The Integration of Banking and Telecommunications: The Need for Regulatory Reform

Kalpak S. Gude*

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Introduction

In the past twenty years technological advances and regulatory changes have not only altered the banking and telecommunications industries, but have also brought the two industries closer together. Many banking institutions now provide telecommunications services, while some telecommunications companies provide financial services. Banks already lease some communications line capacity to other users and extensively use telecommunications systems to provide automated teller machines (ATMs) in locations far removed from bank branches. Telecommunications companies offer such traditional bank services as issuing and processing credit cards.

While the Federal Communications Commission (FCC or Commission) has aggressively restructured its regulations to allow industry participants to take advantage of technological innovations, banking regulators have done exactly the opposite.(note 1) Bank regulations have remained stagnant in the face of tremendous upheaval in the definition of what constitutes "banking services."

The result is increased competition in providing services previously dominated by banks, including financing, leasing, and issuing and processing credit cards. New banking competitors, particularly telecommunications companies, are diversifying their business operations, while banks remain constrained by antiquated rules and regulations.

The key to the competition between banks and telecommunications companies has been the convergence of computers and telecommunications. Technological advances have made it possible to provide computer services over networks where data can be transferred and processed at locations separate from its collection or production.(note 2) These technical capabilities have led to an emergence of special non-common carrier providers of Value Added Networks (VANs). VANs are communications networks that add value to transmitted data, usually by providing processing services.(note 3) These providers use existing networks, or create new ones, to provide customers with information services ignored by the traditional telecommunications industry. At present, the VAN industry in the United States is valued in the billions of dollars and growing.(note 4) The same is true around the globe, with Japan expected to support a VAN industry worth $2 billion by 1995 and Europe already supporting a VAN industry worth more than $2 billion as of 1992.(note 5)

In the United States banking institutions have invested substantial amounts of money to position themselves to provide many VAN services. These banks have been some of the most active businesses in modernizing facilities to enable themselves to enter this growing field.

This Note first describes the telecommunications services currently provided by banks--services such as leased lines, ATMs, and home banking. It then discusses the regulations that prevent banks from diversifying into new business fields. Finally, this Note evaluates the present competitive atmosphere in the financial services sector and explains why increased freedom for banking institutions would benefit both the banking industry and consumers.

I. Telecommunications Services Currently Provided by Banks

Banks and financial services companies have been major players in the telecommunications sector for many years. Even with the regulatory problems that hinder them,(note 6) banking institutions have been offering new services and features to improve the efficiency and convenience of their business. Banking is no longer defined by an individual customer conducting business through a teller; it is now characterized by a system of electronic transactions conducted

over computer networks from points around the globe.(note 7) Today, 57 percent of banking transactions occur outside bank branches.(note 8) According to the First Manhattan Consulting Group, the future will bring a dramatic shift away from the traditional bank branches toward more electronic systems. First Manhattan predicts one in five bank branches will close by the end of the decade.(note 9) Although banks will likely offer new services in the future, they already use telecommunications technology in three important ways: leased lines, ATMs, and home banking.

A. Leased Lines

Leasing telecommunications lines has grown in importance in recent years. The practice usually consists of buying excess transmission capacity from telecommunications providers and using it for specialized purposes. Advances in communications switching technology(note 10) have made it feasible for some businesses to lease access to these lines and to provide new data processing services by attaching their own switching and computer processing equipment.(note 11)

With the proliferation of private telecommunications lines and the decrease in the cost of computer and networking equipment, leasing communications lines is a burgeoning field. In the past, data communication was done over the public voice network, but the limitations of that network, in both speed and accuracy, encouraged many business users to look to private digital lines for their communications needs.(note 12) Many advanced service providers have entered the field by attaching network management equipment to the lines.(note 13)

Two types of users have shown a great interest in leased lines. First, large multinational users are attracted by the high volume capacity at a cost-effective price and often need security and high speed in their point-to-point connections.(note 14) The second group consists of the new service providers who are able to keep the costs of marginal services down by leasing capacity based on volume instead of time.(note 15)

Banks are included in both groups. Many multinational banks require the high capacity and security of leased lines for communications between branches and customers located around the world. Banks have also provided new services, such as ATMs, which can use leased lines to serve consumers more efficiently.

At present, because excess capacity is needed in the banking field to insure against network failure, and because of overbuilding during the 1980s, banks use only between 10 and 30 percent of their network transmission capacity.(note 16) This has created a desire among banks to lease some of this excess capacity to other businesses.

The problem for banks has been the existence of regulations that prohibit diversification and limit the use of bank-owned telecommunications networks to the transmission of banking data.

The future of leased lines may be threatened by the emergence of Integrated Services Digital Networks (ISDN), networks capable of transmitting voice, data, and video. These networks may reduce the need for leased lines due to the increased capacity of the public network.(note 17) Other concerns expressed by banks are possible regulations banning leased lines or technical decisions not to support leased lines.(note 18)

The current users of leased line communications contend, however, that present leased line services are essential to their future telecommunications needs. They claim that the aspects of leased line service that must be maintained include "full user control, faster response time, better security, and greater flexibility of use."(note 19)

B. Automated Teller Machines

Automated teller machines have become a critical component of a bank's ability to communicate with customers and are the most recognizable electronic financial service. ATMs allow use of the telecommunications network for remote withdrawals, deposits, and account information retrieval twenty-four hours a day. There are over 94,000 ATM machines in service in the U.S. and they process over 642.1 million transactions per month.(note 20)

