1976

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THE FEDERAL BANK COMMISSION ACT:
A PROPOSAL TO CONSOLIDATE THE FEDERAL BANKING AGENCIES

Recent bank failures have sparked a new momentum for bank regulatory reform. The past four years have seen the failure of three multi-million dollar commercial banks: Franklin National Bank, New York, declared insolvent on October 8, 1974; United States National Bank, San Diego, closed its doors on October 18, 1973; and Hamilton National Bank, Chattanooga, closed on February 16, 1976.1 These failures have shaken public confidence in banking institutions, but, more importantly, have demonstrated weaknesses in banking regulation.

As background to an examination of the Federal Bank Commission Act,2 this Note will explore the two most important causes of the deficiencies in the present commercial banking system. The first cause is the existence of a "dual banking" system, under which banks may choose between state or federal charters. The resulting division of regulatory authority encourages banks to "shop" for the most favorable regulation.3 The second major cause of deficiencies in the banking system is the three-tiered organization of federal regulation.4 The Act

1 N.Y. Times, Feb. 29, 1976, at 2, col. 5.
3 See generally Redford, Dual Banking: A Case Study in Federalism, 31 LAW & CONTEMP. PROB. 749 (1966).
4 The three federal regulatory agencies are: the Comptroller of the Currency, responsible for administration of national banks; the Federal Reserve Board, which formulates monetary policy and regulates all banks which are members of the Federal Reserve System; and the Federal Deposit Insurance Corporation (FDIC), which provides protection for depositors of member banks and insured nonmember banks through insurance and supervisory functions. The interrelationship of these three agencies will be examined throughout this Note.

The following chart depicts the relationship among the banking regulatory agencies and the bank classes which they regulate.

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CHARTER

FEDERAL CHARTER

Bank Class

NATIONAL BANKS

REGULATORY AGENCY

COMPTROLLER OF THE CURRENCY

FEDERAL RESERVE BOARD

FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)
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Published by EngagedScholarship@CSU, 1976
consolidates the three federal agencies into a single regulatory Commission. Emphasis also will be placed on the Act's effect on the dual banking system, with a view toward improving the overall structure of banking regulation.

I. STATUTORY AND ADMINISTRATIVE BACKGROUND

A. The Present Regulatory Scheme

The banking system is comprised of four bank classes. The bank class determines which agency or agencies will regulate a particular bank. National banks, chartered under federal law, are supervised primarily by the Comptroller of the Currency, but also are subject to regulation by the Federal Reserve Board by reason of mandatory membership in that system and to regulation by the Federal Deposit Insurance Corporation (FDIC). All banks chartered under state law are subject to regulation by the state banking authority exercising jurisdiction over the bank charter. State banks are also divided into three classes. Those which are voluntary members of the Federal Reserve System are subject to supervision by the Federal Reserve Board and by the FDIC; state banks which are insured by the FDIC but are not members of the Federal Reserve System, are subject to regulation by the FDIC; and state banks

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9 Id. § 1820b (1970).
which are neither insured by the FDIC nor members of the Federal Reserve system are subject only to state regulation.

The three federal administrative agencies — the Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation — evolved in different historical periods to effectuate varied economic and regulatory purposes. The present structure has been aptly characterized as "an amalgam of coincidence and inadvertence." 10

Until 1863, all banks were state-chartered institutions with the exception of the two banks of the United States which existed for short periods during the nineteenth century. 11 The national banking system began with the passage of the National Currency Act of 1863. 12 This Act authorized the chartering of national bank associations and the corresponding issuance of national bank notes. Supervision of the banking associations was vested in the Currency Bureau of the Treasury Department, headed by the Comptroller of the Currency. The Currency Act was superseded in 1864 by the National Bank Act, which established the modern legal framework for national bank regulation. 13 The National Bank Act left intact the Office of the Comptroller of the Currency.

The second and third tiers of the federal regulatory system emerged largely in response to crises in banking history. The Federal Reserve System was established in 1913 14 in response to the financial panic of 1907. 15 After the stock market crash of 1929 and the subsequent bank failures of the 1930's, the Federal Deposit Insurance Corporation was developed in 1933 16 to protect depositors in the event of bank failures. 17

Because the federal banking agencies were developed in response to banking crises rather than as part of an integrated regulatory scheme, a

10 Hearings on S. 2298 Before the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. 65 (1975) (statement of J. L. Robertson) [hereinafter cited as 1975 Hearings on S. 2298].

11 R. Robertson, The Comptroller and Bank Supervision: A Historical Appraisal 19 (1968). The first Bank of the United States was established in 1791 but was disbanded in 1811 when the fear of expanding federal bank supervision led to congressional opposition to the bank's recharter. The demise of the second Bank of the United States, chartered in 1816, came in 1832 when President Jackson vetoed the congressional bill to recharter the bank.


13 Act of June 3, 1864, ch. 106, 13 Stat. 99. Generally, the National Bank Act required that incorporators of national banking associations file articles of association with the Comptroller. Minimum capital requirements were instituted; the requirements varied depending upon the population of the association's service area. See R. Robertson, supra note 11, at 49. The modern rules for the incorporation of national banks may be found in 12 U.S.C. §§ 21-28 (1970).


commercial bank may enjoy competitive advantages depending on the regulatory agency governing its bank class.

B. Competitive Inequalities Among Differing Bank Classes:
A Case for Consolidation

The competitive inequalities among the four bank classes suggest a need for reform of commercial bank regulation. Some of the disparity among classes is attributable to the statutes and regulations, which grant different powers and impose different requirements on banks dependent upon their bank class. Most of the inequality, however, stems from the fact that federal regulatory authority is divided among three different agencies. When presented with the same policy issues, the three agencies often respond inconsistently. Although an understanding of both types of inequalities is necessary to recognize the deficiencies within the commercial banking system, only the inequalities attributable to inconsistent agency standards may be resolved through the agency consolidation proposed by the Federal Bank Commission Act.

1. Statutory Inequalities Among the Bank Classes

Statutes which grant different powers to and impose different requirements on banks according to bank class are one source of competitive inequalities among commercial banks. These statutes are interpreted and applied by the regulating agency in the form of administrative rulings published in the Federal Register. Most of the competitive advantages have been granted to national banks through broad statutory delegations of power and through liberal Comptroller rulings interpreting these statutes. The advantages are counterbalanced to some extent by the stringent reserve requirements of the Federal Reserve Board; these requirements apply to all national banks.

Because national banks derive most of their powers from federal statute courts have held them to be federal instrumentalities. This court-fashioned federal instrumentality doctrine has traditionally held national banks immune from state interference and control. The doctrine has been modified somewhat in recent years. For example, in 1972 federal law expressly subjected national banks to state sales and use taxes. Generally, national banks are now considered subject to

17 See notes 12-13 supra and accompanying text.
18 See, e.g., State Nat'l Bank v. Laura, 45 Misc. 2d 430, 256 N.Y.S.2d 1004 (1965), (New York statute, which limited the right of unqualified foreign corporations to sue in state court, was inapplicable to a national bank on the ground that the national bank was excluded from the purview of the state statute by reason of the bank's creation under federal law). See also Owensboro Nat'l Bank v. Owensboro, 173 U.S. 664 (1899) (national banks exempt from state taxation under the federal instrumentality doctrine).
state laws unless those laws conflict with federal regulatory statutes or "impose undue burdens" on the performance of national banking functions. National banks, however, continue to transcend state restrictions on interstate operations. A national bank may not, without its consent, be sued in any state or federal court except those in the country or judicial district in which it is located. This immunity affords a distinct competitive advantage to national banks engaged in substantial interstate operations, since state banks are subject to suit in any state in which they are found to be "doing business" within the broad jurisdictional guidelines of the minimum contacts theory or the "doing business statutes." State banks engaged in interstate commerce are, therefore, subject to suit in a considerably larger number of forums than are their federally chartered counterparts.

Perhaps the most far-reaching advantage national banks have is granted through an incidental powers clause, which authorizes a national bank to exercise "all such incidental powers as shall be necessary to carry on the business of banking." In the last fifteen years, the Comptroller of the Currency has broadly construed this provision to allow national banks considerable innovation in banking services.

The purpose of this 1969 amendment, which became effective January 1973, was to remove the immunity from state taxation previously granted to national banks. States were thereby allowed, for tax purposes, to treat national and state banks in the same manner. See Lake County Nat'l Bank v. Kosydar, 36 Ohio St. 2d 189, 305 N.E.2d 799 (1973).

In national bank branch decisions, state law applies even though state statutes may impose burdens upon national banks. For a general discussion of the demise of the federal instrumentality doctrine see Schwind & O'Leary, Are National Banks Federal Instrumentalities Today?, 86 Banking L.J. 99 (1969).

An example of interstate operations is the interstate sale of traveler's checks.

Both the language and usage of the incidental powers clause appear to be patterned after the "necessary and proper" clause of the United States Constitution, U.S. Const. art. 1, § 8, cl. 18. As interpreted, these clauses afford broad implied powers to national banks (incidental powers clause) and to Congress (necessary and proper clause) beyond the enumerated powers expressly conferred by statute. For a general discussion of the commerce clause and the necessary and proper clause see D. Engdahl, Constitutional Power: Federal and State in a Nutshell § 5.04-05 (1974).
Most notably, the Comptroller expanded national banking powers in the areas of travel services, direct leasing of personal property, and data processing.

The Comptroller’s favorable rulings awarded national banks a competitive advantage both within and without the banking industry. These regulatory rulings resulted in litigation, through which national bank expansion was dampered but not thwarted. As a result, the larger national banks that maintained capital to venture into broad service offerings emerged champions of vertical integration.

It should be noted that continued bank expansion into the services area may change the complexion of the banking industry. Banking institutions may become suppliers of varied services to the same extent that they presently engage in traditional banking activities. As banks enter the services industry, they will compete with nonbank businesses, such as travel and auto leasing agencies, as well as with other financial institutions. Moreover, the competition between banks will be based on factors other than price, such as the ability of existing banks to expand into the services market. While some authors argue that such innova-

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30 The Comptroller, in 12 C.F.R. § 7.7475 (1963), reaffirmed the banking practice of selling travel services to bank customers; the practice was originally approved by the office in 1935. This ruling was modified in Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972), in which the sale of travel services was held invalid to the extent that it authorized the national bank operation of a “full-scale travel agency.” See also American Soc’y of Travel Agents v. Bank of America Nat’l Trust & Sav. Ass’n, 385 F. Supp. 1084 (N.D. Cal. 1974) (when a national bank agreed with a travel bureau to assume the venture’s financial risks and to proffer the bank’s name and reputation to that venture, the bank engaged in the travel business and its activities were no longer within the protective provisions of 12 U.S.C. § 24 (Seventh) (1970)).

31 12 C.F.R. § 7.3400 (1976) (permitted national banks to purchase, upon specific request of a customer, equipment for direct lease to that customer. Such leases have been upheld as incidental to banking functions, and construed as the functional equivalent of a bank loan). See also analogous Federal Reserve regulations controlling the leasing activities of bank holding companies in 12 C.F.R. § 225.4(a) (1976).


33 See, e.g., note 30 supra. Most plaintiffs in this litigation were either state banks or service delivery institutions, which felt threatened by the seemingly unending expansion of national banks into traditionally nonbanking services areas. See Saxon v. Georgia Ass’n of Independent Insur. Agents, 399 F.2d 1010 (5th Cir. 1968) (group of insurance agents deterred national bank expansion into the insurance industry in cities of more than five thousand persons); M & M Leasing Corp. v. Seattle First Nat’l Bank, 391 F. Supp. 1290 (W.D. Wash. 1975) (unsuccessful suit by local auto leasing agents to check national bank entrance into motor vehicle leasing).

