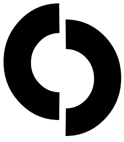

NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

NR 2001- 89

FOR IMMEDIATE RELEASE
October 15, 2001

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Remarks by
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Comptroller of the Currency
Before the
New York State Department of Banking
New York, NY
October 15, 2001

A few years ago Chairman Greenspan of the Federal Reserve remarked to a former Comptroller of the Currency that the OCC had an important but little recognized advantage in the bureaucratic competition that goes with the territory the banking agencies share. He was referring to our history. After all, the OCC has been around since the Civil War, eclipsing such newcomers as the FDIC and the Federal Reserve itself by 50 years or more. History is important to the OCC -- important enough that we have been steadfast in resisting suggestions that we change our name to something more closely approximating our actual mission, which has had virtually nothing to do with the currency for roughly 75 years -- something I am condemned to explain at every cocktail party I attend.

So I take special pleasure in recognizing the remarkable history of the only financial regulatory agency in this great country to which the OCC must defer in terms of longevity: the New York State Department of Banking, now 150 years old. And I hope that when the OCC itself reaches that milestone twelve years from now, in 2013, we will have the opportunity to

repay the hospitality you have extended to me today. Needless to say, I am honored to be with you on this historic occasion.

It also gives me an opportunity to express our heartfelt admiration for the way you and all New Yorkers have borne up under the awful and unprecedented strains of the past month. The Banking Department deserves a large share of the credit for the way that the financial institutions that make this great city their home were able to bounce back as quickly as they did. It is exactly what we would have expected from the most venerable of our financial regulatory agencies.

By itself, of course, longevity proves little beyond an aptitude for self-preservation, but that is hardly the case with the New York Banking Department. Indeed, New York State legislators and regulators have been responsible for many of the basic concepts upon which the structure of bank regulation in this country is based.

When the New York State legislature passed the Safety Fund Act (as it came to be called) in 1829, it broke ground in two essential ways. For one thing, it established an effective mechanism for insuring bank obligations. How serious a problem this had become is illustrated by this contemporary newspaper account of the scene that erupted when a Pennsylvania bank stopped redeeming its notes:

"Hundreds of poor laborers were running in every direction with their hands full of the trash and not able to induce a broker to give six-pence to a dollar for them. We passed in the market a woman who makes her living by selling eggs, butter, and vegetables, who had almost all she was worth, about $17, in the bank's notes. When apprised that it was worthless, she sank down in agony upon her stool and wept like a child. This is but one of a hundred similar cases."

Such poignant scenes prompted the New York law, requiring banks to pay an amount equal to one-half of one percent of their capital each year for six years into a fund, from which

the obligations of failed banks would be paid out. A half dozen states adopted similar laws of their own. In New York, the Safety Fund worked wonders in restoring public confidence, and when the fund was liquidated in 1866, it even had a small surplus to show for it. But this happy experience was not universal. Losses had put the safety funds of states like Michigan and Vermont out of commission in short order. How can we account for this mixed record of success?

According to most historians, the answer lies in a key feature in the New York law that was missing in the others. New York provided for the appointment of three bank commissioners to examine the financial status of banks and report annually to the legislature. With that provision, professional bank supervision in the United States essentially began.

More than a century later, the safety fund concept came to the nation at large in the form of federal deposit insurance. But the FDIC is not the only federal banking agency inspired by New York. The OCC -- and the national banking system -- owe a similar debt to New York banking law and practice.

In the Free Banking Act of 1838, the Albany legislature -- in an historic act of self-denial -- sought to expand the availability of banking services for a rapidly growing economy by curtailing its own power to grant bank charters one at a time by legislative action. That requirement had inevitably introduced political considerations into the chartering process, and New York lawmakers wisely recognized that this was an area in which politics did not belong. So it decided that bank charters would henceforth be available to any qualified organizers who met certain standards and conditions. Among them was that the organizers deposit with a state official -- the Comptroller of the Currency -- an amount of government securities, which would

serve as the basis for the new institution's notes. In the event of insolvency, the securities would be sold to redeem the notes.