Beyond increasing customer contact, a great benefit to banks is that ATMs are extremely efficient, because fewer

personnel are needed to perform the great number of transactions. To operate ATM systems cost effectively, economies of scale are needed.(note 21) In the United States there are seven national and some two hundred regional shared networks, the majority of which are jointly owned by a number of different banks.(note 22) These networks of ATMs are also expanding abroad. In the past decade, the Royal Bank of Canada entered into a partnership arrangement with a U.S. network, the Plus System, to arrange for shared ATMs in the United Kingdom. The Royal Bank planned to coordinate all data transmission between North America and the system's ATMs in the U.K. and also to process all foreign-exchange transactions involving Canadian, U.S., and British currency.(note 23) Because of efficiency gains, this type of expansion and collaboration between ATM networks and banks around the world can be expected to increase.

The development of new communications technologies may make it possible for banks to expand the types of transactions a customer can process via an ATM. The ability of banks to provide these new services will depend as much on the cost of access to the telecommunications system as it will on the technological capabilities. Regulatory developments in the banking industry will have great impact on both cost and capability.

C. Home Banking

The banking industry also employs telecommunications technology in a third area--home banking. These systems allow customers to access bank computers from remote locations, using networks that may be public (public phone network), private (private access terminals), or both.

Many large banks have begun to provide complex home banking services for their customers.(note 24) Chase Manhattan Bank currently operates Spectrum, which enables customers to access the Chase Manhattan computers through the public telephone network.(note 25) Citibank also has a home banking system, Direct Access. Along with other banking features, it allows customers to use Citibank's brokerage facilities and manage or monitor their individual retirement accounts.(note 26) Chemical Bank's system, Pronto, also has transactional capabilities. Through Chemical Bank's network gateway, customers can retrieve price quotes on stocks and commodities, check their portfolios, obtain general information, and access discount brokerage services.(note 27) The transactional capabilities of home banking will expand as questions of security and accuracy of the systems are addressed.(note 28)

II. The Present Regulatory Structure Preventing Further Bank Entry into the Telecommunications Sector

The Federal Reserve Board, in its desire to maintain a secure banking system, strictly limited bank involvement with business services outside the financial services sector. The rationale was that the integrity of the banking system could be jeopardized by allowing banks to use profits from their traditional bank services to cross-subsidize risky business ventures in areas outside of their natural expertise.(note 29) As the definition of "financial services sector" has changed, regulation of the industry in the same manner has become more difficult.

In general, a bank holding company cannot own a telecommunications entity unless that entity is primarily in the business of transmitting financial data or information related to banking.(note 30) Regulations allow bank holding companies to be involved in transmitting data, but only if it is "financial, banking, or economic" in nature.(note 31)

The Board designed these restrictions to protect banks and the public from the perceived risks of diversification that could affect a bank's solvency.(note 32) The result of these regulations is that banks wishing to use their private communications networks to compete with telecommunications providers are prevented from doing so, unless they target customers who are interested in transmitting only financial data.

Bank subsidiaries are also restricted from entering fields outside of the financial services sector. They may compete in only those non-banking activities that are closely related to the traditional services of banking.(note 33) The Bank Holding Company Act states:

> In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound business practices.(note 34)

Courts have interpreted this standard to mean that bank holding companies can provide a service if (1) banks generally have provided the service in the past; (2) banks generally provide services that are operationally or functionally similar to the proposed services, making banks particularly well suited to provide the proposed services; or (3) banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.(note 35)

In 1982 Citicorp, the largest commercial bank in the United States, attempted to enter the telecommunications field to provide common carrier service.(note 36) The FCC rejected the application, stating that the Bank Holding Company Act did not authorize Citibank to furnish this type of service without approval of the Federal Reserve Board.(note 37) This ruling set a precedent that the financial regulatory system (Federal Reserve Board), rather than the marketplace at large, would define the permissible activities for banks and their subsidiaries.(note 38)

The Federal Reserve Board followed this standard in approving Citicorp's acquisition of Quotron. Quotron is a company that provides data processing and data transmission activities for customers such as securities and commodities exchanges, brokerage firms, commercial banks, and insurance companies.(note 39) The Board concluded that most of Quotron's business in data processing and related services was sufficiently related to banking services, but it did require Citicorp to divest certain Quotron activities, and it imposed limitations on others. The Board mandated that Citicorp keep a close nexus between these new services and the traditionally permissible activities of bank holding companies.(note 40)

III. The Rationale Behind Allowing Banks to Provide More Telecommunications Services

There are several reasons to modify the present regulatory restrictions preventing banks from entering the telecommunications sector. First, banks are in a position to offer new services to the public at very competitive rates. Allowing banks to capitalize on their already developed technological infrastructure will yield greater access to account information and transactional capabilities for consumers. Second, the competition in the financial services industry has been increasing dramatically in recent years, and if banks are not allowed to expand their business offerings, their future viability may be affected. Third, telecommunications regulations are already well developed for handling many of the problems that new competitors might cause.

