Risk, Regulation, and Bank Holding Company Expansion into Nonbanking (p. 2)

John H. Boyd
Stanley L. Graham

A Visible Hand: The Fed’s Involvement in the Check Payments System (p. 18)

James N. Duprey
Clarence W. Nelson
This publication primarily presents economic research aimed at improving policymaking by the Federal Reserve System and other governmental authorities.

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In This Issue

The Hazard of Diversification

When banking institutions can expand into other lines of business, some think they will diversify to reduce their total risk. Others think just the opposite. In “Risk, Regulation, and Bank Holding Company Expansion into Nonbanking” (p. 2), John H. Boyd and Stanley L. Graham explain the reasoning behind these two views and then test to see which one best describes the behavior of U.S. bank holding companies since 1970. They find that in 1971–77, when these companies were relatively free to invest in some new lines of business, diversification was associated with greater risk of failure. But in 1977–83, when the companies were more tightly regulated, that association disappeared. These findings suggest to Boyd and Graham that, left to their own devices, bank holding companies will expand into new lines of business to increase their risk, but that regulation can control this risk-taking—at least for the lines of business bank holding companies are currently allowed.

The Bogey of Nonpar Checking

It is common knowledge that the Federal Reserve System was originally set up to provide the nation with a stable currency and a sound banking system. Less well known, however, is why the Fed was given an operating role in the nation’s payments system. In “A Visible Hand: The Fed’s Involvement in the Check Payments System” (p. 18), James N. Duprey and Clarence W. Nelson describe the problems of the check payments system before the Fed was created, suggest reasons why the private sector was unable to resolve them, and indicate how the framers of the Federal Reserve Act intended to have the Fed resolve them. Duprey and Nelson argue that while a unified national check-clearing system clearly would have been more efficient than the fragmented system that then existed, both private and Fed initiatives to reform the payments system met strong resistance from the banking community—especially smaller nonpar banks. These banks were reluctant to give up their profitable practice of nonpar payment (paying less than the written amount of checks drawn on their accounts). Duprey and Nelson conclude that, despite the banking community’s resistance, the Fed did improve the efficiency of the check payments system.