2008

Is There a Dual Banking System

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IS THERE A DUAL BANKING SYSTEM?

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ABSTRACT

There is a fierce controversy being waged today about the status of the historic dual banking system in American law. National banks (banks chartered by the national government) derive their powers from federal law. States, on the other hand, assert that they should be able to control certain aspects of national bank operations such as consumer protection written as state law. While the national banks acknowledge that states do have certain areas where they may control national bank activities—much contract law, for example, which is essentially state law—the national banks also assert a high level of authority—preemption—over the states where both national and state law have application.

States assert that the degree of preemption claimed by the national banks is excessive. Our paper makes the point that this conflict is almost inevitable, given the existence of national and state banks operating in the same areas. The point of the paper is that the controversy has nothing to do with the so-called dual banking system and calling upon the name of the system to support either national or state bank authority is misleading and adds nothing to the argument.

The paper goes on, however, and asserts that, given recent changes in both national and state law, the dual banking system does not exist at all in any meaningful way and resort to it clouds rather than illuminates the underlying conflict. The authors believe that national and state banks are really no more different from one another than are two national (or two state) banks.

Statutes like the Federal Deposit Insurance Corporation Improvement Act of 1991 and the state “blue sky” laws are discussed in this context.

1. INTRODUCTION

A. The Argument

There is a fight being waged between two armies on the status of banks in the federal system. Given the nature and clarity of the argument, it is reminiscent of Matthew Arnold’s presence “on a darkling plain/Swept with confused alarms of struggle and flight.”1 We know that the dispute has something to do with the “dual banking system”, generally described as a system composed of banks with federal charters (“national” banks) contrasted with state chartered banks. It is in relating the dual banking system to the fight that we encounter the famous darkling plain.

As to the state chartered banks, they do not enter into the fight and insofar as the position taken in this article is concerned, there should be little or no dispute where state banks are concerned. They are chartered by state law but, as we shall see,2 their completely neutral status is somewhat muddied by the fact that federal law plays no small part in their power structure. Since, however, the Comptroller of the Currency, chief administrator of national banks, lays no jurisdictional claim

2 See infra Chapter IV.
to the state banks and they take no part in the preemption argument that is the essence of the fight, they lie largely outside its penumbra.

The fight is over national banks alone and how jurisdiction over them shall be divided between the federal and the state governments. We believe and assert in this article that there is no meaningful dual banking system; this in part explains the absence of state banks from the underlying dispute. But whether there is or is not, the fight between federal and state governments over national banks would exist because both want that jurisdiction in some measure. It is part of our position that assertions often randomly made about the dual banking system have no real relevance to the fight between the two governments. Both are looking for jurisdiction over national banks. We can divide that jurisdiction in different ways. But nothing depends upon the existence of the dual banking system.

A paper written by the Office of the Comptroller of the Currency on the dispute has as its first sentence (also first paragraph) the following:

Today, the dual banking system, which has been a hallmark of banking in the United States for nearly 200 years, is under attack, as many states have attempted to assert legislative and enforcement authority over national banks in a way that contradicts constitutional principles that have been well-settled since the early nineteenth century.

About this quotation, we would say: (i) the dual banking system is illusory, so it is hardly under attack; (ii) it had been a hallmark of banking in the United States, but is no longer; and, (iii) states are attempting to assert authority over national banks, but this is not new and has nothing to do with the historic dual banking system.

B. State Controls over National Banks

The present controversy may not unfairly be said to date to January 13, 2004, when the Comptroller issued a set of regulations. Those regulations dealt with two issues:

1. The extent to which federal law preempted state law for national banks. As we shall discuss, one cannot be precise about this power division between state and nation. Any activity may fall on either side of the line. Only certain principles of construction can be given. There really was nothing new in the Comptroller’s

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4 See infra Chapter VI.
2. The extent to which state authorities have visitorial powers over national banks in such areas as authority to examine and review books and to use the courts to deal with perceived violations of law.\(^8\) As with application of law generally, the regulation specifies certain areas where state authorities do have such visitorial powers.\(^9\) Again, the power given to the Comptroller is not absolute; it is at one end of a spectrum with the states exercising power at the other end. One must always determine where the particular power at issue falls. This aspect of the regulations did lay down a rule somewhat harsher than what had been generally accepted previously: the visitorial authority of the states was deemed minor compared to that of the Comptroller.

C. If There Were No State Banking System

If, however, there were no state bank—that is, no possibility of a dual banking system—it is most probable that the dispute over the degree and form of state intrusion into the national banks would be essentially unchanged from what it is today: state interests would assert jurisdiction over the banks up to a line of uncertain specificity and the federal interests would dispute this jurisdiction beyond a line of their own choosing.

The controversy has been most visible recently in the United States Supreme Court where an opinion affirmed the preemptive supremacy of a subsidiary of a national bank against powers being asserted by the Michigan State Office of Insurance and Financial Services.\(^10\) The majority opinion quite correctly did not mention the dual banking system\(^11\) because, as we assert, dual banking has nothing to do with preemption and supremacy. The dissent does deal with dual banking over the course of several pages but the place of dual banking in its argument is unclear. The dissent does make the following points:

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\(^7\) The standard for preemption adopted by the Comptroller in its final rule was intended to be "distillation of the various preemption constructs articulated by the Supreme Court." Bank Activities and Operations; Real Estate Lending and Appraisals, 69 Fed. Reg. 1904, 1910 (January 13, 2004) (to be codified at 12 C.F.R. pts. 7 and 34). An earlier verbalization in a proposed rule was criticized by commentators as being a broader preemptive standard than that previously articulated by the Court. See Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 46119 (August 5, 2003) (to be codified at 12 C.F.R. pts. 7 and 34).

\(^8\) A part of the Comptroller’s regulation, designated 12 C.F.R. § 7.40000(a)(2), identifies the following activities as examples of state “visorial powers” accepted by the Comptroller:

(i) Examination of a bank;

(ii) Inspection of a bank’s books and records;

(iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and,

(iv) Enforcing compliance with any applicable federal or state laws concernning those activities.

\(^9\) See 12 C.F.R. § 7.4000(b). Included with other authorities given to states is the duty to functionally regulate “insurance activities of any person (including a national bank ...)” as granted in §301 of the Gramm-Leach-Bliley Act, Pub.L. 106-102, 113 Stat. 1338, November 12, 1999.


\(^11\) Except in a footnote where it corrected a mistake about dual banking made by the dissent. We deal with this at note 13, infra.
First, “the dual banking system’s main virtue is its divergent treatment of national and state banks.”\(^\text{12}\) As we point out below, the enactment of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)\(^\text{13}\), and the forty-seven state ‘wild card’ statutes have forced national and state banks into essential legal identity. The Scott article cited in the dissent as support for its assertion was published in 1978, well before enactment of FDICIA and almost all the wild card statutes.\(^\text{14}\)

Second, “state law must usually govern the activities of both national and state banks.”\(^\text{15}\) Under FDICIA, state law cannot govern state banks and must give way to federal law.

Third, “[t]he policy of competitive equality is . . . firmly embedded in the statutes governing the national banking system.”\(^\text{16}\) It is fundamental banking law that the federal policy of competitive equality is applicable only to branch banking. The majority decision observes this in footnote seven. As to more general banking, “National banks have been National favorites.”\(^\text{17}\)

Fourth, “the dual banking system has remained intact.”\(^\text{18}\) It has not. FDICIA and the wild card statutes have altered it in pronounced ways.

It is worthy of note that the decision of the Court of Appeals for the Sixth Circuit from which the appeal to the Supreme Court was taken\(^\text{19}\)—which also affirms the superior standing of the Comptroller—makes no mention of the dual banking system in setting the line of division between federal and state authority. (Actually, the line would fall in different places depending upon the particular area of law under discussion/dispute.) We maintain that the dual banking system, despite protestations about it, simply does not advance the argument.

\textit{D. A Proposal for the De-Jure End of Dual Banking}

Our argument is premised upon the essential irrelevance of the state banking system as it is now constituted to considerations of preemption. We propose that, in the interest of efficiency and economy, the remnants of the dual banking system—or, as more honestly put, the state banks—be eliminated.

\textit{II. A Brief History of the Dual Banking System}

Historically, the Bank of North America,\(^\text{20}\) chartered by the Second

\begin{footnotes}
\item[15] \textit{Watters}, 550 U.S. at 42.
\item[16] \textit{Id.} at 43.
\item[18] \textit{Watters}, 550 U.S. at 43.
\item[20] In 1787, the Bank of North America changed to a Pennsylvania Charter following controversy about the legality of a congressional charter.
\end{footnotes}
Continental Congress in 1781, is acknowledged as the first significant bank chartered by the United States government. Before creation of the Bank of North America, other banks such as the Bank of Pennsylvania existed; however such banks were chartered by individual states.21

In the early 1780’s, state chartered banks began mainly issuing paper money ("bank notes") in addition to coinage already in circulation. These bank notes assisted greatly in the expansion of U.S. commerce. Further, these state chartered banks were allowed to effectuate "traditional" bank activities, such as accepting deposits and making loans.22 Bank notes were secured by the assets of the issuing bank23 in the way more typical of business loans.

However, banks were effectively prevented from extending loans if customers refused to accept their notes. The acceptance of banks’ notes was usually decided based on the banks’ records in exchanging their notes for specie—typically coins—when called upon by their customers.

During the late 18th Century, U.S. banks were largely "supervised" by the market. Gradually, the banking system transformed into a dual structure. Those banks which sought to put bank notes in the market place normally sought for a charter from either state or federal authorities.

In order to finance the American Revolution, Congress printed the new country’s first paper money. This paper money, known as "continentals", was issued in high quantity which had an attendant inflationary effect. Initially, the resulting inflation seemed relatively mild. However, inflation became more problematic by the time of the Civil War.24

A. Creation and Closing of the First and Second National Banks

The history of U.S. banking at the federal level starts with the creation of the First and Second Banks of the United States (the “Bank” or “Banks”). In 1791 Congress chartered, and President Washington subsequently approved, the First Bank of the United States. Alexander Hamilton, Secretary of Treasury, played a significant role in drafting the Bank’s charter, modeling it after the charter of the Bank of England.

Thomas Jefferson, Secretary of State, thought that the Bank was "unconstitutional", arguing that the Bank obtained an "unauthorized" extension of federal authority. He stressed the idea that Congress maintained solely delegated

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23 Unlike today, at that time, banks were not required to maintain any minimum reserve requirement. In the early 1800’s, New York State developed the "safety fund system". The system, every member bank contributed a small percentage of its capital annually to a state managed fund. The aim was to protect note-holders in the event of bank collapse. In 1842, Louisiana followed suit, by enacting legislation limiting the number of banks and requiring them to maintain one third (1/3) of their assets in cash and two-third (2/3) in short-term obligations.
24 Paper money has little or no intrinsic value as a commodity, it is costless to produce, usually taking the form of tokens or pieces of paper; and was not redeemable for any commodity.
authority, clearly provided in the United States Constitution. According to Jefferson, the only basis in the Constitution for chartering the Bank was set forth in the “necessary and proper” clause.\textsuperscript{25}

Another dissenter, James Madison, stated that the First Bank of the United States was:

\begin{quote}
[\textit{C}ondemned by the silence of the Constitution; was condemned by the rule of interpretation arising out of the Constitution; was condemned by its tendency to destroy the main characteristic of the Constitution; was condemned by the expositions of the friends of the Constitution whilst depending before the public; was condemned by the apparent intentions of the parties which ratified the Constitution; was condemned by the explanatory amendments proposed by Congress themselves to the Constitution.\textsuperscript{26}
\end{quote}

Although Hamilton acknowledged that the Constitution was silent with respect to regulation of the banking system, he argued that Congress had the authority to borrow money, tax, and regulate interstate and foreign commerce. Therefore, he argued the “necessary and proper” clause of the Constitution, granted Congress the authority to pass any act necessary to carry out its authorities. President Washington supported the Hamiltonian rationale.\textsuperscript{27} The First Bank of the United States headquartered in Philadelphia, was granted a charter of twenty years. The Secretary of the Treasury supervised the Bank.\textsuperscript{28}

At that time, the Bank was almost the largest business entity in the United States.\textsuperscript{29} Among other things, it served as a repository of government funds; a source of loans for individuals and the federal and state governments; was responsible for control of the money supply by regulating the amount of notes state banks could issue, and the transfer of reserves across the country; and acted as a de facto depository of the Treasury’s funds.\textsuperscript{30} The Bank fiercely competed with state banks in the business of money lending and as a depository. State banks considered such competition unfair as the Bank, in addition to providing banking services, also regulated banking activities.\textsuperscript{31}

Gradually, the Bank expanded its activities in major banking transactions and money interests. Such expansion was not welcomed by many people who became uncomfortable with the concept of a large and powerful “central bank”.\textsuperscript{32}

Twenty percent (or one-fifth) of the First Bank of the United States’ stock was owned by the government and the remaining eighty percent of the Bank’s stock

\textsuperscript{25} See U.S. Const. art. I, § 8, cl. 8.


