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ELECTRONIC FUNDS TRANSFER AND NATIONAL BANKS*

The controversial growth of electronic funds transfer (EFT) has caused a series of economic dislocations and inequities. The dispute is caused not by differences in academic or philosophical opinion, but rather by competing economic forces attempting to protect their legitimate interests. Much of the controversy concerns four important issues: the application of state and federal branching laws, the sharing of EFT terminals, the government's role in EFT development, and the economics of EFT.

The branch terminal issue concerns which government—state or federal—should define "branch" for purposes of applying the McFadden Act to nationally chartered banks. Although the Act defines "branch," it also requires national banks to comply with the state's branching laws. This conflict is illustrated by the important Supreme Court decision of First National Bank v. Walker Bank and Trust Co. The defendant, Walker, attempted to create a branch without purchasing a pre-existing bank. The Court reasoned that, because the Act requires national banks to satisfy state branching laws, Congress intended to maintain a competitive equality between state and nationally chartered banks. The state in this case allowed creation of branches only by purchase; therefore, the Court held that Walker's branch was illegal.

* The Panel member who presented the nationally chartered banks' position on EFT would not consent to publication of his remarks. Because we believe that the views expressed by Peterson, Electronic Funds Transfer and the Small Bank, 1977 WASH. U.L.Q. 513, may be better appreciated in context, we here present the national banks' position on EFT development as we have been able to determine it.

3. The term "branch" as used in this section shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent.
7. 385 U.S. at 262.
The subtle distinction between state statutes regulating branches and the federal definition of "branch" became indistinguishable in *First National Bank v. Dickenson.* Florida prohibited branch banking and charged that First National's remote electronic depository violated this prohibition. National argued that its depository was not a branch as defined by federal law and therefore was not prohibited by state law. The Court reasoned that the gloss of competitive equality, developed in *Walker,* applied to the Comptroller's authority under the McFadden Act to define "branch"; thus, when defining "branch," the Comptroller must maintain a competitive equality between state and national banks. Because the depository would give First National a competitive advantage, the Court held that the depository was a branch under the federal definition and therefore was prohibited.

Although *Plant City*’s holding was arguably limited to cases involving state statutes that prohibit branch banking, courts have subsequently held that it applied to the use of EFT terminals by national banks regardless of the state laws. For example, in *Independent Bankers Association of America v. Smith,* the Court of Appeals for the District of Columbia Circuit held that if a national bank establishes a terminal to receive deposits, cash checks, or lend money, it is a branch under Section 36(f) and must therefore meet the branching requirements set forth in 12 U.S.C. § 36(c) and the capital requirements set forth in 12 U.S.C. §§ 36(d) and 51. This ruling severely hinders national banks. If a state bank's terminal is a branch, it must conform

9. *See note 6 supra* and accompanying text.
11. 396 U.S. at 136-37.
14. *See note 3 supra.*
15. 12 U.S.C. § 36(c) (1970) provides in relevant part:

A national banking association may, with the approval of the Comptroller of the Currency, establish and operate new branches . . . Except . . . no such association shall establish a branch outside of the city, town, or village in which it is situated unless it has a combined capital stock and surplus equal to the combined amount of capital stock and surplus, if any, required by the law of the State in which such association is situated for the establishment of such branches by State banks, or, if the law of such State requires only a minimum capital stock for the establishment of such branches by State banks, unless such association has not less than an equal amount of capital stock.
to the state's capital and surplus requirements for branches. If a national bank's terminal is held to be a branch, however, it must meet the capital and surplus requirements of both the federal and state statutes of the state in which it is located.

The National Commission on EFT, unfortunately, has not adequately addressed this aspect of the branch/terminal issue. In its preliminary report, the Commission recommended that the off-premise deployment of EFT terminals should be regulated by different rules than those which govern the establishment of "brick and mortar" branches. This would not, however, overturn the Independent Bankers case. This requires that Congress amend the McFadden Act to ensure that all banks will be treated equally in the establishment and operation of EFT terminals.

