The National Banking System

The National Bank Acts 1863, 64 & 65

The National Bank Act of 1863 was designed to create a national banking system, float federal war loans, and establish a national currency. Congress passed the act to help resolve the financial crisis that emerged during the early days of the American Civil War (1861–1865). The fight with the South was expensive and no effective tax program had been drawn up to finance it. In December 1861 banks suspended specie payments (payments in gold or silver coins for paper currency called notes or bills). People could no longer convert bank notes into coins. Government responded by passing the Legal Tender Act (1862), issuing $150 million in national notes called greenbacks. However, bank notes (paper bills issued by state banks) accounted for most of the currency in circulation

Through the National Bank Act, Congress sought to achieve both short- and long-term goals. One crucial objective was to generate cash desperately needed to finance and fight the Civil War. After prospective national bank organizers submitted a business plan and had it approved by the OCC, they were required to purchase interest-bearing U.S. government bonds in an amount equal to one-third of their paid-in capital. Millions of much-needed dollars flowed into the Treasury in this manner.

But the national banking system was also designed to achieve longer term economic goals. Under the new system, the purchased bonds were to be deposited with the Treasury, where they were held as security for a new kind of paper money: national currency. Bearing the name of the issuing national bank and the signatures of its officers, these notes were otherwise identical in design, size, and coloration. Anyone holding a national bank note could present it for redemption in, gold or silver coin, at the issuing bank or at reserve banks around the country. If, for whatever reason, the issuing bank was unable to meet the demand for cash redemption, the system was set up so that the government could sell the bank's bonds and pay off the noteholders directly. Once accepting and holding national currency became essentially risk-free, it gained in public confidence and circulated throughout the nation. This represented a marked improvement over the pre-Civil War money supply, which had involved thousands of different varieties of paper money issued by local banks, rampant counterfeiting, chronic uncertainty about the value of paper money, and, as a result, difficulty conducting private business. Through the more orderly national money and banking system, Congress sought to promote economic growth and prosperity and a stronger sense of American nationalism.

Shortly after the turn of the 20th century, the country adopted a new currency system based on Federal Reserve notes, which were obligations of the government rather than individual banks. With that change, national currency faded in importance, and the OCC's mission focused increasingly on the safety and soundness of national banks.

The Dual Banking System

The founders of the national banking system envisioned it becoming the country's only banking system, a system operating under a single set of rules and uniform oversight provided by the OCC (Office of the Comptroller of the Currency). To that end, the National Bank Act encouraged existing banks to join the new system and penalized banks that chose to continue operating under state authority. But many bankers preferred the more relaxed rules and oversight of the states and state authorities were loath to relinquish control over these institutions. A compromise thereby evolved under which states continued to supervise the banks they had chartered, but with additional oversight and support contributed by the Federal Reserve and the Federal Deposit Insurance Corporation. It is said that the United States has a "dual" banking system in which regulatory responsibility is shared between the federal government and the states.