34 Since 1963, when the Supreme Court adopted a “hard line” against horizontal bank mergers in United States v. Philadelphia Nat’l Bank, 374 U.S. 321 (1963), banks have tended to engage in mergers of the market and product extension variety. See, e.g., United States v. Marine Bancorporation, 418 U.S. 602 (1974) (market extension). Market extension mergers involve banks in different markets, which are not direct competitors. Product extension mergers involve banks which may or may not be competitors but which produce complementary products. When banks expand into broad “nonbank” service offerings, they are acquiring new inputs (travel service operations, leasing activities) in order to make a more attractive final “product” package for bank customers. In this sense, bank product expansion into traditionally nonbank areas is essentially a conglomerate form of vertical integration.
tion has a positive effect on competition in the banking industry, it would appear that the banks which survive such "economic warfare" will do so based upon their relative size and their ability to absorb potential losses.\(^{35}\) This increased reliance on services expansion may decrease the number of competitors in a given area if smaller banks are forced into merger or liquidation due to their inability to raise the capital prerequisite for expansion.\(^{36}\)

The Federal Reserve Act also offers competitive advantages to banks which are members of the Federal Reserve System.\(^{37}\) Some of the advantages of Federal Reserve membership are intra-agency services including the System's check collection services and free deliveries of coin and currency from the district Federal Reserve Bank.\(^{38}\) A more substantive advantage to membership is derived from the Federal Reserve's role of extending credit to member banks "to accommodate commerce, industry and agriculture."\(^{39}\) The extent of this benefit, however, is somewhat diminished by the central bank's authority to extend credit to nonmember institutions in emergency situations.\(^{40}\)

Many commentators argue that a significant disadvantage to Federal Reserve membership stems from the reserve balances that each member bank is required to maintain on deposit with the Federal Reserve Bank of its district.\(^{41}\) These balances constitute specified percentages of the bank's time and demand deposits.\(^{42}\) While both com-


\(^{36}\) Shull, Bank Expansion: The New Competition and the Old Predatory Practices, 91 BANKING L.J. 726, 729 (1974). Some economists contend that the decrease in number of small banks through merger is not always detrimental to market competition. The creation of medium-sized banks through merger of smaller firms may challenge the market power of a dominant firm in the same market and intensify competitive rivalry; however, the same merger may create a hazard to the continued survival of smaller firms, since it may trigger a series of mergers and thereby significantly increase absolute concentration in banking markets. See E. SINGER, ANTITRUST ECONOMICS: SELECTED LEGAL CASES AND ECONOMIC MODELS 134-35 (1968). Further empirical data is needed to determine the extent to which smaller banks are forced out of business because of their inability to modernize and expand at a pace consistent with their larger market rivals.

In addition to the potential decrease in the number of banks, one commentator has suggested that the following dangers may result from an increased reliance on nonprice competition in commercial banking markets: (a) development of "uneconomic" barriers to entry; (b) creation of conditions which will require the creation of new standards for chartering and branching activities; (c) increased inefficiencies in the production of banking services as institutions expend more effort and time in expanding traditionally nonbank services; and (d) diminution in bank profits and capital adequacy. See Havrilesky, supra note 35, at 134-35.

\(^{37}\) The Federal Reserve System is comprised of all national banks and state-chartered institutions which are voluntary members of that system. 12 U.S.C. §§ 222-23, 321 (1970).


\(^{39}\) 12 C.F.R. § 201.2(a) (1976).

\(^{40}\) 12 C.F.R. § 201.2(f) (1976).


mentators and bankers argue that the reserve requirements for member banks are higher than those set by state banking authorities for nonmember banks, at least one study has demonstrated that, in fact, the opposite pattern exists. 43

Although the actual level of required reserves should not discourage Federal Reserve membership, restrictions on the form of such reserves may chill the appeal of membership status. Member banks must maintain reserves in the form of vault cash or reserve deposits at the district Federal Reserve Bank, 44 and these balances must consist solely of non-earning assets. By contrast, nonmember banks may hold their reserves in a variety of forms including vault cash, correspondent balances at other banks, cash items in the process of collection, certificates of deposit, and governmental securities. 45 A further advantage afforded to nonmember reserves exists in the approximately twenty-five states which permit these balances to earn interest. 46 The competitive disadvantage associated with member reserves thus increases proportionally with increases in the degree of flexibility which a state banking authority grants to nonmember reserve holdings, particularly with respect to the rate of return obtainable through such holdings.

2. Inequalities Based on Inconsistent Agency Standards

Because a particular bank may be regulated by one or more different agencies, dependent upon its classification, further competitive inequalities among bank classes may result from the conflicting inter-agency policies which regulate a type of banking transaction. Such inter-agency discord may be illustrated through merger and branch approval patterns.

43 Klein, A Paper Prepared for the Committee on Banking, Housing and Urban Affairs, in Compendium, supra note 35, at 207-09. State nonmember banks are usually required to establish separate reserve accounts within the banks themselves; state member banks are required to maintain reserves on deposit with the Federal Reserve Bank of their district. The 1971 study indicated that reserve requirements on demand deposits for nonmember banks were lower than those set by the Federal Reserve in only 15 states; 10 states had identical requirements; and 25 states had higher reserve requirements on nonmember banks. In states where member bank reserve requirements on demand deposits were lower than those imposed on nonmember banks, in only two states did the number of member banks exceed nonmember institutions. Similar data was obtained for requirements on time deposits. These figures indicate that the requirements for holding the reserves in non-interest earning assets, rather than the actual amount of reserves required, is the controlling factor in determining whether state banks volunteer for Federal Reserve membership. See notes 44-46 infra and accompanying text.

44 12 C.F.R. § 204.5 (1976).

45 The advantages to holding reserves in interest-bearing assets, such as Treasury Bills, may be illustrated by an examination of the rate of return earned on such securities by nonmember banks. During 1973, nonmember bank reserves invested in three-month bills yielded an average return of 7.03 percent, more than double the rate of return in 1963. These figures may explain the accelerating exodus of state banks from the Federal Reserve System. Boehne, Falling Federal Reserve Membership and Eroding Monetary Control: What Can Be Done?, in CURRENT PERSPECTIVES IN BANKING: OPERATIONS, MANAGEMENT, AND REGULATION 534 (T. Havrilesky & J. Boorhan ed. 1976). See also Klein, supra note 43, at 209-11.

46 For a list of these states, see Klein, supra note 43, at 211.
All three federal regulators share authority for merger decisions. The scope of their authority is dependent upon the character of the surviving entity. The Federal Reserve Board maintains jurisdiction in merger cases when the surviving institution is a state member bank. When the survivor is a national bank or a state nonmember insured bank, Comptroller or FDIC approval is required. The Comptroller has primary and exclusive approval jurisdiction over domestic branch decisions involving national banks; the Federal Reserve Board and the FDIC perform secondary approval functions over branch decisions of state banks which are members of the Federal Reserve System or which retain FDIC insurance.

Of the three federal agencies, the Comptroller is generally the most lenient in merger approvals. This leniency reflects the Office's policy of encouraging bank expansion, both in terms of diversification of services and actual size. The agency contends that bank mergers are procompetitive, stimulating competition through the creation of additional consumer services or through the advent of better management.

The problem with the Comptroller's approach is that the substantial disparity in the size of banks, which is encouraged by a liberal merger policy, is contrary to the forms of competition which the antitrust laws are designed to protect. The underlying assumption of the federal antitrust laws is that numerous independent competing firms provide greater competition in the marketplace than do a few large firms which dominate an industry. Data on whether an industry composed of firms of approximately the same size would be more competitive than an

48 Id.
49 Id.
53 F.I.N.E. STUDY RESPONSES, supra note 29, at 245.
54 In oligopolistic markets, a few sellers dominate the distribution of a homogeneous product. The oligopolistic market grants to its member firms the power, whether or not utilized, to establish prices and outputs and, thus, to subordinate the role of competition to the firms' desire for profit maximization. A comparison of the pricing policies in oligopolistic and competitive markets indicates that prices are more rigid and less responsive to economic variables, such as demand, in oligopolistic industries. See E. SINGER, ANTITRUST ECONOMICS: SELECTED CASES AND ECONOMIC MODELS 100 (1968). Each seller will seek to price similarly to avoid retaliatory price reductions by other sellers which, in turn, would reduce overall profits and revenues for all. This conscious "parallel business behavior," however, is not a per se violation of the federal antitrust laws. For example, a uniform restriction by film distributors and producers of "first run" movies to downtown Baltimore theaters was insufficient behavior to establish an unlawful conspiracy under section 1 of the Sherman Act. Theatre Enterprises, Inc. v. Paramount Film Distrib. Corp., 346 U.S. 537 (1954). Other collusive conduct by sellers in oligopoly markets, however, may violate the antitrust laws. See, e.g., United States v. Parke, Davis & Co., 362 U.S. 29 (1960) (company policy of terminating drug wholesalers who sold to price-cutting retailers constituted conduct violative of section 1 of the Sherman Act); United States v. Trenton Potteries Co., 273 U.S. 392 (1927) (defense of reasonableness immaterial to charge of direct price-fixing of vitreous pottery by manufacturer and distributor members of a potters' trade association).
industry with firms of different sizes, is inconclusive.\textsuperscript{55} There is significant evidence, however, that domination of an industry by a few large firms is anticompetitive in that it allows for administered pricing.\textsuperscript{56} While a liberal bank merger policy does not force these anticompetitive practices, it does produce a more concentrated banking industry in which to achieve collusive behavior.

In contrast to the Comptroller’s merger policy, the Federal Reserve Board is the most stringent in its examination of proposed mergers. Recognizing the potential anticompetitive effects of bank mergers, the Board has adopted the “potential competition” doctrine. Advanced by the Justice Department, this doctrine opposes approval of acquisition of a large bank in one local market by a large bank located in a separate local market, even though there is no apparent competition between the two institutions at the time of the proposed merger or acquisition.\textsuperscript{57} It would appear that evidence of the potential anticompetitive effects of a proposed merger should be sufficient grounds for merger denial.

Although the entrance of a large bank into a new geographic market may initially stimulate competition for depositors, the long-range effect would appear to be anticompetitive. The elimination of competing banks, as large banks drive local institutions out of business or prevent them from becoming significant rivals in other markets,\textsuperscript{58} appears more probable than not. The “potential competition” doctrine only restricts mergers in a prescribed situation,\textsuperscript{59} and is, therefore, only a “band-aid” approach to maintenance of competitive levels in the banking industry.


\textsuperscript{56} Oligopolistic sellers tend to price similarly. In order to maximize profits, they tend to adjust output and employment levels to accommodate fluctuations in demand. The term “administered prices” has been used to characterize this similar pricing. See id. at 108 and authorities therein cited.

\textsuperscript{57} Shull, The Potential Competition Doctrine and Market Extension Acquisitions in Banking, in Compendium, supra note 35, at 728. A proposed merger may be held to violate section 7 of the Clayton Act, 12 U.S.C. § 18 (1970), if it substantially lessens competition within the relevant product market (the line of commerce) and geographic market (section of the country). Brown Shoe Co. v. United States, 370 U.S. 294, 324 (1962). For section 7 purposes, in at least two bank merger cases, the Supreme Court defined commercial banking as the relevant “line of commerce” and the geographic market as the place where the seller/banker operates. United States v. Phillipsburg Nat’l Bank & Trust Co., 399 U.S. 350, 360-61 (1970); United States v. Philadelphia Nat’l Bank, 374 U.S. 321, 358 (1963).

The Justice Department has expressed concern that three types of market extensions through bank mergers may be prima facie violative of section 7 of the Clayton Act, 15 U.S.C. § 18 (1970): (1) when a bank which is a statewide leader wishes to acquire a bank in an area in which that leader is not presently competing; (2) when a bank in a metropolitan area wishes to acquire a suburban bank with a strong position in its local market; and (3) when a leading bank in a local market wishes to acquire a leading bank in another local market into which the acquiring bank could enter de novo (through charter or branch). Alcorn, Phillipsburg and Beyond — Developing Trends for Substantive Standards for Bank Mergers, 9 Hous. L. Rev. 421, 451 (1972).


\textsuperscript{59} See note 57 supra and accompanying text.
Even this limited approach has been severely undercut by the 1974 Supreme Court case of *United States v. Marine Bancorporation*, in which the Court refused to apply the potential competition doctrine to find an antitrust violation of section 7 of the Clayton Act. In *Marine*, a large bank, capable of entry into the Spokane, Washington market either through sponsorship as a branch of an existing bank or through charter, instead entered through merger with a medium-sized bank. The merger thus deprived the Spokane market of competition that the merging bank could have offered by means of the other modes of entry.