\textsuperscript{27} See GERALD T. DUNNE, MONETARY DECISIONS OF THE SUPREME COURT 19 (1960)


\textsuperscript{31} \textit{id.}

was owned by private investors. Interestingly, the U.S. government borrowed money from the Bank in order to purchase the stock. Private investors were required to use government bonds to pay seventy-five percent of their stock subscription prices in the Bank. Accordingly, a large percentage of the Bank's capital was guaranteed by some form of government obligation.

The First Bank of the United States was capitalized at $10 million, which was divided into 25,000 shares of voting stock with a par value of $400 per share. The Bank mandated a thirty share limit per individual. Interestingly, the Bank permitted foreigners to buy shares in the Bank; however, they did not have voting rights. The First Bank of the United States maintained significant liquidity. For instance, in 1809 the Bank's specie (banknote) ratio was approximately forty percent in comparison to a modern average reserve (deposit) ratio of close to twelve percent. Accordingly, the Bank was one of the most liquid banks in the country. The Bank was also remarkably profitable. Most of its income was earned by way of loans and the funding of other banks, which required temporary liquidity.

Various historians regard the First Bank of the United States as a success. For example, Treasury Secretary Gallatin stated that the Bank was "wisely and skillfully managed".

During the life of the First Bank of the United States, state banks substantially increased the number of bank notes in circulation. Describing that period, John K. Galbraith writes that "State banks, relieved of the burden of forced redemption [imposed by the First Bank], were now chartered with abandon; every location large enough to have a church, a tavern, or a blacksmith shop was deemed a suitable place for setting up a bank. These banks issued notes, and other, more surprising enterprises, imitating the banks, did it likewise. Even barbers and bartenders competed with banks in this respect." Effects of the war with England added to the high inflation during 1812-

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33 Id.
39 ld.
40 ld.
41 Albert Gallatin served as Secretary of Treasury from 1801 until 1814.
1815, in which prices increased an annual average of 13.3%.

As the charter of the First Bank of the United States neared renewal, a debate began. Those in favor of renewing the Bank’s charter argued that the Bank’s circulation of approximately $5 million in paper currency accounted for almost twenty percent of the country’s money supply. This was the basis of the future national currency that the U.S. would create.

The opposition was comprised of primarily state banks. They claimed that the Bank’s issuance of bank notes came at their expense. State banks also complained that the Bank’s issued currency was not discounted, unlike bank notes issued by state banks. For example, the currencies issued by 712 state banks were discounted up to 100%. The result of such unfair treatment of state banks allowed the Bank to attract more customers. Accordingly, Congress faced significant pressure not to renew the Bank’s charter.

In addition to the aforementioned currency issue, foreign ownership of the Bank’s stock, unresolved constitutional questions regarding the Bank’s legitimacy, as well as an unfounded suspicion of the banking business in general made renewal of the Bank’s charter unlikely. By the year 1811, when the Bank’s charter was near expiration, Congress refused to renew it, therefore causing the Bank to cease operations.

Subsequently, in 1816, Congress decided to charter the Second Bank of the United States. The Second Bank of the United States had similar powers and responsibilities to its predecessor. Nevertheless, the Second Bank failed to achieve results close to that of the First Bank of the United States. Further, the Second Bank suffered from lack of proper management and corruption.

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46 See EDWARD L. SYMONS & JAMES J. WHITE, BANKING LAW 12 (West Pub’g 1984).
53 See supra note 48.
57 See TONY A. FREYER, PRODUCERS VERSUS CAPITALISTS: CONSTITUTIONAL CONFLICT IN
The stock ownership of the Second Bank was similar to that of the First Bank, meaning eighty percent of shares were offered to the public and twenty percent were offered to the federal government. Shareholders of the Bank had the right to appoint twenty directors and the President of the United States could elect the remaining five directors. Although the Bank’s objective was to obtain a “currency principle” to keep its specie (deposit) ratio consistent at approximately twenty percent, the ratio swung between twelve and sixty-five percent. Like the First Bank of the United States, the Second Bank angered state banks by returning to currency redemption practices.

The Second Bank of the United States played a significant role in limiting issuance of state bank notes across the U.S. by providing its own federal bank notes for specie payment. In addition, states were furious particularly at the fact that, with a charter from the federal government, the Second Bank of the United States (for that matter, its predecessor too) could open branches and operate wherever it wanted, without the need for state permission.

Great efforts were undertaken to close the Second Bank, including seeking a determination that its existence was unconstitutional. In retrospect, the most serious example occurred when the state of Maryland sought to tax activities of branches of the Bank. In response, the Bank, also trying to stabilize credit and currency, called in its loans and tightened its credit policies. Litigation ensued between the state of Maryland and the Bank, culminating in the Supreme Court landmark decision on federal preemption, McCulloch v. Maryland in 1819. The Court unanimously found the Bank’s charter to be constitutional, declaring that “[s]tates have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control” the operations of a federally created entity such as the Bank.


See Robert V. Remini, Andrew Jackson and the Bank War (1967).

See Bray Hammond, Banks and Politics in America: From the Revolution to the Civil War 48-63 (1957).


See McCulloch v. Maryland, 17 U.S. 316, 317 (1819).

See id. at 321.

See id. at 316, 436.

See id. What emerged was one of the landmark judicial decisions in the history of the U.S. Speaking for a unanimous Supreme Court, Chief Justice Marshall declared constitutional Congress’s creation of a national bank and declared unconstitutional Maryland’s attempt to weaken it through taxation. On the first opinion, Marshall elaborated the view of federal power associated with Alexander Hamilton, an expansive view, based on a strong union. On the second point, regarding Maryland’s attack on the Second Bank, Marshall invoked the Supremacy Clause – paragraph 2 of Article VI – holding that the Constitution of the United States, and the laws promulgated under it, are the law of the land and carry a presumption of supremacy over the States. “The States,” Marshall wrote, “have no
Chief Justice Marshall wrote: "After the most deliberate consideration, it is the unanimous and decided opinion of this court that the act to incorporate the Bank of the United States is a law made in pursuance of the Constitution, and is part of the supreme law of the land."69

Appointment of Nicholas Biddle as the President of the Second Bank of the United States in 1823 brought positive changes to the Bank.70 However, in 1828, as the Bank started to obtain control of money supply and restore financial stability, Andrew Jackson, a staunch opponent of the Bank, was elected the President of the U.S.71 A few years prior to the expiration of the Second Bank’s charter, a debate ensued in Congress concerning renewal of the Bank’s charter.72 Eventually, Congress approved a bill to renew the charter.73 President Jackson strongly disagreed with this bill and promptly vetoed it.74 President Jackson stated in his veto that:

A bank of the United States is in many respects convenient for the Government and useful to the people. Entertaining this opinion, and deeply impressed with the belief that some of the powers and privileges possessed by the existing bank are unauthorized by the Constitution, subversive of the rights of the States, and dangerous to the liberties of the people, I felt it my duty... to call [to] the attention of Congress to the practicability of organizing an institution combining all its advantages and obviating these objections. I sincerely regret that in the act before me I can perceive none of those modifications of the bank charter which are necessary, in my opinion, to make it compatible with justice, with sound policy, or with the Constitution of our country."75

Facing such strong opposition from President Jackson, Congress did not pass any other bills for renewal of the Bank’s charter.76 As result, the Bank’s charter expired in 1836.77

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75 See President Andrew Jackson, Speech Before the US Senate on the Veto of "The Bank Bill" (July 10, 1832).
77 The U.S. banking system would be without a "central bank" until 1913, when the Federal Reserve was formed.
B. National Banks (American Free Banking Experience) 1836 - 1860

In 1837, following the vacuum left from the Second Bank of the United States as well as failure of several state banks, various states began considering different ways to regulate their bank activities. The Michigan Act of 1837 was the first “free banking” law in the United States.78 “Free banking” meant chartering based on the terms of a general law of incorporation rather than a particular legislative act.79 It was a major change from the previous situation. Such a law also authorized the issuance of banknotes.80 Under the Michigan Act, individuals or groups were given a banking charter conditioned upon fulfillment of the proper prerequisites.81 In 1838, New York introduced a “free banking” approach.82

Due to generally inadequate regulation of state banks, some banks failed and some others became involved in fraud. The “free-banking” period from 1837 through 1863 was known as the “wildcat banking” era.83 This, of course, applied only to state chartered banks; the federal government neither chartered nor regulated.84

Other states followed suit and adopted similar approaches in regulating the business of banking in their states.85

Although state banks could not issue/print money to be used as legal tender in commerce, their notes represented bills of credit and were typically issued in exchange for specie deposits.86 These notes would bear the name of the issuing bank, and would entitle the bearer to the note’s face value in gold or silver, upon presentation to the bank.87 Such notes were convenient in order to conduct large transactions, extension of credit, etc. They could be produced easily, unlike gold and silver stock of the nation, which were in small transactions and in decline.88 In 1837, in Briscoe v. Bank of Kentucky,89 the Supreme Court ruled that state banks

80 See William H. Dillistin, Bank Note Reporters and Counterfeit Detectors, AM. NUMISMATIC SOCY (1949).
85 See Kenneth Ng, Free Banking Laws and Barriers to Entry in Banking, 1838-1860, 48 J. Econ. Hist., 877-89 (1988).
87 Id.
were constitutional and also the notes issued from them were constitutional.90

During the “free banking” era, there were 712 state banks in operation, each having their own currency.91 By today’s standards, it is difficult to imagine how individuals and businesses conducted their business affairs, while trying to measure the risk and value of several different banknotes. By taking advantage of the limited supply of gold and other precious coins being used as “money” in commerce, state banks supplied a vast amount of what was used as circulating currency.92

State banks were generally required to buy state bonds, at market value, and then deposit the bonds with the state auditor as collateral.93 State banks could also issue banknotes in value not higher than the value of the bonds.94 Therefore, performance of the bond market had a direct effect on the ability of the banks to issue banknotes.95 In addition, state banks were required to redeem banknotes in gold or other precious coins.96 State banks’ examiners were responsible for regulating and enforcing state banks’ reserve requirement.97 Depositors were granted a lien on state banks’ assets.98

A survey of “free banking” activities of 709 state banks in the states of New York, Indiana, Minnesota, and Wisconsin from 1838 to 1863, revealed that approximately half of these banks failed to redeem their own banknotes for specie, approximately sixteen percent of these banks could not redeem their own banknotes, and approximately sixteen percent of banks survived for less than one year (in fact, the average existence of state banks was almost five years).99 The losses suffered by depositors in each of the four states were between $1.6 million and $2.1 million.100

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90 Id. Kentucky authorized a state owned and operated bank to issue notes that circulated as currency. The bank gave Briscoe the notes in exchange for a promissory note. Briscoe failed to repay, so the bank sued him. Briscoe claimed that the bank (and thus Kentucky) had violated the Constitution. The issue in the case was by issuing notes and currency, did the bank violate the constitutional prohibition in Article 1 Section 10 that “No State shall emit Bills of Credit”? The Court rejected Briscoe’s argument. The clause prohibiting bills of credit applied to notes issued indirectly through a corporation. But the bank had issued the notes on its own credit, not on the credit of the state.

91 See DAVID S. KIDWELL & RICHARD PETERSON, FINANCIAL INSTITUTIONS, MARKETS, AND MONEY 59 (5th Ed. 1993).


94 See BARTON A. HEPBURN, HISTORY OF COINAGE AND CURRENCY IN THE UNITED STATES AND THE PERENNIAL CONTEST FOR SOUND MONEY (1903).


