The Growing Similarity Among Financial Institutions

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DEPOSITORY financial institutions are able to exist because of certain efficiencies which allow them to provide credit to borrowers at lower rates and higher net returns to depositors than would be available without such intermediaries.[1] These efficiencies, combined with nationally mandated priorities concerning the roles of these institutions in society, have produced institutions which are specialized in scope. Despite some efforts to maintain this specialization, financial institutions are forming a new framework within which to operate. By creating and reacting to competitive challenges, financial institutions are breaking away from their specialized roles and successfully altering traditional distinctions.

CHANGES IN ASSET COMPETITION

Response of Thrifts to Rising Interest Rates

Most depository financial institutions are subject to regulatory ceilings on the rates they are allowed to offer to attract funds. In general, these ceilings pose few problems to the institutions as long as the ceiling rates remain competitive with market rates. However, during periods of rising interest rates, short-term money market rates rise above the interest rate ceilings imposed on these institutions.

Because of their more diverse and more stable source of funds, commercial banks are not as seriously affected as "thrifts" by such an imbalance in relative interest rates;[2] being very specialized institutions, thrifts suffer more acutely from deposit outflows, called disintermediation, as market rates rise. When other short-term interest rates become more attractive than those which can be earned at the thrifts, depositors transfer their funds out of savings accounts and into other instruments. Twice during the last eight years, once in the second half of 1969 and again in 1974, disintermediation put severe financial strain on the operations of thrifts.

To complicate matters, thrifts further suffer from problems relating to short-term financing of long-term assets (mortgages). Since only a fraction of thrifts' mortgage portfolios are replaced in any one year, the average return on mortgages (the major earning asset of the institutions) typically does not rise fast enough to match increases in short-term rates. At such times, thrifts are caught in an earnings squeeze.

As these situations arise, thrift institutions increasingly are being pressured to stabilize their deposit sources of funds. Thrifts, taking advantage of the current level of technology, are attempting this stabilization by offering new deposit services (which are discussed in a following section).

At the same time, when high and variable interest rates have forced many institutions to examine the structure of their assets, thrifts are emphasizing shorter-term assets in their portfolios.

Such assets typically have shorter maturities than mortgages, yet still are within regulatory bounds. Investments, such as U.S. Government and agency securities and state and local government securities, are growing in importance. Investment securities at savings and loan associations (S&Ls) rose $23 billion between 1970 and 1976, or at an 18 percent annual rate, compared to an 11 percent rate between 1960 and 1970 (Table I). These securities increased to 9 percent of assets in 1976 from 7 percent in 1970. Investment in corporate and other securities by mutual savings banks (MSBs) increased at a 17 percent rate over the six-year period, compared to a 10 percent rate in the 1960-70 period, and rose from 16 to 25 percent of total assets between 1970 and 1976.

To shorten the average maturity of other assets, some thrifts are emphasizing the development of consumer loans, often forging new regulatory powers. Mutual savings banks and state-chartered S&Ls in Connecticut, Maine, and New York state have been authorized to expand the type of consumer loans they

[1]This article focuses only on commercial banks, savings and loan associations, mutual savings banks, and credit unions.

[2]Thrifts here include saving and loan associations and mutual savings banks.

Table I

DISTRIBUTION OF ASSETS

	1960 ($ millions)	1970 ($ millions)	1976 ($ millions)	Annual Rates of Change 1960 - 1970	1970 - 1976
COMMERCIAL BANKS[1]					
Business Loans	$43,132	$112,215	$177,128	10.0%	7.9%
Mortgages	28,694	73,053	149,276	9.8	12.7
Consumer Loans	26,377	66,006	118,051	9.6	10.2
U.S. Treasury and Agency Securities	60,423	61,617	136,729	0.2	14.2
State & Local Securities	17,337	69,390	104,374	14.9	7.0
Other Assets	80,360	194,070	318,462	9.2	8.6
TOTAL	256,323	576,351	1,004,020	8.4	9.7
SAVINGS & LOAN ASSOCIATIONS					
Mortgages	$60,070	$150,331	$323,130	9.6%	13.6%
Investment Securities[2]	4,595	13,020	35,660	11.0	18.3
Other Assets	6,811	12,832	33,209	6.5	17.2
TOTAL	71,476	176,183	391,999	9.4	14.3
MUTUAL SAVINGS BANKS					
Mortgages	$26,702	$ 57,775	$ 81,630	8.0%	5.9%
U.S. Government Securities	6,243	3,151	5,840	– 6.6	10.8
State & Local Securities	672	197	2,417	–11.6	51.9
Corporate and Other Securities	5,076	12,876	33,793	9.8	17.5
Other Assets	1,878	4,996	11,131	10.3	14.3
TOTAL	40,571	78,995	134,811	6.9	9.3
CREDIT UNIONS					
Loans Outstanding	$ 4,402	$ 14,152	$ 34,293	12.4%	15.9%
Other Assets	1,257	3,798	10,542	11.7	18.6
TOTAL	5,659	17,950	44,835	12.2	16.5

