The Effects of Structural Deregulation on State Banks in New York During the 1970s

Michelle Zagardo*

ABSTRACT

New York eliminated restrictive branching and merging laws in 1976. A study of national- and state-chartered banks in New York found that the number of commercial banks as well as the number of mergers decreased during the 1970s (Kunreuther, 1976). In a study of state- chartered banks I find no change in merger activity as well as an increase in the number of state-chartered commercial banks during this period. Additionally, I categorize banks by size to examine their activity around the period of deregulation and find differences in behavior when comparing banks with total assets above the state median to banks with total assets above the state average.

I. INTRODUCTION

In 1971 the state of New York passed banking legislation that would eliminate restrictive branching and merging laws within the state in 1976. I compiled a data set to explore the effects of structural deregulation on New York state-chartered commercial banks during this time period and I found that there was an increase in bank mergers in 1976. In addition, the number of state-chartered commercial banks increased between 1972 and 1975 which is opposite what Kunreuther (1976) found when she studied this deregulation.

Restrictive structural regulations were pervasive in the United States banking system until the late 1990s. When structural deregulation began, it took place in a piecemeal fashion which made banking the ideal industry in which to evaluate the response of market structure to distinct policy changes. A review of the literature revealed several nationwide studies of structural deregulation but only one study done at the state level (Carlson & Mitchener, 2009).

The unique structure of the New York banking system in the 1970s and the legislative reforms combined with the concentration of many of the nation's largest banks operating in New York provided a rich environment to analyze that state's banking market. The 1971 law provided for an intermediate period between 1972 and 1976 that let small banks prepare for the likely increased competition they would face from bank holding companies and larger banks from urban markets.

---

* Mount Holyoke College, class of 2010, 50 College Street, South Hadley, MA 01075, zagar20m@mtholyoke.edu.
Paper from the 4th annual NYSEA Undergraduate Paper Competition.

The customary categorization of banks by size in the literature is median asset size but this practice does not capture the control of very large bank holding companies in the market. Therefore, I categorized banks by average asset size which preserved the dominance of the bank holding companies in the analysis and revealed stark differences between the two classifications.

II. A BRIEF HISTORY

In 1934 the Stephens Act was passed in NY and divided the state into nine banking districts. Banks were permitted to branch and merge within their district. This was the beginning of a period of continuous regulatory change that affected the activities of banks and bank holding companies (BHCs). Regulators struggled between allowing increased competition in the evolving industry while protecting the interests of smaller banks. In 1967 regulators and law makers began reexamining the Stephens Act and, after much debate, proposed legislation to eliminate the nine banking districts (Robards, 1975). William T. Dentzer was the superintendent of banks in NY at the time and said that:

> "the problem in all of this for any public official is to be sure that in the end we come up with a system which is more competitive than it would otherwise be if it's left to go its own normal, course, without any inhibitions" (Heinemann, 1970, September 8, 59).

The legislation passed in June 1971 and would become effective in 1976 (Heinemann, 1971, June 5, 37). Banks would be allowed to branch and merge throughout the state beginning in 1976.

III. THE LITERATURE

Regulators speculated about the effects that the elimination of banking districts in NY would have on entry, exit, and mergers in the market. In a nation wide study to identify which banks engage in mergers, Wheelock and Wilson (2004) found that the largest banks in a BHC are more likely to be the acquiring banks and that banks from urban areas make more acquisitions than those in rural areas. Carlson and Mitchener (2009) studied branching in California during the 1920s and found that the Bank of America was more likely to acquire state-chartered banks than national banks. McLaughlin (1995) found that when states lifted the ban on intrastate banking, BHCs merged their bank subsidiaries.

Kroszner & Strahan (1997) study the time until a state deregulates and they use the median asset size of banks as the cutoff between large and small banks. When using this classification with my data I found that it did not represent BHC activity and so I classified banks using the average asset size.

According to a 1976 study by Kunreuther the number of bank mergers in New York decreased throughout the 1970s. There were 130 bank mergers between 1961 and 1970 and 46 bank mergers between 1971 and 1975. The study included both state and federal commercial banks in New York but does not include a breakdown of mergers by year or type of charter. Kunreuther's finding drives her conclusion that the number of mergers that regulators were willing to approve decreased. She also found that the total number (federally- and state-chartered banks) of commercial banks in New York decreased from 296 in 1970 to 276 in 1975.

