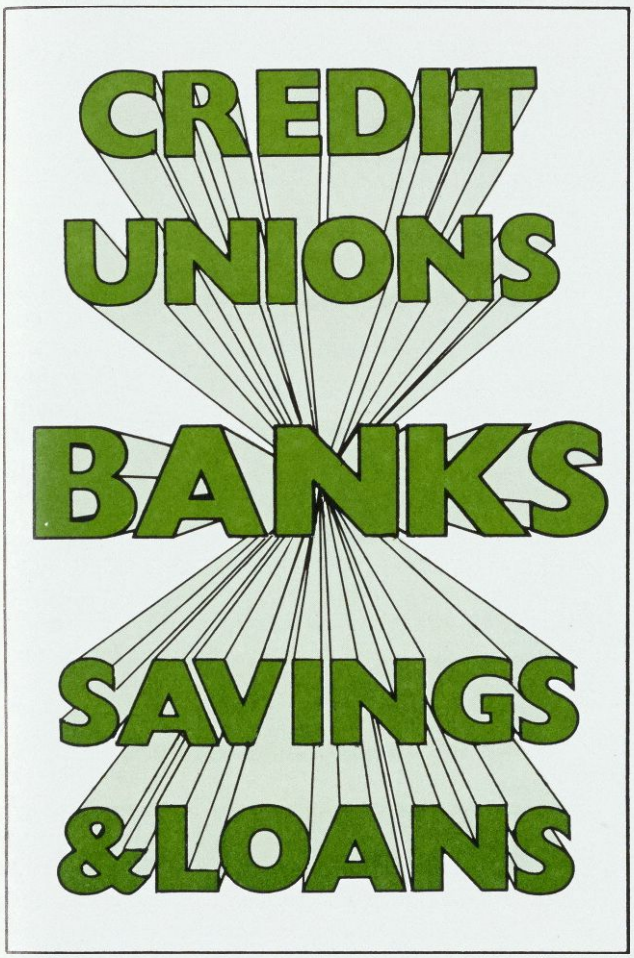
Depository Institutions: Trends Show Major Shifts



In the early 1980s, commercial banks, mutual savings banks, savings and loan associations and credit unions in the United States entered a new era. Many of the old restraints that had affected their behavior and performance since the Great Depression were removed. Many new competitors also came into their markets from outside the chartered depository institutions, which had been their main competitors for 50 years.

The depository institutions entered this era with very different functions and attributes. Yet each type of institution will have to function in much the same environment as the others from now on. What are these attributes and how did depository institutions acquire them? An accurate perspective on historical trends should help us project how the institutions will behave in the '80s and how they will perform. The data presented here seldom are assembled in one place with consistent definitions across institutions and over time. Utilizing this integrated data base, this article examines a number of interesting trends in the evolution of depository financial institutions over the last 20 years.

Market Shares and Offices

Twenty years ago, banks had more assets than other financial institutions and offered a wider array of services. In 1960, for example,

After growing more slowly than S&Ls or credit unions for most of the last 20 years, commercial banks have surged since 1979. Thrifts and credit unions were hurt more seriously by the recent period of high interest rates and recession.

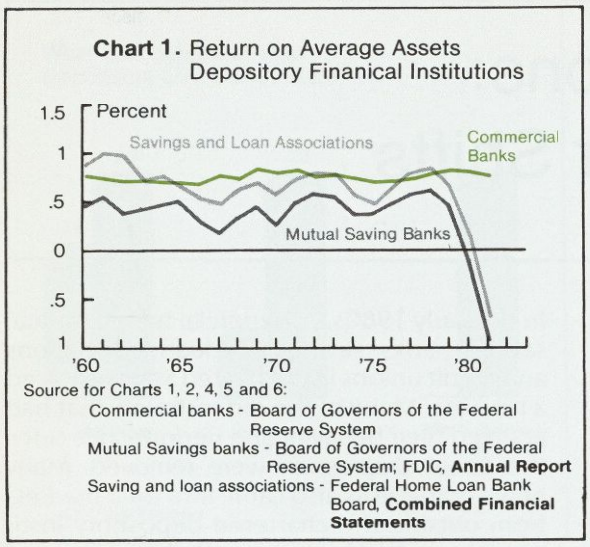


Chart 1. Return on Average Assets
Depository Finanical Institutions

Source for Charts 1, 2, 4, 5 and 6:
Commercial banks - Board of Governors of the Federal Reserve System
Mutual Savings banks - Board of Governors of the Federal Reserve System; FDIC, **Annual Report**
Saving and loan associations - Federal Home Loan Bank Board, **Combined Financial Statements**