100 See ARTHUR J. ROLNICK & WEBER E. WARREN, THE FREE BANKING ERA, FED. RESERVE BANK
A significant cause of state bank failure was a decline in the market value of the bonds banks held.\footnote{See Kurt Schuler, Note Issue by Banks: A Step Toward Banking in the United States?, CATO JOURNAL, Vol. 20, No. 3 (2001)} As previously stated, banks were typically required to link note issues to the value of the bank’s bond holdings.\footnote{See infra note 93.} Upon occurrence of a decline in the market value of the bank’s bonds, the bank was required by state authority to withdraw part of its currency from circulation.\footnote{See infra note 94.} This meant that the bank would call in loans, which resulted in shortage of monies supply, as well as a stricter regime of credit to individuals and businesses.\footnote{See LARRY J. SECHREST, FREE BANKING: THEORY, HISTORY, AND A LAISSEZ-FAIRE MODEL 16-17, (1993).}


C. Survival of State Banks After 1863

The main purpose of Congress in enacting the National Bank Acts of 1863 and 1864, was to form a system of nationally chartered banks, establish a uniform national currency and create an active secondary market for Treasury securities to assist in financing the Civil War.\footnote{See Mark Furletti, The Debate Over the National Bank Act and the Preemption of State Efforts to Regulate Credit Cards, 77 TEMPLE L.REV. 425, 449 (2004).} Provisions of the Acts included free entry and collateralized bank notes.\footnote{See Comment, Circumventing the McFadden Act: The Comptroller of the Currency’s Efforts to Broaden the Branching Capabilities of National Banks, 72 Ky. L.J. 707 (1984).} The Acts were aimed at facilitating federal control over the U.S. banking system without the formation of a central bank.\footnote{See National Banking Act, http://en.wikipedia.org/wiki/National_Banking_Act.}

As previously mentioned, states began the widespread chartering of banks well before the federal government. Congress together with Salmon P. Chase, Secretary of the Treasury, expected state banks to apply for federal charters, go out of business and form a system of nationally chartered banks.\footnote{See Wayne A. Abernathy, Assistant Secretary of the Treasury for Financial Institutions. A Financial System that Best Serves the Needs of Consumers. Remarks to the Conference of State Bank Supervisors 2003 Annual Meeting and Conference, (May 29, 2003) available at http://www.ustreas.gov/press/releases/js437.htm.} Presumably, this would result in a uniform national currency and create an active secondary market for Treasury securities that were all supportive of financing the Civil War.\footnote{Id.} Such
expectation was never achieved. The dual banking system we know today was essentially a historical accident and not the intention of Congress.

When Congress saw that the 1863 and 1864 Acts failed to convince state banks to convert to federal charters, it tried a different approach. This time, in 1865, Congress passed acts, which would impose a prohibitive ten percent tax on state banknotes. There was no such corresponding tax on national banknotes. It was unclear whether Congress' intent was to assure only one kind of currency or to push individual states out of the bank business. Many state banks could not withstand the tax burden and closed. In 1864, the number of state banks was 1,500. By the end of the decade, the number was reduced to 250. Surviving state banks, however, were able to avoid the tax by creating checking accounts (demand deposits), which eliminated the need for banknotes.

By 1870, there were 1,638 national banks and only 325 state banks. In the 1870's, banks started to replace usage of paper and coin currency with deposits. Depending upon the state(s) involved, state charted banks often had numerous advantages over the federally chartered banks. State banks were usually permitted to keep lower cash reserves relative to deposits and less capital. They also had more flexible opportunities in branching out than federally chartered banks, including the potential to branch interstate if state law permitted, an ability not granted to national banks until the Reigle-Neal Act of 1994. In addition, state banks tended to have fewer restrictions than federally chartered banks on the kinds of loans they could make.

Although state banks were banknote taxed, they held more customer deposits than national banks. Such dory advantages fostered a resurgence in the number of state banks. For instance, in the year 1888, there were about 3,500 state banks.

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113 See National Bank Act, Ch. 106, 13 STAT. 99 (1864).
115 Id.
116 Id.
125 Id.
banks and 3,100 national banks. Some newly established banks saw the prohibitive tax on states’ banknotes as an incentive to request national charters. Gradually, state banks seeking federal charters began to increase. The structure of a dual banking system began to take form. During the period 1873 through 1907, demand deposits outweighed coin and paper currency circulation. Banks unable to meet immediate payment of their demand deposits often collapsed. Their depositors suffered loss of a portion or in some instances, all of their funds on deposit. The average yearly failing rate for banks from 1870 through 1913 was 0.78% (as compared to 1.01% for non-banks). The state bank instabilities contributed to the bank crises of 1873, 1884, 1893, and 1907.

Congress created the Federal Reserve Act of 1913. The Federal Reserve System ("Fed") was the central bank of the United States. The main objectives of the Federal Reserve were to facilitate the flow of bank reserves from capital surplus to capital deficient areas, to provide liquidity by means of a discount facility (called and in fact structured as a window) to banks suffering temporary liquidity problems, and to provide liquidity to the banking system by offsetting outflows of currency and gold. The Fed, however, failed to attain these objectives and prevent the financial (banking) crisis of the 1930's, the 1970's and 1980's. Ironically, the banking industry had smoother sailing before formation of the Fed. In fact, the Fed introduced greater "rigidities" during the Great Depression (such as prohibition of the clearing house certificates issuance, making temporary bank suspensions more difficult, etc.) than were in existence prior to creation of the Fed.

Through the Twentieth Century, a constant series of occurrences—legislative, economic, even philosophic in nature—tested the vigor of the state bank system. Although often weak, small, poorly regulated and inadequately funded, the state bank system, even when brought to its knees as part of a faltering

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126 See supra note 117.
127 Id.
130 Id.
131 See id.
economy, responded both timely and shrewdly to these events which often did not take into consideration the well-being of state bank activities.139 State banks have not only survived but have successfully competed with their federal rivals.140 Much of the Twentieth Century reflected a significant growth in the number of banks.141 State and federal, they reached about 30,000, an all time high, in the early 1920s.142

Problems with adverse effects upon the state banking system include:

i) Bank collapses escalated rapidly in a fourteen year period, from 1920 to 1933, to almost 9,000 commercial banks, which suspended operations, the majority of which failed.143 In particular, small-sized banks were hit the hardest. These small banks were primarily located in small rural areas in the Midwest and were unable to weather the post World War I recession;144 but their failures did not have any substantial impact on the national financial system.145

ii) Banks took a heavy blow during the Great Depression.146 From 1929 (stock market crash) until 1933, commercial banks were reduced roughly from 26,000 to 14,000.147 Deposits dropped by approximately thirty-five percent.148 Depositors rushed to withdraw their monies from the banks,149 and people sought to protect themselves by hoarding gold.150 The result was a national contraction of credit.151

iii) In 1932, under the leadership of Senator Carter Glass, a Democrat from Virginia, and Representative Henry B. Steagall, a Democrat from Alabama, efforts were made to expand banks’ credit.152 This resulted in the Fed issuing rules to

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147 See supra, note 145.
149 A process known as “a run on the banks.”
liberalize acceptance of commercial paper for re-discount purposes.\textsuperscript{153} In addition, more than $750 million of the nation’s gold reserve was made available for loans to individuals and businesses.\textsuperscript{154} The initiative taken from Glass and Steagall seemed to have positive results as evidenced by the number of bank failures that dramatically decreased.\textsuperscript{155}

Nevertheless, from the end of 1932 to the beginning of 1933, another wave of bank failures hit the U.S.\textsuperscript{156} This time such failures led to a significant banking crisis, which required the intervention of President Franklin D. Roosevelt.\textsuperscript{157} His first act as President was to declare a “bank holiday” in the country by closing all banks for at least one week (actually banks were closed for four days).\textsuperscript{158} Such action was intended to stop panicky withdrawals by depositors.\textsuperscript{159} President Roosevelt’s decision was effective.\textsuperscript{160} The U.S. government warned those banks, which were not insolvent to not open their businesses.\textsuperscript{161}

iv) Under these difficult circumstances, Congress passed the Banking Act of 1933\textsuperscript{162} (commonly known as the Glass-Steagall Act), which in part prohibited commercial banks from getting into the investment banking business.\textsuperscript{163} The Act also prohibited the payment of interest on demand deposits and established the Federal Deposit Insurance Corporation (the “FDIC”) as a temporary agency.\textsuperscript{164}

v) Two years later, Congress passed the Banking Act of 1935\textsuperscript{165}, which established the FDIC as a permanent government agency.\textsuperscript{166} The FDIC’s main


\textsuperscript{160} Id.

\textsuperscript{165} See Banking Act of 1935 Pub. L. No. 74-305, 49 Stat. 684. Later on, Congress passed Federal Deposit Insurance Act of 1950 Pub.L. No. 81-797, 64 Stat. 873, which revised and consolidated earlier legislation into one Act, embodying the basic authority for the operation of the FDIC.

purpose was to require banks to maintain sufficient assets to remain solvent.167 Opponents of the Act argued it would encourage bad banking, creating a burden to the taxpayer.168

vi) By the end of 1934, the banking system started to recover from the Great Depression, and by 1937, bank deposits had reached pre-Depression levels.169 During World War II (1939 through 1945), bank deposits increased substantially and in fact doubled between 1941 and 1946.170

vii) In 1956, Congress enacted the Bank Holding Company Act171, one effect of which was to inhibit interstate banking.172 As a result, banks tended to remain small and focused primarily on business within local markets.173 The Act also limited activities of bank holding companies to those activities “closely related” to banking.174 Thereafter, the banking system remained relatively stable, with bank failures occurring at a rate of approximately ten per year.175

viii) History repeated itself during the financial crisis of the 1980s.176 Although the actual number of banks that failed in the 1930s well exceeded the number of failures in the 1980s, the actual asset decreases were dramatically higher in the 1980s.177 During the 1980s, a dozen Savings and Loans Associations lent monies to people in the commercial real estate markets, which collapsed.178 Since debtors were unable to pay these associations back, the latter went out of business.179 From 1980 to 1992, the number of the Savings and Loan Associations decreased from 3,998 to 2,039. In response to this situation Congress, in 1989, consolidated the deposit insurance of banks under the FDIC180. In addition, two funds were formed, the Bank Insurance Fund (the “BIF”)181, which covers

174 Id.
175 See Kaufman, supra note 144.
177 Id.
178 See id.
181 Insured banks pay a premium on all their deposits, even those deposits that are not covered by insurance. For many years, premium income exceeded the cost of failures. But as the size of bank failures increased, the BIF went into the red in 1991. Instead of being declared insolvent, however, its
commercial banks and savings banks, and the Savings Association Insurance Fund (the “SAIF”), which insures deposits at S&Ls.  

ix) In 1980, Congress enacted the Depository Institutions Deregulation and Monetary Control Act, which eliminated federal ceilings on deposit interest rates.

x) On September 29, 1994, Congress passed the Riegle-Neal Interstate Banking and Branching Efficiency Act. Under this Act, Congress permitted banks to branch beyond state lines.

xi) In 1999, Congress abolished major portions of the Glass-Steagall Act and removed some of the restrictions of the Bank Holding Company Act, by enacting the Gramm-Leach-Bliley Act. This Act allowed bank holding companies to engage in a full range of financial services, including lending, taking deposits, investment advising, insuring, stock and bond underwriting, and other investment banking services.

In retrospect, state banks have responded both timely and shrewdly to all changes in legislation and other federal regulatory initiatives, which often did not take into consideration the health of state banking activities. State banks have discovered how to not only survive, but to compete successfully with federally chartered banks.

III. PURPORTED BENEFITS OF THE DUAL BANKING SYSTEM

A. Crucibles for Innovation / Brandeis

In 1932, Justice Louis Brandeis, in his dissenting opinion in New State Ice Co. v. Liebmann stated the important role which state law plays in the American federalist system of government. He said:

To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel

losses were covered with loans from the US Treasury, as authorized by Congress. In 1992, the fund staged a comeback. With increased premiums and a sharp improvement in bank profitability due to a drop in the interest rates, the BIF repaid its loans and was well in the black again by mid-1993.

See supra note 53.


Justice Brandeis’ dissent was based on public concern over the possibility of “destructive competition” in the ice business as well as the industry’s responsibility to consumers and need of Oklahoma’s economy for the licensing scheme. However, the gravamen of Justice Brandeis’ dissent concerned his statement on the states’ roles as laboratories of innovation.