A. Banks Are Well Poised to Provide Further Telecommunications Services

Banks in the United States are well situated to provide expanded telecommunications services. Technology has in recent years played a major role in the development of the industry and will continue to do so in the future. Banks have invested billions of dollars in technological innovations, spending approximately $15.3 billion on information technology in 1993.(note 41) Chemical Bank alone spent $1 billion on technology from 1987 to 1990.(note 42) This level of investment has given banks the ability to process vast amounts of information rapidly, integrate new functions into their business, and raise the quality of service by reducing errors.(note 43)

As previously mentioned, an expansion of home banking and ATM services is expected even under the present regulatory structure. For banks to survive and prosper in the future, however, it will be necessary to allow them to increase their leased lines business and to expand their VAN services outside of the purely financial services sector.

ATM networks are being developed to assist bank customers in opening accounts, applying for loans, and obtaining

financial counseling services. The services will integrate videodisc technology with microprocessors to create a two-way communications system between bank computers and customers.(note 44)

Microcomputer systems that allow corporate customers to determine balances, cleared checks, and investment account information are being developed.(note 45) Plans also exist to add check-writing features to some of these systems.(note 46) Point-of- sale support will be a logical next step in the use of ATM cards. More exotic "smartcards" will be able to perform certain processing operations while being removed from the system.(note 47) These features will be dependent on the network conditions and the regulatory structure that supports these industry applications.

Voice mail and voice response systems will become more important in the future. Voice mail is a system that replaces receptionists by electronically storing phone messages. Voice response can even replace the person for whom the message is left by responding to requests for information.(note 48)

If regulations were changed, an opportunity would exist for banks to use their excess leased line capacity to participate in message, voice, and general data transmission. To provide these services, banks would have to agree to be regulated as common carrier providers.(note 49) If regulations were changed, the private networks that banks have built may provide an opportunity to expand their VAN services to areas outside the banking sector. Following the expected growth of ATMs and home transactions, general information access and delivery are potential growth areas for banks.

B. Telecommunications Companies and Their Role in Providing Banking Services

While banks are using their own networks to provide new services to their customers, other industry groups have realized the profits that can be made in the financial services sector. Telecommunications companies in particular have capitalized on the fact that the key to modern financial services is the ability to transport information rapidly and accurately, a skill they have already mastered. Another important factor prompting telecommunications companies to provide financial services has been deregulation within their own industry, increasing competition in a previously secure market.

1. Deregulation of Telecommunications Providers

The Federal Communications Commission has had to reevaluate how it regulates the telecommunications industry. Technological innovations have necessitated a revision of regulatory structures to facilitate business opportunities and enhance productivity within the industry. The FCC has thus decided to follow free-market principles to promote increased competition, in the hopes of improving the telecommunications industry's responsiveness to market forces.

One early attempt at deregulation of common carriers came in 1971 when the FCC attempted to distinguish between three categories of services in its *Computer I*(note 50) decision: the regulated telecommunications services, the nonregulated data processing services, and the hybrid services (combination services that offered both telecommunications and data processing capabilities).(note 51) The hybrid services were to be regulated on a case-by-case basis, distinguishing them from the common carrier regulations.(note 52) Existing telecommunications providers were faced with competition for the first time because these new service providers could transmit as well as provide additional processing capability.(note 53)

In 1976 the FCC announced its *Computer II* decision.(note 54) Instead of three categories, *Computer II* divided the field between "basic services" and "enhanced services."(note 55) A basic service is the point-to-point transfer of information with the transmitted data remaining unchanged. Enhanced services include networks with additional services or features. To qualify as a value-added service, which could be provided by less heavily regulated private enterprises, some additional service had to be supported beyond those provided by normal common carriers.(note 56) This decision better defined the deregulated "enhanced services" portion of the telecommunications industry, promoting entry of further competitors.

The problem with this redefinition was that new technology blurred the lines between the "basic" computer services

and the "enhanced" network.(note 57) Services previously provided by computers outside the network could now be done digitally within the network.

The breakup of AT&T in 1982 was a watershed event in the field of telecommunications. The Modification of Final Judgment (MFJ) decision was based on antitrust proceedings aimed at reducing the dominant position of AT&T.(note 58) It resulted in the divestiture of the regional Bell Operating Companies, or "Baby Bells," from AT&T.(note 59)

Technological improvements were a major cause for the divestiture. These developments included (1) alternative forms of transmission (microwave, satellite), making it possible to bypass the common carrier networks; (2) the merging of computer and telecommunication technologies and the emergence of computer networking and electronic switching; and (3) the development of new computers and terminals with sufficient size and speed to make data interchange commercially viable.(note 60)

Deregulation and increased competition have resulted in the need for telecommunications companies to expand their service offerings and to extend into new areas in which they traditionally had not participated, like financial services. Banks now face increasing competition from the telecommunications companies. In the United States, banks are prohibited from operating telecommunications systems except for transmitting financial information.(note 61) Telecommunications companies, on the other hand, have begun to invade the territory traditionally held by banks. As regulations are reduced in the telecommunications industry, the non-common carrier network providers are entering the VAN sector. One of their primary areas of interest is the financial services field, which places them in direct competition with the heavily regulated banking industry.

