Banking Regulation in the United States and Canada

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The North American banking system has been in existence for over 200 years. During this time it has evolved from a fledgling industry supporting an agrarian society into a sophisticated system of financial services meeting the world’s capital requirements.

This evolution was not a uniform process. The banking systems of the United States and Canada are products of each country’s unique history. The United States’ historical emphasis on the rights of the states and the protection of individuals from corporate abuse has produced a decentralized system in which thousands of individual banks operate under significant regulation of both form and function. The importance of Canada’s federal identity and its ever-present provincial disputes created an entirely different system whose foundation lies in large national banks operating in a less restrictive regulatory environment.

Yet, despite these obvious and drastic differences, there are several similarities in the two systems. Both banking systems have been forced to react to similar business cycles and economic factors. The primary activities of banks in each country are equivalent. Finally, in recent years both systems have undergone considerable deregulation in an effort to remain competitive in a global environment.

In this article, I compare the banking systems of the United States and Canada, focusing on three principal areas. First, I discuss the historical development of the regulatory environment governing each system. I then examine the current unique deregulation process occurring in each country. Finally, I evaluate the relative performance and success of the American and Canadian banking systems.

The Central Banks

In analyzing the regulatory structures of the Canadian and American banking systems, it is first necessary to examine the nature and structure of the central banking authority in each country.

United States

The central banking authority in the United States is a coordinated group of financial agencies called the Federal Reserve System.
The Federal Reserve System was adopted in 1913 in reaction to the widespread bank closures resulting from the panic of 1907. The system was organized to blend both private and public authority through a mixture of centralized and decentralized policies. (Boreham, “The Central Banks,” p. 28)

The Federal Reserve System is unique among the major central banks of the world. Unlike its counterparts, the Fed is structurally decentralized and geographically scattered throughout the country. It is made up of 12 Federal Reserve Banks regionally distributed throughout the United States. The Fed is privately owned by the member banks of the Federal Reserve System. (Boreham, “The Central Banks,” p. 29) While the central banks in other countries deal with all the commercial banks in their respective countries, the Federal Reserve System includes approximately 40 percent of the commercial banks in the United States. (Boreham “The Central Banks,” p. 30)

The Federal Reserve System is organized around four main agencies: The Federal Reserve Banks; The Federal Open Market Committee; The Board of Governors; and the member banks of the Federal Reserve System. (Boreham, “The Central Banks,” p. 29) While the central banks in other countries deal with all the commercial banks in their respective countries, the Federal Reserve System includes approximately 40 percent of the commercial banks in the United States. (Boreham “The Central Banks,” p. 30)

The Federal Reserve System is organized around four main agencies: The Federal Reserve Banks; The Federal Open Market Committee; The Board of Governors; and the member banks of the Federal Reserve System. The 12 Federal Reserve banks are geographically dispersed throughout the United States. Each bank is privately owned by the member banks in its district. The Federal Reserve banks have several primary responsibilities. The banks are empowered to loan emergency funds to depository institutions in their districts. Each Federal Reserve bank is responsible for the examination and supervision of state member banks in its district. Finally, the Fed banks must act as the guardian for the ultimate reserves of all depository institutions and to ensure the efficient transfer of these funds between Federal Reserve banks. (Boreham, “The Central Banks,” p. 30)

The Federal Open Market Committee has emerged as the effective decision making body for the Federal Reserve System. This committee meets between 10 and 12 times per year to make general decisions on the course of monetary policy. These policy decisions are enacted through open market operations, in which the Federal Reserve buys or sells securities on the open market in order to increase or decrease the existing money supply. (Moore, p. 70)

The Federal Reserve Bank of New York is responsible for conducting the Fed’s open market operations through daily purchases and sales of Treasury securities. (Boreham, “The Central Banks,” p. 29)

