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COMPLEXITIES OF BANKING LAWS AND PRACTICES ASSOCIATED WITH MULTIPLE BANKING JURISDICTIONS

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COMPLEXITY OF BANKING LAWS AND PRACTICES ASSOCIATED WITH MULTIPLE BANKING JURISDICTIONS

The increasing complexity of banking laws and of the practices based upon such laws is a growing source of concern to all persons interested in the soundness and usefulness of the American banking system. This complexity confuses both the banks for whom government supervision is intended to assure sound practices and the administrative authorities who are attempting to exercise the supervision. It has caused many people to ask whether it does not defeat the purposes intended to be served by government supervision.

Since banking is a complicated business and the more government supervision attempts to reach the details of business the more complicated the supervision tends to become, some of it may be unavoidable. It is not the purpose of this memorandum to deal with complexity of this nature.

This memorandum is concerned with a different and largely unnecessary type of complexity, which grows out of the multiple banking jurisdictions of the present American banking system. These multiple banking jurisdictions appear both in divisions of authority between State governments and the Federal Government and in divisions of authority between the various bank supervisory agencies of the Federal Government.

The complexities that result from the existence of the several banking authorities of the Federal Government will be considered in the first part of this memorandum.

The somewhat different complexities that arise from the division of authority between the Federal Government on the one hand and the State governments on the other will be considered in the second part of this memorandum.

I. DIVISION OF AUTHORITY BETWEEN THE SEVERAL FEDERAL BANKING AGENCIES

Federal supervision of banks rests upon regulatory statutes enacted and amended from time to time by Congress. In recognition of the rigid and unchanging nature of statutes and the necessity to meet changing conditions, many of the statutes provide for the issuance of regulations by regulatory bodies. Thus, the "gaps in the statute" are filled in from time to time by regulations and administrative constructions intended to facilitate its enforcement and its observance.

Unless there is some enforcement, a regulatory statute is meaningless. Unless both statute and enforcement have some elements of reasonableness and flexibility, the banks will be burdened to an impractical extent. Out of necessities such as these the Federal agencies for the supervision of banks arise. All sound Government supervision rests on the principle that administrative agencies supplement the courts by formulating and applying administrative standards within the limits of the authority granted. Because of the close relation between the formulation of the rule or standard and its application, it is possible for a single agency to perform each function better as a result of its experience gained in performing the other. Also, vesting both functions in a single agency reduces delays and complications because standards can be constantly studied in the light of practical experience gained in their application and there is no problem of placing complicated cases before courts or other agencies that do not have practical contact with the situation.

Supervision of banks is among the oldest and most extensive ventures of the Federal Government into the field of business regulation. The present set-up of Federal bank supervision, nevertheless, instead of serving to reduce complexity by merging the formulation and application of administrative standards, leads to exactly opposite results.

Three different agencies are directly concerned with the administration of Federal banking statutes. 1/ Theoretically, the Comptroller of the Currency has general supervision over national banks, the Federal Reserve authorities over State member banks, and the Federal Deposit Insurance Corporation over insured nonmember banks. Each of the three agencies, however, issues regulations and interpretations that must be followed by banks for which the particular agency is not primarily responsible. Moreover, there is statutory authority for additional examinations which, if made, would further complicate the situation.

This divided and overlapping responsibility among the Federal bank supervisory agencies may be said to be of two general types. One type

1/ In addition, the Reconstruction Finance Corporation may exercise certain control over banks in whose capital structure it has invested; and the Secretary of the Treasury licenses all member banks under regulations still in effect under emergency banking legislation, and he exercises control over certain activities of the Comptroller of the Currency.

is found when responsibility for the formulation of administrative standards is separated from the responsibility for their application. Another type is found when the responsibility for the formulation of administrative standards is divided between different agencies or their application is divided. Each type of scattered responsibility is found throughout Federal bank supervision. In many cases a single subject of bank supervision involves both types of scattered responsibility.

In this connection it should be emphasized that whether a bank is a national bank, a State member bank, or an insured nonmember State bank, it is subject to Federal supervision. In many instances, each of these three classes of banks is subject to substantially the same requirements. No doubt the principal reason for placing the supervision over these three classes of banks under the control of three Federal agencies independent of each other is that each of such agencies was established at a different period during the development of Federal supervision of banks, rather than being the result of a studied plan of proper administrative organization.

Separation of Formulation of Standards from Application

The fact that Congress finds it desirable to legislate in a broad manner on a subject and to entrust the issuance of regulations or the interpretation of statutory provisions to an administrative agency is an indication that constant contact with and consideration of the problems involved are essential to the effective carrying out of the Congressional policies. It indicates, too, that problems will be constantly arising that must be settled promptly as a part of enforcement instead of awaiting decision by a court or other separate agency.

The most satisfactory situation obtains when the agency issuing the regulations or construing the statute is in constant and direct touch with the problem through the enforcement of the regulations or statutes. Experience tends to indicate that satisfactory administration is not obtainable when one agency formulates regulations and another enforces them.

When formulation of administrative standards is separated from their application, it is more difficult for the formulating agency to adapt its regulations and interpretations to the facts of practical operation. Similarly, it is more difficult for the enforcing agency to give the banks authoritative answers to operating problems. Facts in the possession of the enforcing agency must be placed before the formulating agency and conclusions of the formulating agency must be relayed to the banks by the enforcing agency. Constant conferences and negotiation are necessary in the effort to maintain contact between the agencies.

Instances of separation of formulation from application are found in the preparation by the Comptroller of investment security regulations that the Board of Governors applies to State member banks, and in the preparation by the Board of trust power regulations that the Comptroller applies to national banks. There are many other such cases and they involve needless waste motion and duplication of effort with the ultimate results likely to be less satisfactory than they should be for both the banks and the public interest.

One of the worst features of such division of duties is that it is impossible to fix the responsibility for unnecessary complexities or unsound practices. Each authority can make a persuasive showing that the difficulty is due to the fault of the other or to the complications of the subject, when often it is the fault of the system and cannot be corrected except by correcting the unsound division of responsibility.

Divided Responsibility for Formulation of Standards or for Application.