Refusing to accept the government's contention that the merger would decrease banking competition on a statewide basis, the *Marine* Court limited the relevant geographic market for section 7 purposes to the Spokane banking market. The Court then ruled that the finding of an actual decrease in competition within this metropolitan area was prerequisite to a section 7 violation, and that the government had failed to demonstrate such a decrease. The Court further required proof that entry by methods other than merger would foster competition within the relevant market. A presumption was thereby created that proposed bank mergers and acquisitions are procompetitive, and the government could rebut this presumption only through satisfaction of an extremely high burden of proof. A consequent retardation in antitrust prosecutions of bank acquisitions is certain to follow.

As a result of this decision the Federal Reserve Board may, at least temporarily, abandon the "potential competition" doctrine and adopt a lenient merger approval policy similar to that of the Comptroller. Other factors also suggest this result. Bank conversions from state to national charters and withdrawals by state member banks from the Federal Reserve System, have become increasingly common during the

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62 418 U.S. at 639-40.
63 The majority refused to accept the basic premise of the potential competition doctrine that the potential entrant, "waiting in the wings," exercises a present influence on the market, or that a toehold entrant may have a substantial competitive effect by preventing major banks in the geographic market from increasing their market shares. See dissenting opinion of Justice White, *id.* at 644 (Justices Brennan and Marshall joining).
64 *Id.* at 639-40. The requirement that the government prove that alternative methods of entry would foster competition as prerequisite to finding a section 7 violation is probably the most difficult aspect of this decision, since such proof is speculative at best. A final stab at the potential competition doctrine was rendered in the majority's conclusion that, absent unlimited branching authority in the relevant market, no new entrant could emerge a substantial competitor to warrant prosecution under the potential competition doctrine. Because no state law affords unlimited branching authority, this conclusion effectively eliminated application of the doctrine to future antitrust prosecutions of bank mergers and acquisitions. See note 85 infra.

The following statistics indicate merger approval and denial rates by the three federal bank regulators from 1960-72: Federal Reserve — approval rate 90.6%, denials 9.4%, mergers construed as anticompetitive by the Justice Department, 50.0%; Comptroller — approvals 98.9%, denials 1.1%, construed as anticompetitive by the Justice Department, 57.2%; FDIC — approvals 96.4%, denials 3.6%, construed as anticompetitive by the Justice Department, 50.5%, overall averages — 97% approvals and 3% denials. See Reid, *Legislation, Regulation, Antitrust, and Bank Mergers*, 92 BANKING L.J. 1, 18 (1975).
last fifteen years. Prompted by the competitive inequalities between bank classes and sanctioned by federal statute, conversions have been utilized by banks to pressure their regulators into a more liberal position with regard to merger approvals. The Federal Reserve Board is very aware of the decline in its membership, and in an attempt to halt withdrawals to nonmember status, it may become reluctant to adhere to policies more restrictive than those advocated by other federal agencies and by the banking industry at large.

Branching issues further exemplify the diffusion of authority among federal banking regulators. Regulatory branching questions differ substantially from those concerning mergers because state restrictions play a greater role in branching cases. Also, while each of the federal regulators retains primary jurisdiction over merger approvals, only the Comptroller has primary approval in branch decisions. Both the Federal Reserve Board and the Federal Deposit Insurance Corporation have only secondary approval functions over state branches with respect to state member banks and nonmember insured banks. Although the Comptroller retains primary approval jurisdiction over those domestic branch cases which concern national banks, that agency may not approve a national branch on terms inconsistent with state law.

Because of the additional state dimension in branching decisions, the federal inter-agency conflict in this area is less pronounced than it is in merger decisions. For example, during the five-year period from 1969 to 1973 the Comptroller denied 13% of all branch applications. By contrast, and largely due to the secondary approval functions of the Federal Reserve Board and the Federal Deposit Insurance Corporation, the

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66 See, e.g., the proposed merger between Bank of South Texas and First National Bank of Alice. The FDIC was asked to approve the merger, but denied it as anticompetitive in December 1974. In August 1975, the application was reconsidered and the merger granted. In the interim, no substantive change in circumstances had occurred; however, "the applicant had reminded the FDIC that the merger could be restructured to result in a national bank, under jurisdiction of the Comptroller rather than under the FDIC." 1975 Hearings on S. 2298, supra note 10, at 7 (statement of J. L. Robertson). See also Brimmer, Market Structure, Public Convenience and the Regulation of Bank Mergers, 86 Banking L.J. 771, 776-78 (1969), for a study of approval-denial rates regarding merger applications before the three federal regulators.


68 See generally Scott, In Quest of Reason: The Licensing Decisions of the Federal Banking Agencies, 42 U. Chi. L. Rev. 235 (1975). Pursuant to 12 U.S.C. § 36 (1970), the Comptroller administers the establishment of national bank branches, whereas, the Federal Reserve Board must approve branches for state member banks (id. § 521) and the FDIC for nonmember insured state banks (id. § 1828(d)). It should be noted that all foreign branch decisions require approval of the Federal Reserve Board, regardless of the bank class involved. Id. §§ 601, 521.

69 Scott, supra note 68, at 81-84.

70 Id. at 76-79.

71 In First Nat'l Bank v. Walker Bank & Trust Co., 385 U.S. 252 (1966), the Supreme Court ruled that national branch banking is limited to those states which permit it and then only to the extent permitted by state law. See also First Nat'l Bank v. Dickinson, 396 U.S. 122 (1969), reaffirming state restrictions on the establishment and operation of national branches.

72 Scott, supra note 68, at 274.
rejection rate of these two agencies was practically nil: 99% approvals for the FDIC and almost 100% approvals for the Federal Reserve Board.\footnote{Id. at 275.} Actually, in the branching area there is intensive policy disagreement among the federal regulators that is not reflected in the approval-denial rates.

Ascertainment of policy goals for branch decisions is difficult. Neither the statutes governing these decisions nor two of the three federal regulators have set standards for branch approvals.\footnote{Id. at 288-94.} Only the Federal Deposit Insurance Corporation has indicated the specific criteria considered in its branch approvals. These are: the financial history and condition of the bank; capital adequacy; future earnings prospects; general character of bank management; public convenience and community needs to be served by the proposed institution; and whether the corporate powers are consistent with the purposes of the Federal Deposit Insurance Act.\footnote{12 U.S.C. § 1816 (1970).}

One author sought to determine the Comptroller's objectives in its approvals of national bank branch applications.\footnote{Provoked by the "determined resistance" of the Comptroller and other banking agencies to provide applicants with "intelligible explanations of licensing decisions," Professor Kenneth Scott undertook to determine the regulatory criteria for branch and charter decisions. Scott, In Quest of Reason: The Licensing Decisions of the Federal Banking Agencies, 42 U. Chi. L. Rev. 235, 288 (1975).} Upon obtaining access to a random sample of files on charter applications, he discovered that the Comptroller based branch approvals on whether the proposed branch would be profitable.\footnote{Professor Scott noted that profitability in a services industry is usually determined through a perception of "public need": the willingness of the public to pay for a service and the extent to which actual or projected payment exceeds costs of delivery. Professor Scott's examination of the national bank branch files, however, revealed that the Comptroller employed less stringent standards to project profitability in the proposed branch area, for instance, whether the other banks in the area could sufficiently serve their customers without the proposed branch. Id. at 284-85.} The Comptroller's unilateral approach thus emerges in stark contrast to the multiplicity of factors considered by the Federal Deposit Insurance Corporation in its branch decisions. Moreover, profitability appears to be a poor indicator on which to base branching decisions, since it demonstrates little more than the projected benefits of branch approval to the stockholders of the branching bank.\footnote{Id. at 285.} An examination of other factors, such as the capital adequacy of the branch applicant and the potential anticompetitive effects of the proposed branch site on the surrounding banking market, would appear more proper indicia for branching decisions.

\begin{itemize}
\item[\footnote{Id. at 275.}] Id. at 275.
\item[\footnote{Id. at 288-94.}] Id. at 288-94.
\item[\footnote{12 U.S.C. § 1816 (1970).} Indirectly, the Federal Reserve Board has provided some clue to the criteria which it uses in evaluating branch approval applications. The Board urges that state member banks supplement branch applications with certain information, including the scope and character of potential branch functions and the supervisory policy of the home office to its branch. The Board will inform the branch applicant, through a "simple statement," of the grounds for each case of branch denial. See 12 C.F.R. § 262.3 (e) (1976).
\item[\footnote{Provoked by the "determined resistance" of the Comptroller and other banking agencies to provide applicants with "intelligible explanations of licensing decisions," Professor Kenneth Scott undertook to determine the regulatory criteria for branch and charter decisions. Scott, In Quest of Reason: The Licensing Decisions of the Federal Banking Agencies, 42 U. Chi. L. Rev. 235, 288 (1975).}] 12 C.F.R. § 262.3 (e) (1976).
\item[\footnote{Professor Scott noted that profitability in a services industry is usually determined through a perception of "public need": the willingness of the public to pay for a service and the extent to which actual or projected payment exceeds costs of delivery. Professor Scott's examination of the national bank branch files, however, revealed that the Comptroller employed less stringent standards to project profitability in the proposed branch area, for instance, whether the other banks in the area could sufficiently serve their customers without the proposed branch. Id. at 284-85.}] Professor Scott further questioned whether the Comptroller can efficiently project branch earnings figures, for, in fact, the applicant may be better equipped to determine bank profitability than the regulator.
\end{itemize}
This "profitability" focus, however, is consistent with the Comptroller's regulatory approach in other areas, most notably, with respect to its encouraged diversification of banking services and merger expansion. All these policies have successfully attracted large state banks to national bank status and secured substantial banking interests within the agency's jurisdiction. Consequently, the Comptroller has promoted a new duality in banking, that of large versus small bank, in contrast to the traditional duality of state versus nationally-chartered institutions.

A final and timely example of this emphasis on bank expansion emerges in the 1974 Comptroller ruling that electronic funds transfer systems are not banking branches. Because state branching restrictions are often stringent and because the Supreme Court has held

79 See notes 29-33 supra and accompanying text.
80 See note 53 supra and accompanying text.
81 Of approximately 14,000 banks in the United States, 4,600 are nationally chartered. Although constituting only 33% of the total commercial bank force, national banks account for 60% of all bank assets. See Weiant & Wood, The Adequacy and Structure of Capital for Banks and Bank Holding Companies, in Compendium, supra note 35, at 375-77.
82 Small banks primarily perform a "safekeeping and payments function" within their service areas; in addition to performing this function, large banks are major intermediaries in medium and long-term credit transactions. F.I.N.E. Study Responses, supra note 29, at 12-13. Smaller banks also differ from larger institutions in the composition of deposit concentrations. A significant proportion of their assets are concentrated within a narrow geographical sphere and among a few depositors; by contrast, large banks secure a broader representation of deposits from many customers. Id. at 14. Other differences between large and small institutions concern loans and investments and are related to the above discrepancies in function and in deposit concentration. For example, the small bank is required to hold substantial liquid assets, so that it can respond to any "deposit volatility" caused by its emphasis on the payments function and its high concentration of deposits among a few customers. The large bank can safely maintain smaller liquidity ratios due to its broader depositor base. Finally, the large bank's credit demands dictate the development of highly diversified loan portfolios. Id. at 14-15.
83 Electronic funds transfer systems encompass a variety of computerized models through which customer transactions may be accommodated without a visit to the bank office during working hours. Generally, the systems function by means of an off-premise terminal, connected by wire to the parent bank's central accounts computer. Comment, Electronic Funds Transfer and Branch Banking — The Application of Old Law to New Technology, 35 Md. L. Rev. 88 n.3 (1975).
84 12 C.F.R. § 7.7491 (1976). In June 1975, the Comptroller modified this ruling to restrict construction of electronic funds terminals by national banks to within fifty miles of the bank's main office or closest branch office, unless the terminals were shared with commercial banks, mutual savings banks, savings and loan associations, or credit unions. This interpretive ruling was later formally rescinded at 41 Fed. Reg. 36,198 (1976). See note 87 infra.
85 In 1975, only 21 states permitted statewide branching by commercial banks: Alaska, Arizona, California, Connecticut, Delaware, Hawaii, Idaho, Louisiana, Maine, Maryland, Nevada, New Jersey, North Carolina, Rhode Island, South Carolina, South Dakota, Utah, Vermont, Virginia, and Washington. Wyoming had no branching statute, although it recognized de facto branches. Of the remaining states, 12 prohibited branching but permitted limited facilities, such as drive-in terminals; the 16 remaining states permitted branching within limited geographic areas. See Table VI — Status of State Branching Statutes, in 1975 Hearings on S. 2298, supra note 10, at 264. There is a correlation between the scope of permissible branching and the geographic location: widespread branching is concentrated in the western states; unit banking is most prevalent between the Mississippi and the Rockies; and limited branching is characteristic of the eastern states, although unit banking and statewide branching are also represented in that region. See generally G. Fischer, American Banking Structure 66-71 (1968).
national branch banking subject to state restrictions, the Comptroller ruling attempted to circumvent state branching law under the guise of electronic transfer terminals. The ruling has been formally rescinded by court order; to date, the Supreme Court has refused to grant certiorari in these electronic funds transfer cases. If national banks were allowed to maintain such systems without the limitations of state branching laws, a result which could be obtained either by congressional legislation or by Supreme Court decision, they could dominate the banking industry. Electronic terminals are less expensive to operate than are branches, and computerized banking services could be easily marketed through interstate commerce.

