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The banking industry after the Riegle–Neal Act: re-structure and overall performance

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Abstract

The passage of the Riegle–Neal Interstate Banking and Branching Efficiency Act (IBBEA) of 1994 allowed bank holding companies to acquire banks in any state after September 30, 1995. We examine the impact of the legislation on the performance of the banking industry by comparing performance measures of banks with their pre-IBBEA levels. We find that the performance improved in the post-IBBEA period but when controlled for general economic conditions and interest rate movements, the impact of IBBEA on bank performance appears insignificant.
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Keywords: Riegle–Neal; Bank consolidation; Banking industry performance

1. Introduction

The passage of the Riegle–Neal Interstate Banking and Branching Efficiency Act (IBBEA) in 1994 was a watershed event in the history of the banking industry. The IBBEA permitted bank holding companies to acquire banks in any state after September 30, 1995. It also invalidated the laws of states that allowed interstate banking only on a regional or reciprocal basis. In lifting the restrictions placed on the banking industry for decades by earlier legislations, the IBBEA gave banks a reasonably free hand to restructure and reorganize to achieve greater efficiency and profitability. The passage of the IBBEA led to significant gains for the banking industry. Brook, Hendershott, and Lee (1998) examined the benefits of takeover deregulation

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and found that $85 billion in value was created in the banking industry. Carrow and Heron (1998) report that the IBBEA's passage had a positive wealth effect on a sample of large bank holding companies. After discussing the benefits of lower barriers to geographic expansion, Carrow and Heron (1998) state, "Clearly more time will need to pass before researchers gain access to the time-series of the pre- and post-IBBEA data required to empirically quantify and distinguish among the hypothesized sources of benefits indicated above." Enough time has now passed to allow an early look at structure and performance changes resulting from passage of the IBBEA.

Several studies in the banking literature suggest the potential benefits of reorganization to the industry. Hunter, Timme, and Yang (1990) report about increased scale economies. Jayaratne and Strahan (1997) report that banks' loan losses and operating costs fell sharply following the state initiatives in which individual stares removed barriers to interstate branching between 1978 and 1992 and that these costs were largely passed along to bank borrowers in the form of lower loan rates. They also suggest that these efficiency gains arose because better performing banks were able to expand their market share once geographic restraints were eased. Calomiris (1999) suggests that bank consolidation waves produce substantial efficiency gains associated with reduced operating costs, enhanced diversification, and enrichment of bank-customer relationships. Based on the above studies, we test the following hypothesis in this study: "The number of banks declined and bank performance significantly improved following implementation of the IBBEA."

We investigate the impact of the IBBEA on the structure and performance of the banking industry by comparing the bank performance in pre- and post-TBBEA periods. We report that there are significantly fewer but bigger banks after the passage of the IBBEA and that the average performance of all banks improved in the post-Riegle–Neal period. However, our findings indicate that the improvement is primarily explained by variables associated with general economic conditions and interest rates and only minimally explained by the variable associated with implementation of the Act.

The rest of the paper is organized as follows: a description of the data set for the study in Section 2, the methodology and results in Section 3, followed by the conclusion in Section 4.

2. Data

In this study, quarterly structure and performance data (1990.1 through 2000.1) are analyzed to identify any significant changes following the September 30, 1995, implementation date of the IBBEA. Banks were categorized by average asset size and data relating to the number of banks and performance measures for each category were analyzed for purposes of this investigation. The data for the study was obtained from the *Federal Reserve Bank of St. Louis* homepage on the Internet. The bank publishes data under the heading "Commercial Bank Performance Ratios." The St. Louis Fed acknowledges that the data source is the *Federal Financial Institutions Examination Council's Reports of Condition and Income for All Insured U.S. Commercial Banks*. The data are seasonally adjusted. For the purposes of the study, quarterly data with regard to six bank groups for the period of the first quarter of 1990 to the first quarter of 2000 based on the value of their average assets was used. The average asset categories (of banks)

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