When the formulation of administrative standards is scattered among different agencies, or the application of such standards is scattered, there often are conflicting regulations or interpretations on the same subject. It must be remembered that the relations of various banks in this country to each other are so close that regulations technically applicable to only one group of banks may affect other groups. For instance, the definition of interest in the Board's regulation regarding the payment of interest on deposits concerned both the member banks who were subject to the definition and the insured nonmember banks which, while subject to the different provisions of the Federal Deposit Insurance Corporation regulation, would lose exchange charges if member banks were forbidden to absorb such charges.

A situation of this sort compels banks to study different sets of standards on the same subject which may vary in details or in important provisions and tends to discredit Federal supervision in the minds of the public. Moreover, it reduces the effectiveness of standards and impairs the efficiency of bank personnel. Bankers who must concern themselves with an unnecessary volume and complexity of regulations have their attention diverted from perfecting their skill in other phases of banking experience and banking judgment.

Different regulations for different classes of banks also result in unnatural competitive advantages and disadvantages.

The efforts of various Federal agencies to bring their standards of divided supervision into agreement often involve endless delay. Hours, days and months of conferences and negotiations are spent to reconcile conflicting views if indeed they can be reconciled at all in many cases. The improvement resulting from study and criticism by persons of different viewpoints usually is accomplished through study and criticism within the staffs of the various agencies and through the suggestions of individual bankers and such organizations as the American Bankers Association. Conferences and negotiations between agencies are less effective. Moreover, the effort to reconcile the conflicting views of several independent agencies is hampered by the human tendency of each agency to be jealous of its prerogatives.

With divided responsibilities the experience that should be available to a single agency is also dispersed among the different agencies. The limited experience of each agency tends to impair the practicability of any regulations and interpretations it may issue and of its efforts at applying them.

One of the worst features of the division of responsibility for formulation of regulation or for enforcement is the fact that each agency tends to avoid ultimate responsibility for sound supervision and guidance of the banking system. No single agency is charged with the important responsibility of seeking solutions for the many problems that confront the banking system and formulating legislative recommendations from time to time for the improvement and simplification of banking and bank supervision. The responsibility should be fixed.

As shown in the subsequent discussion, divided administrative responsibility is a burden to the banks in every phase of their contact with Federal supervision-- when they enter Federal supervision, and while they operate under it.

Beginning of Operation under Federal Supervision.

Certain Federal statutes apply to all banks regardless of whether they are national, State member, or insured nonmember banks. If noninsured banks are subsidiaries of holding companies that control member banks they may be affected by Federal regulation of bank holding companies. Federal Reserve banks are authorized to aid noninsured banks in making "working capital loans" and may in certain circumstances make certain discounts and advances for noninsured banks. The authority of the Board of Governors to regulate the extension and maintenance of credit for the purpose of purchasing or carrying securities registered on a national securities exchange is applicable to nonmember banks as well as member banks. The Board has authority to make "inspections" and require reports necessary for the performance of its functions in this connection.

There is, however, no systematic supervision of noninsured banks as a result of these statutory provisions. Regular Federal examination and supervision of banks is confined to national banks, State member banks and insured nonmember banks. It is entirely voluntary with any bank whether it enters any of these classifications. There is no legal prohibition against any bank's continuing to operate as a noninsured bank.

The procedure for entering the sphere of Federal supervision varies widely according to whether a bank becomes a national, a State member, or an insured nonmember bank. If a bank wishes to operate as a national bank, its application is considered by the chief national bank examiner of its district for final action by the Comptroller of the Currency in Washington. If it wishes to operate as a State member bank, it applies to the Federal Reserve bank of its district for final action by the Board of Governors in Washington. If it wishes to operate as an insured nonmember bank, it applies to the supervising examiner of the Federal Deposit Insurance Corporation of its district for final action by the Federal Deposit Insurance Corporation in Washington.

Each agency is supposed to accept only sound banks. Except for certain statutory capital requirements for member banks, the same statutory standards specified in Sec. 12B (g) of the Federal Reserve Act,1/ must be considered by the different Federal agencies in accepting or rejecting banks. It is impossible, however, to eliminate the human equation in the administration of any statute, least of all in a statute requiring the exercise of judgment and discretion as to the relative soundness or unsoundness of various banks. Accordingly, it is impossible for a noninsured State bank to know definitely that it can not qualify to operate under Federal auspices until its applications have been successively denied to become an insured nonmember bank, to become a State member bank, and to convert to a national bank. In the process there is ample opportunity for banking interests to play off one authority against the other.

1/ "The factors......to be considered.....shall be the following: The financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this section".

The division of authority is seen to be particularly unreasonable when it is realized that, except for certain statutory capital requirements for member banks, each Federal agency is directed by statute to consider the same factors specified in Sec. 12B (g) of the Federal Reserve Act.[1] Even if the three different types of banks represented three progressive stages of banking strength, there would be little excuse for the division of responsibility among three different agencies.

The three agencies attempt to exchange information on the various applications that they receive, but the necessity for attempting to correlate policies causes much wasted time and impedes proper action. Too often a bank actually tries to evade the requirements of one Federal agency by shifting to the supervision of another Federal agency, and is not satisfied until it has tested the requirements of the different agencies. Much time and effort must be expended by the agencies in a useless effort to coordinate standards that should emanate from a single source. For example, the Board has felt it necessary to advise Federal Reserve banks to communicate with the Federal Deposit Insurance Corporation representative in cases of insured nonmember banks applying for Federal Reserve membership to be sure that no Federal Deposit Insurance Corporation requirement was being evaded.

Minimum Capital Requirements

Minimum capital requirements are closely related to the question of the beginning of operation under Federal supervision and present similar complexities. Insured nonmember banks are not subject to any specific Federal statutory requirements, although the Federal Deposit

1/ See footnote on page 9.

Insurance Corporation undoubtedly gives careful consideration to the question of capitalization in passing upon the admission of banks to insurance and necessarily must establish some administrative standards on the subject. Section 5138 of the Revised Statutes provides that a national bank must have a capital of at least $50,000 to be organized in a place that does not exceed 6,000; that it must have at least $100,000 in a place exceeding 6,000 but not exceeding 50,000; and that it must have at least $200,000 to be organized in a place over 50,000, except that in outlying districts of such a place a national bank may be organized with $100,000 capital where State banks may be organized with $100,000 or less. State member banks are subject to the same capital requirements as national banks except that State member banks in cities under 3,000 may, in certain circumstances, have $25,000 capital and the Board, after 1941, may waive statutory capital requirements for banks having average deposits over $1,000,000.

