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SEPTEMBER 15, 1979

OUTLINE

INTRODUCTION: Belief in our Federal system
Desire to discuss federalism, especially re financial structure

DUAL SYSTEM OF BANKING

(a) Historical Development of the System -- emergence of the national debate (systems origin, 1927 McFadden Act, 1933 Banking Act.)

(b) Contemporary Challenges

i. Treasury study of McFadden due this fall

ii. Federal Reserve membership question

(c) Present strengths of dual banking -- need to preserve state authority in specific actions

(d) Morgan efforts in Senate Banking Committee to influence laws to maintain state authority

CONCLUSION: Future of our political system has always depended on a balance between the national and state governments -- it will continue to do so --

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INTRODUCTION:

Basic Belief in Our Federal System of Government

When I first went to Washington to begin my term as a United States Senator from North Carolina, I carried certain basic views with me to our nation's capital, views which I believed were shared and are shared by the vast majority of the citizens of our state.

Chief among those beliefs was a firm commitment to maintain the integrity of our federal system, which

preserves important rights and responsibilities to the governments of the states.

Nothing I have experienced in Washington these past five years has caused me to doubt the wisdom of that view. My five years in Washington have convinced me all the more that we must do all we can to safeguard the integrity of our federal system, and to preserve its vitality. Yet on many fronts, including the financial one, I see developments which threaten that vitality.

I would like to discuss our federal structure as it pertains to our financial and economic system tonight,

some past and present challenges to it, and some thoughts about the future.

THE DUAL BANKING SYSTEM: Historical Development and Overview

At the heart of our federal structure in the area of financial institutions is our dual system of federally- and state-chartered institutions.

Our nation's first banks were unincorporated associations operating under state law. Subsequently, the legislatures of some of the states chose to grant corporate charters to banks, thus beginning the practice

of governmental licensing of banks.

At the instance of Alexander Hamilton, the first Secretary of the Treasury, a National Bank was chartered during the first term of Washington's Presidency. After it rapidly expanded its role, its aggressive posture engendered opposition and its charter was allowed to lapse. In the early 19th Century a second national bank was chartered -- an event which led to the first great debate concerning the dual system. Under the leadership of President Jackson, traditional agrarian opposition to the National Bank

was united with the opposition of speculative businessmen who disliked the Bank's restrictive monetary policy, and those who opposed the Bank's monopolistic status. Although Congress renewed again the Bank's charter, President Jackson vetoed the bill and dissipated the funds of the National Bank into many state banks, causing the National Bank to cease functioning as a central bank. Federal regulation of the monetary system was thus abandoned until the passage of the National Bank Act of 1863.

Since 1863, both our national and state bank

systems have developed side by side, allowing freedom of choice and movement between the two systems, with the principle of competitive parity between the two systems established by a series of legislative and judicial actions.

Between 1864 and 1927, the National Bank Act did not provide for the establishment of branches by National banks. The law of many states on the other hand, permitted state-chartered banks to establish branches.

Prior to the turn of the century, this situation

created no problem. At that time there only were 87 banks (82 state and 5 national) operating a total of 119 branches, most of which were outside of the head-office city. By the end of 1923, however, there were 671 banks (580 state and 91 national) operating 2,054 branches, most of which were in the head-office city. In his Annual Report for 1923, the Comptroller of the Currency warned:

> "If state banks engage in unlimited branch banking, it will mean the eventual destruction of the national banking system. ... "

But by the mid-1920's, Congress had become

aware of the problem.

McFadden Act of 1927

The bill which ultimately became the McFadden Act of 1927 passed during the 69th Congress. Competitive equality was achieved granting national banks the right to have intra-city branches

> "if such branches were permitted to state banks by the law of the state in question"

and, at the same time, limiting state bank members of the Federal Reserve System to intra-city branching.

