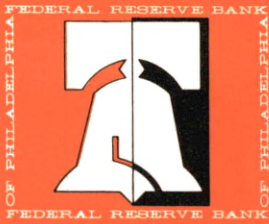


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Banking's Widening Limits

Boom in Multibank Holding Companies

Banking Structure Changes in the  
60's: A New Financial Climate

**FEDERAL RESERVE BANK of PHILADELPHIA**

# business review



**1972**

### **Banking's Widening Limits**

. . . Fast-paced changes in banking's competitive environment greatly enlarge the world in which bankers operate.

### **Boom in Multibank Holding Companies**

. . . Multibank holding companies more than doubled during the past decade, spurring dramatic increases in the number of affiliated banks.

### **Banking Structure Changes in the '60s: A New Financial Climate**

. . . Structural reforms in banking in the U. S. and Third District during the '60s set in motion changes that have made the industry more responsive to economic forces, which should yield even greater benefits for the consumer.

**On our cover:** The First Bank of the United States, built between 1795 and 1797, is one of the oldest bank buildings in the nation. It conducted business here until its charter expired in 1811. The Bank of the U. S. was part of Treasury Secretary Alexander Hamilton's program to define the proper relationship between the national government and the national economy. Among other things, he proposed the creation of a central bank that would serve as a depository for Federal funds, issue paper money, provide commercial interests with a steady and dependable credit institution, and serve the government with short-term loans.

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# Banking's Widening Limits\*

by *David P. Eastburn*  
*President, Federal Reserve Bank  
of Philadelphia*

Our first speaker this evening has put his finger on one of the most important forces determining the mood of our society today: the rather shocking discovery that we face many limits of resources and abilities to get all the things we want. This has been a frustrating discovery and helps to explain why so many are puzzled, pessimistic, and groping for new answers.

Our second speaker has pointed out a new awareness of limits on our ability to get exactly the kind of economy we'd like to have and how this awareness has been influencing economic policy.

Now I'd like to take a rather broad look at the future of banking with this idea of limits in mind. The different twist that I see,

however, is that in a number of respects limits are not closing in—they are widening. In very fundamental ways you will be doing business under new rules that offer broader, not narrower, opportunities.

## BACKGROUND

As background for this theme, I want to point out some trends which should be obvious to us all, but the significance of which may not be appreciated fully.

Ten years ago, the typical (median) bank in Pennsylvania had deposits of \$3 million; now it has over \$16 million. In Pennsylvania, 7 out of 10 banks were unit banks; now the unit bank is on the decline; 243 banks in Pennsylvania have disappeared in those ten years.<sup>1</sup>

We now have a state increasingly made up of regional branch banks, serving communities over a wide radius, performing all

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\* A speech delivered at the twenty-seventh annual series of field meetings sponsored by the Federal Reserve Bank of Philadelphia for bankers at ten locations throughout the Third Federal Reserve District (eastern two-thirds of Pennsylvania, southern half of New Jersey, and Delaware) in April and May 1972. The exact text varied somewhat from location to location to incorporate regional differences. This version was given at the Valley Forge Hilton, May 4, 1972.

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<sup>1</sup> For details on banking structure changes in the Third District, see Jerome C. Darnell, "Banking Structure Changes in the '60s: A New Financial Climate," pp. 11-22.

kinds of services and bringing new competition into areas where one or a couple of unit banks used to have things pretty much their own way.

The kinds of business banks do—their correspondent relationships, their daily dealings in Federal funds, and in many other respects—make the old concept of the “country bank” obsolete.

In other words, the days of the “country bank”—as we used to think of it, isolated from the rest of the world—are numbered. Meanwhile, the limits on banks are widening. This view of banking underscores the overall significance of three important problems that I want to talk about.

### NEW COMPETITION WITH NONBANK INSTITUTIONS

The first of these is a new, tougher, competitive environment between banks and their nonbank competitors. Since we met a year ago, a Presidential Commission—the Hunt Commission—has released a report that points the way things are likely to move. For example, it recommends that savings and loan associations and mutual savings banks be permitted to offer checking accounts and credit cards. At the same time it recommends that all institutions operating in the same market compete on the same basis—with the same tax treatment, interest rate ceilings, supervisory burdens, and reserve requirements. I’m not at all optimistic that these recommendations will be implemented soon or very fast, but I believe they suggest the nature of our future financial system.

They may strike you as attempts to widen the limits for your nonbank competitors rather than for you, and in a narrow sense they are. But in a broader sense they open up new possibilities for a freer financial system all around, and in the long run they can’t help but benefit banks.

As you consider the Hunt Commission report, I can appreciate that you will want to

look out for your interests, but I hope that you’ll also look for opportunities that these kinds of changes offer to banking and to the economy as a whole.

### COMPETITION AMONG BANKS

Competition *among* banks is another area in which limits will be widening. This will take a number of forms.

**Banking structure.** One of these is the banking structure itself. At our meeting last year I said that I believed a change in the banking laws of Pennsylvania was inevitable. The real question for Pennsylvania, it seems to me, is not whether to make a change, but what kind of change would be best for the Commonwealth. I don’t have any position at the moment on what changes would be best. I do think, however, that the Federal Reserve Bank of Philadelphia has some responsibility to provide whatever objective information it can to help those who will have to make these critical decisions. So, in cooperation with the Federal Reserve Bank of Cleveland, which has jurisdiction over the western one-third of Pennsylvania, we are now making a fairly large-scale study to determine what the implications of possible changes in the branching law might be. Among other things, we are trying to estimate what would happen to the concentration of banking resources over the next five or ten years if the laws were changed in various ways—for example, to permit districtwide branching or statewide branching. We aim to release the results of the study early in the fall to appropriate officials as well as to the public at large.

When we do, I hope you will give us your comments and reactions. Again, as with the Hunt Commission report, I understand that you must look after your own interests, but I hope that in doing so you can take a long and broad enough view to see that wider limits on the structure of commercial banks could benefit you as well as the entire economy.

**Regulations J and D.** Another aspect of widening competition among banks is in the area of what we in the Fed like to call the payments mechanism. In your terms, of course, this is simply how you collect checks, how you make and get payment, and how much float<sup>2</sup> you have to work with.

The Fed has a responsibility that goes back almost 60 years to the original Federal Reserve Act to facilitate the check payment system. Looking ahead, we believe that the economy simply must have a better system of making payments than it now has. Steps are already underway to eliminate checks completely, but in the meantime better, quicker, and more efficient ways of handling checks and making payments will be absolutely essential if the economy is not to get bogged down in paper and funds are not to be held up.

Last year at our meeting I indicated that we were exploring the feasibility of regional check processing centers. Since then we have asked you for some information needed to plan this regional system, and we are now using it to determine what the best system might be. We will be in close touch with you as we go along in order to make sure we are on the right track.

So far as *check collection*—the movement of paper—is concerned, you have as much to gain as does the general public by a more efficient system; and you have much to lose if we don't get a better system.

Where *payments* are concerned, the question becomes more complex. We in the Fed have a responsibility not only for

the payments system but for a healthy, growing economy. So naturally we feel it is important to associate one with the other: What changes should be made in the payments system to help make the economy function better? As we look at our responsibilities this way, it becomes clear that some means must be found to speed up the flow of payments and cut down on the large volume of float that has built up because payments are not made promptly.

Therefore the Board of Governors has proposed the change in payments—technically, Regulation J—which I communicated to you several weeks ago.<sup>3</sup> This is another example of how opportunities for banks are being widened rather than narrowed. Let me try to show you why I think so.

For years, banks in the large cities and money centers have paid for checks in immediately available funds on the day of presentment. Banks outside of these centers have paid for items presented to them by the Federal Reserve on the day *after* presentment in immediately available funds. As we look at this situation, we see two points: First, although the dollar amount of funds affected by this slower payment by banks outside of the money centers accounts for only 15 percent of the total, it is an important 15 percent which, if speeded up, could help the economy work better; second, the reason for allowing banks outside of these money centers to get the preferential treatment of one day's float has disappeared. As I've tried to stress, we now have a much different banking system than

<sup>2</sup> Float represents checks deposited by commercial banks at District Federal Reserve Banks which have been credited to those banks' reserve accounts, but not yet debited against the accounts of the banks on whom the checks are drawn. It arises because of such factors as collection schedules and transportation and processing delays. In effect, float constitutes a noninterest-bearing loan from Federal Reserve Banks to the commercial banks involved.

<sup>3</sup> The Board of Governors of the Federal Reserve System proposed on March 27, 1972 a requirement that *all* banks served by the Federal Reserve System pay for checks drawn upon them in immediately available funds. Payment would have to be made the same day that the checks are presented for collection. This proposal would eliminate the present practice whereby certain banks pay for checks in funds not available until the next business day after presentment.

we once had. The "country bank"—as we used to think of it—is fast disappearing. The time has come to recognize this fact in the payments system.