The Board of Governors, located in Washington, D.C., is the central controlling body of the Federal Reserve System. The Board has several primary duties: 1) contributing to the creation of monetary policy; 2) approving the discount rates established by regional Federal Reserve Banks on a biweekly basis; 3) setting reserve requirements for all depository institutions; and 4) regulating certain member bank operations. (Boreham, “The Central Banks,” p. 29)

The member banks of the Federal Reserve System comprise two principal groups. Every national bank is required to join the Federal Reserve System. State chartered commercial banks may join, provided they are willing to meet certain regulatory requirements. Historically, the Federal Reserve System has included only about 40 percent of all commercial banks. However, these banks were responsible for holding 75 percent of all commercial bank deposits. (Boreham, “The Central Banks,” p. 30)

Canada

The Canadian central banking authority is the Bank of Canada. It was created in 1934, by an Act of Parliament, in response to the financial devastation of the Great Depression. The Bank of Canada was originally privately owned, although amendments to the Bank of Canada Act in 1936 and 1938 transferred ownership to the Canadian state. (Boreham, “The Central Banks,” p. 28)

As opposed to the Fed, the Bank of Canada is a single entity located in Ottawa. To conduct more efficient operations, it has established six regionally located branches. The Bank of Canada is responsible for the supervision of Canada’s six nationally chartered Schedule I banks and 59 Schedule II banks. Schedule I banks are those Canadian banks permitted to engage in a full range of banking activities. They must be widely held and cannot be under foreign control. Schedule II banks are limited in the activities they may engage in, but they...
may be closely held and possess significant foreign ownership. (Jordan, p. 10) There are six principal instruments of control used by the Bank of Canada to implement its policy decisions. The Bank of Canada utilizes open market operations, transfers of government funds, swap transactions with the Exchange Fund Account, advance policy, changes in secondary reserve requirements, and moral suasion. (Boreham, "The Central Banks," p. 32) It should be noted that the Bank of Canada relies on open market operations to a much lesser extent than the Fed, and utilizes them only when it desires an immediate impact on interest rates. (Boreham, "The Central Banks," p. 33)

**Regulation of Commercial Banking**

The regulation of financial institutions has been in existence nearly as long as the financial institutions themselves. Throughout history, the primary purpose of the regulation of financial institutions has been "to set forth measures that would induce institutions to carry out their fiduciary responsibilities." (Kaufman, p. 147) Regulation is traditionally practiced in two ways: the regulation of form and the regulation of function. The regulation of form restricts the structure and size of banks, while functional regulation restricts the financial areas in which a bank may practice.

**United States**

There are two laws which have had profound effects on the structure of the American commercial banking system. These efforts were enacted to regulate both the form and function of American banking.

The McFadden Act was passed in 1927 to regulate the blossoming banking industry. This act imposed structural restrictions on federally chartered banks. It states that federally chartered banks are prohibited from branching across state lines and are further restricted by the branching regulations of their home state. (Guttmann, "Changing of the Guard...," p. 159)

In 1992, fewer than half of the states participated in full interstate banking. (Reed, p. 4)

It must be noted that the banking industry has attempted to skirt the restrictions imposed by the McFadden Act by forming bank holding companies as allowed by the Bank Holding Company Act of 1956. These attempts flourished in the 1980s with the creation of limited-service banks. These banks offer all the services of normal commercial banks, but are prohibited from offering both demand deposits and commercial lending services. They therefore are not restricted by the Bank Holding Company Act's definition of banking and are permitted to branch nationwide. The creation of new limited-service banks was banned in 1987 by Congress. The previously existing 170 LSBs were permitted to expand at seven percent per year. (Guttmann, p. 159)

The Glass-Steagall Act was instituted in 1933. It created restrictions for services available from commercial banks. The Glass-Steagall Act established that commercial banks were prohibited from underwriting or trading corporate stocks and bonds in the United States. (Guttmann, p. 9) This act also created the Federal Deposit Insurance Corporation, which insured bank depositors from losses due to bank insolvency. (Guttmann, p. 7) The original amount of insurance was $5,000 per depositor. This amount has undergone several increases to its current amount of $100,000 per depositor. (Guttmann, p. 7)

