

Research Department  
Federal Reserve  
Bank of  
San Francisco

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## Moratorium?

Early in April, Comptroller of the Currency C. Todd Conover declared a moratorium to last through 1983 on the granting of national charters to non-banking companies to establish new subsidiaries called "non-bank banks." These subsidiaries differ from a "bank" as defined by the Bank Holding Company Act in that they do not engage in commercial lending and demand deposit functions. As a result, their activities are not subject to the restrictions of the Act. The Comptroller's action was a response to the profound implications of this freedom for the geographical and product line restrictions imposed upon commercial banks by the McFadden, Bank Holding Company, and Glass-Steagall Acts.

As amended by the Banking Act of 1933 (also known as the Glass-Steagall Act), the McFadden Act allows national banks to branch where state banks are permitted to branch by state law. The effect of this condition is to prohibit interstate branching as state laws have generally not provided for such branching. The Douglas Amendment to the Bank Holding Company Act allows bank holding companies to acquire banks in other states only where state law in those other states specifically permit such acquisitions. The Glass-Steagall Act requires a separation of investment and commercial banking; it prohibits any person or firm engaged in the issue or underwriting of securities from receiving deposits.

At the heart of the issues of financial structure and regulation raised by the non-bank banks' ability to escape the restrictions of these acts is the basic question, what is a bank? This Letter explores some recent attempts to "legislate" an answer while making the point that market developments often define themselves.

### "Non-bank banks"

Non-bank banks are not "banks" as specified by the Bank Holding Company Act, but

in all other aspects, they are free to resemble banks, for example, to provide consumer financing and to accept federally insured (non-demand) deposits. Their difference from banks, as described above, means that they are not subject to the restrictions of the Bank Holding Company Act. It also means that an entity acquiring a non-bank bank does not qualify as a bank holding company under the same Act and is therefore not subject to regulation by the Federal Reserve, which supervises and regulates all bank holding companies.

These powerful attractions have induced the acquisition of some 18 non-bank banks by such diverse entities as Wilshire Oil, Parker Pen, McMahan furniture stores and Dreyfus Mutual Fund. They have also led to a considerable backlog of applications by other firms, including Dimension Financial Corporation (DFC) of Kansas which has applied to establish some 31 non-bank banks in 25 states. DFC apparently intends these entities to offer a broad range of financial services (such as consumer and mortgage loans, insured deposits, discount brokerage and sweep accounts, insurance, tax, and financial planning).

Another group of non-bank banks was specified by last year's Garn-St Germain Act which explicitly stipulated that depository institutions chartered by the Federal Home Loan Bank Board or insured by the Federal Savings and Loan Insurance Corporation are exempt from the definition of a bank for purposes of the Bank Holding Company Act. Moreover, federally chartered S&Ls are not subject to the interstate banking restrictions of the McFadden and Bank Holding Company Acts or (through their affiliates) to the securities constraints of the Glass-Steagall Act.

Drawn by the thrifts' vastly expanded powers under the 1980 Monetary Control

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Act as well as by the stipulations of the Garn-St Germain Act, a growing number of non-bank firms, such as brokerage houses, have applied to acquire S&Ls.

#### **Plugging the loopholes**

In testimony before the House and Senate Banking Committees following the Comptroller's announcement, Chairman Volcker of the Federal Reserve System called for a *legislative* moratorium on the acquisition of existing banks (the Comptroller's regulatory moratorium applies only to the establishment of new enterprises) that are candidates for conversion to non-bank banks and on the acquisition of S&Ls (except failing S&Ls) by non-depository firms. He argued that the broader moratorium would give Congress time to re-examine the public policy issues raised by the impact of market, technological, and legislative enactments (particularly at the state level) upon the financial and regulatory structure.

In short, he argued that the current interaction between market forces and the legal and regulatory structure offers no assurance that the problems that have developed will be resolved in a manner consistent with such fundamental goals as the "safety and soundness" of financial institutions (commercial banks in particular), the avoidance of excessive risk, competitive equity, the need to ensure an effective mechanism and structure for the transmission of monetary policy, and the avoidance of conflicts of interest and an excessive concentration of financial resources and power.

To ensure that the change is channelled along "constructive lines," Chairman Volcker called for a thorough re-examination of the ground rules governing financial structure, including the specific activities appropriate for a "bank." He noted, for example, that thrift institutions, while not considered banks, have "indisputably" become "bank-like" institutions. Other fundamental goals, he stressed, could be better served by less regulation. He argued that

a gradual relaxation of the restrictions on inter-state banking would be desirable — perhaps with a limitation on the size of banks that could be acquired across state lines. He reiterated previous recommendations that the Glass-Steagall Act be modified at least to permit banks to underwrite municipal revenue bonds and to offer mutual funds. As a "reasonable starting point" in addressing the question of just what specific product lines are appropriate for banks, he strongly endorsed the "traditional presumption" that there should be some separation of the ownership of banks from that of businesses engaged in commercial and industrial activities.

Finally, Chairman Volcker urged Congress to establish the "outer bounds" within which states can extend the powers of banks and thrift institutions so that the dual banking system "may continue to be a useful and constructive force." This concern, shared by Treasury Secretary Regan, was prompted by the growing tide of liberalizing actions already taken at the state level. These include South Dakota's recent move to allow state banks to sell the full gamut of insurance (anywhere except in South Dakota). Long sought by most banks, expanded authority to sell insurance was rejected by Congress last year in the process of approving the Garn-St Germain Act.

