

A deregulated rerun: Banking in the Eighties

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The story of commercial banking during the past 25 years has been one of rapid and sometimes radical change. The more significant changes include the shift from demand deposit sources of funds toward interest-sensitive money market liabilities such as federal funds and certificates of deposit; the payment of interest on checking accounts; the growth of variable-rate loans and the shortening of loan maturities; the decline of the prime rate convention; the growth of consumer and real estate lending; the development of automatic transfer services between different types of accounts; the rapid growth of branch banking and bank holding companies both within and between states; and the infringement of traditional commercial banking functions (such as the creation and servicing of checking accounts) by nonbank institutions, accompanied by infringements in the opposite direction (such as underwriting and brokerage activities by banks), with complaints on both sides. The legality of many of these innovations has been questioned but they have for the most part been accommodated by the regulators, courts, and Congress.

All these developments are important and the publicity they have received is deserved. But they are not unprecedented. Almost entirely they represent returns to practices that were well-established by the 1920s or the resumption of trends that were underway in that decade but were interrupted by the Great Depression and World War II. The similarities between the years since 1960 and those preceding 1930 are not difficult to understand and may be explained in terms of interactions between the profitable lending opportunities that go with high interest rates and the restrictive regulatory framework that has long been imposed on the American banking system.

The most severe of these restrictions, especially when compared with the nationwide branch-banking systems of Canada and Great Britain, are the limitations on branching. Branching across state lines has been almost completely prohibited and most states either prohibit or severely limit branching within their boundaries. For many years national

banks (that is, banks chartered by the Comptroller of the Currency under the National Bank Act of 1863¹) were limited to a single office. Americans have denied themselves the principal means by which in other countries funds are sent from net lending to net borrowing sections of the country, that is, between branches of truly national banks. The portfolio diversification, the protection against excessive reliance upon the fortunes of particular sections, that naturally arises in such a national system has also been impeded by the American system of small, geographically concentrated banks.

Other restrictions that have in various times and degrees been imposed on commercial banks include prohibitions or severe limits on real estate loans, interest payable on deposits, and brokerage, underwriting, investment advisory, and trust services. But rules are made to be broken, and frequently have been in the financial sphere, where there appears to be no natural separation of functions, no obvious criteria governing who should lend in what form to whom. In a prosperous and expanding economy with abundant profit opportunities it is inevitable that many firms and individuals will seek to extend their activities in a variety of directions, even into areas that by tradition or law had been reserved to others or prohibited altogether.

Recent innovations in banking are widely known and have been discussed in many places.² The purposes of this paper are to document the innovations of the 1920s and previously and, along the way, to indicate the similarities between old and new banking trends. Before proceeding to our list of pre-1930 developments it may be worthwhile to look at the interregnum that lasted from the early 1930s until well into the 1950s. The

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Great Depression halted and reversed nearly all extensions of financial institutions into new areas for the simple reason that profit opportunities had virtually been extinguished. In a world of massive industrial and financial failures the overriding thought was not expansion but survival, principally by retrenchment.

Although the Great Depression's trough is usually dated in 1933, a strong recovery was not mounted until World War II and the entire decade of the 1930s was characterized by deep depression. The unemployment rate, which had risen from 3 percent to 25 percent between 1929 and 1933, was still 17 percent in 1939. Industrial production and real per capita gross national product remained lower in 1939 than in 1929, and real gross private domestic investment in 1939 was only 61 percent of its value 10 years earlier. Interest rates fell throughout the decade and the average yield on corporate Aaa bonds was 2.92 percent in June 1939, compared with 4.73 percent in June 1929. The rate on 4- to 6-month prime commercial paper fell from 6.00 percent to 0.56 percent during the same period. (Changes in the commercial paper rate are compared with developments in banking in Figures 1 to 3). This decade of bank failures and depressed loan demands and interest rates saw member bank excess reserves as a percentage of deposits rise from one-tenth of one percent to 10 percent, a hundredfold increase. Loans fell from 69 percent to 29 percent of deposits.

The demand for bank credit picked up during the war, but almost entirely in the form of government borrowing, which the Federal Reserve enabled the banks to finance by supplying unlimited reserves through open market purchases of government securities that were designed through an agreement with the Treasury to maintain stable and low interest rates—three-eighths of 1 percent on Treasury bills and about 2 percent on long-term Treasury bonds. This pegging operation continued until mid-1947 and the Federal Reserve did not cease active support of bond prices until 1953. Private investment and loan demands had begun to rise immediately upon the end of the war but interest rates did not return to pre-1930 levels until the 1960s. Now let us compare developments during the earlier period with those of today.