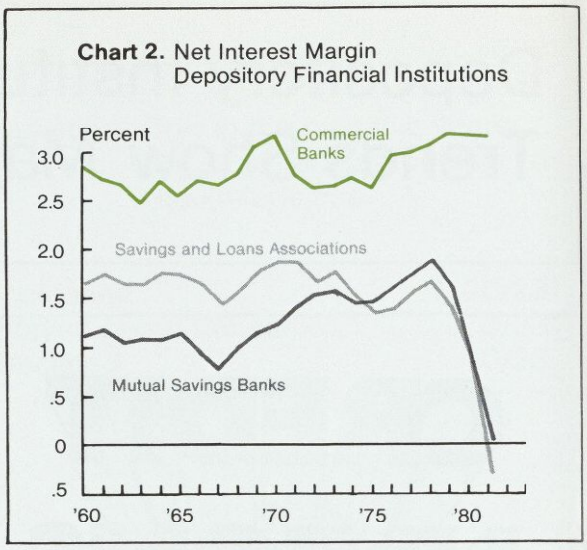


Chart 2. Net Interest Margin
Depository Financial Institutions

commercial banks held more than twice the volume of assets of S&Ls, mutual savings banks, and credit unions combined. They vastly exceeded S&Ls and mutual savings banks in the number of offices, but had only a few more offices than credit unions. Commercial banks at the time were general financial institutions offering both deposit and loan services to businesses and consumers. S&Ls, mutual savings banks and credit unions, on the other hand, offered limited services primarily to consumers. The vast majority of commercial banks' liabilities were subject to interest rate ceilings, whereas those of the thrift institutions were not subject to such ceilings until 1966. Banks' return on assets in 1960 was well above that of mutual savings banks, but not quite so high as S&Ls' return. Banks' net interest margin, however, greatly exceeded that of both types of thrift institutions (see Charts 1 and 2).

Between 1960 and 1980, the different types of institutions were dealt different hands (by the economic environment, regulations and, possibly, their own motivations) with which to play the competitive game of the 1980s. Over most of the period since 1960, commercial banks have grown more slowly than S&Ls or credit unions. Mutual savings banks, on the other hand, confined as they are to the more slowly growing Northeast, have lagged all three of the other types of institutions.

Since 1979 this trend has reversed dramatically as commercial banks grew rapidly and regained some of the business they lost during the 1970s. In this period, the other types of depository institutions were facing serious financial problems and were unable to compete as effectively against commercial banks (see Table 1).

Even during the period when assets of commercial banks were growing more slowly, however, they were the only kind of depository institutions whose number was expanding even as the number of other depository institutions declined. In the case of S&Ls, the decline was quite rapid. The number of mutual savings banks and S&Ls declined throughout the period while that of credit unions rose from 1960 until 1970, their peak year. Their numbers have declined consistently since. Mutual savings banks and S&Ls disappeared almost exclusively through merger. Credit union numbers declined mainly through voluntary liquidations.

Commercial banks, on the other hand, increased in number from approximately 13,500 to almost 15,000 during the period. Even if we count banking units (bank holding companies plus independent banks), the number has declined only slightly since 1960 (see Table 2).

