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HISTORY AND INFLUENCE OF THE BANKING SYSTEM

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INTRODUCTION

There are a lot of factors that play into an economy. With the changing and developing financial systems that are put in place it is important that we stay on top of each of these systems, so that we can fully understand the way that financial markets operate and behave in our economy. With a changing market system and economy, we will be taking a look at some of these institutions today so that we can have a better understanding of their purpose. We can categorize financial institutions into two groups. non-depository institutions and depository Institutions. We will not be taking a look at non-depository institutions today but rather depository institutions and how they are different from non-depository institutions. First, we will be taking a look at a little bit of history of each of the types of depository institutions to understand how they came to be and then discuss how these types of institutions operate and what purpose they serve us in today's economy. Lastly, we will be taking a look at their position in today's economy and how they came to be one of the most influential players in today's economy.

NON-DEPOSITORY INSTITUTIONS

Before we can take a look at depository institutions, we will briefly go over its other half, non-depository institutions, so that we can fully grasp what they do and what they are. When we talk about the types of financial institutions, it is important to separate the types into two distinct categories. We can classify them these two groups as depository institutions and non-depository institutions. These are the two types of financial institutions.

There are 4 types of non-depository institutions in today's markets. They are known as mutual funds, security firms, which include investment banks, pension funds and insurance companies. Non depository institutions are government or private organizations. These organizations do not accept hard deposits, rather, they are intermediaries between savers and borrowers. These types of institutions fund their lending by selling bonds, notes, and stocks, otherwise known as securities, to investors to reduce risk. When dealing with non-depository institutions, the reduction of risk is essential in their success.

DEPOSITORY INSTITUTIONS

Now that we understand what non-depository institutions are, we will be discussing depository institutions. There are three main types of depository institutions. Depository institutions include commercial banks, thrift institutions and savings and loans associations and credit unions. These types of institutions allow a lender to deposit funds into the bank directly. These institutions provide safekeeping for the funds and can also lend out funds to other businesses from the pool of money that has been collected by lenders. The main difference between depository and non-depository institutions is that they accept physical hard deposits from its customers.

There are a number of various types of depository institutions. The three main types of depository institutions that we will be covering are commercial banks, thrifts and savings banks and credit unions. Each one of these three types of depository institutions have a huge impact on the economy as a whole.

COMMERCIAL BANKS

The first type of bank that we will be discussing are commercial banks. The earliest form of commercial banks was in the form of private for-profit firms. The commercial bank was highly accredited with building the growth of the economy of the United States. Although many other depository and non-depository institutions helped in this process, it is with the help of commercial banks that the economy today is strong. Commercial banks borrowed the wealth of their liability holders and then redistributed the wealth to the issuers of their assets. The banks in turn would profit whatever difference in cost and then net the return. (EH.net)

Some of the early instances of commercial banks occurred during the 1970s. During colonial america many banks were created. There were only a small number of commercial banks during this time. Most of these commercial banks however, were not very successful due to some being guilty of fraud and others operating under English laws that since, had been displaced.

Shortly after the American revolution, in which English laws had no longer been in effect, many banks started to come up from the ruins. By 1782 the Bank of North America had erected which provided a substantial number of loans. By the end of the 1800s many new commercial banks had been established.

Commercial banks play a huge role in the economy today. Its primary role is to accept deposits from customers and ensuring the safeguard of the money but also as a medium to allow them to loan to others. The services extend to include maintaining checking and savings accounts from its customers. The federal Reserve also controls economic inflation using commercial banks and can regulate and help stabilize a failing economy by holding and pushing funds to commercial banks

THRIFT INSTITUTIONS

The next type of depository institution that we will be discussing are thrift institutions. The main purpose of thrift institutions is to essentially collect deposits and then issue mortgages for the purchase of a home. They are not quite as big as commercial banks and do not possess the kind of liquidity that is often associated with commercial banks. With this being said, the interest that is paid is generally higher. These types of institutions are focused and centralized and established in communities and more community based in turn. You may also obtain similar service from a thrift institution similar to what you may find in a commercial bank. Thrift institutions can have either corporate structure that is owned by shareholders or they can be owned by the customers of the thrift institution.