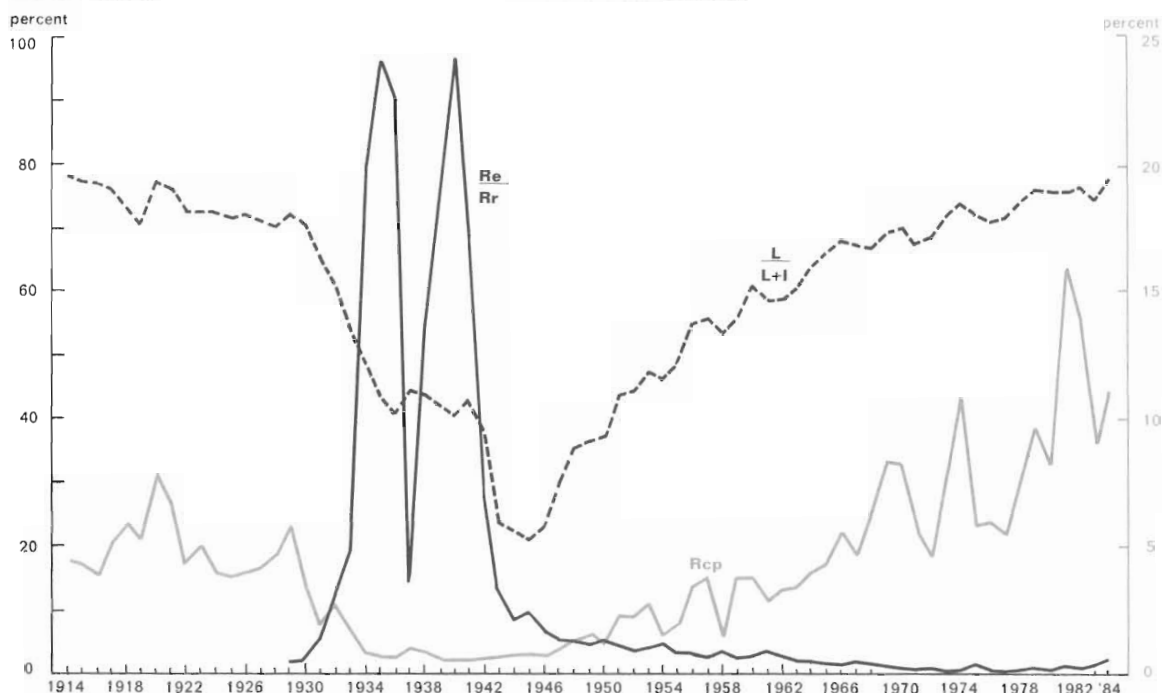
Commercial bank loans, investments, and reserves

In 1914, commercial bank loans made up 78 percent of bank earning assets, that is, of total loans and investments. (See Figure 1.) U.S. government securities constituted only 5 percent of bank earning assets. Bank securities purchases reduced the loan-to-earning-asset percentage to 70 and raised the percentage for U.S. securities to 16 by the end of World War I. There was some movement toward the pre-war figures during the 1919-1920 expansion, and again during 1928-29, but loans were only 73 percent of earning assets in 1929, after which there was a dramatic decline in loans (which fell 56 percent between 1929 and 1936) and an equally dramatic rise in bank holdings of U.S. securities (which more than tripled between 1929 and 1936). Loans and U.S. securities each made up about 40 percent of bank earning assets in 1936. These proportions were fairly stable between 1936 and 1941. Large-scale purchases of U.S. securities during World War II, accompanied by only a slight rise in loans, resulted by 1945 in banking earning assets consisting of 73 percent U.S. securities and 21 percent loans. Perhaps the most striking feature of bank portfolios during the past 40 years has been their strong and almost continuous movement toward the loan/investment ratio that existed before World War I. Loans as a percentage of earning assets rose from 21 percent in 1945 to 61 percent in 1960, 70 percent in 1970, 73 percent in 1980, and in 1984 to 78 percent, which is where we came in.

Commercial bank excess reserves have varied inversely with profit opportunities and the availability of liquid, low-risk sources of reserves. It is convenient to express the excess reserves of Federal Reserve member banks as a percentage of their required reserves, as in Figure 1. Beginning in 1929, the first year for which data on excess reserves are available, excess reserves were 1.8 percent of required reserves. Excess reserves rose sixtyfold between 1929 and 1936, to become 90 percent as large as required reserves.

Excess reserves were reduced by administrative action to 14 percent of required reserves when the Federal Reserve doubled reserve requirement ratios in a series of steps between August 1936 and May 1937. But nearly all

Figure
Loans and investments, excess reserves, and the commercial paper rate



DEFINITIONS:

$\frac{L}{L+I}$: Loans as a proportion of loans and investments, all commercial banks, end of June.

$\frac{R_e}{R_r}$: Member bank excess reserves as a proportion of required reserves, average of daily figures for June.

R_{cp} : 4-6 month prime commercial paper rate (1914-79) or average of 3- and 6-month prime commercial paper rates (1980-84), average of daily figures for June.

SOURCES: *Banking and Monetary Statistics, 1914-41* and *1941-70* and various issues of *Annual Statistical Digest* and *Federal Reserve Bulletin*, all published by the Board of Governors of the Federal Reserve System, Washington, D.C.

NOTE: Some of these series (particularly those pertaining to commercial bank assets and liabilities) have been revised from time to time, so that the data are not perfectly comparable over time. However, the revisions have not been so great as to affect the principal movements shown in the charts and discussed in the text.

additions to reserves during the next three years were kept as excess reserves and by 1940 excess reserves were 97 percent of required reserves. That is, by the end of the 1930s nearly one-half of member bank reserves were in excess of legal requirements. Although interest rates remained low during World War II, the Fed's bond support program meant that banks could convert their excess reserves into highly liquid short-term governments without fear of loss and excess reserves had fallen below 10 percent by 1945. Rising interest rates induced further economies in reserves during the

postwar period and excess reserves as a percentage of required reserves fell below 3 percent in 1956, below 2 percent in 1963 (returning to their 1929 relation), and below 1 percent in 1970.

