Growth, Prosperity, and the Delaware Way!

How the Financial Center Development Act Turned a 98-Pound Weakling into a Banking Powerhouse

by
Richard P. Eckman
Senior Counsel
Troutman Pepper Hamilton Sanders LLP
and
Greg Koseluk
VP, Marketing & Public Relations
Delaware Bankers Association

A (Very) Brief History of Banking in Delaware

1795 – The Bank of Delaware, the first bank chartered in the First State is established at 4th and Market Streets in Wilmington. Capital stock: $100,000.

1895 – Seventeen bankers meet to form The Delaware Bankers Association.

1895 to 1980 – In the pre-interstate banking era, Delaware, like most other states, conducts the business of banking based on the needs of the local populations. Like the rest of Delaware, the First State's banking industry is small and modest. After 185 years, that reputation was about to quickly change, thanks to a Supreme Court decision. and very high interest rates.

From Nebraska with Love…

You've probably never thought of Nebraska and Delaware in the same sentence. What do Cornhuskers and Blue Hens have in common, apart from being States of the Union? The roots of Delaware's banking explosion in the 1980s can be traced to Nebraska, specifically, the First National Bank of Omaha. That bank mailed credit card offers to residents of nearby Minnesota. A Minnesota bank, Marquette National in Minneapolis, sued First National of Omaha for violating Minnesota's usury laws. The case went to the U.S. Supreme Court, which unanimously found in favor of the Nebraska bank holding that a national bank could "export" its home interest rate to customers residing in other states and charge them the maximum rate allowed in their home state. Before the Marquette decision, banks typically only dealt with local customers because of the uncertainty of whether they could export rates to out of state customers.. The banking laws also placed restrictions on interstate banking, which prohibited a bank from buying a bank in another state or operating branches outside its home state without permission from the new state.

The problem facing the credit card industry in the 1970s was, in addition to not being able to operate a national credit card market due to uncertainty regarding exportation, was hyperinflation. The fed tightened interest rate so much that the

30-year treasury bill yielded 16%. Banks like Chase Manhattan and Citibank were limited to a 12% interest rate in New York for credit cards. They were losing millions of dollars a month because their cost of funds was exceeding the interest rate they could charge their customers. As a result, both banks began to look for a state where they could set up a new bank and charge a market rate of interest on their credit cards.

…by Way of South Dakota

Delaware may be small, but it's quick, right? Not that quick. Actually, it was South Dakota that was first out of the gate but not by design. South Dakota was in the process of changing its usury laws, not to attract credit card banks, but to free up capital for South Dakotans. Enter Citibank, looking to revive its flagging fortunes after New York State refused to loosen its interest rate caps. South Dakota, also hurt by the recession, fashioned a bank-friendly solution to attract Citi.

Meanwhile, Back in the First State

Pete duPont became Governor of Delaware in 1977 committed to expanding the State's economic development, creating jobs, and generating tax revenue. A task force of business and government leaders was formed to strategize this resurgence beyond the State's two primary industries: chemical and auto manufacturing. Ironically, it was a chemical industry CEO who suggested banking as a possible windfall for Delaware.

"The first state to follow South Dakota was Delaware," Bill Janklow, South Dakota's Governor in the early 1980s, explained in a 2004 interview. "On Citibank's board of directors were all these corporate titans, and one of them was Irving Shapiro. Irving Shapiro was the CEO of the DuPont Company, headquartered in Delaware. And Shapiro, when we were doing our Citibank deal, went back to Delaware and said to Pete du Pont: 'Pete, this is crazy. Delaware has got this long history of being kind of the corporate locus for America. This financial services industry, it's all going to go to South Dakota. Let's get the law changed in Delaware.'"

At roughly the same time Irving Shapiro was making his suggestion, another large New York bank approached Governor du Pont seeking a friendlier business environment. Chase Manhattan Bank, seeing what Citibank had done in South Dakota, reached out to Delaware in early 1980. Chase had a connection with Delaware already since it had an Edge Act branch in the state. Henry Beckler, who used to work for Chase in New York, and was then a consultant to Bank of Delaware, was instrumental in working to overcome the mixed reactions of local bankers concerned about letting a large bank like Chase into Delaware. After a lot of discussion about ways to protect the local banks, a second meeting in June 1980, championed by Shapiro, yielded better results. Much like Citibank in South Dakota, Chase was looking to eliminate the interest rate ceiling, along with a revised banking code that would permit an out of state bank to establish a new limited purpose bank in the state.