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68 First Nat'l Bank v. Dickinson, 396 U.S. 122, rehearing denied, 396 U.S. 1047 (1969); First Nat'l Bank v. Walker Bank & Trust Co., 385 U.S. 252 (1966), rehearing denied, 395 U.S. 1032 (1967). Walker Bank & Trust is the leading case on construction of the McFadden Act, 13 Stat. 484, as codified and amended, 12 U.S.C. § 36 (1970), the statutory authority for the establishment and operation of national bank branches, and it incorporated state branching restrictions into section 36(c) of that Act. Dickinson reaffirmed the application of state law to national branches and further clarified the federal definition of "branch" under section 36(f) of the McFadden Act, in effect ruling that any branch which afforded a "competitive advantage" to a national bank constituted a section 36(f) branch and was, therefore, subject to state branching law pursuant to section 36(c). 396 U.S. at 136-37.

Dickinson is ambiguous, however, on whether the federal definition of branch under section 36(f) is preliminary to these considerations of state law application and of competitive equality under section 36(c), or whether the section 36(f) branch definition initially includes examination of the competitive effects. If the second construction is adopted and the activity meets the definitional requirements of section 36(f), state branching restrictions are incorporated by federal definition. Comment, Electronic Funds Transfer and Branch Banking — The Application of Old Law to New Technology, 35 Md. L. Rev. 88, 100 (1975). The Comptroller capitalized on this ambiguity through its electronic funds transfer ruling. Contending that the section 36(f) definition of branch is preliminary to application of state law under section 36(c), the Comptroller asserted that because electronic systems are excluded from that definition, they are not subject to state branching restrictions.

At least four state banking authorities have successfully challenged the 1974 Comptroller's ruling in federal court. In all of these cases, both the district courts and the courts of appeals concluded that computer bank terminals constituted branches and were, therefore, governed by state branching limitations.

Electronic funds terminals may be analogized in function to the supplementary services provided by branches to the home office. This functional approach tends to force an equation of terminal services with branching activities. Until comparative studies indicate significant differences between the effects of conventional branching and those of off-premise computer delivery systems, the courts can be expected to utilize this analogy. Moreover, the potential anticompetitive effects of computer bank terminals cannot be ignored.

C. A Competition in Laxity

The foregoing analysis indicated several problems in the field of bank supervision and regulation. Statutory inequalities persist among bank classes and national banks, through the incidental powers clause, enjoy extensive powers unmatched by their state counterparts. The


91 Colorado ex rel. State Banking Bd. v. First Nat'l Bank, 394 F. Supp. 979 (W.D. Colo. 1975), modified, 540 F.2d 479 (10th Cir. 1976) (district court held that an electronic terminal is a branch only to the extent that it conflicts with state law, thus computer systems were only branches to the extent that deposits were received; court of appeals reversed in part holding that the use of electronic systems to withdraw and transfer funds also constituted branch banking and offended 12 U.S.C. § 36 (1970)); accord, Missouri ex rel. Kostman v. First Nat'l Bank, 405 F. Supp. 733 (E.D. Mo. 1975), aff'd, 538 F.2d 219 (8th Cir. 1976), cert. denied, 429 U.S. 941 (1976); Independent Bankers Ass'n of America v. Smith, 402 F. Supp. 207 (1975), aff'd, 534 F.2d 921 (D.C. Cir. 1976) (customer terminal constituted a branch under 12 U.S.C. § 35(f) (1970) and was subject to state branching laws; the court enjoined the Comptroller from further implementation of his ruling that computer terminals were not branches); accord, Illinois ex rel. Lignoul v. Continental Ill. Nat'l Bank & Trust Co., 409 F. Supp. 1167 (N.D. Ill. 1975), aff'd, 536 F.2d 176 (7th Cir. 1976), cert. denied, 429 U.S. 871 (1976).

92 See also note 86 supra.

93 An example of this functional equation of electronic terminals and branch services is evident in the district court opinion of Independent Bankers Ass'n of America v. Smith, 402 F. Supp. 207 (D.D.C. 1975).


95 See note 90 supra. The potential anticompetitive effects of electronic funds transfer systems may result from increased asset concentrations among banks which own and lease these systems. These banks could easily control the product market in computer services if they are permitted to restrict entry into this market. Other antitrust violations may occur if access to the facilities is limited by the controlling banks. Restrictions on access could be obtained either by refusing to deal with potential customers or by charging unreasonable prices for use of the facilities. See Bemard, Some Antitrust Issues Raised by Large Electronic Funds Transfer Systems, 25 Cath. L. Rev. 749 (1976). The increased asset size of banks with EFT systems also may permit these banks to dominate the delivery of banking services in the geographic market in which they are located.


97 See notes 27-32 supra and accompanying text.

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Statutes which enumerate bank powers also vary among the bank classes. The distribution of regulatory authority for merger approvals contributes to inter-agency conflict at the federal level; branching questions illustrate state-federal discord.

State branching decisions also illustrate the potential for duplication of effort inherent in a system of regulatory stratification. The secondary approval functions of the Federal Reserve Board and the Federal Deposit Insurance Corporation over branch applications of state member banks and nonmember insured banks, serve as a hierarchy of rubber-stamping rather than a system of checks and balances. Cost and time inefficiencies are also manifest in processing decisions which affect more than one bank class, because such decisions are subject to scrutiny by several regulatory agencies. Such decisions also must be discussed by the Interagency Coordinating Committee on Bank Regulation, comprised of representatives from the FDIC, the Federal Reserve Board, the Federal Home Loan Bank Board, and the Office of the Comptroller. While attempts at coordination may appear productive in theory, in practice these attempts have proved time-consuming and often fail to achieve uniform results.

Banking, like other regulated industries, tends “to probe for the soft underside of the regulatory body.” Under the present regulatory system, the “soft underside” is often readily apparent. For example, the Office of the Comptroller is predictable in its support of bank expansion; therefore, a large state bank which desires to move into the nonbank service area may convert to national charter, particularly if the state law of its chartering jurisdiction is restrictive. Similar regulation-shopping occurs at the federal level. A state member bank may decide that the federal reserve requirements impound too large a percentage of its assets, and withdraw from the Federal Reserve System. Regulatory agencies, keenly aware of this “regulation-shopping”, may compromise their regulatory policies in order to maintain membership of the banks within their jurisdictions.

This pattern of deregulation has been termed by banking commentators a “competition in laxity.” It is encouraged by the current system of financial support of federal bank supervision. The expenses of the Comptroller are borne by supervised national banks through a dual as-

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96 See, e.g., notes 20-26 supra and accompanying text.
99 Some of this discord has been minimized by the Supreme Court decisions which subject national banks to state branching restrictions. See note 86 supra. See also notes 83-95 supra and accompanying text.
101 See note 73 supra and accompanying text.
103 Id.
106 See also 1975 Hearings on S. 2298, supra note 10, at 67 (testimony of J. L. Robertson), partially attributing the recent bank failures to the institutionalized laxity among the federal regulators.
assessment — a flat fee per bank and a percentage of bank assets.\textsuperscript{107} The expenses of the Federal Deposit Insurance Corporation are also satisfied through direct assessment income; the operating costs of the Federal Reserve System are paid through Federal Reserve funds, which constitute an indirect assessment on supervised banks.\textsuperscript{108}

Under this system, it is natural for federal regulators to succumb to pressures exerted by banking interests since their operating budgets depend on control over a substantial number of banks. The pressures from banking interests may be direct, through lobbying, or indirect, as exemplified by withdrawals from the Federal Reserve System.\textsuperscript{109} This financial dependence of the federal regulatory agencies on the regulated banks should be suspect because public and private interests in industry regulation do not always coincide.\textsuperscript{110}

With these problems in mind, the Federal Bank Commission Act\textsuperscript{111} was proposed as an attempt to eliminate the difficulties inherent in a system of stratified federal bank regulation. An examination of this bill, which advocates consolidation of the three federal regulators into a single commission, is necessary for an understanding of banking reform at the federal level.

II. FEDERAL BANK COMMISSION ACT

A. Legislative History

Consolidation of federal bank supervision into a single agency was proposed as early as 1919,\textsuperscript{112} only six years after the division of federal bank regulation between the Office of the Comptroller and the Federal Reserve Board.\textsuperscript{113} Since that time, it has been the focus of numerous advisory reports: the Brookings Institution in 1937,\textsuperscript{114} the Hoover Com-


The Federal Bank Commission Act, the consolidation proposal pending before the Senate Committee on Banking, Housing, and Urban Affairs, was originally proposed by James L. Robertson, former Governor of the Federal Reserve Board, in an address before the Tennessee Bankers Association in May 1962. It has been the subject of two bills before the House of Representatives and the topic of congressional hearings in 1963 and 1965. A third set of hearings was conducted in 1975. Hearings on the pending Senate legislation have not yet been scheduled.

Former Governor Robertson's proposal is distinguishable from previous consolidation schemes in its suggestion to establish a new government.

75th Cong., 1st Sess. 222-23 (1937). The report was to be used by the Senate Select Committee to Investigate Executive Agencies of the Government with a View to Coordination.

115 The Hoover Commission urged that a task force be established to study banking agencies. It also suggested the transfer of the FDIC to the Department of the Treasury and the consolidation of all supervisory powers within a single federal agency, preferably the Federal Reserve Board. U.S. Comm'n on Organization of the Executive Branch of the Gov't, Report on Independent Regulatory Comm'ns 11-12 (1949).


117 The Hunt Commission Study advocated stripping the FDIC and the Federal Reserve of all regulatory powers and urged instead the establishment of a new Federal Administrator of State Banks and of a single Federal Deposit Guarantee Association. Under this plan, the Administrator would supervise all state-chartered banks at the federal level; the Association would take charge of deposit insurance and related functions; and the Office of the Comptroller would remain intact. The study further advocated "removal of regulatory barriers" in order to enhance banking competition. Most notably, it was suggested that savings and loan associations be allowed to perform banking functions and that prohibitive state branching laws should be suspended. Report of the President's Comm'n on Financial Structure and Regulation (1971).


119 The original proposal was essentially the same as the pending bill, however, the initial proposal was more specific. It suggested that the Federal Bank Commission consist of two separate arms, each headed by a single administrator: a Director of Insurance would handle the deposit insurance functions presently performed by the FDIC; and a Director of Bank Examinations would administer all bank examination and supervisory functions. The Director of Examinations would also be required to submit to the Bank Commission reports and recommendations with respect to every charter, branch, merger, and holding company application as well as reports of any instance in which an insured bank engaged in unsound practices or violations of the law. 1975 Hearings on S. 2298, supra note 10, at 24-25 (statement of J. L. Robertson). The bill now pending before the Senate Committee eliminates this two-unit approach; instead it would afford the Commission broad delegatory powers. S. 684, 95th Cong., 1st Sess. § 7(a), (b), 123 Cong. Rec. S2472 (daily ed. Feb. 10, 1977).