2. Financial Services Offered by Telecommunications Providers

By relaxing government controls, the FCC has blurred the distinctions among various telecommunications businesses. These include local phone companies, long-distance companies, cellular phone companies, and even cable companies.(note 62) Due to the competition that AT&T has recently faced from MCI, US Sprint, and other long distance companies, it has attempted to persuade the FCC to drop the tighter regulation that its "dominant carrier" designation brings.(note 63) Local phone companies are also expected to face competition within the next few years.(note 64) These actions are forcing telecommunications providers to pursue other areas of business, including credit card issuance and processing, equipment financing and leasing, videotext service, electronic data interchange, and gateway services.

a. Credit Card Issuance and Processing The entry of AT&T and the Baby Bells into the credit card business has been unnerving to the banking industry. Banks fear that telecommunications companies would use information that they have gathered in their role as communications providers and compete with banks directly in the financial services sector.(note 65)

AT&T began this trend when, in collaboration with the Universal Bank of Columbus, Georgia, it introduced the AT&T Universal Card. The agreement between AT&T and Universal Bank set forth that cardholders would be permitted to use the card issued by Universal Bank to place calls on the AT&T network at a favorable rate and be charged on the cardholder's account; that AT&T would be responsible for marketing the card and performing certain back- office processing services; and that AT&T would agree to purchase receivables and fund telephone receivables in excess of $25 million.(note 66) The card was an immediate success and had attracted more than thirty million customers by December of 1990, making it one of the nation's most widely held cards.(note 67)

The Baby Bells have followed the lead of AT&T. Ameritech has offered its own card, the Ameritech Complete Mastercard.(note 68) The card works very much like the AT&T Universal Card and is offered jointly by Ameritech and Household International.(note 69)

These new providers of credit card services have generated great concern in the banking industry. Telephone companies can collect information through their main common carrier business (a business in which there are not many competitive alternatives) and use this information to target bank customers.(note 70)

Although major credit card issuers, such as Citicorp and American Express, are concerned about the new competition, ironically they remain among the biggest corporate customers of the telecommunications companies for authorization and funds-transfer messages.(note 71) This continued dependence on potential competitors could be a major problem in the future.

On the other side, the telecommunications companies have argued that increased competition in their own field is driving this growth and that if restricted, the United States will fall behind in the development of communications technology.(note 72) William Davidson, a professor of international business at the University of Southern California and a consultant for the regional Bells, stated that banks would benefit from deregulation. He claimed that banks in Canada, in conjunction with telecommunications companies, are offering better services than banks in the United States. This is the result of the more open regulatory policies in Canada.(note 73)

b. Equipment Financing and Leasing The telecommunications industry is also becoming increasingly involved in equipment financing and leasing. AT&T and several of the Baby Bell companies have large equipment financing and leasing units that compete with banks.(note 74) AT&T Capital Corporation provides project financing for energy production companies, makes loans to small businesses, and provides financing for firms in Canada and Europe.(note 75) NYNEX Capital Funding Co. provides funding for some NYNEX subsidiaries.(note 76) Critics say that the knowledge telecommunications companies could gain through commercial financing could assist them ultimately to become full service financial providers.(note 77)

c. Videotext Services Videotext services offered by telecommunications corporations could be used to provide many new financial services easily accessible to most consumers. Prodigy (a joint venture of IBM and Sears) and Compuserve offer videotext services(note 78) and some banking services.(note 79)

The French Minitel videotext system is often touted as an example of the benefits and potential of this field.(note 80) U.S. telecommunications companies have been wary about offering a similar information service, because the service would be expensive and difficult to popularize.(note 81) This business sector is likely to grow as more powerful technology becomes commonly available in the home.

While the Baby Bells look forward to entering the video services business, technical and regulatory problems still must be solved. Fiber optics, which uses light to carry information, will facilitate videotext implementation, but it requires all homes to be wired with fiber-optic lines.(note 82) Federal law still bars the phone companies from offering video services within their telephone service areas,(note 83) although the companies can buy or build cable-TV systems in other geographical regions.(note 84) The FCC has proposed changes to the regulations that would allow phone company participation in the video field, but any large-scale phone company participation would require congressional action.(note 85)

d. Electronic Data Interchange American Bankers Association officials have claimed that AT&T and the regional Bell Operating Companies (RBOCs) are becoming "near banks" because they do everything that banks do except maintain debit/credit deposit accounts.(note 86) With Electronic Data Interchange (EDI), even this distinction would be lost. EDI is similar to electronic funds transfer (EFT), the process by which banks move funds from one account to another or from one bank or banking location to another.(note 87) Using EDI, the net payment must pass through the bank, but all intermediate transactions could travel directly between the buyer and seller and bypass the banks. Banks would then provide virtually no value-added service and would be able to charge only nominal fees for the ultimate transfer of money.(note 88)

The benefit of EDI is its efficiency. It replaces commercial paper documents such as shipping orders, invoices, and purchase orders with electronic transactions.(note 89) Information travels from computer to computer via satellite, telephone lines, tapes, or computer floppy disks in a standardized format that alleviates the requirement for standard software or hardware.(note 90) This efficiency, along with stiff international competition, will make EDI the industry standard.

To avoid being excluded, banks will need to develop their own EDI hubs or other direct electronic contact with their customers. This may only be possible for large banks such as Chase Manhattan, which has developed a system for handling transmission of electronic invoices, purchase orders, and final payments without third-party VANs.(note 91)

e. Gateway Services Gateway services allow consumers to access a variety of information services by dialing a single access number.(note 92) While Baby Bells cannot develop and market electronic databases under current regulations, they can provide electronic "gateways" between information providers and users.(note 93)

Gateway services are a double-edged sword for banks. Although they provide banks with more flexibility in developing comprehensive services, such as home banking and ATMs, they also may result in Baby Bells becoming increasingly involved in the financial services industry.(note 94) Once again, these technological advances create direct competition between banks and telecommunications firms.

