practice because customers expect personal attention). Chemical Bank New York Corporation hopes to capitalize on Texas Commerce Bancshare's local orientation. See *American Banker*, Jan. 5, 1987, at 18, col. 3.

local community, and these people will insure that the bank remains responsive to local needs.²⁰³ By allowing foreign financial institutions to expand into Texas financial markets, rather than forcing them to find alternative methods through nonbank financial institutions and other deregulated financial industries, Texas is, in the long-term, creating jobs and opportunities.²⁰⁴ Interstate banking is, therefore, a positive step towards Texas' future economic development.²⁰⁵ For example, the merger agreement between Chemical Bank New York and Texas Commerce Bancshares (TCB), if federally approved, will allow Texas Commerce to remain a separate corporate entity and to retain its name and its management structure.²⁰⁶ Chemical Bank will inject new capital into the TCB system and lend its expertise in organizing branch banking systems.²⁰⁷

e. Financial Safety and Soundness

Acquisition of a troubled bank by a foreign multibank holding company is preferable to an FDIC takeover.²⁰⁸ While the FDIC merely collects loans, a foreign acquirer provides needed capital and prevents the disruption of the failed bank's operations.²⁰⁹ Risk of bank failure may also be reduced be-

203. See TEX. REV. CIV. STAT. ANN. art. 342-404, § 1 (Vernon Supp. 1987) (requiring that majority of commercial bank's board of directors be Texas residents); see also HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 42 (Jan. 30, 1986) (acquiring bank enters local market to gain potential depositors and potential borrowers).

204. See *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 2, at 5-6 (Aug. 13, 1986) (testimony of Franklin Raines, General Partner of Lazard Freres, before Texas Senate Economic Development Committee) (ultimately, out-of-state banks will infiltrate Texas financial market).

205. See J. Sexton, *Interstate Banking and Branch Banking* 9 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (highly fragmented banking structure of Texas hinders economic development).

206. See *American Banker*, Jan. 5, 1987, at 18, col. 4 (no management changes and Texas Commerce name will be preserved as result of merger); Shearson Lehman Bros., *Presentation on Analysis of Merger of Chemical Bank New York Corp. and Texas Commerce Bancshares* 28 (Jan. 16, 1987) (summarizing benefits to both organizations).

207. Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987) (merger will attempt to return Texas Commerce Bancshares to position it held before economic slump).

208. See J. Sexton, *Interstate Banking and Branch Banking* 3-5 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee). Sexton lists the following as the primary problems with allowing the FDIC to handle Texas bank problems: (1) a bank must be rendered completely useless before the FDIC will inject capital into the bank, (2) the stigma of an FDIC takeover decreases the efficiency of the financial organization, (3) the FDIC is unwilling to spend its financial resources, knowing that such resources are contributing to the preservation of interstate barriers, and (4) the FDIC acts as a receiver, interested only in turning loans to cash. See *id.*

209. See *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic*

cause potential large acquirers possess intrinsic financial strength.²¹⁰ Even if some of these large acquiring institutions engage in high-risk loans or investments, such risk is counterbalanced by their diversification in numerous economic sectors.²¹¹ Texas' interest in the safety and soundness of acquisitions by foreign multibank holding companies is satisfied by allowing the Texas Banking Commissioner jurisdiction over foreign bank holding companies.²¹²

2. Disadvantages

Increased concentration of financial assets caused by interstate mergers could weaken the national banking system.²¹³ Assuming that the number of banks will decrease as a result of interstate banking legislation, each bank will control more assets, and a bank failure could, therefore, affect a greater number of people.²¹⁴ Increased competition, fueled by interstate banking, could tempt some banks into taking greater risks, confident that the FDIC will not allow them to fail.²¹⁵

While financially-stronger commercial banks expanding into Texas may offer a wider range of services, one disadvantage is that these services may

Development, 69th Leg. tape 2, at 10 (Aug. 13, 1986) (testimony of Franklin Raines, General Partner of Lazard Freres, before Texas Senate Economic Development Committee) (FDIC participation more disruptive than rescue acquisition by another financial institution).

210. See J. Sexton, *Interstate Banking and Branch Banking* 11 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee). Because of the inherent strength of larger banking institutions, their questionable international loans may not be a matter of particular concern. See *id.* at 10.

211. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 39 (Jan. 30, 1986) (diversification protects bank because collapse of one economic or industrial sector will not necessarily endanger other sectors).