In recent years the continued increase in the number of banks and decline in the number of thrifts may have been partially the result of more liberal branching standards for S&Ls promulgated by the Federal Home Loan Bank Board. The influence of these standards came well after the number of thrifts started to fall, however. Further, the number of mutual savings banks has declined although they were not affected by the Bank Board's standards. The sharp declines in the

Table 1. Average Annual Asset Growth
Insured Depository Financial Institutions

	Commercial Banks, Domestic Offices	Mutual Savings Banks	Saving and Loan Associations	Credit Unions
1960-1981	9.31	7.34	11.42	13.29
1965-1970	8.66	6.27	6.50	11.22
1970-1975	10.53	9.31	14.05	16.13
1975-1980	10.08	7.30	13.34	13.82
1980-1981	9.67	2.00	5.80	7.17

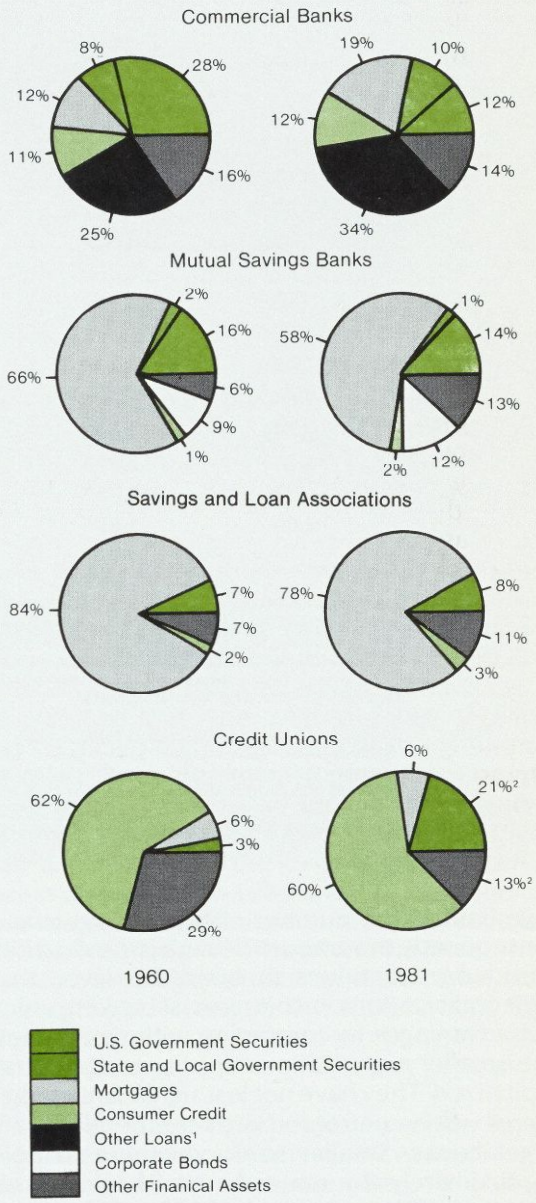
Sources: Commercial Banks - Federal Reserve Board
Mutual Savings Banks - FDIC, **Annual Report**
S&Ls - FHLBB, **Combined Financial Statements**
Credit Unions - CUNA, **Yearbook 1979** and Credit Union **Statistical Reports 1981**

number of thrifts in recent years are probably more closely related to financial problems.

Over the longer term, this increase in the number of commercial banks, together with a decline in other institutions, should not be surprising. In fact, it is quite consistent with studies of economies of scale in financial institutions. These studies indicate that commercial banks' unit costs begin to rise slightly once the unit has assets in the neighborhood of $50 million to $75 million. Studies of savings and loan associations, which may be generally applicable to mutual savings banks, indicate that costs decline to a much greater size of institution, possibly in the neighborhood of $500 million in deposits. The more specialized thrift institutions thus appear able to take advantage of much greater scale economies than do commercial banks. Consequently, thrifts appear to have more motivation to merge and combine in order to achieve large scale production.

Further consolidation of both types of institutions—thrifts and commercial banks—probably has been inhibited by branching laws that prohibited interstate banking and in many cases intrastate branching for banks and thrifts until late in the 1970s when the Federal Home Loan Bank Board changed its policies to allow more statewide branching for S&Ls. Prohibitions against commercial bank statewide branching still exist in many states. Sixteen have limited branching, 11 still only allow unit banks, and 12 states still have significant prohibitions against multibank holding companies. Further reasons for lack of consolidation may include the U. S. Supreme Court's antitrust guidelines that ignore nonbank competition and nonlocal competition in dealing with combinations of commercial banks. These guidelines as enforced by the regulatory agencies

Chart 3. Distribution of Financial Assets
Depository Financial Institutions
1960 and 1981



Source: Federal Reserve System, **Flow of Funds**
¹Primarily business loans
²The shift in credit union assets from other assets to U.S. Government Securities resulted primarily from a shift out of deposits at S&Ls.