Competitive equality could be further ensured if Congress adopts the Commission's suggestion and determines how banking institutions may receive deposits. The Commission believes that Congress can effectively determine the legitimate boundaries of the market place. The Commission's preliminary report states that financial institutions with branches should be allowed to operate within the state rather than—as is the practice in some states—within the community in which the institution's headquarters is located. In addition, the report concludes that financial institutions should be permitted to follow natural markets in the establishment of terminals. Congressional enactment of the report's proposals would finally eliminate the use of state lines to partition natural market areas.

The Commission has also recommended a policy that would allow sharing of EFT terminals to promote competition, yet protect financial institutions from the harmful competitive effects of an expanding EFT technology. After considering EFT terminals and the four types of sharing—mandatory, non-discriminatory, permissive, and pro-competitive—the Commission approved pro-competitive sharing. The par-

16. NATIONAL COMMISSION ON ELECTRONIC FUND TRANSFERS, EFT AND THE PUBLIC INTEREST: A REPORT OF THE NATIONAL COMMISSION ON ELECTRONIC FUND TRANSFERS (Feb. 1977) (hereinafter cited as EFT COMM'N PRELIMINARY REPORT). The Commission addressed a number of controversial issues in its preliminary report. This report should be used as a starting point for an analysis of any EFT problem.

17. Id. at 31.
18. See id. at 43-44.
19. See id. at 43.
20. See id.
21. Id. at 50, 51.
22. Id. at 53-61.
ties may agree to share but, if challenged, the sharing will be permitted, required, or prohibited on a case-by-case basis depending on its competitive effect in the market.\textsuperscript{28} The Commission noted that some states have enacted statutes requiring mandatory sharing, a development approved by many financial institutions.\textsuperscript{24} The Antitrust Division of the Department of Justice, however, has held that mandatory sharing has an anticompetitive effect upon the electronics firms that develop EFT technology. Two years ago, Nebraska enacted a mandatory sharing statute and applied to the Department of Justice for a business review letter. The commercial banks there spent large sums on equipment and software to implement a statewide mandatory sharing network. Despite a Department of Justice ruling that the system was anticompetitive,\textsuperscript{25} Nebraska intends to implement its program. While the ultimate result is unpredictable, there is general agreement that the state statute will not necessarily immunize the operators of the network.

The proper role of the federal government in regulating EFT systems was considered by the Commission. It urged that Congress aggressively oversee the use of automated clearing houses (ACH), but not point-of-sale (POS) systems.\textsuperscript{26} The Commission adopted this position because ACH systems are in place; indeed, the Federal Reserve Board and the Federal Reserve Banks are already operating ACH systems.\textsuperscript{27} In addition, a six state interregional experiment in which clearance and settlement data will be transferred over the Federal Reserve Board's telecommunications network is about to commence operation. Although intent on protecting existing ACH systems, Congress will probably allow—in the interest of competition—the private sector and market forces to develop the fledgling POS systems.

The only data concerning the economics of EFT with which I am familiar is contained in \textit{Retail Banking in the Electronic Age}.\textsuperscript{28} The

\begin{itemize}
\item \textsuperscript{23} Id. at 50.
\item \textsuperscript{24} Id. at 51. \textit{See} Peterson, \textit{Electronic Funds Transfer and the Small Bank}, 1977 \textit{Wash.U.L.Q.} 513.
\item \textsuperscript{25} Antitrust Division, U.S. Dep't of Justice Press Release, March 7, 1977 (business review letter to W. Brandt from D. Baker).
\item \textsuperscript{26} EFT COMM'N PRELIMINARY REPORT, \textit{supra} note 16, at 75, 76, 78.
\item \textsuperscript{28} W. BAXTER, P. COOTNER, \\& K. SCOTT, \textit{Retail Banking in the Electronic Age: The Law and Economics of Electronic Funds Transfer} (1977).
\end{itemize}
authors argue persuasively that as many as 140 nets and 5,555,000 terminals will be needed to support a given EFT system.\textsuperscript{29} If single networks are permitted only within state boundaries, very few states will be able to support more than a few nets. In most areas, therefore, EFT service can be supplied only if regional nets, across state lines, are permitted. This economic data suggests that financial institutions should move carefully in the establishment of terminals and nets.

The place of EFT terminals in banking is not yet clear, but the creation of these systems is inexorable. The EFT Commission should have a significant impact on these developments and provide Congress with sufficient information for it to effectively resolve the compelling issues before it.

\textsuperscript{29} Id. at 111.