212. See TEX. REV. CIV. STAT. ANN. art. 342-914 (Vernon Supp. 1987) (Texas Banking Commissioner has jurisdiction to enforce agreements between foreign bank holding companies and domestic bank holding companies; foreign bank holding company may be penalized for violations).

213. See Texas Independent Bankers Association, *Interstate Banking* 7 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (failure of large bank could cause significant "ripple effects" throughout entire financial system).

214. See HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 39 (Jan. 30, 1986) (discussing consequences of large bank failures). Large bank failures receive wider publicity, thus weakening the public's confidence in the entire banking system. Large bank failures are also more burdensome for deposit-insurance systems, and large banks require larger merger partners to avoid bank failure. See *id.* But see *id.* at 40 (majority of bank failures linked to poor management and lending practices, not size).

215. See *id.* at 38 (if large bank fails and overtaxes FDIC's ability to compensate depositors, panic could be triggered).

only be available to higher-income customers.²¹⁶ Even though the Texas interstate banking law attempts to insure that the entire community will profit from an interstate acquisition of a local bank, its provisions are discretionary with the Texas Banking Commissioner.²¹⁷ Large banking institutions utilize more formalized credit evaluation systems; such systems must be followed by all member banks.²¹⁸ However, Attorney General Mattox has issued an opinion noting that the Texas Constitution prohibits the foreign *operation* of commercial banks in Texas.²¹⁹ While foreign *ownership* of Texas banks is legal, an acquired Texas commercial bank or multibank holding company must be maintained as a separate corporate entity in order to comply with the constitutional mandate against foreign operation of banks in Texas.²²⁰ The only provision in the new Texas interstate banking law relating to this problem is the requirement that a majority of the bank's directors be Texas residents.²²¹ Attorney General Mattox has noted, "[e]ach instance involving disregard of the corporate entity must rest on its own facts."²²² Unless the Texas Constitution is amended to allow foreign *operation* of Texas banks, foreign multibank holding companies cannot legally dic-

216. See *id.* at 45 (bank's specialized services, like higher interest rates paid on larger deposits, may realistically only be available to higher-income groups).

217. See TEX. REV. CIV. STAT. ANN. art. 342-912, § 6 (Vernon Supp. 1987) (Texas Banking Commissioner encouraged, but not required, to consider listed factors).

218. See Texas Independent Bankers Association, Interstate Banking 9 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (more formalized lending standards of large banks make it more difficult for businesses to obtain bank credit); see also Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987) (smaller banks help customers "make the grid" in order to obtain loans and other financial services).

219. See TEX. CONST. art XVI, § 16(a). The Texas Constitution states, "No foreign corporation, other than the national banks of the United States domiciled in this State, shall be permitted to exercise banking or discounting privileges in this State." *Id.*; see also Op. Tex. Att'y Gen. No. JM-630, at 2844 (1987) (foreign *operation*, not *ownership*, intended to be prohibited); see also Wall St. J., Feb. 4, 1987, at 8, col. 5 (constitutionality of Texas' interstate banking law questioned by Texas lawmakers opposed to interstate banking).

220. See Op. Tex. Att'y Gen. No. JM-630, at 2847 (1987) (Texas Constitution violated if foreign bank holding company disregards separate corporate existence of acquired Texas bank); see also Wall St. J., Feb. 4, 1987, at 8, col. 5 (violation of Texas Constitution's mandate against foreign operation of Texas banks is \$1,000 fine per day and revocation of Texas bank's corporate charter).

221. See TEX. REV. CIV. STAT. ANN. art. 342-404 (Vernon Supp. 1987). Attorney General Mattox conceded that it will be difficult to determine whether or not a Texas commercial bank is being maintained as a separate corporate entity apart from its parent foreign multibank holding company. See Op. Tex. Att'y Gen. No. JM-630, at 2849-50 (1987).

222. Op. Tex. Att'y Gen. No. JM-630, at 2847 (1987); see also Wall St. J., Feb. 4, 1987, at 8, col. 6 (Chemical New York Corporation believes its merger agreement with Texas Commerce Bancshares complies with Texas constitutional prohibition against foreign corporation's operation of Texas banks).

tate the policies of acquired Texas financial institutions.²²³

Not all Texas multibank holding companies seek to be acquired by, or merged with, foreign multibank holding companies.²²⁴ To avoid such takeovers, Texas multibank holding companies may merge. This was recently evidenced when RepublicBank Corporation and InterFirst Corporation merged operations.²²⁵ However, the RepublicBank/InterFirst consolidation will result in an estimated dismissal of three thousand bank employees.²²⁶ The opportunities for Texas multibank holding companies to expand across state lines, however, are limited by other states' regional reciprocal interstate laws.²²⁷ Some Southeastern states are contemplating whether to allow Texas banks to expand into their states.²²⁸ Even though large banking institutions reduce risk of default through diversification of loan portfolios, their participation in the international debt crisis is a matter of great concern.²²⁹ Federal regulators give little weight to the amount and number of such loans; thus Texas banks should be careful with the foreign financial institutions with whom they become involved.²³⁰

