The impact of NINOWs on deposits in Illinois

The legal authority for thrift institutions to offer "check-like" services is being increasingly broadened. Historically, only commercial banks have been permitted to offer and provide third-party payments services (checking accounts). However, in recent years judicial interpretations and legislative changes have generally eased such restrictions. Negotiable order of withdrawal (NOW) accounts, developed by New England thrift institutions, and noninterest-bearing negotiable order of withdrawal (NINOW) accounts, issued by some state-chartered savings and loan associations (S&Ls) in Illinois, are important components of the current trend.[1] Legislation currently under consideration by Congress, if enacted, would further this trend by permitting all depository institutions, nationwide, to offer some form of NOW accounts.

The NOW account is an interest-bearing savings account with check-like withdrawal privileges, providing the convenience of a checking account while paying interest like a savings account. The NINOW account is different from a NOW account in that no interest is paid on deposits. Thus, the NINOW is a very close substitute for the commercial bank check.

Because of the potential shift in deposits that might occur between financial institutions due to experimentation with new third-party instruments, all financial institutions, regulatory bodies, and Congress are viewing the NOW phenomenon with considerable interest. The experiences with NOWs in New England and the more recent adoption of NINOWs in Illinois provide insight into the possible deposit shifts that might occur.

[1]For further information on the trend of increasing competition between commercial banks and thrifts, see Jack S. Light, "Increasing competition between financial institutions," *Economic Perspectives*, May/June 1977.

NOWs in New England

For a long time thrifts have wanted to expand their depository powers to include third-party payments in order to compete with the one-stop service offered by commercial banks. An innovative mutual savings bank in Massachusetts in July 1970 submitted a plan to the state banking commissioner to issue NOW accounts, which the commissioner denied. However, in May 1972 the Massachusetts Supreme Judicial Court ruled unanimously that mutual savings banks could legally offer NOW accounts. Thereafter, many mutual savings banks in Massachusetts began offering the new service, and in September 1972 a savings bank in New Hampshire (whose law was judged similar to Massachusetts') began offering NOWs. The new interpretations of existing laws in the two states pertained only to state-chartered institutions; thrifts under federal regulatory jurisdiction could still not issue NOW accounts.

The resulting competitive imbalance led to federal legislation in August 1973, authorizing all depository institutions (except credit unions) in both states to offer NOW accounts. The debate over NOW accounts in New England continued, kindled in part by the results of formal studies[2] which recommend-

[2]Studies recommending reform within the financial institutions industry began with the Commission on Money and Credit in 1961, followed by President Kennedy's Committee on Financial Institutions in 1963 (the Heller report), the Hunt Commission in 1971, and more recently, the Financial Institutions and the Nation's Economy (FINE) study in 1975.

ed major reform within the financial institutions industry. In March 1976 Congress expanded the NOW experiment to include all six of the New England states.

Impact of NOWs in New England

Although NOW funds are considered expensive liabilities, competition for NOW funds has, nevertheless, been very active between the depository institutions in New England. Although commercial banks have been effective in competing for NOW deposits, thrifts have made significant inroads into third-party payments, the provision of which has heretofore been the exclusive privilege of commercial banks. Nearly three-fourths (74 percent) of the savings banks and S&Ls in New England offer the NOW service. However, their aggregate NOW deposits are currently less than that of commercial banks. About 62 percent of New England commercial banks offer the NOW service, and they hold 63 percent of the total NOW deposits in New England.

About 1.5 million NOW accounts, totaling over $2 billion, were outstanding in New England as of April 1977. Massachusetts institutions are dominant, holding 80 percent of the NOW accounts and 70 percent of the NOW deposits. Commercial banks hold 57 percent of NOW deposits in Massachusetts, 66 percent in New Hampshire, 75 percent in Connecticut, 80 percent in Maine, 99 percent in Rhode Island, and 93 percent in Vermont.[3]

While the NOW experience has exerted a measurable impact upon New England deposits, the impact has not severely affected the overall deposit structure of depository institutions in the six states. At year-end 1976 NOW balances in New England amounted to only about 2.8 percent of total aggregate deposits of commercial banks, mutual savings banks, and S&Ls in that area.