The laboratories of innovation concept shows up in various examples where states originated positive change in the banking system. For instance, the “negotiable order of withdrawal” ("NOW") accounts—which, technical definitions aside, enabled the payment of interest on consumer demand deposits—were created by state banks. In the 1980’s, states also provided their banks more power than the federal banking institutions in securities and insurance activities. In addition, state banks tended to engage in more real estate brokerage and development activities than did national banks. The entry by state chartered bank subsidiaries into insurance, securities, as well as real estate activities stimulated the Fed to broaden non-banking activities of bank affiliates in a holding company.

Justice Brandeis’ concept of states as “laboratories of innovation” was one of the most well known federalist metaphors. In the context of banking, it was considered to provide states with the power to “experiment” with people’s monies. However, the famous dictum did not seem to have anything to do with federalism; rather it articulated a commitment to scientific/socialist methods of experimentation at the state level.

Both liberal and conservative justices have quoted Justice Brandeis in various cases, conveying pragmatic spirit, which logically appeals to compulsive tinkerers, connoting equally popular sentiments in favor of localism and decentralization.

Under the laboratory metaphor a strong case can be made for the power held

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190 The ice company was licensed by the State of Oklahoma, whose legislature had determined that the manufacture, sale, and distribution of ice were a public business and that a license was required by anyone seeking to enter the business. An ice company contended that the act providing for the license was valid. The U.S. Supreme Court stated that a regulation which had the effect of denying or unreasonably curtailing the common right to engage in a lawful private business, such as that under review, could not be upheld consistently with the Fourteenth Amendment.


195 This encouraged the OCC to develop national banks subsidiary operations.

196 Eager, supra note 77.


198 Cohen, supra note 190.

by state institutions capable of adapting to changes of economic circumstances and social values. A state based experiment reduces the risk naturally associated with national action. Successful state experiments with banking regulation have taught valuable lessons and have built public confidence in innovative policies. In the end, such experiments have created a receptive environment for banking models and policy recommendations, which may have gone unappreciated at the federal banking level. In addition, state banking-based innovation accommodates adaptation to local needs, circumstances, and preferences of the state banking community.200

Legislative banking experiments must be limited by the authority granted by state law. Banking policy experiments do not function with the efficiency of disinterested, scientific process of trial and error. Experiment bears risks generated mainly from the fact that state bank regulatory experiment carries a heavy burden of responsibility to the state citizens. The goal is to limit what state bank regulators may do to state chartered banks and state consumers, inhibit rash, indiscriminating lawmaking, and protect the welfare of the state banking system.201

Constitutional constraint and state bank policy experiment breed unavoidable friction with each other. However, out of this friction can come innovated banking activities, which facilitate consumer and business banking activities at the cheapest cost.202 Justice Brandeis’ “laboratories of innovation” can transform state governments into a vanguard for the national administrative state.203

Experimentation, at the state level, in social and economic innovations is a serious responsibility. Denial of a state’s experiment rights has had, as a consequence of FIDICIA, consequences to the country. Indeed, the federal system could benefit from a single courageous state’s choice to act as a laboratory, attempting social and economic experiments, without risk being imposed nationwide.204 Further, federal courts have the power to prevent states from exercising such right of experimentation, if they judge the state’s acts to be unfit, arbitrary or against public interest.205

Justice Brandeis said that the cheap cost to get in the business of the ice market would lead to “wasteful”, “destructive”, and “ruinous” competition.206 As a result, consumers would “suffer” because producers “go to extremes in cutting prices.”207 Some producers will be pushed out of business as a result of being unable to collect their costs. Therefore, “the business of ice . . . lends itself

201 See Greve, supra note 199.
202 Id.
205 See New State Ice, supra note 200, at 311.
207 See New State Ice, 285 U.S. at 292.
peculiarly to monopoly” pricing. Monopoly risk had nothing to do with the licensing scheme. The Oklahoma state statute was meant to “create and foster” rather than to abate “monopoly in the hands of existing establishments, against, rather than in aid of, the interest of the consuming public.”

Justice Brandeis saw federalist “experimentation in things social and economic” as a way to progressive ends. Due, in part, to Justice Brandeis state laboratory doctrine, courts have empowered state governments through creative interpretations of the Tenth and Eleventh Amendments. In addition, courts have resurrected constitutional doctrines, which in turn, have disciplined state governments to encourage state governments to compete with the federal government to improve their own citizens’ lives.

More recently, Justice Stevens, based on Justice Brandeis’ dissent in New State Ice, argued that the Supreme Court ought to set aside constitutional concerns over an experiment in line with prevailing state efforts to overcome the “atavistic” sentiments that hold up private discrimination against social issues, such as homosexuality concerns.

Justice Brandeis might well have welcomed the solutions to many of the nation’s economic and social concerns, which have emerged from his “states as laboratories of experimentation of democracy” premise; and correspondingly would more than likely be unsatisfied with the trend of later legislation. The legislation has diminished the role of state experimentation regardless of the Supreme Court’s right to protect the power authority of States in the name of constitutional federalism. The Supreme Court’s approach towards states’ innovative experimentation remains an important issue, which deserves both public and expert attention.

Justice Brandeis’ articulation on the states’ right to serve as laboratories for

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208 Id. at 291.
209 Funny that this should be true of many other decisions that form the foundation of the post-New Deal Court’s jurisprudence – for instance, the famous 1938 decision in the United States v. Carbone Products, 304 U.S. 144 (1938), which established the Supreme Court’s “dual standard” of judicial review (none for economic rights, plenty for a few other rights and especially those of “discrete and insular minorities”). See MICHAEL C. DORF, CONSTITUTIONAL LAW STORIES 397 (Foundation Press 2004).
210 See, e.g., PHILIPPA STRUM, BRANDEIS: BEYOND PROGRESSIVISM 89 (Lawrence University Press of Kansas 1993).
experimentation, as well as a dozen court rulings, which based their arguments on Justice Brandeis' findings, have had an impact on state bank authorities in regulating their banking systems. Today, however, state regulators are inhibited in "experimenting" with state banking activities by the principles of FIDICIA, which fundamentally limit state bank powers to those of national banks. FIDICIA, when considered together with the wild card statutes have forced state banks and national banks to mirror each other and have consequently deprived the country of the benefits of its dual banking concept.

B. Competition Among Regulators and Opportunities for Banks

The structure of the U.S. bank regulatory system is unique in the world. In America, banks report to a combination of federal and state banking regulators. Banks can select their own type of charter, federal or state, which best fits their business purpose. Commercial banks, which are federally chartered, are regulated by the OCC. On the other hand, state banks are regulated by their home states and occasionally a federal regulator (e.g., the Federal Reserve System regulates state chartered banks which voluntarily select membership in the Federal Reserve; the FDIC regulates state, nonmember banks). In other words, banks determine which regulators they will report to based on the chosen charter.

Traditionally, federal and state bank regulators compete for banks to adopt their respective charters. In the end, productivity of the regulators is demonstrated less by volume of their regulations than by the number and size of banks within their regulatory spheres. As a result of this competition, individual banks are the winners.

American banking history has proven that when one regulator fails to provide banks with the right conditions, banks will find other opportunities elsewhere, mainly by switching to another charter. Classic examples are Marine Midland Bank (presently HSBC Bank USA) and later J.P. Morgan Chase Bank.

1. Marine Midland Experience

In the 1970's, Marine Midland Bank found itself in financial difficulty. The bank had expanded across New York State, particularly in New York City, without a clear strategy and long term expansion plan.

Finding itself in deep water, Marine Midland Bank sought financing. The Hong Kong and Shanghai Bank Corp. ("HSBC"), a wealthy bank located in Hong Kong, seemed to be the perfect suitor for Marine Midland Bank. HSBC expressed interest in acquiring a portion of Marine Midland. Before entering into this transaction, Marine Midland Bank sought to obtain permission from the New York State Banking Department, the bank's chartering regulatory authority. The New

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217 See CARL FELSENFELD, BANKING REGULATION IN THE UNITED STATES 21 (2d ed. 2006).
218 There seemed to be no requirement that its regulatory approval be obtained; but responsible banks generally will share their plans, particularly those as important as switching a charter, with their
York State Banking Department flatly rejected Marine Midland Bank’s permission. In order to justify its position, the New York State Banking Department made unnecessary disclosure demands on Marine Midland.219

In an effort to foster the HSBC/Marine Midland transaction, Governor Hugh Carey sought legislation aimed at overcoming the objections of the New York State Banking Department and its Superintendent, Muriel Siebert. The Chairman of Marine Midland, Mr. Edward W. Duffy, tried his best to diminish Superintendent Siebert’s fear of possible “Chinese” (HSBC) control of Marine Midland. Governor Carey also discounted Chinese control over Marine Midland. Some conservative members of the New York State Assembly, such as Assembly Banking Committee Chairman, Herman D. Farrell, proposed legislation which would have prohibited foreign banks from acquiring New York State banks with assets over two billion dollars, and would have required public hearings on foreign takeovers of smaller banks.220 Such legislation could have prohibited the Marine Midland Bank takeover. Superintendent Siebert expressed fear that HSBC would have shifted Marine Midland’s focus from domestic lending to international trade, adding that HSBC had not provided adequate financial information.221

As the word circulated internally at Marine Midland Bank that HSBC was acquiring shares of the bank, the bad jokes began. Word spread among Marine Midland’s almost 11,000 employees that HSBC was taking the “silver out of the dining room and replacing it with chopsticks”.222 The headline of a local newspaper in upstate New York read “Red Chinese Buy Midland”.223

Facing the difficulties presented by the New York State Banking Department, Marine Midland Bank made a strategic decision; it converted from a New York State-charter to a federal charter.224 The decision eradicated the need for the unreasonable disclosure sought by the state and expedited the transaction. The OCC’s approval order on Marine Midland application stated that “areas of MMB’s [Marine Midland Bank] performance are judged to be capable of significant improvements”.225

New York Banking Superintendent Siebert sat on the proposed HSBC state level acquisition of Marine Midland for months. After the department refused Marine Midland’s request, Comptroller of the Currency John Heimann wasted no time “inviting” the bank under OCC’s umbrella. (Formally, it was Marine Midland bank’s application for a national charter since the Federal Reserve had already approved the application for control of the bank.)226

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221 Id.


223 Id.


226 See The Comptroller’s Foreign Banks Study, ABA BANKING JOURNAL, May 1980, at 34.
Taking advantage of the Marine Midland case, the OCC then undertook a comprehensive study of foreign banks operating in the U.S. Conclusions of the study were so thorough that it could have easily held up action in the Marine Midland case for longer time than the OCC intended to devote to the application. Running against time, Comptroller Heimann went ahead and granted a national charter to Marine Midland.227

Marine Midland’s shareholders approved the accord.228 As a result, Marine Midland would receive $230 million in new capital from the sale of new stock to HSBC.229 With the blessing of the OCC, HSBC acquired 51 percent ownership of Marine Midland in 1980230 for $314 million.231 Upon acquisition, Marine Midland’s assets were close to $20 billion.232

For Marine Midland, the HSBC investment came at a crucial time due to the bank’s inability to tap capital markets to support its growing asset base. The bank had sharply reduced earnings in the years prior to the HSBC’s acquisition.233 In 1975, Marine Midland branches were under surveillance by state bank regulators because financial troubles were affecting earnings and reducing dividends to the bank’s shareholders.234

Marine Midland proved to the New York State Banking Department that banks will do whatever it takes, even switching charters, in order to achieve their business goals. The New York State Banking Department learned a valuable lesson the hard way: the state bank regulator’s failure to provide suitable conditions for state chartered banks to conduct banking business could translate into loss of business for state regulators. One can easily imagine a switch from federal to state regulation if the underlying facts were different. This type of behavior might be seen as the dual banking system in action.