IV. DATA

I construct a data set of state-chartered banks in New York between the years 1965 and 1979. The bank level, balance sheet data come from the "Consolidated Statement of Conditions of Banks, Trust companies, and Private Bankers," compiled by the New York State Banking Department. I obtained this historical data from the New York State Library. The bank balance sheet information is as it was reported on December 31 of each year between 1965 and 1979 except the year 1966 in which banks reported on June 30.[2]

The literature reveals that there are important differences between big banks and small banks so I use two measures of "bigness" to examine the banking activity. First I define "big" banks to be those with total assets above the average in each year. I chose this measure because it is skewed toward the biggest banks and therefore provides a distinction between small banks and those banks that are among the largest in the country (as some New York banks were). Additionally, if a bank had assets above the average in each year and was a member of a BHC then it was one of the biggest banks in its BHC. Wheelock and Wilson (2004) differentiate the biggest bank in a BHC from the rest of the banks in the BHC and find that they are more likely to engage in mergers. This is because a BHC is likely to use the big bank to acquire the other BHC subsidiaries once merging is no longer limited geographically.

The second measure of "bigness" that I use defines "big" banks to be those with assets at or above the median in each year. Whenever there was an even number of banks, I chose the big banks to be those with assets strictly greater than the median. This is a measure used by Kroszner and Strahan (1997) as well as Stiroh and Strahan (2003). Both measures reveal different characteristics of banking activity before and after the policy change.

V. RESULTS

Banks were broken up into categories using two definitions of "big". Regardless of the definition of "big" Tables 1 and 2 show that there is a market consolidation in 1976 that coincides with the elimination of banking districts.

When "big" is those banks with above average assets, the market consolidation of 1976 includes the acquisition of 3 big banks, 6 national banks, and 12 small banks. There were 3 big banks that were each acquired by a member of their own BHC during the consolidation of BHC subsidiaries. When "big" banks are those with assets above the median, the 1976 consolidation is comprised of the acquisition of 14 big banks, 6 national banks, and 4 small banks. After 1976, with the exception of the Chemical Bank Corporation merging its subsidiaries in 1978, overall merger activity decreased following the removal of branching and merger restrictions. This could be because banks were able to open branches in order to expand their operations instead of expansion through mergers. When "big" is above the median, all of the acquiring banks except 3 are big.

Table 1: Big Bank Behavior
(those with assets above the average in each year)

	1972	1973	1974	1975	1976	1977	1978	1979	Total
Total number of banks	123	124	125	125	109	112	109	112	
Number of big banks	17	15	13	14	12	12	12	12	
Percent big	13.8	12.1	10.4	11.2	11.0	10.7	11.0	10.7	
Number of big banks that made acquisitions	1	0	1	1	5	1	1	0	**
Number of banks acquired by big banks	1	0	1	2	21	1	5	0	31
Number of big banks that were acquired	0	0	0	0	3*	0	0	0	3
Number of national banks acquired	1	0	1	2	6	1	1	0	12

* Two acquisitions by Marine Midland bank and 1 acquisition by Bank of New York in the consolidation of their respective BHC subsidiaries.
**This value is not equal to the sum of the row values because some banks made acquisitions is more than 1 year.

Table 2: Big Bank Behavior
(those with assets above the median in each year)

	1972	1973	1974	1975	1976	1977	1978	1979	Total
Total number of banks	123	124	125	125	109	112	109	112	
Number of big banks	62	62	63	63	55	56	55	57	
Number of big banks that made acquisitions	3	0	6	3	8	2	2	1	**
Number of banks acquired by big banks	3	0	6	4	24	2*	6	1	46
Number of big banks that were acquired	0	0	0	0	14	0	0	0	14
Number of national banks acquired	2	0	5	2	6	1	1	1	18

*One of the banks was chartered and merged in the same year so it does not report balance sheet data
**This value is not equal to the sum of the row values because some banks made acquisitions in more than 1 year.

Tables 3 and 4 display small bank activity. There are no banks below the median asset that acquire national banks as they do when “small” is defined to be below the average. Banks below the average asset engaged in mergers steadily throughout the period with no bank making more than one acquisition at a time. The differences in the activity that is seen in the different threshold levels that define the size of the banks reveals that there is a cutoff between the biggest banks and those banks that acquire one bank at a time. Banks below the average do not appear to be affected by the policy change because they do not change their behavior in 1976 by acquiring more banks. Big banks, on the other hand, acquire several banks as soon as statewide mergers are permitted. There is a stark difference between above median asset banks and their smaller counterparts. There were no banks below the median asset that acquired a national bank and only three banks with assets below the median that made any acquisitions at all.