We see this proposal for Regulation J as a new opportunity for banks, particularly for this growing group of regionally important banks, to play a role in speeding up payment of funds. Incidentally, the leadership in banking sympathizes with this general view. The Monetary and Payments System Committee of the American Bankers Association has taken the position that "the long-term best interests of banking and our customers cannot be served by the existence of any type of settlement system which utilizes a set of procedures, the effect of which maximizes float to the advantage of one user and the disadvantage of another."

The Fed and the banks share a common problem. We are both under fire because of the large volume of float—free credit—that has built up. We both have a big stake in speeding up the flow of payments. And we both want this payments system to be fair and equitable among banks.

For this last reason, I want to emphasize that the Fed has given great consideration to the impact of the proposal on individual banks. Most of you will be paying one day earlier on items presented to you by the Fed, but you will also be receiving funds one day earlier on checks you send us that are drawn on other Third District "country" banks. How this nets out will depend on the size of these two flows. Some of you will gain; some of you will lose. I have sent you a letter and a form which indicates how you can figure this out. I encourage all of you to work this out for your own planning purposes and to send us a copy. We want to know how the change in J would affect you, but I also hope you will evaluate it from the broader view of how it would help banking customers and the economy.

If you look at the proposed changes in Regulation J from the broader view you will

also better understand the proposed changes in Regulation D—reserve requirements.<sup>4</sup> Again, this change is simply a recognition that the old distinctions between "city" and "country" banks are no longer valid.

Ever since the Federal Reserve was established, "city" banks have carried higher reserve requirements than "country" banks. There was good reason for this once, but the reason has long since passed. The problem, though, has been how to get a more modern and equitable kind of reserve structure. The proposals attempt to do this by wiping out the distinction between "city" and "country" and putting requirements on the basis of size regardless of where a bank happens to be located.

Again, I have sent you material which should help you figure out what the proposed change in Regulation D would mean for you. When you make this computation and relate it to the effect of the proposed change in payments you can find out what the net impact of both J and D would be on you. Let me repeat: We're anxious that you let us know.

I'm particularly concerned with what the proposals may mean for membership in the Federal Reserve. You may recall that I've talked about this in previous meetings. The Third District is a special problem in this regard because Pennsylvania law is inequitable with respect to reserve requirements.<sup>5</sup> With the return on money as high as it has

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<sup>4</sup> The Board of Governors also on March 27, 1972 proposed that reserve requirements for System members be based upon the amount of net demand deposits of a bank. As a result, member banks of the same size (net demand deposits) would be subject to the same reserve requirement, regardless of their location.

<sup>5</sup> In Pennsylvania, state-chartered banks that are not members of the Federal Reserve System may keep up to 40 percent of their required reserves in the form of U.S. Government securities, obligations of the Commonwealth, or other assets ruled appropriate by the State Secretary of Banking. Banks that are members of the System are not allowed to hold any part of required reserves in the form of earning assets.

been in recent years, the cost of holding idle funds in the form of noninterest-bearing reserves has been of great concern to member banks. As a result, some of them have withdrawn from Fed membership and others have considered withdrawing to take advantage of what amounts to lower reserve requirements for nonmembers.

The net effect of the two proposals on some banks—especially the large regional banks—might be an additional factor influencing their attitude about membership. I believe that the proposals are a good thing; but if they seriously complicate an already serious problem of membership, every effort should be made to minimize that effect.

## MONETARY POLICY

I've talked about widening horizons for banks on two fronts: new competitive relations with nonbank institutions and new competitive relations with other banks. A third point deals with the impact on you of changes in monetary policy.

In past meetings we have always talked about monetary policy and you have always listened politely and, I hope, with some interest. I think you will find, however, that as time passes monetary policy will be of more and more practical importance to you.

Two things are happening. On the one hand, as I've said, banks are changing. Most of you, for example, are in the Federal funds market<sup>6</sup> every day, and so you have a real interest in money market rates. As your banks become larger, and as your markets become increasingly broad, you will become more and more influenced by trends affecting national financial markets.

At the same time something is going on within the Fed. We have been engaged in a search for the best guide for conducting monetary policy. One possibility—one that has prevailed for a long time, in fact—is to

rely mostly on interest rates. With this approach, higher interest rates imply tighter credit conditions and lower rates imply an easier monetary policy. An alternative guide is to rely on changes in the quantity of money and credit. A slower growth rate in monetary expansion is viewed under this approach as a more restrictive policy, and a faster growth rate is viewed as more expansionary.

Recently we have been paying more attention to this second approach, the so-called monetarist view. This has several implications, but there is one of particular importance to you, namely, that wider changes in interest rates may well be in store for you.

As this principle applies to the policy problem currently facing us, it may well be that higher interest rates will be essential in the near future if we are to maintain control over the money supply. Inflationary pressures are still a serious threat facing the economy. If we become preoccupied with holding interest rates at a particular level, we could abdicate our responsibility to keep the dollar reasonably stable.

## CONCLUSION

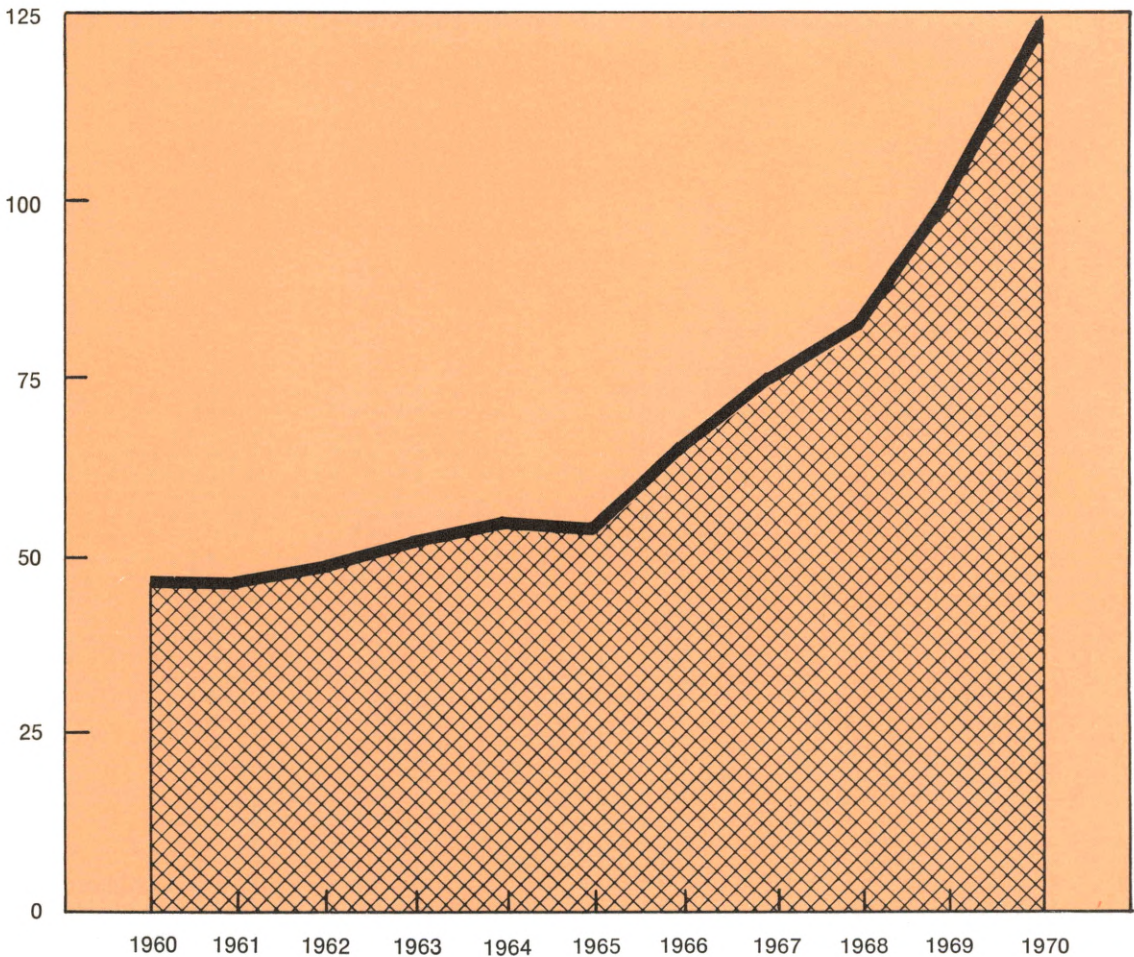
The essential point for you in all this, however, is that you could be operating in an environment in which interest rates change more frequently and fluctuate more widely. And since you are no longer isolated country banks, you will likely become less and less insulated from this changed environment. This fact—along with changes in your competitive environment, both with nonbank institutions and other banks—greatly enlarges the world in which you operate. It can be a frightening world and you might prefer not to be in it. But I suspect you have little choice. You have the alternative of reacting to it in a narrow or a broad way. To those bankers with the breadth of vision that today's fast-paced events demand, it can be an exciting and rewarding world—one I hope you will actively be a part of. ■

<sup>6</sup> Federal funds, in general, are uncommitted reserves which banks lend to one another usually for short periods.