Liability management

In the 1920s most of the liabilities of large banks paid interest that varied closely with other money market rates. Of vital importance to the money center banks and to their correspondents in outlying areas was interbank

lending in the form of bankers' balances, either as time or demand deposits. Competition for these interbank deposits was one of the most important means by which funds were induced to flow from surplus to deficit regions of the country. During the 1920s about 20 percent of the deposits of New York City and Chicago banks consisted of balances owed to other banks, principally interest-bearing demand deposits. Federal funds and repurchase agreements were also significant sources of funds for the more aggressive banks.³ In 1922, for example, the average daily purchases of fed funds in New York City were about 6 percent as large as the interbank deposit liabilities of New York City banks, a figure that rose to 12 percent in 1925 and 18 percent in 1928.⁴ The fed funds market virtually disappeared during the 1930s and 1940s in the face of low interest rates, massive excess reserves, and easy Federal Reserve credit.

However the prohibition of interest on demand deposits by the Banking Act of 1933⁵ meant that renewed competition for reserves in the form of interbank lending in the 1950s and afterward had to shift its emphasis from bankers' balances to federal funds. By the 1980s the liabilities of New York City banks in the forms of federal funds and repurchase agreements were more than seven times as large as their interbank deposit liabilities and about 45 percent as large as their total deposits. The competition for nondeposit funds that was resumed in the 1950s has gone far beyond the point at which it was interrupted in 1930. Again, rising interest rates, and the resulting increased cost of idle reserves helped induce this behavior.

Until the 1930s many banks also paid interest on the demand deposits of their nonbank customers, with the minimum required balance for interest-earning demand deposits ranging from \$100 to \$10,000.⁶ Interestingly, service charges on deposits, which had not been common before the 1920s, became widely used during that decade. A 1929 survey by the New York State Bankers Association showed that about 35 percent of banks imposed service charges on small accounts.⁷ High interest rates and the growing competition for funds had resulted in greater cost consciousness and a desire to set prices of services in line with costs.⁸

The competition for funds in the 1920s was also reflected in increasing interest rates on

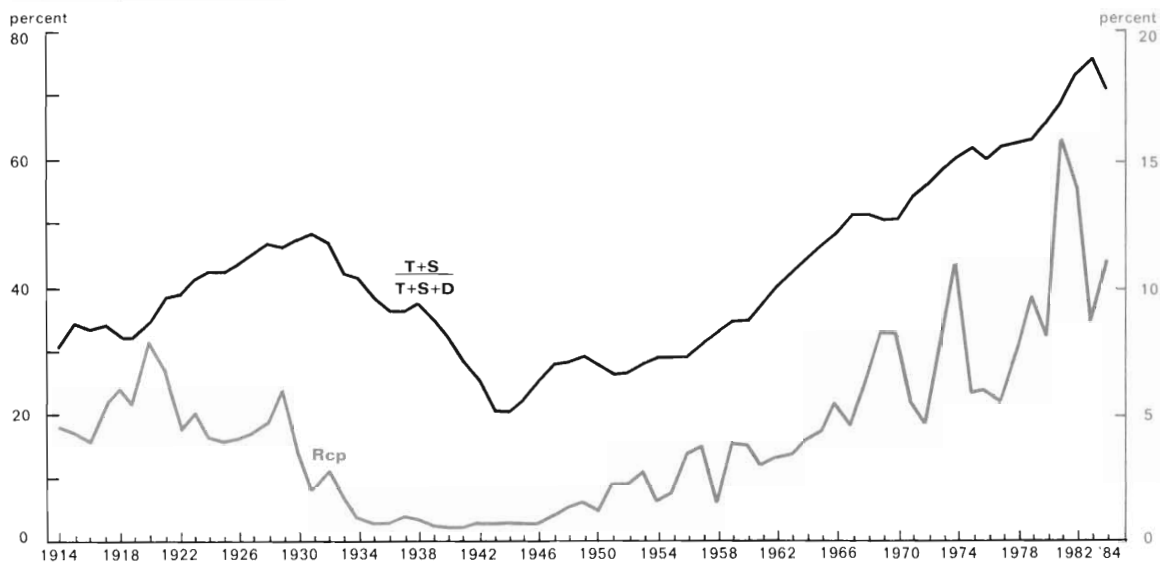
time and savings accounts, a development that was stimulated by reductions in reserve requirements on those accounts. The National Bank Act had not distinguished between types of accounts in setting reserves requirements, and the same was true of the laws under which most state banks operated. But in 1913 the Federal Reserve Act reduced the reserve requirement ratios on time and savings deposits to less than one-half of those on demand deposits, and most states followed suit in order that state banks would not be placed at a competitive disadvantage.⁹ The resulting reduction in the marginal cost of time and savings accounts, in combination with generally rising interest rates and growing competition for funds, led to increases in time and savings accounts as a percentage of total national bank deposits from 19 percent in 1914 to 23 percent in 1919 and 41 percent in 1929. The percentages for all commercial banks in these three years were 31, 33, and 46 respectively. (See Figure 2.)