122 1965 Hearings, supra note 107. Neither the 1963 nor 1965 versions of the bill were ever reported out of the House Committee on Banking and Currency, and, therefore, no committee reports are available.

mental agency, the Federal Bank Commission, to administer bank regulatory functions at the federal level. The prior proposals appealed for unification within one of the existing regulatory agencies or within the Treasury Department. Subsequent to the widespread dissemination of Robertson's proposal, three alternative consolidations were suggested, each of which vested some administration within a newly-created agency. These alternatives, however, are responses to the Federal Bank Commission Act rather than proposals in their own right. They focus upon coordination and compromise between existing federal agencies rather than upon true consolidation, which necessarily entails transfer of existing agency functions into a single regulatory body. Since they present the main arguments against adoption of the Federal Bank Commission Act, each of these proposals will be discussed below. Before examination of these alternatives, however, the Act itself should be outlined.

B. Description of the Act

The Federal Bank Commission Act is premised upon three congressional findings: that the existing federal regulatory structure is incapable of insuring safe and sound commercial banking; that a sound banking environment is crucial to a stable economy; and that the Federal Reserve System can best fulfill its primary responsibility to conduct national monetary policy if it is relieved from its banking supervisory functions. These three findings correspond to the Act's expressed policies of advocating consolidation to effectuate impartial and uniform application of the federal banking laws; preserving and strengthening the dual banking system; and enabling the Federal Reserve Board to concentrate solely upon the development and implementation of monetary policy.

The Act proposes to foster these policies by the transfer of all examination functions performed by the existing federal agencies to the Federal Bank Commission, and by the elimination of the Office of the Comp-

124 COMM'N ON MONEY AND CREDIT, THEIR INFLUENCE ON JOBS, PRICES, AND GROWTH 174 (1961) (sole federal bank regulation in Federal Reserve Board); U.S. COMM'N ON ORGANIZATION OF THE EXECUTIVE BRANCH OF THE GOVT,' REP. ON INDEPENDENT REGULATORY COMM'NS 11-12 (1949) (transfer of FDIC powers to the Treasury Department and consolidation of all federal bank regulatory authority, preferably in Federal Reserve Board); S. REP. No. 1275, 75th Cong., 1st Sess. 222-23 (1937) (vest most regulatory power in FDIC). See generally Remarks of J. M. Bucher, Member Board of Governors, Federal Reserve System, to the Annual Convention of the Western Independent Bankers Ass'n (March 11, 1975), reprinted in COMPENDIUM, supra note 35, at 876.


127 Id. § 2(b)(1)-(3).
troller and of the Federal Deposit Insurance Corporation. Stripped of its supervisory functions, the Federal Reserve Board would be free to concentrate solely upon development of national monetary policy. Moreover, the Act contemplates federal deregulation of state-chartered banks. The Commission could remove itself from state insured bank supervision when satisfied that the state banking authorities would be competent to accept full responsibility for state bank regulation.

According to the proposed Act, the Federal Bank Commission would consist of a five-person board, selected on a non-partisan basis to serve for staggered five-year terms. Four of the Commissioners would be appointed by the President and be subject to approval by the Senate; the fifth would be designated by the Chairperson of the Board of Governors of the Federal Reserve Board from among members of the Board. The Commission would assume exclusive jurisdiction over all areas presently under the control of the three federal banking agencies. Specifically, branch, charter, and merger questions, and those concerning bank holding companies and fiduciary and foreign banking activities would be subject to the Commission’s interpretation. The new agency also would be authorized to promulgate regulations in all banking areas except monetary policy. Functions related to policy interpretation or implementation could be delegated by the five-person board; however, the promulgation of regulations and the formulation of general policy would rest exclusively with the board itself.

In addition to its policy and rule-making functions the Commission would also review, either upon its own motion or upon that of others, actions taken by its subordinates. Review could be obtained by any institution which is terminated or against which a cease and desist order has been issued. Also, any person adversely affected by a ruling of the Commission could apply for a review of that action.

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128 Id. § 5(c) (transferring all Comptroller functions to the Federal Bank Commission but for the currency and redemption duties transferred to the Secretary of the Treasury), and id. § 5(d) (transferring all FDIC functions to the Bank Commission).
129 Id. § 2(3).
130 Id. § 312(d), amending 12 U.S.C. § 326 (1970). Removal would be discretionary with the Commission; no statutory standards are set. Former Governor J. L. Robertson advocates revision of S. 2298 to include a provision contained in the 1963 and 1965 versions of the bill. This provision would defray all costs of federal bank supervision from deposit insurance assessments and would provide state insured banks with a refund of the insurance amount assessed by state regulators. Mr. Robertson argued that such assessment and refund to state insured banks would put state and national banks on a financial parity and would encourage state banking authorities to accept total supervisory responsibility for state banks. 1975 Hearings on S. 2298, supra note 10, at 67 (testimony of J. L. Robertson). For the comparable provision in the 1965 version of the Federal Bank Commission Act, see H.R. 107, 89th Cong., 1st Sess. § 11 (1965). See also notes 201-02 infra and accompanying text.
131 Id. § 7(b), (d).
132 Id. § 7(c).
C. Impact of the Act on the Present Regulatory Scheme

While consolidation of the three federal banking agencies will not, of itself, resolve all the problems of the current regulatory structure, its potential benefits should not be overlooked. Not only would unification of federal bank supervision reduce costs and increase efficiencies through the elimination of wasteful duplication of effort, but it would also promote consistency in decision-making. All branch, charter, and merger applications would be scrutinized by a single agency instead of three, and banking decisions would be made according to a single set of rules. Moreover, consolidation, if accompanied by substantive changes in federal banking statutes, should diminish the laxity associated with federal inter-agency conflict and should remove the present impetus for regulation-shopping at the federal level.

Opponents of the Federal Bank Commission Act, by contrast, advance the following arguments against consolidation: the existing regulatory scheme has worked well in the past; centralized regulation and the attendant concentration of power in a single agency would eliminate competition between agencies and the innovation in the banking industry attributable to such competition; and consolidation would impair, if not destroy, the dual banking system. The first argument may be dismissed as the most tenuous. The inadequacies of the current federal regulation have already been indicated, and they imply a need for regulatory reform. The other two arguments should be more carefully examined, however, since they address the economic effects of consolidation as a means to reform bank regulation.

136 Although the rules governing banking activities should be applied in an impartial and consistent manner, they need not be singular in focus. The Federal Bank Commission could adopt varied standards by which a particular banking activity could be regulated. For example, a branch application could be approved or disapproved, depending on factors such as the size and capital adequacy of the home office and the projected effects of the branch on banking competition in the surrounding area. Such varied guidelines would promote flexibility in branch approvals; the single-agency regulator would foster consistent decision-making in each case.

137 There is a possibility, however, that under one agency regulation-shopping will remain under the guise of federal to state charter conversions. Conceivably, states may enact legislation rendering federal chartering less desirable than state incorporation and regulation. States could then compete to attract banks to their jurisdictions in much the same way that the state of Delaware attracts corporations that wish to take advantage of that state's liberal corporation and tax laws.


139 Traditionally, this argument has dominated the debate over federal agency consolidation proposals and is most often advanced by state bankers and state banking authorities, who are concerned with protecting their geographic domains. See, e.g., 1963 Hearings, supra note 121, at 329 (statement of Randolph Hughes, Chairman of the Legislative Comm. of the National Ass'n of Supervisors of State Banks (NASSB)); see also 1965 Hearings, supra note 107, at 122-23 (statement of F. S. Cullom, Chairman of the Legislative Comm., NASSB). See generally Hackley, Our Baffling Banking System — Part II, 52 Va. L. Rev. 771, 817 (1966).

140 A further example is the inadequacy of the accounting practices presently employed by regulatory agencies in bank examinations. The practices "insulate the bal-
A serious objection to regulatory consolidation is that it would promote an unhealthy concentration of power within a single federal regulatory agency. The premise of this argument is that the strength of diffuse regulation is its encouragement of experimentation through the creation of separate laboratories with which to test new regulatory approaches. For example, proponents of this argument might note that only the Comptroller of the Currency adopted a policy which would encourage bank expansion into traditionally nonbank service industries, such as travel accommodations and data processing equipment. The other federal banking agencies have not adopted similar policies. Therefore, it may be argued, the Comptroller has provided a testing ground to determine the scope of permissible bank expansion into traditionally nonbank service areas.

Those who oppose the Federal Bank Commission Act contend that the benefits of inter-agency competition would be lost if the federal agencies were consolidated. While single-agency regulation, in theory, could impede regulatory experimentation, this detriment may be outweighed by the public savings to be attained through single-agency regulation in terms of consistent regulatory standards and reduced costs of regulation. Diffusion of federal banking authority, moreover, may actually impair the ability of three federal regulators to accommodate changes within the banking industry. In general, a regulatory agency is created to supervise industry and to advise the legislature regarding the definition of regulatory objectives and policy. The agency is viewed as an expert in its area of activity. Ostensibly, diffusion of supervisory authority narrows the areas of responsibility, policy focus, and expertise of each participating agency. For example, the Federal Reserve Board could overstate the significance of the banking system as a conduit for monetary policy, while the Federal Deposit Insurance Corporation could become preoccupied with the integrity of the federal deposit insurance fund. Under present federal regulation, no one expert or agency determines the overall economic purpose and public policy for bank regulation.

As indicated, the competition among the federal banking agencies is more accurately described as a "competition in laxity" rather than innovative competition. Two factors contribute to this condition: the lack of inter-agency policy coordination, as described above, and the fact that two of the three federal banking agencies, the Office of the Comptroller of the Currency, and the Federal Reserve, focus more narrowly on the economic effects of instability and the Federal Deposit Insurance Corporation on the integrity of their deposit insurance fund. Moreover, the agencies overstate the significance of the banking system to the overall economy. Kaufman, Preventing Bank Failures, in PERSPECTIVES ON COMMERCIAL BANKING, 1975 Hearings on S. 2298, supra note 10, at 792; see also Greenbaum, Economic Instability and Commercial Banking, 1975 Hearings on S. 2298, supra note 10, at 305-06.

See notes 29-33 supra and accompanying text.
troller of the Currency and the Federal Deposit Insurance Corporation, are funded by the banks they regulate. 144 Two earlier versions of the Federal Bank Commission Act would have congressionally funded the Commission. It is strongly urged that a similar provision be incorporated into the present draft of the Act. 145 Such direct legislative accountability would promote objectivity in bank examination and lessen the risks caused by the regulatory agencies' attempts to build a power base among the banking community in order to sustain sufficient operating funds. It is further suggested that legislative accountability could be managed more efficiently through single-agency regulation. A centralized information base for regulatory policy could respond more efficiently to legislative inquiries than can three distinct regulatory bases. 146

Opponents of the Federal Bank Commission Act also fear that single-agency federal regulation would decrease competition in the commercial banking industry. Competition among banks is maximized when each bank's market share is small and when the number of banks doing business in a given geographic area is large. 147 The commercial banking industry, however, may be characterized as an "admixture of monopoly and competition." 148 For example, the deposit submarket of commercial banking industry is moderately concentrated when measured by absolute concentration ratios, but the commercial banking industry, as a distinct primary service product market, is comprised of a large number of banking institutions. In other words, relatively few commercial banks control a large share of the total bank deposits. Accordingly, competition in commercial banking services coexists with oligopolistic control over deposit transactions.

In 1972, of the almost 14,000 independent banks in the United States, the sixteen largest banks held one-third of all the commercial bank deposits in the nation, and the 168 largest commercial banks, approximately one and one-half percent of the total, held 49 percent of all such deposits. 149 These figures suggest that a small percentage of all commercial banks dominate that banking market. It has been argued that, given this concentrated market structure, a single federal regulator would further entrench the deposit concentrations of these dominant banks. This contention presumes that the single agency would adopt a

144 See notes 107-08 supra and accompanying text.
146 Data and information sources are generally guarded by the regulated firm. It is in banking management's interests, at least in the short run, to volunteer no information and to resist agency extensions of data-gathering since any information turned over to the agency could be introduced against the bank in future hearings. Trebing, A Critique of Regulatory Accommodation to Change, in Regulation in Further Perspective 56 (W. Shepherd & T. Gies ed. 1974). The difficulties in obtaining such data are compounded when three regulators compete for data.
149 The following table indicates that, at the end of 1972, 79 percent of the commercial banks in the United States held only 16 percent of the aggregate deposits in the banking
The above argument generally is correct in its assessment of the anticompetitive effects of passive governmental regulation on concentrated markets. As indicated, the federal banking agencies have adopted a passive approach to regulation through their "competition in laxity." The argument emphasizes that antitrust problems would recur if the Federal Bank Commission followed this approach. Banking competition may decline with a single federal regulator, since it is easier for a regulated industry to capture one agency than to control three. An entrenched market structure, coupled with regulatory acquiescence, provides dominant firms with the potential to dictate the rate of industry innovation, rather than allowing the rate to be market-determined.