# Boom in Multibank Holding Companies

**CHART 1**  
**THE NUMBER OF MULTIBANK HOLDING COMPANIES MORE THAN DOUBLED DURING THE LAST DECADE, WITH THE BIGGEST SURGE AFTER 1965.**

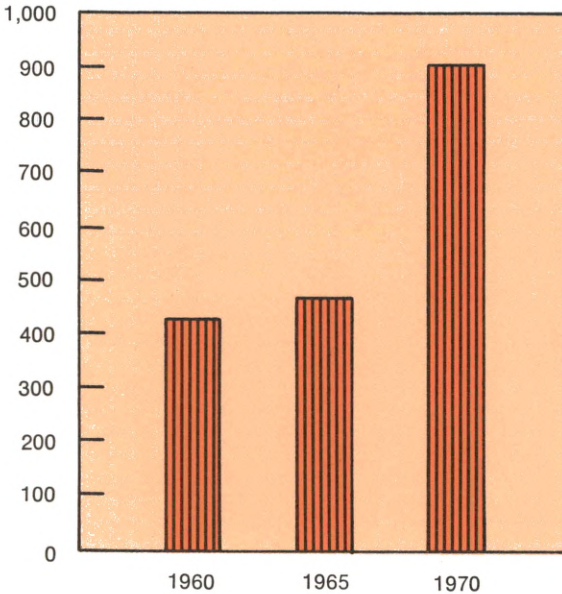
Number of Multibank Holding Companies





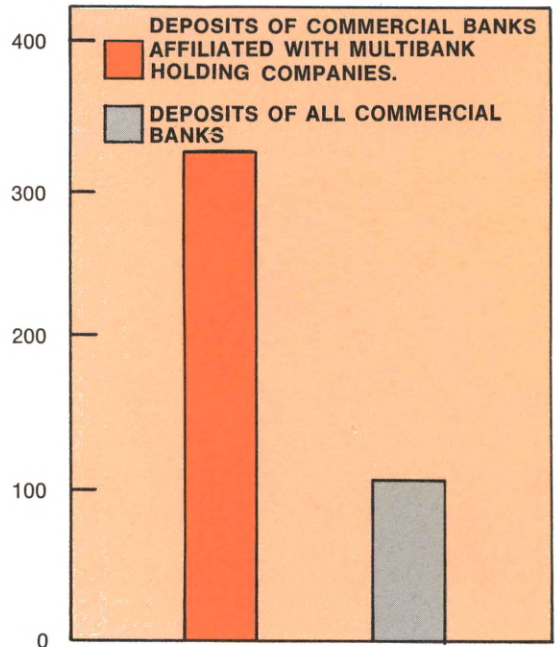
**CHART 2  
THIS RAPID EXPANSION RESULTED IN  
MULTIBANK HOLDING COMPANIES  
ACQUIRING MORE THAN 400 ADDITIONAL  
BANKS . . .**

Number of Banks Controlled  
by Multibank Holding Companies

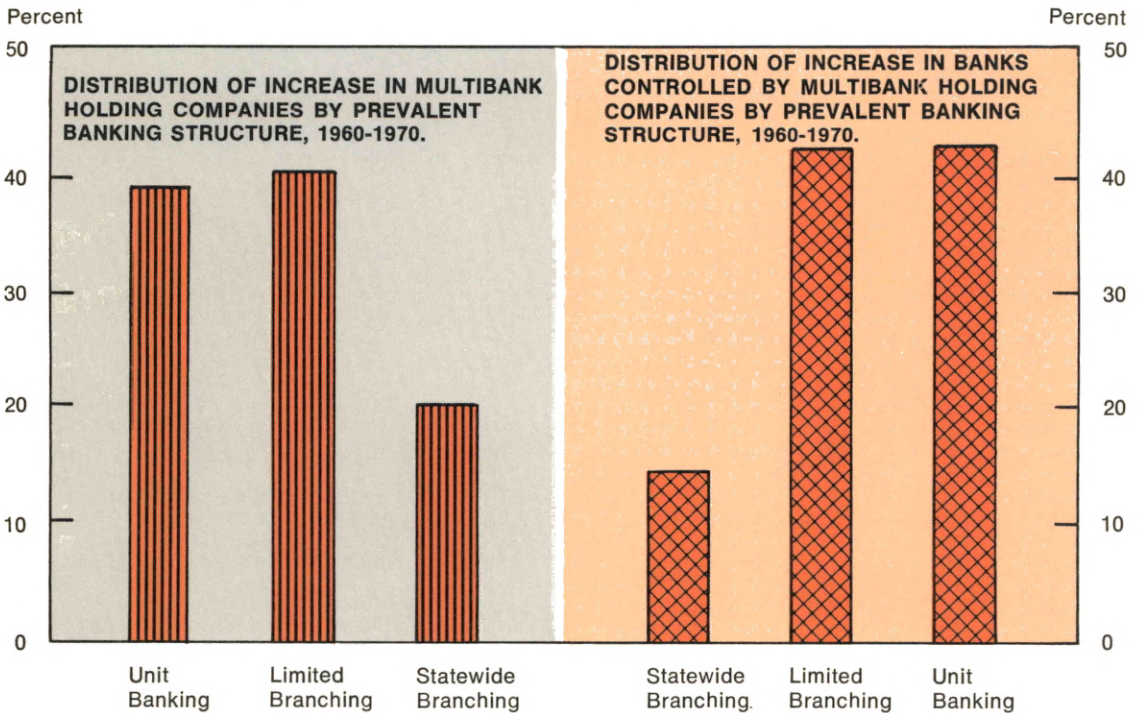


**CHART 3  
CAUSING DEPOSITS CONTROLLED BY  
HOLDING COMPANIES TO GROW THREE  
TIMES FASTER THAN DEPOSITS OF ALL  
COMMERCIAL BANKS.**

Percent Increase 1960-1970



**CHART 4**  
**STATES WHERE THE PREVALENT BANKING STRUCTURE IS EITHER UNIT BANKING OR LIMITED BRANCH BANKING WERE RESPONSIBLE FOR A MAJOR PORTION OF THE BOOM IN MULTIBANK HOLDING COMPANY ACTIVITY SINCE 1960.**



# Banking Structure Changes in the '60s: A New Financial Climate

by Jerome C. Darnell

American banking experienced more boat-rocking in the '60s than in any other recent decade. High-water marks for the banking industry during the past decade included the widespread adoption of bank-sponsored credit cards, automated data processing for internal bookkeeping and outside customers, overdraft checking through consumer credit lines, and increased reliance on nondeposit sources of funds.

Although these changes have been among the greatest attention-getters, more basic, and perhaps far-reaching, alterations took place in the *structure* of the banking industry. These included changes in the number of banks and branches, type of organization, and relative size of banks. To be sure, economic forces help generate reform. However, much of the overhauling can be tied to modifications in the regulatory environment in which banks operate.

The consequences of these structural reforms have served as operational barometers for banking and managerial attitudes. Thanks to adroitly reorienting their organi-

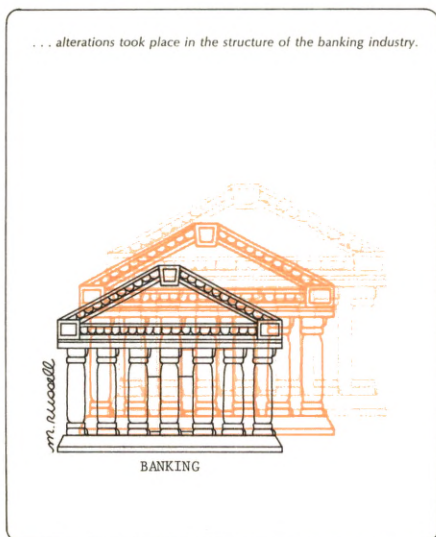
zational structures, banks have grown larger and have been allowed to expand their product lines and enter new territorial waters. Structural reshuffling promises not only to promote new competitive relationships among banks themselves, but to alter the competitive position between banks and other financial institutions.

