

Carter administration pushes interstate banking plan

by Kathy Burdman

Every official and regulatory agency of the Carter administration over the past few months has gone on record as supporting a wholesale move toward "lifting the barriers to interstate expansion of domestic [banking] institutions," as Comptroller of the Currency John Heilmann told the House Banking Committee Sept. 25.

By far the most sweeping plan is contained in a top-secret "Report on the Douglas Amendment and the McFadden Act" written by President Carter's Domestic Policy Adviser, Stuart Eizenstat. The report, now being drafted in legislative form for the lame-duck Congress in November, would wipe out so many smaller regional banks that it has been embargoed for publication by Carter until after the election.

'Phased liberalization'

The Eizenstat report calls for the "phased liberalization," as its author told the American Bankers Association Sept. 5 in a speech excerpted below, of both the McFadden Act, which prohibits the large banks from setting up branches across state lines, and the Douglas Amendment, which prohibits them from having subsidiaries interstate.

Eizenstat calls first for the "liberalization" of the Douglas Amendment to allow the so-called survivor banks, money center banks such as Citibank, to have, through their holding companies, subsidiary full-service banks in states throughout the Union. In practice, Eizenstat is paving the way for the "survivors" to simply buy up hundreds of weaker small banks and make them into subsidiaries, since the survivors have no intention of making new banking investments in these areas.

Eizenstat secondly calls for "changes" in the McFadden Act regarding "treatment for electronic facilities." Sources at the Comptroller of the Currency say the administration wants to expand the practice initiated this month by Citicorp, whose credit-card subsidiary has begun to solicit savings deposits on credit cards in Washington, D.C. and other major cities—setting up

"phantom branches" nationally. This will also run savings banks out of business, because Citibank is paying 8 percent for deposits, far above the limit imposed on the thrifts.

According to the Conference of State Bank Supervisors, which roundly denounced the plan in a Sept. 16 press release, Eizenstat will also propose in his legislation another "liberalization" of McFadden across state lines within Standard Metropolitan Statistical Areas

The McFadden Act and the Douglas Amendment

The 1927 McFadden Act is the backbone of the U.S. dual banking system. It establishes state lines as the boundary within which banks may expand branches.

The U.S. dual banking system has its roots in the Lincoln administration's 1863 National Currency Act and 1864 National Bank Act, which encouraged the founding and expansion of local banks to finance industry and agriculture, and set up a dual structure of state banking agencies to encourage local banks and federal agencies to encourage nationally chartered banks.

The 1927 McFadden Act allowed both local state-chartered and nationally chartered banks to expand branching equally within a state to encourage general local banking activity, and also formally ceded responsibility for state branching laws to the states. It specifically forbids, however, any bank from extending its branches across state lines, to keep the big New York banks and other money center banks from running local banks out of business, and taking local depositors' money out of the community for use in

(SMSAs). Chase Manhattan, for example, would be able to put hundreds of branches directly into New Jersey and Connecticut, and take over the banking market from local banks.

Administration spokesmen such as Comptroller Heimann and Fed Governor Henry Wallich have been frank in stating that the prime beneficiaries of this legislation will be the largest 100 or so money center banks, by deliberate design. According to Heimann, "the realities of the financial marketplace" dictate that "large bank combinations" must be able to expand and purchase smaller subsidiaries nationally. Wallich notes that since the big money center banks are taking a beating on the international market due to their incompetent lending practices there, they must be bailed out by a government grant of whole chunks of the domestic U.S. banking market. "American banks' . . . rank among the world's largest banks has declined" due to McFadden and Douglas, he states. "Easing of restrictive banking legislation would improve the position of money center banks" and give them the ability "to acquire a larger volume of core deposits" in the domestic market.

speculative national and international markets.

A **branch** is a full-service office of a bank headquarters, completely backed by the capital of the head office, and is the legal equivalent of the head office.

The 1956 Douglas Amendment, Section 3(d) of the Bank Holding Company Act of the same year, establishes state lines as the boundary within which **bank holding companies** may own **subsidiaries**. It is a pillar of the dual banking system.

A bank holding company is a legal fiction under which a large money center bank such as Citibank has itself legally chartered as a "subsidiary" of a holding company shell such as Citicorp. The holding shell can then also acquire non-banking corporations such as insurance and finance companies, both in-state and interstate, allowing Citibank, in effect though not in law, to vastly expand.

The Douglas Amendment prohibits Citibank from having its holding company set up another "sister" subsidiary bank in states outside Citibank's home state. If Douglas were abrogated, the Citicorp holding company could own subsidiaries in every state, making Citibank in effect a nationwide bank. In practice, local banks now in existence would be bought up to be turned into subsidiaries, and funds would flow out of local communities back to the holding company in New York.

DOCUMENTATION

Eizenstat and Heimann versus regional banks

White House Domestic Policy Adviser Stuart Eizenstat, in a Sept. 5 speech to the American Bankers Association, described his classified report on the Douglas Amendment and the McFadden Act as "the transcendent financial reform of the 1980s" for the U.S. banking system. Excerpts from his speech follow.

