Consolidation In The U.S. Banking Industry Since Riegle-Neal

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ABSTRACT

The Riegle-Neal Banking and Branching Efficiency Act of 1994 eliminated previous restrictions on interstate banking and branching in the U.S. banking industry. It was expected that this deregulation would accelerate the consolidation already underway among U.S. banks. Previous research examined the initial impact of Riegle-Neal on the number of banking institutions and branches by analyzing data from immediately before the act was passed in 1994 to immediately after it became fully effective in 1997. That research found an increase in the rate of consolidation among U.S. banks, with an increase in the number of mergers, an increase in the number of newly chartered banks, a decrease in the number of bank failures, and an increase in the number of new bank branches. This paper considers whether these immediate effects of Riegle-Neal have persisted into the longer term or have moderated in the years since the act became fully effective. The analysis of data since 1998 presented here indicates that the initial effects of the act have moderated. The rate at which the number of banking institutions is decreasing has slowed. The rate of merger and acquisition activity has decreased. Bank failures are very low. There has been a slow down in the increase of new bank branches.

Keywords: Banking; Consolidation; Branches

INTRODUCTION

The McFadden Act of 1927 and other legislation restricted the ability of U.S. banks to engage in interstate banking and branching. The Riegle-Neal Banking and Branching Efficiency Act of 1994 removed these restrictions by allowing banks to request regulatory approval for mergers across state lines. Section 44, a) 1) stated that beginning on June 1, 1997 interstate mergers could be approved. Section 44, a) 3) indicated that such mergers could be approved before June 1, 1997 if the home states of each bank involved in the merger approved interstate banking merger transactions with all out of state banks. This was expected to accelerate the trend toward consolidation which was already taking place in the U.S. banking industry.

In previous research Matasar and Heiney (2002) studied the immediate effects of the deregulation instituted by Riegle Neal. They examined the effects of the act on consolidation in the U.S. banking industry in terms of the number of banking institutions, merger and acquisition activity, the number of de novo banks, the number of bank failures, and the number of bank branches. In addition, they studied the impact on bank profitability, the availability of service and the level of fees, and employment and compensation in the industry.

Since Riegle-Neal was passed in 1994 and became fully effective in 1997, Matasar and Heiney examined data from 1990 to 1998 to capture the initial impact of the act by looking at the period from before the act was passed to immediately after the act became fully effective. They indicated that:

This study of Riegle-Neal may appear somewhat premature or preliminary because of the short period of time since the law was enacted and fully enforceable. Nonetheless the findings herein reveal the direction that changes associated with the law are likely to take and thus serve as a base-line for future analysis.

The snowball of change in the banking community continues to roll and pick up speed even as this book is being written. What is being presented here, therefore, is a still photo of a moment in time, as well as comparison with the *past. The future of banking and of financial services in the 21st century is likely to differ considerably from what it was at the end of the 20th century. Hopefully this book offers a foundation for further thought and understanding of the future now being considered.* (Matasar and Heiney, 2002, p. viii.)

This paper examines the consolidation in the U.S. banking industry which has taken place since Rielge-Neal became fully effective. It presents information on that consolidation in terms of the number of banking institutions, the number of bank branches, merger and acquisition activity, bank failures, and de novo banks.

THE CAUSES AND CONSEQUENCES OF CONSOLIDATION IN THE BANKING INDUSTRY

When Riegle-Neal eliminated the restrictions on interstate banking and branching activity, it was expected that newly available merger and acquisition opportunities across state lines would accelerate the consolidation among U.S. banks already underway. There were concerns regarding the resulting impact on the level of bank services and fees and on employment in the industry. Rose (1997) presents a thorough examination of the possible consequences of the increased consolidation resulting from increased interstate banking.

One reason to expect increased merger activity was the opportunity to take advantage of economies of scale. A merger can be a less costly way to achieve efficient asset size than internal expansion. Calem (1994) indicates that there are economies of scale in the banking industry up to an asset size of $75 million. Economies of scale seem to run out for banks with assets between $75 and $300 million. Beyond $300 million in assets, diseconomies of scale seem to set in.

