Branch by Branch

BY DOUG CAMPBELL

How North Carolina became a banking giant

In 1804, the North Carolina General Assembly chartered the first two banks in state history. One of them, the Bank of Cape Fear in Wilmington, made its own sort of history by simultaneously opening a branch office in Fayetteville. Though having a branch might not seem remarkable today, North Carolina's historically liberal policies toward branching are key to understanding the state's status now as a banking giant.

"Statewide branching ultimately gave our banks an advantage," says Joseph Smith, North Carolina's commissioner of banks. "It allowed our banks to get to a size and scale of having greater resources to compete. It gave our banks something of a head start in the mergers and acquisitions game, and it also promoted competition that served them well going across state lines."

North Carolina — the 11th-largest state by population — today is the second-largest banking state in the country. It is home to the headquarters of three of the top 10 U.S. banks ranked by assets. Bank of America, based in Charlotte, is the largest U.S. commercial bank and Charlotte-based Wachovia is No. 4. BB&T Corp. of Winston-Salem currently sits at No. 9. Those three banks alone give North Carolina a more than $1 trillion lead over the third-largest banking state, California, though New York is still far and away the largest banking center.

An 1848 $10 bill from the Bank of Cape Fear, in Wilmington, N.C., one of the first state-chartered banks.

To be sure, there were many forces at work besides branching that helped North Carolina banks get an edge over their out-of-state counterparts. Creative and aggressive managers — such as the near-legendary Hugh McColl of NationsBank (now Bank of America) and Ed Crutchfield of First Union (now Wachovia) — pushed their organizations to grow. Also important were policies like allowing banks to get involved in a lot of nonbank activities, such as insurance brokering, of which BB&T is now a nationwide leader.

But branching set the tone in North Carolina, it is generally agreed. Without the experience from branching, no amount of management expertise could have produced the banking empire that now exists in the Tar Heel State. "They were competitive bankers, but they already had the size that allowed them to be the acquirers rather than the acquirees," explains Lissa Broome, a law professor at the University of North Carolina who directs the school's Center for Banking and Finance.

Rural Roots

North Carolina's original embrace of branching was not the result of a farsighted strategy to build banks of nationwide power. Rather, it was an immediate economic necessity. A predominantly rural state in the early 19th century, North Carolina allowed branching as a means to get banks into more communities than otherwise possible. "To get banking services in the Carolinas at all they had to tap capital from people in a number of different places," Broome says. Even though there were only three state-chartered banks in North Carolina until the 1850s, each had multiple branches, allowing for close to statewide coverage.

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While other states were placing restrictions on branching, fearful that big-city banks would drive out smaller banks and then operate in a non-competitive fashion, North Carolina maintained liberal policies. This created a uniquely competitive banking environment in North Carolina, Broome says. Besides having the ability to set up branches, North Carolina banks had little restrictions in buying other state banks, giving them experience in integrating the operations of another bank and early on showing the economic efficiencies of putting together two banking organizations.

Beyond the fear that big banks would exercise monopoly power, why would states restrict branches? Thomas Hills, a retired bank executive who has studied North Carolina banking history, suggests several reasons. One is that for many years North Carolina had four large population centers evenly distributed around the state — Charlotte, Raleigh, Greensboro, and Asheville. This was in contrast to states like Georgia, with a single big city in Atlanta. "There was never the big city against the agrarian area dynamic," Hills says.

Meanwhile, North Carolina banks were amassing size and scale that out-of-state banks weren't close to approaching. The mid-20th century was a time of slow but steady growth in North Carolina banking. In 1950, not a single North Carolina bank was among the 50 largest banks in the country. By 1960, Wachovia had cracked that list. By 1980, North Carolina National Bank (NCNB) had vaulted over Wachovia and into the top 25 largest U.S. banks.

Branched Out

In 1975, North Carolina was one of just 16 states (plus the District of Columbia) that allowed statewide branching. (As it happened, Maryland, Virginia, and South Carolina also allowed some degree of statewide branching, with only West Virginia in the Fifth District keeping branch restrictions.) By 1992, all but one state — Iowa — had at the least significantly relaxed branching restrictions.