New England NOW data
(April 29, 1977)

	Number of institutions: Total	Number of institutions: Offering NOWs	Number of NOW accounts	NOW balances *(million dollars)*
Commercial banks	389	246	549,417	1,421
Mutual savings banks	303	249	686,845	643
Savings & loan assoc.	251	159	224,995	203
Total	943	654	1,461,257	2,267

Source: Federal Reserve Bank of Boston.

NINOWs in Illinois

Following the developments in New England, the Illinois legislature in October 1975 passed a law permitting Illinois state-chartered savings and loan associations to issue a modified NOW account—the NINOW. (Federally chartered S&Ls in Illinois may not offer any form of NOW or NINOW.)

From the standpoint of the user, the NINOW account is essentially the same as a commercial bank checking account—neither pays interest on deposits and both function as third-party payment instruments.

Other things being equal, the NINOW form of account—compared to the NOW—should cause a smaller transfer of funds out of commercial banks and into S&Ls. Because NINOW and checking accounts both provide essentially the same service, there appears to be little incentive for a consumer to substitute a new S&L NINOW account for his commercial bank checking account, except that such a move might result in improved convenience of location to some consumers. (Most banking studies show that convenience of location is one of the most important factors determining the choice of financial institution with which the customer does business.) Therefore, a shift in deposits to S&Ls, commensurate with the improvement in convenience, could be expected to occur.

The authority for state-chartered S&Ls to offer the new service appears to have had a negligible impact on the overall deposit structure in Illinois thus far. Of 413 savings and loan

[3]Data from the Federal Reserve Bank of Boston. For a more rigorous analysis of NOW development in New England, see Ralph C. Kimball, "Recent Developments in the NOW Account Experiment in New England," *New England Economic Review*, November/December 1976, and Katherine Gibson, "The Early History and Initial Impact of NOW Accounts," *New England Economic Review*, January/February 1975.

Deposit structure of Illinois commercial banks and savings and loan associations
(December 31, 1976)

Financial institutions	Number of firms	Deposits: Demand	NINOWs	Time and savings	Total
		(million dollars)			
Commercial banks	1,247	21,786	0	41,316	63,102
Savings and loan assoc.	413	0	12	25,040	25,052
Federally chartered	153	0	0	16,137	16,137
State-chartered	260	0	12	8,903	8,915
S&Ls issuing NINOWs*	55	0	12	3,491	3,503

Source: Federal Reserve Bank of Chicago; Federal Home Loan Bank of Chicago; Office of Commissioner, Illinois Savings & Loan Associations.

*As of July 1, 1977.

associations in Illinois, 260 are state-chartered organizations legally empowered to issue NINOW accounts. As of July 1, 1977, 55 S&Ls had obtained approval from the Illinois Commissioner of Savings and Loan Associations to issue this type of deposit; an additional 17 applications were pending before the commissioner.

These 55 savings and loan associations held total NINOW deposits of about $12.5 million, representing 30,305 accounts. A survey of 25 S&Ls offering the NINOW service in the Chicago Metropolitan Area revealed that the average number of accounts per S&L was 617. The range was from near zero for those just initiating the NINOW service to over 1,000 accounts for two large S&Ls; however, for most the number of accounts ranged from 300 to 700. The average NINOW account balance for all S&Ls was $497, with most balances falling in the range of $300 to $700.

Survey of NINOWs at 25 S&Ls

Asset-size group	Number of S&Ls in each group	Average asset size	Average no. of NINOW accounts	Average NINOW deposits per account
(million dollars)		*(million dollars)*		
$0-25	6	$16	367	$557
25-50	7	36	394	516
50-100	6	74	521	389
100 +	6	183	1,114	533
Total sample	25	76	617	497

In an effort to ascertain the degree to which the public is using NINOW accounts, those S&Ls surveyed were asked to indicate the average number of items processed per account per month. The average for the 25 S&Ls was 14 items, while the range was from 6 to 22. As a general rule, there is a direct relationship between the age of the accounts and the number of items processed; as the customer becomes more familiar with his NINOW account, he uses it more.