The fact that State member banks are subject to certain capital requirements that are defined in the National Bank Act is an interesting example of overlapping responsibilities. If the Board undertakes independently to construe the statutes, conflicting interpretations of the same provision and the necessity for efforts to coordinate the interpretations may result. If, on the other hand, the Board refers such questions to the Comptroller of the Currency for his interpretation, negotiations and delays are an unsatisfactory consequence.

<u>Establishment of Branches</u>

The establishment of branches by banks subject to Federal supervision presents a situation similar to the entrance of banks into Federal supervision and the determination of minimum capital requirements. Each group of banks receives the authorization for the establishment of its branches from the agency that admits the banks of that group to Federal supervision although the Federal Reserve authority over State member banks extends only to the establishment of out-of-town branches. It obviously is difficult--often impossible--for three different agencies to follow consistent standards with respect to such a subject. The Comptroller, the Board, the Federal Deposit Insurance Corporation, or two of these agencies, may refuse to permit the establishment of a branch in a particular locality, but another of these agencies may permit the establishment of a branch---or for that matter a separate bank---in the same locality. The same interests may operate a national bank, a State member bank, and an insured nonmember bank. Such interests will naturally not be content with the unfavorable conclusion of one of the authorities on the question of establishing a branch at a particular locality. They will consider it a part of the regular procedure to petition in turn each of the agencies through the different types of banks controlled. As in the case of other matters of divided responsibility, conflicting procedure can be avoided, if at all, only by complicated interagency conferences and negotiations.

Aside from the matter of pure discretion, the statutory provisions to be followed by the various authorities present additional unnecessary complexities. Section 5155 of the Revised Statutes provides that a national bank may establish a branch only "if such establishment and operation are at the time authorized to State banks by the statute law of the State" in which the national bank is located; that it may not establish an out-of-town branch unless it has at least $100,000 capital if it is located in a State with a population less than 500,000 and with no cities over 50,000; $250,000 if it is in a State with a population less than 1,000,000 and with no cities over 100,000; or $500,000 in any other State; and that the aggregate capital of the national bank must not be less than the aggregate required for the establishment of an equal number of national banks in the various places where the bank and its branches are situated. These provisions are necessarily construed by the Comptroller of the Currency from time to time as he applies them to cases of particular national banks.

Apparently, in an effort to achieve some correlation between the three Federal bank supervisory authorities in this connection, section 9 of the Federal Reserve Act provides that State member banks may establish branches only upon the same conditions as those permitted for national banks. If the Board attempts to construe section 5155 without regard to the Comptroller of the Currency's interpretations, conflicting interpretations may result. If the Board attempts to obtain the Comptroller's interpretations on specific questions, other difficulties result.

Such difficulties were encountered in construing the requirement that the aggregate capital of national banks with branches must not be less than the aggregate capital required for "an equal number of national banking associations situated in the various places where such association and its branches are situated." The question was whether this required one unit of capital for each branch, or one unit of capital for each city in which a branch is located. The question was admittedly a close one, and the Board's Counsel felt that one unit was required for each branch while the Comptroller felt that one unit was required for each city in which a branch was located. After much study and negotiation, the Board, at the recommendation of its Counsel, decided to follow the Comptroller's interpretation as the lesser of two evils.

As a final complexity in this field, the Board of Governors is the agency that approves the establishment of foreign branches of national banks.

Examinations and Reports

Examinations of Banks. - As indicated previously, the Comptroller examines national banks, the Federal Reserve System examines State member banks and the Federal Deposit Insurance Corporation examines insured nonmember banks. Moreover, there is statutory authority for overlapping examinations.

Examinations are important since by means of them specific supervisory requirements are enforced and the assets and managerial policies of banks are tested. It is difficult, if not impossible, for examination policies, particularly as to classification of assets, to be reasonably uniform when both the formulation and the enforcement of standards are divided among three different agencies. With respect to the importance of uniform standards in criticizing assets and managerial policies, it has been stated that there should be "coordination of examination policy with credit control policy; and systematic and continuous supervision and instruction of the examiners in terms of a uniform and flexible policy".[1]

1/ Jacob Viner in "Recent Legislation and the Banking Situation" in The American Economic Review, Vol. XXVI, No. 1, Supplement, March 1936, (written after he had participated with Charles O. Hardy in preparing a "Report on the Availability of Bank Credit in the Seventh Federal Reserve District" in 1935).

Far from there being any real coordination of examination policy with credit control policy under the present arrangement, the divided responsibility for examinations has resulted in conflicting requirements on such elementary matters as the classification of depreciation and losses. There have been conflicts between the policies of the Comptroller, the Board and the Federal Deposit Insurance Corporation over the use of valuation reserves and over the treatment of depreciation in securities. The three agencies have never been able to agree upon a standard form of examination report. Is it reasonable to expect satisfactory coordination of examination policy with credit control policy when there are conflicts regarding these much simpler matters?

In addition to the division of authority in connection with examinations there is an overlapping of authority as well. The Federal Deposit Insurance Corporation may publish the report of its examination of any insured bank (except a national bank or a bank in the District of Columbia) if its recommendations are not complied with within 120 days. However, the Federal Deposit Insurance Corporation may not examine a State member bank except with the permission of the Board of Governors. There is statutory authority for additional examinations which might further complicate the situation. For example, the Board has authority to examine national banks as well as State member banks. In addition, it may make inspections of any banks, even noninsured banks, in connection with its function of prescribing margin requirements under the Securities Exchange Act of 1934.

Examination of Affiliates. - Examination of affiliates of member banks (in general, organizations controlled by or under common control with member banks) is divided in a manner similar to the examination of banks and additional difficulty is introduced when, as is often the case, the same institution is an affiliate of both a national bank and a State member bank. In such cases, the Comptroller of the Currency and the Federal Reserve authorities must arrange between themselves which agency will examine the common affiliate. Sometimes it happens that both authorities examine the same affiliate.

Examination of Holding Company Affiliates. - In general, examination of holding company affiliates of member banks (broadly, organizations controlling member banks) depends upon the requirement that in applying for a voting permit they must agree to receive examiners authorized to examine the banks with which they are affiliated. The Board has authority to determine that an organization is not a holding company affiliate (except for certain purposes) because not engaged "as a business" in holding stock of or managing or controlling banks or trust companies. Thus, in applying this provision to organizations controlling national banks, the Board often has the responsibility of determining, in effect, whether the Comptroller may examine the organization. In some cases the same organization is both a holding company affiliate and a simple affiliate of the same member bank. In such cases the examination of the organization is not dependent upon its obtaining a voting permit, but the complexities mentioned above in connection with the examination of affiliates apply.