[1]Insured banks.
[2]Includes cash.
Sources: *Banking and Monetary Statistics* 1941-1970; Federal Reserve *Bulletins*.

make, which includes overdraft checking. Credit card services also have been accorded increased importance by thrifts. In 1974, Visa U.S.A. Inc. altered its bylaws to permit membership for MSBs, and in May 1976, membership was extended to S&Ls. As of August 1977, 124 of the nation's 469 savings banks were offering bank credit card services.[3]

One of the most publicized changes in thrifts' asset structure is the variable rate home mortgage (VRM), which is being successfully marketed by some state-chartered S&Ls in California and the Midwest.[4] The interest rate on a variable rate mortgage is tied to a cost of funds index such that the mortgage rate adjusts, within certain bounds, to changes in short-term market rates. With variable rate mortgages, the returns to the thrifts on their mortgage portfolios adjust more rapidly to changes in the level of interest rates than with traditional mortgages.

Increased Competition from Credit Unions

In addition to pressures from high and variable interest rates, thrift institutions will be faced with increased competition for mortgages from credit unions (CUs). In the past, length of loan maturity at credit unions was restricted to not more than 10 years, effectively excluding CUs from the mortgage market. Although state laws often permitted more latitude to credit unions with respect to real estate loans, mortgage holdings of state-chartered CUs typically have been small.

This is likely to change as a result of legislation recently passed by Congress which enables CUs to supply mortgage loans within expanded size and maturity ranges. As a result of legislation which was

[3]*Savings Bank Journal* (August 1977), p. 40.

[4]In 1976, five California S&Ls together made about $6.4 billion in new mortgage loans. Of this amount, $4 billion, or 63 percent, were VRMs. These five associations represent approximately 30 percent of the S&L industry in California. *American Banker*, May 23, 1977.

