

Policy Watch

The Repeal of Glass-Steagall and the Advent of Broad Banking

James R. Barth, R. Dan Brumbaugh Jr. and
James A. Wilcox

This feature contains short articles on topics that are currently on the agendas of policymakers, thus illustrating the role of economic analysis in illuminating current debates. Suggestions for future columns and comments on past ones should be sent to C. Eugene Steuerle, c/o *Journal of Economic Perspectives*, The Urban Institute, 2100 M Street NW, Washington, D.C. 20037.

Introduction

What can banking companies do? Enactment of the Gramm-Leach-Bliley Act (GLBA) on November 12, 1999, provided a new legal answer to that question.¹ GLBA widened the range of activities that banks and their holding companies can conduct. GLBA repealed the parts of the Banking Act of 1933 that separated commercial banking from the securities business, which have come to be known as “Glass-Steagall.” It also repealed the parts of the Bank Holding Company Act of 1956 that separated commercial banking from the insurance business. Thus, GLBA permits single holding companies to offer banking, securities, and insurance, as they had before the Great Depression.

¹ The Act is named after Chairmen Phil Gramm (R-Texas), James A. Leach (R-Iowa), and Tom Bliley (R-Virginia) of the Senate Committee on Banking, Housing, and Urban Affairs, House Committee on Banking and Financial Services, and House Committee on Commerce, respectively.

■ *James R. Barth is Lowder Eminent Scholar in Finance, Auburn University, Auburn, Alabama, and Senior Finance Fellow, Milken Institute, Los Angeles, California. R. Dan Brumbaugh, Jr. is Senior Finance Fellow, Milken Institute, Los Angeles, California. James A. Wilcox is Chief Economist, Office of the Comptroller of the Currency, Washington, D.C.*

Glass-Steagall lasted more than six decades. After numerous well-funded and well-meaning attempts to repeal Glass-Steagall over the last six decades, why was it finally repealed in 1999? We identified three important factors, apart from whatever persuasion lobbyists and political action committees mustered.

The first was the increasing weight of empirical evidence generated by academics. A number of studies found that the securities activities of commercial banks bore little responsibility for the banking traumas of the Great Depression (Benston, 1989; Puri, 1996; Kroszner and Rajan, 1997). For example, Kroszner and Rajan (1997) showed that, partly because commercial banks dealt with older and larger firms, the securities that they underwrote performed better than those underwritten by investment banks.

The second factor was more recent experience. Regulators had allowed U.S. banking companies to undertake limited securities and insurance activities in recent years. By the end of the 1990s, few U.S. banking problems had been attributed to the wider range of permitted activities. Advocates of repealing Glass-Steagall also cited the extensive experience from other developed countries of banking companies that had securities and insurance businesses as providing support for the repeal of Glass-Steagall.

The third factor was rapid technological advance that has already markedly reduced the costs of using data from one business to benefit another business, and is expected to reduce such costs further in the future. These cost reductions raised the expected profitability of cross-selling insurance and securities products to both household and business customers. Together, these three factors added powerfully to the case for repealing Glass-Steagall.

GLBA permits many additional activities to be conducted within subsidiaries of U.S. banks; it permits even more activities to be undertaken by a new institution, financial holding companies that own banks, but not by the banks themselves. GLBA permits the financial holding companies the opportunity to conduct "broad banking," which means that they can engage in a wide range of banking, securities and insurance activities. However, the broad banking that GLBA permits U.S. financial holding companies to conduct is more restrictive than European "universal" banking, in that universal banks tend to have more freedom to own and be owned by nonfinancial companies.

GLBA effectively repeals federal laws and preempts many state laws that prevented affiliations among banks, securities firms, and insurance companies. It will allow and promote experimentation and learning by banking companies. Before concluding that GLBA reduced banking regulations and complexity, however, note that the GLBA comprises 144 pages of text. While the new law eliminated many restrictions, it also often maintained the practice of delineating allowable activities with a combination of numbing detail and vague terms. Thus, banking companies may well face additional uncertainty in the short run until regulators and courts interpret some of the law's language and until regulators sort out what role each will play in the regulation of broad banking companies.