In a 2017 Forbes article, Glenn C. Kenton, then Delaware's Secretary of State, gave Chase's motivation for approaching Delaware. "They said, 'We do not want to go to South Dakota for two reasons: A) Citibank is already there and B) It's South Dakota. Chase Manhattan asked whether Delaware would give it the same deal as South Dakota gave Citicorp. "The governor and I got together and said 'Yes.'"

Following the June meeting, Governor du Pont created a bank task force comprised of state and local officials, business executives, and approximately a half-dozen bank lawyers and bank officials. Secretary of State Kenton headed the group. O. Francis Biondi, a private Wilmington lawyer and member of the task force, took a lead role in crafting the legislation assisted by his colleague Walt Tuthill and Rick Eckman, then an inhouse banking lawyer at the Bank of Delaware, and others, started by reviewing South Dakota's statute and drafting a new banking code for Delaware, which would ultimately become the Financial Center Development Act.

The drafting took approximately six months with much of the work carried out in private by these Delaware lawyers and New York based lawyers for Chase Manhattan Bank and J.P. Morgan & Company. J.P. Morgan was interested in Delaware because the tax rate charged to banks by New York was too high in their opinion. While this may have resulted in a bill that was well suited to the banks' needs, the process was not without its critics by the time it was completed. Aside from the drafting group, there was limited input by other Delaware officials.

By January 1981, the bill was ready for its public unveiling. Governor du Pont briefed key legislators at a breakfast meeting on January 14th, with the public release of the bill the following day. In all, 41 representatives and 21 senators sponsored the landmark legislation. The following week, on January 21st, the FCDA's one hearing, lasting three hours, was held. Irving Shapiro and Francis Biondi testified in support of the bill, along with various state officials.

The claim was made that the public, the press, and some state officials, including Frances M. West, head of Delaware's division of consumer affairs, were deliberately kept out of the drafting process. Glenn Kenton defended the action to the New York Times in 1981

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soon after the bill's enactment. ''I didn't see any sense in running that fundamental principle [that banks should be free to set interest rates] by anybody who doesn't agree with it.'' Irving Shapiro, also to the Times, defended the drafting process. "The people who had an interest in the bill were involved.'' He added that care had to be taken in the process so as not to ''scare the banks away.''

According to the New York Times, when the 61-page act reached the Delaware General Assembly, many of the bill's sponsors admitted that they didn't understand some of its complicated nuances. Further detractors complained that the hearing for the bill was only three hours long, preventing concerted rebuttal. Supporters, including Governor du Pont, pointed out the deliberations were as extensive as any in the previous four years.

On February 3, 1981, the Delaware State Senate, passed the FCDA, by a vote of 14 to 7, without a hearing. Eighteen amendments were proposed, unsuccessfully. Once passed, the Financial Center Development Act was signed by Governor du Pont on February 18th.

You Are Cordially Invited to Delaware

While the FCDA was similar to legislation enacted by other states, it included certain conditions for a bank to come to Delaware to assuage the concerns of local banks and to insure that the economic development impact of the bill would be realized. The act contained four major provisions. The first provision allowed out-of-state bank holding companies or its subsidiary to acquire a single newly established bank in Delaware. The Bank Holding Company Act of 1956, specifically the Douglas Amendment, prohibited bank holding companies from acquiring more than five percent of the voting shares of a bank's stock in another state, unless the other state permitted it. The FCDA, like the South Dakota legislation before it, took advantage of this condition. Additional provisions limited the the out-of-state bank to a single office and the bank could not operate in a manner to the substantial detriment of existing local banks, a key concern of the local banks. Additionally, the new bank would have to have $10 million or more in capitalization, with at least $25 million in capitalization and 100 employees by the end of its first year of operation in Delaware. Applications would have to be approved by the Delaware Bank Commissioner, who also had the power to order divesture of the holding company's stock if the conditions were not met and federal law required approvals by the Federal Reserve Board and the Comptroller of the Currency in the case of Chase.

