

Holding Patterns

Bank holding companies are something of a mystery to most people. The following article reviews how bank holding companies have evolved and looks at how their growth has affected modern American banking.

What Is a Bank Holding Company?

Simply defined, a bank holding company (BHC) is a company that owns or otherwise controls one or more banks. Furthermore, all bank holding companies fall into either of two broad categories: one-bank holding companies (OBHCs) and multibank holding companies (MBHCs). A one-bank holding company is usually formed by a bank seeking to diversify into such nonbanking activities as operating a courier service or operating a data processing service; whereas multibank holding companies are most often formed by banks hoping to expand into a wider geographic area.

Bank holding companies have been in existence since the early part of the twentieth century. Most of the early BHCs, however, were one-bank holding companies organized by families or individuals in order to gain certain tax advantages.

One major exception was the multibank holding company formed by A.P. Giannini, founder of the Bank of America. When the McFadden Act (1927) barred interstate banking, Giannini formed the multibank holding company now known as First Interstate Bancorp. (Today, First Interstate has affiliated banks in 15 western states.)

Fits and Starts

Multibank holding companies experienced moderate growth during the 1920s, but then the Great Depression of the 1930s precipitated a long-lasting financial crisis that forced many banks and bank holding companies into insolvency. The Depression also prompted Congress to pass the Banking Act of 1933, a piece of legislation intended to prevent banks from engaging in business activities unrelated to banking.

The combination of economic hard times and government regulation curtailed the growth of bank holding companies. In fact, the number of multibank holding companies declined from a high of 97 at the end of 1931 to a low of 20 at the end of 1948.



During the Mid-1960s, One-bank Holding Companies Gained New Importance.

In the Money

Banking began to change during the 1950s. One word helps to explain why: *prosperity*.

Rising incomes, affordable private cars, and improved highways gave Americans greater mobility. More and more people chose to leave their urban neighborhoods for houses in the suburbs.

The period of extended prosperity also led bankers to abandon some of their Depression-era caution and to pursue new business more aggressively. But in many cases banks were unable to follow their customers to suburbia; restrictive bank branching laws often stood in the way.

Multibank holding companies, however, provided a perfect vehicle for expansion. They enabled the heavily-regulated banking organizations to open offices in new areas and to offer customers a wider range of services.

The First Act

Concern over the possibility of unregulated holding company growth prompted Congress to pass

the Bank Holding Company Act of 1956 and to give the Federal Reserve System responsibility for administering the Act. The BHC Act gave the Federal Reserve approval power over the formation of new bank holding companies and authority to determine which nonbanking (but bank-related) activities would be open to bank holding companies. Another provision required bank holding companies to secure Federal Reserve approval prior to acquiring 25 percent or more of the stock of additional banks. And Section 3(d) of the Act, better known as the Douglas Amendment, prohibited multi-bank holding companies from acquiring a bank in another state unless that state's laws specifically authorized such acquisitions.

The Bank Holding Company Act effectively slowed the growth of multibank holding companies. (Between 1956 and 1962, they actually declined in number.) The Act, however, completely ignored one-bank holding companies, because it defined a BHC as any company that owned or controlled two or more companies.

During the mid-1960s, one-bank holding companies gained new importance. Many of the nation's largest banks sought to form one-bank holding companies and, thereby, diversify into nonbanking activities. By 1970, OBHCs controlled a significant percentage of commercial bank deposits, so Congress once again turned its attention to holding company regulation.

The 1970 amendments to the BHC Act eliminated the legal distinction between one-bank and multibank holding companies by defining a holding company as "any company which has control over any bank." Any company that qualified as a BHC was required to register with the Federal Reserve System and to file reports with the System. Furthermore, a registered bank holding company was required to obtain approval of the Board of Governors of the Federal Reserve System before acquiring more than 5 percent of the shares of additional banks.

Another major provision of the amended Bank Holding Company Act established a two-part test

which all activities must meet in order to be exempted from outright prohibition as a nonbanking activity. Under Section 4(c)(8), the Board of Governors must first determine whether an activity is "so closely related to banking or managing or controlling banks as to be a proper incident thereto"; and second, whether the performance of this activity "by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."