Table 3: Small Bank Behavior
(those with assets below the average in each year)

	1972	1973	1974	1975	1976	1977	1978	1979	Total
Total number of banks	123	124	125	125	109	112	109	112	
Number of small banks	106	109	112	111	97	100	97	100	
Percent small	86.2	87.9	89.6	88.8	89.0	89.3	89.0	89.3	
Number of small banks that made acquisitions	2	0	7	2	3	1	2	1	**
Number of banks acquired by small banks	2	0	7	2	3	1*	2	1	18
Number of big banks that were acquired	0	0	0	0	0	0	0	0	0
Number of national banks acquired	1	0	4	0	0	0	0	1	6

*Chartered and merged in the same year so it does not report balance sheet data
**This value is not equal to the sum of the row values because some banks made acquisitions in more than 1 year

Table 4: Small Bank Behavior
(those with assets below the median in each year)

	1972	1973	1974	1975	1976	1977	1978	1979	Total
Total number of banks	123	124	125	125	109	112	109	112	
Number of small banks	61	62	62	62	54	56	54	55	
Number of small banks that made acquisitions	0	0	2	0	0	0	1	0	*
Number of banks acquired by small banks	0	0	2	0	0	0	1	0	3
Number of big banks that were acquired	0	0	0	0	0	0	0	0	0
Number of national banks acquired	0	0	0	0	0	0	0	0	0

*This value is not equal to the sum of the row values because some banks made acquisitions in more than 1 year.

The New York policy change that I am analyzing by looking at state-chartered bank activity was passed in 1971 and became effective in 1972. Banking districts were eliminated in 1976. Kunreuther (1976) groups her data into the period between 1971 and 1975. While my functional data set does not include the years prior to 1972, it is likely that my data captures the trend because the policy was passed in 1972. If my results are biased from the year omitted in my data then it is probable that it would increase the number of banks that above median, non-BHC banks acquire. The acquirers are likely to have assets above the median because there is a very low incidence of below median asset banks making acquisitions throughout the entire period. They are also not likely to be the biggest members of BHCs because BHCs were interested in entering new markets and were therefore seeking acquisitions in other districts. Since they were not the biggest banks in BHCs they were most likely banks with assets below the average in each year. BHCs were not able to merge their BHC subsidiaries until statewide mergers were permitted in 1976. Since BHC acquisitions are legally different than acquisitions by banks in BHCs, the BHCs themselves were making acquisitions during this period in different banking districts but waited to consolidate their subsidiaries through mergers until later.

In my data set there are 14 state-chartered banks acquired between 1972 and 1975. This accounts for one third of the acquisitions cited by Kunreuther (1976) during the period from 1971 to 1975. Small banks below the average asset acquired 11 banks during this period while above average banks made 3 acquisitions. Defining “big” through median assets changed this so that below median banks only made 2 acquisitions during this period while above median banks made 12 acquisitions. The state banks below the average asset in my data engaged in steady merger activity between 1972 and 1979. Above average banks also saw steady mergers but the large banks waited to make their acquisitions in 1976 while small banks below the average did not change their merger behavior around the policy change. This is likely due to the fact that below average banks are not the lead banks in their BHC.

Using the definition of big banks as those with assets above the median we can see that mergers are relatively constant throughout the period with a cluster of acquisitions in 1976. Kunreuther (1976) concluded that the decrease in mergers between the 1960s and 1970s in her data was due to a decrease in regulators willingness to approve mergers. However the relatively constant behavior regardless of the definition of “big” suggests that this may not have been the case for state-chartered banks.

There are possible reasons for the differences between Kunreuther’s and my findings. Wheelock and Wilson (2004) found that national banks were more likely to make acquisitions than state banks and banks in statewide branching states were more likely to engage in mergers than banks in limited branching and unit banking states. New York was a limited branching state before 1976. National and big banks may have changed their acquisition strategy once the policy was passed in 1971. They may have geared up for the mergers they would face in 1976 by reducing merger activity relative to their behavior prior to 1970 because they would no longer have to use mergers as their primary expansion method.

The year of second greatest activity for acquiring state-chartered banks was 1974. In fact, the same number of state-chartered banks acquired banks in 1974, before the policy change, as in 1976 (8 institutions), but the number of acquisitions was higher in 1976. If Kunreuther (1976) is correct that there was a decrease in mergers that the authorities would approve then the merger activity of state-chartered banks suggests that they may have been held to different regulatory standards. State bank merger activity appears differently than Kunreuther’s data that includes both national and state banks. The rate at which state banks merge appears relatively constant prior to 1975 so the decrease in mergers was on the end of national banks.

