Bank and thrift performance since DIDMCA

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The financial services industry has changed dramatically over the past five years. The consumer, the regulatory agencies, and the financial services industry have influenced and been influenced by these changes. However, it is unclear how much of this change is attributable to the new laws and how much to other economic and technological factors. The liberalization of FHLBB policies on advances and adjustable mortgage instruments, the decline in interest and inflation rates, technological developments, and the generally improved economy may have contributed as much, if not more, to the current status and future prospects of the financial services industry.[1]

The changes initiated by the acts have affected the source and cost of funds, the asset powers and use of funds, and hence the growth and profitability of banks and thrifts. This article examines the acts' impact on these factors for commercial banks and thrifts by looking at their performance during selected pre- (1975-1979) and post- (1980-1984) legislation periods. Are these institutions net winners or losers in the changing game of deregulation? Is size an important determinant of an organization's ability to adjust and react to the changing and more competitive financial services industry in the post-legislative period?

Sources of funds

Designed to promote competitive equality among depository institutions, the acts authorized depository organizations throughout the nation to offer interest-bearing transaction accounts, and to expand their deposit offerings and servicing capabilities. As short-term interest rates continued to rise in the late 1970s and Regulation Q became more and more binding, pressures mounted for a consumer deposit instrument at depository institutions that, like the money market mutual fund (MMMF), yielded a market rate of return. This led Congress, in 1980, to legislate a phase-out of Regulation Q. This process was accelerated with the introduction of the money market deposit account (MMDA) in December 1982. The MMDA was created to bring competitive equality to banks, thrifts, and nondepository financial institutions. This savings instrument, along with the NOW and Super NOW accounts, although not significantly altering the growth rate of total deposits, altered the composition of the liability portfolio of both banks and thrifts in the post-legislation period. (See Table 1 and Figures 1 and 2.)

Banks

The deposit-to-asset ratio for banks, on average, and for all but the largest banks, has remained approximately the same or risen only slightly from 1975 to 1984.[2] (See Table 2.) Looking at the types of deposit liabilities held by banks, transaction deposits since 1975 have gradually become less significant as a source of funds. However, one component of transaction deposits, other checkable deposits, has become increasingly important. (See Table 1.) The introduction of the automatic transfer savings (ATS) account in 1978 and the negotiable order of withdrawal (NOW) account in 1980 contributed to this transition. By 1983-1984 a significant shift is apparent with Super NOWs making up approximately one-quarter of other checkable deposits.

Commercial bank funding from savings accounts also decreased continuously over the past decade due to below market rates on savings. This trend corresponded with a continual increase in banks' reliance on small and large time deposits as a source of funds. This trend was reversed by the introduction of the MMDA. The increasing reliance on small and large time deposits had been in large measure driven by the changing structure of interest rate ceilings. These shifts in funding sources (particularly from 1979 to 1982) also reflected the flow of retail funds away from banks to MMMFs and other savings instruments bearing market rates of return.

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Table 1
Source of funds: percentage of total deposits by institution type

	Transaction				Nontransaction				
		Other checkable deposits							
Year	Demand deposits	Except Super NOW	Super NOW	Total	Savings	MMDA	Small time	Large time	Total deposits
Banks									
1975	33.9	.04	NA	33.9	24.0	NA	21.5	20.6	623.5
1980	28.4	1.8	NA	30.2	20.1	NA	28.5	21.2	929.8
1982	21.1	6.5	NA	27.6	14.5	.2	33.9	23.8	1107.5
1984	18.4	5.4	2.2	26.0	9.5	18.4	27.6	18.5	1342.2
Thrifts									
1975	*	.1	NA	.1	53.6	NA	44.7	1.5	403.2
1980	*	.8	NA	.8	31.9	NA	61.6	5.7	683.9
1982	*	2.5	NA	2.5	25.1	.2	64.2	8.0	752.3
1984	*	2.8	1.2	4.0	17.9	15.6	48.9	13.6	954.5

*Demand deposits for thrifts are not available separately and are included in other checkable deposits.
Note: Percentages may not add to 100% due to rounding.
SOURCE: Federal Reserve Board H.6 Release, various years.

