

A note on the increase in noninsured commercial banks

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According to data published in the *Annual Statistical Digest* of the Board of Governors of the Federal Reserve System, the number of commercial banks that are not insured by the Federal Deposit Insurance Corporation (FDIC) more than tripled between 1970 and 1986 from fewer than 200 to more than 600.¹ Although noninsured banks accounted for only 1 percent of all 13,688 commercial banks in 1970 and less than 5 percent of all 14,866 reported commercial banks in 1986, the increase in their numbers accounted for almost 40 percent of the reported 1,200 increase in the total number of commercial banks.

It is surprising that there should be such a strong demand for the services of noninsured depository institutions at this particular time. The recent sharp increase in the number of failures of depository institutions—commercial banks and thrift institutions—to the highest levels since the banking crisis of the early 1930s has increased the value to the public of the protection afforded by federal deposit insurance. Authorized by the Banking Act of 1933 and implemented for banks in 1934, federal deposit insurance has been expanded through the years to cover larger and larger amounts at a broader range of depository institutions. Today, it guarantees the par value of accounts at chartered commercial banks, savings banks, savings and loan associations, and credit unions up to \$100,000 per separate account.

Federal deposit insurance is widely considered to be a valuable advantage that these institutions have over their competitors, such as money market funds. Indeed, it is doubtful whether, in the absence of such deposit insurance, many (if any) depositors would maintain their funds in any of the many savings and loan associations that are currently insolvent by generally accepted accounting principles (GAAP) but have not yet been closed by the Federal Savings and Loan Insurance Corporation. Without federal deposit insurance, these institutions would be unable to repay all of their depositors in full and on time.

Both because of the increased value of federal deposit insurance and because the number of banks in the country or in a particular local or regional market is widely used as a surrogate for the intensity of competition, it is of interest to explore the reasons for the extraordinarily sharp increase in the reported number of noninsured banks. Careful examination of the data leads to the conclusion that the increase is to a large extent illusory and reflects primarily the inclusion of noncommercial banking institutions and the double counting of U.S. branches of foreign banks. Because noninsured banks are part of the total number of banks, the overstatement of noninsured banks also overstates the total number of banks in the country and in many local markets. If the number of banks is to be used as a measure of bank market structure or competition, it needs to be corrected for this bias.

The Board of Governors has collected data on the total number of banking institutions for many years. These data are obtained from many sources, including records of charters granted to new institutions. Bank organizers may obtain charters either from the Comptroller of the Currency, if they wish to establish a national bank, or from the individual state departments of financial institutions, if they wish to establish a state bank.

But, departments of financial institutions in many states are also empowered to grant charters to other depository institutions, such as trust companies that do not conduct deposit and other banking business or industrial (Morris Plan) banks, which are more like consumer loan companies or credit unions than commercial banks. These institutions are included in the total number of noninsured banks in the Board's data base. Clearly, if the num-

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Table 1
Adjustments to number of banks

	<u>1980</u>	<u>1986</u>
Total commercial banks, <i>Annual Statistical Digest</i>	14,836	14,866
Total commercial banks, current Board data base*	14,884	14,879
Less reported noninsured banks	- 436	- 640
Reported insured banks	14,448	14,239
Minus member nondeposit trust companies**	- 14	- 13
Plus insured branches of foreign banks, adjusted for double counting***	+ 14	+ 23
Insured banks, adjusted	14,448	14,249
Plus noninsured banks, adjusted	+ 115	+ 214
Total commercial banks, adjusted	14,563	14,463

*Differs from figure in *Annual Statistical Digest* because of revisions, the inclusion for 1980 of banks in Puerto Rico and the Virgin Islands, and other unexplained discrepancies.

**Nondeposit trust companies that are members of the Federal Reserve System had been included in the number of noninsured banks prior to 1986 but were included with insured member banks in the 1986 *Annual Statistical Digest* table.

***Although some U.S. branches of foreign banks obtained FDIC insurance after 1978, they continued to be reported in the noninsured category. They must be added back to get the total number of insured banks.

ber of banks is to be consistent and economically meaningful, these institutions should be excluded.

In addition, the U.S. branches of foreign banks are included in the count of noninsured commercial banks in the Board's listing.² Although most U.S. branches of foreign banks do engage in the business of commercial banking, the reported number of noninsured banks is greatly inflated by the way in which U.S. branches of foreign banks are treated. Every U.S. branch of a foreign bank is recorded as a separate bank, even if two or more branches of the same foreign bank are in the same state. The basic reason for this treatment, which differs from that accorded branches of domestic banks, is noneconomic. It occurs because branches of foreign banks are required to submit separate call reports (financial statements) to regulators. This gives rise to the potential for two types of double counting: double counting of multiple branches of a foreign bank in the same state, and—because, in contrast to U.S. banks, foreign banks are permitted to establish branches across state lines—double counting of offices of the same foreign bank in more than one state.