Table II

A COMPARISON OF SELECTED INTEREST RATES

	NEW AUTO LOANS			OTHER CONSUMER GOODS			PERSONAL LOANS		
	Credit Unions[1]	Commercial Banks	Auto Finance Companies	Federal Credit Unions[1]	Commercial Banks	Consumer Finance Companies	Federal Credit Unions[1]	Commercial Banks	Consumer Finance Companies
1973									
January	9.98%	10.01%	11.89%	11.36%	12.46%	19.04%	11.39%	12.65%	21.00%
February	9.98	10.05	11.86	11.37	12.51		11.40	12.76	
March	9.90	10.04	11.85	11.33	12.48	18.92	11.44	12.71	20.79
April	9.89	10.04	11.88	11.30	12.50		11.43	12.74	
May	9.90	10.05	11.91	11.24	12.48	18.88	11.41	12.78	20.76
June	10.02	10.08	11.94	11.26	12.57		11.44	12.78	
July	10.12	10.10	12.02	11.27	12.51	18.93	11.44	12.75	20.55
August	10.06	10.25	12.13	11.26	12.66		11.51	12.84	
September	9.99	10.44	12.28	11.27	12.67	18.69	11.49	12.96	20.52
October	9.97	10.53	12.34	11.32	12.80		11.48	13.02	
November	10.02	10.49	12.40	11.43	12.75	18.77	11.43	12.94	20.65
December	10.22	10.49	12.42	11.43	12.86		11.36	13.12	
1974									
January	10.20	10.55	12.39	11.41	12.78	18.90	11.37	12.96	20.68
February	10.27	10.53	12.33	11.38	12.82		11.34	13.02	
March	10.06	10.50	12.29	11.23	12.82	18.69	11.16	13.04	20.57
April	10.00	10.51	12.28	11.31	12.81		11.15	13.00	
May	10.17	10.63	12.36	11.31	12.88	18.90	11.23	13.10	20.57
June	10.23	10.81	12.50	11.40	13.01		11.31	13.20	
July	10.31	10.94	12.58	11.39	13.14	19.24	11.28	13.42	20.78
August	10.19	11.15	12.67	11.25	13.11		11.23	13.45	
September	10.39	11.31	12.84	11.26	13.20	19.30	11.29	13.41	20.93
October	10.44	11.53	12.97	11.24	13.28		11.44	13.60	
November	10.45	11.57	13.06	11.39	13.16	19.49	11.60	13.47	21.11
December	10.34	11.62	13.10	11.46	13.27		11.56	13.60	
1975									
January	10.29	11.61	13.08	11.51	13.28	19.80	11.52	13.60	21.09
February	10.45	11.51	13.07	11.55	13.20		11.48	13.44	
March	10.48	11.46	13.07	11.48	13.07	20.00	11.50	13.40	20.86
April	10.66	11.44	13.07	11.60	13.22		11.52	13.55	
May	10.77	11.39	13.09	11.67	13.11	19.63	11.57	13.41	20.72
June	10.86	11.26	13.12	11.63	13.10		11.57	13.40	
July	10.71	11.30	13.09	11.56	13.13	19.87	11.50	13.49	20.97
August	10.59	11.31	13.10	11.52	13.05		11.55	13.37	
September	10.51	11.33	13.18	11.52	13.06	19.69	11.55	13.41	21.14
October	10.62	11.24	13.15	11.64	13.00		11.68	13.38	
November	10.58	11.24	13.17	11.65	12.96	19.66	11.64	13.40	21.09
December	10.61	11.25	13.19	11.71	13.11		11.61	13.46	
1976									
January	10.68	11.21	13.18	11.68	13.14		11.59	13.40	
February	10.81	11.18	13.14	11.65	13.02	19.58	11.59	13.24	21.13
March	10.73	11.13	13.13	11.61	13.02		11.56	13.13	
April	10.61	11.08	13.13	11.59	12.95		11.48	13.16	
May	10.59	11.00	13.15	11.61	12.96	19.37	11.46	13.27	20.93
June	10.65	11.02	13.17	11.59	12.99		11.50	13.32	
July	10.68	11.06	13.16	11.60	13.02		11.55	13.38	
August	10.68	11.07	13.18	11.56	13.02	19.51	11.50	13.31	20.86
September	10.73	11.07	13.21	11.52	13.08		11.42	13.40	
October	10.87	11.04	13.20	11.52	13.03		11.43	13.26	
November	10.87	11.02	13.22	11.55	13.06	19.57	11.44	13.40	21.23
December	10.86	11.02	13.21	11.61	12.97		11.52	13.31	

[1]Credit union rates are centered 3 month moving averages of weighted interest rates.

Sources: Credit union rates are from National Credit Union Administration. Other rates are from Board of Governors of the Federal Reserve System.

formally passed in April 1977, CUs are able to make mortgages with maturities up to 30 years and home improvement or mobile home loans with maturities up to 15 years.

Consumer Loan Market

While credit unions are recent competitive additions to the mortgage market, they are mature and effective competitors with commercial banks in the consumer loan market.[5] Credit unions, with $34 billion in consumer loans in 1976, represent the third largest consumer instalment lender in the country and hold over 16 percent of the 1976 dollar volume of consumer instalment loans outstanding. Over 76 percent of credit union assets is devoted to consumer loans. Commercial banks, with $118 billion devoted to consumer loans, hold 48 percent of the total outstanding consumer instalment debt.

From 1960 to 1970, consumer loans at CUs increased strongly at a 12 percent annual rate. Since 1970, growth has been even more rapid; CU loans have more than doubled between 1970 and 1976, increasing at an average annual rate of 16 percent. The consumer loan business at commercial banks has not grown as fast. Between 1960 and 1970, these loans grew at an annual rate of 9.6 percent, slightly slower, on average, than in the subsequent six years.

The growth of CU loans, and therefore their assets, has been aided by favorable loan rates compared to those of commercial banks and other lending institutions (See Table II). Credit unions are able to profitably offer lower instalment loan rates because they experience lower fixed costs on loans. Several factors contribute to lower fixed costs, including lower costs in assembling information on loan applicants and collecting payments. Regulations governing CUs require a common bond among members before organization of a credit union is permitted. This common bond often provides an established source of information on members and facilitates the payment of the loan through payroll deductions, for example. Moreover, because of the subsidies granted them, credit unions often realize free office space and clerical help, pay no Federal taxes and generally pay little state tax, thus escaping many expenses other institutions face.[6]

During December 1974, for example, direct loans on new cars carried an interest rate of 11.62 percent at commercial banks, while at credit unions such loans carried a rate of 10.34 percent. Personal loans at commercial banks were made at an interest rate of 13.60 percent at that time; at CUs they were made at an 11.56 percent rate.[7] (Table II) Since credit union rates already include such factors as the cost of credit life insurance, the basic rates would be even lower than those indicated here.