Compared to total deposits of all Illinois banks and S&Ls, NINOW deposits are of negligible relative importance. Total NINOW deposits ($12.5 million) represent only about 0.01 percent of total bank and S&L deposits and are equal to only about 0.05 percent of total demand deposits of commercial banks. Viewed another way, the sum total of NINOW deposits is about the same as the deposit size of the 733rd largest commercial bank in Illinois.

However, the total impact of NINOW activity on deposit structure in the state is not limited to the $12.5 million in aggregate NINOW deposits. Almost all S&Ls offering the NINOW account require the customer to open a companion passbook account.[4] The most common tie-in combination is a minimum balance of $0-20 in the NINOW account and $200-500 in a companion passbook account. If funds fall below one or both of the set minimums, service charges are usually made to the NINOW account.

[4]Only two of the 25 surveyed S&Ls offer the NINOW without some provision for a tie-in passbook account.

It is not unusual for companion passbook deposits to range five times larger than NINOW account deposits. Consequently, the aggregate $12.5 million in NINOW accounts understates the total effect of the NINOW activity, and if both the NINOW and passbook accounts are taken into consideration, the full effect could be as great as $75 million.[5] Nevertheless, even this combined amount is still a very small fraction (0.09 percent) of aggregate state deposits of S&Ls and commercial banks.

The failure of S&Ls offering NINOWs to penetrate effectively the market for commercial bank demand deposits can be attributed to several factors.

First, offering the NINOW is a totally new experience to which the S&Ls apparently are adjusting slowly. Expertise in providing and marketing third-party instruments is not acquired readily. After nearly two years of the NINOW's legal existence, only 55 of the 260 eligible S&Ls in Illinois are competing by offering the service. The small percentage is indicative of the cautious approach that S&Ls are taking. Obviously, if all eligible S&Ls in Illinois were offering the NINOW, the effect upon deposits could be significantly greater.

Secondly, S&Ls have been neither aggressive nor persistent in their promotion of the NINOW service to the general public and have concentrated their efforts primarily on their existing customer base. The usual promotional scheme consists of providing NINOW information in fliers sent to customers and advertising NINOWs in posters and pamphlets in S&L lobbies. However, there are some exceptions: a few S&Ls have resorted to limited local newspaper and radio advertising specifically designed to inform the public of the NINOW service.

[5]This amount is overstated because some of the companion passbook accounts were already in the S&Ls prior to the opening of the companion NINOW account.

Thirdly, the restructuring of liabilities to include NINOW deposits shortens the maturity of S&L liability portfolios. Managements of many S&Ls may not perceive the short-term nature of NINOW deposit liabilities as being consistent with the longstanding S&L policy of balancing long-term mortgage assets with long-term deposit liabilities.

Lastly, from the consumer's point of view, the NINOW has little more to offer than a commercial bank checking account. While convenience of location has undoubtedly favored NINOW growth at some individual associations, the overall effect has been minimal because of the limited number of S&Ls offering NINOW accounts.

Summary and conclusions

Up to the present the inroads of S&L NINOW accounts into commercial bank deposits in Illinois have been inconsequential. Given the reluctance of eligible S&Ls to offer NINOWs and their passive approach to marketing the implemented NINOW service, it appears that the full potential of the NINOW has not been thoroughly exploited by the S&Ls in Illinois.

Proposed legislation to authorize NOWs nationwide could have a significant impact upon the third-party payments structure in Illinois. If passed, it would enable all S&Ls and commercial banks in Illinois (as well as the nation) to offer interest-paying NOW accounts. S&Ls with experience in issuing NINOWs could easily shift to the NOWs and have a competitive advantage over the S&Ls not issuing the NINOWs. Moreover, those S&Ls issuing the NINOWs would also be in a better position to compete effectively with the commercial bank NOW service.

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