The introduction of the MMDA at banks significantly decreased the percentage of banks' total deposits from small and large time deposits, from 57.7 percent in 1982 to 46.1 percent in 1984. Initially, banks experienced substantial and rapid growth of MMDAs. They regained direct access to the retail deposit market that had been lost to the MMMFs. Yet a significant portion of the funds flowing into these new accounts were simply shifted from small

Figure 1
Deposit components at commercial banks (post-legislation period)

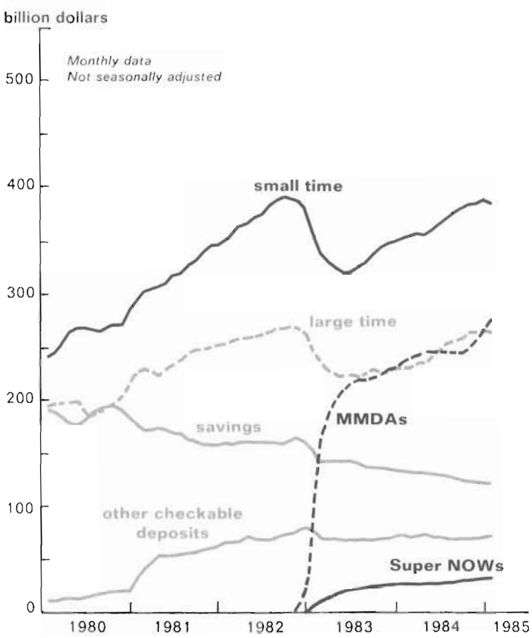

Figure 2
Deposit components at thrifts (post-legislation period)

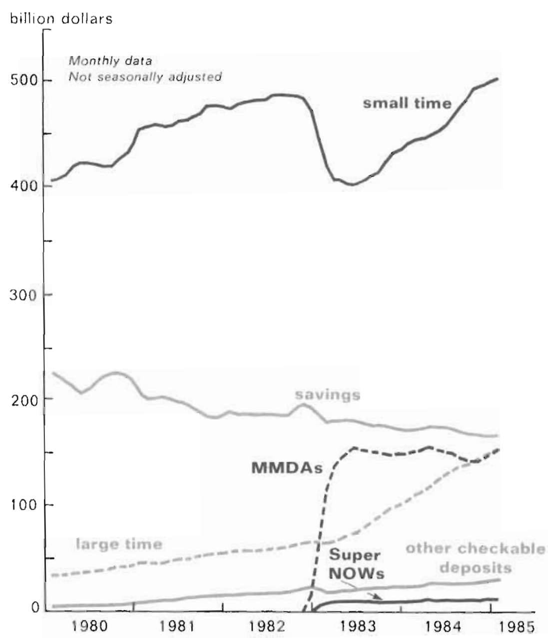

Table 2
Assets and liabilities of banks and thrifts
(in percent of total assets)