The first instance of thrift institutions began in the United Kingdom and was established by the building society in the 1800s. What followed was competition in the United States with the intent to establish a broken mortgage system. Early loans were easily defaulted on since the interest on the loans "ballooned" and borrowers were not able to pay them. This series of events was worsened by the great depression. In 1932 president Hoover enacted the Federal Home Loan Bank Act which was targeted to provide low costs funds to banks for the purpose of mortgages (Investopedia.com).

The impact that Thrift banks began with the newly created mortgage system which was created by the Veterans Affairs in 1944. They gave a sort of hope to returning veterans that being able to purchase a home was achievable and encouraged many veterans to move out of apartments and live the American dream. By 1970, mostly all mortgages that were issued to the public came from thrift institutions. Homeownership rose from 44% to 64% over the course of 60 years (Investopedia.com).

As the years progressed and thrift institutions failed, more and more regulations were put in place. These regulations essentially "blurred" the line between the differences of a commercial bank and a thrifts bank. With the introduction of the Dodd-Frank Act, many essential take ways from a thrift institution were stripped away. Thrift institutions, by law, are required to provide 65% or more of the loans in their portfolio to consumers (Investopedia.com).

CREDIT UNIONS

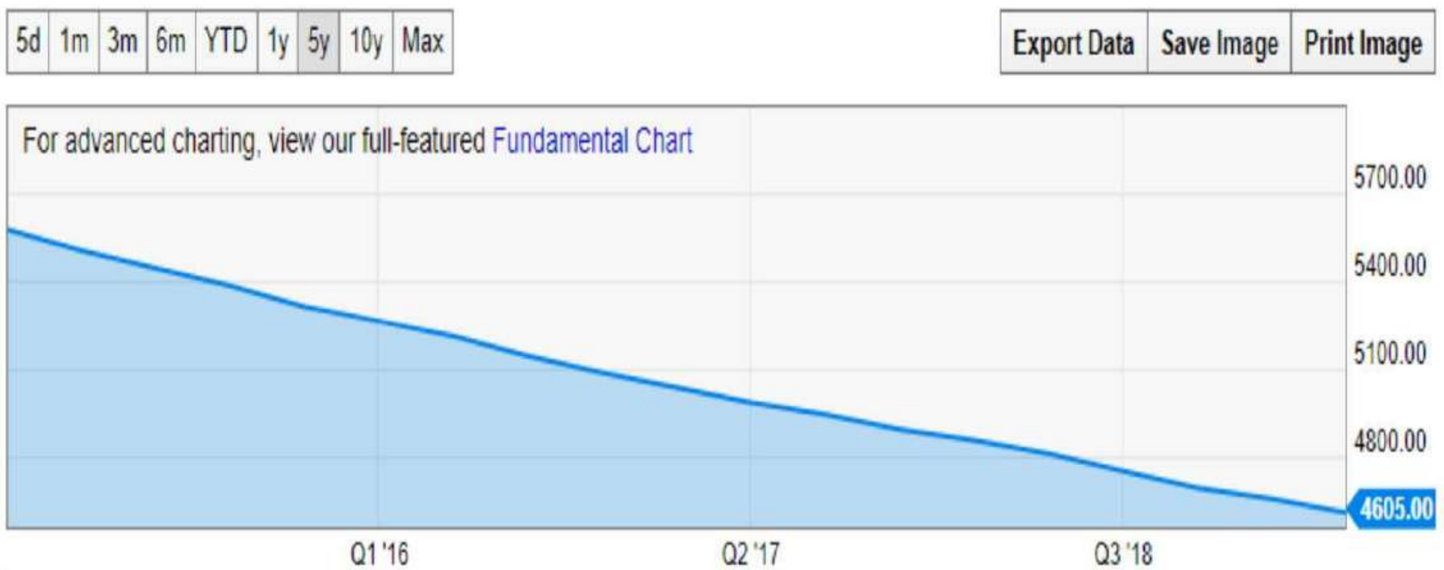
The final type of institution that we will be covering are credit unions. Credit Unions were first created in the 1900s in Europe as a part of a "voluntary and self-governed association of people that work towards a common goal" called cooperatives. This movement inspired the idea to collect money into a pool so that others can benefit from it in the form of credit. If an individual needed money to pay a bill, then they can take it from the pool and pay it back later. This led to the creation of the first thrift institution in Germany in 1849. The bank was created to offer an alternative means to borrow money. Meanwhile, In the United States, in the state of Manchester New Hampshire, the first American credit union opened up to the public. (Howstuffworks.com).