Savings and loan associations and mutual savings banks, supported by their regulators, complained about the growing competition from commercial banks. Time and savings accounts in S&Ls and MSBs as a percentage of those in commercial banks fell from 77 percent in 1915 to 43 percent in 1925. In New York, Massachusetts, and Connecticut, the strongholds of mutual savings banks, commercial bank time and savings deposits grew from less than one-fifth to more than one-half of those in mutual savings banks.¹⁰ The Commissioner of Banks of Massachusetts and the Superintendent of Banks of New York both wrote the following in their reports for 1918:

If in any state there has been created a great system of mutual savings banks, in that state the national banks, although not mutual but operated for the profit of shareholders, will be authorized to call their interest departments savings departments, and so appropriate a word which has for a generation or more been synonymous in this State with mutual institutions created under State laws. These deposits, moreover, will not be segregated, nor will the entire net income from investments be distributed among the depositors.¹¹

The New York Superintendent also wrote:

Figure 2
Time and savings deposits as a percentage of total bank deposits, and the commercial paper rate



DEFINITIONS:

$\frac{T+S}{T+S+D}$: Time and savings deposits as a proportion of total commercial bank deposits, end of June.

R_{cp} : See Figure 1.

SOURCES: See Figure 1.

NOTE: See Figure 1.

It is not surprising, in view of the extension of Federal control over various classes of business and industry as a result of the necessities of the war, that the attention of the advocates of centralization and Federal domination should be attracted by the prosperity and success of State banking institutions. In their desire to bring under Federal control all classes of banking institutions, they seem, in the first instance, to have conceived the idea of conferring all the multifarious powers of the different classes of State institutions in all the States upon National Banks and to create a Federal system of department banks into which all banking institutions would ultimately be driven. Such a bank would closely resemble one of our great department stores. . . . Instead of having a uniform system of National Banks consisting of strictly commercial banking institutions and needing no other definition than the name, we would have heterogeneous varieties of hybrid institutions of as many kinds perhaps as there are States

or possibly of as many types as there are classes of State banking institutions in all the States.

Later the Federal Reserve Board expressed concern over the growing tendencies of banks to provide automatic transfers between savings and demand deposits and to allow depositors to draw checks against savings deposits.¹² The Federal Advisory Council (a citizens advisory group) recommended to the Board that Regulation D, which governs reserve requirements, "might be amplified to prevent some of the abuses which have developed, such as the withdrawal by check of savings and time deposits and the lack of a clear distinction between demand and time deposits."¹³ Savings associations also allowed drafts, or checks, to be drawn against savings accounts.¹⁴

These trends were reversed by the great decline in interest rates and the virtual disap-

pearance of bank competition for funds in the 1930s and 1940s. Time and savings deposits as a percentage of total commercial bank deposits in the United States fell from 46 percent in 1929 to 36 percent in 1939 and 20 percent in 1944, which was the low point, well below the 1914 figure of 31 percent. Postwar prosperity and rising rates saw the figure rise to 47 percent (about the 1929 figure) in 1965, 62 percent in 1975, and 75 percent in 1983.

The resumption of interest-rate competition for funds was eventually also reflected in the effective resumption of interest payments on checking accounts and the ability to write checks on savings accounts. Congress had attempted to end these practices by the banking laws of the 1930s, but as soon as they once again became profitable, financial institutions, accommodated by their regulators or the courts, found ways of implementing them—including repurchase agreements and automatic transfer services by commercial banks, negotiable order of withdrawal (NOW) accounts by New England savings institutions, and share draft accounts by credit unions. However, in 1979 the last three practices were enjoined by a U.S. Court of Appeals.¹⁵ The court expressed the following views in its ruling on suits filed by the American Bankers Association (with the Tioga State Bank) against the National Credit Union Administration, the Independent Bankers Association against the Federal Home Loan Bank Board, and the U.S. League of Savings Associations against the Federal Reserve Board:

It appears to the court that the development of fund transfers . . . utilized by . . . commercial banks with "Automatic Fund Transfers," savings and loan associations with "Remote Service Units," and federal credit unions with "Share Drafts," in each instance represents the use of a device or technique which was not and is not recognized by the relevant statutes, although permitted by regulations of the respective institutions' regulatory agencies.¹⁶

The court pointed out that these procedures amounted to "the practical equivalent of checks drawn on . . . interest-bearing time deposits" in violation of laws governing the institutions concerned.

The history of the development of these modern transfer techniques reveals each

type of financial institution securing the permission of its appropriate regulatory agency to install these devices in order to gain a competitive advantage, or at least competitive equality, with financial institutions of a different type in services offered to the public. The net result has been that three separate and distinct types of financial institutions created by Congressional enactment to serve different public needs have now become, or are rapidly becoming, three separate but homogeneous types of financial institutions offering virtually identical services to the public, all without the benefit of Congressional consideration and statutory enactment.