Reports of Banks. - The situation regarding reports of banks is similar to that regarding their examinations. In general, banks are required to submit condition and other reports to the agencies that examine them. The three Federal agencies have been unable to agree on a standardized form of condition report. The press has reported the differences as being a controversy between the Federal Deposit Insurance Corporation and the Comptroller of the Currency (although the Comptroller is one of the three directors of the Federal Deposit Insurance Corporation). The Comptroller was quoted as saying that for national banks "the forms of Call Reports under the Federal law are required to be prepared under the direction and authorization of the Comptroller of the Currency". 1/

All insured banks, including members of the Federal Reserve System, must report their "deposits" and "uncollected items" twice each year to the Federal Deposit Insurance Corporation for the purpose of paying their insurance assessments. "Deposits", as reported for this purpose, are defined differently from the "deposits" that must be reported to other agencies and, thus, different sets of records must be maintained. If authority were not divided, the reports, and the records on which they are based, could be consolidated. The Board also has authority, as yet unexercised, to require reports from any banks in connection with the authority for prescribing margin requirements under the Securities Exchange Act.

Reports of Affiliates. - The responsibility for reports of affiliates is divided in much the same way as responsibility for examination of affiliates. Reports are made to the same agency that

1/ New York Herald Tribune, March 14, 1936.

examines the bank with which the institution is affiliated. Since the Board and the Comptroller have authority to waive reports of affiliates, questions may arise when the same organization is an affiliate of both a national bank and a State member bank.

Reports of Holding Company Affiliates. - The responsibility for reports of holding company affiliates is both divided and overlapping. In general, a holding company affiliate must file reports with the agency that examines its subsidiary banks. Obvious difficulties arise when there are both national and State member bank subsidiaries. The Board, however, has authority to determine that organizations are not holding company affiliates (except for certain purposes) because not engaged "as a business" in holding stock of or managing or controlling banks or trust companies. When such a determination is made, a holding company affiliate does not have to file reports unless it is also an ordinary affiliate. Thus, in applying the provision to organizations having national bank subsidiaries, the Board often has the responsibility of determining, in effect, whether or not reports should be filed with the Comptroller of the Currency.

Management

Responsibility for administering the Federal statutes regarding the management of member banks and the relations of the management with its bank and with other organizations is divided between the Board and the Comptroller of the Currency.

The Board is authorized to issue regulations regarding the service of officers, directors or employees of member banks with other banks and to "enforce compliance with" the requirements. It is authorized to issue regulations regarding the service of directors, officers or employees of member banks with securities companies; to issue regulations regarding loans by member banks to their executive officers; to require full disclosure of commissions or profits when a director or the firm of a director sells securities or other property to a member bank.

Most important of all, the Board is authorized to remove officers or directors of member banks who continue, after warning, to violate any law or to follow unsafe or unsound practices.

The Federal Reserve authorities also apply these standards to State member banks. The application of these standards to national banks through the examination of such banks is, however, in the hands of the Comptroller of the Currency. In fact, the removal of an officer or director of a national bank must be commenced by the Comptroller of the Currency's certifying to the Board that the officer or director has continued to violate the law or to operate unsoundly after being warned by the Comptroller.

Relations with Affiliated Institutions

The provisions regarding relations of member banks with affiliated institutions result in both divided and overlapping responsibility. The provisions regarding the separation of stock of member banks from stock of other corporations and the provision regarding credit relations of member banks with their affiliates and holding company affiliates use the same language to apply to both national banks and State member banks, so that the identical language must be construed for national banks by the Comptroller and for State member banks by the Board. Differences in practice can result such as that which developed between the Board and the Comptroller of the Currency as to whether the renewal of a loan to an affiliate should be considered to be an extension of credit within the meaning of the provisions regarding credit relations with affiliates.

The Board apparently is the agency to construe section 20 of the Banking Act of 1933, which forbids the affiliation of member banks with securities companies, since there is a $1,000 a day penalty which may be assessed by the Board and collected by the Reserve bank by suit or otherwise. The application of the Board's interpretations, however, is entrusted to the Comptroller, insofar as they apply to national banks.

Similarly, the Board issues permits for holding company affiliates to vote the stock of member banks. However, if the subsidiary member banks are national banks the application of standards, such as determining that corrections are made in the subsidiary banks, is in the hands of the Comptroller.

Conduct of Banking and Other Operations

Interest on Deposits. - The provisions regarding the payment of interest on deposits represent both separation of formulation from application and divided responsibility for each of these functions. The Board prescribes a regulation on the subject which is applied by the Federal Reserve authorities to State member banks but is applied by the Comptroller to national banks. At the same time, another regulation on the same subject is prescribed by the Federal Deposit Insurance Corporation and applied by the Federal Deposit Insurance Corporation to insured nonmember banks. The Federal Deposit Insurance Corporation and the Board devoted much time and effort to attempts to reconcile the various provisions on the subject. The vital question of the definition of the term "interest" could not be reconciled by these agencies until, by force of necessity and as a matter of expediency, uniform general language was agreed upon which merely defined interest in very general terms. Until the agreed language is construed in particular cases, however, and until uniformity in such constructions is obtained, the public and the banks are left in confusion as well as in the unfair condition of one bank following one practice and other banks another.

Reserves against Deposits. - The Board construes the provisions regarding reserves to be held by member banks against deposits, issues regulations on the subject, and recently increased the reserve requirements to twice the amount formerly in effect.

The Federal Reserve authorities receive reports at least twice monthly from all member banks as to their deposits and assess penalties for deficiencies in reserves as indicated by these reports. So far as State member banks are concerned, the Federal Reserve authorities also can verify the accuracy of the reports and the classification of deposits through their examination of such banks. However, such verification in the case of national banks is dependent upon examinations by the Comptroller.

Release or Modification of Restrictions on Deposits. -

Deposits subject to restriction in insured banks are not insured if there is any release or modification of the restriction without written consent of the Federal Deposit Insurance Corporation. Knowledge of such restrictions and of the desirability of modification is, however, under the control of the Comptroller of the Currency and the Federal Reserve authorities with respect to national and State member banks, respectively.