	Banks			Thrifts		
	1975	1980	1984	1975	1980	1984
Assets						
Cash	10.5	9.5	8.3	1.7	1.6	2.0
Investments[1]	36.7	35.5	34.8	12.9	14.6	23.1
Loans	49.8	53.5	54.0	81.8	80.1	67.1
Residential mortgages	*9.3*	*10.4*	*10.1*	*66.8*	*66.2*	*52.9*
Commercial mortgages	*6.6*	*8.2*	*8.1*	*12.8*	*10.5*	*9.6*
Consumer loans	*14.1*	*14.2*	*12.2*	*2.1*	*3.2*	*3.8*
Commercial loans	*10.4*	*11.5*	*13.2*	*0.1*	*0.1*	*0.8*
Other loans[2]	*9.4*	*9.2*	*10.4*	*NA*	*NA*	*NA*
Subsidiaries	0.0	0.0	0.0	0.2	0.3	0.6
Other	3.0	2.0	2.9	3.4	3.4	7.2
Total assets	100.0	100.0	100.0	100.0	100.0	100.0
Liabilities						
Total deposits	87.7	87.9	87.4	87.5	85.9	87.7
transaction	*33.4*	*27.7*	*23.9*	*0.1*	*0.5*	*NA*
savings	*20.2*	*15.6*	*19.1*	*40.0*	*19.8*	*NA*
time	*34.1*	*44.7*	*44.4*	*48.5*	*65.6*	*NA*
Borrowed funds[3]	0.8	1.7	1.9	3.3	5.0	5.6
Other liabilities	2.1	1.2	1.5	2.8	2.6	1.5
Total liabilities	90.6	90.8	90.8	93.6	93.5	94.8
Capital						
Subordinated debt	0.2	0.2	0.1	0.0	0.0	0.0
equity[4]	8.5	9.0	9.2	6.4	6.5	5.1
Total capital	8.7	9.2	9.3	6.4	6.5	5.1

[1] Mortgage backed securities held by thrifts were: 1975=3.0%1980=3.6% 1985=9.0%
[2] Other loans by thrifts are included in commercial loans.
[3] Federal Home Loan Bank advances used by thrifts were: 1975=4.5% 1980=3.2% 1984=3.7%
[4] Regulatory equity provided to thrifts was .2% in 1984.
SOURCE: Report of Condition and Semiannual Financial Reports as of December 31, 1985, December 31, 1980, and June 30, 1984.

time deposits within the banking system and large CDs held by MMMFs. (See Figure 2.)

In the pre-legislation period, banks' savings account deposits were a greater share of total deposits than were small time deposits. This trend was reversed in the post-legislation period and remained so until the introduction of the MMDA. For 1983 and 1984, MMDA deposits plus traditional savings deposits accounted for 28 percent of funding, approximately the same percentage of banks' overall funding as savings deposits provided prior to the acts (1976-1978). They accounted for approximately one-half of the nontransaction funds from accounts under $100,000 (that is, savings, MMDAs, and small time deposits).

The introduction of the MMDA has led to a rapid decline in the share of large time deposits at banks. Large time deposits as a percentage of total deposits at banks declined by 5.4 percentage points from 1982 to 1983 but changed only minimally from 1983 to 1984. With the renewed ability to compete aggressively for retail deposits, banks, particularly the largest ones, were able to rely less on the more costly and less stable wholesale deposits.

The period following the acts not only saw an overall reduction in the use of uninsured domestic deposits (i.e; large time deposits over $100,000, excluding Eurodollars) by banks, but also saw a shift in the share of uninsured deposits from money center banks to other banks.[3]

Thrifts

The ratio of total deposits-to-assets for thrifts has approximately equaled that for banks and has also remained relatively stable over the pre- and post-legislation periods. (See Table 2.) However, the two types of institutions differ in that borrowed funds have been a greater percentage of assets for thrifts and continue to grow more rapidly at thrifts than at banks.[4] This primarily reflects differing FHLBB and Fed lending policies. FHLBB advances, especially in the post-legislation period, have come to be viewed as a legitimate funding

Table 4
Composition of operating ratios for banks and thrifts

	Operating income to total assets				Operating expense to total assets				
	Loans	Investments	Other	Total*	Salary	Deposit interest	Other	Total*	Net income to total assets
	(%)	(%)	(%)	(¢/$)	(%)	(%)	(%)	(¢/$)	(¢/$)
Banks									
1975	61	32	8	6.84	24	49	26	5.89	.78
1980	62	31	7	9.87	20	57	23	8.41	1.09
1984	59	34	7	11.25	16	61	23	10.10	.90
Thrifts									
1975	87	9	4	7.57	10	76	15	6.89	.50
1980	81	17	2	9.43	8	78	14	9.28	.11
1984	74	23	3	11.21	8	77	15	10.73	.31

*Total refers to the ratio of operating income (expense) to total assets in cents per dollar of assets.
SOURCE: Reports of Condition and Semiannual Financial Reports for periods ending December 31, 1975, December 31, 1980 and June 30, 1984.

sets in nontraditional lending and are far below the maximum allowable percentages for all classes of nontraditional lending. (See Table 2.)