C. Telecommunications Regulations Already Exist to Manage Bank Entry into the Telecommunications Field

The telecommunications regulations that are most important to the financial services industry are those pertaining to common carriers, tariff regulations concerning access to the network for enhanced service providers, and regulations relating to market entry for providing VAN services. These three areas of regulation will control what kind of telecommunication competition will exist in the field as well as the cost of value-added service. Although the telecommunications field is in a state of flux, the FCC is attempting to accommodate new market participants by liberalizing rules that deal with various aspects of the industry.(note 95) These new rules, instituted by the FCC, will be far more adept at handling the problems accompanying bank provision of telecommunications services than will the traditional bank regulations.

1. Common Carriers

The FCC has defined common carriers as entities that offer communications services to the public, for profit, without discriminating.(note 96) Any businesses, including banks, that are involved in transmitting voice or data in two-way communications from point to point fall under this category. Title II of the Communications Act establishes a regulatory framework for common carriers.(note 97)

Title II divides competitors into dominant and nondominant carriers. Title II defines dominant carriers as those having market power to set prices or the capability to engage in anticompetitive conduct.(note 98) Dominant carriers must obtain approval, under Section 214 of the Communications Act, before constructing transmission facilities.(note 99) In the area of telecommunications, AT&T has been defined as the dominant carrier with all the attendant regulations.(note 100) All other carriers are classified as nondominant and are subject to reduced regulations.

The FCC's goal has been to promote competition in the common carrier market. Consequently, its regulations have made it unlawful to restrict the ability of market participants to lease and resell private line communications capacity or to share the costs of communications lines with other customers.(note 101) This system has promoted the entry of small niche competitors into the market.

The FCC has also promoted competition by modifying the tariff system. In the past, all carriers were forced to make tariff filings specifying their rates and the terms of their offerings.(note 102) The FCC later changed this rule by requiring filings from the dominant carriers only.(note 103) The modification removed one layer of regulatory constraints from the smaller nondominant participants, which allowed them to be more flexible in their rate structure and gain competitiveness.(note 104)

The entry of banks into the common carrier field could be focused, at least at the beginning, on supplementing their VAN services by allowing the transmission of related voice or message information. This would allow banks to use more efficiently their excess line capacity or to lease telecommunications capacity of other providers and to attach their own switching or gateway systems.

2. Enhanced Services

Not all transmission services fall under the common carrier umbrella.(note 105) Some are considered "ancillary" services, unregulated by Title II.(note 106) Instead, the FCC regulates the services under Title I of the Communications Act.(note 107) Title I has not adequately addressed the problems of the enhanced services sector. The speed of technological advancement has made it virtually impossible for regulators to keep pace.

In the past, the FCC's focus was to establish lines of demarcation between telecommunications (common carrier) and related electronic services.(note 108) These boundaries were important because they determined how services could be offered and who could offer them. They also established the regulatory framework for the entire telecommunications industry. With advances in technology, line drawing becomes difficult and cannot always be done rationally.(note 109) If a bank offered on-line transactional services, it would not be clear whether this should be considered a common carrier type of service or a nonregulated communications service.(note 110) The difference between the two choices could affect the type of service offered, or even whether the service would be offered at all.

A main concern for the enhanced service providers (those who combine communication and data processing services) has always been connection to the main telecommunications network. In 1974 in *Bell Telephone Co. v. FCC*, the U.S. Court of Appeals for the Third Circuit affirmed the obligation of the local phone companies to give enhanced service providers access to the network.(note 111) This created a need to regulate the rate structure for the specialized carriers. These new competitors were divided into two groups: those needing switched access service and those needing special access service.

Providers used switched access service to access the local exchange to reach all numbers on the public telephone network. The rates for this service included a flat monthly charge for network access and maintenance, and a contribution to the Universal Service Fund to promote Universal Access.(note 112) The special service option rates included a monthly charge per channel termination and fixed and variable monthly charges for line access.(note 113)

The FCC has considered the possibility of restructuring the access fee for interstate calls that leak from private networks into the local exchanges operated by the RBOCs. The private network providers are able to pay a flat monthly fee for their network connection.(note 114) The FCC has considered removing the access fee exemption that has existed for enhanced service providers.(note 115)

The financial service providers have vehemently opposed this proposal, claiming it would raise their costs dramatically and result in problems in the reliability of the credit card business due to reduced use of the on-line authorization system.(note 116) They criticize the FCC for trying to apply a regulatory approach designed for long-distance telephone service to industries for which it was ill-suited.(note 117) These protests have delayed the FCC's implementation of this proposal. Enhanced service providers and private networks remain the last two groups still exempt from paying deregulated rates.(note 118)

The FCC is striving to create a system where companies can provide enhanced services to the public efficiently and competitively. In the future, banks will likely be more involved in delivering expanded telecommunications services. They will only be able to gain the full benefits from the regulatory reform if they are allowed to participate more actively in the field.