There are several other regulatory initiatives worth noting. These measures were instituted to ensure safer banking and promote increased competitiveness in the banking industry. The first group of initiatives includes Fed Regulations G, U, T, and X. These regulations were designed to restrict the distribution of credit by instituting margin requirements. (Guttmann, p. 157) Regulation Q imposed rate ceilings on deposits at commercial banks. (Guttmann, p. 157) This measure, since phased out, sought to pacify the intense competition between financial institutions for deposits which encouraged banks to assume undue risks. (Guttmann, p. 158)

**Canada**

Commercial bank regulation in Canada was a unique process. In response to the financial devastation of the Great Depression, the
Parliament produced a series of Bank Acts during the 1930s. These acts were designed to restrict the functions of Canada's financial intermediaries and preserve the integrity of the Canadian financial market. This flurry of legislation created the four pillars financial framework which provided for separation between the main financial functions and between financial and nonfinancial activities. (Economic Council of Canada, p. 44) This framework created strict divisions between Canada's commercial banking, trust, securities dealing, and insurance industries. The securities industry was exclusively regulated by provincial governments, while the remaining three were primarily federally regulated. (Jordan, p. 9)

Under this plan, banks primarily collected short-term funds through demand deposits and provided loans to businesses for the financing of inventories and accounts receivable. Trust companies were responsible for the maintenance and management of estate, trust, and pension funds. Insurance brokerages supplied both commercial and personal insurance policies. Investment dealers were involved in the trading and underwriting of corporate securities. (Economic Council of Canada, p. 44)

The Bank Act is subject to revision every ten years. (Jordan, p. 11) These revisions have provided important regulatory initiatives for the Canadian banking system. The 1954 revision of the Bank Act was responsible for establishing reserve requirements under the control of the Bank of Canada. This revision also increased the required reserve ratio and altered its computation to a monthly basis. (O'Brien, p. 187)

The 1967 revision of the Bank Act established several provisions. The act created required secondary reserve requirements to be supervised by the Bank of Canada. (O'Brien, p. 194) These reserves represent excess reserves held in addition to primary reserves based on a percentage of asset holdings. The act also removed the interest rate limit imposed on deposits at commercial banks. (O'Brien, p. 193) By removing this rate ceiling, regulators sought to improve the competitiveness of commercial banks in acquiring consumer savings. The 1967 revision also created the Canadian Deposit Insurance Corporation, which would insure deposits up to a $20,000 limit. (O'Brien, p. 192)

This amount has subsequently been increased to $60,000 per depositor.

The Bank Act Revision of 1980 imposed ownership restrictions for Schedule I and Schedule II banks. Nationally chartered Schedule I banks are permitted to engage in the full range of financial activities. The act requires these banks to be widely held with no one interest greater than ten percent. (The Canadian Bankers' Association, p. 2) Schedule II banks are closely held Canadian banks or banks with significant foreign ownership. These banks are restricted in their abilities to branch and with respect to their size, through ceilings on the percentage of domestic banking assets that can be owned by Schedule II banks. (Jordan, p. 10)

**Deregulation**

The process of regulating financial institutions in the United States and Canada was a reaction to the financial trauma of the Great Depression. This process continued for nearly forty years in an effort to preserve the integrity of banking systems. Yet as both countries entered the 1980s, several factors began to reverse this trend of regulation.

First, intense inflationary pressures during the late 1970s led borrowers and lenders alike to avoid long term commitments. Commercial banks sought to overcome this deficiency through innovation and by focusing on expanding fee-based services rather than relying on interest-derived income. (Economic Council of Canada, p. 46)

Technological change also drove the process of deregulation. The creation of automatic teller machines and electronic fund transfers has led to de facto branch banking. Improved communications systems have provided more efficient flows of information, allowing better timing and reduced costs of transactions.