Although the difference in rates charged has not been so great since 1974, it is nevertheless noteworthy. During 1976, interest rates for new auto loans at CUs varied between 15 and 53 basis points below those at commercial banks. Personal loans at credit unions fluctuated between 157 and 198 basis points below personal loan rates at commercial banks.

As a result, credit unions are advancing their position in the consumer loan market. Based on instalment credit outstanding, CUs held 13 percent of the total credit outstanding in 1972 (15 percent of automobile credit). In 1976, they held about 17 percent of total credit outstanding (23 percent of automobile credit). Commercial banks, on the other hand, have held a fairly constant share of instalment credit, averaging about 48 percent of the total. The share of automobile credit held by commercial banks declined from 62 percent in 1972 to 58 percent in 1976.

Thus, CUs have found themselves in a favored position relative to commercial banks in the consumer loan market. This advantage, combined with favorable interest rates at a time when the public has become increasingly interest-rate conscious in the face of inflation, has propelled the growth of CUs. As a result, credit unions are providing commercial banks with intensifying competition for consumer loans. Moreover, as S&Ls and MSBs continue to move to shorten the maturity of their asset portfolios, thrifts will become more effective competitors in this market as well.

Future competition in this market is likely to focus on credit card services. Membership rules of Visa U.S.A. Inc. were extended in 1976 to include credit unions. Recently, Visa approved 32 credit unions as card-issuing members, 22 of which participate in a pilot program sponsored by Credit Union National

[5]Commercial banks, finance companies, and credit unions comprise the three largest sources of consumer loans. As mentioned above, S&Ls and MSBs are not yet strong competitors in this market.

[6]Peggy Brockschmidt, "Credit Union Growth in Perspective," Federal Reserve Bank of Kansas City *Monthly Review* (February 1977), pp. 3-13.

[7]Interest rates for credit unions are from the National Credit Union Administration and are centered three-month moving averages of weighted interest rates; those for commercial banks are from the Board of Governors of the Federal Reserve System.

Table III

SELECTED REGULATORY AND INSTITUTIONAL CHANGES

DATE	COMMERCIAL BANKS	OTHER FINANCIAL INSTITUTIONS
September 1970		Savings and loan associations (S&Ls) are permitted to make preauthorized nonnegotiable transfers from savings accounts for household-related expenses.
June 1972		Massachusetts mutual savings banks (MSBs) begin to offer Negotiable Order of Withdrawal (NOW) accounts.
September 1972		New Hampshire MSBs begin to offer NOW accounts.
January 1974	All depository institutions in Massachusetts and New Hampshire (except credit unions) are authorized by Congressional actions to offer NOW accounts. This action limited interest-bearing negotiable deposits to these two states. Thus, interest-bearing negotiable transfer accounts at banks begin on an experimental basis.	
January 1974		Nebraska S&L begins Point-of-Sale (POS) electronic funds transfer system. First Federal S&L of Lincoln, Nebraska places an electronic terminal in a "Hinky Dinky Supermarket." The terminal allows customers of the S&L to pay for groceries, make deposits to, or withdrawals from their savings accounts.
April 1974	State of Washington enacts legislation which allows state-chartered commercial banks, MSBs, S&Ls to establish any number of automated facilities throughout the state, provided that those operating these facilities share the cost and operations of the terminals when asked to do so by the state authorities. Commercial banks are required to share facilities with other commercial banks and have the option of sharing them with thrift institutions. Thrifts are permitted, but not required to share facilities.	
May 1974		Experimental 24-hour electronic facility opens on a shared basis by 15 Washington MSBs and S&Ls.
June 1974		New York state bank regulation permits MSB to offer noninterest bearing NOW accounts (NINOWs).
August 1974		Administrator of the National Credit Union Administration grants 3 Federal credit unions temporary authority to begin offering share drafts. These 3 credit unions were joined by 2 state credit unions in a 6-month pilot program (launched October 1974.)
September 1974		Pennsylvania Attorney General rules MSB may legally offer a form of negotiable order of withdrawal account.
December 1974	Comptroller of the Currency's interpretive ruling permits national banks to operate Customer-Bank Communication Terminals (CBCTs).	Federal Home Loan Bank Board (FHLBB) adopts a regulation which gives depositors traveling more than 50 miles from their homes access to their savings account balances through any other federally-insured S&L by means of a Travelers Convenience Withdrawal (wire or telephone access).
January 1975		California state-chartered S&L offers Variable Rate Mortgages (VRMs). Minnesota MSB introduces Pay-By-Phone service.
April 1975	Commercial banks are authorized to make transfers from a customer's savings account to a demand deposit account upon telephone order from the customer.	FHLBB adopts two regulations: 1). Authorizes Federal S&Ls to offer their customers bill-paying service from interest-bearing savings accounts. 2). Allows Federal S&L service corporations and companies to make consumer loans (limited to states which allow such activity and subject to state restrictions).
May 1975	CBCT operated exclusively by a national bank is subjected to a 50-mile geographical restriction unless CBCT is available to be shared with one or more deposit institutions. A national bank may use a CBCT established and operated by some other institution and may participate in a statewide EFTS system.	
June 1975		Oregon governor signs into law legislation which allows the state's only MSB to offer checking accounts.