The extent to which individual thrifts are using their new asset powers varies widely. Besides financial factors, size and location (i.e.; the influence of liberalized asset powers of state-chartered thrifts, which has occurred primarily in the South and West) seem to have an important influence on the aggressiveness of thrift institutions in expanding into nontraditional lending.[19]

Survey results of S&Ls in Illinois and Wisconsin indicate that few S&Ls, mostly the largest ones, are willing to take the associated risks and are able to surmount the start-up costs of entering the business of commercial lending.[20] Only 41.8 percent of thrifts held commercial and industrial (C&I) loans as of June 1984, and 30.6 percent of total C & I loans at these thrifts were held by the top ten institutions. This contrasts with the same concentration measure for total thrift assets—13.8 percent and traditional thrift assets—residential mortgages 14.1 percent and commercial mortgages 14.8 percent.

In becoming providers of bank-like services, thrifts are more likely to enter the business of consumer lending, which unlike commercial lending, has fewer barriers to entry for thrifts, i.e., it is more familiar and less costly to enter. In fact, the smallest thrifts (under $100 million total assets), which account for 52.8 percent of all thrifts, win the honors for growth of consumer loans. Their consumer loan-to-asset ratio increased from 2.1 percent in 1975 to 4.0 percent in 1984 and is the highest ratio of all thrift size classes. (See footnote 20.)

In contrast with the limited participation in commercial lending, 88.6 percent of all thrifts made consumer loans in 1984 and 17.0 percent of the total consumer loans made by thrifts were held by the top ten thrifts. Moreover, thrifts as a group have made significant inroads in the consumer loan market, particularly in the submarket for mobile home loans. Such moves are reflected in decreased market shares for commercial banks. (See Table 5.)

The most dramatic change in thrifts' asset portfolio in the post-legislation period has not been their use of new asset powers but rather the increased flexibility in yields on their most prominent asset—mortgages. The FHLBB's authorization (April 1981) of adjustable mortgage loans (under regulatory limitations) and the standardization of AMLs by Freddie Mac has increased the availability and market acceptance of flexible mortgage instruments—particularly, adjustable rate mortgages (ARMs).[21]

In January 1985, ARMs, balloons, and other adjustable mortgages accounted for 71 percent of thrift mortgage originations. These mortgages also made up 37.9 percent of thrifts' mortgage portfolios. Also, almost all S&Ls (91.4 percent as of Dec. 1984) offered ARMs.

The improved economy and increased mortgage demand, and thrifts' ability to offer new types of mortgage instruments, especially ARMs, has diminished their need to turn to new, unfamiliar, and nontraditional lending powers to alter their asset portfolio. With 22 percent of their assets in variable rate mortgage instruments (as opposed to 1.4 percent in 1980), thrifts have substantially increased their ability to reduce interest rate risk exposure.

Table 5
Percentage of consumer installment credit by institution type[1]
(1975-1984)

Total credit	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984
Amount outstanding	$164.9	$185.5	$230.8	$275.6	$311.1	$314.9	$335.7	$355.8	$396.1	$460.5
Commercial banks	47.7	48.3	48.7	49.4	48.1	46.7	44.0	43.0	43.4	44.5
Thrifts	NA	NA	4.1	4.0	4.1	4.4	4.9	4.7	7.0	8.4
Credit unions	15.6	16.4	16.3	16.7	15.4	14.0	13.7	13.3	13.5	14.2
Other	32.7	31.1	30.9	29.9	32.4	34.9	37.4	38.0	36.1	32.9

[1] Other includes finance companies, retailers, auto dealers and gasoline companies for the years 1977-1984. For 1975 and 1976, other includes finance companies and retailers (except 30-day charge credit). Amounts of credit outstanding are at end of period and are in billions of dollars.
SOURCE: *Federal Reserve Bulletins*, Domestic Financial Statistics-Consumer Installment Credit, various issues.