Kunreuther found that the total number of commercial banks, including both national and state banks, decreased from 296 in 1970 to 276 in 1975. In my data, state-chartered banks increase from 123 banks in 1972 to 125 banks in 1975. While I do not have the number of state-chartered commercial banks in

1970, the nature of the policy change suggests that the market consolidation did not begin until 1972. If there is a bias then the rate of mergers (about 3.5 per year between 1972 and 1975) by above median banks allows me to estimate that there would be 7 more banks in 1970 than in 1972. Therefore, state-chartered banks would have decreased from 130 banks in 1972 to 125 banks in 1975 indicating that state banks have a different experience than national banks which would have decreased by 15 in number during the same period.

Between 1976 and 1979, the number of acquiring banks decreased and the number of acquisitions more than doubled from 14 to 34 compared to the period between 1971 and 1975. Above average banks were primarily acquiring while the acquisitions by below average banks stayed constant. The notable difference between above average, big banks and small banks is that big banks acquired many banks at a time while small banks only acquired one bank at a time. Notice that big banks acquire 21 banks in 1976. There are 2 banks that each acquire 1 bank, 1 bank that acquires 2 banks, and together the other 2 banks acquire 17 banks. The Bank of New York (New York City) acquired 7 banks when it consolidated its BHC subsidiaries and Marine Midland Bank (Buffalo) acquired the other 10 banks while also consolidating its BHC subsidiaries. Acquisitions by big banks were clustered around 1976 while acquisitions by small banks were clustered around 1974 when 7 banks acquired one bank each. Notably, 4 of the 7 acquired banks were national banks. When looking at above median banks, 6 of the 8 that made acquisitions in 1976 acquired banks outside of their initial banking district.

Following the increase in mergers up to 1976 there was a decrease in merger activity (with the exception of the Chemical Bank that acquired member banks in its BHC in 1978). Given the policy change that allowed banks to expand through branches, it appears that banks decreased expansion through merger activity.

VI. CONCLUSION

The goal of my study was to examine the activity of state-chartered banks following structural deregulation. My results are consistent with the literature that the majority of acquiring banks are large, BHC members. Acquired banks primarily had assets below the state average. Banks below the average asset engaged in mergers steadily throughout the period with no bank making more than one acquisition at a time. After 1976, with the exception of the Chemical Bank Corporation merging its BHC subsidiaries in 1978, overall merger activity decreased following the removal of branching and merger restrictions. This could be because banks were able to open branches in order to expand their operations instead of expansion through mergers.

Unlike Kunreuther's (1976) study, there is no evidence in my data that mergers are decreasing throughout the time period. The difference between our data is that her data includes national banks. The push for structural deregulation began in 1967 so national banks and big banks may have changed their expansion strategies as they anticipated statewide branching and merging. Since national banks are more likely to engage in mergers a change in policy, or even regulatory focus, would affect them more than the state banks. I suggest this alternative to her theory that regulators stopped approving mergers.

Lastly, Kunreuther (1976) found that the total number of banks in New York decreased from 1970 to 1975. In my data, state banks had a net increase in numbers from 1972 to 1975.

ENDNOTES

1. I would like to thank Professors Melanie Guldi and James Hartley for their guidance during the research process.
2. The December 31 filing could not be located by the reference librarian with whom I corresponded.

REFERENCES

Carlson, M. & Mitchener, K. 2009. "Branch banking as a device for discipline: competition and bank survivorship during the Great Depression." *Journal of Political Economy*, 111: 165-210.

Heinemann, H. E. 1970 (September 8). *New York Times* [national ed.], p. 59.

------------------------ 1971 (June 5). *New York Times* [national ed.], p. 37.

Kidder, K. 1971. "Bank Expansion in New York State: The 1971 Statewide Branching Law." *Federal Reserve Bank of New York, Monthly Review* (November).

Kroszner, R. & Strahan, P.1997. "The political economy of deregulation: evidence from the relaxation of bank branching restrictions in the United States." Federal Reserve Bank of New York, Research Paper 9720.

Kunreuther, J. 1976. "Banking structure in New York State: progress and prospects." *Federal Reserve Bank of New York, Monthly Review* (April).

McLaughlin, S. 1995. "The impact of interstate banking and branching reform: evidence for the states." *Current Issues in Economics and Finance*, Federal Reserve Bank of New York..

Robards, T. 1975 (November 2). *New York Times.* [national ed.], p. 181.

Wheelock, D. & Wilson, P. 2004. "Consolidation in U.S. banking: which banks engage in mergers?" *Review of Financial Economics*, 13: 7-39.