Limitations on Loans to One Borrower. - A national bank is generally forbidden to lend more than 10 per cent of its unimpaired capital and surplus to one borrower, but there are a number of relaxations and exceptions to this general requirement. Among the exceptions is one for "banker's acceptances of other banks of the kind described in section 13 of the Federal Reserve Act." Since these acceptances are governed by regulations of the Board, the regulations formulated by the Board on this subject will, in effect, be applied by the Comptroller in certain cases in connection with the limitations on loans to a single borrower.

State member banks are not subject to the 10 per cent limitation on all loans to one borrower. There is a general provision forbidding them to make loans in excess of 10 per cent of the bank's unimpaired capital and surplus to one person upon the security of stock or bond collateral; but, in the case of loans secured by certain Government obligations, the 15 per cent additional limit applicable to national banks for such loans applies. In addition to the usual questions regarding the interpretation of the national bank provision on this subject by the Comptroller, the

Comptroller is specifically authorized to relax the restrictions further with the approval of the Secretary of the Treasury. Thus, certain standards may be formulated by the Comptroller on this subject to be applied to State member banks by the Board.

Loans on Real Estate. - The aggregate amount of loans which a national bank may make on real estate is stated in terms of a percentage of the bank's time and savings deposits. These deposits probably would be determined on the basis of the Board's definition of such deposits for the purposes of reserves and interest payments. Thus the formulation of the standards that govern the aggregate real estate loans of a national bank is separated from their enforcement.

Loans to Purchase or Carry Registered Securities. - The Board prescribes regulations regarding the extension and maintenance of credit for the purpose of purchasing or carrying securities registered on a national securities exchange. These regulations apply not only to national, State member and insured nonmember banks, but to noninsured banks as well. In fact, there is legal authority for them to be extended to persons other than banks. The application of these standards, however, is separated from their formulation, since they are applied to national banks by the Comptroller, State member banks by the Federal Reserve System, and insured nonmember banks by the Federal Deposit Insurance Corporation.

Limitation on Aggregate Loans Secured by Stock or Bond Collateral. - The Board may fix by Federal Reserve districts the percentage of member banks' capital and surplus which may be represented by loans secured by stock or bond collateral. Since any limitation fixed by the Board would be applied by the Comptroller for national banks, this is an instance of the separation of formulating from enforcing responsibility.

Loans on or Purchase of Own Stock. - State member banks are required to conform to the provisions on this subject applicable to national banks. This results in the type of complexities found in connection with provisions such as those relating to the establishment of branches and minimum capital requirements.

Investment in Securities. - The restrictions on investments in securities are applicable by their terms to national banks, and State member banks are required to comply with them. It was the view of the Board that in issuing certain regulations and interpretations on this subject, the Comptroller of the Currency exceeded his authority. The Board took the position that it could not properly apply these interpretations to State member banks. Thus, as a result of this divided authority, State member banks and national banks are subject to different requirements on this subject.

Investment in Foreign Banking Corporations. - Control over the investment of member banks in foreign banking corporations is divided. The Board grants permission to both national and State member banks to make such investments, while the Comptroller of the Currency, through his examinations, determines whether these requirements are being followed by national banks.

Investment in Bank Premises. - Control over investments of member banks in bank premises is divided between the Board and the Comptroller, each exercising control over such investments of the banks which it examines.

Fiduciary Functions. - The provisions regarding fiduciary functions are an outstanding example of responsibility for formulation being separated from responsibility for application. The Board grants authority to national banks to exercise trust powers and issues regulations regarding such functions. The application of the standards laid down in this connection, however, is entirely dependent upon the Comptroller of the Currency, who examines the national banks. An additional complication is introduced here by the authority of the Federal Deposit Insurance Corporation to issue certain regulations regarding the deposit and insurance of trust funds. These regulations may affect the trust operation of banks, but the application of these standards is separated from their formulation in the case of national and State member banks.

Acceptances. - The Board may issue general regulations relaxing the restriction on the aggregate amount of bankers' acceptances that member banks may accept for one person. The administration of these requirements is divided since the application to national banks depends upon the examinations of the Comptroller.

Exchange and Collection Charges. - The Board is authorized to regulate the exchange and collection charges which member banks and nonmember clearing banks may charge in certain cases and it usually construes the provisions regarding exchange and collection charges. Application of these requirements to national banks, however, is in the hands of the Comptroller. Moreover, certain nonmember banks are clearing banks or have otherwise agreed to remit at par. Thus certain insured nonmember banks under the general supervision of the F.D.I.C. have considerable dealings with the Federal Reserve System and are affected by the System's regulations regarding check collections.

Placing Brokers' Loans for Nonbanking Institutions. - The same language forbids national banks and State member banks to place brokers' loans for nonbanking institutions but violations are punishable by a $100 per day fine that may be collected by the Reserve bank of the district. This represents an instance of divided responsibility in which either the Comptroller and the Board construe the provisions independently or the Board construes the provisions for both State member and national banks with the Comptroller merely applying the provisions to national banks.

Payment of Unearned Dividends. - State member banks are required to comply with the statutory provisions that forbid national banks to pay unearned dividends. This also involves a determination of "bad debts". In administering this provision for State member banks, the Board either must follow the constructions of the Comptroller of the Currency on this question, which creates the complexities resulting from the separation of the formulation of administrative standards from their administration, or the Board must construe the provision itself and thus create the complexities of divided formulation of administrative standards.

Protection against Burglary, and Other Insurable Losses. - The F.D.I.C. may require banks to provide protection against burglary, defalcation and other insurable losses. The facts concerning the adequacy of coverage, however, in the case of a national or a State member bank are in the possession of the Comptroller and the Federal Reserve authorities, respectively.

Advertisement of Deposit Insurance. - The F.D.I.C. issues regulations regarding the statutory requirement that signs be displayed stating the insurance of deposits and that similar statements be included in advertising. The administration of these provisions is dividdd in a way similar to the administration of the provisions authorizing the F.D.I.C. to require insured banks to obtain protection against insurable losses.

Loans to and Capital for Banks

The Reserve banks may discount certain paper for and make advances to member banks—and in certain cases nonmember banks. Until June 30, 1939 the Reconstruction Finance Corporation also may make loans to banks and, at the request of the Secretary of the Treasury with the approval of the President, it may purchase preferred stock or capital notes and debentures of banks. Until July 1, 1938, in order to reduce the risk or avert loss and facilitate the merger or consolidation of insured banks, the Federal Deposit Insurance Corporation may purchase or lend upon assets or may guarantee insured banks against loss from assuming liabilities and purchasing assets of another insured bank.

