Lecture 21 will use the following transparencies.
Historical Development of the Banking Industry

Outcome: Multiple Regulatory Agencies
1. Federal Reserve
2. FDIC
3. Office of the Comptroller of the Currency
4. State Banking Authorities
### Table 1
Size Distribution of Insured Commercial Banks, September 30, 1999

<table>
<thead>
<tr>
<th>Assets</th>
<th>Number of Banks</th>
<th>Share of Banks (%)</th>
<th>Share of Assets Held (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $25 million</td>
<td>1211</td>
<td>14.0</td>
<td>0.4</td>
</tr>
<tr>
<td>$25–$50 million</td>
<td>1851</td>
<td>21.5</td>
<td>1.2</td>
</tr>
<tr>
<td>$50–$100 million</td>
<td>2179</td>
<td>25.3</td>
<td>2.8</td>
</tr>
<tr>
<td>$100–$500 million</td>
<td>2693</td>
<td>31.2</td>
<td>9.8</td>
</tr>
<tr>
<td>$500 million–$1 billion</td>
<td>296</td>
<td>3.4</td>
<td>3.7</td>
</tr>
<tr>
<td>$1–$10 billion</td>
<td>314</td>
<td>3.6</td>
<td>15.9</td>
</tr>
<tr>
<td>More than $10 billion</td>
<td>77</td>
<td>0.9</td>
<td>66.1</td>
</tr>
<tr>
<td>Total</td>
<td>8621</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

**Ten Largest U.S. Banks**

<table>
<thead>
<tr>
<th>Bank</th>
<th>Assets ($ billions)</th>
<th>Share of All Commercial Bank Assets (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Bank of America, National Association, Charlotte, N.C.</td>
<td>563.23</td>
<td>10.48</td>
</tr>
<tr>
<td>2. Citibank, N.A., New York</td>
<td>312.61</td>
<td>5.82</td>
</tr>
<tr>
<td>3. Chase Manhattan Bank, New York</td>
<td>299.39</td>
<td>5.57</td>
</tr>
<tr>
<td>4. First Union National Bank, Charlotte, N.C.</td>
<td>220.67</td>
<td>4.11</td>
</tr>
<tr>
<td>5. Morgan Guaranty Trust Company of New York, New York</td>
<td>160.56</td>
<td>2.99</td>
</tr>
<tr>
<td>6. Bank One, National Association, Chicago</td>
<td>85.93</td>
<td>1.60</td>
</tr>
<tr>
<td>7. Wells Fargo Bank, National Association, San Francisco</td>
<td>85.71</td>
<td>1.59</td>
</tr>
<tr>
<td>8. Fleet National Bank, Providence, R.I.</td>
<td>80.48</td>
<td>1.50</td>
</tr>
<tr>
<td>9. Keybank National Association, Cleveland, Ohio</td>
<td>74.59</td>
<td>1.39</td>
</tr>
<tr>
<td>10. BankBoston, National Association, Boston</td>
<td>71.54</td>
<td>1.33</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1954.71</strong></td>
<td><strong>36.37</strong></td>
</tr>
</tbody>
</table>

*Source: www.ffiec.gov/cgi_bin/pbisa60.dll/nic_prod/uo_extract_top_bhcs/getinfo2aj_top_bhcs=1*
Branching Regulations

Branching Restrictions: McFadden Act and Douglas Amendments

Very anticompetitive

Response to Branching Restrictions

1. Bank Holding Companies
   A. Allowed purchases of banks outside state
   B. BHCs allowed wider scope of activities by Fed
   C. BHCs dominant form of corporate structure for banks

2. Nonbank Banks
   Not subject to branching regulations, but loophole closed in 1987

3. Automated Teller Machines
   Not considered to be branch of bank, so networks allowed
Bank Consolidation and Number of Banks
Bank Consolidation and Nationwide Banking

Bank Consolidation: Why?
1. Branching restrictions weakened
2. Development of super-regional banks

Riegle-Neal Act of 1994
1. Allows full interstate branching
2. Promotes further consolidation

Future of Industry Structure
Will become more like other countries, but not quite:
Several thousand, not several hundred
Bank Consolidation and Nationwide Banking

Bank Consolidation: A Good Thing?