Congress adopted precisely the same provisions in the National Currency Act of 1863. In a real sense, the national banking system that the OCC supervises today was the banking system of the State of New York on a national scale. Again, what began in New York became a blueprint for the nation.

The history I've just cited certainly supports the argument we often hear in support of the dual banking system, namely that the states have been the main engines of the innovation in the banking industry. That argument has more than a grain of truth to it. But it lacks refinement and ultimately does not comprehend the real value of duality in our banking system. While the states have surely been innovators, national banks and the OCC also have a proud record of innovation. Just by way of example, national banks issued the first negotiable certificate of deposit in 1961, securitized loans for the first time in 1984, and introduced a whole range of new financial products and services to the banking public over the past several decades. The wild card statutes on the books in most states -- which effectively tie state bank powers to innovation in the national system -- testify to that leadership.

The fact is that innovation is inherent in the dual banking system -- and perhaps the most powerful argument that can be offered in its defense. State banks led the way with new products and services in the 19th century because they had to do so as a matter of survival. In the National Bank Act of 1864, Congress had deliberately stacked the deck against them, fully expecting that state banking would succumb to the competitive disadvantages imposed against them in the law. Indeed, in 1865 Congress passed a "death tax" on state bank notes, intended to drive state banks to the national charter. Instead, state bankers proved resourceful in pursuing deposit banking and

in developing new markets and new ways to serve existing ones. They ensured that they would be around for many years to come. By the same token, national banks, facing increasing competition from state banks and nonbanks in the 1960s and since, were obliged to come up with ways of reinvigorating the national charter -- and they did, in the ways I've just mentioned.

In short, neither the state nor national banking systems have had a monopoly on innovation, at least not for more than a few years at a time. For no sooner has one side gained the lead, then the other has redoubled its efforts to take it back. The result has been a dynamic, competitive, and creative industry, responsive to the people and communities it serves.

This happy outcome could hardly have been predicted. Indeed, some people still scratch their heads in wonderment that the dual banking system, with its further division of federal authority among a number of agencies, has worked as well as it has. Its most ardent supporters concede that on paper, it probably shouldn't. The idea of duality has withstood repeated assaults -- beginning with Congress in 1863 -- from those who saw it as unwieldy, if not irrational, that the banks of the country should be free to choose the regulatory regime under which they would operate. It is true -- but not widely known -- that the laws creating the Federal Reserve system and the FDIC had an ulterior purpose: the elimination -- or at least the reduction -- of state banking, which many thoughtful people saw as a less safe and sound brand of banking than the U.S. economy could afford.

How then do we account for the persistence of the dual banking system in America? Part of the answer, I believe, is that the dual banking system is a true expression of our national character -- reflecting core national values of competition, federalism, and freedom of choice.

It took a while for this truth to sink in, but once it did, Congress reversed its opposition to the dual banking system and instead worked diligently to nurture it, intervening at critical

intervals to ensure a healthy balance between the state and national bank charters. Through legislation, Federal regulators and national banks obtained the authority to match innovations and incentives coming from their state counterparts. For example, following a Supreme Court decision holding that national banks did not have the right to branch, Congress in 1927 passed the McFadden Act, granting national banks branching powers roughly equivalent to those already enjoyed by many state banks. And it relaxed other legal restrictions -- such as those barring national banks from offering safe deposit boxes and making most real estate loans -- which were eroding the value of the national bank franchise.

At the same time, Congress has been cautious about encroaching on the authority of the states to charter and empower banks. For example, excepting only insurance underwriting, the states have been left free to allow their banks to engage in activities not permissible for national banks so long as the FDIC determines the activity would not pose a significant risk to the insurance fund.