3. Market Entry

For several years, the FCC has struggled with the problem of market entry into the value-added network sector. The goal has always been to open up the industry for competition from as many sources as possible.(note 119) In *Computer II*, the FCC decided to regulate basic services by the common carrier rules and reduce regulation on enhanced services.(note 120) The FCC allowed common carriers to offer extended services but required that subsidiaries be set up to prevent cross-subsidization that could result in unfair competition. The FCC was worried that the common carriers (RBOCs) would be able to undercut other competition by giving themselves lower access charges and other benefits.(note 121)

The FCC decided in 1986 that the common carrier providers would be allowed to provide enhanced service without the creation of subsidiaries.(note 122) The FCC said that the problem of cross-subsidization could be adequately addressed

through accounting measures alone, and that the creation of subsidiaries was unnecessary.(note 123) The FCC ordered the RBOCs to implement Open Network Architecture (ONA) as a way to unbundle services they provided and allow enhanced service providers to compete. ONA would make network connections equally accessible to all market participants.(note 124) Also, the FCC prevented the states from instituting any regulations different from those the FCC had already put in place.(note 125)

In 1990 the U.S. Court of Appeals for the Ninth Circuit vacated *Computer III*. It concluded that accounting safeguards alone could not constrain the RBOCs' ability to cross- subsidize.(note 126) *Computer III* is still important, though, because the FCC moved to reinstate its ONA requirement and to grant the waivers necessary to permit the RBOCs to continue to offer enhanced services without separation for an interim period.(note 127) The FCC has made it clear that the phone companies must be able to capitalize on the benefits of cross synergies, thus revealing that full separation is still not in the long-term plan.(note 128)

Conclusion

The banking industry is at a crossroads. Change in the industry is inevitable, and the direction of that change may well transform banking in the United States into something wholly different from what exists today.

With technological advances, banks are able to serve their customers more efficiently. The banking industry has invested billions of dollars in new technology and has gained the capability to provide services well beyond the traditional, narrow sphere of financial services.

New computer and telecommunications technology has also made it possible for new competitors to provide banking services. Telecommunications companies, realizing that modern banking is merely the moving of electronic transactions from location to location, have entered the financial services industry to capitalize on their networking and computing strengths. Telecommunications regulations have changed dramatically in the past ten years and have encouraged new competitors to challenge the banking establishment.

With the dramatic changes occurring in other industry sectors, the bank regulators have maintained a surprisingly slow and plodding course, keeping to the same regulatory path that they laid out half a century ago. Despite new competition entering the banking field, banks have not been allowed to meet that competition by entering new business areas and expanding their customer base. The bank regulators have instead consistently maintained that diversification would be an evil that the industry should assidously avoid.

The question for the future will be whether banks can continue to exist as their core business sector becomes more competitive and they are prevented from expanding into new areas. The present course is by no means the only regulatory path that might be taken. The telecommunications industry has reformed itself to handle new competitors, and banks have invested money in the technology necessary to compete in the field. Telecommunications is a natural area for the financial services providers to enter.

The Clinton Administration has spoken eloquently about the National Information Infrastructure's potential benefits. A background paper released by the Administration stated that:

> To fully realize the benefits of private investment and more competition in the information infrastructure, regulatory change is needed. For many years, government regulation assumed clear, stable boundaries between industries and markets. This assumption sometimes prompted regulators to view (and to regulate) firms in various industries differently, even when they offered similar services. . . . The time has come for another approach. Even if the lines between industries and markets were clear in the past, technological and market changes are now blurring them beyond recognition, if not erasing them entirely. Regulatory policies predicated on such perceived distinctions can harm consumers by impeding competition and discouraging private investment in networks and services.(note 129)

With the implementation of this vision of increased competition and greater access to new technology, the suggested removal of barriers between markets must include the banking industry.

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Notes

*B.S. Rochester Institute of Technology, 1989; candidate for J.D. Indiana University School of Law-Bloomington, 1994. The Author wishes to thank his wife, parents, and family for their encouragement and sacrifice. Return to text

1. Regulation of the banking industry is accomplished by several different agencies, most importantly the Federal Reserve Board and the Department of Commerce. Return to text

2. Organization for Econ. Co-operation and Dev., The Telecommunications Industry 42 (1988) [hereinafter OECD, Telecommunications Industry]. Return to text

3. Marjorie Greene, Office of Tech. Assessment, U.S. Congress, Public Policy and International Telecommunications Technology in Financial Markets: An Overview 6 (1992). Return to text

4. *Id.* at 8. Return to text

5. OECD, Telecommunications Industry, *supra* note 2, at 42-43. Return to text

6. *See infra* part II. Return to text

7. *See* Walter V. Shipley, *A Scenario for the Future of U.S. Banking*, Am. Banker, Sept. 26, 1990, at 9, 9. Return to text

8. Brian Tracey, *Study Sees a 20% Drop in Branches*, Am. Banker, Nov. 22, 1993, at 1, 1. Return to text

9. *Id.* Return to text

10. Computer switching is the method for controlling the direction of communications signals. Return to text

11. Organization for Econ. Co-operation and Dev., Trends of Change in Telecommunications Policy 110 (1987) [hereinafter OECD, Trends of Change]. Return to text

12. *Id.* Return to text

13. *Id.* Return to text

14. *Id.* The speed of leased lines results from the fact that much of the network switching protocol is bypassed. *Id.* Return to text

15. *See id.* Return to text

16. Office of Tech. Assessment, U.S. Congress, U.S. Banks and International Telecommunications 19 (Background Paper No. OTA-BP-TCT-100, 1992) [hereinafter Office of Tech. Assessment]. Return to text

17. Eugene Sekulow, *Industry Opinions: Telecoms in the 1990s*, Comm. Int'l, Oct. 1991, at 49, 49. Return to text

18. OECD, Trends of Change, *supra* note 11, at 111. Return to text

19. *Id.* Return to text

20. *The EFT Express Zips Along the High Road*, Bank Network News, Nov. 12, 1993, *available in* LEXIS, News Library, Nwltrs File. Return to text