The court recognized that the statutes had been rendered obsolete by events and also appreciated that "enormous investments" had been made in the new technology. The court also recognized the disruptions that would result from the sudden withdrawal of these services, upon which the financial community had "rapidly grown to rely." Therefore, about 7 months, until January 1, 1980, were allowed for compliance with the court's ruling. The lag would also give Congress time to decide whether it wanted to override the court by changing the law. Spurred to action, Congress began hearings in June, enacted legislation in December that temporarily authorized the devices found illegal by the court, and granted those devices statutory approval in the Depository Institutions Deregulation and Monetary Control Act of 1980. And financial institutions were thereby enabled to continue to compete for funds in the 1980s in much the same way as in the 1920s.

Risk management

The liquidity and interest-rate risks to which banks were exposed by their short-term, interest-sensitive liabilities were offset in the 1920s, as in the 1980s, by the use of these liabilities to fund short-term and variable-rate loans. During the earlier period between 25 and 30 percent of the loans of large banks were call loans, mainly to brokers and dealers in securities, with rates that were subject to daily revision. About 45 percent of the loans of large New York City Banks were call loans. Most of the remaining loans were business loans with maturities less than 90 days.¹⁷ Although the liquidity of many of these loans was doubtful

because they were repeatedly renewed as parts of long-term customer relationships,¹⁸ their short-term contractual nature permitted the frequent adjustment of loan rates in line with the costs of funds.

However, these characteristics of bank loans, which had evolved in response to volatile interest rates and increasingly competitive conditions over several decades, were greatly modified by the events of the 1930s and 1940s—especially by the low and stable interest rates, enormous excess reserves, and easy Federal Reserve credit discussed above. Short-term loans were no longer necessary for liquidity purposes, which were met by excess reserves and large holdings of short-term government securities, or to hedge interest-rate risk, which was virtually nonexistent. Furthermore, the great decline in stock market activity greatly reduced the demand for call loans. One of the consequences of this combination of events was the increased use of explicit long-term loans. Business loans with maturity of one year or more (term loans) rose from almost nothing in 1929 to nearly one-third of business loans in 1940, a trend that continued until well into the 1950s.¹⁹

The high and volatile interest rates, very low excess reserves, and more volatile money stock changes in recent years have induced a return to the loan practices of the 1920s. For example the Federal Reserve's *Survey of Terms of Bank Lending* indicates that during the 6 years following 1977 (the first year of the survey in its present form) term loans fell from 16 percent to 9 percent of commercial and industrial loans, the percentage of term loans with floating rates rose from 49 to 73 percent, and the average maturity of short-term loans fell from 2.2 months to 1.1 months.²⁰ Recent data on bank loan rates show that these rates have become as variable as, perhaps more variable than, rates on short-term money market instruments such as commercial paper.²¹ Apparently, "sticky" loan rates were peculiar to the 1930s to 1960s.

Investment banking by commercial banks

The so-called "tradition" of the separation of commercial banking and investment banking functions, including the idea that the former's credit ought to be limited to short-

term, self-liquidating commercial loans, is unique to the English-speaking peoples and even there the tradition has been honored more in the breach than the observance. The Bank of England, the First and Second Banks of the United States, and most early state banks were chartered with the express goal of helping to float government debt. Commercial banks were especially active in underwriting government bonds during the Civil War and World War I, and had become heavily involved in corporate issues during the nineteenth century. It is likely that commercial banks first "became partners in underwriting syndicates . . . in order to obtain newly issued bonds at favorable prices. Acquisition of securities for the bank's own portfolio led to purchases on behalf of customers, particularly correspondent banks. In a few cases, that eventuated in a full range of investment banking activities."²²

In 1902 the Comptroller of the Currency ruled that commercial banks were prohibited by the National Bank Act from underwriting or distributing equities. But the First National Bank of Chicago organized a state bank, owned by the same shareholders as First National, to carry on its securities activities. The First National Bank of New York and the National City Bank of New York soon followed suit.²³ Later, in the 1920s, official hostility toward securities underwriting by commercial banks changed to support, or at least acquiescence, in order to prevent defections from the national banking system, and the McFadden Act of 1927 legalized a wide range of securities activities by national banks. "For all practical purposes, adoption of the McFadden Act represented an abandonment of traditional banking theories and a recognition of a natural economic development. By the end of the decade, there was no longer any institutional separation of banking functions."²⁴ In 1929, 591 commercial banks were underwriting securities directly or through affiliates. These institutions originated 45 percent of all new bond issues in 1929, up from 22 percent in 1927.²⁵

Commercial bank performance of what some people thought were not proper commercial banking functions did not prevent these firms from complaining about the invasions of their turf by others. Private investment banking houses paid interest on deposit liabilities and in 1912 the largest house, J. P. Morgan, had deposits of \$160 million, compared with

\$252 million in National City Bank, the largest commercial bank.²⁶

Trust companies had also become major competitors of commercial banks. Trust companies originally specialized in the management of property for others but by 1900 "the range of financial services they offered increased until, apart from their fiduciary function, they became indistinguishable from commercial banks"²⁷—except, as bankers bitterly pointed out, in their virtual freedom from regulation, including legal reserve requirements. However New York State and some other states began to subject trust companies to reserve requirements during the early years of this century and commercial banks received a further equalizing concession in 1913 when the Federal Reserve Act extended trust powers to national banks. In 1910 a trust officer forecast that "we shall have but one kind of financial institution, which will combine all the functions of the commercial bank, savings bank, and trust company."²⁸ He might also have included "investment bank," but perhaps he meant that function to be comprehended by "commercial bank."