The administration has undertaken a study of the geographical restraints on banking in the United States. . . . Several weeks ago we presented to the President recommendations for the liberalization of existing geographical restraints. . . . A phased liberalization of existing geographical restraints would serve the public interest. There are two ways in which such a liberalization of geographical restraints may be carried out. First, through the modification of the McFadden Act . . . or through the modification of the Douglas Amendment to the Bank Holding Company Act.

As between the two, over the short term, a modification of the Douglas Amendment would have a less intrusive effect. The President is likely to ask Congress to follow the precedent adopted by many states in adopting the bank holding company expansion route of takeovers of subsidiaries across state lines. The administration is likely to suggest Congress initially consider regional or other restrictions on such acquisitions under the Douglas Amendment.

With respect to the McFadden Act, the administration will not make recommendations for specific changes at this time, with the exception of treatment of certain electronic facilities.

Comptroller of the Currency John G. Heimann, in Sept. 25 testimony before the House Banking Subcommittee on Financial Institutions, called for an end to all interstate banking regulation and in particular the Douglas Amendment. He said in part:

For years, pressure has been building for relief from the legal restraints that artificially confine the expansion of U.S. institutions' full-service banking operations to a single state. . . . Those artificial restraints impede the rational development of strong domestic institutions that can best serve the banking needs of the American public

and maintain their position of leadership in the world-wide financial arena.

The confinement of U.S. banking organizations' full-service banking to a single state is not only anomalous and unfair relative to foreign banks' acquisition opportunities, but also outmoded. . . . Rather than setting up barriers to foreign acquisitions, Congress should begin lifting the barriers to interstate expansion of domestic institutions.

We have consistently supported gradual eliminations of restrictions on bank expansion, in the interest of increasing competitive opportunities and maximum reliance on the discipline of the marketplace. . . .

At this juncture we must begin to formulate new rules to govern acquisitions of healthy banks, including large bank combinations, not merely extraordinary measures to provide for the rescue of failing institutions. We fully support H.R. 7080 [The Emergency Bank Acquisitions Act—ed.], of course, but in the context under discussion here, that proposal must be regarded as the minimum required legislative adjustment to the realities of the financial marketplace today. Looking beyond emergency acquisitions . . . at a minimum the Congress should devise a practical plan for phasing out the Douglas Amendment restrictions on interstate bank holding company acquisitions. . . .

The Conference of State Bank Supervisors, the organization of the nation's 50 state bank commissioners, challenged the administration's Eizenstat report in a Sept. 16 press release. CSBS President Angelo Bianchi, New Jersey Commissioner of Banks, also hit the Fed's interest rate policy. Excerpts from the release:

CSBS President Bianchi challenged Mr. Eizenstat's false contention that state statutory limitations on geographic expansion of individual banks have been the primary causes of the banking industry's loss of market share. Commissioner Bianchi's view was widely shared by bankers present; and Mr. Eizenstat could not offer a reply of substance to the challenge.

Factors other than McFadden/Douglas provisions have stifled the growth of the industry as a whole. Loss of market share has been caused primarily by unrealistic inflexibilities in Regulation Q, state usury ceilings made counterproductive by monetary/fiscal excesses, extremely high interest rates, and by an uncontrolled tidal wave of other federal regulatory red tape. . . .

Attacks on McFadden and Douglas are unduly negative. The U.S. banking system is the greatest in the world. It is decentralized; decisions generally are made close to the point of need . . . to accommodate widely diverse needs of thousands of trade areas. Some banks serve primarily large businesses nationwide; some serve primarily agriculture and households locally. . . .

The proposal for 'free banking zones'

Without the approval of Congress or notification of the American public, the Carter Federal Reserve is planning to bring the \$1.2 trillion Eurodollar market into the United States, reorienting the U.S. banking system as a whole toward international debt refinancing.

This month, Federal Reserve Chairman Volcker intends to have the Fed Board of Governors pass a proposal by the New York Clearing House Association, the organization of New York's top 12 banks, for "free banking zones" in major U.S. cities. U.S. banks would be authorized to set up new branches called International Banking Facilities (IBFs) which would be allowed to operate in the U.S. itself, free of federal reserve requirements, federal interest rate regulations, federal and state taxes, and other government regulation.

Volcker's Staff Director for Monetary Policy, Stephen H. Axilrod, and his Washington staff are now wrapping up a new classified study for the Fed of the New York banks' IBF proposal. The Federal Reserve Board, under Regulation D on reserve requirements of the Federal Reserve Act, claims to have the power to implement the entire IBF program without Congressional action. All it need do is lift the reserve requirements. With the passage of the March 1980 Monetary Control Act, the Fed Board of Governors announced in an Aug. 15, 1980 revision of Regulation D, "the Board's authority to establish a reserve requirement necessary for the implementation of monetary policy on Eurocurrency transactions is extended to cover all domestic depository institutions." The language in the Monetary Control Act specifies that this includes all "foreign branches, subsidiaries, and *international banking facilities*" of non-member and Fed member institutions [emphasis added].

What is the Eurodollar market?

The \$1.2 trillion Eurodollar market, located primarily in the City of London, was first set up there as an "outlaw" market where international bankers could move funds for speculative purposes outside the U.S. precisely because of the relatively sound American bank law tradition which mandates federal supervision of