



Bauerle's Bank Notes

Winners and Losers

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"Government should not pick winners and losers," is a political shibboleth: a familiar statement, often repeated, but of questionable validity. Leaders of Washington Mutual and National City Bank voiced it in 2009 when the U.S. government did not bail them out like Citibank and Bank of America.

Governments have forever picked winners and losers. Spain's Ferdinand and Isabella sponsored Christopher Columbus rather than rivals whose names are lost to history. From 1930-1960, as CEOs of Pan Am and TWA, Juan Trippe and Howard Hughes dueled to win international air routes awarded by the U.S. government. Trippe usually won. Yesterday's New York Times reported Amazon is spending heavily to reshape the nation's transport systems in its own image.[\[i\]](#)

In our federal system, the overlap between state and federal jurisdiction often makes a mess of the selection process. Two spheres where conflicts are rife now are marijuana production and sale, and promotion, regulation and taxation of financial e-commerce. Banks have a minor stake in the first controversy and everything at risk in the second.

Colorado voters in 2012 amended their state constitution to legalize marijuana production and sale. Yet marijuana remains a Schedule I drug under the federal Controlled Substances Act and its growth and sale a federal crime. Because federal jurisdiction over commerce is limited to interstate activity,[\[ii\]](#) Coloradans in the pot trade are supposed to operate only within Colorado's borders. The fly in the ointment has been what to do with the cash they receive for their crop.

Pot industry promoters in 2014 chartered Four Corners Credit Union in Colorado as a destination for pot sale proceeds. But the Federal Reserve Bank of Kansas City turned down Four Corners' application for a "master account" so Four Corners could transfer money through the Fed and otherwise operate its business. Four Corners sued and lost. The federal judge who heard the case said he could not compel the Fed to issue the master account because he had sworn to uphold the Constitution and laws of the United States. The

appropriate remedy, he said, is for Congress to change federal law.[\[iii\]](#)

As Pennsylvania, Ohio and other states move toward limited legalization of marijuana, I expect to get the same questions from Eastern clients as Western clients have posed about what can and cannot be done with pot earnings under the changing mosaic of federal and state laws.

As the Times story about Amazon illustrates, e-commerce is an even more fertile field of controversy. Congress in December enacted the Permanent Internet Tax Freedom Act,[\[iv\]](#) continuing its ban on states' taxation of Internet access. The constitutional foundation for the statute is the same principle at play in the pot wars: states may control intrastate commerce but not interstate commerce, including that carried out over interstate telephone networks.[\[v\]](#)

The economic premise of the legislation, that e-commerce is an indisputable social good and should cost the public little or nothing, is one of the most prevalent shibboleths of our time. In many domains it is so widely accepted that we hardly notice it. Its leading proponents are the technology companies that are "a shoal of piranhas" according to one banking industry observer.[\[vi\]](#) People's propensity to mistake piranha for grouper is illustrated by an article titled, "The Bank of the Future is Here: And It's Free," published recently on the Wall Street Journal's Marketwatch website. Millennial Jurica Dujmovic wrote:

[Mondo](#) could be your bank of the future, as it provides you with a debit card and a powerful, versatile and easy-to-use mobile app.

After being funded 5 million British pounds (\$7 million) by [Passion Capital](#), Mondo announced it was selling 1 million pounds of equity in the business through a crowdfunding campaign on [Crowdcube](#) (a fundraising platform) to raise another 6 million pounds. Just a few days ago, [Crowdcube crashed because of investors' overwhelming demand](#). . . .

A long-term vision of Mondo, however, is what makes it truly disruptive. You will be able not only to have access to your money, but also to a marketplace of service providers for your next mortgage loan, money transfer or consumer loan. This means it's you - and not your bank - who is choosing the terms, ensuring you always get a good deal. As they say, the bank of the future will be a marketplace. . . .

The reason I believe traditional banks won't be able to keep up is because of infrastructure expenses, from maintaining branches and personnel, to keeping IT and support systems running efficiently. Mondo has 1% to 2% of a traditional bank's cost base. Furthermore, traditional banks won't be able to copy and catch up to Mondo. Most of their systems were built in 1980s, which means they're technologically inferior and simply can't handle that much data being thrown at them without a big (and pricy) overhaul.