Cons:
1. Fear of decline of small banks and small business lending
2. Rush to consolidation may increase risk taking

Pros:
1. Community banks will survive
2. Increase competition
3. Increased diversification of bank loan portfolios: lessens likelihood of failures
Separation of Banking and Other Financial Service Industries

Erosion of Glass-Steagall
Fed, OCC, FDIC, allow banks to engage in underwriting activities

Gramm-Leach-Bliley Financial Services Act of 1999: Repeal of Glass-Steagall
1. Allows securities firms and insurance companies to purchase banks
2. Banks allowed to underwrite insurance and engage in real estate activities
3. OCC regulates bank subsidiaries engaged in securities underwriting
4. Fed oversee bank holding companies under which all real estate, insurance and large securities operations are housed
5. Banking institutions become larger and more complex

Separation in Other Countries
1. Universal banking: Germany
2. British-style universal banking
3. U.S./Japan separation
International Banking

The Reasons for Rapid Growth
1. Rapid growth of international trade
2. Banks abroad can pursue activities not allowed in home country
3. Tap into Eurodollar market

U.S. Banks Overseas
1. Regulators
   A. Federal Reserve (Regulation K)
2. Structure
   A. Edge Act Corporations
   B. International Banking Facilities

Foreign Banks in U.S.
1. Regulators
   A. Same as for U.S. domestic banks
2. Structure
   A. 500 offices in U.S.
   B. 20% of total U.S. bank assets
<table>
<thead>
<tr>
<th>Bank</th>
<th>Assets (U.S.$ Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Deutsche Bank, Germany</td>
<td>742.5</td>
</tr>
<tr>
<td>2. UBS, Switzerland</td>
<td>685.9</td>
</tr>
<tr>
<td>3. Citigroup, U.S.</td>
<td>668.6</td>
</tr>
<tr>
<td>4. Bank of America, U.S.</td>
<td>617.7</td>
</tr>
<tr>
<td>5. Bank of Tokyo-Mitsubishi, Japan</td>
<td>579.8</td>
</tr>
<tr>
<td>6. Bayerische Hypo Vereinsbk, Germany</td>
<td>538.6</td>
</tr>
<tr>
<td>7. ABN Amro Holding, Netherlands</td>
<td>504.1</td>
</tr>
<tr>
<td>8. HSBC Holdings, U.K.</td>
<td>483.1</td>
</tr>
<tr>
<td>9. Fuji Bank, Japan</td>
<td>481.4</td>
</tr>
<tr>
<td>10. Credit Suisse Group, Switzerland</td>
<td>474.0</td>
</tr>
</tbody>
</table>

Financial Innovation and Decline in Traditional Banking

Innovations Increasing Competition

1. Money market mutual funds
   Avoids deposit rate ceilings and reserve requirements

2. Junk bonds
   Result of better information in credit markets

3. Commercial paper market
   Result of better information in credit markets and rise in money market mutual funds

4. Securitization
   Result of better information in credit markets and computer technology
The Decline in Banks as a Source of Finance
Bank Profitability
Share of Noninterest Income
Decline in Traditional Banking

Loss of Cost Advantages in Acquiring Funds (Liabilities)

\[ \pi \uparrow \, i \uparrow \, \text{then disintermediation because} \]

1. Deposit Rate Ceilings and Regulation Q
2. Money Market Mutual Funds
3. Foreign banks have cheaper source of funds: Japanese banks can tap large savings pool

Loss of Income Advantages on Uses of Funds (Assets)

1. Easier to use securities markets to raise funds: commercial paper, junk bonds, securitization
2. Finance companies more important because easier for them to raise funds
Bank Failures

Number of Bank Failures

![Graph showing the number of bank failures from 1935 to 2000. The graph peaks around the 1980s and shows a significant increase compared to earlier periods.]
Banks’ Response

Loss of cost advantages in raising funds and income advantages in making loans causes reduction in profitability in traditional banking
1. Expand lending into riskier areas: e.g., real estate
2. Expand into off-balance sheet activities
3. Creates problems for U.S. regulatory system

Similar problems for banking industry in other countries