SELECTED REGULATORY AND INSTITUTIONAL CHANGES (Continued)

DATE	COMMERCIAL BANKS	OTHER FINANCIAL INSTITUTIONS
June 31, 1975	U.S. District Court Judge Robinson rules CBCTs authorized for national banks by the Comptroller of the Currency are illegal and must be shut down. (About 72 CBCTs, owned by national banks, have been installed in various parts of the country under the interpretive ruling issued by Comptroller December 12, 1974.) Robinson's decision directly attacks the December 12, 1974 interpretation, calling the terminals branches, both as defined by the U.S. Supreme Court in its 1969 Plant City case and as construed by Congress when it passed the McFadden Act in 1928.	
September 1975	Commercial banks are authorized to make preauthorized nonnegotiable transfers from a customer's saving account for any purpose. Previously (since 1962), such transfers were limited to mortgage-related payments.	Massachusetts MSB introduces VRM program.
October 1975		State legislation permits state-chartered thrift institutions in Maine to offer personal checking accounts.
November 1975	Federal Reserve amends definition of savings deposits in Regulations D and Q to permit business savings accounts, up to $150,000, at member banks.	
December 1975		State legislation permits thrift institutions in Connecticut to offer personal checking accounts. While the authority to offer share drafts was still officially temporary, additional credit unions begin to offer share draft accounts following the end of the 6-month pilot program initiated in Fall 1974. As of the year end, 222 credit unions (roughly 1 percent) in 44 states have been approved to offer share drafts to their shareholders.
January 1976		Federal Reserve System adopts a policy for automated check clearing systems (ACHs) to offer their services on a nondiscriminatory basis to all types of financial institutions. Illinois S&Ls begin offering noninterest bearing NOW accounts.
February 1976		Congress authorizes all depository institutions in New England to offer interest-paying NOW accounts (effective March 1, 1976).
May 1976	U.S. Court of Appeals for the District of Columbia upholds earlier ruling by the U.S. District Court for the District of Columbia that national banks' CBCTs are branches under the McFadden Act.	New York governor signs legislation permitting checking accounts, including over-draft privileges, at state-chartered MSBs and S&Ls.
October 4, 1976	U.S. Supreme Court lets stand ruling that CBCTs are bank branches.	
February 14, 1977	Iowa statewide electronic banking system begins operating and represents the nation's first shared statewide network, encompassing a broad range of large and small banks in Iowa. (At last count, the system had 33 participating banks; 92 merchant terminals operate through a switch or central computer).	
April 1977		All but 15 of the nation's 470 MSBs have either NOW accounts, traditional checking accounts, or a combination of the two. Legislation enacted to expand credit union lending authority, including authority to make 30-year mortgage loans.

Association. As CUs are given endorsement to apply for Visa credit, they undoubtedly will improve their competitive position. Federal credit unions are limited by regulation to charging no more than one percent per month on the unpaid balance of a loan. Under present conditions, this regulation would limit interest rates on credit card services to 12 percent per year, while many banks typically are charging 18 percent annually.

CHANGES IN LIABILITY COMPETITION

Deposit liabilities of financial institutions are also undergoing change, primarily surrounding the distinction between demand and savings deposits. Important institutional changes have occurred since 1970 which have allowed more vigorous competition for deposits among institutions (See Table III for a listing of some of these developments). Combined with various maximum rates of interest allowed financial institutions, these changes will likely translate into new positions in the competition for deposits (See Table IV).