## STRUCTURAL TRENDS IN THE NATION AND THIRD FEDERAL RESERVE DISTRICT

During the 1960s many alterations occurred in the banking industry's structure in the nation as well as the Third District states of Pennsylvania, New Jersey, and Delaware:<sup>1</sup> Banks grew larger and larger,

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<sup>1</sup> Although the states of Pennsylvania and New Jersey are not completely within the Third District, statewide changes are included for both, partially for convenience in gathering data. Perhaps a more compelling reason for including data of a statewide scope is that most changes in bank structure are determined by policies applicable to the entire state regardless of Federal Reserve District boundaries.



branching systems spread rapidly, thousands of new offices opened, and holding companies linked banks together throughout entire states. Changes such as these fall into three categories: public accessibility to banking services, organizational realignments, and control of banking resources. Modifications in these areas are important for they are the genesis of banking trends in the 1970s. More than this, structural reform affects not only the quality and extent of banking services to the public, but also the competitive posture of the industry.

**Changes in Public Access to Banking Services.** Several important developments had a direct impact on the public's accessibility to banking services. Nearly 1800 *new banks* were organized during the past decade—more than for any comparable time span since the 1920s. However, mergers between existing banks continued at the record clip of the 1950s, nearly offsetting the number of newly organized banks.<sup>2</sup> But despite little

<sup>2</sup> The largest net increases in the number of banks were concentrated in a three-year span from 1963 to 1965 when the net addition totaled almost 400. Net decreases in the number of banks had been the rule for ten years before 1963; net annual decreases have been common since 1965.

change in the level of individually chartered banks, the number of *banking offices* (individual banks plus branch offices) jumped significantly. This surge came about because brand-new branch offices opened at a rate more than twice that of the 1950s, the most productive branching period in the past. As a result, branch offices more than doubled, from less than 11,000 to nearly 22,000. Thus, the public gained about 50 percent more banking offices for supplying services during the 1960s (see Charts 1 and 2).<sup>3</sup>

These changes have not evolved in an even pattern throughout the country. States with more liberal branching provisions typically have fewer individual banks and more branches. Unit banking involves large numbers of individually chartered banks and very few branch offices.<sup>4</sup> That is why most new banks are chartered in unit-banking states, nearly all branch openings occur in branching states, and most bank mergers are in branching states with the merged bank converted into a branch office (see Chart 3).

The Third District states are good examples of diversity in structural revamping. Pennsylvania and New Jersey experienced significant change, each from differing causes. Banking structure in Delaware has remained stable. In contrast to the U.S., each of these states had a net decline in the number of banks. The furious merging pace was the leading cause of the relatively large slippage in individually chartered banks in Pennsylvania and New Jersey. A quarter of all mergers in the nation took place in the two states: The Keystone State registered

<sup>3</sup> All of the charts are based on data from publications of the Federal Deposit Insurance Corporation and the Federal Reserve System.

<sup>4</sup> Branch offices will be found in nominally unit-banking states because the term "branch office" includes facilities provided at military and government establishments and "limited service" offices, also referred to as "facilities." Thus, most unit-banking states have some facilities that are classified as branch offices.

the highest number (243); New Jersey ranked fourth. Conversely, branch office openings in the two states exceeded the national rate. Consequently, the overall gain in total offices matched the national growth rate.

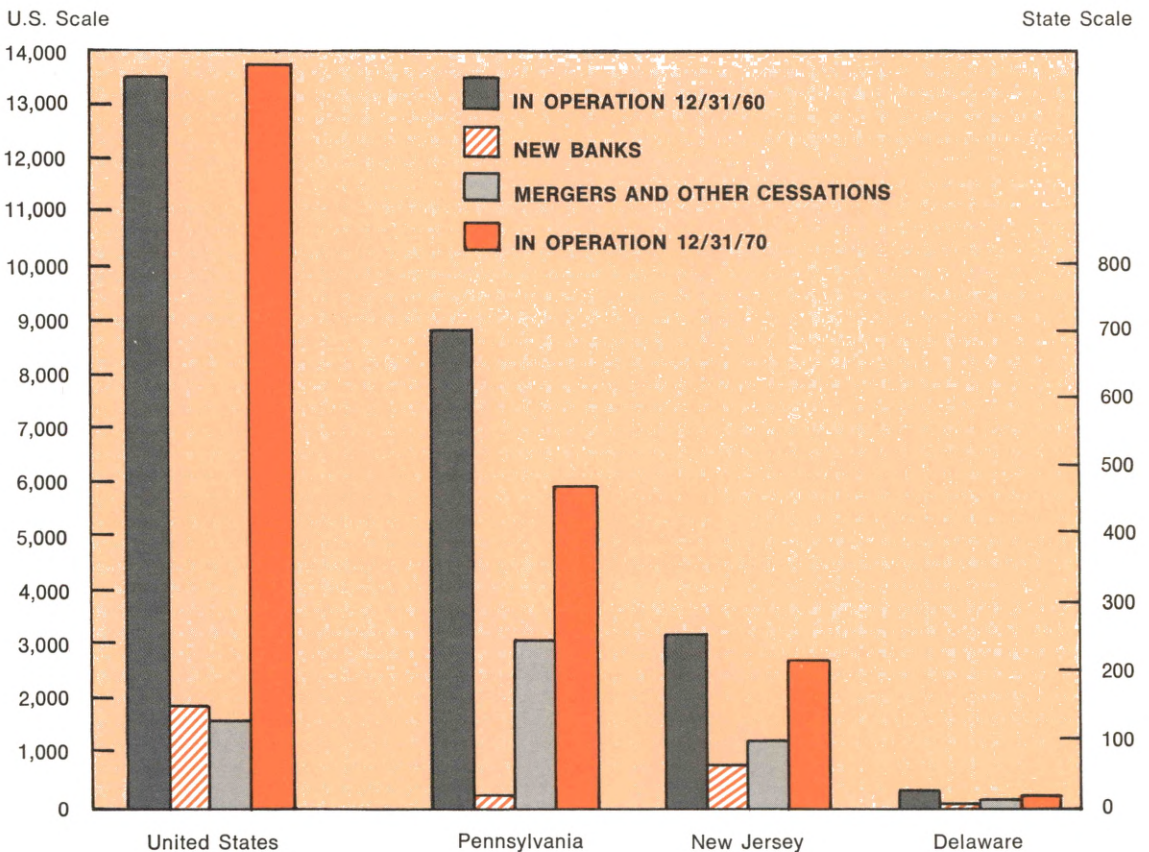
*Population per banking office* is probably a better indicator than number of banks and branches for evaluating how convenient or accessible banking services may be. It is generally felt that the lower the ratio, the better the accessibility for the public in acquiring

those services.<sup>5</sup> Advocates of branch banking like to point out that branching usually makes available more offices per population.

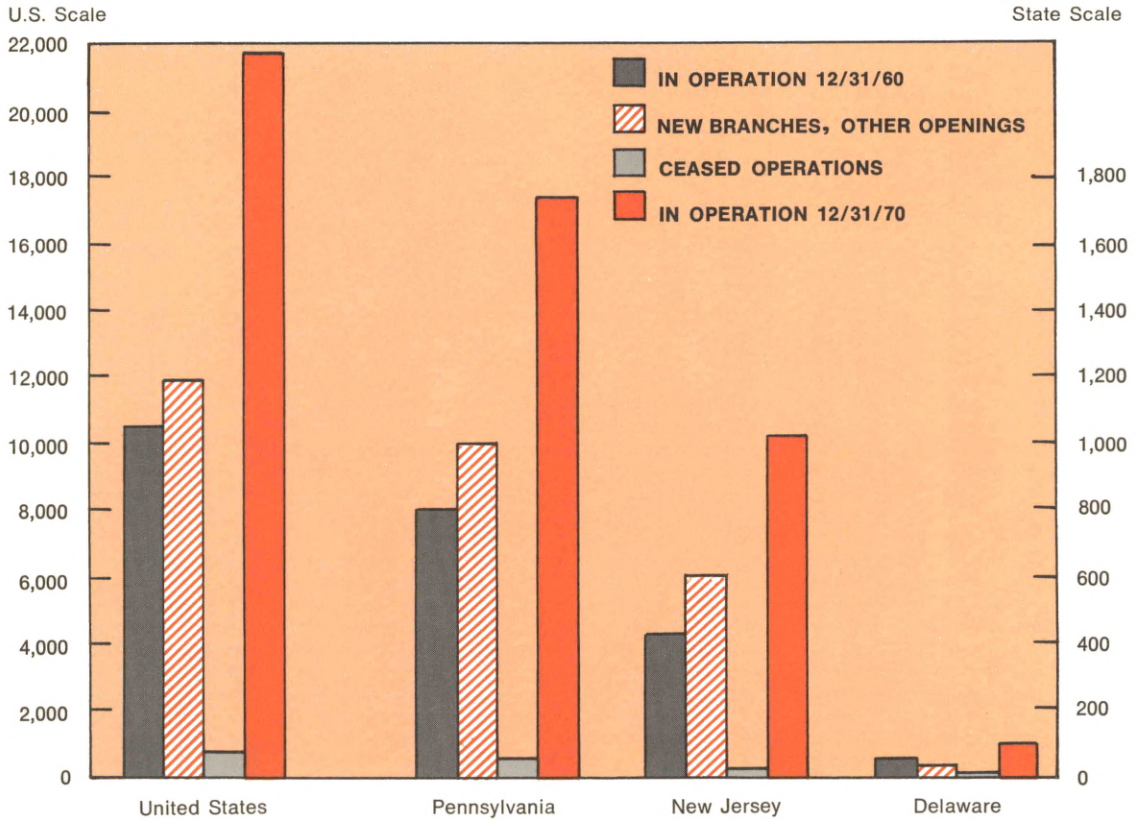
Population per banking office has been ebbing throughout the country since its high

<sup>5</sup> This ratio is useful when making comparisons over different time periods and among various geographical regions. However, since it is calculated on a statewide basis, the ratio can be misleading because it reveals nothing about the actual distribution of people and offices within a state.