Merger activity may also be a mechanism to replace inefficient management. Calomiris and Karceski (1998) ask, "Is the Bank Merger Wave of the 1990s Efficient?" The economic analysis of government regulation often argues that regulation has the effect of protecting less efficient firms from competition by more efficient firms. Economides, Hubbard, and Palia (1996) present a political economy model in which it is argued that federal branching restrictions were designed to protect smaller, less efficient banks from larger, more efficient banks. Jayaratne and Strahan (1998) also examine the relationship between entry restrictions and efficiency for commercial banks.

It can also be argued that the interstate mergers newly allowed by Riegle-Neal provided an opportunity for banks to reduce risk through geographic diversification. The extent to which geographic diversification reduces risk for an institution depends on the correlation of economic conditions in different areas of the country. If economic conditions are very highly positively correlated across regions of the country, then geographic expansion through interstate banking and branching will not contribute significantly to the objective of risk reduction. Carlino and Sill (2000) find that the correlation coefficients for real per capita personal income across the regions of the U.S. are typically above 0.88. The far west region is an exception for which correlation coefficients with the other seven regions are between 0.20 and 0.32. Sherwood-Cali (1990) examines the economic stability of different regions of the country in terms of state industry diversification. She finds that the reduction of volatility due to industry diversification provides the opportunity of risk reduction through geographic expansion of financial institutions.

Smoluk, Andrews, and Voyer (2003) provide a methodology for examining the "potential benefits of risk reduction for financial institutions wishing to grow primarily through a strategy of geographic expansion." (p. 47) They find that "by strategically investing in different regions, a financial institution could reduce its potential earnings risk by over 58 percent while maintaining or improving potential profitability." (p. 48)

THE INITIAL IMPACT OF RIEGLE-NEAL: 1990 – 1998

Between 1990 and 1998 the number of banking institutions in the U.S. decreased by 3,288 or 26.7% from 12,303 to 9,015. The change in the number of banking institutions is determined by the number of mergers and acquisitions, the number of bank failures, and the number of new banks formed. This decrease in the number of banks was primarily due to merger and acquisition activity during this period. From 1990 to 1998 there were 4,944 banking mergers. During this period there were only 70 bank failures. Therefore, mergers and failures would have resulted in a decrease in the number of banks of 5,014. The fact that the number of banking institutions decreased by less than this amount is due to the 1,071 de novo banks which began operation in this period. Furthermore, the effect of the decreasing number of institutions on the availability of service was ameliorated by an increase in the number of bank branches by 13,396 from 49,848 to 63,244. (Matasar and Heiney, 2002)

CONSOLIDATION IN THE U.S. BANKING INDUSTRY SINCE RIEGLE-NEAL: 1998 – 2003

The Number of Banking Institutions

Table 1 and Figure 1 present information on the number of banking institutions and changes in the number of institutions for Federal Deposit Insurance Corporation (FDIC) insured commercial banks in the 50 states and the District of Columbia. These data are slightly different from those reported in Matasar and Heiney (2002) because they come from a different FDIC report, and the data reported above for 1990 to 1998 did not include the District of Columbia. In Table 1 the number of banking institutions decreased from 12, 329 to 8,756 between 1990 and 1998. This decrease of 3,573 was a decrease of 28.98% over the 8 year period for an average of 3.62% per year. Between 1998 and 2003 the number of banking institutions decreased from 8,756 to 7,752. This decrease of 1,004 was a decrease of 11.47% for the 5 year period, or an average of 2.29% per year. It appears that the rate of consolidation has slowed since the initial impact of Riegle-Neal.

Consider the percentage changes in the number of institutions before Riegle-Neal was passed in 1994, the period during which Riegle-Neal became effective from 1994 to 1998, and the period since Riegle-Neal became fully effective, i.e., after 1998. From 1990 to 1994 the rate at which the number of institutions was decreasing increased from 2.9% to 4.69% per year. Between 1994 and 1998 when Riegle-Neal began to have its initial impact the rate of decrease in the number of banks held at over 4.0% per year. Since 1998 the rate of decrease in the number of institutions has decreased steadily from 4.03% to 1.5% for 2003.