Some thrifts were permitted in 1970 to make preauthorized nonnegotiable transfers from savings accounts for household-related expenditures. However, the major impetus for change occurred in 1972 when MSBs in Connecticut and New Hampshire began to offer Negotiable Order of Withdrawal (NOW) accounts. These accounts are essentially interest-bearing savings accounts on which checks can be written. While, at first, introduction of NOW accounts was limited to these two states, authorization for NOW accounts was expanded in 1976 to include MSBs, S&Ls, and commercial banks in all New England states (Table V).[8] Moreover, expanded authority for NOW accounts is currently being proposed to include all states.[9]

At credit unions, similar services are called "share draft accounts." Introduced at five credit unions in 1974, share drafts are now available at more than 940 CUs in 46 states.[10] These accounts, offered through a Credit Union National Association program, permit payable-through drafts which are drawn on the members' interest-bearing share accounts. Share drafts are processed through the credit union's account at a commercial bank.

In addition to NOW accounts, savings and loan associations have also initiated several services which allow them to compete for demand deposit business that has gone, traditionally, to commercial banks. Primarily through the use of electronic services, these thrifts have access to another source of deposits, one which they may be able to more successfully retain than other sources during business cycle fluctuations. At the same time, these services allow thrift depositors to use their savings accounts more like the transaction accounts of demand deposits.

Through electronic terminals, called remote service units (RSUs), depositors of thrift institutions are able to perform within seconds many of the transactions formerly conducted through demand deposit accounts, such as withdrawing cash, making charge account and loan payments, and transferring funds from one account to another.[11] One basic advantage of these units is that they frequently are located in such convenient places as supermarkets, airports, and factories. Moreover, S&Ls as well as MSBs have introduced telephone transfers to third parties and automatic payment services which allow their customers to more easily utilize their savings accounts for transactions purposes.[12]

As far as customers are concerned, the new deposit services at nonbank institutions are little different from demand deposit accounts of commercial banks, except in one important respect: typically, nonbank deposit services explicitly pay interest, whereas those of commercial banks do not.[13] Commercial banks have been prohibited since 1933 from explicitly paying interest on demand deposits. Savings deposit accounts at S&Ls and MSBs, on the other hand, are permitted by law to bear interest which is one-quarter of one percent higher than similar accounts at commercial banks.[14] Thus, not only have thrifts begun to

[8]On January 1, 1974, total NOW account balances in Massachusetts amounted to $138 million. Three years later, in January 1977, NOW balances totalled $1.47 billion. During the same time period, NOWs in New Hampshire increased from $5 million to $186 million.

[9]Some institutions, mainly state-chartered thrifts, have surpassed the initial offering of NOW accounts. Savings banks in New England and five other states are authorized to offer demand deposit accounts.

[10]About 200,000 CU members wrote approximately $800 million in share drafts during 1976.

[11]Between January 1974 and December 1976, 112 applications for remote service units have been approved by the Federal Home Loan Bank Board. Federal Home Loan Bank Board *Journal* (April 1977), p. 39.

[12]Fourteen savings banks in New York, Connecticut, Maine, New Jersey, Pennsylvania, and Washington offer pay-by-phone services (Table VI).

[13]In a few areas, nonbank deposit accounts called Non-Interest Negotiable Order of Withdrawal accounts, (NINOWs) do not bear interest.

[14]Current ceilings on passbook accounts at commercial banks and thrifts are 5 and 5¼ percent, respectively.

Table IV

COMPOSITION OF DEPOSITS

	End of Period			Annual Rates of Change	
	1960 (millions)	1970 (millions)	1976 (millions)	1960-1970	1970-1976
COMMERCIAL BANKS[1]					
Demand	$155,386	$246,168	$332,283	4.7%	5.1%
Time & Saving	73,015	233,006	492,719	12.3	13.3
NOW			$1,265	—	—
TOTAL	228,401	479,174	825,002	7.7	9.5
SAVINGS & LOAN ASSOCIATIONS					
Savings Capital	$ 62,142	$146,404	$336,030	9.0%	14.9%
NOW			180	—	—
MUTUAL SAVINGS BANKS					
Time and Savings	$ 36,086	$ 71,157	$121,961	7.0%	9.4%
NOW			580	—	—
Other	257	423	916	5.1	13.7
Demand			493	—	—
TOTAL	36,343	71,580	122,877	7.0	9.4
CREDIT UNIONS					
Members' Savings	$ 4,981	$ 15,486	$ 38,968	12.0%	16.6%
Share Drafts			803	—	

[1]Insured banks

Sources: *Banking and Monetary Statistics* 1941-1970; Federal Reserve *Bulletins*; *National Fact Book of Mutual Savings Banking*, 1971, 1975, 1977; *Statistical Abstract of the United States*, 1974.

compete with commercial banks for demand deposits, but by servicing their "demand deposits" from savings accounts, thrifts generally seem to be making the most of their interest rate advantage.