The increasing internationalization of financial markets has also produced deregulatory pressures. In an effort to remain globally competitive, banks must constantly innovate to remain profitable. The increased pace of deregulation in the European community has forced both the United States and Canada to reassess their regulatory efforts in the context of global
profitability. (Economic Council of Canada, p. 48)

United States

The regulatory structure of the United States has always been the subject of sharp criticism. As one critic states, "The regulatory structure erected 50 years ago has been adapted through piecemeal changes wrought by legislated amendments, court interpretations, and regulatory rulings. The result has been described as an 'archaic and disorderly drift'." (England, 1991, p. 4) In response to these criticisms two pieces of legislation were passed during the 1980s which have been hailed as the most significant banking bills since the 1930s.

The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) was passed in 1980. This legislation was designed to create a level playing field for competition between the various types of depository institutions in the United States. This law contained six major provisions:

1. It created uniform legal reserve requirements on similar classes of reservable liabilities at all depository institutions, regardless of membership in the Federal Reserve System.
2. It removed interest rate ceilings on time and savings deposits by phasing out Fed Regulation Q. This was to be accomplished over a period of six years.
3. The DIDMCA authorized depository institutions to offer negotiable order of withdrawal accounts. These NOW accounts are, in effect, interest bearing checking accounts previously banned in 1933.
4. The legislation allowed thrift institutions to engage in commercial lending activities.
5. It gave all depository institutions with checkable accounts equal access to the temporary borrowing facilities of the Federal Reserve System.
6. Finally, the DIDMCA raised the government deposit insurance coverage from $40,000 to $100,000 per depositor at federally insured institutions. (Boreham, "No Natural Separation," p. 21)

The Garn-St. Germain Act, passed in 1982, continued the deregulation of depository institutions. This act provided that the first $2 million of reservable liabilities were exempt from reserve requirements. The Garn-St. Germain Act also gave increased powers to the savings and loan industry. It empowered S&Ls to offer demand deposits to clients with existing business relationships, to increase their holdings of consumer loans to 30 percent, and to increase their percentage of commercial loans to 55 percent of total assets. (Boreham, "No Natural Separation," p. 21)

There has also been extensive pressure to repeal the McFadden Act of 1927 and allow unlimited interstate branching. Critics state that these restrictions create banks which are too small to enjoy the economies of scale experienced by large foreign institutions. Furthermore, branching restrictions can produce de facto monopolies for banks in rural areas. Branching restrictions also limit the potential deposit base for banks and increase the likelihood of insolvency and failure. (Guttmann, p. 159)

Similar criticisms have been leveled at the Glass-Steagal Act and its functional prohibitions. Over the past fifteen years, bank profitability has been hindered by an inability to diversify because regulations have limited the range of assets and services which banks may offer. Another rationale for deregulation is the lack of a clear distinction between classically defined money, whose growth the central bank should rigorously control, and credit, which is supposed to be determined by the market. (Kaufman, p. 147) Finally, there is already significant de facto deregulation of the functional barriers established between commercial and investment banks. Investment banks now offer cash management accounts and money market funds which mimic the demand deposits of banks. Commercial banks have also blurred the distinction by offering limited underwriting, insurance coverage, and discount brokerage services. (Guttmann, p. 137)

The federal deposit insurance system has not escaped the furor over regulation. In 1991, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) was passed. This act greatly expanded the regulatory and insurance powers of the Federal Deposit Insurance Corporation by including the troubled thrift industry in its domain. It also enabled the FDIC to borrow up to $30 billion from the U.S.
Treasury. It gave the FDIC increased flexibility in establishing insurance premiums for member institutions. Finally, FDICIA established minimum institutional capital levels which would trigger specific, permanent, corrective actions by federal banking agencies. (FDIC, 1991, p. 36)