Using Mondo will be free. The company plans to make enough money from fair and

transparent overdraft charges. [\[vii\]](#)

Mr. Dujmovic's take on Mondo is naïve and dangerous. His belief that Mondo can replace Bank of America or the Second National Bank of Warren, Ohio, gives no credence to the operational and legal underpinnings of our financial system. Like the Colorodans who voted smoking cannabis into a constitutional right, he embraces change without considering its consequences. Unlike pot sales, none of us will be able to opt out of financial e-commerce. It's here, it's now, and we must do the necessary to make it work. We can't "Just Say No". Needed post-haste are the following:

1. Realistic and Comprehensive Assessment. Excitement over fintech innovation needs to be tempered by awareness that all age-old risks of financial commerce remain. Fraud, mistake, system failures, and people taking undue advantage of their neighbors are still with us. The Garden of Eden fintech is not. Business people, consumers, legislators and regulators need to approach fintech's transformation of financial services not with goo-goo eyes, but with a keen eye for risk identification, assessment and mitigation.

2. Fairly Apportioning Infrastructure Investment. Unlike excise-taxed Colorado marijuana businesses, fintech pioneers piggyback their inventions on the existing banking system without paying for the privilege. The need for substantial investment to protect the integrity of universal electronic financial commerce is well known to industry experts. What must be built is public awareness that financial e-commerce cannot be "free" and that fintech companies have to pay their fair share of the cost. Those costs then need to be apportioned accordingly.

3. Sustaining Alternative Delivery Models. Some people, including me, desire to continue patronizing community banks. There are important roles for these institutions to play in many American towns and cities. To extend the transportation metaphor used above, not every trip is from New York to Paris. Sometimes one simply needs to get to Marion from LaRue, in Central Ohio. In times of national emergency, power outages or otherwise, physical banking offices are an important backstop to systemic disruptions of a national financial e-commerce network. Government and industry leaders should assure continuation of these alternatives even as the overall number of banks and branches dwindles. In the process, the public will need to be informed about the value of redundant systems and the need for appropriate sharing of their costs. What community banks must do is sharpen their game so they offer an alternative to fintech that is qualitatively superior.

The importance of banking and financial commerce to our economy makes careful selection of winners and losers essential. We need well-informed, thoughtful and practical leadership. And we must be prepared to pay for a system that works effectively for all.

[i] "When Paul Misener, Amazon's global head of policy, took over the company's Washington office 15 years ago, he had a staff of two focused on retail tax laws and other technology-related issues. Amazon now has more than 60 people listed as its lobbyists-both employees and contractors-double what it had just two years ago, according to the data from the Center for Responsive Politics. . . . Already, the company's drone push in Washington has had some success. Amazon has worked with NASA, for example, to create an air traffic system that would establish lanes in the sky for drones. Amazon has also urged Congress to adopt rules that would allow the retailer to fly drones beyond a pilot's line of sight, a crucial hurdle to Amazon's goal of operating drones from its warehouses. . . . This month, the Senate Transportation Committee drafted a bill that would insure rules for delivery drones within two years."

<http://www.nytimes.com/2016/03/21/technology/amazon-leans-on-government-in-its-quest-to-be-a-delivery-powerhouse.html>

[ii] *Gibbons v. Ogden*, 22 U.S. 1 (1824).

[iii] *Fourth Corner Credit Union v. Federal Reserve Bank of Kansas City*, U.S.D.C. Colo., case no. 15-cv-0133 (slip opinion dated Jan. 5, 2016).

[iv] P.L. 113-235. Prohibited are bit, bandwidth and e-mail taxes as well as taxes on Internet access. States are permitted to levy sales or use taxes on e-commerce transactions just as they do on mail order transactions.

[v] *Weiss v. U.S.*, 308 U.S. 321 (1939)(holding intrastate telephone communications inadmissible in federal criminal prosecution, unlike interstate telephone communications, which are admissible).

[vi] <http://www.latestnigeriannews.com/news/2501415/fintechs-a-shoal-of-piranhas-have-forced-banks-to-switch-from-compete-to-collabo.html>

[vii] <http://www.marketwatch.com/story/the-bank-of-the-future-is-here-and-its-free-2016-03-03>

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