Various of these devices may have to be resorted to in different cases when a bank needs additional funds. The requirements may vary from merely a need to replenish reserves to the necessity for complete recapitalization, and the distinction between the several types of accommodation may not be apparent. The necessity for dealing with different agencies in such cases is a troublesome and sometimes dangerous complexity.

Consolidation with Another Bank

The approval of the Comptroller of the Currency is required for one national bank to consolidate with another or for a State bank to consolidate with a national bank. The approval of the F.D.I.C. is required for any insured bank to consolidate with a noninsured bank, assume liability for the deposits of a noninsured bank or transfer assets to a noninsured bank in return for an assumption of deposits. Under conditions of membership the Board exercises certain control over consolidations of member banks.

When banks of different types are to be consolidated, as for instance the consolidation of a noninsured bank, a State member bank, and a national bank, all three of the Federal agencies may have to pass on the consolidation.

Termination of Federal Supervision; Liquidation

The termination of a bank's operation under Federal supervision affords examples of both the separation of the formulation from the administration of administrative standards and also of divided formulation of administrative standards. A bank may shift the type of Federal supervision to which it is subject by changing from a national bank to a State member bank or insured nonmember bank, from a State member bank to a national bank or insured nonmember bank, or from an insured nonmember bank to a State member bank or national bank. It also may voluntarily withdraw completely from Federal supervision, although if it does this its existing deposits, less withdrawals, remain insured for two years and the bank must pay its regular insurance assessments during this period.

Termination of Federal supervision by the Federal supervisory authorities is in general divided between the three agencies in much the same way as control over admission to Federal supervision.

With respect to a national bank, the Comptroller of the Currency may appoint a conservator, may appoint a receiver, or may institute suit to forfeit its charter. Suits by the Comptroller to forfeit national bank charters have been extremely rare and must be predicated on specific violations of law. Among the provisions for forfeiture of the charter are a number for the bringing of an action by the Comptroller in his own name at the direction of the Board of Governors, including those regarding cases in which the voting permit of a holding company affiliate of a national bank has been revoked by the Board because of violations of law or of the agreement. The Comptroller may appoint a conservator "whenever he shall deem it necessary in order to conserve the assets of any bank for the benefit of the depositors and the creditors thereof." There are many statutory grounds for the appointment of a receiver, but the one most generally resorted to is insolvency.

The Board of Governors, after hearing, may terminate the membership of a State member bank for violation of law or applicable regulation or condition of membership. Termination of Federal Reserve membership automatically terminates Federal Deposit Insurance, although the bank may be readmitted to deposit insurance by the Federal Deposit Insurance Corporation as a nonmember of the Federal Reserve System.

The Federal Deposit Insurance Corporation may terminate the insured status of an insured nonmember bank after notice and hearing. The Federal Deposit Insurance Corporation also may terminate the insurance of a national bank or a State member bank although in such event it must first give the Comptroller or the Board of Governors, as the case may be, an opportunity to obtain correction.

If the insured status is then terminated, the Comptroller must appoint a receiver if it is a national bank and the Board must terminate Federal Reserve membership if it is a State member bank. Unless the national bank has made adequate provision for the payment of its depositors, the Comptroller must appoint the F.D.I.C. as receiver. The F.D.I.C., however, then conducts receivership operations under the general supervision of the Comptroller, although the Comptroller is authorized to waive the requirements of receivership regulations for the F.D.I.C. in order to simplify administration.

The division of responsibility for the termination of Federal supervision raises so many difficulties that the statutes have made certain efforts to coordinate these functions by requiring that the F.D.I.C. attempt to obtain correction of national bank difficulties through the Comptroller or of State member bank difficulties through the Board of Governors before expelling the banks from insurance. These efforts, however, merely increase the complexities.

Conclusion

The complexities resulting from the division of Federal bank supervision among the three banking agencies of the Federal Government are much greater in the aggregate than they appear to be when considered item by item. Fundamentally, all phases of Federal bank supervision are aimed at one object--the soundness of the banking and general economic systems. The interrelation and interlocking of all phases of Federal bank supervision strongly suggest the need for consolidation in a single agency with, of course, proper provision for delegation of certain routine functions.

An illustration of the interlocking of all Federal banking supervision is found in the recent efforts of the Federal bank supervisory authorities to correct unsound practices in a certain national bank. The Federal Deposit Insurance Corporation instituted proceedings to terminate the bank's insurance, the probable results of which will be the appointment of the Federal Deposit Insurance Corporation as receiver. During the course of consideration of the advisability of such action by the Federal Deposit Insurance Corporation, of which board the Comptroller of the Currency is a member, he, by certification filed with the Board of Governors, instituted proceedings against the president of the bank to remove him from office. The Board promptly initiated an unavoidably expensive hearing but, during the course of deliberation, the Comptroller appointed a conservator. The result is that the Board of Governors has removed an officer from a bank in which the Comptroller of the Currency has already appointed a conservator, who in turn, unless effective corrections are made in the bank, will be supplanted by the Federal Deposit Insurance Corporation as receiver, which will in turn operate under certain supervision of the Comptroller of the Currency. Such unnecessarily complex proceedings can scarcely be expected to result in satisfactory supervision.

II

DIVISION OF BANKING AUTHORITY BETWEEN FEDERAL AND STATE GOVERNMENTS

Perhaps the most unfortunate result of the division of banking authority between the Federal and State Governments is the competition in laxity between the two systems which weakens the standards of both. The complexity, however, that results from the dual banking system is also an unfortunate characteristic. Various examples of this complexity will be considered in the following pages, and these, although possibly less in number than those considered in the first part of this memorandum, are in some respects more harmful because they are more fundamental.

Widely diverse banking standards naturally result from the existence of the different banking systems and banking laws in the 48 States. While this type of complexity will be considered to some extent, more attention will be devoted to the more serious complexity resulting from the duplication and conflicts between State and Federal supervision.

In addition to such duplications and conflicts, both Federal and State statutes contain many complexities that are due to the competitive aspects of the dual banking system. An outstanding example is the provision regarding the establishment of branches by national banks. Instead of there being one simple standard , the extent to which national banks may operate branches in a particular State is, in general, that provided by the State statutes for State banks.

