

April 15, 1974

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MEMORANDUM FOR MR. WILLENS

Re: Marianas Banking

Attached is a memorandum submitted to Bob Kelley for inclusion in his summary of the United States Code. In the interest of brevity, it is oversimplified almost to the point of uselessness; unfortunately bank regulation is an area where the details and nuances are of critical importance.

As I suggest in the memo, however, Guam et al. presently have the best of all feasible alternatives; both local and national banks are permitted. All banks in such areas have full flexibility with respect to Federal Reserve membership, and U. S. banks are permitted to have branch offices in such areas. As is the case in the tax area, however, I do not think the legislative climate would permit creation of a "banking haven" in the Marianas. You will recall that at a much earlier point we discussed the possibility of establishing a system on the European model: i.e. commercial banks which would be permitted to accept demand deposits yet engage in underwriting and other investment banking activities. However, both the Senate and the House have relatively active studies concerning the continued

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desirability of the securities restrictions. I do not believe they would be willing to prejudice such studies by adopting different rules in legislation for the Marianas.

I hope we can discuss these matters before you leave.

RAG

April 15, 1974

MEMORANDUM FOR MR. KELLEY

Re: Federal Banking Laws

Title 12 includes, inter alia,^{*/} most provisions of Federal law concerning bank regulation. Subjects covered include chartering and operation of national banks, insurance of bank deposits, and establishment of, membership in, and operation of the Federal Reserve System. Three agencies perform these functions: the Board of Governors of the Federal Reserve System ("FRB") and the Federal Deposit Insurance Corporation ("FDIC"), both "independent" agencies and the Office of the Comptroller of the Currency (the "Comptroller"), a "bureau" of the Treasury Department.

The regulatory systems these agencies administer are, for two reasons, complex and overlapping. The first source of confusion is the tradition of a "dual system" of banking in the United States: commercial banks, all of which perform the same function, may be chartered as national banks by the Comptroller or as state banks under state law. Both types of banks are, however, subject to pervasive Federal regulation.

Moreover, Congress has never addressed the question of bank regulation in a comprehensive manner.

^{*/} Legislation relating to the role of commercial banks in certain aspects of housing finance is codified in Title 42.

Instead, legislation has taken two forms: restrictive "band aid" measures addressed to a particular abuse, or a broadening of bank authority to serve an unrelated political objective.

The Federal Agencies

Set forth below is a summary of the principal functions of the Federal bank regulatory agencies:

1. Comptroller. Chartering of national banks. Supervision and regulation, including the conduct of detailed examinations of each national bank three times every two years and approval power over branching and national bank mergers. The Comptroller (a presidential appointee) is one of three members of the FDIC board.

2. FRB. Administration of the Federal Reserve System, a mechanism which facilitates check clearing, funds transfer and borrowing between and among both national and state banks. Membership in the system is mandatory for national banks and optional for state banks. ^{*/} Exercises supervisory and regulatory authority over state bank members ("state member banks") similar to Comptroller's authority over national banks.

3. FDIC. Two functions: insures deposits in all banks; supervision and regulation of state banks which are not state member banks.

*/ Approximately 60% of U. S. Banks are members.

Fundamental Substantive Considerations

All banks, national or state, may engage in similar banking functions -- e.g. demand and time deposits, loans, trust services (if special authority is obtained), underwriting and dealing in general obligations of Federal, state and local governments, etc. All banks are prohibited from underwriting and dealing in securities (other than as described above) and from paying interest on demand (checking) deposits. To preserve the "doctrine of competitive equality" ^{*}/ branching powers of national banks are governed by state law. 12 U.S.C. § 36.

The principal differences which do exist are not between national banks and state banks as such, but between members of the Federal Reserve System (all national and some state banks) and non-members. As noted above, approximately 40% of the 14,000 U. S. banks are non-members. Non-members are denied access to the borrowing facilities and certain other services of the twelve regional Federal Reserve Banks and members are restricted in the size of transactions they may engage in with non-members. As a practical matter, these restrictions make membership mandatory for any large bank.

Many smaller, locally-oriented, banks, however, view one aspect of membership -- the "reserve requirement" --

*/ First National Bank in Plant City v. Dickinson, 396 U.S. 122 (1969).

as outweighing the benefits of access to the System. Each member is required to maintain on deposit with its local Federal Reserve Bank a portion -- which ranges from 13 to 17 percent -- of its customers' demand deposits. While prudent banking clearly requires the maintenance of some funds in fully liquid cash, current reserve requirements exceed these levels of prudence. Instead, the FRB-imposed requirements are a means of effecting monetary policy and, in addition, a source of funds for each Federal Reserve Bank's own banking operations.^{*/} Non-members are free to lend or otherwise invest any of their funds above the prudent cash level.^{**/}

Bank Regulation in the Territories^{***/}

Existing law affords slightly greater flexibility to territorial banks than is available to banks in the United States. Charters may be issued by local authorities; national

^{*/} A discussion of the structure and operations of the twelve Federal Reserve Banks is beyond the scope of this memorandum. To oversimplify, however, it can be said that the Reserve Banks are the banks for privately held banks.

^{**/} Contending that its ability to control monetary policy is severely hampered, the FRB perennially seeks authority to impose reserve requirements upon non-members. Support for such legislation is growing and enactment may be possible in the next Congress.

^{***/} Federal banking law is uniform with respect to Guam, Puerto Rico, the Virgin Islands and other possessions and territories. The term "territories" will be used collectively to refer to all such political entities.

banks are also expressly permitted.^{*/} FDIC insurance is available to all territorial banks. FRB membership is optional, for both local and national banks.^{**/} Territorial banks are supervised and regulated by one of the three Federal agencies, pursuant to the same division of responsibility which applies to domestic banks. The prohibitions against securities activities and interest on demand deposits apply to territorial banks.

Domestic banks are permitted to operate branches and other banking operations in the territories.^{***/} However, permission to engage in such activities must be obtained from the FRB which, as a practical matter, has respected strong expressions of local policy in opposition to such intrusions.

Conclusions and Recommendations

It would not appear feasible to seek different treatment for banking in the Marianas. The most meaningful drawback of existing law is the restriction on securities activities. Sound arguments can be made for permitting broader bank participation in the securities markets and there is little doubt that any such broader authority would be most useful in attracting capital to the Marianas. However, both the Senate and House are in the early stages of a re-evaluation of all existing securities restrictions,

^{*/} 12 U.S.C. §§ 40-42.

^{**/} See 12 U.S.C. § 466. Non-member national banks are, however, subject to a 15 percent reserve requirement. 12 U.S.C. § 143.

^{***/} 12 U.S.C. §§ 601-605.

and the pendency of these studies would probably preclude the enactment of special rules for the Marianas.

RAG