Mergers and Acquisitions

Table 2 provides additional information concerning the breakdown of the changes in the number of institutions due to new banks, mergers, and failures. From 1994 to 1997, the period from when Riegle-Neal was passed to when it became fully effective, the number of unassisted mergers increased from 547 to 599. Since Riegle-Neal became fully effective in 1997 the number of unassisted mergers has decreased from 599 to 276 in 2002. The number of mergers has decreased for each of these years except the year 2000. It appears that merger activity increased during the period in which Riegle-Neal became effective and has decreased since that time.

Newly Chartered Banks

The data on newly chartered banks in Table 2 indicates that new charters had been decreasing during the period prior to the passage or Riegle-Neal. From 1990 to 1994 the number of new charters decreased from 165 to 49 per year. After the passage of Riegle-Neal, the number of new charters increased each year from 49 in 1994 to 231 in 1999. Since 1999 the number of new charters has decreased each year to only 91 in 2002. It is clear that the period during which Riegle-Neal became effective was one in which the number of institutions was decreasing but the number of newly chartered banks was increasing at the same time.

Table 1: Number of Institutions

Year	Number of Institutions	Change	% Change
	Institutions	Number of Institutions	Number of Institutions
2003	7752	-118	-1.5
2002	7870	-192	-2.38
2001	8062	-235	-2.83
2000	8297	-266	-3.11
1999	8563	-193	-2.22
1998	8756	-368	-4.03
1997	9124	-386	-4.06
1996	9510	-411	-4.14
1995	9921	-510	-4.89
1994	10431	-513	-4.69
1993	10944	-505	-4.41
1992	11449	-460	-3.86
1991	11909	-420	-3.41
1990	12329	-368	-2.9
1989	12697	-422	-3.22
1988	13119	-586	-4.28
1987	13705	-488	-3.44
1986	14193	-209	-1.45
1985	14402	-81	-0.56
1984	14483	29	0.2
1983	14454	19	0.13
1982	14435	34	0.24
1981	14401	-20	-0.14
1980	14421	70	0.49
1979	14351	27	-0.19

FDIC, Historical Statistics on Banking

Table 2: New Charters, Mergers, and Failures

Year	New	Unassisted	Failures	
	Charters	Mergers	Mergers	Paid Off
2002	91	276	6	4
2001	129	360	3	0
2000	192	456	6	0
1999	231	421	6	0
1998	194	563	3	0
1997	188	599	1	0
1996	145	553	5	0
1995	101	609	6	0
1994	49	547	11	0
1993	61	480	35	27
1992	72	428	72	25
1991	105	446	85	20
1990	165	393	141	17
1989	192	411	175	31
1988	229	598	173	36
1987	219	543	136	50
1986	255	341	101	40
1985	330	336	87	29
1984	391	330	61	16
1983	361	314	32	12
1982	315	256	24	7
1981	198	210	5	2
1980	205	126	7	3
1979	203	223	7	3
1978	149	165	4	1