Chartering of Banks

In the case of the chartering of a bank that wishes to be a State member bank or an insured nonmember bank, there is a complete duplication of the investigation of the justification of the bank, by the State authorities for chartering and by the Federal authorities for admission to Federal Reserve membership or deposit insurance. This necessarily tends to be wasteful and inefficient even if the examination is made jointly. In some cases the Federal and State authorities disagree as to the qualification of a bank, but instead of this divided responsibility serving as a sound restraint upon the organization of additional banks, it is more likely to result in laxness on the part of both authorities. In addition, the possibility of a bank's obtaining a State charter if it cannot obtain a national charter, and vice versa, results in the shifting of banks from one jurisdiction to another and threats of such shifts.

Capital Requirements

Capital requirements naturally vary widely among the 48 States. Various types of requirements are found; among them as of a recent date were a Nebraska requirement of $10,000 for places less than 1,000, a New Jersey requirement of $50,000 irrespective of population and a Connecticut requirement of $100,000 in towns of less than 50,000 and $200,000 elsewhere. Rhode Island had no statutory requirement.

The competitive aspects of division of authority between the Federal and State governments, however, have introduced complexities into the capital requirements for national banks. Instead of these requirements being stated simply and concisely, they are tied to the provisions of State law by the provision that although national banks in cities over 50,000 must have $200,000 capital, "in the outlying districts of such a city where the State law permits the organization of State banks with a capital of $100,000 or less, national banking associations * * * may, with the approval of the Comptroller of the Currency, have a capital of not less than $100,000".

Establishment of Branches

The Federal provisions regarding the establishment of branches by national and State member banks illustrate the unnecessary complexities resulting from the competition between the Federal and State systems of supervision. Section 5155 of the Revised Statutes requires a national bank to meet certain capital requirements and obtain the approval of the Comptroller of the Currency in order to establish branches; but, in addition, it provides that such branches may be established only "if such establishment and operation are at the time authorized to State banks by the statute law of the State" in which the national bank is located. Thus, in order to determine the conditions regarding the establishment of a branch by a national bank in a particular State, it is necessary to consult both the Federal and State law on the subject.

The establishment of branches by insured nonmember banks or of out-of-town branches by State member banks requires the approval of Federal authorities and in most States it also requires the approval of State authorities.

Examinations and Reports

Examination of Banks. - The examination of State member banks and insured nonmember banks is an outstanding example of complexity resulting from the division of banking authority between the Federal and State governments. Since these banks are under both Federal and State supervision, the authorities are confronted with the alternative of duplication of examinations or of one authority's accepting the examinations made by the other. Each alternative has its disadvantages, and in either case the bank is subject to requirements and corrective measures imposed by two authorities.

An effort has been made to avoid these difficulties through the device of joint examinations, both the Federal and State authorities sending in examiners at the same time. However, this often results in the same examination's taking much longer since the two sets of examiners to a certain extent "get in each other's way."

Furthermore, even if the examination is made jointly there may be wide discrepancies in the classification of assets, as has been illustrated by recent cases. Such results are inevitable with duplicating and conflicting examinations. These, of course, are in addition to the extra expense to both the banks and the supervisory authorities entailed by this duplication.

Reports of Banks. - Since the three Federal bank supervisory authorities have not been able to agree on a standard form of condition report, it is not surprising that the forty-eight State authorities have not adopted a standard report. As a result, State member banks and insured nonmember banks often find that they must submit separate reports that deal with the same subjects but differ in some particulars and thus result in duplication of work for the banks. Furthermore, it sometimes is necessary for them to publish two different reports. Some progress has been made toward standardization of reports. As of June 30, 1936, half the States accepted publication of condition reports on the form prescribed by the Board. However, the process of standardization under the present divided responsibility is obviously a laborious one that distracts the attention of both banks and bank supervisors from the more fundamental issues of banking soundness.

Examinations and Reports of Affiliates and Holding Company Affiliates. - The absence of legislation in most States on the subject of affiliates and holding company affiliates somewhat reduces the duplications and complexities in this field but, except for the difference in degree, the complexities in connection with examinations and reports of affiliates and holding company affiliates are similar to those found in connection with the examinations and reports of banks. The complexities are particularly great when a nonmember bank controlled by a holding company affiliate is to be examined by Federal examiners, since special arrangements must be made for such sporadic examinations.

Conditions of Membership

The Board of Governors has no general authority to issue regulations regarding the operations of State member banks. This is at least partly due to the competitive aspects of the dual system— the fear that if the Board had this power it might lead to withdrawals from the System. The result, however, is that the Board often has to resort to "conditions of membership" to correct unsound practices. This is an exceedingly unsatisfactory method of handling the situation, since these conditions of membership cannot be given general application. They apply only to the particular bank that accepts them, and banks entering the System prior to the imposition of such a condition are not affected. The result is that there are really many different standards that must be met by the various State member banks, and the Board is unable to simplify the situation because of its inability to prescribe general regulations.

Removal of Management

Directors and officers of member banks may be removed for continuing, after warning, to violate the law or to engage in unsound practices. There are similar provisions in some States, and the natural tendency for each authority to shift to the other the responsibility for such an unpleasant task tends to prevent such action from being as prompt and direct as it should be.

Exercise of Trust Powers

Banking and Trust Business in Same Institution. - The provisions of the Federal Reserve Act authorizing national banks to exercise trust powers were largely intended to place national banks in a favorable competitive position in comparison with State institutions exercising such powers. There is a wide difference of opinion as to whether it is sound for deposit banking and trust businesses to be combined in a single institution, and in any event the combination of the two functions introduces many complexities due to the relations of the banking department with the trust department. Not only was the division of authority between the Federal and State Governments largely responsible for the trust and banking businesses being combined in national banks, but it was also a cause of such businesses being combined in several States. In 1919, largely as a result of the Federal legislation, New York authorized State banks to exercise trust powers, although this business had formerly been confined to trust companies. A similar change was made in Michigan, probably for the same reasons.

Operation of Common Trust Funds. - Federal statutes tax common trust funds operated by banks as if such funds were separate entities unless the funds are operated in accordance with regulations on the subject prescribed for national banks by the Board of Governors. Thus, in practical effect, any such regulations which may be prescribed by the Board will cover the operations of State member banks and nonmember State banks, as well as national banks, although actually the Board's regulations apply by their terms to national banks only, and, even as to them, the regulation in practice will be administered by the office of the Comptroller of the Currency rather than by the Board.