While too little regulation can be a sham and function to legitimize monopoly gains within an industry, overreaching regulation may prove deleterious to competition by unduly restricting entry into regulated markets. How to balance the need for competition against that for industry regulation, to the extent that regulation carves out legally protected market shares, is a question which is far from settled.

An examination of single federal administrative agencies sheds little system. The 168 largest banks, one and one-half percent of all banks, held 49 percent of all deposits. These figures include demand, time, and savings deposit totals.

Size Distribution of Insured Commercial Banks

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<thead>
<tr>
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150 See notes 96-111 supra and accompanying text.


152 For example, to the extent that governmental regulation creates unnatural barriers to market entry in a regulated industry, the market shares of existing firms become legally protected. Demsetz, Why Regulate Utilities?, in REGULATION IN FURTHER PERSPECTIVE, id. at 135. In the banking industry, governmental regulation is less pervasive than in the public utility area, however, the rate of entry is nevertheless restricted by regulation. Branching limitations, minimum capital requirements, and reserve requirements constitute the primary regulatory barriers to entry. One commentator concluded that in recent decades such restrictions have reduced the rate of bank entry by 33-55 percent from freely competitive levels. Peltzman, Bank Entry Regulation: Its Impact and Purpose, cited in L. Ritter & W. Silber, Principles of Money, Banking, and Financial Markets 382 n.7 (1974).
light on this question, since the agencies tend to protect the competitors in the regulated industry rather than to protect competition. This practice illustrates the tension between regulation and antitrust policy. The federal antitrust laws are designed to protect industry competition, not individual competitors. Should the Federal Bank Commission follow the practices of other single regulatory agencies, banking competition probably would be reduced. To the extent that market competition is better for the banking industry than is regulation, those who oppose the Federal Bank Commission Act based upon the fact that consolidation may reduce banking competition, would appear to have a valid argument. At least some degree of regulation is necessary to insure safe banking. Evidence indicates that the rate of bank failures increases as market forces predominate over regulation. Thus, in this regard, the evidence weighs in favor of regulation at the expense of some competition in banking markets; whereas, in areas such as merger approvals, competitive factors would seem to be the overriding consideration.

A final argument against consolidation is that it would destroy the dual banking system, which offers banks the option of selecting state or federal charters. Equating consolidation with greater federal control over state banks, proponents of this view contend that state banking authorities would become overpowered by a single-agency federal regulator. For example, they fear that the Bank Commission would inherit the combined budgets of the existing federal agencies and, therefore, that state authorities would be unable to compete with agency innovation at the federal level. Consolidation does not, by itself, dictate expanded federal control over the banking industry. In fact, a provision of the Federal Bank Commission Act contemplates suspension of federal examinations of state member banks once state authorities demonstrate to the Bank Commission that they can adequately super-


155 The extent to which the banking industry should be regulated has been a subject of increased debate in recent years. See Benston, The Optimal Banking Structure: Theory and Evidence, in Current Perspectives in Banking: Operations, Management, and Regulation 365 (T. Havrilesky & J. Boorman ed. 1976).

156 See generally Guttenberg, Reflections on Bank Regulatory Structure and Large Bank Failures id. at 502.

157 One of the primary purposes of banking regulation is to safeguard bank deposits for the public. Arguably, reliance on market competition should govern in commercial banking markets only so long as it serves this end. See notes 219-23 infra and accompanying text.

158 See generally Redford, Dual Banking: A Case Study in Federalism, 31 Law & Contemp. Prob. 749 (1966), for a good introduction to the subject of dual banking.

159 See notes 187-92 infra and accompanying text for a discussion of dual banking.

160 Most state banking agencies are now unable to compete with the three federal regulators because of insufficient state appropriations for regulation. As a result, state agencies tend to mirror federal innovation in banking regulation.
vise those banks within their jurisdictions.\textsuperscript{161} This provision actually would expand the examination functions of state banking authorities and, thus, arguably strengthen the dual banking system.

D. Alternative Proposals for Centralization

The diffusion of authority among the three federal banking agencies undermines the legislative accountability of all three agencies. The existence of multiple regulatory agencies, as well as fifty state agencies, enables federal and state regulators to shift the blame among themselves for errors in judgment, unsound policies, and negligence.\textsuperscript{162} Recent bank failures have made legislators increasingly aware of the need for uniform regulation and has prompted consideration of consolidation of the three agencies as a viable means of reinstating legislative accountability at the federal level.

The congressional support for consolidation is evident in the jurisdictional provisions of recent banking legislation. This legislation generally designates a single agency to promulgate substantive regulations and requires the three federal banking agencies to enforce such regulations with respect to the banks which they examine. An example of this trend towards centralized regulation is the Bank Holding Company Act of 1956, as amended in 1970.\textsuperscript{163} Under this Act, the Federal Reserve Board retains exclusive jurisdiction over both multi-bank and one-bank holding companies, irrespective of the bank's bank class.\textsuperscript{164}

The federal banking agencies are aware of this growing congressional preference for centralization but oppose the Federal Bank Commission Act because it would dissolve the existing agencies. In attempting to


\textsuperscript{162} Address by Frank Wille, Chairman, FDIC, Before the Fall Meeting of the Ass'n of Registered Bank Holding Companies 3 (Nov. 17, 1975) (on file in the offices of the Cleveland State Law Review).


The 1956 Bank Holding Company Act defined a bank holding company as any corporation or other business association which controlled two or more banks, 12 U.S.C. § 1841 (1970). One-bank holding companies were, therefore, excluded from this earlier definition but were brought within the purview of the statute by the 1970 amendments to the Bank Holding Company Act. One-bank holding companies control the single lead bank as well as other nonbanking interests. This nonbanking expansion has caused bank holding companies to increasingly rely on non-price competition; a similar reliance on non-price competition has resulted from national bank expansion into nonbank service industries. Antitrust regulation becomes complicated by this non-price dimension. The Bank Holding Company Act does not exempt from the antitrust laws any holding company activities which are anticompetitive or monopolistic. United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963). See generally Pierson, Bank Holding Company Capital, in COMPRENDIUM, supra note 35, at 434.
reconcile these competing concerns, representatives from the Federal Reserve Board and the Federal Deposit Insurance Corporation have suggested alternative proposals to the Federal Bank Commission Act.\textsuperscript{165} Two reform proposals have gained strong support within the Federal Reserve Board; neither has obtained majority approval by the Board.\textsuperscript{166} The first sanctions consolidation of the Comptroller's functions within the Federal Reserve System;\textsuperscript{167} the second advocates the creation of a Federal Bank Examination Council either administratively or legislatively established.\textsuperscript{168} The Council would be authorized to set standards and procedures for all three federal agencies and would review significant problem cases. Representatives from the three regulatory agencies would sit on the Council.\textsuperscript{169}

Both Federal Reserve proposals illustrate the agency's reluctance to abdicate its bank supervisory functions. The Federal Reserve Board has consistently emphasized the close relationship between the formulation of monetary policy and bank regulation\textsuperscript{170} and thus opposes\textsuperscript{171} the

\textsuperscript{165} For a general discussion of the Federal Reserve proposals see 1975 Hearings on S. 2298, supra note 10, at 280-85 (statement of Robert C. Holland, Member, Board of Governors of the Federal Reserve System); the proposal recommended by Frank Wille, Chairman of the FDIC, also appears in the Hearings, id. at 272-80.

\textsuperscript{166} Id. at 285.

\textsuperscript{167} Consolidation within the Federal Reserve Board emerges as the most often suggested proposal for bank regulatory centralization. The present rationale for this proposal is that all national banks are required to be members of the Federal Reserve System and are subject to the Board's regulation, the Board has primary responsibility for all bank holding companies, and many of the major bank subsidiaries of such holding companies are national banks; therefore, consolidation of national bank supervision within the Federal Reserve Board would increase efficiencies "without some of the dangers of complete unification." 1975 Hearings on S. 2298, supra note 10, at 284 (statement of Governor Holland).

\textsuperscript{168} Id.

\textsuperscript{169} This Federal Reserve proposal was withdrawn from consideration by the Senate Banking Committee before the close of the 94th Congress. The Committee's leadership withdrew the proposal after the Committee narrowly voted to block further consideration of two related bills, H.R. 12834 — a bill to restructure the Federal Reserve System, and H.R. 3035 — a measure to permit interest payments on public funds deposited in demand accounts in commercial banks. The three bills were originally components of a legislative "package" proposed to institute changes in the Federal Reserve System and in the regulation of foreign banks and thrift institutions. In March 1976, that package was split into three proposals in response to formidable opposition to the plan by a wide variety of groups, including the American Bankers Association, the AFL-CIO, and the Ford administration. The withdrawal of the Federal Bank Examination Council scheme may, therefore, be viewed as a "saving" tactic by Senator William Proxmire, Chairperson of the Senate Banking Committee, in an effort to allow discussion of this proposal in conjunction with that of the Federal Bank Commission Act upon its early revival in the 95th Congress. See generally 34 CONG. Q. WEEKLY REP. 2822 (1976).

\textsuperscript{170} The role of the Federal Reserve as monetary policy-maker and as lender of last resort interacts more sensitively than ever before with the effects of prevailing bank supervisory and regulatory policies. Each of these areas of public policy increasingly influences the effectiveness of the other. The Board's policy is based on the conviction that to divorce them is to weaken both. Bd. of Gov. of the Fed. Reserve System, 62d Ann. Rep. 262-63 (1975). But see Remarks of J. M. Bucher, Member Board of Governors Federal Reserve System, to the Annual Convention of the Western Independent Bankers Ass'n, (March 11, 1975), reprint ed in Compendium, supra note 35, at 857-88. Mr. Bucher contends that when the same agency that has the responsibility for setting national monetary policy plays a major role in bank regulation, conflicting objectives may arise, based on these separate agency re-
Federal Bank Commission Act plan to strip the Federal Reserve of all bank supervisory powers.\textsuperscript{172}

Although more far-reaching than the Federal Reserve proposals, the reorganization plan initiated by Frank Wille of the Federal Deposit Insurance Corporation also stops short of a total consolidation of the regulatory agencies. This proposal entails the centralization of the supervisory duties presently performed by the Federal Reserve Board and the FDIC into a new agency, headed by the Federal Supervisor of State Banks,\textsuperscript{173} and the formation of a five-member Federal Banking Board, with powers limited to the implementation of a national policy for bank regulation.\textsuperscript{174} Congress would determine which matters required national uniform regulation, and these matters would define the scope of the Banking Board's jurisdiction.\textsuperscript{175} The Board would consist of three ex-officio members, one from each of the existing federal banking agencies, and two appointed by the President and confirmed by the Senate.\textsuperscript{176}

The Wille proposal thus contemplates the perpetuation of the three federal regulators, although federal regulation of state-chartered institutions would be consolidated under the Federal Supervisor of State Banks. Federal inter-agency conflict could be expected to continue between two agencies, the Federal Supervisor and the Comptroller, with the Federal Banking Board acting as an arbitrator. The greatest downfall of the Banking Board scheme is its focus on crisis resolution rather than on the use of preventive measures to promote consistent decision-making.