During the Great Depression is where a new meaning for credit unions took precedence. With the Federal Credit Union Act of 1934, signed in by president Roosevelt, laws were enacted that allowed low income individuals to take out a loan. Alternatively, the main differentiating factor from a credit union and the other depository institutions is that credit unions are non-profit organizations. Some argue that credit unions should be taxed just like other institutions. However, credit unions do not keep any of its profits but instead disperses them at the end of the year so that their ending balance remains at zero balance for the purpose of remaining a non-profit organization.

Credit unions are also not owned by shareholders but instead by its customers. Customers can make deposits and own a portion of the credit union in a relative proportion to the size of the deposit. This in turn allows for a very dispersed ownership of the credit unions which can allow many different types of investors to own a portion of the company and receive dividends while simultaneously benefiting from the services that the credit union has to offer. Credit unions along with many other institutions offer such as checking and savings accounts. However, credit unions are able to provide these services at a bigger rate since its ownership structure is different than that of a commercial bank.

DEPOSITORY INSTITUTIONS TODAY

Since the creation of each of the depository institutions, we have seen a tremendous growth in the economy. If you believed that the number of institutions of commercial banks have been increasing you would be incorrect. In fact, commercial banks have seen a tremendous dwindling in numbers due in part by lower level bank failures and buy outs. This data represents the numbers of commercial banks over the past 5 years.



As the chart in figure 1 demonstrates, the number of commercial banks has almost halved in the past 5 years. This is mainly because when a bank fails no new banks takes it place. The creation of new banks is quite rare in this day in age. So, where does that leave us with the banks that are currently in place? Well, banks tend to take over smaller banks in a process know as mergers and acquisitions. Most banks either fail or are acquired. Since no new banks are being put in place of the older banks then larger banks face lesser and lesser competition. Most of the banks that have failed come from smaller communities and the inability for new banks to gain a foothold. The same exact thing can be said for both thrift institutions and credit unions.

Non-depository institutions today have begun to slice away at the mortgage opportunities that have once been held by the thrift institutions. The following chart demonstrates by how much that percentage is today. As you can see in figure 2, non-depository institutions which are not considered banks are accounting for an overwhelming percentage of mortgage lending.

Over 51% of all mortgages in the United States have been issued by non-banks and though non-banks include non-depository institutions, they also include lending from other organizations such as Veteran Affair home loans and home loans by the Federal Housing Association which accounts for more than 138 billion dollars a year. With all this in mind it is important to note that thrift institutions still hold a rather significant portion of mortgage lending.

This leads us to today. In a changing world, some argue that there is no need for a bank. However, data suggests that many other non-bank entities lack the revenue generating capabilities nor the innovation that banks possess. It remains so that these institutions are the primary reasons that we are able to remove ourselves from financial crisis, even though these same institutions are responsible for such collapses, such is the case with the financial market crash of 2008, where banks lent out subprime mortgages to individuals. Not only that, but no other entities at the moment allow the capability for the federal reserve to push and pull funds in order to adjust inflation and keep the economy strong. Without the help of these institutions, financial crises could have led to bigger and greater damages and disaster than what we have seen. Even though thrift institutions have also dwindled in numbers, it is important to understand that without thrift institutions we would not have the number of homeowners that we have in todays economy.

CONCLUSION

It is understandably clear that banking intuitions uphold and remain a relevant part of our economy. Simply put, banks grow the economy and without them the economy cannot be what it is today. Since the creation of the first commercial banks we have seen many instances where banks have been erected for many different purposes. Some come about with the soul intention of helping others within their communities. It is these small ideas that have led to the creation of one of the greatest economies in the world. Commercial banks help can help control the economy with the help of the federal reserve and thrift institutions are highly acclaimed for allowing customers the ability to be able to purchase a home. On the other hand, credit unions have been around with a community focus and being able to allow for borrowers with little income to be able to take out a loan and establish credit for every day financial situations.

Banks today maintain a high level of financial leverage and create innovations that allow in the continued growth in the economy. Even though it is attributed to some of these institutions for crashes in the market and the economy, the damage is mitigated through the use of these entities. It is with the help of these organizations that allow our economy to function and allow ease and comfort in day to day life. Each one of these entities, some with the help of non-depository intuitions can allow for investments and an unprecedented amount of opportunistic growth. Even though banks today do not hold as much of the lending that it once had due to regulations, they are still an essential part of our economy and continue to maintain a foothold in today's financial markets.

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