Competition From the Financial Services Industry ... Contributed to the Growth of Bank Holding Companies.

Boom Years

Passage of the 1970 amendments had little effect on the rate of bank holding company formation. By the end of 1970, 121 multibank holding companies controlled 16 percent of U.S. commercial bank deposits, and 1,352 one-bank holding companies held more than one-third of U.S. commercial bank deposits. At year-end 1981, MBHCs and OBHCs controlled more than three-fourths of all bank deposits.

This rapid growth resulted, in part, from the willingness of American bankers to be more aggressive in the pursuit of profitable opportunities. As memories of the Depression faded, bankers seemed more willing to assume the added risks involved in expansion and innovation.

Competition from the financial services industry also contributed to the growth of bank holding com-

panies. Providers of nonbank financial services offered customers a wide range of innovative products, while technological advances allowed people in all parts of the country to take advantage of those products. Before long, even small investors began to realize that the local bank was not the only place to put their money.

Banks responded to the increased competition by forming bank holding companies. Multi-bank holding companies and one-bank holding companies allowed the highly-regulated banks to tap new markets and to offer new services.

When Is a Bank Not a Bank?

During the 1980s, Congress and the various bank regulators once again focused their attention on the Bank Holding Company Act. Non-bank enterprises, including several financial services companies, were attempting to acquire banks by taking advantage of a loophole in the Act.

The Bank Holding Company Act defines a bank as an institution that "accepts deposits . . . and engages in the business of making commercial loans." Controversy arose when a number of nonbanking enterprises attempted to enter the banking business by purchasing a commercial bank and then spinning off either the bank's deposits or its commercial loan portfolio.

In general, the FDIC and the Comptroller of the Currency tended to approve such purchases, whereas the Federal Reserve often expressed opposition and favored closing the loophole. The Federal Reserve opposed the acquisitions on the grounds that the loophole enabled the acquired banks to circumvent the Douglas Amendment to the BHC Act. Under the Douglas Amendment, bank holding companies were prohibited from acquiring a bank in another state unless that state's laws specifically authorized such acquisitions.

(As of September 1984, the FDIC, the Comptroller of the Currency, and the Federal Reserve had not yet reached complete agreement on the "loophole" question. In all probability, Congress will have to resolve the issue.)

Looking Ahead

Since the mid-1960s, bank holding companies have multiplied and expanded far ahead of projections. The unforeseen growth probably says as much about projections as it says about bank holding companies.

Nevertheless, an article in the July 19, 1984 edition of *American Banker* offers some interesting observations on the future of bank holding companies. The article

profiles First Interstate Bancorp (formerly Western Bancorp), one of the nation's largest bank holding companies.

According to Joseph Pinola, First Interstate's chairman and chief executive officer, "Banking is the merchandising of financial services, it's not making loans. It's a whole new game."

Pinola compares banking to the fast-food business. In fact, First Interstate grants franchises to banks

in other states, and the franchisees share uniform lending and investment policies. This system allows First Interstate to hold onto customers who move anywhere within the 15 states it serves.

Whether or not franchising represents the wave of the future remains to be seen. One thing, however, is certain: the rapid growth of bank holding companies has changed the nature of American banking.

Multi-Media

The Federal Reserve in Electronic Payments, published by the Federal Reserve Bank of Boston, 6 pages.

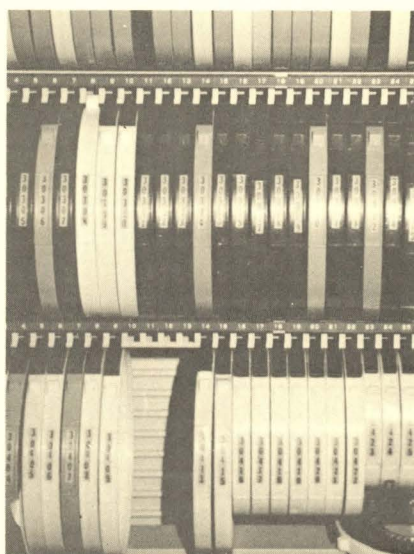
As the nation's central bank, the Federal Reserve is responsible for ensuring the speed and efficiency of the nation's payments system. In fulfilling this responsibility, the Fed provides a variety of services, including electronic funds transfer services, to the nation's depository institutions.