Uniformity in regulation does not appear to be a result of the Wille proposal, since the Banking Board's jurisdiction is dependent upon a vague standard. The Board's powers would be restricted to those areas that Congress deemed require uniform regulation. Irregularity in decision-making. He particularly emphasizes the need for bank examiners to be insulated "from any possible temptation of the monetary authority to use supervisory powers to implement monetary policy . . . this exemplifies the kind of collision that could undercut either monetary policy or regulatory objectivity or both." \textit{Id.} at 888-89. He also supports former Governor Robertson's argument against consolidation within the Federal Reserve, since the responsibilities for developing monetary policy are so great that the Board should not be assigned further duties in terms of bank supervisory functions. \textit{Id.} at 887-88; \textit{1975 Hearings on S. 2298, supra note 10, at 71 (testimony of J. L. Robertson).}

\textsuperscript{171} \textit{1975 Hearings on S. 2298, supra note 10, at 281 (statement of Robert Holland).}

\textsuperscript{172} It is questionable whether any substantive banking reform may be effectuated through the coordinated efforts of existing regulators. The biases and prejudices affiliated with the present structure present a foreboding obstacle to regulatory change. Consolidation within a new agency — the Federal Bank Commission — would, at least, facilitate reform through the requisite formulation of new governing policies. Absent substantive regulatory reforms, however, consolidation may prove as ineffective as attempts at agency coordination.

\textsuperscript{173} See also note 117 supra.

\textsuperscript{174} See \textit{1975 Hearings on S. 2298, supra note 10, at 276 (statement of Frank Wille), for a discussion of the Federal Banking Board proposal.}

\textsuperscript{175} Mr. Wille assumed that a number of areas would be subject to the Banking Board's jurisdiction, for instance, insurance functions, bank holding company powers, and bank merger regulation.

\textsuperscript{176} \textit{Id.}
sion-making would persist in those areas not within the Board's jurisdiction. Further, new conflicts would arise over which issues demanded Board jurisdiction, and, since Congress would make the determination, the decision might not be rendered on a timely basis. Moreover, it is highly questionable whether Congress has the ability to delineate areas of national banking concern. Such delineation is a full-time task and should be performed by experts who are abreast of the banking industry's rapid changes. While the Federal Bank Commission Act recognizes this fact, and places all regulatory questions under the jurisdiction of a team of five experts, the Banking Board proposal does not; it merely adds a new bureaucratic layer to an already complex regulatory structure.177

Therefore, the Federal Banking Board proposal would substantively maintain the present regulatory scheme although, in form, it would appear to diminish inter-agency conflict. It emphasizes coordination of issues and policies rather than of agencies. It should be noted, however, that this proposal resembles the Bank Commission Act in its plan to remove supervisory functions from the Federal Reserve Board.178 This provision signifies the primary point of departure of the Banking Board proposal from the Federal Reserve's Bank Examination Council scheme.179 The appropriations provision, however, is the strongest reform measure of the Federal Banking Board proposal. It would substitute congressional agency funding for funding through bank assessment. A similar appropriations provision has been contemplated by the drafters of the Federal Bank Commission Act although it is not included in the present form of the bill.180 It would appear that as long as the regulators are tied financially to those they regulate, banking agencies will remain dependent upon the banks within their jurisdictions.

III. DUAL BANKING AND THE FEDERAL BANK COMMISSION ACT

A. The Dual Banking System: Its Purposes and Effects

The term "dual banking" denotes a system in which banks are permitted to select between two chartering systems, one federal and one state. Bank regulation is correspondent to the chartering jurisdiction selected. In the broadest sense, the term signifies the arrangements under which federal and state banking structures coexist in a comprehensive regulatory environment.

The dual banking system originated in 1863, when the National Currency Act established federal chartering of national banks.181 At its inception, state-chartered institutions were regulated by state banking

177 The Wille proposal, in effect, merely adds two coordinating committees to the present federal structure: a general coordinating committee in the Federal Banking Board, and a coordinating agency in the Federal Supervisor of State Banks, for the federal supervision of state-chartered institutions.


179 See notes 168-69 supra and accompanying text.

180 See notes 144-45 supra and accompanying text.

authorities and national banks were regulated by the Comptroller of the Currency. In 1913, this regulatory system was complicated with the passage of the Federal Reserve Act;\footnote{182 Act of Dec. 23, 1913, ch. 6, 38 Stat. 251.} regulation no longer was determined solely by the type of bank charter selected. State banks could become subject to federal regulation if they voluntarily elected membership in the Federal Reserve System. A similar regulatory hybrid was created in 1933, when the Federal Deposit Insurance Act\footnote{183 Act of June 16, 1933, ch. 89, 48 Stat. 168.} subjected state insured banks to dual regulation by the Federal Deposit Insurance Corporation and by the state agency controlling the bank charter. As previously indicated, the present scheme of bank classification is illogical because it developed largely in response to periods of financial crisis rather than pursuant to an overall regulatory scheme. In a technical sense, the banking system may still be characterized on the basis of the type of charter selected, whether federal or state. Such characterization, however, fails to accurately describe the bank regulated. A state bank which is regulated solely by its state banking authority possesses qualities different from a state bank which is supervised by that authority but which is also subject to regulation by the Federal Reserve Board.\footnote{184 See, e.g., discussion of differing reserve requirements for state member versus state nonmember banks, at notes 41-46 supra and accompanying text.}

It is, therefore, questionable whether any genuine federal-state duality exists. For example, it may be argued that there are fifty-four banking systems — those of the fifty states and the District of Columbia, the national banking system, and two federal-state systems by reason of the voluntary election of some state banks to join the Federal Reserve System or to obtain federal deposit insurance.\footnote{185 Hackley, \textit{Our Baffling Banking System — Part II}, 52 VA. L. REV. 771, 815 (1966).} Similarly, the banking system may be depicted as a four-tiered structure comprised of national banks, state member banks, state non-member insured banks, and state non-member non-insured banks. Any of these characterizations is more accurate than that of a single federal-state dichotomy and, therefore, calls to question whether a dual banking system does, in fact, exist.

Probably the most accurate description of the system is that it is quadruple in nature.\footnote{186 Id. See notes 5-9 supra and accompanying text.} The “myth” of duality, however, has prevailed, and its spokesmen assert that its continuance is necessary to maintain competitive banking.\footnote{187 \textit{See also} notes 158-61 supra and accompanying text.} Proponents of dual banking contend that many small banks would be unable to enter the commercial banking market if they were required to meet the higher minimum capital requirements for federal chartering. They, therefore, suggest that dual banking increases competition in the banking industry by simultaneously increasing the number of competitors in the commercial banking market and, correspondingly decreasing the market share held by each bank. Although it is conceded that dual banking may increase the number of
competitors in a geographic market, it exerts little effect on banking deposit concentrations. Concentration ratios are not a direct measure of competition, however, when they are examined in conjunction with additional information, such as overall industry growth, the rates of entry and exit of firms, and merger rates, an antitrust analysis of market power can be obtained. Banking concentrations vary widely within states, from Kansas, where the five largest banking organizations held 13.2 percent of the bank deposits in 1973, to Nevada, where the five largest banking organizations held 97 percent of the deposits. Empirical data indicate that branching restrictions, which limit the size of banks, exert a more substantial check on concentrations in commercial banking deposit submarkets than do the number of banks within the state.

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Percent of Deposits Held by Five Largest Banking Organizations, 1973

Table from the Public Economics Center Report, in 1975 Hearings on S. 2298, supra note 10, at 208.
Dual banking does not affect branching, since both national and state banks are subject to the same state branching limitations within a given geographic area.\textsuperscript{192}

A second related argument, made by those who favor the dual banking system, is that the system fosters a healthy competition between state and federal banking agencies. They contend that this competition, in turn, encourages innovation in banking regulation. It has already been demonstrated that the mere existence of multiple regulatory agencies does not promote beneficial inter-agency competition. If one banking agency adopts a posture of regulatory laxity, a domino effect may occur among the other agencies, so that they can maintain the banks then within their jurisdictions.\textsuperscript{193}

To the extent that a state may be prompted to modernize antiquated banking laws to enable its banks to compete more favorably with national banks, federal-state agency competition facilitates bank innovation. Unfortunately, this type of innovation is generally unilateral due to the disparity in resources between state and federal agencies. State agencies tend only to emulate federal innovation; their own capabilities for experimentation are severely limited by restrictive state appropriations.

If the dual chartering system produces only a minimal public benefit, how and why does that system continue to survive? One banker suggested that the perpetuation of dual banking is dependent on three maxims: freedom of movement between state and national bank systems; minimized federal control over state banks; and maintenance of competitive equality between state and national banks.\textsuperscript{194} It would appear that the present regulatory structure encourages dual banking, since it supports two of the three foregoing principles. Conversions ensure freedom of movement between state and federal charters.\textsuperscript{195} Moreover, federal control over state institutions is optional, since Federal Reserve membership is voluntary with state-chartered banks as is membership in the Federal Deposit Insurance program. One undesirable aspect of the dual banking system, which may pose a threat to its continued existence, is its failure to achieve competitive equality between state and national banks.\textsuperscript{196} This failure is largely attributable to the disparate funding of federal and state agencies. Furthermore, duality has, in fact, promoted competitive inequalities among federal

\textsuperscript{192} See note 86 supra.

\textsuperscript{193} See discussion of the "competition in laxity" among federal banking agencies at notes 96-111 supra and accompanying text.

\textsuperscript{194} 1965 Hearings, supra note 107, at 331-34 (statement of Randolph Hughes).

\textsuperscript{195} A state bank may be converted into a national bank, 12 U.S.C. § 35 (1970), or, subject to certain requirements regarding minority shareholders, a national bank may convert, merge, or consolidate with a state bank, 12 U.S.C. § 214 (1970). While conversions permit bankers to take advantage of the "soft underside" of bank regulators, they also serve a positive function in permitting banks to discover which agency best serves their institutional needs.

\textsuperscript{196} It was previously suggested that a new duality has, in fact, emerged in banking, that of the large versus the small bank. See note 82 supra and accompanying text.
and state banks for it has enabled banks to "regulation-shop" between federal and state banking systems.\textsuperscript{197}

B. The Case for Strengthening the Dual Banking System

The primary attribute of the federalist system is its decentralization of governmental power. Through the maintenance of alternative banking systems, the states have provided an avenue for innovative experimentation which could counteract any stagnation resulting from uniform regulation at the federal level.\textsuperscript{198} This result generally has been obtained under the dual banking system without discouraging the development of a national banking policy.\textsuperscript{199}

State chartering proffers an additional benefit to banking competition. It increases the number of competitors in banking markets, since state capital requirements are less stringent than the federal standards.\textsuperscript{200} Increased competition may further the national policy of maximizing banking services while minimizing the costs of service.\textsuperscript{201} A further argument advanced by proponents of a dual banking system is that it provides an alternative forum for the supervision and protection of essentially local transactions.\textsuperscript{202}

Proponents of a dual banking system fear that the Federal Bank Commission proposal would weaken the competitive position of state banks.\textsuperscript{203} The Bank Commission Act fails to devise methods to increase state agency allocations. Only a single provision of the Act attempts to strengthen the dual banking system. Section 312(d) of the Act

\textsuperscript{197} As previously stated, regulation-shopping between federal and state banking systems takes the form of conversions, see note 195 supra, whereas, regulation-shopping at the federal level most often assumes the form of voluntary membership or withdrawal from the Federal Reserve System.


\textsuperscript{199} The most serious impediment to the development of national banking policy is federal inter-agency conflict rather than any state-federal discord incident to dual banking.

\textsuperscript{200} See J. COCHRAN, MONEY, BANKING, AND THE ECONOMY 73-74 (1975), for a comparison of chartering requirements in New York and Illinois with those for attaining national bank status. See also R. KENT, MONEY AND BANKING 165-66 (1966). Generally, the capital-stock requirements of newly organized state and national banks vary according to the size of the cities in which the banks operate. Surplus requirements further mandate that both state and national banks accumulate amounts equal to specified percentages of the bank's capital stock. For example, Illinois law requires the establishment of surplus of at least 10 percent of the capital and a reserve for operating expenses of at least 5 percent to be provided at the time of incorporation. National bank chartering requirements are considerably higher. See 12 U.S.C. §§ 21-28 (1970).

\textsuperscript{201} Competition among banks regulates both the prices charged for banking services and the quality of service delivered; moreover, it provides an incentive for the efficient use of resources by banking management. The tension between governmental regulation and free-market competition is especially strong in the banking industry, in which bank failures are viewed as an unacceptable result of free-market competition.

\textsuperscript{202} One problem is the determination of what is a "local" transaction. See Baker, Chartering, Branching, and the Concentration Problem, in CURRENT PERSPECTIVES IN BANKING: OPERATIONS, MANAGEMENT, AND REGULATION 415 (T. Havrilesky & J. Bootman ed. 1976).