Major Provisions

Financial Holding Companies and the Financial Subsidiaries of National Banks

The Banking Act of 1933 and the Bank Holding Company Act of 1956 greatly restricted the ability of banks to conduct the activities associated with securities firms, insurance companies, merchant banks, and other financial companies. Banks and bank holding companies were significantly limited in their ability to enter these markets either directly or through subsidiaries of the bank.

Under the new law, financial subsidiaries of banks are allowed to conduct most financial activities. Major exceptions are that financial subsidiaries cannot engage in insurance or annuity underwriting, insurance company portfolio investments, real estate investment and development, or certain aspects of merchant banking. (After a five-year moratorium, financial subsidiaries may be allowed to engage in all aspects of merchant banking.) Moreover, the total assets of all of a national bank's financial subsidiaries cannot exceed the lesser of 45 percent of the consolidated assets of the bank (including its subsidiaries) or \$50 billion.²

However, GLBA permits formation of a new category of holding company, the financial holding company, which is allowed to own banks as subsidiaries and also own other subsidiaries that engage in all other financial activities—including those that the financial subsidiaries of banks cannot enter directly. GLBA provides an initial list of activities that are considered “financial in nature,” including underwriting and dealing in securities; sponsoring and distributing all types of mutual funds; insurance underwriting and agency activities; merchant banking; and holding insurance company portfolio investments.

GLBA generally prohibits state regulators from restricting banking companies from engaging in any of the financial activities permitted by GLBA. In the case of insurance agency activities, however, states may impose restrictions in 13 specified areas. The areas cover advertising practices, licensing requirements, various notices and disclaimers, restrictions on paying fees to nonlicensed employees, and other potential coercive sales practices. Foreign banks operating in the United States are permitted to engage in the new financial activities on the same terms as U.S. banking companies.

In addition, GLBA allows savings and loan and other “thrift” holding companies to conduct banking, securities, and insurance activities as well. Preexisting “unitary” thrift holding companies, which held a single savings and loan (or other thrift institution), retain their already existing power to affiliate with commercial companies, that is, those that engage in nonfinancial businesses. However, GLBA did not extend this option either to other thrifts or to banks. Instead, the law narrowed this avenue to mixing banking and commerce by prohibiting new thrift holding companies from acquiring commercial firms or engaging in new commer-

²Also, a national bank that is one of the 50 largest banks must have not fewer than one issue of outstanding “eligible debt” that is currently rated in one of the three highest investment grade rating categories by a nationally recognized statistical rating organization.

cial activity. It also forbade existing unitary thrifts from transferring their right to mix banking with commerce.

Regulatory Structure

Financial holding companies may engage in activities that are “financial in nature” or “incidental to financial activities” or even “complementary to financial activities,” as long as the Federal Reserve determines that the activity does not pose a substantial risk to the safety or soundness of banks. However, the Federal Reserve does not serve as primary bank regulator, except for the roughly 15 percent of banks that are state-chartered Fed member banks. The Treasury Department participates in determining what new activities are financial in nature. Indeed, given the explosive growth in e-commerce and e-finance, considerable legal and regulatory wrangling may arise as various activities are sorted into the “financial” and “nonfinancial” categories.

GLBA generally adheres to the principle of “functional regulation,” which holds that similar activities should be regulated by the same regulator. Under functional regulation, federal and state banking regulators regulate bank activities, federal and state securities regulators regulate securities activities, and state insurance regulators regulate insurance activities. GLBA maintains the banking agencies’ authority to examine banks and affiliated companies, but limits their authority to examine functionally regulated subsidiaries. They are generally directed to use examinations made by federal and state securities and insurance regulators.

Contention between the regulators that will have jurisdiction over various parts of financial holding companies may arise from the differing goals of different regulatory agencies. For example, banking agencies cannot prescribe capital requirements for any functionally regulated securities firms or for any insurance subsidiary that is in compliance with the capital requirements of another federal or state regulator. Furthermore, the banking agencies cannot require a securities firm or insurance company to infuse funds into a bank if the appropriate securities or insurance regulator determines such an action would materially and adversely affect the securities firm or insurance company. In such a situation the banking agency may only require that the functionally regulated company be sold.