Impact on Income

The rate of growth in total operating income was lower in the post- than the pre-legislation period for both banks and thrifts, only more so for banks. For all bank and thrift size categories the percentage of income attributed to loans and the rate of growth of loan income declined in the post-legislation period. The decline in income share from loans was twice as great for thrifts as for banks. (Unlike banks, thrifts had experienced a similar decline in the pre-legislation period.) But thrifts still obtain, on average, 15 percent more of their income from loans than do banks.

The growth of bank and thrift investment and loan income varied in relation to changes in interest rates in the pre- and post-legislation periods. The differing maturities of bank and thrift loan portfolios is reflected by the fact that the rate of growth of loan income fell much more dramatically for banks (40 percentage points) than for thrifts (7.3 percentage points) from the pre- to the post-legislation period. However, the rate of growth in investment income fell for both thrifts and banks, although more for thrifts, in the years 1980 to 1984. Also offsetting the declining share of income from loans, was an increased proportion of income from "other" income except for the smallest banks and the largest thrifts.

The final score: net income

In an environment of deregulation, on average, banks in every size class except the smallest (less than $100 million) were able to maintain their 1980 level of net income. However this smallest size group accounts for 83.9 percent of all banks. Thus, banks as a whole had a lower level of net income at the end than at the beginning of the post-legislation.

Although thrifts continued to post substantial losses in the years following the acts, on average, thrifts in each size class experienced significant increases in net income levels by June 1984. Interestingly, on average, the rate of increase in net income for thrifts was approximately equal to the rate of decrease in net income for banks from 1980 and 1984. Despite these gains, 833 thrifts or 24 percent of all thrifts experienced losses in the first half of 1984. This compares favorably to the 34.3 percent of thrifts that had negative net income in 1980.

The net worth of thrifts as a group worsens only marginally (for 1984) when regulatory net worth (income capital certificates, Garn St Germain net worth certificates, and appraised equity capital) is eliminated. The impact of regulatory net worth is substantial for the largest thrifts for it was these thrifts that had, and still have, the lowest levels of net income and were the heaviest users of these methods of net worth enhancement.[22] As with banks, the smallest thrifts gained the least with respect to improved performance in the post-legislation period. This size category composes over half (52.8 percent) of all thrifts. The improved levels of net income were most significant for the larger size categories of thrifts—the over $1 billion group (6.0 percent of all thrifts) and the $100-$500 million size group (34.9 percent of all thrifts).

Conclusion

The effect of the acts on bank and thrift performance cannot be quantified separately from other factors. Declining interest and inflation rates and the generally improved economy, and more liberal FHLBB policies (e.g., on advances and flexible mortgage instruments) may be attributed equal, if not more, importance than the acts themselves for the current status and future prospects of the financial services industry. Managerial expertise and institution size have also played a large role in the ability of and manner in which institutions have reacted to the deregulated environment. Well managed institutions performing well in the more regulated environment are likely to perform well in the less regulated environment. Regulatory and statutory restrictions which had imposed inherent differences in the balance sheets of thrifts and banks also can not be overlooked in the ability of these institutions to react to the more level playing field.

Nonetheless, an analysis of average bank and thrift balance sheets and income statements across size classes for the pre- and post-legislation periods gives an indication of the absolute and relative impact of the acts on banks and thrifts, and the influence of size on the manner in which an institution adjusts to the new environment.

The consumer of financial services has gained from the more competitive environment created by the acts. There are increased alternatives for commercial and consumer loans and insured deposit instruments with competitive market rates of return. As a whole re-regulation resulting from the acts has thus far had a positive or, at worst, neutral impact on all parties, except perhaps the smallest banks. Further deregulation of product lines and geographic barriers, if adequately monitored, should be viewed favorably.