223. See Wall St. J., Feb. 4, 1987, at 8, col. 6 (Texas Attorney General's office will monitor policies on loans, interest rates, advertising, and management in effort to insure that foreign multibank holding companies comply with constitutional prohibition against foreign corporation's operation of Texas banks).

224. See American Banker, Jan. 6, 1987, at 2, col. 4 (MCorp. seen as desirable takeover target, but has publicly announced it is "not for sale"); N.Y. Times, Aug. 25, 1986, § D, at 1 (Texas American Bancshares of Fort Worth hired Goldman, Sachs & Co. to help defend against possible takeover bids). *But see* American Banker, Sept. 16, 1986, at 6, col. 3 (Allied Bancshares of Houston publicly announced that it will welcome takeover offers).

225. See American Banker, Jan. 6, 1987, at 23, col. 3 (two multibank holding companies accused by Wall Street analysts of "circling the wagons").

226. See American Banker, Jan. 6, 1987, at 23, col. 1 (jobs cut in consolidation effort); *see also* Interview with Robert E. Orr, Executive Vice President, Member Bank Administration, National Bancshares Corporation of Texas, in San Antonio, Texas (Jan. 20, 1987) (noting considerable layoffs RepublicBank/InterFirst consolidation will cause).

227. See J. Sexton, Interstate Banking and Branch Banking 9 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (Texas multibank holding companies not permitted to expand into most states with regional interstate banking laws).

228. See American Banker, Sept. 26, 1986, at 1, col. 4 (southeast states may amend interstate banking laws to include Texas).

229. See, e.g., HOUSE STUDY GROUP, SPECIAL LEGISLATIVE REPORT NO. 123, at 39 (Jan. 30, 1986) (large out-of-state banks with large percentage of assets in speculative loans to foreign countries could pull Texas into international debt crisis); J. Sexton, Presentation of Paper Concerning Both Interstate Banking and Branch Banking 10 (July 31, 1986) (unpublished manuscript available from Texas Senate Economic Development Committee) (federal regulators give little weight to amount of assets tied up in risky loans to foreign countries).

230. See *Hearings on Tex. S.B. 10 and S.B. 11 Before the Senate Comm. on Economic Development*, 69th Leg. tape 1, at 12-13 (Aug. 13, 1986) (testimony of State Senator Henderson, before Texas Senate Economic Development Committee).

V. CONCLUSION

The advent of interstate banking and branch banking offers Texas multibank holding companies the opportunities to expand, diversify, and ultimately create a more competitive banking environment in Texas. While the number of multibank holding companies may not increase as rapidly, the size of multibank holding companies will grow as a result of both intra- and interstate mergers. As national deregulation of the financial industries continue, Texas banks will ultimately become more competitive. The anticompetitive effects of deregulation will result in states continuing to adopt interstate banking laws. The size and power of Texas' financial institutions will tempt regional interstate banking states into opening as Texas multibank holding companies. Given the weakened condition of Texas' banking system, however, the Board of Governors of the Federal Reserve System may not approve certain mergers between Texas and foreign multibank holding companies.

Limited branch banking allows Texas multibank holding companies the time and flexibility to restructure their operational systems. The result will be a method of providing services more conveniently and at a lower cost to the consumer. Full interstate banking offers Texas multibank holding companies the opportunity to expand into other states, but more importantly, it offers these companies the opportunity to merge with, or to be acquired by, the nation's strongest financial institutions. Expansion of these institutions into Texas will result in the influx of necessary capital into Texas financial markets, a larger variety of services made available to Texas consumers, greater expertise in branch banking management, and, finally, greater economic stability.

Since foreign multibank holding companies cannot legally participate in the operation of their Texas acquisitions, the extent of their influence is therefore unclear. Amending the Texas Constitution may solve the immediate problem of whether foreign banking corporations may "operate" in Texas. Yet, the more far-reaching problem of *how much* foreign influence is desirable in Texas financial markets may have to be resolved by a decision whether to amend Texas' interstate banking law. Texas needs the financial strength and resources of stable foreign multibank holding companies, not their sterility and inflexibility.