GLBA exempts some bank activities that have a “securities” component from regulation by the Securities and Exchange Commission. Examples include: third party networking arrangements, trust activities, traditional banking transactions such as commercial paper and exempted securities, employee and shareholder benefit plans, sweep accounts, affiliate transactions, private placements, safekeeping and custody services, asset-backed securities, derivatives, and other identified banking products. For new hybrid products, GLBA requires the SEC, in consultation with the Fed, to define and set general rules for the new financial product before seeking to regulate bank sales of any such new product.

Provisions for Community Lending

As intense negotiations between the Treasury, the Fed, and Congress inched GLBA toward passage, the potential curtailment of the Community Reinvestment Act (CRA) of 1977, which requires banks to make credit available in all areas of communities in which they operate, became a major obstacle.

In the end, GLBA provided that banks with less than \$250 million in assets will be examined for compliance with CRA only once every five years if they have prior “outstanding” ratings and only once every four years if they have prior “satisfactory” ratings. The overwhelming majority of banks are rated satisfactory or outstanding. GLBA also requires that banks and community groups must make certain CRA agreements public and must make annual reports on how funds and other resources involved in such agreements were used. Another CRA-related provision of GLBA is that financial holding companies and banks with financial subsidiaries will not be allowed to engage in any new activities or make any new acquisitions unless each of the insured institutions in the company received at least a “satisfactory” rating in its prior CRA exam.

Another mechanism for community lending involves the Federal Home Loan Bank System, a government-sponsored enterprise that comprises 12 regional Federal Home Loan Banks. These banks, which were established during the Great Depression to assist housing, are often perceived as having the backing of the federal government, which allows them to borrow more cheaply than they could otherwise. GLBA permits banks with less than \$500 million in assets to obtain long-term Federal Home Loan Bank advances that may be used to fund lending to small businesses, small farms, and small agribusinesses in addition to residential housing. This provision of GLBA directs subsidized lending toward selected institutions, which in turn can provide cheaper credit to designated categories of businesses.

New Privacy Protections

In the last days before passage of GLBA, concerns over consumer privacy—an issue that had received very little attention until that point—suddenly erupted. Perhaps the concerns should have been anticipated. As banking companies have begun to engage in wider ranges of financial activities, the issues of what customer information can be shared and with whom is naturally going to be of concern to the public and to banking companies.

GLBA requires regulators to establish standards for enhancing the privacy of consumers’ personal information held by financial institutions. GLBA generally allows customers to “opt out” of having their personal information shared with nonaffiliated third parties, bars financial institutions from disclosing customer account access codes to nonaffiliated third parties for telemarketing purposes without permission, and mandates annual disclosure of a financial institution’s policies and procedures for protecting customers’ personal information.

According to the Conference of State Bank Supervisors (1999, p. 1): “The law’s privacy measures were not as strict as some in the industry had feared—but

Congress left the door open for stricter requirements at the state level.” Financial institutions therefore may end up facing a confusing and burdensome hodgepodge of federal and state privacy rules. The privacy issue will undoubtedly generate more controversy in the future.

GLBA: Ratifying the Status Quo?

In many ways, the barriers between banking and other financial industries had been crumbling for some time even before the passage of the GLBA, as a result of regulatory decisions and earlier legislation. As such, GLBA is better seen as ratifying and extending changes that had already been made, rather than as revolutionary.

Banking Involvement in Securities Activities

Glass-Steagall barred national banks and state-chartered, Federal Reserve member banks from investing in shares of stocks, limited them to buying and selling securities as agents, and prohibited most from underwriting and dealing in most securities. It also prohibited Federal Reserve member banks from being affiliated with any company that is “engaged principally” in underwriting or dealing in securities. It made it unlawful for securities firms to accept deposits, and prohibited officer, director, or employee interlocks between a Federal Reserve member bank and any company “primarily engaged” in underwriting or dealing in securities. Certain securities were exempt from Glass-Steagall restrictions, including municipal general obligation bonds, U.S. government bonds, private placements of commercial paper, and mortgage-backed securities. These are collectively called “bank-eligible securities.” All other securities are deemed “bank-ineligible securities.”