2. Recent J.P. Morgan Chase & Co. Switch

In early 2004, the New York State Banking Department and federal regulators closely watched how J.P. Morgan Chase & Co. would sort through the web of federal and state banking charters the bank would have once it closed the deal to acquire Bank One Corp. The New York State Banking Department at the time oversaw over 100 banks and thrifts that together held approximately one

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227 Id.
229 See N.Y. Times, Section 4, Pg. 4, Column 6, October 18, 1979.
230 See Nancy Buckwalter, Building the ‘New Marine’: Cash Infusion, A New Strategic Focus Aimed at Building a Multistate, Multinational Competitor, NATIONAL EDITION, August 1983, at 48. HSBC extended full ownership of Marine Midland Bank in 1987 in which HSBC spent $770 million. Marine Midland Bank branch offices were branded as “HSBC Bank USA”. Id.
233 Id.
234 See Jack Egan, Hong Kong Shanghai Corp. to Buy 51% of Marine Midland, , WASH. POST, April 6, 1978, at D10.
trillion dollars in assets. The department was the largest state banking supervisor in the U.S.

About 60 percent (equivalent to approximately $638 billion) of bank and thrift assets supervised by the Department, resided in JP Morgan Chase Bank. As such, JP Morgan Chase was a “rain-maker” for the budget of the State Banking Department. The bank paid $17.2 million in assessment fees to the department in fiscal 2002, or 24.5 percent of the department’s $70 million budget.

Eager to keep JP Morgan Chase under New York State supervision, the Department’s Superintendent, Diane Taylor, admitted that “[y]ou have to be prepared for everything. Nothing is a given in this world. We’d have some reconfiguring to do. Obviously their assessment is a substantial portion of our revenue.”

Superintendent Taylor nervously tried to remain calm in the face of speculations that the New York State Banking Department would fight “tooth and nail” with federal regulators to keep JP Morgan Chase under New York charter after acquiring Bank One Corp. In this regard she said:

“We’re not a marketing organization... JP Morgan Chase should choose the banking charter that best suits the company’s needs. I want them to make the best decision for the bank as a whole, because it is a very important for the economy of the state of New York. I am hoping that the New York State charter is a part of that. I think it’s a very good charter. It allows a lot of innovation; there are a lot of good things about the charter, and I hope it is within their business plan to continue to work with us”.

Traditionally, state and federal bank regulators constantly lobby banks to retain or switch charters. For example, in 2000, the Comptroller of the Currency, John D. Hawke Jr., went personally to Memphis and tried to “convince” National Bank of Commerce from switching to a Tennessee charter.

The New York State Banking Department, among others, hoped that a sense of the bank’s history with the State of New York (since 1799 the bank’s original predecessor company, The Manhattan Co. was established in New York) JP Morgan Chase & Co. would decide to remain “loyal” to its New York roots.

Ultimately, JP Morgan Chase & Co. declared that the bank would switch its state charter to a federally chartered bank in order to avoid conflicting New York

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235 See Press Release, State of New York Banking Department, Consumer and Banking Officials Team Up to Launch ‘Bank on New York’ Campaign – Dozen of Financial Institutions to Participate in Effort to Encourage Low-Income New Yorkers to Open Bank and Credit Union Accounts (Jan. 6, 2005).


238 Id.

239 Id.

240 Id.

241 Id.

242 Id.
State requirements on lending practices.\textsuperscript{243}

During the summer of 2004, the OCC granted JP Morgan Chase conditional approval for the holding company’s lead bank subsidiary to adopt a national charter. About one week after the purchase of Bank One Corp., JP Morgan Chase Bank applied to convert from a state charter to a federal charter. On October 13, 2004, the OCC released a letter, which gave the bank its formal approval.\textsuperscript{244} On July 9, 2004, a JP Morgan Chase spokeswoman said: “The national charter will allow the new bank, like Bank One and like all of our major competitors, to follow uniform national regulation rather than separate rules for each state in which we operate.”\textsuperscript{245}

Today, JP Morgan Chase & Co. maintains corporate headquarters in New York City, and the bank’s retail financial services and commercial banking headquarters are in Chicago.\textsuperscript{246} According to the Bank, its assets in 2005 were $1.1 trillion, and it maintained operations in more than fifty countries.\textsuperscript{247}

Under federal charter, Chase Bank would operate about 300 branches of Chase Mortgage, which is one of the top ten non-prime lenders in the country. Chase Bank chooses to keep the former JP Morgan’s mortgage operations under federal charter in forty-seven states. There was no change made for Chase Bank in the states of New York, New Jersey, and Connecticut because the bank was already conducting commercial banking activities in these states, therefore exempting the bank from restrictive state banking laws.\textsuperscript{248}

In retrospect, the main reason JP Morgan Chase & Co. selected the federal charter was probably the aggressive legal actions taken by New York State in the areas of lending and privacy.\textsuperscript{249} The Bank anticipated that the Federal charter would exempt it from conflicting and deleterious state laws. As put by JP Morgan Chase spokeswoman, Charlotte Gilbert-Biro: “A number of existing operations outside our [JP Morgan Chase & Co.] tri-state bank markets will become part of the FSB [Federal Savings Bank] so that we will be organized and operate in those markets as our customers see us, as a single financial services provider”.\textsuperscript{250}

Additionally, executives of J.P. Morgan Chase admitted that having a national charter was intended to make it easier for the bank to offer products and

\textsuperscript{243} See Mara Der Hovanessian, A Street-Savvy Bank Cop, BUSINESSWEEK, Aug. 15, 2005.


services across its seventeen state territories.\textsuperscript{251}

JP Morgan Chase was the second high profile bank in 2004 to switch from a New York State charter to a national charter. HSBC Bank USA, the primary domestic bank subsidiary of HSBC Holdings PLC, with $99.9 billion of assets, completed its charter swap on July 1, 2004. HSBC's choice of a federal charter also struck a major budget blow to the New York State Banking Department.\textsuperscript{252}

According to the estimates of the Department, assessment fees that the agency charged those two banks totaled 27.8 percent of its $77.5 million budget for fiscal year 2003.\textsuperscript{253}

In the same year, 2004, “inspired” by JP Morgan Chase’s move, Harris Trust and Savings Bank of Chicago with $54 billion in assets, applied to the OCC to consolidate its twenty-five Illinois bank charters into a national charter, the new bank to be called “Harris Bank”.\textsuperscript{254}

The JP Morgan Chase charter swap was a watershed moment in U.S. banking history, and may impact the future of dual banking. The issue for regulators becomes how to work with these changes and foster an environment of innovation and competition for banks, which enables banks to provide the best services and products to their customers.\textsuperscript{255}

C. Possible Competition in Laxity; Race to the Bottom

The charter switching phenomena of the early 2000's started a debate over the desirability of revisions to federal preemption rules and whether national bank regulators can properly protect customers’ interests.

As a result of conversions to a national charter, the OCC’s supervision over assets has grown tremendously.\textsuperscript{256} In the late 1990’s, the agency oversaw banks with about $2.5 trillion of assets,\textsuperscript{257} accounting for more than 58 percent of the nation’s banking assets.\textsuperscript{258} In 2005, the agency’s responsibility was almost $5 trillion; including $662 billion from the JP Morgan Chase switch and $119 billion from the HSBC switch.\textsuperscript{259} In 2005, among the ten largest retail banks in the

\textsuperscript{252} See Davenport, \textit{supra} note 245.
\textsuperscript{255} See Taylor, \textit{supra} note 236.
\textsuperscript{259} See Todd Davenport, \textit{How Addition of JPM Chase Is Changing the OCC}, \textit{American Banker},
nation, SunTrust is the only bank, which has a state charter.\textsuperscript{260}

The OCC prepared itself in advance for the influx of charter conversions. For example, the agency’s New York office has about 60 on-site examiners specialized in derivatives and other specialty products.\textsuperscript{261} As the OCC’s Senior Deputy Comptroller, Douglas W. Roeder, said “We [the OCC] haven’t had to disrupt and shut down and stop everything in a crisis mode . . . I take confidence from the fact that the process is probably set up the right way and certainly can benefit from evolving.”\textsuperscript{262}

Faced with an avalanche of federal regulatory requirements, particularly with regard to large size nationally chartered banks, the OCC did not hesitate to continue the increase of its examiners. As Deputy Comptroller Roeder stated: “We [the OCC] try to get people early in their career life, train them as fundamental examiners, and then introduce them to larger banks . . . That’s still our bread and butter”.\textsuperscript{263} The OCC also provided an advance cash payment of $75,000 for examiners who were willing to relocate to its New York office.\textsuperscript{264} Due to shortage of staff, the OCC went as far as hiring examiners from other banks and Wall Street.\textsuperscript{265} Deputy Comptroller Roeder confirmed this trend when he stated:

“We complement the homegrown examiner with someone off the Street who doesn’t necessarily need the learning curve on the technical side and can help us gain momentum, around the pace of how some of these businesses move . . . Certainly within the regulatory community, word gets out. People do recognize that there are opportunities, particularly in New York, for experienced examiners”.\textsuperscript{266}

Accordingly, the OCC and the New York State Banking Department began competing for employees. The New York State Banking Department’s examiners have, thus far, “resisted” any temptation to join the OCC’s New York office.\textsuperscript{267}

From a regulatory point of view, a main focus of the OCC’s work has turned to the credit card business. Almost 70% of credit card assets in the U.S. banking system are under the national charter. This concentration presents challenges beyond the OCC’s traditional risk analysis.\textsuperscript{268}

Consider the OCC’s position on preemption: the agency claims that part of its responsibility concerns consumer protection. Although nationally chartered


\textsuperscript{261} See Douglas W. Roeder, Senior Deputy Comptroller for Large Bank Supervision, Statement before the U.S. Senate Permanent Subcommittee on Investigations, Committee on Governmental Affairs, on how the OCC supervises large national banks in general and complex structured transactions such as those entered into by Enron (Dec. 11, 2002), (transcript available at http://www.occ.treas.gov/ qi/qi22-1/7-speeches.pdf).

\textsuperscript{262} See Davenport supra note 259.

\textsuperscript{263} \textit{Id.}

\textsuperscript{264} Id.


\textsuperscript{266} See Davenport, supra note 259.

\textsuperscript{267} \textit{Id.}

\textsuperscript{268} \textit{Id.}
banks assure the OCC that they have put everything in place to ensure that the banks’ employees behave ethically, reality indicates that many workers do not meet that standard. Breaches in risk control at banks have occurred because bank employees were stimulated by their bank employers to make a quick dollar or build a business without fundamental risk monitoring in place. Even the OCC by its own admission accepts the fact that it does not have enough human expertise to supervise compliance by the nationally chartered banks.

State bank regulators, such as the New York State Banking Department, in order to remain competitive with the OCC, are revising and improving their policies in connection with state chartered banks. However, not everything is going smoothly. As a result of departures of many banks from state bank supervision, state regulators have been forced to increase assessments fees on the mortgage brokers, mortgage banks, check cashers, money transmitters, and other financial companies these state agencies examine.

As one example, the New York State Banking Department has decided to charge every financial company based on time spent and resources devoted to its examination. State chartered banks are less than thrilled with this decision. Some of these banks express their “mood” openly. William McGarry, the President and CEO of Ridgewood Savings Bank, a New York chartered thrift, warned that there could be more conversions to national charters, if the State Banking Department increases fees on state chartered banks. He said: “If costs were to run amok, they [New York State Banking Department] might suffer more defections.”

Choice of charter is a delicate topic for federal and state bank regulators due to their competition in supervising banks. In the early 2000s, competition and occasional enmity between national and state bank regulators increased sharply. The OCC’s preemption rules issued in January 2004 prompted state bank regulators to argue that the heavy-handed approach of the OCC could leave consumers unprotected. On the other hand, banks were known to go from the OCC to state regulators in order to escape aspects of consumer protection.