There are opponents to this increase in FDIC powers. Opponents charge that the current system of deposit insurance encourages a moral hazard problem for member banks. They assert that banks close to insolvency are encouraged to assume greater risks because federal insurance absolves banks from any direct liability to their customers. Partly to address this problem, in 1991 Congress imposed additional restrictions on the use by the FDIC of the controversial “too big to fail” policy. This policy stated that the failure to protect large institutions from failure would damage the entire banking system, so the FDIC assumed all losses incurred by the insolvent institution. (FDIC, 1991, p. 37) This policy created de facto full coverage to all liability holders of large banks. Given the FDIC’s current financial deficit, it was doubtful that this policy could have been implemented in a large-scale financial crisis. Proposed limitations on FDIC powers have ranged from the abolishment of deposit insurance, to limiting its coverage to smaller amounts, to the preservation of the current system provided that mechanisms are introduced to reduce risk taking incentives and enhance regulatory oversight. (Klausner, p. 8)

Canada

The Canadian commercial banking system has undergone radical restructuring during the 1980s. This process has led to the dissolution of the four pillars system.

This explosive deregulation has at its roots the ongoing power struggle between provincial and federal authorities. The struggle began in 1987, when Quebec, in an effort to assume the role of Canada’s financial center and financial innovator, removed the majority of restrictions on its financial services industry. Ontario soon followed suit in an effort to “ensure that our financial markets are so structured that Toronto will be able to maintain its rightful place, not only as the center of Canada’s capital markets, but as a major international financial center.” (Jordan, p. 11) The federal government in Ottawa jumped into the fray with a policy paper proposing the toppling of the four pillars. The goal of these proposals was to “remove unnecessary regulatory barriers and allow common ownership of firms from the four traditional pillars, while retaining separate institutions for supervisory purposes.” (Jordan, p. 11)

Legislation to make the proposed reforms law followed swiftly in 1987. As Jordan has stated, “Federal financial institutions were permitted to own more than ten percent of any class of shares of a Canadian corporation dealing, directly or indirectly, in securities, including portfolio management and investment counseling.” (Jordan, p. 16) Such purchases are subject to the approval of the Minister of Finance. Trust, loan, and insurance companies were granted full consumer lending powers and full commercial lending powers, provided they maintain $25 million in capital. (Coozati, p. 7) In response to these new powers, a new central federal agency was created. The Office of the Superintendent of Financial Institutions was given the power to supervise banks and federally chartered trust, loan, and insurance companies. It also oversees the securities dealings undertaken by these institutions. (Jordan, p. 15)

The Canadian Deposit Insurance Corporation remained substantially unchanged. The CDIC’s authority was expanded in establishing discretion for the issuance of deposit insurance coverage. The CDIC also took concrete measures to initiate a process for termination of coverage.

In examining the current regulatory environment, it is necessary to examine one more facet of the U.S.-Canadian relationship: the current status of commercial banking under NAFTA. The North American Free Trade Agreement sets forth provisions for the creation of a unified trading environment for the United States, Canada, and Mexico. This agreement encompasses all the major provisions from the Free Trade Agreement negotiated between the United States and Canada in 1988. It specifically sets forth rules for the interaction of the commercial banking industries of the United States and Canada. This agreement is not designed to achieve uniformity in regulation.
Instead, it seeks to secure freedom of entry while preserving the regulatory prerogatives of the host country. (Laub, p. 28) Accordingly, the United States has agreed that all domestic and Canadian chartered banks in the United States will be permitted to underwrite and deal in securities backed by the Canadian government. Furthermore, the United States has agreed not to invoke federal laws to prevent Canadian banks from operating in more than one state. Canada has provided that the United States will be exempt from foreign ownership provisions. Canada also promises it will not abuse its control over entry provisions for the commercial banking industry. (Laub, p. 28)

Given the drastically different paths the commercial banking systems of the United States and Canada have followed in the process of deregulation, a comparison of commercial bank performance during this time period provides unique insights into the relative success of each system's evolution.