FDIC, Historical Statistics on Banking

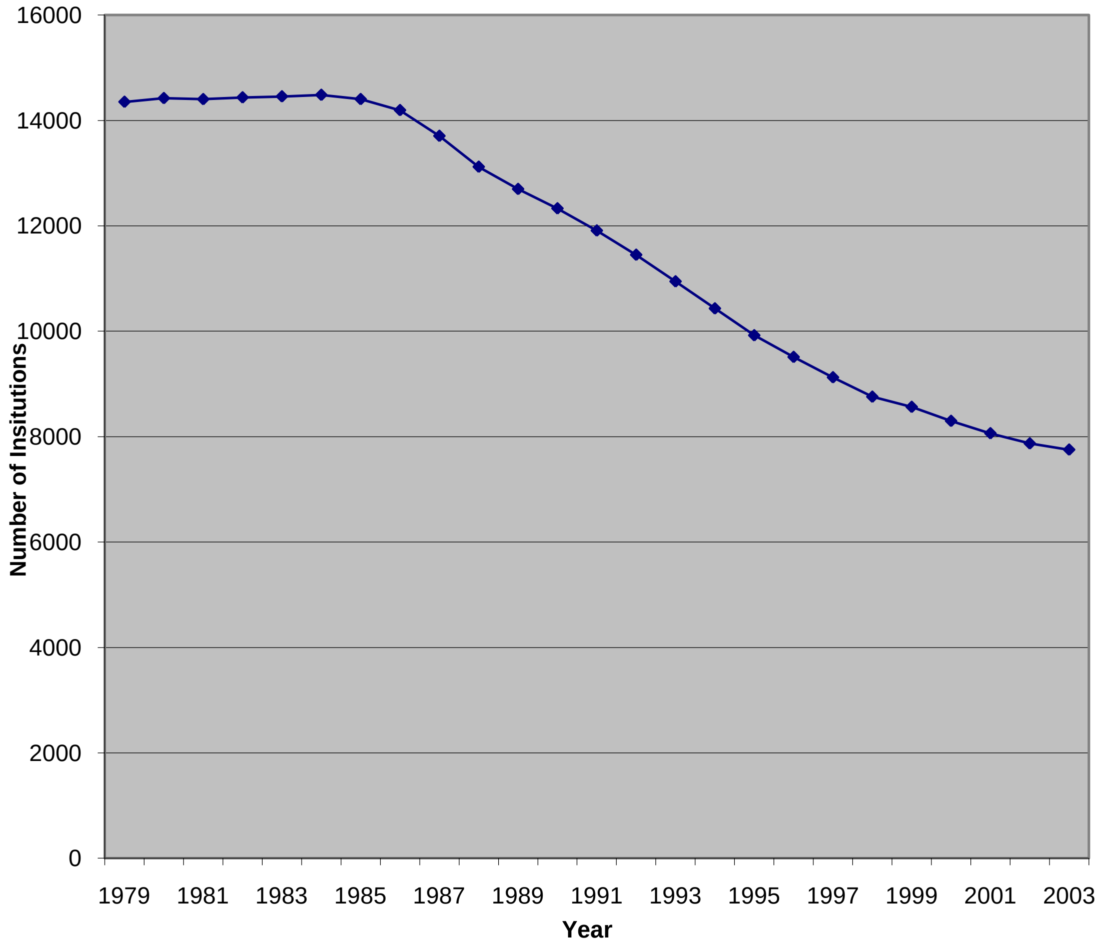

Figure 1: Number of Institutions

Bank Failures

Table 2 indicates that bank failures have not played a major role in the change in the consolidation trend in the U.S. banking industry during these periods of time. From 1990 to 1994 the number of bank failures assisted by mergers decreased consistently from 141 to 11. During that same period the number of paid off failures increased from 17 to 27. These numbers of failures, however, were consistently lower than the number of failures in the mid to late 1980s. After the passage of Riegle-Neal in 1994, the number of paid off failures was zero until there were 4 in 2002, and the number of failures assisted by mergers decreased to single digits.

Branches

Table 3 and Figure 2 present information on the number of bank branches and changes in the number of branches. Again, compare the period during which Riegle-Neal became effective and the period since then. Between 1990 and 1998 the number of branches increased from 50,017 to 61,394. This was an increase of 11,377 or 22.75% over the 8 year period. This is an average of 2.84% per year. From 1998 to 2003 the number of branches increased by 5,372 from 61,394 to 66,766. This is an increase of 8.75% for the 5 year period for an average of 1.75% per year. It appears that the rate at which branches are increasing has slowed since Riegle-Neal.

Prior to Riegle-Neal the rate at which branches were increasing decreased from 4.97% in 1990 to 1.79% in 1993, with an actual decrease in the number of branches in 1992. In 1994 the number of branches increased by 4.17%, and between 1994 and 1998 the percentage change in the number of branches fluctuated between 2.2% and 4.39% with no particular pattern. Since 1999 when the number of branches increased by 2.78% the pattern has again fluctuated down to 1.8% for 2003.