**CHART 1**  
**CHANGES IN NUMBER OF BANKS**  
**U.S., PENNSYLVANIA, NEW JERSEY, DELAWARE, 1960-1970**



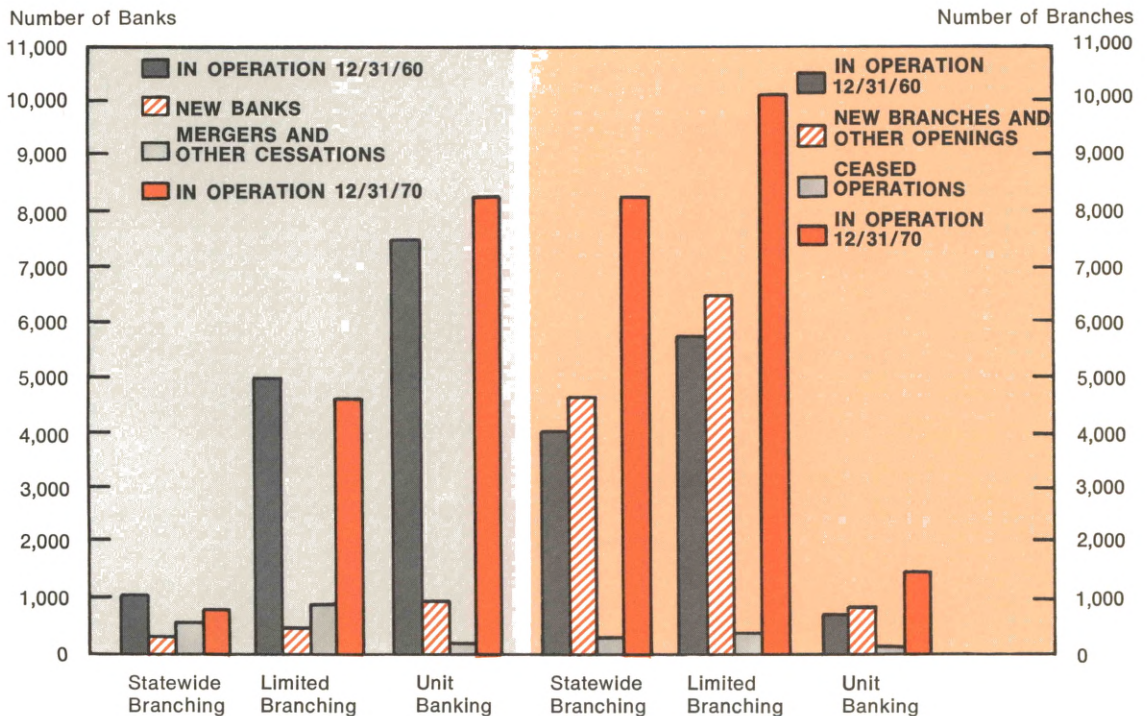
**CHART 2**  
**CHANGES IN THE NUMBER OF BRANCHES**  
**U.S., PENNSYLVANIA, NEW JERSEY, DELAWARE, 1960-1970.**



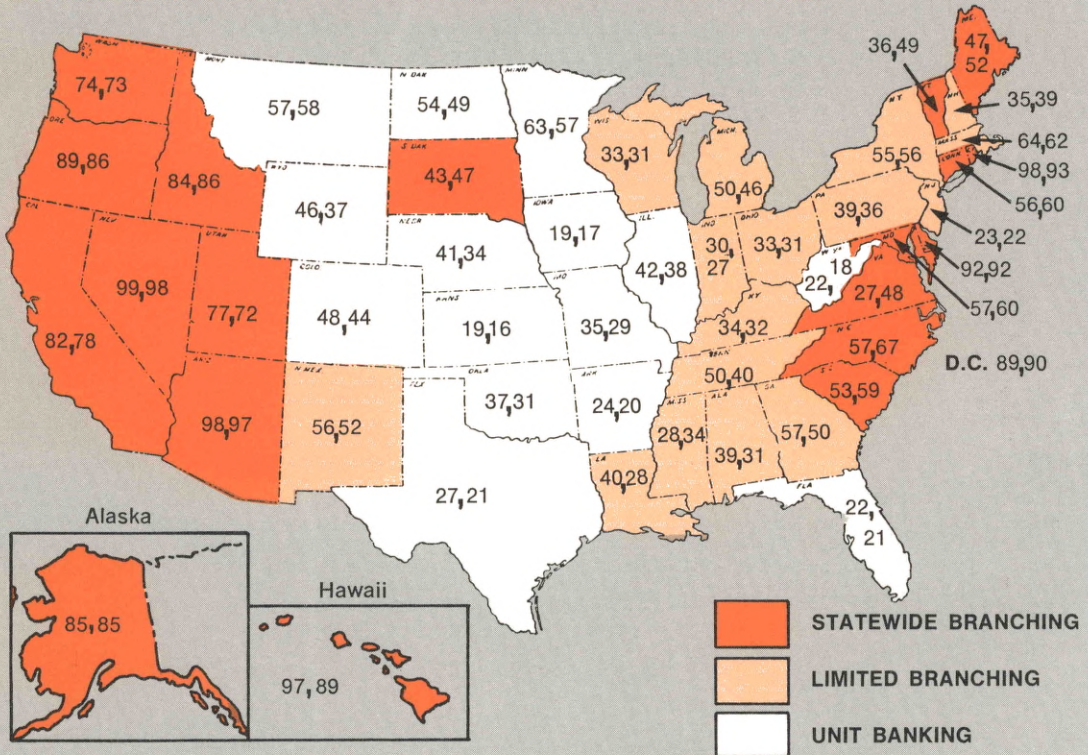
## PARALLELS WITH THE PAST

Two surprising milestones were reached in the 1960s. First, in 1962 the total number of individually chartered banks in this country reached the lowest level of this century. Not since 1900 have we had so few banks as the 13,426 that existed at the end of 1962. The number of individual banks peaked out at around 32,000 in 1921, and then a steady decline started that was to last until the low point in 1962. In 1968, the second milestone year, the number of banking offices (individual banks plus branch offices) finally topped the 1922 record of 32,500. We should hasten to point out that the parallel between 1968 and 1922 is not as close as it might appear at first because all but 1800 of the bank offices in 1922 represented individually chartered banks. By 1968 only four out of ten offices represented individual banks.

**CHART 3  
CHANGES IN NUMBER OF BANKS AND BRANCHES BY TYPE OF BRANCHING PREVALENT  
1960-1970.**



**STATEWIDE BRANCH BANKING PREDOMINATES IN THE WEST AND ON EAST COAST;  
UNIT BANKING PREVAILS FROM THE MISSISSIPPI TO THE ROCKIES**



Note: First figures indicate the percentage of deposits held by five largest banks or bank groups in the state as of June, 1961. Second figures are for June, 1970. A bank group includes banks that are controlled by a bank holding company. Changes in branching classifications of states since 1960 are as follows: South Dakota from unit banking to statewide branching; Virginia and Maine from limited to statewide branching; New Hampshire and Wisconsin from unit banking to limited branching.