Performance

The commercial banking systems of the United States and Canada possess drastic differences in both structure and regulatory environment. These differences provide a unique opportunity to evaluate the comparative performance of the two banking systems. Such a comparison cannot be perfect, due to inherent differences between the two countries. However, similarities in population demographics, macro economic performance, and commercial bank holdings and strategies make a comparative evaluation more than useful.

United States

According to Wallich, "It has been said that the United States has some of the world's best banks and the world's worst banking system." (Wallich, p. 152) The commercial banking system of the United States is not the world power it once was. Poor profitability, lagging innovation, and rapidly increasing insolvencies have shown the clear weaknesses in the American banking system.

The performance of American commercial banks during the 1980s was substandard both in profitability and global competitiveness. Between 1982 and 1990 the number of commercial banks in the United States declined in seven of the nine years. The net change during this period was a decline of nearly 3,000 banks. (FDIC, 1990, p. 6; FDIC, 1984, p. 6; FDIC, 1983, p. 6) In 1993 there was only one bank out of the estimated 13,000 commercial banks in the United States whose debt was worthy of Moody's Aaa highest debt rating. (White, p. 21)

One dramatic reason for this decline has been the rash of bank failures and insolvencies. In 1988, 200 banks failed. These banks possessed over $54 billion in assets. (FDIC Annual Report, 1989, p. viii) The number of bank closures declined slightly over the next three years, although the assets of failed banks rose. In 1991, the number of insolvent banks declined to 127, although the assets of these banks were a record $63.2 billion. (FDIC Annual Report, 1991, p. 1) Of equal importance is the number of problem banks recognized by the Fed. The number of banks classified as problem banks reached an all time high of 1,624 in mid-1987. (FDIC Annual Report, 1989, p. ix) This number declined to 1,090 banks in 1991 with assets of over $609 billion. (FDIC Annual Report, 1991, p. 15) The failures of the American banking system in the 1980s were unparalleled. According to Calormiris, "The losses per deposit dollars due to bank and thrift failure in the last decade dwarf the losses of failed banks in the 1930s." (Calormiris, p. 20)

There are several reasons for this rash of bank failures. The most important of these is the extreme competition from non-bank intermediaries and from securities markets at home and abroad. This competition has forced American commercial banks to take greater risks in an effort to offer competitive returns to consumers. In the decade from 1980 to 1990, bank portfolios reflected this change. Holdings of cash and investment-grade securities declined from 36 to 27 percent of assets. During the same period, the percentage of riskier loan holdings rose from 54 to 61 percent. (White, p. 21)

American banks have taken extreme loan losses during the 1980s. By investing almost solely in the volatile real estate and energy markets, many banks made themselves vulnerable to the downturns which occurred in these mar-
kets during the late 1980s. Real estate loans increased from 15 to 23 percent of assets during this period. Especially hard hit were the Southwest and Northeast regions of the country. (White, p. 21)

A final cause was the lack of diversification due to regulatory prohibitions. Many banks suffered financial difficulties because they were unable to diversify their portfolios to reduce risk. Their inability took two forms. Banks were restricted geographically by the McFadden Act. This prevented banks from having access to a wider range of deposits which would be less affected by a regional economic downturn. Banks have also been restricted in the form of assets they may hold by the Glass-Steagall Act. This act has prevented diversification through holding a wide range of assets, therefore increasing the potential damage from declines in demand for certain financial instruments.

A final symptom of the weakened American banking system is the uncertain status of the Federal Deposit Insurance Corporation. The bank failures of the 1980s have strained the resources of the FDIC. By instituting its “too big to fail” policy the FDIC overreached its capabilities. In 1987 the FDIC reached its peak level of funding with $18 billion in available reserves. By 1991 emergency funding was needed to keep the FDIC in solvency. The FDIC’s ratio of insurance funds to insured deposits also tumbled during the 1980s from 1.16% in 1980 to .60% in 1990. (Salsman, p. 107) It is estimated that in a severe recession the cost of bailing out insolvent banks would exceed the current funding of the FDIC and the Bank Insurance Fund, and render both agencies bankrupt.

