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The McFadden Act: A Look Back

It has been 56 years since the Congress enacted the 1927 McFadden-Pepper Act, which included an implicit prohibition of interstate branching by commercial banks. Many of the arguments that surfaced during the five year debate over the Act and subsequent key amendments are again appearing.

The recent manifestations are propelled by the inexorable march of technological and market developments that have steadily undermined barriers to interstate banking per se. This "Look Back" is designed to provide a historical perspective to the debate that resulted in the effective preclusion of interstate branching by commercial banks in the McFadden Act.

Some background

In 1910, California and eleven other states explicitly permitted at least some intra-state branching while nine state specifically prohibited it. By 1924, the number of states permitting some form of branching had risen to 18, while the number prohibiting it also rose to 18. The ambivalence toward branching represented by these statistics prevailed on the national level as well, although with the added issue of inequitable treatment of state-chartered and national banks. National banks, unlike their state-chartered counterparts, had never been permitted to open branches. The National Banking Act of 1863 made no mention of branch banking whatsoever, and this omission was construed by the Comptroller, the Treasury and the Supreme Court as a prohibition.

Two concerns, therefore, shaped the debate over the McFadden-Pepper Act: the potential anti-competitive effects of branch banking and the dual system of regulating banks. These continue to influence discussions of branching deregulation and, now, just as before, the actions of state governments may force the hand of Congress.

Federal Reserve Board views

In 1922, Congressman Louis T. McFadden (R-Pa), a former bank President, introduced a bill that would allow national banks parity with state banks in establishing branches. But the bill encountered strong opposition and failed to move. At about the same time, Comptroller of the Currency and Board member, D.R. Crissinger, became increasingly worried over the competitive disadvantage placed upon national banks by the prohibition on branching. Unsuccessful in his efforts to get the Congress to adopt remedial legislation, he issued a ruling that national banks could establish agencies, teller windows or additional offices within the city of the parent bank for the purpose of accepting deposits and cashing checks, *provided* that state banks were permitted by state law to operate branches in that state.

Crissinger contended that the additional offices were not branches inasmuch as they were not authorized to make loans, a ruling that triggered a storm of protest, including a blistering anti-branching resolution adopted by the ABA.

At this point, the Federal Reserve Board, which had been sympathetic to branch banking, reversed its attitude. Although National Banks constituted the backbone of the Federal Reserve System, a majority of the Board concluded that the best way to ease these banks' competitive disadvantage in states that permitted state-chartered banks to branch was not to allow branching by national banks, but to circumscribe branching by state *member* banks. The chief advocate of this view was the new Comptroller of the Currency (and Board member), Henry Dawes, who, in testimony to Congress, asserted that "Branch banking, unless curbed, will mean the destruction of the national banks and thereby the destruction of the Federal Reserve System..." Consequently, in a 4-3 vote on November 1923, the Board

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adopted a resolution designed to stop the spread of branching outside home cities and immediately contiguous areas.

Dissent

This remarkable inducement to non-membership by state banks in states with liberal branching laws was roundly assailed by Vice Chairman Edmund Platt in the first dissenting opinion of record in the Board's ten year history. Platt not only questioned the legality of the resolution but sharply criticized the majority's actions to discourage, rather than encourage, branch banking. He cited the great success of branch banking in California (where A.P. Giannini's Bank of Italy then counted 61 branches serving 42 communities) and branch banking's particular contribution to the agricultural sector of the Golden State's economy.

But notwithstanding Platt's strong dissent, Comptroller Dawes had his deputy draft a bill which generally embodied the Board's anti-branching resolution. The measure was introduced into the House Banking Committee in 1924 by Congressman T. McFadden. In addition to various provisions that broadened the deposit and lending powers of national banks, Section 9 stipulated that any state bank entering the System after enactment could not retain its existing statewide branches, and that while present state member banks could retain all existing branches, they could not establish additional branches outside their home city. National banks received severely limited branching authority in their home cities based on the size of the cities' population, but in all cases, branching authority was predicated upon the grant of such authority to state banks by state law.

McFadden, meet A.P. Giannini

In the summer of 1924, Congressman McFadden visited California and in a subsequent letter to A.P. Giannini, characterized the state's branch banks as "splendidly managed" and serving the public needs "in a thoroughly bankable way." But his views had no effect upon a sizeable majority of his Banking Committee colleagues, including Congressman Hull of Chicago, who secured the adoption of more restrictive ABA-endorsed branching amendments when the bill again came up for consideration. These included stipulations designed to head-off branching by any national or state member banks in the states which might permit branching in the future.

The amended bill passed the House on January 24, 1925, but in the Senate, encountered the strong opposition of Senator Carter Glass, the Virginia Democrat who had been the principal author of the Federal Reserve Act and who was a staunch advocate of branch banking. The Banking Committee struck the Hull amendments, and the bill lapsed upon adjournment. However, like Dracula rising from his coffin, the bill was not completely dead.

Trying again

When the 69th Congress convened in December 1925, Congressman McFadden re-introduced his bill. It again passed the House with the Hull amendments only again to encounter the opposition of Senator Glass and the Senate Banking Committee.