It is important to recognize that double counting at the national level does not necessarily constitute double counting at the state level. For example, if a foreign bank has

branches both in California and in New York, it is entirely appropriate that the bank be counted in the totals for both states; it represents one of the competing banking organizations within each state. However, when the data are aggregated to the national level, the bank should be counted only once. Thus, the national total should be smaller than the sum of the state totals.

Some of the branches of foreign banks should even be excluded from the state totals because their banking activities are sharply limited. Although the International Banking Act of 1978 grandfathered the activities of existing out-of-state branches of foreign banks, it required each foreign bank to declare a "home state" and prohibited any newly established branches in other states from engaging in deposit-taking activities (except those related to international business). Thus, branches of foreign banks established in other states since 1978 do not offer a full line of commercial banking services. They have been retained in the state totals in this study because of the difficulty in identifying the scope of activities conducted by individual branches.

Careful examination of the Board's data base for 1980 and 1986 revealed that many of the noninsured institutions included could not accurately be classified as commercial banks. Industrial banks, primarily in Colorado, ac-

Table 2
Number of noninsured banks in 1986, by state

ASD*	Board's current data base	Less insured branches of foreign banks	Reported total noninsured banks	Adjustments			Breakdown of noninsured banks			
				Less industrial banks	Less nondeposit trust companies	Less double-counted branches of foreign banks	Total noninsured banks, adjusted	Noninsured branches of foreign banks	As defined under Bank Holding Company Act	Private banks
AL	0		0				0			
AK	1		1		1		0			
AZ	7		7		7		0			
AR	3		3	1	2		0			
CA	50		43		18	3	22	22		
CO	79	7	86	81	5		0			
CT	1		1		1		0			
DE	3		3		3		0	3		
DC	3		3		3		0			
FL	13		13		13		0			
GA	1		1		1		0			
HI	4		4		4		0			
ID	0		0		0		0			
IL	68	10	59	1	20		39	38	1	1
IN	3		3		1		1			
IA	1		1		1		1		1	
KS	2		2		1		1		1	
KY	2		2		1		0			
LA	1		1		1		0			
ME	1		1		1		0			
MD	1		1		1		0			
MA	9	3	6		0		2	5	1	1
MI	2		2		0		1		1	
MN	2		2		2		0			
MO	2		2		1		0			
MS	5		5		5		0			
MT	1		1		1		0			
NE	1		1	1	4		0			
NV	1		1		1		0			
NH	3		3		3		0			
NJ	3		3		3		0			
NY	2		2		2		0			
NC	237	35	202		24	15	163	160	1	2
ND	2		2		2		0		1	
OH	2		2		2		1		1	
OK	3		3		3		1		1	
OR	8		8		8		3	5	3	
PA	16	2	14		7		7	3		4
RI	14		14	10	0		0		1	
SC	0		0		0		0			
SD	0		0		0		0		1	
TN	5		5	1	8		1		1	
TX	14		14		3		0			
UT	3		3		3		0			4
VT	1		1		2		0			
VA	0		0		0		0			
WA	14		14		3		11	10		1
WI	0		0		0		0			
WV	0		0		0		0			
WY	8		7		7		0	1	3	
WY	1		1		1		0	2		
PR	10		10		1		2			
VI	6		6		1		2			
50 states + PR and VI	632	57	583	.96	181	26	230	249	16	1
Total	640									
Interstate double-counting							-36		4	
U.S. total, adjusted							214	183		

*Data taken from the *Annual Statistical Digest*

**Differs from table in *Annual Statistical Digest* because of unexplained discrepancies.

counted for 121 of the 414 noninsured banks reported in 1980 and for 96 of the 583 noninsured banks for 1986. Nondeposit, nonbank state-chartered trust companies accounted for 95 of the total reported noninsured banks in 1980 and for 181 in 1986.³

Double counting of noninsured foreign branches within the same state, particularly in New York, accounted for 30 reported noninsured banks in 1980 and 26 in 1986. In addition, 39 of the reported noninsured banks represented double counting of the same foreign bank in more than one state in 1980. The equivalent number was 66 in 1986.⁴ The increase reflects rapid expansion across state lines of branches of foreign banks.