Deposit of Trust Funds with Banking Department. - Section 11(k) of the Federal Reserve Act provides that funds held in the trust department of a national bank may not be deposited in the banking department unless certain securities are set aside for the protection of the trust funds. This is based upon the fundamental principle that any relaxation of the restrictions against trustees using trust funds for their own benefit should be surrounded with abundant safeguards. Many persons believe that this is a sound requirement which should be followed by all banks. In order to apply the same requirement to State member banks as to national banks, the Board adopted the policy of requiring State member banks to accept this requirement as a condition of membership. At this point, however, there arose in several States a conflict with the State laws which prevent the posting of any collateral for deposits. Thus, banks that were subject to this requirement and wished to deposit trust funds in their banking departments found themselves subject to two conflicting regulations and were unable to comply with one without violating the other. In some cases banks attempted to solve the difficulty by holding the funds in cash or depositing them in another institution, but these alternatives are in many cases unattractive and in any event result in complicated problems relating to bookkeeping or safeguarding.

Reserve Requirements

As might be expected, the provisions of the 48 States regarding reserves against deposits vary both as to the amount and the manner in which the reserves are to be kept. The law of most States provides that State banks that are members of the Federal Reserve System may comply with the reserve requirements of the Federal Reserve Act in lieu of the State requirements, but there appears to be no such provision in Louisiana, Minnesota, North Dakota, and Texas so that apparently State member banks in these States must comply with two different sets of reserve requirements.

Since reserve requirements are important as a means of monetary control, the fact that nonmember banks are not subject to any uniform reserve requirements complicates such control. This fact as well as the possible effect upon membership in the Federal Reserve System had to be taken into account when the increasing of reserve requirements was recently under consideration.

Interest on Time and Savings Deposits

Although the Board of Governors is directed to limit from time to time the rate of interest that national banks may pay on time and savings deposits, this subject has been complicated by statutory provisions resulting from competition between the State and national systems. Section 24 of the Federal Reserve Act provides that the rate of interest that a national bank may pay upon time or savings deposits "shall not exceed the maximum rate authorized by law to be paid upon such deposits by State banks or trust companies organized under the laws of the State in which such association is located." Thus national banks are, to a certain extent, subject to regulation by both Federal and State authorities on this subject. State member banks and insured nonmember banks are, of course, confronted with the same difficulty.

Different interest rates are usually permitted for different classifications of deposits. Complex problems may arise when the classifications of the Federal and State authorities are different. For instance, the regulations of the Board of Governors and the Federal Deposit Insurance Corporation regarding the payment of interest on deposits permit maximum rates of 2-1/2 percent on time deposits with a maturity of six months or more and on all savings deposits, 2 per- cent on time deposits with maturity between six months and 90 days, and 1 per cent on time deposits with maturity less than 90 days. As of July 1, 1935 the Mississippi authorities adopted a schedule of rates on time and savings deposits of 2 percent on the first $5,000,

$1\frac{3}{4}$ percent on the next \$5,000 and $1\frac{1}{2}$ percent on deposits of more than \$10,000. The complexities involved in applying two such schedules to the deposits of a particular individual are obvious.

Loans to Purchase or Carry Registered Securities

Another type of complexity is presented by the regulations under the Securities Exchange Act regarding loans by banks for the purpose of purchasing or carrying registered securities. These regulations are applicable to noninsured banks as well as insured banks. Noninsured banks are not at present subject to regular examinations by any Federal agency, even in cooperation with State agencies, and there would be obvious objections to additional examinations solely for the purpose of enforcing these regulations. While these banks do not have very much business of this character, the enforcement of these regulations, insofar as such banks are concerned, is almost completely disassociated from their formulation.

Strengthening Capital Structure, Reorganizations and Consolidations

When the programs were inaugurated to strengthen the banks through the Reconstruction Finance Corporation, first by authorizing the Corporation to lend to banks and later by authorizing the Corporation to invest in the capital structure of banks, it was an easy matter to authorize national banks to avail themselves of these privileges. However, many complexities arose in the conflicting provisions of State law. Special enabling legislation had to be obtained in many States and this, of course, interfered with the orderly handling of the difficulties. In some States the necessary legislation could not be enacted because of constitutional provisions. Similar difficulties arise in connection with reorganizations and consolidations.

Closing and Liquidation of Banks

The Board of Governors may expel a State member bank from membership in the Federal Reserve System for violation of the Federal Reserve Act or applicable regulations or conditions of membership. The FDIC may terminate the insurance of any insured bank for continued unsafe or unsound practices. However, neither agency has the authority to take the definite step of placing a State bank in liquidation. Although expulsion from membership or termination of insurance may practically compel the closing of a State bank, the actual appointment of a receiver is entirely dependent upon action by the State authorities.

In case of conflict between the State and Federal authorities, the State authority may refuse to close a bank which the Federal authorities believe should be closed for the protection of its depositors. In such case the bank might continue in operation and prefer many depositors after being expelled from Federal supervision. Since insurance of existing deposits continues for two years after official termination of a bank's insured status, the continued operation of a bank during this period may work to the detriment of the insurance fund.

Furthermore, even when a State bank is placed in receivership it is likely that the liquidation will be conducted by a State receiver. Although the FDIC accepts the receivership of closed insured banks if tendered by the State authorities,
eight insured State banks suspended in 1934 was liquidated by the State authorities; eighteen of the twenty such banks suspended in 1935 were liquidated by State authorities; and 34 of the 40 such banks suspended in 1936 were liquidated by State authorities. The negotiations which the F.D.I.C. must continuously conduct with the State receiver in order to protect the interests of the fund introduce a complexity that would not exist if supervision were not divided between the State and Federal Governments. Furthermore, the activities of State receivers in liquidating a bank too rapidly or too slowly may run directly counter to Federal credit policies. This may seriously affect the general credit situation and impair the insurance fund, intensifying the complexities inherent in any banking difficulties.

Conclusion

As in the case of complexities resulting from the several banking authorities of the Federal government, the complexities resulting from the division of banking authority between the Federal and State governments are much greater in the aggregate than they appear when considered item by item. Considered in the aggregate these complexities are a serious burden to the banks as well as a serious impediment to sound supervision.