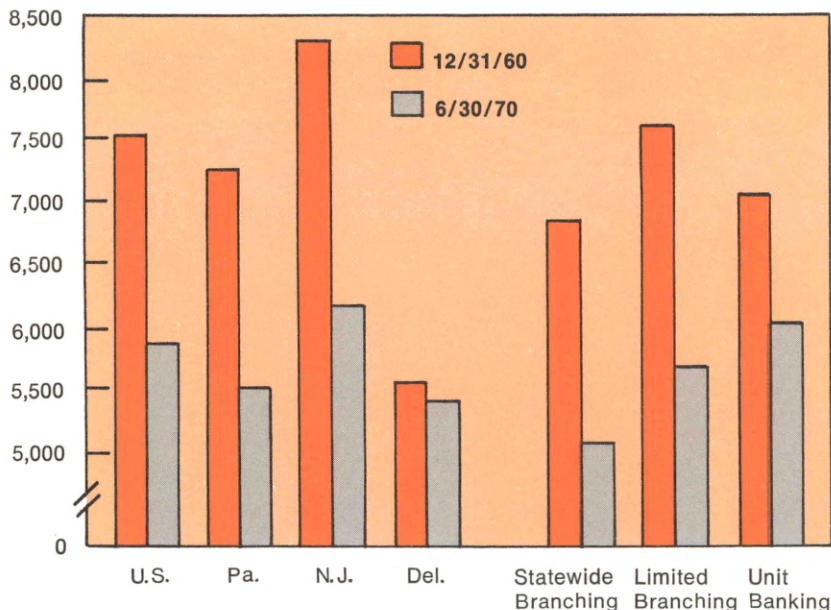
tide of the early 1950s. The ratio is now at its lowest level since 1932. It will probably continue to dip even lower in the 1970s. One reason for the drop in "persons per office" is the trend toward more liberal branch banking in a growing number of states (see Map). States in which some form of branching is permitted usually have more offices for a given population size, and the ratio has been falling more rapidly in these

states.<sup>6</sup> Because of the large increase in new

<sup>6</sup> Branching states do not always have the edge in this regard, however, because four of five states with the lowest population per office are unit-banking states. The only exception among the bottom five is South Dakota, which has had the lowest ratio for years. The other four with the lowest ratio—North Dakota, Iowa, Nebraska, and Kansas—are among the more sparsely populated states in the Great Plains area. At the other extreme, the five states with the highest population per office are all unit-banking states.



**CHART 4**  
**POPULATION PER BANKING OFFICE**



branch offices, the ratio declined in Pennsylvania and New Jersey at a faster clip than in the nation as a whole. Delaware's ratio has remained virtually the same over the past ten years (see Chart 4).

**Changes in Organization of Banking Resources.** Bankers, in addition to making their services more accessible to the public, were busy making organizational changes. Dominant among these were revival of the multibank holding company and widespread adoption of its one-bank counterpart. As the name suggests, a bank holding company is a corporation chartered for owning stock in commercial banks. A multibank holding company, if not prohibited by state law, can function as a *deus ex machina* for constructing a *de facto* statewide branching network in a limited branching or unit-banking state. Moreover, the holding company can also have nonbanking sub-

sidaries so long as they are "closely related" to banking.

A wave of multibank holding companies rolled in during the late '60s, with their scope of operations doubling in only five years. In the ten years before the 1966 amendment to the Bank Holding Company Act of 1956, they were in a dormant stage of development: The number of holding companies had remained steady, the number of banks controlled increased by only 10 percent, and the proportion of total bank deposits held by group banks<sup>7</sup> hardly changed. The number of banks affiliated with holding companies and their deposits doubled in the five years following the '66 amendment. Furthermore, the number of

<sup>7</sup> Group banking is another term for banks controlled by multibanking companies.

multibank holding companies soared from 53 to 121. Over half of the upsurge in group banking occurred in just ten unit-banking states that do not outlaw multibank holding companies. With few exceptions, the remainder of the growth was in limited branching states.

The national tide of multibank holding companies has not been so pronounced in the Third District states. New Jersey revamped its banking law in 1969, removing the prohibition of them. By the end of 1970, three bank groups in the Garden State controlled 14 banks. Pennsylvania is one of seven states with limited branching that has chosen to preserve the validity of its restriction on statewide banking by prohibiting multibank holding companies. Delaware has no law pertaining to holding companies, and since the Diamond State already allows statewide branching, no multibank holding companies have been organized there.

In the late 1960s another organizational phenomenon, the one-bank holding company, surfaced to prominence. In mid-1968 many larger banks across the country discovered almost simultaneously that holding companies could enter nonbanking harbors that were closed to banks. As a result, well over 1000 banks (both large and small) sailed with the tide into nonbanking waters for the first time. This tide also has been

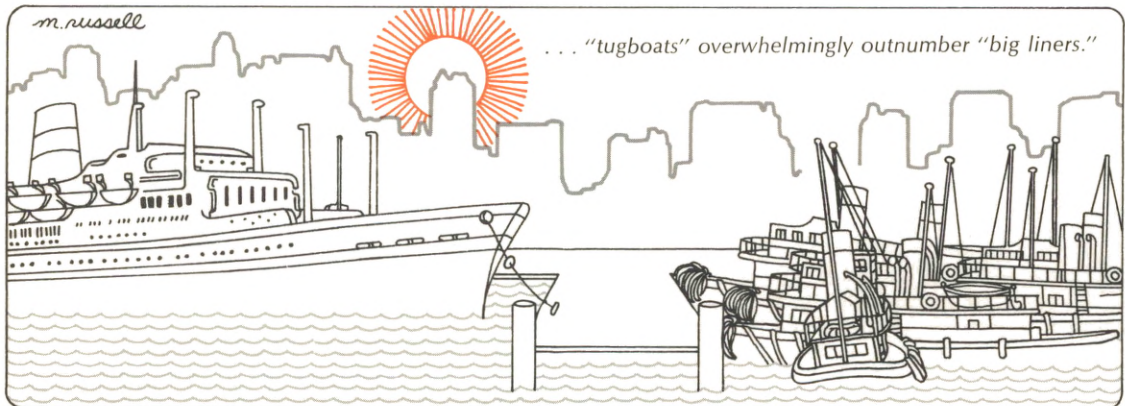
more subdued in the Third District states than in other sections of the nation. Only a relatively small number of banks have reorganized under the aegis of a one-bank holding company. At present Pennsylvania has 21 banks operating under one-bank holding company control, New Jersey has ten, and Delaware has three.

#### Changes in Control of Banking Resources.

Although most of the world's largest banking institutions are located in this country, "tugboats" overwhelmingly outnumber "big liners." Since total deposits of all banks doubled in the past decade, it is hardly surprising that the typical bank doubled in size also. The movement toward greater public accessibility and shifts in organizational structure facilitates larger banks. But because of the very large number of small banks, the median size is still less than \$10 million in deposits (see Chart 5).

Median bank size increased more rapidly in Pennsylvania and New Jersey than in the nation because of the large number of mergers. In the 1960s the middle-size Pennsylvania bank had a fivefold increase; the median New Jersey bank tripled in size. Median bank sizes in Pennsylvania and New Jersey now rank among the highest in the nation. Delaware's median bank size doubled.

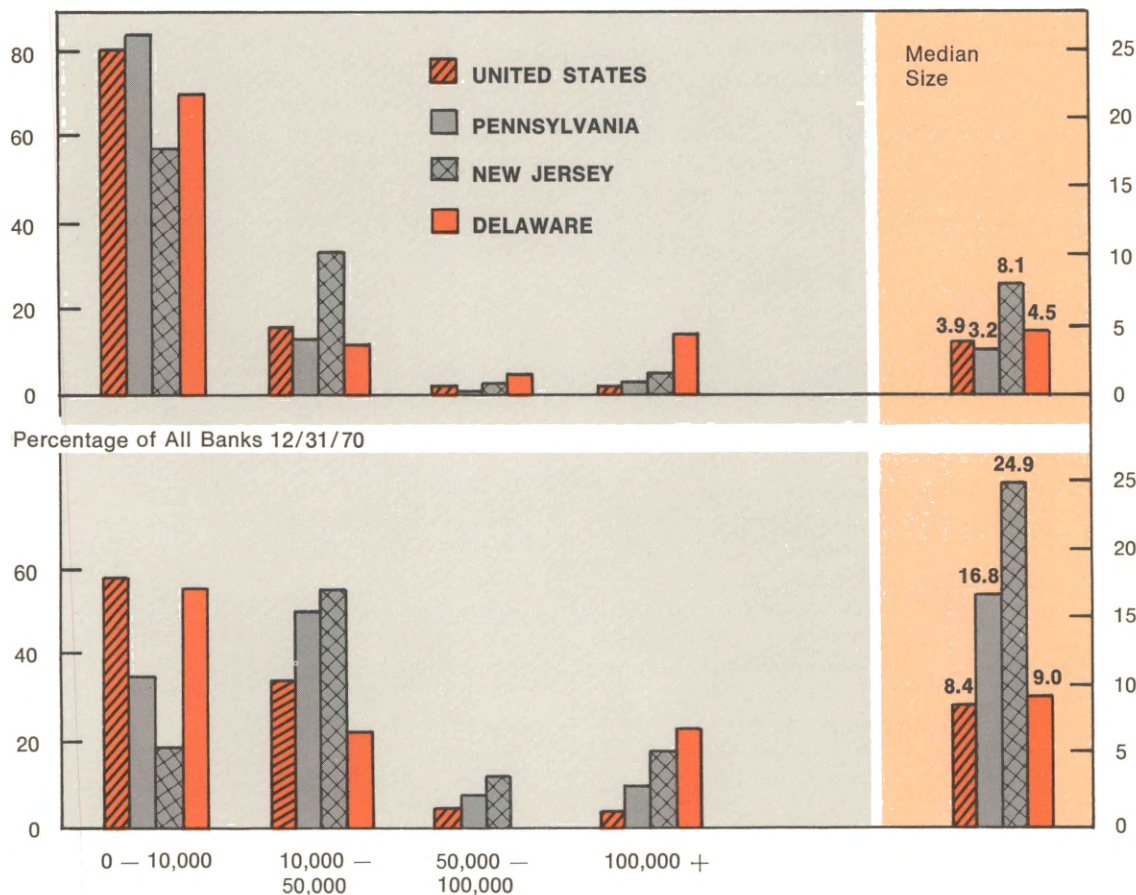
Another way of examining banking structure modifications is by comparing concen-