One important additional indication of the mood of Congress in making it clear that the question of the desirability of branches was a matter strictly up to the states to decide, emerged from the Senate rejection of the so-called "Hull amendments" to the House bill in the 69th Congress. The House bill had originally proposed that national banks might only establish in-town branches at the time of the enactment of the bill. No right was given to such national banks if, at a later time, state law permitted state banks to establish in-town branches. The Senate Banking Committee, however, struck that provision on the grounds that it

constituted an unwarranted "pressure" by Congress on state legislatures to decline to expand branch authority, and that the matter of branching privileges was a matter for the states to decide. It said:

> "The real purpose of the Hull amendments, is to bring pressure to bear upon the leading bankers in states which now prohibit branch banking by depriving them of the motive to seek a change in the state laws favorable to branch banking. It is to coerce them to remain silent. ... this is an unprecedented

policy for the federal government to pursue and constitutes an unwarranted interference with the rights of citizens of these states in their relationship to the state legislatures."

Banking Act of 1933.

During the depression, a fundamental challenge to the principle of competitive equality in branching occurred. Many persons felt that many bank failures during the Bank Holiday were due to the fact that small rural banks were not strong enough to weather economic adversity, and that these locations could best be served

by branches of larger and stronger banks. Their view was that branch banking should be authorized for national banks regardless of state branch law in order to meet what was considered to be a crisis in banking.

This view was stated by the dominant banking figure of the times, Senator Carter Glass of Virginia. Accordingly, in 1932, the Senate Banking Committee reported out a bill, S. 4412, to expand the authority of a national bank to establish branches granted in the McFadden Act of 1927 beyond just the municipality in which its main office was located, irrespective of

state law.

This proposal met with vigorous opposition. It was obvious that if national banks were granted a competitive advantage over state banks in the matter of branching, state banks would convert to national banks and the state banking system would be destroyed, unless the state legislatures in all of the non-branch or limited-branch states moved immediately to conform their statutes to this unrestricted branch proposal -- the reverse effect of the situation in 1922-27 when the Comptroller argued that unless national banks were

given the right to branch in competition with state banks, the national banking system would be destroyed.

Senator Norbeck of South Dakota led the opposition, saying in 1932:

"... I believe in the American system of banking. We have a dual system. We have two systems. We have one controlled by the states, we have another one controlled by the federal government. The two have grown up side by side. I think they have rendered splendid service, and I think we should be ever jealous of anything that will tend to destroy one system for the

benefit of the other."

The Banking Act of 1933 was finally enacted on June 16, 1933. National banks were permitted to establish out-of-town branches if such branches were authorized to state banks under state law. At the same time the restriction was removed on branches of state banks which were members of the Federal Reserve System, previously imposed by the McFadden Act of 1927. Thus, the Banking Act of 1933 established the same competitive equality between national and state banks in the matter of branching outside city limits which the McFadden Act

of 1927 had established for intra-city branches. Congress felt that it was imperative for the preservation of the dual banking system that there be competitive equality between national and state banks in the matter of branch banking. The manner in which Congress achieved that competitive equality was by having "... exactly the same standards -- state law -- apply to the establishment of national bank branches as apply to state bank branches."

Contemporary Relevance:

I cite this historical development of our national

banking system, because I believe it is important to have an understanding of some of the present challenges to the dual banking system.

Last year, in the International Banking Act of 1978, the Congress mandated a study by the Executive branch of the McFadden Act. That study was to be completed this month, but it is behind schedule and is now expected later this fall.

Moreover, the Congress during this and last year has been considering changes in the Federal Reserve Act, which, as you know, have contemplated

mandatory membership in the Federal Reserve system. At each stage of that consideration, I have made clear my strong opposition to anything which undermines the vitality of the dual banking system. It is clear that mandatory FED membership would do precisely that. The Senate Banking Committee will continue its consideration of this issue with hearings on September 26 and 27.

I believe we must ask ourselves whether it is prudent to risk the continued existence of the dual system to achieve the goal of stopping the erosion of Federal Reserve membership.

The essence of the problem is the growing feeling among member banks that the amount of reserves required to be maintained with the FED is not justified by the services rendered. During the first half of 1979, another 37 member banks withdrew from the Federal Reserve System. Of that number, 12 were state member banks, and 25 were national banks. During that same period, four banks entered the System, all as state member banks.

Yet there is considerable debate among economists as to the necessity of reserves for the conduct of

monetary policy. I'm inclined to believe we can find a way to lessen the reserve requirement, without establishing the principle of mandatory membership.

Strengths of Dual Banking System

I believe the dual banking system offers our nation a number of strengths, and continues to serve an important national public interest. The dual banking system is, after all, the recognition that each state is different, and that our system of government and finance should allow maximum flexibility for local considerations.