However, the terms “engaged principally” and “primarily engaged” were not defined in Glass-Steagall. Similarly, a bank holding company or its nonbank subsidiary could engage in nonbanking activities, including securities activities, as long as the Federal Reserve determined that the activities were “closely related to banking.” Beginning in 1987, based upon such interpretative freedom, the Federal Reserve allowed bank holding companies to establish securities subsidiaries to engage in limited underwriting and dealing in municipal revenue bonds, mortgage-related securities, consumer-receivable related securities, and commercial paper. Since the authorization for dealing with these technically bank-ineligible securities was authorized by the Fed under Section 20 of Glass-Steagall, the securities affiliates are commonly referred to as “Section 20 subsidiaries.”

At first, the Federal Reserve decided that the revenues from bank-ineligible securities activities could not exceed 5 percent of Section 20 subsidiary’s total revenue. Then, in 1989, it raised the limit on revenue from bank-ineligible sources from 5 percent to 10 percent and allowed underwriting and dealing in all debt and equity securities. In 1997, the Fed further raised the limit on revenue from bank-ineligible sources to 25 percent. Because of such revenue limits, only the

largest bank holding companies were able to own full-line investment banks. Even so, there are now more than 40 Section 20 subsidiaries. GLBA eliminated these revenue limitations altogether. It further allowed securities underwriting to be done in financial subsidiaries of banks and financial holding company affiliates.

Restrictions on securities activity by banks had been further relaxed in recent years by state laws and by a determination by the Federal Deposit Insurance Corporation (FDIC) in 1984 that Glass-Steagall did not apply to affiliates of banks that were not Federal Reserve members. Roughly half of the states have authorized affiliates of such banks to deal in securities beyond the limits established for member banks. Furthermore, U.S. banking companies have long been permitted to engage in securities activities outside the United States through foreign subsidiaries.

Banking Involvement in Insurance Activities

The Bank Holding Company Act of 1956 and its amendments generally prohibited banking companies from engaging in insurance activities. However, bank holding company affiliates and national banks were allowed to engage in insurance agency activities in places with fewer than 5,000 people. Also, banks have been permitted to underwrite and sell insurance that would pay off an outstanding mortgage or credit balance in the case of death, illness, or disability.

Thirty-five states allow state-chartered banks greater powers to sell insurance than are available to national banks. Five states allow insurance underwriting (Lamb, 1999). In addition, U.S. banking companies have long been permitted greater freedom to conduct insurance businesses outside the United States through their foreign subsidiaries than they were permitted within the United States.³

Mixing Banking, Finance, and Commerce

Another way for banks to expand into new activities opened up in 1996, when the Office of the Comptroller of the Currency (OCC) reinterpreted certain “incidental” powers that it was granted under the National Banking Act of 1864 to permit operating subsidiaries (“op subs”) of national banks to engage in activities beyond those permitted the bank. Op subs have been allowed to underwrite municipal revenue bonds, corporate bonds, and even equity securities. Furthermore, the OCC decided that certain financial products, like annuities, were not insurance products but instead banking products, which meant that banks could sell them. The OCC also continued to allow national banks to engage in a wider range of securities and insurance activities.

Even before the passage of GLBA, some banks participated in broader financial and even commercial activities through what came to be known as “nonbank banks.” The Bank Holding Company Act of 1970 redefined a bank as an institution that both accepts demand deposits *and* makes commercial loans. By the early 1980s, securities, insurance and other firms began acquiring banks and then stopped

³ For example, without the new law, Citigroup would have been forced to discontinue its insurance underwriting activities by 2003.

either commercial lending or accepting demand deposits, so that they no longer qualified as banks. These “nonbank banks” were much less restricted in their commercial activities. In addition unitary thrift holding companies (again, holding companies that owned a single savings and loan or other thrift) can engage in any financial or commercial activity.

These laws enabled financial firms like Merrill Lynch and State Farm Insurance and commercial firms like Sears Roebuck and Ford Motor Company to own savings and loan institutions. In addition, bank holding companies may acquire up to 5 percent of the voting stock of a commercial firm. Bank holding companies may also acquire nonvoting stock as well, so long as the sum of the bank holding companies’ holdings are no more than 24.9 percent of a commercial firm’s capital and the bank holding company does not have controlling influence over the commercial firm.