21. "Economies of scale" refer to the economic theory that the cost per unit of any good or service would generally decrease if the number of units produced is increased. Return to text

22. National Telecommuniations and Information Administration, U.S. Dep't of Commerce, NTIA Telecom 2000: Charting the Course for a New Century 450 (1988) [hereinafter NTIA]. Return to text

23. Robert R. Bruce et al., The Telecom Mosaic: Assembling the New International Structure 208 (1988). Return to text

24. Smaller banks also offer home banking services, including access to account balances, status of checks, and information on loans and investment accounts. Return to text

25. Chase Home Banking and Info. Sys., Spectrum Application, Customer Agreement (1992) (copy on file with the *Federal Communications Law Journal*). Return to text

26. *Id.* Return to text

27. *Id.* Return to text

28. Peter J. Brennan, *Voice Response Technology Grows Into a Sophisticated Marketing Tool*, Mag. Bank Mgmt., Aug. 1993, at 50, 50. Return to text

29. *See generally* Bruce et al., *supra* note 23. Return to text

30. *See* 12 C.F.R. sec. 225.25(b)(7)(i) (1993). Return to text

31. 12 C.F.R. sec. 225.25(b)(7)(i) (1993). Return to text

32. Bruce et al., *supra* note 23, at 231. Return to text

33. *Id.* Return to text

34. 12 U.S.C. sec. 1843(c)(8)(G) (1988). Return to text

35. *E.g.*, National Courier Ass'n v. Board of Governors of the Fed. Reserve Sys., 516 F.2d 1229, 1237 (D.C. Cir. 1975). Return to text

36. Greene, *supra* note 3, at 11. Return to text

37. *Id.* Return to text

38. *Id.* Return to text

39. Citicorp, N.Y., N.Y., *Order Approving Acquisition of Quotron Systems, Inc.*, 72 Fed. Res. Bull. 497, 497 (1986). Return to text

40. *Id.* at 500. Return to text

41. Brian Hellauer, *The Back Office: Systems- Industry Picks Up Technology Spending as Outlook Improves*, Am. Banker, July 19, 1993, at 1A. Return to text

42. Shipley, *supra* note 7, at 12. Return to text

43. *Id.* Return to text

44. Bruce et al., *supra* note 23, at 209. Return to text

45. *Id.* Return to text

46. *Id.* Return to text

47. *Id.* Return to text

48. Brennan, *supra* note 28, at 50. Return to text

49. Greene, *supra* note 3, at 11. Return to text

50. *In re* Regulatory and Policy Problems Presented by the Interdependence of Computer and Comm. Servs. and Facils., *Final Decision and Order*, 28 F.C.C.2d 261 (1971) [hereinafter Computer I]. Return to text

51. *Id.* para. 5. Return to text

52. *Id.* paras. 40-44. Return to text

53. OECD, Telecommunications Industry, *supra* note 2, at 42. Return to text

54. *In re* Amendment of sec. 64.702 of the Commission's Rules and Regs. (Second Computer Inquiry), *Final Decision*, 77 F.C.C.2d 384 [hereinafter Computer II], *modified by Memorandum Opinion and Order*, 84 F.C.C.2d 50 (1980), *aff'd and clarified by Memorandum Opinion and Order on Further Reconsideration*, 88 F.C.C.2d 512 (1981), *aff'd sub nom.* Computer & Comm. Indus. Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983), *aff'd on second further recon., Memorandum Opinion and Order*, 56 Rad. Reg. 2d (P & F) 301 (1984). Return to text

55. *Id.* para. 5. Return to text

56. *See id.* Return to text

57. *See id.* para. 6. Return to text

58. United States v. AT&T, 552 F. Supp. 131, 135-36 (D.D.C. 1982), *aff'd sub nom*. Maryland v. United States, 460 U.S. 1001 (1983). Return to text

59. *Id.* at 225. Return to text

60. OECD, Telecommunications Industry, *supra* note 2, at 31. Return to text

61. 12 C.F.R. sec. 225.25(b)(7) (1993). Return to text

62. Dana Blankenhorn, *Greater Competition Is on the Line for Telephone Companies*, Chi. Trib., Nov. 8, 1992, sec. 14, at 10. Return to text

63. Carla Lazzareschi, *AT&T Reaches Out to Grab a Chunk of Computer Market*, L.A. Times, Dec. 4, 1990, at D1. Return to text

64. Blankenhorn, *supra* note 62, at 10. Return to text

65. Jeanne Iida, *Some Bankers Fear the Baby Bells Have Too Many Good Connections*, Am. Banker, Apr. 20, 1990, at 1, 3. Return to text

66. Harvey N. Bock et al., *Developments in the Interstate Delivery of Consumer Financial Services*, 46 Bus. Law. 1223, 1251 (1991). Return to text

67. Lazzareschi, *supra* note 63, at D1. Return to text

68. *Ameritech Enters the Credit Card Business*, Pub. Util. Fort., Nov. 1, 1991, at 85, 85. Return to text

69. *Id.* Return to text

70. Iida, *supra* note 65, at 2. Return to text

71. *Id.* Return to text

72. *Id.* Return to text

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74. *Id.* at 1. Return to text

75. Office of Tech. Assessment, *supra* note 16, at 20. Return to text

76. *Id.* Return to text

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78. Jonathan Weber, *Baby Bells Crawl Into Information Services*, L.A. Times, Nov. 10, 1991, at D8. Return to text