Credit unions are in an even better competitive position. The maximum rate permitted members' savings accounts at CUs is 7 percent. Although not all CUs pay the highest rate, about 50 percent paid between 6 and 7 percent in 1975, significantly higher than the ceiling rates at other institutions. This favorable rate differential for CUs not only appeals to current and potential members, but also allows credit unions to retain funds when other institutions are suffering from disintermediation.

By increasing the convenience of the services which compete with demand deposits, nonbank institutions effectively have decreased the transactions cost to customers of their accounts. Coupled with the higher maximum interest rates allowed these institutions, their deposit growth rates generally have been stronger than those of commercial banks. Since 1970, savings of credit union members have increased at a 17 percent annual rate, and in the last two years, have grown at about a 19 percent rate (Table IV). Total deposits of commercial banks, on the other hand, grew at nearly a 10 percent rate in the period between 1970 and 1976, up from the 8 percent rate which prevailed between 1960 and 1970. Savings capital of S&Ls and deposits of MSBs grew at annual rates of 9 and 7 percent, respectively, between 1960 and 1970. The latter institutions maintained deposit growth rates of 15 and 9 percent, respectively, since 1970.

While many new demand deposit services began in 1974, data on such services tend to be incomplete, making comparisons difficult. However, NOW account data are the most complete, and available across institutions. These data indicate that the dollar volume of NOW accounts at commercial banks increased from $65 million in 1974 to $1.3 billion by the end of 1976. NOWs at S&Ls and MSBs have also shown intense growth, though not as strong as at commercial banks. Between 1974 and 1976, NOWs at thrift institutions increased $146 and $367 million, respectively (Table V). In the same two-year period, share draft balances at CUs grew from $375,000 to $803 million.

In an era of rising prices, people have become more aware of the cost of holding money. More money holders are seeking methods of reducing noninterest-bearing claims in favor of highly liquid earning assets that can either be easily transformed into payments

Table V

NOW Account Activity in New England

Month Ended	Commercial Banks: Number of Banks offering NOWs	Commercial Banks: Outstanding balances ($ thousands)	Mutual Savings Banks: Number of MSBs offering NOWs	Mutual Savings Banks: Outstanding balances ($ thousands)	Savings and Loan Associations: Number of S&Ls offering NOWs	Savings and Loan Associations: Outstanding balances ($ thousands)
September 1972[1]			23	$ 11,094		
December 1972[2]			59	45,272		
December 1973[2]			90	143,254		
December 1974[2]	63	$ 65,249	151	213,661	81	$ 33,666
December 1975[2]	134	358,940	175	386,560	121	93,756
December 1976	242	1,265,262	248	580,596	159	179,622
June 1977	247	1,501,135	250	661,760	158	213,498

[1]Massachusetts only.
[2]Massachusetts and New Hampshire only.
Source: Federal Reserve Bank of Boston.

media or used indirectly for payments. The above figures tend to indicate the extent to which these preferences are influencing relative rates of deposit growth.

IMPACT

In certain areas, new competition has prompted commercial banks to retaliate in order to maintain or regain their competitive position. In some cases, commercial banks have been successful in initiating telephone transfers and automatic payment services similar to those at nonbank institutions.[15] Perhaps the best example of a situation in which commercial banks have been able to equalize competition is the case of NOW accounts in New England. Initiating NOW accounts in 1974, two years after their introduction by MSBs, commercial banks have surpassed savings banks in NOW balances and have about equalled the number of savings banks offering the accounts (Table V).[16]

In other cases, commercial banks have been less successful. For example, although national banks have initiated electronic terminals, called Customer Bank Communication Terminals (CBCTs), placement of them has been limited and certainly more restrictive than that of the similar Remote Service Units of savings and loan associations. The courts have judged that CBCTs are branches as defined in the McFadden