\textsuperscript{203} See notes 158-61 supra and accompanying text.
provides for the exclusive state examination of state member banks "[d]uring any period in which examinations made by or for a State banking supervisory agency are, in the judgment of the Commission, adequate to serve the purposes for which examinations are authorized. . ."204 Although section 312(d) would appear to increase state control over large banks residing within the state, its effectiveness could well be emasculated by the Act's failure to adequately address the current funding problems of state banking agencies.205 Without a substantial increase in capital allocations, most state banking agencies would be unable to assume examination of state member banks. Additional legislation is, therefore, necessary to strengthen and promote the dual banking system.

Although federal monetary support for dual banking must be generated through the Congress, the courts can do much to prevent the further deterioration of state banking agencies by restricting increased federal regulation of state banks. The courts have yet to establish workable standards by which to balance state and federal banking interests; however, some judicial direction may result from the recent Supreme Court case of National League of Cities v. Usery.206 In Usery, the Supreme Court moved toward restricting congressional authority under the commerce clause207 in cases of federal encroachment on the "integral functions" of state and local governments.208 The Court specifically invalidated the application of federal wage and hour regulations to state and local government employees.209 This restriction of

205 Id. Three aspects of § 312(d)(2) should be noted. First, pursuant to that section, the Federal Bank Commission could suspend federal examination of state banks. Such suspension, however, is discretionary; state agencies may or may not be permitted to assume examination of state member and state nonmember insured banks. Secondly, the section only allows for the state agency to assume examination functions. General regulatory control over state insured banks would remain within the Bank Commission. Finally, the Act makes minimal provisions for state agency funding. The Commission would be authorized to reimburse state agencies for all or part of the costs for examination of state nonmember insured banks from the federal deposit insurance fund. The Act does not guarantee such reimbursements to state agencies. Moreover, it affords no monetary allowance for state agency assumption of examination functions over state member banks. This latter reimbursement provision was absent from the corresponding portion of the 1975 bill. Compare S.2298, 94th Cong., 1st Sess. & 203(d), 121 CONG. REC. 15378 (1975) with S.684, 95th Cong., 1st Sess. § 312(d)(2), 123 CONG. REC. S2478 (daily ed. Feb. 10, 1977).
207 U.S. CONST. art. I, § 8, cl. 3, endows Congress with the power: "To regulate commerce with foreign nations, and among the several states, and with Indian tribes." Under modern construction of the commerce clause, Congress is granted plenary power to regulate commercial activity with any appreciable effect on interstate commerce. See D. ENGDAHL, CONSTITUTIONAL POWER: FEDERAL AND STATE IN A NUTSHELL § 5.01-05 (1974).
208 426 U.S. at 851. In Usery, the Court found that the states' freedom to structure employer-employee relations in areas such as fire and police protection, constituted an "integral" part of state and local governments.
209 Although the Court found that the establishment of wage and hour regulations was within congressional authority under the commerce clause, the Court held that application of these wage and hour provisions to the states was an unconstitutional exercise of the federal commerce power. Id. at 845-46.
Congress' plenary power under the commerce clause was a break with established precedent and could signal a new construction of that clause.\(^{210}\)

Unfortunately, the *Usery* Court failed to articulate a workable standard for the limitation of the federal commerce power under the tenth amendment.\(^{211}\) No balancing test was enunciated by the Court, although it seemed to imply that any such test would be based on the protection of "traditional [state] governmental functions."\(^{212}\) The *Usery* decision only suggested that federal intrusions into state affairs, which are based on the interstate commerce power, should be questioned through some balancing of competing state and federal interests. The federal interest in uniform regulation of matters affecting interstate commerce should be weighed against the state interest in preserving a sphere of sovereign operations within the federalist system.\(^{213}\)

The balancing test implicit in the *Usery* decision, therefore, suggests that state banking authorities should be preserved, since banking regulation may be deemed to constitute an integral revenue function of state government. Moreover, the decision would appear to provide a constitutional basis for congressional legislation to strengthen the dual banking system.

### IV. Conclusion

The present scheme of fragmented bank regulation is not only inefficient, but it has promoted competitive inequalities among the several bank classes. These disparities are most evident in the liberal Comptroller rulings which have permitted national banks to expand both externally through merger and internally through entry into nonbank service areas. Further problems with present regulation arise in connection with the "competition in laxity" that has developed among the federal regulatory agencies. A regulatory scheme which allows banks to switch regulators with impunity becomes a system of deregulation, since "no agency is going to chase its constituents into the arms of a more sympathetic regulator,"\(^{214}\) particularly if the agency's operating budget is based on assessments levied against the banks it regulates.

\(^{210}\) Justice Brennan's dissent in National League of Cities v. Usery, 426 U.S. at 856-80, suggested that the majority ignored decades of commerce clause precedent in reaching its decision. But see Note, Municipal Bankruptcy, the Tenth Amendment and the New Federalism, 89 Harv. L. Rev. 1871, 1874-78 (1976), which suggests that the *Usery* decision was at least "foreshadowed by decisions in other cases exhibiting heightened solicitude for states' interests."

\(^{211}\) Note, Municipal Bankruptcy, the Tenth Amendment and the New Federalism, 89 Harv. L. Rev. at 1881-84; see also Note, State Governmental Immunity from Federal Regulation Based on the Commerce Clause — National League of Cities v. Usery, 26 DePaul L. Rev. 101, 114 (1976).

\(^{212}\) 426 U.S. at 851-52; Note, State Governmental Immunity from Federal Regulation Based on the Commerce Clause — National League of Cities v. Usery, 26 DePaul L. Rev. at 117.

\(^{213}\) Id. at 118.

\(^{214}\) 1975 Hearings on S. 2298, supra note 10, at 66 (testimony of J. L. Robertson).
While consolidation of the federal banking agencies under the Federal Bank Commission Act would not remedy all of the existing problems of bank regulation, it would eliminate the wasteful duplication of effort associated with overlapping agency responsibilities and would ensure consistency in federal regulatory decisions.

A major regulatory problem that is not resolvable by consolidation emerges in conflicts between various economic policy goals for bank regulation. For example, the policy conflicts between competitiveness and soundness and between competitiveness and operating efficiency would not solely be determined by any administrative restructuring, however, the regulatory structure may significantly influence "the extent to which the realized trade-off between these various conflicting goals approaches the optimum trade-off." Consolidation of the federal agencies would eliminate one level at which goal conflicts are presently manifested. No longer would such policy conflicts arise from the interplay among federal regulators. Dissonance would remain within the federal banking agency, but moves toward policy agreement would be more immediately mandated than under the multiple-agency system. The efficient operation of the Federal Bank Commission largely would depend on achieving such agreement. Under the tripartite system, by contrast, resolution of policy conflicts is inhibited. Although each agency desires to resolve intra-agency conflicts in order to operate most efficiently, there is no incentive to harmonize inter-agency policy conflicts. In fact, continued inter-agency conflict has sometimes been promoted to attract banks to an agency. The Office of the Comptroller, for example, seems to encourage such policy conflicts over bank expansion issues, since it uses its expansionist policies to attract large banks to national bank status.

A strengthened dual banking system is one means by which genuine experimentation in policy development may be fostered. As previously indicated, the Federal Bank Commission and state banking agencies could provide separate laboratories for the resolution of banking policy conflicts. Deregulation of the banking industry, it has been argued, would provide an alternative means to encourage banking experimentation. Resort to the rivalry of the marketplace would be expected to produce a detrimental effect in reducing the number of banks in a given market if smaller banks became unable to compete with larger banking interests. The relationship between competition and industry innovation is far from settled; thus, predictions of increased banking innovation related to deregulation seem highly speculative.

216 See notes 79-82 supra and accompanying text.
217 See notes 192-93 supra and accompanying text.
218 Although most would agree that competitive markets are conducive to industry innovation, some economists argue that a monopolist has an incentive to innovate in order to maintain his monopoly status or because he is less concerned than other businessmen that a competitor would steal his invention. See T. MORGAN, ECONOMIC REGULATION OF BUSINESS: CASES AND MATERIALS 17 n.5 (1976). See generally Markham, Concentr...
Increased reliance on the market, moreover, would require a greater assurance than presently exists that bank failures will not undermine public confidence in the banking industry.\(^1\) In light of the nightmarish bank runs of the 1930's, it is questionable whether the public should be made to readily accept bank failures. Consequently, there is a strong case to be made for the governmental protection of commercial banks, since the failure of large banks would most likely set off a chain of bank runs.\(^2\)

A final argument against deregulation is related to the ignorance of bank depositors. In a free market economy, efficiencies are realized, in part, because buyers determine the volume of production.\(^3\) The efficient functioning of this system is predicated on the belief that buyers are best able to judge the desirability of a product or service.\(^4\) This premise, however, does not hold in the area of commercial banking regulation, where one of the critical factors in smooth market operations is the maintenance of safe bank deposits. Because most depositors would be unable to afford the costs of determining bank safety, some governmental regulation in banking would appear warranted.\(^5\)

Federal consolidation and the dual banking system provide the structural skeletons for the development of effective banking policy reform. By eliminating administrative overlap and inconsistency in decision-making at the federal level, the Federal Bank Commission Act promises to end two existing obstacles to such reform. Without substantive reforms, consolidation may itself prove counterproductive. Ostensibly, the banking industry could more easily capture a consolidated agency than a tripartite regulatory system.\(^6\)

While the full scope and nature of necessary banking reforms may only be determined through extensive empirical study, the problems attendant to the present regulatory system dictate that some reform is requisite to protect the public from unsound banking practices. That such reform would necessitate an active rather than passive approach to regulation would appear obvious.

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\(^1\) Guttentag, *Reflections in Bank Regulatory Structure and Large Bank Failures*, in *Current Perspectives in Banking: Operations, Management, and Regulation* 511-12 (T. Havrilesky & J. Boorman ed. 1976). The author emphasizes that the most crucial step toward reduction of the hazards associated with deposit payoff is the elimination of the FDIC’s insurance fund and its credit line with the Treasury.

\(^2\) See generally Mayer, *Preventing the Failures of Large Banks*, id. at 515.

\(^3\) In a model of pure competition, an optimum allocation of resources is ascertained only after consumer preferences or community demands are known. See E. SINGER, *Antitrust Economics: Selected Legal Cases and Economic Models* 23 (1968). By contrast, in monopoly markets, output is restricted by the seller so that profits may be maximized. Id. at 63.


\(^5\) Id.

[E]conomic statesmanship, as contrasted with economic engineering, lies in recognizing the need for reforms and making them in time; and "in time" means before a serious crisis arises to compel remedial action to be taken. The history of banking reform in the United States reflects little of the statesmanship as thus defined. 225

The recent failures of three large banking institutions should forewarn regulators of the dangers manifest in the further promotion of laxity; as yet, little reform has been instituted. Unless timely reforms are implemented, current regulatory policies, or the lack thereof, could destroy both the regulators and the regulated and threaten the effective operation of the economy. 226

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225 Whittlesey, Examination and Supervision: Indications and Inferences, in Compendium, supra note 35, at 619.

226 The numbers and size of bank failures have dramatically increased in recent years. During the past four years, bank failures averaged $937 million in deposits annually, an increase of 21 times over the average of $45 million among failed banks during the previous 13 years. Moreover, the recent bank failures, which included Franklin National Bank and United States National Bank, were the largest in the nation's history. The above information was obtained by the General Accounting Office in its audit of the three federal banking agencies, and was filed with the Senate Banking Committee on January 31, 1977. The office also found that during the years 1971-75 the number of problem banks rose from at least 352 to 607; during that same period, the number of problem banks with deposits greater than $100 million increased from 13 to 83.

These figures suggest a dismal forecast for bank depositors. The problem is further compounded by the fact that, in most cases, the General Accounting Office found that bank examiners had identified the banking problems two years prior to failure; however, the banking agencies were fatally tardy in requiring the correction of such failures. These findings thus present, perhaps, the strongest case for federal consolidation and for regulatory reform. See 123 Cong. Rec. S2470 (daily ed. Feb. 10, 1977) (remarks of Senator William Proxmire).