Types of Banks

- Commercial banks;
- Savings and loan associations;
- Mutual savings banks;
- Credit unions.

All four types take deposits and make loans.

The latter three types are the *thrift institutions*.

Dual Banking System

Commercial bank charters:

- National banks;
- State banks.

Commercial Bank Concentration

Before the Great Depression, the United States had more than 30,000 commercial banks, but approximately half went bankrupt during the depression. By 1980 approximately 15,000 banks still remained. Since then the number has steadily declined, as many banks have merged, and today (2012) there are 6,000 banks.

The largest five banks now hold more than 50% of all bank assets, and the largest 1% of the banks hold most of the assets. Concentration increased after the 2008 financial crisis, as many weak big banks were merged into stronger banks.

Banking is much more concentrated in other countries. In many European countries, the total number of banks is small, and the five largest banks control most of the assets.

Distrust of Banks

Historically there has been much distrust of the economic power of large banks in the United States.

Twenty-year federal charters to the Bank of the United States (1791) and Second Bank of the United States (1816) were allowed to lapse.

Branch Banking

The McFadden Act of 1927 restricted a bank to operate in a single state, and to follow the branch regulations of that state. Consequently the United States has many banks.

Texas and Illinois restricted a bank to a single office. At the other extreme, California permitted statewide branching.

Bank Consolidation

Since 1985, there has been much bank consolidation via mergers, and banks have operated across state lines.

Bank regulators allowed this consolidation, even though they lacked legislative authority. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 belatedly gave this authority.

Bank mergers have continued, but at present still no bank has branches all over the country.

Separation of Commercial and Investment Banking

Until the Great Depression, large banks in the United States were both commercial banks (taking deposits and making commercial and industrial loans) and investment banks (marketing new issues of stocks and bonds).

Some felt this combination made banks more risky and contributed to the banking crisis of the Great Depression. The Glass-Steagall Act of 1933 forced banks to choose between the two activities—some chose commercial banking, while others chose investment banking.

No Stock Buying

Commercial banks were no longer allowed to buy stock, and their economic power declined.

Repeal

The Gramm-Leach-Bliley Act (the Financial Services Modernization Act of 1999) repealed the Glass-Steagall Act, and banks can now do both commercial banking and investment banking and can also be involved in other financial sectors. The different arms of the company are organized as separate corporations, united by a central holding company owning each arm.

These changes were made at the behest of the banks, who expected to earn higher profits. The banks also claimed that greater efficiency would result.

Speculation

A danger is that a bank will risk federally-insured deposits in speculative activity. This danger exists, regardless of whether the bank is large or small.

Too Big to Fail

As large banks have become larger, a further danger is that a large bank will exploit its "too big to fail" status, to engage in speculation, with high leverage. Some lenders figure that the government will not let a large bank fail, and therefore the lenders will lend at a very low interest bank. High leverage at a low cost of funds allows the bank to make enormous profits.

This danger was realized during the recent housing boom, as many large banks lost great amounts on careless home-mortgage investing. The bank bailouts focussed on large banks. In contrast, most small banks avoided big losses, because very high leverage is unavailable to them.

Dodd-Frank

The Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 is still being implemented, but it includes provisions potentially to regulate and to reduce speculative trading by banks.

Unfortunately this legislation has sidestepped the “too big to fail” problem. The Federal Reserve maintains that it retains full discretion on whether and how to bail out any bank whose failure would endanger the economy.

Universal Banking

A *universal bank* is one that can engage in *any* financial activity—commercial banking, investment banking, life insurance, property insurance, mutual funds, etc.

Germany, Switzerland, and the Netherlands have universal banking.

A universal bank can own stock, and some have great economic power.

The Future

Eventually the banking system will perhaps be like Europe, with a handful of banks dominating the industry and operating throughout the country.

References

[1] Richard W. Fisher and Harvey Rosenblum. How huge banks threaten the economy. *Wall Street Journal*, April 4, 2012.