[1] Throughout the article thrifts refer to savings and loan associations (S&Ls) and mutual savings banks (MSBs). Ratios for banks and thrifts presented in this article were derived by calculating ratios at the institution level, summing those ratios and dividing by the appropriate number of observations for each size class.

[2] Deposit-to-asset ratios for banks by size group:

	All Banks	Assets < $100 mil.	Assets $100-$500 mil.	Assets $500 mil-$1 bil.	Assets > $1 bil.
1975	87.7	88.0	86.0	81.8	78.4
1980	87.9	88.4	85.6	81.6	73.9
1984	87.4	87.8	86.8	83.3	75.8

[3] Large time deposits as a percentage of total large time deposits, by size group and year for banks:

	Assets < $100 mil.	Assets $100-$500 mil.	Assets $500 mil-$1 bil.	Assets > $1 bil.
1980	13.7	14.8%	7.0%	64.4%
1984	15.2%	16.9%	6.4%	61.5%

[4] The use of borrowings is particularly important for the largest thrifts and varies directly with thrift size. Listed are borrowings-to-asset ratios.

	All thrifts	Assets < $100 mil.	Assets $100-$500 mil.	Assets $500 mil-$1 bil.	Assets > $1 bil.
1975	3.3	2.9	4.7	5.2	5.2
1980	5.0	3.8	6.6	9.1	9.8
1984	5.6	3.2	6.9	11.7	13.5

[5] "Advances Grow for Old and New Uses,"M. Kulczycky, *Savings Institutions*, April 1985. For recent major FHLBB regulatory changes per thrifts, see *Savings Institution Sourcebook*, U.S. League of Savings Institutions 1981, 1982, 1983, and 1984.

[6] "The Thrift Industry in Transition,"P. Mahoney, A. White and D. Goodman, 71 *Federal Reserve Bulletin* (137) March 1985. (Also see footnote 4.)

[7] Maturity structure of liablities of FSLIC insured S&Ls and thrifts for 1981 and 1984, respectively. (Percentage of total deposits.)

	Large CDs	Accounts with no fixed term MMDAs, passbook savings, other	Small Denomination CDs Term 1 yr. or less	Small Denomination CDs Term over 1 yr.
July 1981	8.9	19.4	39.7	31.6
Dec. 1984	14.8	24.8	29.0	31.3

[8] "NOWs and Super NOWs: Implications for Defining and Measuring Money," B. Higgins and J. Faust, *Economic Review*, Federal Reserve Bank of Kansas City, January 1983.

[9] For detail on changes in reserve requirements, see: 70 *Federal Reserve Bulletin* Table A6 1.15 "Reserve Requirements of Depository Institutions," December 1984.

[10] *Bank Rate Monitor*, Advertising News Service, Inc., Miami Beach, Florida.

[11] "Lasting Effects of Deregulation on Monetary Policy," H. Roth *Economic Review*, Federal Reserve Bank of Kansas City, March 1985.

[12] "Money Market Account Competition," L. Wall and H. Ford, *Economic Review*, Federal Reserve Bank of Atlanta, December 1984; and "Competition For Money Market Deposits Accounts," M. Keeley and G. Zimmerman, *Economic Review*, Federal Reserve Bank of San Francisco, Spring 1985.

[13] "Cost of Savings Deposits: The evidence from Illinois and Wisconsin Savings and Loan Associations," unpublished paper, Elijah Brewer, Federal Reserve Bank of Chicago; and "Financial Change and Monetary Targeting in the United States," John P. Judd and John L. Scadding, Asilomar

Conference Proceedings, Federal Reserve Bank of San Francisco, November 28-30, 1982.

[14] Percentage change in expense categories for banks for pre- and post-legislation periods. Other expenses include the purchase of Fed funds, provisions for loan losses, and occupancy expenses.