CONCLUSION

This paper has extended previous research which studied the initial impact of the Riegle-Neal Act on consolidation in the U.S. banking industry by examining the period of time since this deregulation became fully effective to see if the immediate effects set in motion by the passage of the act have continued or moderated.

The data on the number of banking institutions indicate that the number of institutions continues to decrease. However, the rate at which the number of banks is decreasing has slowed since Riegle-Neal became fully effective. Merger and acquisition activity, which increased during the period of time Riegle-Neal became effective, has also moderated since 1997. Similarly, de novo banking activity, which increased between 1994 and 1999, has decreased in more recent years. Finally, the rate of increase of bank branches has decreased since Riegle-Neal.

Table 3: Number of Branches

Year	Number of Branches	Change Number of Branches	% Change Number of Branches
1984	41485		
1985	42970	1485	3.58
1986	44054	1084	2.52
1987	45017	963	2.19
1988	46036	1019	2.26
1989	47650	1614	3.51
1990	50017	2367	4.97
1991	51591	1574	3.15
1992	51544	-47	-0.09
1993	52467	923	1.79
1994	54656	2189	4.17
1995	56028	1372	2.51
1996	57258	1230	2.2
1997	59773	2515	4.39
1998	61394	1621	2.71
1999	63101	1707	2.78
2000	63487	386	0.61
2001	64965	1478	2.33
2002	65584	619	0.95
2003	66766	1182	1.8

FDIC, Historical Statistics on Banking

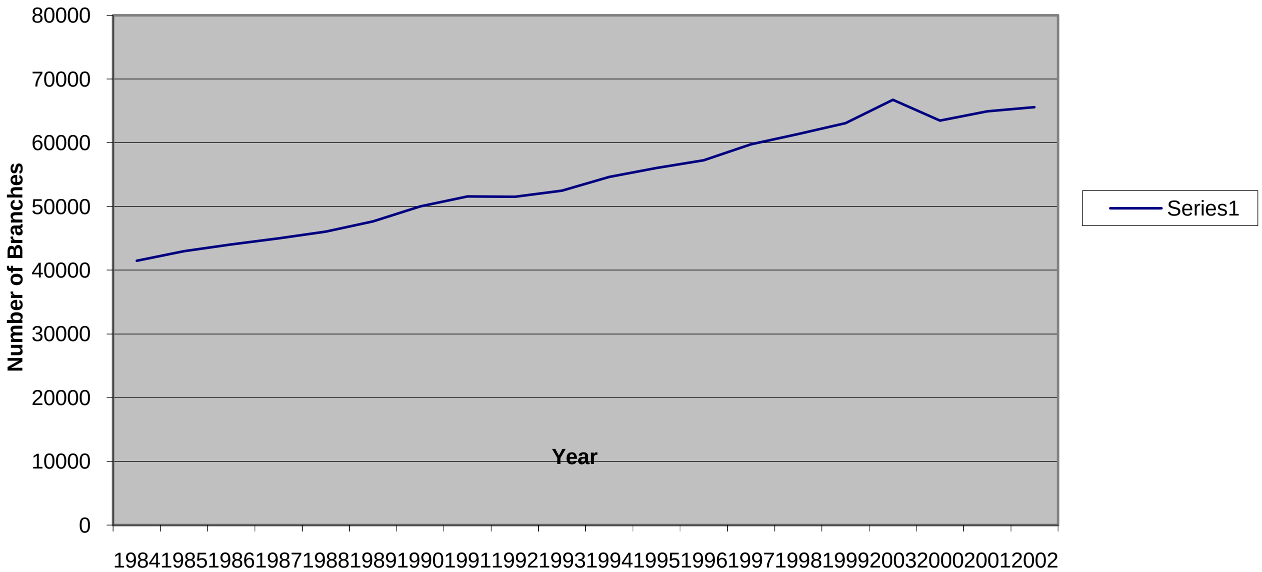

Figure 2: Number of Branches

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