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271 See Michele Heller, Preemption Fight Could Give Fuel to Subprime Bill, AM. BANKER, Apr. 20, 2004, at 4


274 Id.


277 First Bank and Trust of Brookings, SD was reported to switch from a national to a state charter in order to escape OCC regulations and engage in a suspect payday loan program. Subsequently, the
A few banks, due to pressure from regulators, have abandoned their initial strategy to switch charters. For instance, in February 2000, National Commerce Financial Corporation (national charter) announced its switch to a state charter, causing Comptroller of the Currency, John D. Hawke, to visit the bank’s Memphis office where he may have attempted to persuade executives of the bank to remain a national bank.278 Logically, as expected, the OCC denied making any such intervention.279 As John W. Ryan, the executive vice president of the Conference of State Bank Supervisors, said, the OCC always seem to be “extremely aggressive” in promoting the national charter.280 He added, “They [the OCC] very heavily market the charter to the largest institutions. They cherry pick.”281

State bank regulators have expressed concern about the threat of the OCC’s preemption rules posed to the dual banking system.282 State agencies see significant structural differences between state and national charters.283 They add that Congress should take action in such regard.284

Congress has tried to stimulate debate about the OCC’s preemption rules and their effects in the dual banking system. For instance, in late 2004, Senator John Edwards introduced a resolution, which would overturn the OCC’s preemption rules.285 Eliot Spitzer, then the New York Attorney General, has been a vocal opponent of the OCC’s preemption rights towards state bank authorities concerning state lending, licensing, and consumer protection laws.286 The legal counsel at the Oklahoma State Banking Department, in criticizing the OCC’s preemption rules said, “the OCC’s standard for preemption has been built on a political platform for the promotion of its charter.”287

Former Comptroller of Currency, John D. Hawke, Jr., has been one of the staunchest advocates concerning the increasing power of the national chartered banks under the leadership of the OCC. Another former Comptroller of the Currency, Eugene A. Ludwig, while speaking about Comptroller Hawke, said that:

What has happened during his [John D. Hawke, Jr.’s] term, which has dramatically changed the national banking system, is the number of conversions . . . which

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278 See Rob Garver, Visit from Hawke Kept ‘National’ in Bank’s Name, AM. BANKER, Feb. 11, 2000, at 1.
279 Id.
280 See Osuri, supra note 275, at 5.
281 Id.
284 See Davenport, supra note 245, at 1.
affirms the predominance of the comptroller’s job as the linchpin for supervision of
the banking system. For good or ill, the fact is that during his time, as a result of
conversions, there will be a huge preponderance of the banking assets of the United
States regulated by the comptroller’s office.288

The OCC has openly criticized the state banking system in the race between
national and state bank agencies to charter more banks. Particularly, the OCC
claims that while state bank regulators often proclaim that state banking is a
“laboratory of innovation,” these regulators have mostly become, as a necessary
consequence of the laws described in this article, copycats of federal practice.289

However, from time to time, federal bank authorities, namely the Fed, the
FDIC, and the OCC, have tried to cooperate with state bank regulators in order to
harmonize adequate operation of the banking system, both at the state and national
level.290 As a director of banking relations at the OCC said: “We [the OCC] have
missed the opportunity to work together in the past” with state bank regulators.291
He added: “We think the banking industry needs us both.”292 One suspects that
there is a measure of disingenuousness in the observation.

Prior to the OCC’s preemption rules, state bank regulators were attracting
more and more national banks to state charter.293 There is evidence that the OCC
issued the more vigorous preemption rules to protect its remaining major national
banks or attract new banks.294 In Oklahoma there are almost 185 state chartered
and 90 national chartered banks.295 Between 2000 and 2004, 23 national banks
switched to a state charter; conversely, during the same period, no state bank
switched to a national charter.296

During the period 1994 through 1998, assets under national chartered banks
increased 45 percent (equal to $3.2 trillion), and the assets held by state chartered
banks climbed 28 percent (equal to $2.2 trillion).297 For the same period, almost
179 state banks switched to national charters and about 156 national banks
converted to state charters.298 We see roughly equivalent charter movement in
both directions.

289 See Steve Cocheo, Days from Retirement, Hawke Empties His Clip, ABA BANKING JOURNAL,
290 See John D. Hawke, Viewpoint: FDIC Paper on Financing Supervision Misses Mark, AM.
BANKER, May 19, 2006.
291 See Barbara A. Rehm, State Regulators Get Set For An Interstate World: Interstate Bank
292 Id.
293 See Todd Davenport, An Issue’s Moment of Truth?: A Complex History, and an Uncertain
294 See Michele Heller, State Legislative Group Protests OCC Preemption, AM. BANKER, Aug. 3,
2004.
295 See Dudley Gilbert, OCC’s Preemption Rule Is About Keeping Market Share, AM. BANKER,
296 Id.
297 See David Harrison, Despite Reform Worries, Federal Charter Dominates, AM. BANKER, June
1, 1999, at 1.
298 Id.
In the year 2005, there were almost 6,200 state chartered banks, while approximately 1,800 were under national charter. Also, since around mid-1980s about 55 percent of all bank’s assets were held by national chartered, increasing dramatically between the period 2003 through 2005 to 64 percent of assets.

Some banks switch from a national to state charter because they expect easier access to, and quicker responses from, state bank regulators. While these banks have similar powers to national banks, they get additional powers from state regulators. As a high state banking official said, “We [the Oklahoma State Banking Department] have started pointing out the difference between national and state banks . . . and that has created new interest in the state charter.”

The FDIC, federal spokesman for state non-member banks and logically a leading spokesman for the state chartering system, has expressed concern that the OCC’s preemption rules are putting state banks at a competitive disadvantage. As a result, in 2005 the FDIC was considering holding a public hearing on a petition filed by the Financial Service Roundtable, which asked the agency to offer a type of preemption for state chartered banks. The petition requested the FDIC to issue a rule giving state chartered banks that branch into another state the same exemption from the host state’s laws that national banks have. Officials on the roundtable claim that the presented plan would provide parity and serve like a wild card for state banks, which would have similar rights to compete in other states as national banks.

The FDIC’s intervention in the preemption matter could be explained as the agency’s effort to level the playing field. In other words, if the FDIC would grant parity to what the OCC has done, then the FDIC would essentially have a total preemption of state laws with regard to all FDIC-insured institutions. In such case, the question becomes how much would be left for the states?

Neil Milner, President of the Conference of State Bank Supervisors, is one of the most vocal advocates in favor of state bank rights. He argues that in order for state bank regulators to have more banks under their jurisdictions, they should offer lower fees than those of national regulators. Otherwise, complaining about

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299 See supra note 3.
300 Id.
308 Id.
309 See Blackwell, supra note 301, at 4.
unfairness on the part of national regulators will not improve anything. Mr. Milner says that "[i]t's OK for states to solicit national banks, and it's all right for Comptroller Hawke to solicit state banks for a national charter."310

In the competition for banks, an ill-chosen word can have the same incendiary effect it will have in a competition for votes. We will assume that a rational bank will generally select a regulator who is more agreeable, easier to work with. Is this the same thing as a 'race to the bottom,' a search for a regulator who is less inclined to enforce restrictive laws? If so, the concept of dual banking can be regarded as a dangerous structure.311 If we look again at the situation described above where the Marine Midland Banks switched its state charter to federal supervision in order to obtain approval for a sale of stock to a Hong Kong bank, this might be interpreted as a needed regulatory change or, conversely, as a race to the bottom type search for the more lenient regulator.312 One cannot be categorical about this. Occasionally we do see what looks like a race to the bottom, as when First Bank and Trust in Brookings, South Dakota, switched from a national to a state charter in order to make payday loans only to be met subsequently by an objection to the lending pattern by the state authorities.313 One’s judgment may be based in large part upon one’s political philosophy. In general, however, we are not inclined to see a general offering of leniency by either federal or state regulators as a blandishment to adopt their charters.314

Federal and state bank regulators will undoubtedly continue to compete for a bigger share of the banking business. The agencies cannot be faulted in competing for banks. The more banks under the respective agency’s supervision, the more power the agency will obtain and the more vitality will exist in the system.

IV. DE-FACTO END OF DUAL BANKING SYSTEM – ESSENTIAL IDENTITY OF STATE AND NATIONAL INSTITUTIONS

A. Variations but Essential Identity from the State Wild Card Statutes

State “wild card” statutes have as their common goal the ultimate grant of authority to state banks to do anything that federally chartered banks are authorized to do.315 They exist in 47 states.316 Sometimes the grant occurs automatically;

310 Id.
316 See Daniel Muccia, First Deputy Superintendent of Banks, Address to the New York Bankers
sometimes it requires enabling state action.\textsuperscript{317} Most "wild card" laws do not automatically grant state banks increased powers without some further action by some local state authority—typically the commissioner of banking.\textsuperscript{318} This officer will review the potential increase in authority and determine whether it is consistent with the desired standards of local banking.\textsuperscript{319} State legislators developed the "wild card" approach to make state banks competitive as well as to allow state legislators to save time and effort in amending their banking laws, when and if required.\textsuperscript{320} It is, however, incontestable that the wild card laws move state banks closer to national banks and consequently reduce the difference between the state and national banking systems.\textsuperscript{321}

Though some out-of-state banks may not be covered by a given "wild card" statute,\textsuperscript{322} a host state banking regulator may have discretion to provide substantive parity for out-of-state banks when operating under its home state law.\textsuperscript{323} The host state regulator might permit out-of-state banks to carry on activities subject to the charters of their home state laws. Through this type of device and the evolution of modern interstate branching laws, state bank charters will necessarily have a broad, not infrequently national, effect.\textsuperscript{324}

The home-state banking regulators of interstate banks, under multi-state supervisory and regulatory agreements and in order to provide the maximum parity with national banks for a state bank, are the primary regulators for all multi-state banks.\textsuperscript{325} Host-state banking regulators, on the other hand, may be correspondingly disposed to permit home state banking laws to obtain parity with federal banks.\textsuperscript{326}

Because it is to their advantage, the banking industry on the state level continuously supports legislation to extend the provisions of states' "wild card"


\textsuperscript{321} See Keith R. Fisher, Orphan of Invention: Why the Gramm-Leach-Bliley Act Was Unnecessary, 80 OR. L. REV. 1301.

\textsuperscript{322} For example, the wild card statutes of New York and Virginia appear by their terms to reach only banks chartered in those states.

\textsuperscript{323} Id.


laws. Such legislation grants state banking broad authority to maintain parity with national chartered banks. Such legislation also provides authority for the state banking authorities to seek the same parity for the state’s thrift institutions.

A state’s banking industry is composed largely of local and regional banks to which have been added since enactment of the Riegle-Neal Interstate Banking and Branching Act in 1992 branches of banks with home offices in other states. When aggregated, these banks represent substantial assets. For example, in 2007, the state of New York had almost $5 trillion of state banks assets and more than 300,000 New York employees. State banking agencies constantly amend existing state laws or add new ones in order to meet the needs of their banks and to keep up with the expanding powers of the national banks. Without such an approach to new legislation, charters of state banks might fail to keep pace with the powers of national banks, ultimately threatening the existence of a viable state bank system. It turns out, however, that the “wild card” device—while designed to enhance the power of the state banks—has the effect of unifying and consequently, ending the dual banking system.

In the last decade or so, the states banking departments have gone “wild” in passing “wild card” legislation. By 2006, 47 states had enacted some form of “wild card” law.

In order to remain competitive, state authorities have become innovative in their efforts. In the interstate branching context, state regulators work to secure some of the natural advantages that accrue to national banks. Acknowledging that national banks would likely be capable of operating under a single set of rules when branching interstate, state banking regulators obtain “parity” laws, providing that host state laws would apply to local branches of out-of-state state banks only to the same extent they would apply to an out-of-state national bank. State banking authorities also acknowledge that interstate branching might be faced with the need to deal with multiple state regulators. As federal-chartered banks

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328 See Lissa L. Broome & Jerry W. Markham, Banking and Insurance: Before and After the Gramm-Leach-Bliley Act, 25 IOWA J. CORP. L. 723.
report solely to the Office of the Comptroller of the Currency, state banking regulators have reached an understanding among themselves that the home state banking supervisors have the basic responsibility for supervising the interstate branches of their banks.  

Further, state banking regulators are seeking robust federal banking legislation, which would define the respective powers and responsibilities of home-state regulators and host-state regulators pertaining to the supervision of state banks branching interstate. In other words, states are looking to sort out their respective state banking laws by looking at the approach taken in the federal arena.  

Occasionally, in the course of implementation, “wild card” provisions conflict with existing state banking laws. For example, in New Jersey, there is a debate over a bank’s right to charge mortgage prepayment penalties.  

Banks and thrifts may not always be eager to exercise their new powers because of varying interpretations of “wild card” laws legislation. Banks in New Jersey say they could put themselves at a disadvantage by using the “wild card” laws to charge pre-payment penalties, which are illegal in the state. New Jersey and several other states have long banned pre-payment penalties. However, when New Jersey passed “wild card” laws (in 2000), banks and thrifts had the option to join federally chartered thrifts in imposing pre-payment penalties.  