Expenses 1975-1980	Salary	Deposit interest	Other	Total
All Banks	14.6	66.3	26.3	42.8
Assets < $100 mil.	14.5	65.4	24.2	42.1
Assets $100-$500 mil.	10.0	65.4	23.2	40.0
Assets $500 mil.-$1 bil.	10.1	75.9	34.5	45.6
Assets > $1 bil.	16.8	102.4	58.2	66.8

1980-1984	Salary	Deposit interest	Other	Total
All Banks	.6	28.6	15.7	20.1
Assets < $100 mil.	.6	29.9	16.8	21.1
Assets $100-$500 mil.	2.6	23.2	2.6	14.1
Assets $500 mil.-$1 bil.	3.7	19.5	1.6	10.8
Assets > $1 bil.	16.3	10.2	4.6	9.1

[15] Percentage change in expenses for thrifts.

Expenses 1975-1980	Salary	Deposit interest	Other	Total
All Thrifts	11.8	38.1	31.0	34.7
Assets < $100 mil.	15.7	38.9	29.2	34.9
Assets $100-$500 mil.	15.3	39.5	24.1	34.7
Assets $500 mil.-$1 bil.	16.4	35.7	30.7	33.0
Assets > $1 bil.	13.5	41.2	28.6	36.6

1980-1984	Salary	Deposit interest	Other	Total
All Thrifts	11.8	15.0	20.6	15.6
Assets < $100 mil.	13.6	16.9	13.7	16.2
Assets $100-$500 mil.	16.2	15.0	15.8	15.3
Assets $500 mil.-$1 bil.	20.3	12.1	30.7	16.0
Assets > $1 bil.	16.9	9.3	35.7	14.8

[16] "From ATM to POS Networks: Branching Access, and Pricing," S. Fedgram, *New England Economic Review*, Federal Reserve Bank of Boston, May/June 1985.

[17] For a summary of new S&L powers granted by state and federal legislation, see: S&L Use of New Powers: "A Comparative Study of State- and Federal-Chartered Associations," R. Goudreau, *Economic Review*, Federal Reserve Bank of Atlanta, October 1984.

[18] Percentage of thrift assets in investments by size group and year.

	All thrifts	Assets < $100 mil.	Assets $100-$500 mil.	Assets $500 mil-$1 bil.	Assets > $1 bil.
1975	12.9	12.4	14.3	18.4	19.3
1980	14.6	14.5	14.0	17.7	18.7
1984	23.1	22.8	22.5	25.3	26.6

Percentage of thrift assets in mortgage-backed securities by size group and year.

1975	3.0	2.9	3.0	3.6	2.2
1980	3.6	3.3	4.0	5.8	4.9
1984	9.0	7.7	9.9	11.8	13.3

[19] Commercial and consumer loans as a percentage of assets for thrifts by size group (June 30, 1984).

	All banks	Assets < $100 mil.	Assets $100-$500 mil.	Assets $500 mil-$1 bil.	Assets > $1 bil.
Consumer	3.8	4.0	3.7	3.8	3.3
Commercial	.8	.6	.8	1.3	1.3

[20] "Cautious Play Marks S&L Approach to Commercial Lending," C. Pavel and D. Phillis, *Economic Perspectives*, Federal Reserve Bank of Chicago, May/June 1985.

[21] The national average for ARMs as a percentage of the number of total conventional home mortgages closed for S&Ls since 1982: 1982Q4 = 39.3%, 1983Q4 = 61.3% and 1984Q4 = 66.0%. *FHLB News*, May 7, 1985 and January 10, 1984.

[22] Net income for thrifts:

	All Banks	Assets < $100 mil.	Assets $100-$500 mil.	Assets $500 mil-$1 bil.	Assets > $1 bil.
1975	.50	.50	.47	.47	.40
1980	.11	.14	.09	.02	(.06)
1984	.31	.34	.30	.33	.17