But for a time, North Carolina banks were in a relatively unique environment that taught them how to compete. Knowing that other banks could eye a good market and swoop in to steal share, North Carolina banks had strong incentives to keep costs low and innovate whenever possible. By the late 20th century, technological advances such as ATMs were making it even more sensible to pursue banking on a wider geographic scale. Moreover, bigger banks were in a better position to use those same technological advances and their accompanying cost savings to their advantage. In this way, technology provided something of a double benefit (one that smaller banks were less able to take advantage of) to the already-large banks in North Carolina.

John Medlin was chief executive of Wachovia in 1985 when a pivotal Supreme Court ruling was handed down. The court in June, in upholding a similar New England law, essentially upheld the lawfulness of the so-called "Southeastern Regional Banking Compact," an agreement between 10 Southern states, including North Carolina, South Carolina, Virginia, and Georgia, to allow banks from participating states to acquire each other.

"When it became possible to [cross state borders] in 1985, our banks were better prepared for that challenge," Medlin says. "Going up to Virginia for us was no farther from Winston-Salem than going to Asheville. This gave us an edge on banks in other states like in Virginia, where banks were confined to counties, and Florida."

The week after the Supreme Court ruling on the compact, Wachovia bought First Atlanta. Around that same time, First Union picked up Atlanta Bancorporation of Jacksonville, Fla. In 1986, NCNB — which had used a loophole in 1982 to buy a trust company in Florida, which then allowed it to also buy banks in the state — acquired banks in South Carolina, Virginia, and Maryland. The race was on.

"All of us felt it was pretty clear that critical mass was important," Medlin says. "If you had a computer system serving 100,000 customers, it costs the same as if it were a million customers. You required economies of scale to be efficient and effective."

Interstate Banking Arrives

While banks in the Southeast compact zone could go about buying each other, federal and state laws still kept most cross-state purchases from happening. The Douglas Amendment to the federal Bank Holding Company Act of 1956 restricted bank holding companies from buying banks in other states. Not until Maine in 1978 eased restrictions on entry by out-of-state banks did the barriers begin to fall at the state level. At the federal level, it wasn't until the Riegle-Neal Act of 1994 that bank holding companies were allowed to acquire banks in any state. (The act's House sponsor was Stephen Neal of North Carolina, whose banks lobbied heavily in favor of the reform.)

Primed to grow, North Carolina banks were ready when the nationwide barriers to cross-state entry began to fall. In 1989, North Carolina was the sixth-largest banking state by assets. Hot on its heels were Massachusetts, Michigan, and New Jersey. By 2006, North Carolina was the No. 2 state in the nation ranked by bank assets. (New York has long held the top spot.)

Most of this leap in the ranking came by virtue of the activities of NationsBank and First Union. The most notable acquisitions for NationsBank came in 1991, with the purchase of Atlanta's C&S/Sovran Corp., then in 1998's merger with San Francisco-based BankAmerica. NationsBank took BankAmerica's name, but kept the headquarters in Charlotte. The most recent big acquisition was of Boston's FleetBoston Financial Corp. in 2004.

The big buys for First Union, meanwhile, came with pickups in 1996 of First Fidelity Bancorp of New Jersey, in 1997 of Signet Bancorp of Richmond, and in 1998 of CoreStates

North Carolina Banks Timeline

1805: The Bank of Cape Fear opens as one of North Carolina's first state-chartered banks. (The charter was granted in 1804.) Simultaneously, it opens a branch in Fayetteville.

1872: Branch and Hadley, the precursor to BB&T, opens in Wilson.

1874: Commercial National Bank, the precursor to NationsBank, opens in Charlotte.

1879: Wachovia National Bank opens in Winston (which later merged with the neighboring city of Salem).

1927: The Federal Reserve Bank of Richmond opens a branch office in Charlotte.

1956: The Douglas Amendment to the Bank Holding Company Act restricts ownership of banking subsidiaries by bank holding companies to only the state in which the holding companies are headquartered.

1958: Union National merges with First National Bank of Asheville, forming First Union.