Let me add that this process has not been a one-way street. As I've already noted, many states have enacted Awild card" statutes -- laws that allow state-chartered banks to exercise powers available to national banks. More recent federal legislation has equalized many of the powers of state and national banks in the context of interstate branching. And working through the Conference of State Bank Supervisors, state authorities have been able to streamline the process of interstate branching by state banks.

Nor -- despite what some critics say -- has the process been a Arace to the bottom.≅ For example, in early 1960s, under Comptroller James J. Saxon, the OCC concentrated on upgrading the qualifications and skills of its examination force. This led to calls from state bankers and

action by state supervisors to match these improvements. The quality of examinations improved significantly on both sides, and the whole dual banking system emerged the stronger for it.

In short, what former Federal Reserve Board chairman Arthur Burns called -- in memorable if misleading terms -- Aa competition in laxity≅ between state and Federal banking authorities -- has actually been a textbook case of federalism in action. The competitive tension between state and national authority has produced a safe and sound banking system, an efficient and effective supervisory regime, and regulatory structures capable of adapting to the demands of an evolving marketplace. The financial system's response to the events of September 11 offers the latest proof of its adaptability and strength.

One lesson we can draw from this history is that while the dual banking system today <u>is</u> healthy and strong, it requires care and feeding to keep it that way. Experience teaches us that the absence of needed legislation -- or the enactment of the wrong kind of legislation -- can do the dual banking system real harm.

For example, while Congress has not encroached upon the chartering authority of the states, the balance of responsibility for the supervision and regulation of state-chartered banks has steadily shifted toward their <u>federal</u> regulators. For more than 30 years, almost every time Congress has imposed new federal bank supervisory and regulatory responsibilities, it has parceled that authority and responsibility among the three federal banking agencies. That approach was originally shaped by concerns that some states lacked the resources to carry out Congress's mandates. As a consequence, the Federal Reserve and the FDIC today perform for state banks virtually every supervisory function that the OCC performs for national banks. The result has been to deprive the states of much of the opportunity to take full responsibility for the supervision of their own state-chartered banks.

A related issue concerns the funding of bank supervision. Today the total cost of supervising state-chartered banks is significantly subsidized -- not only by the two federal agencies that supervise such banks, but also by national banks, primarily through their contributions to the deposit insurance fund from which FDIC supervisory expenses are drawn. This anomaly has had the effect of magnifying the assessment disparity between state and national supervisors, encouraging many banks to make charter choices based on comparative costs, rather than on the values inherent in the charter or the quality of supervision. This has tended to undermine the substantive and qualitative competition between the charters that has always been our system's hallmark.

My hope is that this matter will be addressed -- if not when Congress reconsiders the subject of deposit insurance reform, as it has pledged to do, then in the not too distant future. The preservation of a strong, competitive dual banking system is crucial to our ability to meet the very real economic challenges our country faces, and putting supervisory funding on a more rational basis, I believe, is crucial to the future of the dual banking system. Under a plan that we have put forward, the costs of both national bank supervision by the OCC and state bank supervision by our state counterparts would be paid out of the FDIC insurance fund, under a formula that made the allocations automatic and nondiscretionary.

In the meantime, we can never forget, particularly at this moment in our nation's history, that whatever differences may separate us are far, far less important than what unites us. In our case, it's a common commitment by federal and state regulators to a safe, sound, and competitive banking system -- a commitment that has expressed itself through cooperation <u>and</u> competition. And I can think of no better model for that relationship than the one that the Office of the

Comptroller of the Currency and the New York State Department of Banking have had for much more than a century.

Again, heartiest congratulations on your 150th anniversary.

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The OCC charters, regulates and examines approximately 2,200 national banks and 52 federal branches of foreign banks in the U.S., accounting for more than 54 percent of the nation's banking assets. Its mission is to ensure a safe and sound and competitive national banking system that supports the citizens, communities and economy of the United States.