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80. Weber, *supra* note 78, at D8. Return to text

81. *Id.* Return to text

82. *Id.* at D9. Return to text

83. 47 U.S.C. sec. 533 (b)(1) (1988); 47 C.F.R. sec. 63.54 (a) (1992). Return to text

84. Weber, *supra* note 78, at D8. Return to text

85. *Id.* Return to text

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87. *Id.* at 22. Return to text

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90. *Id.* Return to text

91. Office of Tech. Assessment, *supra* note 16, at 23. Return to text

92. NTIA, *supra* note 22, at 468. Return to text

93. Yvette D. Kantrow, *Maturing Baby Bells Pose Bigger Threat to Banks; Spinoffs Also May Increase Communications Options*, Am. Banker, Apr. 15, 1988, at 8. Return to text

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96. National Ass'n of Reg. Utils. Comm'rs v. FCC, 533 F.2d 601, 608-09 (D.C. Cir. 1976). Return to text

97. 47 U.S.C.A. secs. 201-228 (West 1991 & Supp. 1994). Return to text

98. *In re* Policy and Rules Concerning Rates for Competitive Common Carrier Servs. and Facils. Authorization, *First Report and Order*, 85 F.C.C.2d 1, para. 56 (1980). Return to text

99. 47 U.S.C. sec. 214(a), (c) (1988). Return to text

100. *See* Michael Kirkland, *AT&T Debates MCI, FCC Before Supreme Court*, UPI, Mar. 21, 1994, *available in* LEXIS, News Library, Wires File. Return to text

101. *In re* Regulatory Policies Concerning Resale and Shared Use of Common Carrier Servs. and Facils., *Report and Order*, 60 F.C.C.2d 261, para. 130 (1976). Return to text

102. MCI Telecomm. Corp. v. FCC, 765 F.2d 1186, 1193 (D.C. Cir. 1985). Return to text

103. 47 U.S.C. sec. 203 (1988). Return to text

104. The Commission reversed its prior requirement by allowing the filing of tariffs by nondominant carriers but not requiring it. *In re* Tariff Filing Requirements for Interstate Common Carriers, *Report and Order*, 7 FCC Rcd. 8072 (1992). The Commission has modified the rule again to streamline the federal tariff requirements for nondominant carriers. The Commission now permits filing by nondominant carriers on not less than a one day notice. Tariff content requirements were also amended to allow nondominant carriers to state in their tariffs either a fixed rate or a reasonable range of rates. *In re* Tariff Filing Requirements for Nondominant Common Carriers, *Memorandum Opinion and Order*, 8 FCC Rcd. 6752, para. 3 (1993). Return to text

105. Computer II, *supra* note 54, para. 123. Return to text

106. *In re* Detariffing of Billing and Collection Servs., *Report and Order*, 102 F.C.C.2d 1150, paras. 30-34 (1986). Return to text

107. *See* United States v. Southwestern Cable Co., 392 U.S. 157, 172-73 (1968). Return to text

108. OECD, Trends of Change, *supra* note 11, at 68. Return to text

109. *Id.* at 69. Return to text

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111. *Bell Tel.*, 503 F.2d 1250, 1282-83 (3d Cir. 1974), *cert. denied*, American Tel. & Tel. Co. v. FCC, 422 U.S. 1026 (1975). Return to text

112. Richard E. Wiley, *The Media and the Communications Revolution: An Overview of the Regulatory Framework and Developing Trends*, *in* 2 Communications Law 1990, at 619, 701 (PLI Patents, Copyrights, Trademarks, and Literary Property Course Handbook Series No. 303, 1990). Return to text

113. *Id.* Return to text

114. Brian Hellauer, *FCC Tariff Proposals Raise Industry Ire; Federal Communications Commission*, Computers in Banking, Feb. 1988, at 24. Return to text

115. *Id.* Return to text

116. *Id.* Return to text

117. *Id.* at 25. Return to text

118. *Id.* Return to text

119. *Cf.* Computer II, *supra* note 54, paras. 19-36. With the advances in computer and network technology, new enhanced service providers have entered the telecommunications field. Modification of the regulations specified in *Computer I* were considered essential to keep pace with the changing industry. Return to text

120. Computer II, *supra* note 54, paras. 2-13. Return to text

121. Wiley, *supra* note 112, at 661. Return to text

122. Computer III, *supra* note 95, para. 98. Return to text

123. *Id.* para. 92; *see also* Robert J. Butler, *In the Aftermath of* California v. FCC*: Computer III, Remand Proceedings Pose Difficult Policy Choices for the Enhanced Services Industry*, Telecomm., May 1991, at 24. Return to text

124. Butler, *supra* note 123, at 24. Return to text

125. Computer III, *supra* note 95, paras. 347-348. Return to text

126. California v. FCC, 905 F.2d 1217, 1238 (9th Cir. 1990). Return to text

127. Butler, *supra* note 123, at 25. Return to text

128. *See In re* Computer III Remand Proceedings: Bell Operating Co. Safeguards and Tier 1 Local Exch. Co. Safeguards, *Report and Order*, 6 FCC Rcd. 7571, para. 1 (1991); Computer III, *supra* note 95, para. 42. Return to text

129. *Background on the Administration's Telecommunications Policy Reform Initiative*, Jan. 13, 1994, at 2, *available in* WorldWindow User (copy on file with the *Federal Communications Law Journal*). Return to text