The banking laws of the 1930s attempted to turn back the clock by divorcing commercial banking and investment banking and in other ways separating financial activities between different types of institutions.²⁹ But the hands have resumed their forward motion as banks have increased their involvement in the securities business and securities firms have reentered the deposit business, so that it has once again become difficult to answer the question "What is a bank?"³⁰

Group and branch banking

Branch banking has from time to time been prohibited or severely restricted in most states, and national banks were not allowed to open branches until well into the twentieth century. These restrictions gave rise to a variety of evasive devices during the 30 years of rapid bank expansion preceding the Great Depression, when the number of bank offices grew from about 9,000 (in 1900) to about 27,000 (in 1929).³¹ Chief among these evasions was the exchange of national for state charters in those states in which branching was permitted. Another device was the bank holding company.

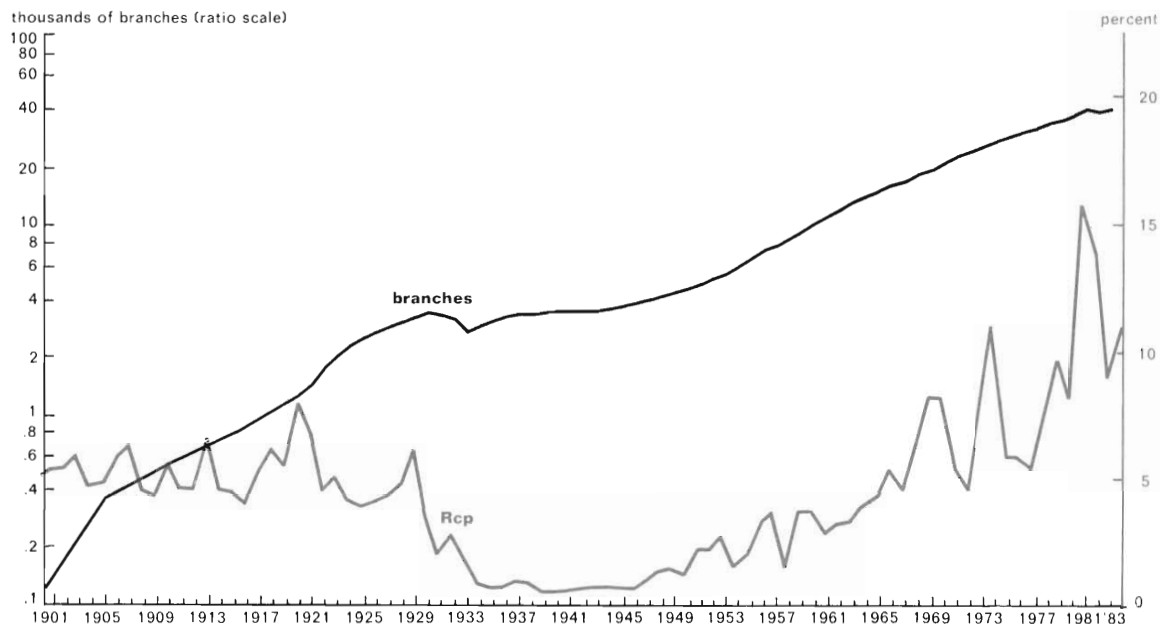
Virgil Willit described the future of banking as the proponents of branching saw it in 1930:

Group banking is simply the result of the introduction into the banking field of the holding company device, which has been long known and much used in other businesses. Through the holding company a number of banks can be operated as practically one institution. Such an institution is very closely akin to a branch bank. Indeed, the opponents of group banking maintain that it is simply a device for evading the legal restrictions on branch banking.

In spite of much criticism and opposition, group banking is developing with amazing rapidity. At the present time group banks control one-fifth of the bank resources of the country. The movement is not localized, for groups are found throughout the country. A few states have attempted to check it by legislation but as yet no adequate means have been found to stop its growth. Thus group banking constitutes a greater menace to the unit system than does branch banking, which is easily amenable to legislative control. This situation has fortified the advocates of branch banking with a new and powerful argument. Unit banking, they contend, is doomed. The question no longer is whether we shall have unit or branch banking; the issue lies, rather, between group and branch banking.³²

Between 1900 and 1929 the number of banks operating branches rose from 87 to 764, the number of branches rose from 119 to 3,533, and the assets of banks with branches rose from 2 percent to 43 percent of total bank assets. In 1921, "to meet the challenge of state branch banks" the Comptroller of the Currency "authorized national banks to open tellers windows limited to accepting deposits and cashing checks where a state permitted its banks to branch."³³ The National Bank Consolidation Act of 1918 had earlier made full-service branching by national banks a little easier by allowing them to keep the offices of the state banks that they acquired.³⁴ Further moves "designed to place the national banks on a more equal competitive plane with the state banks,"³⁵ or in the parlance of the 1980s, to "level the playing field," came in the McFadden Act, which relaxed restrictions on the real estate lending of national banks³⁶ and allowed them to open full-service branches. However, these branches were confined to the

Figure 3
Commercial bank branches and the commercial paper rate



DEFINITIONS:

Branches: Number of commercial bank branches, ratio scale, end of year. Before 1920, data are available only for selected years.