Taking into consideration such lawsuits filed by consumers challenging the mortgage pre-payment penalties imposed by the New Jersey banks, the New Jersey Division of Banking ruled that although New Jersey laws have a general prohibition on pre-payment penalties, “state-chartered depositories may impose a reasonable pre-payment penalty in the same manner that their federal counterparts

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341 See Ali, supra note 340.
342 See Glukowski v. Equit One, Inc., 360 N.J. Super. 1, 9-12 (2003). The New Jersey Banking Association sought clarification about the conflict between state laws and “wild card laws” in mortgage pre-payment penalty. Id. The association filed a friend-of-the-court brief on behalf of a mortgage company, which was sued for charging a $1,400 mortgage prepayment penalty. Id. at 10. The plaintiff was Mark Glukowski, who in 1999 received a loan from Equity One Inc. of Marlton, New Jersey, which had a balloon payment in 2009. Id. at 9. In 2001, Mr. Glukowski sold the property and paid off the mortgage but was assessed a 2% fee on the principal balance of the loan. Id. at 10. The plaintiff argued the prepayment fees was in breach of New Jersey law, but a Law Division judge dismissed the case, saying that federal law preempted state law. Id. The New Jersey Appellate Court found, however, that there was no federal preemption. Id. at 12.
Most of the state bank regulators give state-chartered banks, but not state thrifts, permission to do whatever federal banks can do. Some state legislators, such as New York, are looking into ways to make the state’s “wild card” provisions automatic, so that such banks would not have to file an application to obtain the same powers as national banks. That New York intended to eliminate the differences between state and national banks through its “wild card” is demonstrated by the State Senate memorandum, which begins “The bill is designed to provide parity to State-chartered banks and trust companies, vis-à-vis national banks.”

Illinois is one of approximately 20 states, which under the “wild card” provisions permits both the state thrifts and state banks to enter activities similar to federally chartered banks or thrifts. Bankers in the state said that the “wild card” law levels the playing field between state and national banks. For example, Paul A. Pogue, the President and Chief Executive Officer of the North Adams State Bank in Ursa (Illinois) said “banks in more competitive markets will probably take advantage of the . . . [“wild card”] law first. I’m sure some will jump at this. I look at it as being good for banking,” he added.

The state of Illinois’ banking agency, under the “wild card” law, retained the right to prohibit banks from conducting an activity believed to be “unsafe,” therefore making the law ambiguous.

Under its “wild card” law, the Illinois state banking regulators have brought state-chartered banks closer to identity with national banks by according them new powers under the state’s “wild card” law including the right to offer credit analysis, real estate appraisal, bill collection, and title insurance. Scott D. Clarke, Assistant Commissioner of Banks and Real Estate of Illinois said: “This provides an excellent opportunity for state-chartered banks. They [state banks] want to provide the widest number of products to remain competitive.” What Illinois did, however, was reduce the vigor of the dual banking system.

Mississippi also has “wild card” law. Reflecting on a Mississippi state

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344 See Jackson, supra note 339.
346 See Damian Paletta, New York State Superintendent of Banks Diana Taylor; Dick Kovacevich, Wells Fargo & Co., 170 AM. BANKER 3 No. 14 (Jan. 21, 2005).
348 See Bill Banhart & Tim Franklin, Thompson Backs Regional Banking Bill, CHI. TRIB., Apr. 12, 1985.
court’s finding on state-chartered banks’ rights to sell insurance products, George Dale, the Commissioner of the State’s Insurance, said that the state has a “parity” law that gives state banks an equal footing with national banks.355 Kathleen W. Collins, counsel for the Financial Institutions Insurance Association of Mississippi, a trade group advocating banks’ right to sell insurance, said that “most states are not going to disadvantage their state banks. If they did many more state banks would apply for national charters.”356

In 1998, the Nebraska banking commissioner was the next state regulator to win “wild card” authority from his state legislature.357 By then, forty-one banking commissioners had already implemented “wild card” laws.358 Nebraska’s banking trade associations actively supported “wild card” law.359 Kurt T. Yost, the executive vice president of the Nebraska Independent Bankers Association, said: “It [“wild card” law] makes life easier for the state’s banks. It’s just a process that streamlines things.”360

In summer of 1997, the New York State Banking Department, one of the largest and most active state banking regulators in the country, adopted permanent regulations based on the provisions of a “wild card” banking bill, which passed in the last hours of the state legislative session.361 The “wild card” law, which permitted state-chartered banks to sell insurance, was the last bill approved for the session by the New York lawmakers, who, for the record, almost killed the bill, as the session of the State Assembly was near closing.362

The New York “wild card” law passed with one major change from the accord achieved between banking and insurance industries. That was that the “wild card” law contains a one-year sunset.363 The sunset could have been extended or shed, while the State Banking Department emerged with regulations, which would have been permanent, and built upon the “wild card” law.364 According to the New York Bankers Association, the State Banking Department, unlike the Insurance Department, obtained authority to approve the new activities and products for state-chartered banks under the “wild card” law, which established the state banks’ parity with national banks.365

357 See Laura Pavlenko Lutton, Nebraska Bill to Expand Bank Powers Advances, AM. BANKER, Mar. 17, 1999.
358 See Laura Pavlenko Lutton, Nebraska May Be in Line to Give Agency ‘Wild Card’ Authority on Charters, 163 AM. BANKER 2, No. 225 (Nov. 24, 1998).
359 Id.
360 Lutton, supra note 358.
361 See New York Banking Bill Passes with One-Year Sunset, 10 REGULATORY COMPLIANCE WATCH 1, No. 32 (Aug. 11, 1997).
362 The day of the closing of the New York State Assembly’s session was August 4, 1997.
363 See Amy S. Friedman, N.Y. Wild-Card Banking Bill Goes to Governor, NATIONAL UNDERWRITER, Aug. 18, 1997 (Life & Health/Financial Services Edition).
364 Id.
365 See supra note 285.
In summer 1998, a year after the initial “wild card” law, George E. Pataki, Governor of New York State, signed a two-year extension of the existing “wild card” statute.\(^{366}\) The statute empowered the State Banking Department to allow state banks to enter into new banking activities as long as those activities were permitted under a federal charter.\(^{367}\) The extension of the “wild card” statute was attained in part due to the persuasion of the New York bank regulators, who warned the state legislators that, if the state failed to extend the statute, most of the 180 state-chartered banks would switch to federal charter.\(^{368}\) In 1998 eight of New York’s ten largest banks held state charters.\(^{369}\) Facing the risk of losing business within the state, Governor Pataki said: “My [New York State] administration was determined to do everything in its power to assist state-chartered institutions in their quest to compete with banks regulated by the Comptroller of the Currency”\(^{370}\). What New York achieved, however, was a narrowing of the difference between state and national banks.

In 2000, the New York State legislators again extended the “wild card” statute for two years.\(^{371}\) The extension of the statute reflected the state regulator’s continuing fear of losing state-chartered banks to national-chartered bank regulator(s) (the OCC).\(^{372}\)

Before the existing “wild card” statute expired in 2003, New York legislators passed a bill, signed by Governor Pataki into law, further extending New York’s “wild card” statute for an additional four years.\(^{373}\) This law now covers state thrifts.\(^{374}\)

Since creation of a comprehensive “wild card” statute, the New York Superintendent of Banking has promoted and sustained regulations to further the comparability of state and national banks.\(^{375}\) As the President of the State Bankers Association testified in a speech to the State Assembly, the statute has given the Banking Department “the authority to grant parity to state banks . . . our comprehensive wild card law allows the Banking Superintendent to foster regulations to ensure a ‘level playing field’ for all State-chartered banking institutions with national banks.”\(^{376}\) In trying to ensure the survival of the state

\(^{366}\) See supra note 285.
\(^{368}\) See New York State Banks can now Sell Insurance Directly, PR NEWswire, June 4, 1998 (Financial News).
\(^{369}\) Id.
\(^{370}\) See N.Y. Extends ‘Wild Card’ Statute for 2 Years; Powers of State Banks, 163 AM. BANKER 2, No. 147(July 24, 1998).
\(^{372}\) See supra note 393.
\(^{374}\) Id.
banks, the legislature has in actuality provided the formula for their end.

In the late 1990’s, the state of Wisconsin also passed a “wild card” law. William D. Brouse, President and Chief Executive of the Wisconsin League, said: “As things kept going in Washington [D.C.], we said we should at least do what we can to protect state banks and thrifts in Wisconsin”. Under Wisconsin’s “wild card” provisions, state-chartered banks would be required to obtain permission to offer the same products and services as national banks. Wisconsin is one of many states working to revise its charter to conform to national banks as federal deregulation continues. The Wisconsin statute most closely resembles the universal charter Maine created in 1997. All state-chartered banks, savings banks, and thrifts in Maine have now equal powers.

In various states there has been a tendency by legislators to strip state bank regulator’s authority over “wild card” laws. For example, in early 1998, the Kansas state banking regulator fought fiercely with the state senate to prevent Senator Steffes’ proposal to eliminate the banking commissioner’s “wild card” authority. Under a commissioner’s order in 1995, state banks were permitted to create subsidiaries to invest in tax-exempt government securities. The Senator argued the move cost the treasury of the state of Kansas millions in tax revenue. This legislation proposal faced swift prevention efforts from the state’s Banking Commissioner, who said that if legislators take authority over “wild card” statutes away from the commissioner’s office, “every state bank in Kansas would switch to a national charter. Then the Legislature would have no control over banks in this state.” The Conference of State Bank Supervisors immediately reacted and stated that such action was the equivalent of “shooting a mosquito with cannon.” Fortunately, the bill never passed the Senate floor.

In conclusion, “wild card” statutes, while on their surface enabling state-chartered banks the opportunity to compete on a level playing field with federally chartered banks, have had the effect of reducing the differences between those two classes of banks leaving us with essentially one, not a dual, banking system.

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378 See id.
380 Id.
381 McConnell, supra note 379.
382 Id.
384 See John Hanna, Ex-Banker Riles Colleagues As Lawmaker, ST. LOUIS DISPATCH (Missouri), Apr. 18, 1999.
386 Kline, supra note 385.
B. The Federal Deposit Insurance Corporation Act of 1991

The activities of state banks are allowed only to the extent permitted by section 24 of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA"). Section 24 requires state-chartered banks to apply to the FDIC for permission to carry out state authorized activities beyond those granted by federally chartered banks. Section 24 does not apply to agency activities.

In the first years after enactment, implementation of Section 24 by state banks proved cumbersome. This is not because the FDIC denied applications to these banks. The truth of the matter is that applications filed with the FDIC took tremendous amounts of time getting through the bureaucratic system established to review applications. Further, the approvals involved only "innocuous practices" of no particular concern to either the state or the national systems.

With time, the FDIC improved its practice of handling state-banks' applications for "expanded" activities. Bankers at the state banking level expressed optimism about the innovative role the Act provided to state-chartered banks. For example, Neil Milner, the President and Chief-Executive-Officer of the Conference of State Bank Supervisors said "Modernization in our banking system has come from the state level... Section 24 has had a stifling effect on state innovations. Our citizens and the banking industry have suffered for it. These new rules encourage banks and states to innovate, while making sure the Bank Insurance Fund is safe."