For readers who would like to know more about electronic payments, this informative new pamphlet covers two major areas: the Federal Reserve's wire transfer system (FedWire) and the Automated Clearinghouse system (ACH).

For free copies of *The Federal Reserve in Electronic Payments*, write to: Publications, Public Services Department T-3, Federal Reserve Bank of Boston, Boston, MA 02106; or phone (617) 973-3459.

Money in the Economy, published by the Federal Reserve Bank of San Francisco, 23 pages.

Most of us take for granted that money and credit conditions have an important effect on our personal financial affairs and on the nation's economic performance. Yet many people are unsure how monetary policy affects the nation's economy and are even less sure about how monetary policy is carried out. *Money in the Economy* is perfect for the reader who is looking for a clear and concise treatment of these subjects.



The 23-page booklet explains what economists mean when they talk about "money," how banks and other depository institutions can "create" money, and how the Federal Reserve makes monetary policy. This leads to a discussion of how Federal Reserve actions in the area of monetary policy can affect interest rates, unemployment, and inflation.

For free copies of *Money in the Economy*, write to: Public Information Department, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco, CA 94120; phone (415) 974-2246.

Depository Institutions and Their Regulators, published by the Federal Reserve Bank of New York, chart.

The Federal Reserve Bank of New York published *Depository Institutions and Their Regulators*, a quick-reference guide to bank regulation in the United States. The chart describes the responsibilities that each of 10 regulators has in 10 areas—from branching to consumer protection. It also summarizes a variety of banking laws and rulings.

In short, *Depository Institutions and Their Regulators* is a valuable resource for readers who need to find their way through the American system of overlapping bank regulation. Single copies are available free from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, NY 10045.

Time For a Change

Enclosed with this issue of *The Ledger* is a replacement to the Audiovisual Materials section of Federal Reserve Bank of Boston's *Catalog*. (The 1983 *Catalog* has a red and white cover.) The enclosed replacement section reflects three major changes: 1) requests for all films listed in the catalog should now be sent to **R.H.R. Filmedia**, 2) the popular economic education film, *Chickenomics*, is now available (on a free-loan basis) to schools and organizations in New England, and 3) *EFT at Your Service, To Your Credit*, and a revised version of *The Fed - Our Central Bank* are now also available on a single videocassette. Borrowers may duplicate the cassette without charge.

Fed Update

FALL EVENTS AT THE FEDERAL RESERVE BANK OF BOSTON

A series of midday music programs continues at the Federal Reserve Bank of Boston's auditorium. All performances begin at 12:30 p.m. and are 30-40 minutes in length. The public is invited at no charge.

- October 4 Boston University School of Music
- October 11 Boston Conservatory of Music
- October 18 New England Conservatory of Music
- October 25 Longy School of Music
- November 1 Boston University School of Music
- November 8 Boston Conservatory of Music
- November 15 New England Conservatory of Music
- November 29 Longy Wind Ensemble
- December 6 Boston University School of Music

- December 13 Celebrating Broadway Dance Company
- December 20 Boston Conservatory of Music

Gallery Exhibitions at the Bank are also open to the public at no charge. Viewing hours: Monday - Friday, 10:00 a.m. - 4:00 p.m.

Cambridge Arts Council Open Juried Photography Exhibition
September 17 - October 12, 1984

Boston Visual Artists Union presents *Views: Land, Sea, Air*
November 7 - December 28, 1984

The gallery and the auditorium are located on the ground floor of the Federal Reserve Bank building, 600 Atlantic Avenue, across from South Station. Programs are subject to change without notice. For more information, please contact Anne Belson, (617) 973-3454; or Kathy Toussaint, (617) 973-3368.

the LEDGER

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Map of Commuting Routes and Parking Facilities