1960: North Carolina National Bank (NCNB) is formed after successor to Commercial National buys Security National of Greensboro.

1975: Some states begin to permit statewide branching, something that North Carolina has allowed since 1804. In 1975, only 16 states allow statewide branching.

1989: North Carolina is the sixth-largest banking state in the United States, trailing California, Illinois, New York, Ohio, and Pennsylvania.

1991: NCNB acquires Atlanta's C&S/Sovran, and the new bank is called NationsBank.

1994: The Riegle-Neal Act allows bank holding companies to acquire banks in any state.

1998: NationsBank merges with BankAmerica, and the new company is called Bank of America. Headquarters of the merged bank is established in Charlotte.

2001: First Union acquires Wachovia, keeping the name Wachovia Corp.

2006: North Carolina is the second-largest banking state in the United States, trailing only New York and leading No. 3 California by more than $1 trillion in assets.

Financial of Philadelphia, the last of which set a record with its $17 billion price tag. Then in 2001, First Union bought cross-state rival Wachovia and kept its name.

During this period, Winston-Salem's BB&T, led by CEO John Allison, quietly emerged. Since 1989, BB&T bought 59 banks and thrifts. Most of those deals paled in size compared with the mega mergers of Bank of America and the new Wachovia. Nonetheless, BB&T today ranks as the ninth-largest bank holding company in the United States. It also added 80 insurance agencies and 30 nonbank financial companies, building on its experience in a state that allowed such forays into nonbanking activities.

By 2000, North Carolina was well established on the global map as a financial services powerhouse. In Charlotte, the headquarters of Bank of America and Wachovia reach 60 and 42 stories, respectively, defining the Queen City's skyline. More than 32,000 people are employed by those two banks in Charlotte alone.

Great Leaders or Great Laws?

When stories are told about North Carolina's ascension in the banking world, the names McColl and Crutchfield, Allison, and Medlin, among others, are raised. It was personal competition, one line of reasoning goes, that led McColl to top his rival Crutchfield with a taller skyscraper. This "great man" theory holds that it was the leaders of North Carolina's banks that drove them to greatness.

Thomas Hills, the retired First Atlanta-Wachovia executive, recently wrote a 160-page thesis on the topic of North Carolina's banking prowess — and Georgia's relative weakness — for a graduate degree in history. (He now works as chief financial officer for the state of Georgia.) Hill thinks that both North Carolina's regulatory environment and its luck in getting some innovative chief executives were the key ingredients.

"They're both equally important," Hills says. "You had brilliant banking leaders in people like John Medlin in Wachovia, Tom Storrs and Hugh McColl at NCNB, and Ed Crutchfield at First Union. North Carolina banks were positioned legally and also from a management strength and a strategic planning standpoint to take advantage of those laws."

Medlin agrees with that assessment. The competitive environment in North Carolina, he says, "challenged management. We developed not necessarily smarter management but more experienced management. The competition between us made each of us better."

In 2006, it might seem that all regulatory barriers to intrastate banking have been removed. But that's not the case. Twenty-seven states, including North Carolina, still place limits on out-of-state banks from opening branches inside their boundaries (unless the out-of-state bank is from a state where North Carolina has a reciprocal agreement). For example, a South Carolina bank can't currently open a branch in North Carolina — unless the South Carolina bank buys a North Carolina bank. For small banks in particular that throws up a high hurdle to growth because they usually lack the capital to make such purchases.

Smith, the North Carolina banking commissioner, believes such prohibitions unnecessarily harm some banks. "There's a whole economic market in western North Carolina, upcountry South Carolina, and the mountains of Georgia — that's one market," Smith says. "Protectionism holds back small- to medium-sized banks that could grow to their natural, optimal size."

In researching his thesis, Hills came to an interesting realization: Not a single, major bank with headquarters in the Southeast has been acquired by a bank from outside the Southeast. With regards to North Carolina, can that record possibly hold up?

On that question, Medlin is realistic. "I wouldn't postulate today what might happen 10 years from now. I would just note that there is a fairly substantial lead right now and banks in North Carolina are still growing." **RF**