Among state banking regulators there is a belief that restrictions on banking activities of the state-chartered banks, as provided under Section 24, seem to unduly interfere with the authority states traditionally exercised over their banks. Since inception, the Act was expected to greatly reduce unnecessary regulatory burden on state-chartered banks, making it much easier for state-chartered banks to enter into banking activities allowed under state law. Nevertheless, since its inception and despite promulgation of the newer regulations, the FDIC has continued on its "innocuous" road and has approved nothing that might dynamize the state banking system. Along with the "wild

388 Id.
390 Id.
391 In fact, the FDIC approved the vast majority of the applications filed by state banks.
393 See id.
395 See supra note 395.
card" statutes, Sec. 24 of FDICIA has had the ultimate effect of unifying the state and the federal banking systems.\textsuperscript{399}

Consistent with the homogenization of state and national banks, FDICIA Section 24 has given the FDIC authority over out-of-state state bank branches as well as branches in the state under consideration.\textsuperscript{400} The FDIC has attempted to establish complete and clear guidance on the application of home state law to interstate branches of state banks.\textsuperscript{401} The role of states as a "laboratory of innovation" in banking may thus ultimately be seen as presently governed by the FDIC under FDICIA section 24.\textsuperscript{402}

According to a 2002 speech by the FDIC Chairman, "applications reviewed by the FDIC have not been in the category of what you'd call pushing the envelope."\textsuperscript{403} Most of the state bank-applicants have requested FDIC authority to invest in securities or to conduct real estate investment and development.\textsuperscript{404} And the bulk of those activities were essentially continuations of non-controversial activities begun before enactment of FDICIA.\textsuperscript{405}

\textbf{C. Gramm-Leach-Bliley Applies Equally to State and Federal Bank Holding Companies}

The Gramm-Leach-Bliley Act ("GLBA")\textsuperscript{406} aims at modernization of the financial services industry by removing regulatory barriers established in the post-Depression period of the 1930's. The Act permits banks, through their financial holding company structures, to engage in a series of new activities, including insurance and securities underwriting activities.\textsuperscript{407}

\textsuperscript{399} See Anne M. Taylor, \textit{The FDIC's Enhanced Powers Over Savings Associations: Does Firrea Make it "Safe"?}, 59 FORDHAM L. REV. 381.


\textsuperscript{401} See 12 U.S.C. 1831a(j).


\textsuperscript{403} See Don Powell, Chairman, Fed. Deposit Ins. Corp., Remarks at the Annual Meeting of the Conference of State Bank Supervisors (May 30, 2002) available at http://www.fdic.gov (under Speeches, Testimony & Articles Section) at http://www.fdic.gov/news/speeches/archives/2002/sp30may02.html. The FDIC has approved the requests of some banks to carry out activities, which are somehow unusual. \textit{Id.} For example, in 1994 on bank received the federal agency's approval to purchase a business, which tests personality characteristics and leadership skills. \textit{Id.} Also, in 1994 another bank received approval from the agency to engage through its subsidiaries in the business of printing services and in the production of microfilm. \textit{Id.} In 1996, another bank got the agency's permission to acquire a subsidiary with only one non-cash asset, a steel mold used in the process of bending and installing cable wire. \textit{Id.}


\textsuperscript{407} \textit{Id.}
Under the provisions of the GLBA, commercial banks, insurance companies and securities firms are able to affiliate or merge among themselves, activities that were highly restricted under pre-GLBA law. The GLBA accomplishes this goal by formation of the financial holding company structure ("FHC"), whose subsidiaries may carry out activities, which are either "financial" in nature, "incidental" to such activities or "complementary" to a financial activity.

The GLBA allows firms which control banks and that meet certain regulatory requirements to become FHCs and to create non-banking subsidiaries. By March 2000, there were almost 150 state and federal bank holding companies ("BHC") authorized by the Federal Reserve Board to become FHCs. By 2003, the number of BHCs electing to become FHCs was approximately 630.

The GLBA’s treatment of state banks is essentially comparable to its treatment of national banks. Under the GLBA, there is no longer any reason to believe that things will be done differently at the state banking or holding company level as contrasted with the federal level; nor is there a relative benefit in selecting a national or a state charter. Here again the traditional dual banking system may be said to be inoperative.

The Federal Reserve Board is the overall supervisor for bank holding companies and for the GLB-created FHCs. There is no regulatory distinction between a holding company created within the federal or the state systems. Under its “streamlined” supervision, the Fed focuses on the consolidated risk position of the entire holding company while relying on information from supervisors of its components.

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With appropriate state permission, state banks may engage in those activities allowed to financial subsidiaries of national banks. Yet to be sorted out is the extent to which the FDIC may continue to permit state banks, authorized by state law, to engage in principal activities under Section 24 of the FDIC without being subject to any of the GLBA restrictions imposed on "financial subsidiaries."

Our conclusion is that the Bank Holding Company Act (as amended several times most importantly by Gramm-Leach-Bliley in 1999) is itself an argument against the dual banking system in that it treats national and state banks in essentially the same manner.

V. SUPPORTS FOR DUAL BANKING SYSTEM

A. In restricting state bank activities to those authorized for national banks, the restriction of FDICIA applies only to the state activities conducted as principal—not as an agent. It thus leaves such agency activities as selling insurance untouched. As a first comment, however, the ability to conduct business as an agent seems too weak a reed to support the massive dual banking system. There is just not enough there to justify the structure.

It does have some validity, however, since agency businesses may be conducted in state banks outside FDICIA and unaffected by FDICIA. In other words, it is only through use of the dual banking system that banks could conduct such businesses at all.

This argument had vitality up to the enactment of the Gramm-Leach-Bliley Act in 1999. Indeed, substantial and flourishing agency businesses were created despite FDICIA in 1992. However, upon enactment of GLB in 1999, the agency dual banking prop largely disappeared. The invention of the financial

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419 See John B Beaty & Ronald R. Glance, Financial Institutions Options, Venable LLP, Jan. 2000 available at http://www.venable.com/publications.cfm?action=view&publication_id=495&publication_type_id=2. The GLBA imposes fewer restrictions on the financial subsidiary of a state bank than on the financial subsidiary of a national bank. Id. Although to qualify to hold a financial subsidiary, the state bank must be well capitalized and meet CRA requirements, there is no requirement that it be well managed. Id. Unlike national banks, state banks have no limitation on the total amount of investments they make in financial subsidiaries. Id.
422 See Gilbert, supra note 401.
423 See Lissa L. Broome and Jerry W. Markham, Banking and Insurance: Before and After the Gramm-Leach-Bliley Act, 25 IOWA J. CORP. L. 723 (2000)
427 See Keith R. Fisher, Toward A Basal Tenth Amendment: A Riposte To National Bank
holding company in GLB with its newly- permissible businesses left the business of banking—or, more accurately in light of GLB—financial institutions, vastly expanded.428 One cannot now find an agency-based business that cannot be conducted in a financial holding company whose basic power is to conduct any business that is "financially related."429

B. There is a circular argument that supports the dual banking system because it is there. There are, after all, national banks and national regulators and state banks with their regulators. This is the system in place. It entitles banks to move from one regulator to another more or less at will and based upon perceptions of current need. Upon consideration, it appears, however, that this is not a justification for a system, but rather the use of a system. Wherever there are two individuals (or entities) doing a job there may be some rationale for going from one to another. Indeed, inside either the national or state systems now, one can move from control by Mr. X in one state to Ms. Y in another. That one may be more cooperative than the other does provide a reason for the move, but it is not a reason for a system putting more than one regulator at a client's disposal.

If we reconsider the Marine Midland Banks situation430 we observe a state bank taking a national charter because the state banking superintendent was not cooperative.431 How do we know, however, that if it perchance had started as a national bank it would not have had an uncooperative federal regulator to be junked in favor of the state equivalent.432 Would we justify two SECs or FCCs so that a regulated entity could switch from one regulator to another? That is, however, what is frequently said in favor of the banking system.433

C. We have mentioned the power of the FDIC to approve state bank activities beyond those of national banks under FDICIA when the FDIC judges that the FDIC "has determined that the activity would pose no significant risk to the appropriate deposit insurance fund; and . . . the State bank is, and continues to be, in compliance with applicable capital standards."434 We have also mentioned how the FDIC has moved very slowly and cautiously in the exercise of this function.435 It has commented upon this itself.436 In no way can the FDIC's

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430 See Gilbert, supra note 401.
The FDIC’s approval of applications for state bank authority to exceed a national bank’s authority under Sec. 24 of FDICIA may be read at the FDIC website under “Regulations & Examinations>Laws & Regulations>Decisions on Bank Applications.” There are several dozen of these approvals. Many of them deal with the continuation of authorities granted or assumed before passage of FDICIA. Some deal with the authority to develop a specific piece of real estate acquired adjacent to the bank premises before authority was a problem. A number themselves limited by firewall limitations and restrictions that assure the limited authority granted.

They all deal with minor and limited issues of law and could not be seen as the nascence of a dual banking system.

To get an idea of this pattern, some decisions randomly chosen are summarized here. They are designed to show by example that the conduct of business that allowed to national banks does not sustain a second banking system.

In re: S&T Bank Indiana, Pennsylvania Approval was granted to (i) invest through a wholly-owned subsidiary in stock of Pennsylvania trust companies, bank holding companies; savings associations and savings and loan holding companies and (ii) to retain stock in out-of-state bank holding companies which represent an investment originally made in a Pennsylvania institution but which, through merger, became an institution outside Pennsylvania. Six firewalls restrain the investment. One provides that there shall be no further investment in the subsidiary without the approval of the FDIC regional director.

Barretville Bank & Trust Company, Barretville, Tennessee Approval was granted for the bank to continue to hold an equity investment previously acquire

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440 See Federal Deposit Insurance Corporation, supra note 440.
441 Id.
443 See supra note 431.
445 See Federal Deposit Insurance Corporation supra note 440.
446 See Federal Deposit Insurance Corporation supra note 440.
447 See Federal Deposit Insurance Corporation supra note 440.
through a to-be-established wholly-owned subsidiary.449

Seven Maine Banks.450 Approval was granted for seven Maine banks to acquire through majority owned subsidiaries a three percent minority interest in a private mortgage reinsurance company organized under the laws of the Turks Caicos Islands, British West Indies.451

Central Carolina Bank and Trust Company Durham, North Carolina.452 Approval was granted for the Durham bank to hold all the stock in Sprunt Insurance Company to be organized under the laws of the British Virgin Islands. Sprunt will sell only reinsurance.453 Six firewalls include the requirement that Sprunt be operated in accordance with law.454 The FDIC will retain the ability to assess the impact of Sprunt’s operations on the state bank.455

First State Bank of Pineville, Kentucky.456 The bank entered into a guaranty agreement before enactment of FDICIA.457 Approval was given to continuation of the guaranty.458

Mutual Savings Bank Milwaukee, Wisconsin.459 Land contiguous to the head office of the bank was purchased before enactment of FDICIA.460 One lot was to be held for use in future expansion.461 The bank received approval to hold the remaining property in order to conduct an orderly distribution.462

VI. THE DUAL BANKING SYSTEM SHOULD BE ENDED DE JURE AS WELL AS DE FACTO

A. Great Simplification at No Real Price

We have attempted to demonstrate that, despite its presence in the printed word, in the process of employment and the formation of associations, there is no realistic dual banking system in existence. Where a concept so loses its function, it

449 See Federal Deposit Insurance Corporation, supra note 440.
451 See Federal Deposit Insurance Corporation, supra note 440.
453 See id.
454 See id.
455 See id.
457 See id.
458 See id.
460 See id.
461 See id.
462 See id.
makes good sense to provide for its de jure in addition to its de facto end.

Bankers complain regularly about the unnecessary complexity of the regulatory system but do not seem to appreciate that turning the so-called dual system into a single regulatory approach to banking can yield obvious simplifications the price for which has already been spent.\textsuperscript{463}

It is strange that there is no proposal along these lines. One would expect committee hearings to be held in Washington and conferences held among bankers to explore the idea. We believe these should occur.

\textit{B. A Federal System Would Be a Better System}

We need not take sides on which would be the better system, national or state. Undoubtedly a certain political timorousness at even addressing this question has made discussion in Washington unlikely. We do believe, however, that a single national banking system would be preferable. Banks are, of course, growing larger and covering more states. Legal considerations affecting them would be simpler and more apparent if we had a single juridical approach. The artificial boundaries of the states would no longer present a confusion of overlapping laws together with the need to apply them to banks both large and small.

No one wants to commit economic suicide and we can anticipate a fierce resistance from the state banking authorities (and perhaps the national authority too) at even considering the issue, let alone resolving it.

\textit{C. State Representatives Can Continue to Represent Consumers without a Dual Banking System}

We began this article with a description of an argument currently being waged over issues of preemption in consumer representation.\textsuperscript{464} We observed that the dual banking system is being forced into the argument without good reason. The allocation of responsibility for consumer protection between state and national authorities will continue to exist—and there will probably be arguments about its proper placement—whether or not there is dual banking.\textsuperscript{465} Consumer protection at the state level does not depend upon a state banking system.\textsuperscript{466} State officials committed to the protection of their consumers will continue to exist whether or not there is a state banking system. The two are not interdependent.\textsuperscript{467}


VII. Conclusion

The dual banking system is an illusion. It is both expensive and useless. This should be recognized and the dual system reduced to one.