R_{cp} : Same as Figure 1, but note the longer time span.

SOURCES: See Figure 1.

head-office city in states that allowed branching by state banks.

The number of branches fell 20 percent between 1929 and 1933, to 2,784. But unit banks declined even more rapidly so that by 1933 the assets of branch systems made up 50 percent of total bank assets. Political opposition to branch banking declined markedly during the early 1930s, when the number of unit banking states was reduced from 22 to 10 and the Banking Act of 1933 permitted national banks to open branches on the same geographical basis as state banks. However the onerous capital requirements imposed on Fed member banks that opened branches outside their head-office cities retarded branching by those banks until 1952, when their capital requirements were reduced to the same level as those of nonmember competitors.³⁷

Branching resumed its growth after 1933. But this growth was for a while much slower than during the first 30 years of the century. By 1940 the number of branches had recovered their 1929 level of about 3,500, and then rose to about 4,700 in 1950. But during the next decade the number of branches more than doubled, reaching 10,200 in 1960, again more than doubled to 21,400 by 1970, and rose to 38,400 in 1980. Group banking has not been left far behind. The proportion of all commercial bank deposits in multibank holding companies rose from about 10 percent in the mid-1950s to 16 percent in 1970 and 34 percent in 1980. It seems that, after some delay, the forecast of the banking industry offered by Professor Willit in 1930 is about to be realized.

Concluding comment

The financial services industry, including commercial banking, is once again on the expansive and competitive path that was temporarily blocked in the 1930s and 1940s—and regulation and legislation, as during the early years of this century, have accommodated the profit-seeking goals of financial firms and their clients. Branching, bank holding companies, interest on checking accounts, and securities activities by banks are responses to profit opportunities, which constitute the only effective deregulatory force. As in the 1920s, *de jure* deregulations—new legislation and new interpretations of existing laws—merely follow *de facto* deregulations that have already been instituted by the public in search of the most efficient means of carrying on financial transactions.

¹ Actually the 1863 law that provided for national bank charters was called The National Currency Act. That act was amended and renamed The National Bank Act in 1864. For the history of these acts see Ross M. Robertson, *The Comptroller and Bank Supervision: A Historical Appraisal*, (Washington, D.C.: Comptroller of the Currency, 1968).

² For example, see discussions of the events leading to the Depository Institutions Deregulation and Monetary Control Act of 1980 and the Garn-St Germain Act of 1982 in *Leveling the Playing Field: A Review of the DIDMCA of 1980 and the Garn-St Germain Depository Institution Act of 1982* (Chicago: Federal Reserve Bank, Chicago, 1983); and also in Federal Reserve Bank of Chicago, *Proceedings of a Conference on Bank Structure and Competition, April 12-14, 1982*, (Chicago: 1982).

³ For discussions of bank transactions in federal funds and repurchase agreements before 1930, see Parker B. Willis, *The Federal Funds Market: Its Origin and Development*, 4th ed., (Boston: Federal Reserve Bank of Boston, 1970), pp. 3-13; and H. G. Moulton, "Commercial Banking and Capital Formation," *Journal of Political Economy*, 26 (July 1918) pp. 705-731.

⁴ These percentages are based on estimates in Willis, *The Federal Funds Market*, p. 12.

⁵ This prohibition is still in force for demand deposits. However, a number of alternative interest-bearing personal transactional accounts have been introduced. Historically, including the 1920s, over 90 percent of interbank deposits have been demand deposits.

⁶ See James M. Boughton and Elmus R. Wicker, "The Behavior of the Currency-Deposit Ratio during the Great Depression," *Journal of Money Credit and Banking*, 10 (November 1970) pp. 405-418.

⁷ *Ibid.*, p. 408.

⁸ Service charges were retained and generally increased when interest rates fell during the 1930s. Total annual service charges grew 80 percent between 1929 and 1933 even though total deposits fell 40 percent and demand deposits fell 36 percent. (*Ibid.*)

⁹ These changes are discussed by Charles M. Linke, "The Evolution of Interest Rate Regulation on Commercial Bank Deposits in the United States," *The National Banking Review*, June 1966, pp. 449-69 and Eugene N. White, *The Regulation and Reform of the American Banking System, 1900-1929* (Princeton: Princeton University Press, 1983), pp. 27-33, 98-102.

¹⁰ Weldon Welfing, *Mutual Savings Banks: The Evolution of a Financial Intermediary*, (Cleveland: Case Western Reserve University Press, 1968) p. 77.

¹¹ This and the next quotation are from Welfing, *Mutual Savings Banks*, pp. 78-79.

¹² See the discussions and references in Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton: Princeton University Press, 1963), p. 277; and, Benjamin J. Klebaner, *Commercial Banking in the United States: A History*, (Hinsdale, IL: Dryden Press, 1974), p. 123.

¹³ Federal Reserve Board, *Annual Report, 1928*, p. 228.

¹⁴ See William H. Kniffen, *The Savings Bank and its Practical Work* (New York: Bankers Publishing Company, 1928), p. 258.

¹⁵ The following discussion is taken from John H. Wood and Norma L. Wood, *Financial Markets* (New York: Harcourt Brace Jovanovich, 1985), pp. 61-63.