The cumulative effect of these developments was to blur the lines separating commercial banks from investment banks and insurance companies. In that regard, GLBA to a large degree simply ratifies developments already occurring.

Potential Benefits to Banks and Their Customers

Banking companies and their customers may benefit from the expanded range of permissible activities under GLBA in several ways. For banks, scope economies are the most likely sources of greater profitability. Certain fixed overhead costs of collecting, processing and assessing information can occur once, and then be used across a range of financial services. Banks can also use existing technology, personnel and delivery channels to distribute securities and insurance services—along with their traditional lending—at relatively low marginal cost. Continuation of the declines in the real costs of data processing and telecommunications arising from technological advance may fuel even greater scope economies in the future. Finally, there may be economies coming from spreading overhead in administration, back office operations, and information technologies over a wider base of financial services.

Because of greater opportunities for diversification, a broad banking company may have lower profit variance than a traditional banking company. Broad banking companies may be affected less when firms bypass banks and raise funds directly in the capital markets, because the decline in their lending activity may be offset by an increase in their securities activity. The lower the correlation of profits of different financial activities, the more stable the total profits of a broad banking company will be. Because a reduction in profit variance of a broad banking company reduces its likelihood of insolvency, a more diversified banking company may pay lower interest rates on its funds that are thought not to be covered by the federal safety net.

Customers will also benefit when broader banking companies achieve scope economies and are thus able to pass along lower prices and to offer more product and service choices to their customers. Santos (1998, p. 39) found that “the results

already unveiled seem to confirm that the enhancement of a bank-firm relationship is a source of important benefits in terms of cost and availability of funding.”⁴ Customers may also encounter lower search and transaction costs with “one-stop” shopping for financial products and services.

Potential Risks from Expanded Banking Activities

Two main concerns arise when banking, securities and insurance activities are combined within the same banking organization. The wider range of activities might increase the risk of insolvency. However, a wider range of activities can also reduce insolvency risk by increasing diversification. Kwan and Laderman (1999, pp. 24, 30) concluded that “[O]n the effects of securities’ activities on banking organizations’ safety and soundness, the bulk of the empirical evidence indicated some potential for risk reduction in expanding banks’ securities powers. . . . The weight of the empirical evidence . . . seems to indicate that engaging in either insurance agency activities or insurance underwriting activities has the potential to reduce BHC [bank holding company] risk and, in particular, the probability of bankruptcy.” Policymakers like FDIC Chairman Donna Tanoue (1999, p. 11) and Federal Reserve Governor Lawrence Meyer (1999, p. 284) have echoed these views.

The second concern is whether banks receive a subsidy, based on the way that federal deposit insurance and access to the payment system and the discount window of the Federal Reserve are implemented, that could be extended to cover the broader range of financial activities. If so, holding companies with bank subsidiaries would have an unfair advantage over their nonbank competitors.⁵

Access to the federal banking safety net offers benefits to banks, but also imposes costs. Banks typically pay positive premiums for deposit insurance, must hold zero-interest reserves, and bear the costs of satisfying banking supervision, regulations, and legislation. As to the net effect of the subsidy related to the safety net, “most evidence suggests that the net marginal subsidy received by these [well-managed and well-capitalized] banks is insignificant or even negative” (Jones and Kolatch, 1999, p. 15; see also Furlong, 1997; Shull and White, 1998; and Whalen, 1999a, b).

Even if there were net marginal subsidies from the federal safety net that accrued to banks, adequate safeguards appear to exist to inhibit banks from passing them through to the other, affiliated subsidiaries of their holding companies. According to FDIC Chairman Tanoue (1999, pp. 15), “[I]n practice, regulatory safeguards for operating subsidiaries . . . and existing safeguards for affiliates

⁴ Also, see Classens and Klingebiel (1999), Saunders and Walter (1994) and Shull and White (1998).

⁵ The Gramm-Leach-Bliley Act does prohibit FDIC assistance to affiliates and subsidiaries of banks—although, of course, this begs the question of whether assistance to a bank might end up helping those affiliates and subsidiaries.