**CHART 5  
DISTRIBUTION OF BANKS BY DEPOSIT SIZE**

Percentage of All Banks 12/31/60

Deposits (in Millions of Dollars)



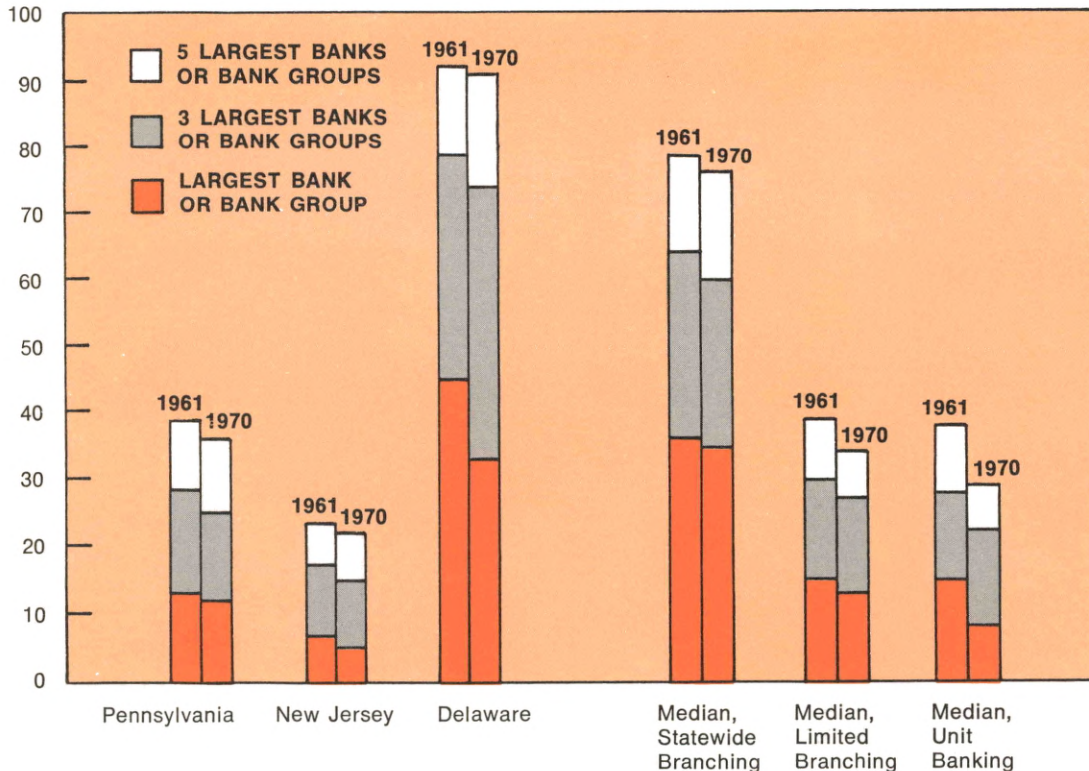
tration ratios—deposit share of the largest bank or banks in a geographical area. Concentration ratios among the largest banks in a state are usually highest in statewide branching states and lowest in unit-banking states. But the ratios vary widely from state to state (see Map). Moreover, in past years the ratio has tended to rise where branching is permitted on a more extensive geographical basis. For example, over the past decade, the ratio of the top five organizations (banks or bank groups) increased in ten

statewide branching states and in three limited branching states, but it rose in only one unit-banking state. Examination of the concentration ratios at the local level, such as in standard metropolitan statistical areas (SMSAs), reveals a similar tendency for the ratio to be higher in branching states than in unit-banking states.

Statewide concentration ratios declined in Pennsylvania and New Jersey in the 1960s (see Chart 6). By 1970 New Jersey's largest banking organization held the smallest share

**CHART 6  
CONCENTRATION OF DEPOSITS IN LARGEST BANKING ORGANIZATIONS**

Percentage of Deposits



of state deposits among all states in the union. Overall, the state has one of the lowest degrees of concentration in the country. At the other end of the concentration scale, Delaware has the fourth highest top-five ratio. The decline in share of deposits of Pennsylvania's and New Jersey's largest banks resulted from the failure of top banks to stay abreast of statewide deposit growth. In contrast, concentration ratios generally rose in several SMSAs, primarily because many regional banks grew rapidly by acquiring surrounding banks. For example, the five-bank concentration ratio increased in 12 of the 18 leading SMSAs in the Third District states.

**WHY DO CHANGES  
IN BANK STRUCTURE OCCUR?**

Economic forces, by affecting supply and demand for bank services, cause bankers to rerig their sails continuously. But supply and demand are not the only currents influencing banking structure reform. Banking, as a "quasi-public utility," is closely regulated by state and Federal governments. And during the '60s changes in the regulatory environment seem to have played a key role in remodeling the banking industry.

For the most part, legislative reform at the Federal level has been directed toward defining the conditions for merging and

holding company acquisitions, with particular concern for preserving the fruits of competition. Before passage of the Bank Merger Act of 1960, banks had merged more or less at will and did not have to be concerned about the competitive impact of their marriage. The Act changed the rules by stipulating the factors to be considered in reviewing mergers and by designating the Federal agency primarily responsible for approval. Congress amended this law in 1966, as well as the Bank Holding Company Act of 1956, to clarify the relationship between these two banking acts and Federal antitrust laws. An additional amendment to the Bank Holding Company Act in 1970 brought one-bank holding companies and their nonbanking subsidiaries under Federal Reserve Board supervision for the first time. In several respects Federal legislation in the '60s was the most important since the banking legislation of the '30s.

Often the economic impact of a particular law may not be felt until years later. Such was not the case, however, with the 1966 amendment to the Bank Holding Company Act. These changes sparked the upsurge in group banking during the late 1960s. The amendments not only clarified the rules for approving holding company acquisitions, but eased restrictions on loan transactions among affiliates of holding companies so that loan participations became easier to transact. Another change was abolition of the 2 percent Federal tax penalty for a company deciding to file a consolidated tax return. As noted earlier, a striking expansion in the scope of holding company operations immediately resulted. Furthermore, it is likely that many expansion-minded banks decided they could no longer wait for an easing in branching restrictions and consequently pursued the holding company course.

Court interpretations have influenced the drift of the merger wave probably more than the Bank Merger Act and its amendments. In

1963 the U.S. Supreme Court dropped a bombshell amidst the banking community with a landmark decision involving the proposed merger of two large Philadelphia banks, Philadelphia National Bank and Girard Trust Corn Exchange Bank. In essence, the Court ruled that bank mergers were subject to the same antitrust standards as nonbank ones. Furthermore, the Act conferred no special immunity to banks from antitrust prosecution. Since the proposed merger would have joined two direct competitors accounting for a significant share of the relevant geographical market, it was judged to have adverse competitive effects in violation of the Clayton Act.

In another important ruling the Supreme Court in 1970 nixed the merging plans of two small Phillipsburg, New Jersey banks, Phillipsburg National Bank and Second National Bank. Among other things, it held that mergers between small banks were subject to the same antitrust standards as mergers between large ones. Customers of small banks are no less entitled to the benefits of competition than are customers of large ones. Gone is the day when banks can choose a marriage partner without regard to the competitive impact. These two



antitrust decisions, along with a series of other High Court interpretations, now mean that lower courts and regulatory agencies are required to give special consideration to maintaining competition in the banking field.

