Chapter 10

Banking Industry: Structure and Competition
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
Financial Innovation

Innovation is result of search for profits

Response to Changes in Demand

Major change is huge increase in interest-rate risk starting in 1960s
Example: Adjustable-rate mortgages

Financial Derivatives

Response to Change in Supply

Major change is improvement in computer technology
1. Increases ability to collect information
2. Lowers transaction costs

Examples:
1. Bank credit and debit cards
2. Electronic banking facilities
3. Junk bonds
4. Commercial paper market
5. Securitization
Avoidance of Existing Regulations

Regulations Behind Financial Innovation

1. Reserve requirements
   Tax on deposits = \( i \times r \)

2. Deposit-rate ceilings (Reg Q)
   As \( i \) ↑, loophole mine to escape reserve requirement
tax and deposit-rate ceilings

Examples

1. Money market mutual funds
2. Sweep accounts
The Decline in Banks as a Source of Finance
Decline in Traditional Banking

Loss of Cost Advantages in Acquiring Funds (Liabilities)
$\pi \uparrow i \uparrow$ 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
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
## Structure of the Commercial Banking Industry

### Table 1 Size Distribution of Insured Commercial Banks, September 30, 2004

<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 $100 million</td>
<td>3,755</td>
<td>49.02</td>
<td>2.36</td>
</tr>
<tr>
<td>$100 million to $1 billion</td>
<td>3,458</td>
<td>45.14</td>
<td>11.25</td>
</tr>
<tr>
<td>$1 billion or more</td>
<td>447</td>
<td>5.84</td>
<td>86.39</td>
</tr>
<tr>
<td>Total</td>
<td>7,660</td>
<td>100.00</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: http://www2.fdic.gov/sdi/main.asp.
## Ten Largest U.S. Banks

### Table 2: Ten Largest U.S. Banks, December 2003

<table>
<thead>
<tr>
<th>Bank</th>
<th>Assets ($ millions)</th>
<th>Share of All Commercial Bank Assets (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Citigroup, New York, NY</td>
<td>1,360,000</td>
<td>28.46</td>
</tr>
<tr>
<td>2. JPMorgan Chase, New York, NY</td>
<td>771,000</td>
<td>16.14</td>
</tr>
<tr>
<td>3. Bank of America, Charlotte, NC</td>
<td>736,000</td>
<td>15.40</td>
</tr>
<tr>
<td>4. Wachovia, Charlotte, NC</td>
<td>401,000</td>
<td>8.39</td>
</tr>
<tr>
<td>5. Wells Fargo, San Francisco, CA</td>
<td>391,000</td>
<td>8.18</td>
</tr>
<tr>
<td>6. Bank One, Chicago, IL</td>
<td>326,000</td>
<td>6.82</td>
</tr>
<tr>
<td>7. Washington Mutual, Seattle, WA</td>
<td>286,000</td>
<td>6.00</td>
</tr>
<tr>
<td>8. Fleet Boston, Providence, RI</td>
<td>200,000</td>
<td>4.19</td>
</tr>
<tr>
<td>9. U.S. Bancorp, Cincinnati, OH</td>
<td>182,000</td>
<td>2.81</td>
</tr>
<tr>
<td>10. SunTrust, Atlanta, GA</td>
<td>125,400</td>
<td>2.61</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,288,385</strong></td>
<td><strong>74.24</strong></td>
</tr>
</tbody>
</table>

*Source: [http://www.nyjobsource.com/books.html](http://www.nyjobsource.com/books.html).*
Branching Regulations

Branching Restrictions: McFadden Act and Douglas Amendment

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. 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 banks, 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 Modernisation 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

Implications: 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
Savings and Loans

Regulators
1. Office of Thrift Supervision
2. Federal Home Loan Bank System (FHLBS)
3. FDIC’s Saving Association Insurance Fund (SAIF)
4. State banking authorities

Structure
1. Fewer restrictions on branching
Mutual Savings Banks

Regulators
1. FDIC
2. States

Structure
1. 400 or so
2. Within-state branching regulations not restrictive, so there are few small MSBs
Credit Unions

Regulators
1. National Credit Union Administration (NCUA)
2. States

Structure
1. Because must have common bond of depositors, most are small with deposits < $10 million
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
# Ten Largest Banks in the World

## Table 3  Ten Largest Banks in the World, 2003

<table>
<thead>
<tr>
<th>Bank</th>
<th>Assets (U.S. $ billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Citigroup, U.S.</td>
<td>1,264,032</td>
</tr>
<tr>
<td>2. Mizuho Financial Group, Japan</td>
<td>1,223,478</td>
</tr>
<tr>
<td>3. UBS, Switzerland</td>
<td>1,116,215</td>
</tr>
<tr>
<td>4. Credit Agricole Group, France</td>
<td>1,098,669</td>
</tr>
<tr>
<td>5. HSBC, U.K.</td>
<td>1,034,216</td>
</tr>
<tr>
<td>6. Deutsche Bank, Germany</td>
<td>1,008,696</td>
</tr>
<tr>
<td>7. BNP Paribas, France</td>
<td>982,917</td>
</tr>
<tr>
<td>8. Sumitomo Mitsui Banking, Japan</td>
<td>863,507</td>
</tr>
<tr>
<td>9. Mitsubishi Tokyo FG, Japan</td>
<td>836,358</td>
</tr>
</tbody>
</table>

*Source: Euromoney 35(422):176, June 2004*