#### **Agency and industry responses**

Reactions to the proposal for a broadened legislative moratorium have been mixed. FDIC Chairman William Isaac (who last year urged state banking authorities to expand the powers of state banks as a specific means of accelerating federal deregulation of financial institutions) argues that a legislative moratorium "will only buy more and more time to drag our feet." He strongly favors accelerating the removal of most of the existing constraints on all commercial banks, as does the Comptroller.

Outgoing FHLBB Chairman Richard Pratt and incoming Chairman Edwin Gray also

oppose a legislative moratorium, on the grounds that there is "no evidence" that the ownership of S&Ls by non-depository (and even non-financial) firms "has ever caused a problem for the thrift industry." Chairman Gray also asserts that the proposed legislative ban on the acquisition of banks and thrifts by other firms "represents the first step toward consolidating the regulatory systems" for the banking and thrift industries, a move which the FHLBB strongly opposes.

Bankers are divided on the legislative moratorium issue. American Bankers Association President William Kennedy believes such a move would merely stall the pace of deregulation. But James Herrington, President of the Independent Bankers Association of America (IBAA), strongly supports a moratorium to give the Congress the opportunity to "clear up the mess" caused by regulatory and legislative "loopholes."

**Congressional response**

Within the House and Senate Banking Committees, response to the proposal for a legislative moratorium has been lukewarm at best. Last month, Senate Banking Committee Chairman Jake Garn (R-Utah) stated that "not one member of the Committee (favors) such a moratorium." However, he recognizes the dilemmas posed on the one hand by the desire to give banks, S&Ls and other segments of the financial industry time to adjust to the recent significant changes in banking laws (such as the Garn-St Germain Act), and the desirability, on the other hand, to keep up with changes resulting from market developments and "loopholes" in existing laws. His Committee will continue to focus on developing a comprehensive approach to financial reform, but Senator Garn has said his current lack of enthusiasm for a legislative moratorium is largely due to the recent absence of a rash of acquisitions.

The attitude of the House Banking Committee appears to be much the same. Some Committee members who are inclined to favor a moratorium note that the multi-state applications of Dimension Financial Cor-

poration, for example, "go to the heart" of the McFadden, Bank Holding Company and Glass-Steagall Acts, but that "even if Congress slapped a temporary embargo on this sleight of hand, we cannot stop the market-place."

**For whom the bell tolls**

In the meantime, the three federal banking agencies (excepting the FHLBB) appear to be coming closer to a definition of a "bank" that is not encumbered by an asset test (e.g., whether the institution makes commercial loans). Such a revised definition might include any institution that offers transaction accounts or any type of federally insured deposit. This definition would closely fit that of a bank prior to 1970, except that it would also include thrift institutions. (Presumably, it still would not include balances in money market funds—a loophole in the existing definition—inasmuch as these are not federally insured and have been determined by the Attorney General to be "investments" and not deposits.)

Absent a legislative moratorium, however, and notwithstanding the Comptroller's unilateral moratorium on applications for the establishment of new "non-bank banks," the course of developments very likely will be in the direction of more applications to acquire S&Ls and existing banks for conversion to "non-bank banks." Also very likely, is continued action by the states to extend both the permissible geographic limits in which state banks may operate and the limits on the product lines which they may offer. (The current reciprocal banking moves of the New England states being a case in point.)

In fact, the bells are already tolling for at least some of the geographic and product constraints of the McFadden, Bank Holding Company and Glass-Steagall Acts. When Congress finally gives its imprimatur to the changes already taking place in the banking market and already ratified in some states, it will once again be "sero sed serio"—late but earnest.

**Verle B. Johnston**

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**BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT**  
 (Dollar amounts in millions)

Selected Assets and Liabilities	Amount Outstanding 5/18/83	Change from 5/11/83	Change from year ago	
			Dollar	Percent
<b>Large Commercial Banks</b>				
Loans (gross, adjusted) and investments*	162,675	- 90	3,352	2.1
Loans (gross, adjusted) — total#	140,945	116	2,402	1.7
Commercial and industrial	44,379	- 592	671	1.5
Real estate	56,148	- 15	- 1,018	- 1.8
Loans to individuals	23,522	- 24	200	0.9
Securities loans	2,888	645	1,097	61.2
U.S. Treasury securities*	7,998	- 37	1,958	32.4
Other securities*	13,731	- 169	- 1,008	- 6.8
Demand deposits — total#	40,346	- 106	2,572	6.8
Demand deposits — adjusted	28,051	- 982	1,780	6.8
Savings deposits — total†	66,303	304	35,708	116.7
Time deposits — total#	65,336	- 626	- 27,771	- 29.8
Individuals, part. & corp.	58,646	- 509	- 24,774	- 29.7
(Large negotiable CD's)	19,055	- 448	- 14,947	- 44.0
<b>Weekly Averages of Daily Figures</b>	<b>Week ended 5/18/83</b>	<b>Week ended 5/11/83</b>	<b>Comparable year-ago period</b>	
<b>Member Bank Reserve Position</b>				
Excess Reserves (+)/Deficiency (-)	101	65		46
Borrowings	6	2		20
Net free reserves (+)/Net borrowed(-)	95	63		25

\* Excludes trading account securities.

# Includes items not shown separately.

† Includes Money Market Deposit Accounts, Super-NOW accounts, and NOW accounts.

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