. . . would inhibit a bank from passing any net marginal subsidy either to a direct subsidiary or to an affiliate of the holding company.”

What Can Banks in Other Countries Do?

GLBA brought U.S. banking laws closer to the banking laws of most other industrial countries. However, compared with other countries, U.S. law still grants fewer powers to banks and their subsidiaries than to financial holding companies, and still largely prohibits the mixing of banking and commerce.

Table 1 compares what banks could do in the U.S. with what banks could do in 18 other countries in 1997. The first two columns indicate whether banks can conduct securities and insurance in an “unrestricted” fashion; whether they are “permitted” to conduct a full range of activities but must sometimes use subsidiaries; whether these activities are somewhat “restricted;” and whether they are “prohibited.” Note that in 1997 Japan and the United States were the most restrictive of all these countries. Thus, GLBA just allows U.S. banking companies to engage in securities and insurance activities that have been permitted for banks or banking companies in many other countries.

The last two columns of Table 1 present information about the extent of mixing of banking and commerce for the same countries. Again, Japan and the United States are the most restrictive. Most other countries place no restrictions on banks owning commercial firms, and vice versa, which was the case in the United States before the Bank Holding Company Act was enacted in 1956. Even after the passage of GLBA, U.S. banking companies and commercial firms have fewer opportunities to mix than are available in other countries.

Many other countries also permit banks more latitude to choose the organizational form in which to conduct securities and insurance activities. In 15 of the countries listed in Table 1, bank holding companies either do not exist or are infrequently used. (Bank holding companies are common only in United States, France, Italy, and Netherlands.) Outside the United States, banks typically conduct their insurance activities in their subsidiaries, while their securities activities are usually conducted directly in banks.⁶ By favoring the holding company structure for conducting securities, insurance, merchant banking, and other new activities, GLBA precludes U.S. banks from choosing an organizational option favored by banks abroad.

Banking laws in other countries matter, not only because they affect global competition, but also because they generate evidence on the costs and benefits of restricting bank activity. Based upon an analysis of more than 60 countries that differ widely in location and economic development, Barth, Caprio and Levine (2000, p. 26)

⁶ The GLBA does not expand the activities permissible to the bank itself, except for municipal revenue bonds. For skeptical discussion of forcing banks to use affiliates and holding companies, see Puri (1996), Shull and White (1998), and Whalen (1999a, b).

Table 1

EU and G-10 Countries: Regulatory Treatment of the Mixing of Banking, Securities, and Insurance Activities and the Mixing of Banking and Commerce (1997)

<i>Country</i>	<i>Securities^a</i>	<i>Insurance^a</i>	<i>Commercial Bank Ownership of Commercial Firms^b</i>	<i>Commercial Firm Ownership of Commercial Banks^b</i>
Austria	Unrestricted	Permitted	Unrestricted	Unrestricted
Belgium	Permitted	Permitted	Restricted	Unrestricted
Canada	Permitted	Permitted	Restricted	Restricted
Denmark	Unrestricted	Permitted	Permitted	Unrestricted
Finland	Unrestricted	Restricted	Unrestricted	Unrestricted
France	Permitted	Permitted	Permitted	Permitted
Germany	Unrestricted	Restricted	Unrestricted	Unrestricted
Greece	Permitted	Restricted	Unrestricted	Unrestricted
Ireland	Unrestricted	Restricted	Unrestricted	Unrestricted
Italy	Unrestricted	Permitted	Restricted	Restricted
Japan	Restricted	Prohibited	Restricted	Prohibited, generally
Luxembourg	Unrestricted	Permitted	Unrestricted	Restricted
Netherlands	Unrestricted	Permitted	Unrestricted	Unrestricted
Portugal	Unrestricted	Permitted	Permitted	Unrestricted
Spain	Unrestricted	Permitted	Unrestricted	Permitted
Sweden	Unrestricted	Permitted	Restricted	Unrestricted
Switzerland	Unrestricted	Unrestricted	Unrestricted	Unrestricted
United Kingdom	Unrestricted	Permitted	Unrestricted	Unrestricted
United States	Restricted	Prohibited, generally	Prohibited, generally	Prohibited, generally

Notes: Securities activities include underwriting, dealing with brokering all kinds of activities and all aspects of the mutual fund business.