Why You Should Come to Our Party

As anyone who has received an invitation to a party or affair can tell you, the invitation alone isn't enough. One wants to know where it is being held, what's being served, who else is invited, and other incentives to entice acceptance. The FCDA deregulated the consumer lending provisions of Delaware law with the philosophy that the bank and the customer should be free to determine the terms and conditions under which they would receive a consumer credit card or loan without legislative or regulatory conditions. Banks were also allowed to impose various fees and charges for revolving credit as well as closed end credit, as long as they were disclosed in the contract (e.g:.the credit card agreement). Usury ceilings were also eliminated on most types of loans. Because the state was in effect eliminating any usury limits on loans generally, lifting of the limit applied not only to banks but finance companies, retailers, and other regulated lenders.

The FCDA presented a very appealing set of incentives, but perhaps the most attractive was the favorable tax rates the Act provided that were strongly supported by J.P. Morgan. Banks were taxed on a sliding regressive scale, meaning the tax rate fell as the bank's income rose. This was a boon for large out-of-state banks facing onerous state and local tax rates in their home states, particularly New York. The initial rate set by the FCDA was 8.7 percent on the first $20 of net income; 6.7 percent on net income of $20 to $25 million; 4.7 percent on income between $25 and $30 million; going down to 2.7 percent on net income above $30 million. At the time of the FCDA's enactment, no Delaware banks had net incomes over $20 million, so this provision was definitely aimed at drawing out-of-state banks to the First State.

The Impact of the FCDA

The Financial Center Development Act succeeded beyond the most optimistic expectations of its supporters. In the first five years following its passage, banking jobs in Delaware increased by more than 20 percent annually, while deposits grew at a rate of 28 percent per year. And while 9,000 new banking jobs were created by 1985, the growth in Delaware's financial service industry created the need for 90 new retail establishments, resulting in an increase of $284.3 million in sales. According to a survey conducted by the Delaware State Chamber of Commerce, every 100 new banking jobs resulted in 10 new jobs in manufacturing, four in construction, 17 in wholesale and retail, 18 in services, and 11 in government. State revenue also saw a significant increase. In 1982, $2.2 million was paid in Bank Franchise Taxes. By 1985 that number had ballooned to $47.3 million, with another $9.5 million in taxes going to local governments. Today, the financial services industry employees over 47,000 individuals in the State of Delaware with many of the top credit card issuers having their home offices in the State. Total Bank Franchise tax revenues over the last 38 years total over $3.2 billion.

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Without a doubt, the FCDA was the most successful economic initiative the state has ever undertaken. Its benefits continue to be felt with the many large financial services industries located here, and the benefits to the state in terms of its offshoots such as real estate, jobs, new fintech companies, and the reputation for innovation continue to pay rewards. The ability of businesses and the State to work together to create this innovation should be an example for others to emulate. The national credit card industry was created by those such as Chase Manhattan who had the foresight to see a problem and find a way to solve it, to the benefit of their shareholders and the millions of credit card customers who can now have access to a credit card. The day when a person moved out of an area and had their credit card cancelled are long gone. Credit cards are ubiquitous today because of the steps Delaware took almost 40 years ago. Those involved who had the foresight to see the possibilities of the FCDA had their dreams realized with the success of this landmark law.

FCDA

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Richard P. Eckman is a Senior Counsel at Troutman Pepper Hamilton Sanders LLP. He represents financial institutions and non-regulated entities in a range of matters involving investment management, commercial and consumer financial services, public finance and trusts. Drawing upon many years of experience inside the banking industry and involvement in drafting key banking regulations, he is a trusted advisor on operational and regulatory issues.

Rick also has an active practice representing non-depository institutions, specialty finance companies, and service providers in compliance matters, payment system issues, strategic transactions, government investigation and enforcement actions. In addition, he advises marketplace lenders on matters such as merchant cash advance and co-branding relationships and represents a number of institutional trustees in Delaware business trust transactions.

Rick advises clients on payment issues including dealing with FinCEN and state money transmitter statutes. He also has helped non-bank lenders and their service providers to design and launch national online lending platforms and businesses.

An active speaker and writer on the activities of state and federal banking regulators, including the Consumer Financial Protection Bureau, Rick was one of the drafters of Delaware's landmark Financial Center Development Act that attracted over 25 financial institutions to the state.

Greg Koseluk is the VP of Marketing and Public Relations for the Delaware Bankers Association. In addition to writing various articles related to banking history for Delaware Banker, he is the author and illustrator of the eight financial literacy childrens book in the Great Investo series. He is also the author of Eddie Cantor, A Life in Show Business*; and* Great Brit-Coms: British Television Situation Comedy.