¹⁶ This and the following quotation are from United States Court of Appeals for the District of Columbia Circuit, September term 1978, nos. 78-1337, 78-1849, 78-2206.

¹⁷ For summaries of bank loans during the 1920s and recently, see John H. Wood, "Familiar Developments in Bank Loan Markets," *Economic Review*, Federal Reserve Bank of Dallas (November 1983) pp. 1-13.

¹⁸ For a discussion of customer relationships before the 1930s, see Davis R. Dewey and Martin J. Shugrue, *Banking and Credit* (New York: Ronald Press Company, 1922), pp. 176-178.

¹⁹ See Neil H. Jacoby and Raymond Saulnier, *Term Lending to Business* (New York: National Bureau of

Economic Research, 1942); and George S. Moore, "Term Loans and Interim Financing," in Benjamin H. Beckhart, ed., *Business Loans of American Commercial Banks* (New York: Ronald Press Company, 1959).

²⁰ See Wood, "Familiar Developments," table 3. For a discussion of the growth of variable-rate loans during the 1970s see Randall C. Merriis, "Business Loans at Large Commercial Banks: Policies and Practices," *Economic Perspectives*, Federal Reserve Bank of Chicago, (November/December 1979), pp. 15-23.

²¹ See Wood, "Familiar Developments," table 2.

²² Klebaner, *Commercial Banking*, p. 82.

²³ For accounts of this and other early episodes of investment banking by commercial banks see Klebaner, *Commercial Banking*, pp. 80-84; and Larry R. Mote, "Banks and the Securities Markets: The Controversy," *Economic Perspectives*, Federal Reserve Bank of Chicago (March/April 1979), pp. 14-20.

²⁴ Edward J. Kelly, "Legislative History of the Glass-Steagall Act," in Ingo Walter, ed., *Deregulating Wall Street: Commercial Bank Penetration of the Corporate Securities Market* (New York: John Wiley & Sons, 1985).

²⁵ Mark J. Flannery, "An Economic Evaluation of Bank Securities Activities before 1933," in Walter, *Deregulating Wall Street*.

²⁶ Klebaner, *Commercial Banking*, p. 82.

²⁷ Klebaner, *Commercial Banking*, p. 83. Also see White, *Regulation and Reform*, pp. 38-42, for a discussion of the banking activities of trusts during this period.

²⁸ Quoted from Klebaner, *Commercial Banking*, p. 84.

²⁹ In fact commercial banks were never completely forced out of the securities business. The Banking Act of 1933 expressly authorized them to buy and sell securities for customer accounts, to purchase some types of securities for their own accounts, and to underwrite Treasury issues and general obligation municipal bonds. (See Mote, "Banks and the Securities Market," p. 17.)

³⁰ John J. Di Clemente, "What is a Bank?" *Economic Perspectives*, Federal Reserve Bank of Chicago (January/February 1983), pp. 20-31. Also see Walter H. Wriston, "Bank 'n' Burger" *Euromoney* (October 1981), pp. 53-54; and Jean M. Lovati, "The Growing Similarity Among Financial Institutions," *Review*, Federal Reserve Bank of St. Louis (October 1977), pp. 2-11.

³¹ The peak number of offices (above 31,000) actually occurred in 1922, before widespread failures of banks in agricultural areas.

³² Virgil Willit, "Introductory Note," in Willit, ed., *Chain, Group and Branch Banking* (New York: The H. W. Wilson Company, 1930), pp. 10-11.

³³ Klebaner, *Commercial Banking*, p. 126.

³⁴ The number of national bank branches rose from 26 in 1915 to 318 in 1925. (White, *Regulation and Reform*, p. 161) The 26 branches existing in 1915 were possible because in the early years of the National Bank Act the Comptroller of the Currency had allowed newly chartered national banks to keep their branches, a policy reversed after 1870.

³⁵ Virgil Willit, "The Rise of Multiple Banking in the United States," in Willit, *Chain, Group and Branch Banking*, p. 102.

³⁶ The Comptroller's office had in the preceding years adopted an increasingly lenient attitude toward national bank evasions of restrictions on their real estate loans, prompting the following analysis and criticism by the Deputy Comptroller:

Banking today is conducted upon widely different lines to what it was when the Bank Act of 1864 was enacted, and the law has not kept pace with the constantly changing conditions. Competition with trust companies and other banking institutions operating under State authority, more liberal in the scope of corporate powers conferred, forced many competing national associations doing business in the same locality into undertakings not contemplated by the national banking laws and foreign to the legitimate functions of a commercial bank. The powers conferred upon trust companies and savings banks to make loans upon real estate security, induced many national associations to make loans upon like security by resorting to indirect methods to evade the restrictions of the statute . . .

While the national banking laws should be construed as broadly and as liberally as possible consistent with the intent and spirit of the statutes, it is the sworn duty of an administrative officer to enforce an observance of the law as it exists and not endeavor to twist it out of shape either to meet his own views or the wishes of bankers as to what it should be.

(Thomas P. Kane, *The Romance and Tragedy of Banking*, New York, The Bankers Publishing Company, 1922, p. 90)

³⁷ For histories of legislation and regulations affecting branch banking and bank holding companies, see Klebaner, *Commercial Banking*; and Gerald C. Fischer, *American Banking Structure* (New York: Columbia University Press, 1968).