Throughout our history, we have resisted the development of an all-powerful national government, and an all-powerful central bank. We must continue to do so.

The dual banking system has been accurately described as the "continuing, ever-real, ever-intense struggle against the seemingly endless intrusion of federal power, its presence in banking and the private sector, and the bureaucracy that shapes and implements it."

In the United States Banker magazine, E. D.

"Jack" Dunn, Commissioner of Banking and Finance for our neighboring state of Georgia, summed up the value of the dual banking system:

> The dual banking system
>
> "... is in the public interest because it leads to a continuing competition to improve the responsiveness of regulatory statutes at both the state and federal levels; it allows for a diversity of regulatory approach reflecting local economic conditions; and most importantly, it protects against the unwarranted abuse of

governmental monopolistic authority by providing a choice of regulators."

It is one of the few areas of our supposedly federal system of government in which federal and state regulators coexist and where federal authority is not totally dominant.

We must preserve the vitality of that dual system. The effort must proceed at both the state and federal levels. At the state level, it means continued innovation and creativity. It means continued steps to upgrade the quality of each state's banking examination and administration. And at the federal level it means a

continued effort to prevent the further erosion of state authority.

Actions in the Senate Banking Committee:

In the Senate Banking Committee, I have made it my practice to question all nominees for federal positions about their experience in state and local government, and about their commitment to the federal structure. I recently elicited from Jay Janis, the new chairman of the Federal Home Loan Bank Board, a written statement of his commitment to the integrity of state laws, as a condition of my support for his confirmation. I also

recently discussed state and local prerogatives with Moon Landrieu, the new Secretary of Housing and Urban Development. All too often, it seems that even someone such as a former mayor, adopts the federal outlook all too quickly after coming to Washington.

I have also worked in the Senate Banking Committee to maintain respect for state law and practice in the course of considering a number of pieces of legislation.

The Community Reinvestment Act:

I warned that the CRA was a significant step in

the direction of federal credit allocation, by giving the federal financial regulatory bodies the right to determine whether a local institution was meeting the credit needs of its primary deposit area. I warned that a paperwork and regulatory nightmare could ensue, and I believe from my conversations with legal officers of various institutions, that I was right. All kinds of questions have been raised as to how an institution insures that it is in compliance with this very vague act.

Truth-in-Lending Simplification Act.

On this bill, which has passed the Senate but

is awaiting action in the House Banking Committee, I insisted that state law and the enforcement authority of state attorneys general not be pre-empted.

International Banking Act of 1978 -- Public Law 95-369

In the International Banking Act, which the Congress passed last year, to make sure that American banks were not put at a competitive disadvantage with foreign banks, the Senate Banking Committee was careful to respect state law in the matters of branching, insurance requirements, and examinations.

Financial Institutions Reform Act of 1978 -- Public Law 95-630:

This controversial bill, which grew enormously before the 95th Congress finally adjourned, contained several provisions which reflected my concern for state law, including a prohibition of conversion of state mutual savings banks to stock ownership. The bill also maintained state law protecting consumers with regard to electronic funds transfers in financial institutions, if state protections were more stringent. The bill also mandated creation of a liaison committee of representatives

of state financial supervisors to meet regularly with the Financial Institutions Examination Council created by the bill. The purpose of the Committee is to encourage the application of uniform examination principles and standards by state and federal supervisory agencies.

S. 684: Federal Bank Commission:

I have also strongly resisted Senator Proxmire's bill to create a single new Federal Bank Commission, which would combine the regulatory functions of the Federal Reserve, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency. I believe that

such a monster agency would take us a very long way in the direction of a centralized, all-powerful banking agency which our country has wisely resisted for so long.

CONCLUSION:

I must emphasize that the struggle is a continuing one. Maintaining an appropriate balance between federal and state power has been the theme running through much of our political history. The fact that we have been able to maintain something of a balance -- despite tipping one way or the other from time to time -- is much of the reason we have been able to succeed at

creating a nation out of so many disparate ethnic, geographical, economic and political interests. I believe our national well-being will continue to depend in large measure on our ability to strike an appropriate balance, and to preserve for future generations of Americans the freedom that comes from preventing the development of a too-powerful central authority in both politics and economics.