Table VI

Selected Services Offered by Mutual Savings Banks

June 30, 1976

	Number of Mutual Savings Banks	Percent of Total
Automated teller facilities	59	12.4%
Checking accounts[1]	222	46.7
Club accounts	411	86.5
Collateral loans	410	86.3
Credit cards	79	16.6
Educational loans	376	79.2
Home improvement loans	447	94.1
24-hour cash dispensing	48	10.1
Individual Retirement Accounts[1]	379	79.8
Money orders	455	95.8
NOW accounts (interest bearing)[1]	254	53.5
Passbook loans	469	98.7
Pay-by-phone[2]	14	2.9
Payroll deductions	281	59.2
Personal loans[3]	369	77.7
Personal trust services	51	10.7
Point-of-sale services	7	1.5
Safe deposit boxes	378	79.6
Savings Bank Life Insurance	325	68.4
Savings payment plan	94	19.8
School savings	119	25.1
Self-employed retirement savings (Keogh)[1]	259	54.5
Travelers checks	453	95.4
Total number of mutual savings banks	475	

[1]As of December 31, 1976
[2]As of June 1977
[3]Includes overdraft loans.
Source: *1977 National Fact Book of Mutual Savings Banking.*

[15]One area in which commercial banks have been successful in attaining an equal footing with S&Ls is for Individual Retirement Accounts (IRAs) and Keogh plans. S&Ls offer these accounts to savers at a 7.75 percent interest rate, while commercial banks offered comparable accounts at a maximum rate of 7.5 percent. Effective July 6, 1977, commercial banks which are members of the Federal Reserve System can introduce a new category of time deposit accounts which are available for use as IRAs and Keogh plans and pay a maximum rate of 7.75 percent.

[16]See Ralph C. Kimball, "Recent Developments in the NOW Account Experiment in New England" and Donald Basch, "The Diffusion of NOW Accounts in Massachusetts," Federal Reserve Bank of Boston, *New England Economic Review* (November/December 1976), pp. 3-19 and pp. 20-30, respectively.

Act of 1928, a severe competitive blow to commercial banks. This ruling subjects placement of CBCTs to state laws prohibiting or limiting branch banking by commercial banks. S&Ls are not subject to any comparable ruling.

Moreover, as more institutions pay interest on their "checking accounts," more pressure is placed on commercial banks to pay interest on comparable accounts. Legislation has been proposed which would allow all financial institutions in the nation to offer NOWs, with an identical ceiling rate.[17] Legislation of this sort would eliminate the interest rate differential on passbook/NOW accounts among institutions.

With one uniform interest rate, it is a short step to complete elimination of all interest rate differentials. Moreover, if nonbank institutions have formal access to other sources of funds, regulators may argue that the institutions no longer "require" the advantage of the interest rate differential to maintain deposit flows.

Whether or not such proposals pass, the innovations which have occurred already have increased the number of alternative services available to consumers. Consumers are now able to obtain larger mortgages at CUs, a wider range of consumer services at MSBs, and closer substitutes for checking accounts at S&Ls. Moreover, the quantity and variety of services offered at each type of financial institution will probably continue to increase in the future.

Such changes are altering the focus of most financial organizations. Having begun as basically specialized institutions, they are now taking on a more diverse character. The distinction between the asset and liability powers of bank and nonbank institutions is becoming blurred, and with it, the distinction between the institutions themselves.

[17] Credit unions have been included among such legislative packages for share drafts.

CONCLUSION

Commercial banks, savings and loan associations, mutual savings banks, and credit unions perform many similar functions. They accept the savings of economic units and allocate them to borrowers. Since 1970, these institutions have been becoming similar in more specific ways. Nonbank institutions are diversifying and broadening the scope of their assets. S&Ls are including shorter-term assets in their portfolios; MSBs and CUs are devoting more assets to various types of consumer loans. In terms of liabilities, demand deposit accounts are no longer the exclusive domain of commercial banks. All types of thrift institutions are permitted some type of demand deposit services.

Thus, competition is intensifying among the institutions and will likely provide them with incentives to increase efficiency and reduce costs to customers in the future. As a result, consumers have more alternatives for "banking" services from which to choose. In the process, asset and liability powers of the institutions have yielded to equalizing forces. Regulations and incentives for specialization, which maintained the distinction among institutions, are being broken down.

The traditional roles of nonbank financial institutions are changing; their domain, once narrow, is now much more extensive and similar to that of commercial banks. However, there is likely to be some limit to this process of financial institutions becoming more similar. Given current trends, the extent of specialization of the institutions is likely to be determined by competitive forces as well as by public policy to channel credit to specific uses.