### WHY BE CONCERNED ABOUT CHANGES IN BANKING STRUCTURE?

Many economists believe that the structure of a market affects the behavior of the banks operating within it. Furthermore, it is argued that changes in this structure will likely induce changes in the price, quantity, and quality of bank services. For these reasons it is generally felt that structural changes which result in more competition in the marketplace will make banks more responsive in meeting customer needs at the lowest possible cost.

How did structural reforms in the 1960s invigorate competition? Bank services became more accessible throughout most of the country because of the expansion of banking offices. Greater convenience probably lowered the cost to the banking public of acquiring services. Improvement resulted not only because of increases in the number of bank outlets already serving the market, but in many cases from increases in the number of banking alternatives. New banks and *de novo* branches in previously untapped markets are the usual ways of increasing those alternatives.

A note of caution should be offered on mergers. Those between existing banks and acquisitions by holding companies usually add little toward improving accessibility to banking services because most merged banks are merely converted into branch offices. Often acquisitions only substitute one owner for another. And competition may be harmed when the marriage partners are rivals or potential rivals in the same market.

Some organizational changes—for example, those of the one-bank holding company

variety—have whetted competition between banks and nonbanking institutions because waters previously closed to banks can now be entered indirectly by the formation of a holding company. Several types of financial intermediaries are now facing new competition from subsidiaries of bank holding companies, and this competition should yield positive benefits for those consumers requiring a broader array of financial services.

However, the depth and breadth of the cluster of products and services generally considered to constitute commercial banking result primarily from bank size more than type of organization. A large bank can offer a more complete package of services than a small one. Being organized as a unit bank, a bank with a statewide branching network, or a bank owned by a holding company may not be nearly as important as a bank's *size*. Thus, most organizational changes have probably had a greater impact on the competitive trend for financial services rather than on the competitive intensity for the usual commercial banking services.

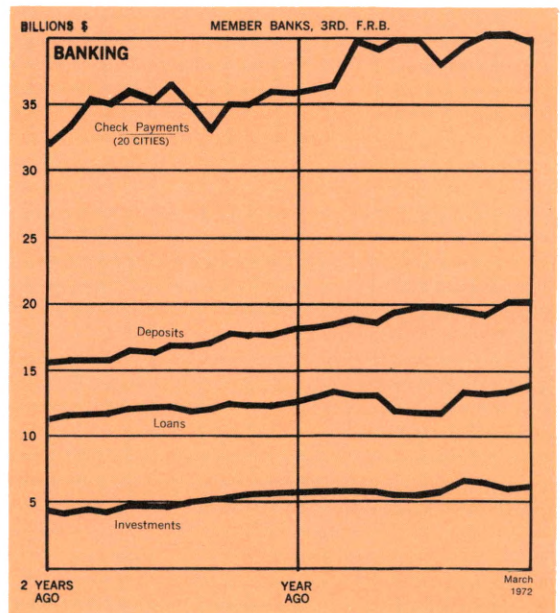
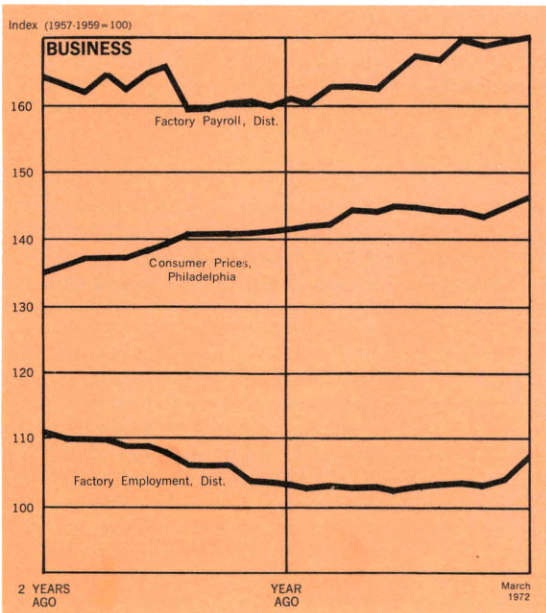
The other major category of change focused on control of banking resources. The competitive impact from this type of change is mixed. The typical bank size has doubled in the past decade. This is an encouraging development from the standpoint of providing a wider array of services. In some areas, however, the rise in bank size has been achieved by mergers that contributed to an increase in bank concentration. While concentration at the state level may rise and ebb without any great consequence, a steady rise in concentration at the local market level is a matter of concern, for it can be a sign of decaying competition.

It can be argued that structural reform in banking in the '60s made strides toward enhancing competition. The record suggests that the system is now more responsive to economic forces. And if these trends continue in the '70s, even greater benefits for the consumer may be in the offing. ■

## **NOW AVAILABLE**

The Federal Reserve Bank of Philadelphia annually publishes a *Report of Operating Ratios*. This *Report* contains average figures for member banks in the Third Federal Reserve District. To obtain copies of the 1971 *Report*, address your requests to Public Services, Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania 19101.

# FOR THE RECORD...



SUMMARY	Third Federal Reserve District			United States		
	Percent change			Percent change		
	March 1972 from		3 mos. 1972 from	March 1972 from		3 mos. 1972 from
	mo. ago	year ago	year ago	mo. ago	year ago	year ago
<b>MANUFACTURING</b>						
Production.....				+ 2	+ 5	+ 4
Electric power consumed.....	+ 3	+ 2	+ 3			
Man-hours, total*.....	+ 1	- 1	- 2	+ 1	+ 3	N/A
Employment, total.....	+ 1	- 2	- 3	+ 1	+ 1	N/A
Wage income*.....	+ 2	+ 6	+ 4	+ 2	+ 9	N/A
<b>CONSTRUCTION**</b>	+38	+ 2	+10	+30	+15	+20
<b>COAL PRODUCTION</b>	- 1	- 5	- 4	+ 9	- 5	- 7
<b>BANKING</b> (All member banks)						
Deposits.....	0	+10	+14	0	+ 7	+10
Loans.....	+ 2	+12	+11	+ 2	+12	+11
Investments.....	+ 2	+16	+17	+ 2	+10	+11
U.S. Govt. securities.....	0	+ 1	+ 3	+ 1	+ 1	+ 1
Other.....	+ 3	+25	+24	+ 2	+16	+17
Check payments***.....	- 4†	+ 7†	+13†	- 2	+10	+13
<b>PRICES</b>						
Wholesale.....				0	+ 4	+ 4
Consumer.....	0†	+ 3†	+ 3†	0	+ 4	+ 4

\*Production workers only  
 \*\*Value of contracts  
 \*\*\*Adjusted for seasonal variation

†15 SMSA's  
 ‡Philadelphia

LOCAL CHANGES Standard Metropolitan Statistical Areas*	Manufacturing				Banking			
	Employment		Payrolls		Check Payments**		Total Deposits***	
	Percent change March 1972 from		Percent change March 1972 from		Percent change March 1972 from		Percent change March 1972 from	
	month ago	year ago	month ago	year ago	month ago	year ago	month ago	year ago
Wilmington.....	+ 7	- 2	+ 8	- 1	-16	+ 8	+ 4	+ 4
Atlantic City.....	- 1	- 4	0	+10	- 7	+ 7	+ 1	+23
Bridgeton.....	- 1	- 3	-	-	-	-	-	-
Trenton.....	0	- 3	+ 2	+10	-21	-16	- 1	+10
Altoona.....	- 1	- 5	+ 1	+ 4	+11	+11	+ 2	+10
Harrisburg.....	0	- 1	+ 2	+ 7	- 4	+15	+ 2	+10
Johnstown.....	+ 2	- 5	+ 6	+ 6	+ 5	+29	+ 1	+ 7
Lancaster.....	+ 1	- 1	+ 5	+14	+ 1	- 1	0	+13
Lehigh Valley.....	+ 1	- 3	+ 2	+ 9	- 1	+ 7	+ 1	+14
Philadelphia.....	0	- 2	+ 1	+ 6	- 1	+ 8	- 1	+ 9
Reading.....	0	0	+ 2	+10	+ 1	+ 4	+ 1	+ 7
Scranton.....	+ 1	+ 5	+ 3	+ 9	+ 3	+ 6	+ 2	+15
Wilkes-Barre.....	+ 1	- 2	+ 3	+ 8	+ 2	+28	+ 1	+21
Williamsport.....	-	-	-	-	+ 4	0	-	-
York.....	0	+ 3	+ 1	+10	- 7	+32	+ 1	+12

\*Not restricted to corporate limits of cities but covers areas of one or more counties.  
 \*\*All commercial banks. Adjusted for seasonal variation.  
 \*\*\*Member banks only. Last Wednesday of the month.