In the meantime, Comptroller Henry Dawes resigned and was replaced by Joseph W. McIntosh, a staunch advocate of branch banking after a visit to California in 1924. As a result, majority sentiment on the Federal Reserve Board again shifted in favor of branching by national banks. Moreover, the prospects of the McFadden bill, even with core features that significantly enhanced the deposit and lending powers of national banks, had not forestalled a substantial shift from national to state charter—166 in the previous year alone.

In any case, Glass and the Senate Banking Committee again rejected the Hull amendments in favor of the original Section 9 provisions, but this time they allowed any state banks subsequently joining the System to

MONETARY POLICY OBJECTIVES

Federal Reserve Board Chairman, Paul Volcker, presented a mid-year report to the Congress on "Monetary Policy Objectives for 1983" on July 20. The report included a summary of the Board's monetary policy plans for the rest of 1983 and 1984, along with a review of economic and financial developments in 1983. Single or multiple copies of the report are available upon request from the Public Information Department, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, CA 94120. Phone (415) 974-2246.

retain any branches acquired *prior* to the law's enactment. The bill passed, but subsequently died in Conference Committee after bitter wrangling with the House members, who insisted that the highly restrictive Hull amendments be restored.

Take that sir...

When the Congress reconvened in December, Congressman McFadden once again submitted his bill (H.R. 2) without the Hull amendments, and it passed the House on January 24, 1927. What had helped turn the tide was the growing number of bank failures (almost 1,000 in the previous year, and almost 3,900 since 1921), of which the overwhelming majority were unit banks.

Influenced in part by this consideration and by the more positive thrust of Senator Glass' amendments as compared with the highly restrictive Hull amendments, and perhaps influenced as well by the sunny Los Angeles climate where it was holding its convention, the ABA voted to endorse the revised bill.

Nevertheless, the measure now encountered stiff opposition in the Senate where Senator Glass and Montana's Burton K. Wheeler (D), a strong opponent of branch banking, at one point escalated their rhetoric into near fisticuffs. In the face of a threatened filibuster by Senator Wheeler and the bill's opponents, closure on debate was invoked—the first time ever in the history of the Senate on a domestic issue—and the bill was passed. The McFadden-Pepper Act was signed into law by President Coolidge on February 25.

Banking Act of 1933

It remained for the Glass-Steagall Banking Act of 1933 to rectify the disparate treatment of national and state member banks (and of both in relation to non-member banks). The circumstances which gave rise to the change involved nothing less than the collapse of the nation's economy in 1929. Between that year and 1933 there were some 9,400 bank failures nationally, the overwhelming majority representing unit banks. By 1932, 23 states permitted branch banking (five more than in 1923), although 18 still specifically prohibited it. To a considerable extent, it was the relative strength of branch banks that inspired the provision in the Banking Act of 1933 amending the McFadden-Pepper Act to allow national banks to operate branches wherever permitted state banks by state law.

The liberalized amendment to the McFadden Act and the relatively good performance of branch banks in the Depression contributed to an increase from 23 in 1932 to 35 by 1936 in the number of banks allowing at least some branching, and an attendant drop from 18 to 9 in the number that continued specifically to prohibit it.

Past is prologue

Today, 22 states and the District of Columbia permit statewide branching and another 18, limited branch banking, while unit banking is prevalent in 11 states. Nevertheless, the Independent Bankers Association remains deeply concerned over the potential implications for local control and economic concentration of interstate branching and banking per se.

In none of the states that limit or prohibit branching by commercial banks are the same limits imposed on thrifts or other financial intermediaries. And looming ever larger in the competition for funds and other traditional banking-type services are the conglomerates, such as Sears-Allstate-Dean Witter-Coldwell Banker and Prudential-Bache, that are not subject to the various interstate restrictions of the McFadden Act.

Increasingly, it is the burgeoning growth of these entities subject to yet another system of regulation that are calling into question the usefulness of the McFadden Act as an "umbrella" protecting local banks from the gales of interstate competition.

Verle B. Johnston

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 8/3/83	Change from 7/27/83	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	162,010	− 467	507	0.3
Loans (gross, adjusted) — total#	140,816	− 329	− 523	− 0.4
Commercial and industrial	43,715	189	− 825	− 1.9
Real estate	56,265	58	− 1,197	− 2.1
Loans to individuals	24,101	0	707	3.0
Securities loans	2,414	− 272	− 376	− 13.5
U.S. Treasury securities*	8,022	− 154	1,783	28.6
Other securities*	13,171	16	− 753	− 5.4
Demand deposits — total#	42,777	2,566	2,021	5.0
Demand deposits — adjusted	29,418	540	1,660	6.0
Savings deposits — total†	66,701	531	35,564	114.2
Time deposits — total#	65,793	28	− 33,835	− 34.0
Individuals, part. & corp.	60,317	180	− 29,882	− 33.1
(Large negotiable CD's)	18,135	− 290	− 19,292	− 51.5
Weekly Averages of Daily Figures	Week ended 8/3/83	Week ended 7/27/83	Comparable year-ago period	
Member Bank Reserve Position				
Excess Reserves (+)/Deficiency (−)	128	73	60	
Borrowings	122	98	76	
Net free reserves (+)/Net borrowed(−)	7	− 25	− 16	

* Excludes trading account securities.
# Includes items not shown separately.
† Includes Money Market Deposit Accounts, Super-NOW accounts, and NOW accounts.

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