Insurance activities include underwriting and selling insurance products/services as principal and as agent.

Definitions: ^a Unrestricted—A full range of activities in the given category can be conducted directly in the bank.

Permitted—A full range of activities can be conducted, but all or some must be conducted in subsidiaries.

Restricted—Less than a full range of activities can be conducted in the bank or subsidiaries.

Prohibited—The activity cannot be conducted in either the bank or subsidiaries.

^b Unrestricted—100 percent ownership permitted.

Permitted—Unrestricted, but ownership is limited based upon bank's equity capital.

Restricted—Less than 100 percent ownership.

Prohibited—Prohibited.

found that “the tighter the restrictions placed on this [securities] activity . . . the more inefficient are banks and the greater the likelihood of a banking crisis. The likelihood of a banking crisis is also greater . . . the tighter the restrictions placed on bank ownership of nonfinancial firms.” They further conclude that “none of these [securities, insurance, real estate and ownership] restrictions produce any beneficial effects with respect to financial development, nonbank sector and stock market development, or industrial competition. Nor is it found that any of them lessen the likelihood of a

banking crisis or enhance bank efficiency.” For additional discussion of this point, see Barth, Nolle and Rice (2000). Such evidence should give pause to those who advocate regulatory restrictions on the activities, ownership and organizational forms of U.S. banks.

Where Is Banking Headed?

It is sometimes alleged that GLBA will accelerate the already rapid pace of mergers of banks and of holding companies. By its nature, GLBA is likely to stimulate primarily mergers that expand banking firms’ scope of product and service offerings. GLBA allows banking, finance, and insurance to be undertaken within a single holding company. However, by 1994, the Riegle-Neal Act had effectively ended the remaining barriers to interstate banking and branching within the United States. Combinations with foreign banking companies have generally been permitted as well. Thus, GLBA does not much change the incentives and abilities to merge across state and national boundaries.

The role of banks in the financial sector has changed markedly over the decades. When the national banking system and its regulator and supervisor, the Office of the Comptroller of the Currency, was established during the Civil War, banks held nearly three-fourths of the total assets of all financial intermediaries. Banks dominated the field of finance. Now, banks’ share of total assets has fallen to less than one-fourth. The field of finance has become much more crowded, as borrowing bypassed banks in favor of direct access to securities markets. This shift changed banks. Rather than relying so heavily on income generated from the spread between the interest rates that banks charged on loans and rates paid on deposits, banks have come to rely more and more on fees for services such as asset and risk management. Indeed, as of the late 1990s, noninterest income had risen to more than 40 percent of operating income for banks with more than \$1 billion in assets, and more than 25 percent for banks with less than \$1 billion in assets.

GLBA will now permit broad banking companies that can engage in banking, securities, and insurance activities. The combined assets of commercial banks, insurance companies, securities firms, and investment companies are almost two-thirds of the assets of all financial intermediaries. To the extent that these now largely separate companies combine as permitted by GLBA, broad banking companies will regain some of the market share that they had more than a century ago.

It remains unclear whether technological advance will make banking more efficiently delivered to customers via the one-stop “portfolio model” or the “portal model.” An example of the portfolio model is Citigroup, which houses in a single holding company a very wide range of banking, securities, and insurance products and services. An example of a portal model is Yahoo Finance, which allows customers to use a single website to access a similarly wide range of products and services that are offered by typically unconnected companies. As competition

between these and other models proceeds, it will be interesting to see if any particular model comes to dominate financial services as banks had in the past.

As banking companies broaden, they will still take deposits and make loans. But broader banks will also offer a broader range of asset and risk management services. These changes are already underway, driven by financial innovations, information technology, and global competition. The challenge of the regulators and supervisors overseeing banking companies will be to allow these banking companies to innovate and adapt to the ever-changing global marketplace while protecting the safety and soundness of the financial system and the interests of those who fund the federal safety net for banking companies.

■ *The views expressed herein do not necessarily represent the views of the Office of the Comptroller of the Currency or of the U.S. Department of the Treasury. The authors thank Nancy Michaleski, Raymond Natter, Gary Whalen and Julie Williams for helpful comments.*

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