If the reported number of noninsured banks were adjusted to eliminate industrial banks, nondeposit nonmember trust companies, and double counting of noninsured U.S. branches of foreign banks, the number would decline by more than 50 percent from 414 to 154 in 1980 and from 583 to 280 in 1986. The adjustments are detailed in Table 1. Of the adjusted 154 non-FDIC insured banks in 1980, 130 were branches of different foreign banks, 11 were incorporated commercial banks, and 13 were nonincorporated or private banks. In 1986, the adjusted 280 noninsured banks consisted of 249 branches of different foreign banks; 20 incorporated banks, including 4 nonbank banks; and 11 private banks.⁵ Thus, 77 percent of the noninsured banks in 1980 and 89 percent of those in 1986 consisted of branches of different foreign banks. Moreover, all the growth in the actual number of noninsured banks between 1980 and 1986 may be attributed to increases in the number of foreign banks operating branches in the United States.

Although a similar analysis of reported noninsured banks was not undertaken for other years, it is unlikely that the results would differ greatly. Thus, there appears to have been no actual increase in the number of domestically chartered noninsured banks in recent years. In addition, both the number of commercial banks in the country and its rate of growth are somewhat lower than is evidenced by the reported figures. This is particularly true in Colorado, where a large number of industrial banks were included, and in New York State, where multiple branches of foreign banks were double counted. For 1980, making the suggested ad-

justments to the number of noninsured banks would reduce the total reported number of commercial banks in the United States from 14,884 to 14,563 (noninsured banks would decline from 436 to 115 and insured banks would remain unchanged). In Colorado, the number would decline from 442 to 323 and in New York from 317 to 285. Similarly, in 1986, the adjustments would reduce the total number of banks in the country from 14,879 to 14,463 (noninsured would decline from 640 to 214 and insured would increase from 14,239 to 14,249). The number of banks in Colorado would decline from 552 to 466, and the number in New York from 441 to 402. The adjustments to the data by individual state are shown in Table 2. If similar adjustments were made to the number of insured banks, the numbers would decline even further.

The Board of Governors has recently announced that the table, "Banks and branches—Number in operation," in the *Annual Statistical Digest* will be revised. Beginning with the data for December 31, 1987, all branches of foreign banks will be excluded. This eliminates the problem of double-counting, but, because many of the branches of foreign banks offer all of the services offered by domestic banks, it results in understating the number of commercial banks. Thus, users of data on number of banks would be well advised to pay careful attention to how the data were compiled and what they do and do not include.

¹ Table 76, "Banks and branches—Number in operation, December 31, 1986, by state," *Annual Statistical Digest* (Washington, D.C.: Board of Governors of the Federal Reserve System, 1987), p. 190. The number of the table varies for earlier years.

² Before the enactment of the International Banking Act of 1978, U.S. branches of foreign banks were not eligible for FDIC insurance. When they did become eligible, the Board continued to list those that obtained FDIC insurance as noninsured banks. The number of insured U.S. branches of foreign banks was 22 in 1980 and 57 in 1986. These have been excluded from the data on noninsured banks in this article. In addition, banks in Puerto Rico and the Virgin Islands were added to the Board's 1980 data base to make it comparable to the 1986 base. There are other minor discrepancies between the Board's current data base for the two years and the figures published in the *Annual Statistical Digest*. The term "total reported number of noninsured

banks," as used in the remainder of this article, is based on the Board's data base rather than the *Digest* table, excluding insured branches of foreign banks and including banks in Puerto Rico and the Virgin Islands for both years.

³ A number of these institutions are members of the Federal Reserve System. Because they have no deposits, they are not subject to the usual requirement that member banks be insured. Prior to 1986, they were counted in the *Annual Statistical Digest* tables as nonmember, noninsured banks. In 1986 they were shifted to the state member bank category. There were 14 such trust companies in 1980 and 13 in 1986.

⁴ The same types of double counting occur for insured branches of foreign banks. Adjusting the number of insured branches of foreign banks for

double counting reduces the reported number of insured banks by 8 in 1980 and by 34 in 1986. A small number of foreign banks (one in 1980, three in 1986) have some branches that are insured and some that are noninsured. The data used here were *not adjusted* for double counting across the two categories.

⁵ Nonbank banks are institutions that, although chartered as commercial banks, either do not accept demand deposits or do not make commercial loans. Therefore, they were not considered banks under the Bank Holding Company Act before its amendment in 1987. However, in view of the small number of nonbank banks and because most of them do offer a broad range of banking services to individuals, it was decided to retain them in the final totals.