The prognosis for commercial banking in the United States is not all dismal. The declining interest rates of the early 1990s have provided a favorable environment for bank profitability. These lower rates make borrowing a more viable option for the American public, giving banks the opportunity to create profits on these loans.

Canada

While the 1980s were not a financial disaster for Canadian banks, they were hardly the best of times. The most important events of this period occurred in 1985 with the failure of the Northland Bank and the Canadian Commercial Bank, two Alberta-based banks with assets representing less than one percent of the total assets of the Canadian banking system. (Boreham, “The Contemporary Banking Scenes,” p. 11) While the failure of two relatively small regional Schedule I banks seems minor, these failures were the first in Canada since 1923. The financial difficulty faced by these institutions was a result of overreliance on Alberta’s real estate and oil boom. When the market turned sour, the banks collapsed with over $1.5 billion in losses. During this period, a bailout attempt was organized, not by the Bank of Canada, but by the five largest banking institutions. The effort was undertaken to preserve consumer confidence in the banking system and, in particular, Schedule I banks. Despite these efforts, the two institutions became insolvent on September 1, 1985, at a cost of $1.8 billion to the Bank of Canada. (Bank of Canada Annual Report, p. 11)

Bank income in Canada during the 1980s has been relatively stable. From 1983-1988, domestic bank profits increased from $1.3 billion to $3.3 billion. (The Canadian Bankers’ Association, p. 16) This profitability may be deceiving, however. During the same period Canadian banks engaged in “voluntary” downsizing and rationalization. From 1979-1986, the total number of bank branches in Canada declined by 6.5 percent. (Boreham, “The Contemporary Banking Scenes,” p. 11) This contraction is the result of mergers and liquidations in banks not able to remain competitive in the current deregulated market.

The ability of Canadian banks to survive the turbulent economic conditions of the 1980s is a testament to the regulatory environment of Canada. Canadian banks are better able to diversify their asset holdings due to deregulated commercial banking markets. Without branching restrictions, Canadian banks are able to attract a national representation of asset holdings, thereby reducing the risks of regional recessions. With the collapse of the four pillar system, Canadian banks are no longer exposed to risks stemming from a limited range of product offerings. In seventy years, only two
Canadian banks have failed. These collapses were the result of failures to take advantage of the functional and geographic diversification possibilities allowed by the Canadian banking system.

Conclusion

The banking systems of the United States and Canada have been in existence for nearly 200 years. During this time both systems have undergone considerable growth and evolution. Although certain thematic similarities can be seen in the history of both banking systems, the process of growth for each banking system has been as unique as the countries they represent.

In response to the worldwide financial trauma of the Great Depression, both the United States and Canada sought to regulate their commercial banking industries. The United States took a strict stance on regulation, imposing restrictions on both the ability to branch and the ability to offer certain services. Canada took a less restrictive view of regulation, creating the four pillars system which imposed function restrictions on financial institutions.

The drastic economic changes of the late 1970s and early 1980s made it clear that the commercial banking systems of the United States and Canada had to undergo extensive change to remain competitive. This process of deregulation has occurred in a piecemeal fashion in the United States, as banks are gradually allowed more freedom but remain in the restrictive environment of structural and functional restrictions. Canada has taken a more aggressive approach by dissolving the four pillars system and allowing Canadian financial institutions to interact as they please.

These two approaches have affected the performance of commercial banks in the United States and Canada. The American banking system has struggled throughout the 1980s, enduring a rash of bank insolvencies and overall poor bank profitability. Canada’s banks, while not tremendously successful, have maintained their stable existence and reasonable profitability throughout the turbulent 1980s.

As both countries move forward towards the 21st century, the banking systems of the United States and Canada will be forced to succeed in a world of intense global competition and swift technological change. At this juncture, it appears the liberalized system of Canadian banking is better prepared to do so.
REFERENCES