Table 2. Number of Depository Financial Institutions (Insured and Noninsured) In The United States

Year	Commercial Banks No. of Charters(1)	Commercial Banks Banking Units(2)	Mutual Savings Banks(3)	Savings & Loans	Cedit Unions(5)	Total Units(6)
1960	13,484	13,105	515	6,320	20,456	39,936
1965	13,818	13,403	506	6,185	22,119	42,213
1970	13,705	12,931	494	5,669	23,699	42,793
1971	13,804	12,951	490	5,474	23,284	42,199
1972	13,950	12,837	486	5,298	23,115	41,736
1973	14,194	12,630	482	5,170	22,999	41,281
1974	14,488	12,642	480	5,023	22,964	41,109
1975	14,654	12,688	476	4,931	22,703	40,798
1976	14,697	12,708	473	4,821	22,615	40,617
1977	14,740	12,750	467	4,761	22,407	40,385
1978	14,741	12,753	465	4,725	22,177	40,120
1979	14,738	12,815	463	4,684	22,002	39,964
1980	14,870	12,787	460	4,592	21,731	39,570
1981	14,882	12,693	441	4,347	20,814	38,235

Sources: Commercial and Mutual Savings Banks: FDIC **Annual Report** (1940-1980) Federal Reserve System **Annual Report** (1981).
Bank Holding Companies: **Federal Reserve Bulletin** (1940) Assn. of Bank Holding Companies (1950), Federal Reserve System **Banking and Monetary Stats.** (1960-1970), **Annual Stats. Digest** (1971-1981).
Savings and Loan Associations: U.S. League of Savings Assns., **Savings and Loan Fact Book.**
Credit Unions: CUNA, **Yearbook, 1979** (1940-1979), **Credit Union Statistical Report, 1981** (1980-1981).
Securities Dealers: SEC **Annual Reports.**

Notes: (1) Includes 480 banks not insured by FDIC in 1981.
(2) Banking Units = (Commercial Banks + Bank Holding Companies − Bank Subsidiaries of Bank Holding Companies).
(3) Includes 111 banks not insured by FDIC in 1981.
(4) Includes 568 savings and loan associations not insured by FSLIC in 1981.
(5) Includes 3,581 credit unions not Insured by NCUSIF in 1981.
(6) Banking Units, Savings and Loan Associations, Mutual Savings Banks, Cedit Unions, and Securities Dealers.

have limited the number of bank mergers and consequently the amount of bank consolidation.

Evidence continues to build, however, that large organizations in commercial banking enjoy few advantages in competing with small ones. The smaller organizations appear to be better capitalized. They have not lost significant market shares when confronted with competition from larger banks. Smaller banks continue to hold approximately the same share of banks' assets that they did in the early 1970s. They have, however, increased their share of all banks' profits.

While numbers of institutions declined or remained stable, commercial and mutual savings banks and S&Ls together increased the number of offices that they operated by almost 250 percent, to 81,158 (see Table 3). Commercial banks lagged with only a 230 percent gain while mutual savings banks jumped 368 percent. (Data on credit union offices is unavailable, but we expect that their gain was small.)

Balance Sheet Trends

Balance sheet trends in the four types of institutions were quite similar between 1960 and 1981. The only major exception reflects a difference in the portfolios of assets and liabilities of commercial banks and of the other three types of institutions, a difference that has persisted since 1960.

Chart 3 shows this continuing difference. Despite some asset shifts, commercial banks continue to be general institutions holding substantial

Table 3. Number of Offices of Depository Financial Institutions (Insured and Noninsured) in the United States

Year	Commercial Banks No. of Charters	Mutual Savings Banks	Savings and Loans	Total Units
1960	24,103	1,002	7,931	33,036
1965	29,736	1,222	9,179	40,137
1970	35,585	1,581	9,987	47,153
1971	37,174	1,686	10,435	49,295
1972	38,822	1,840	11,149	51,811
1973	40,912	1,974	12,206	55,092
1974	43,193	2,122	13,798	59,113
1975	44,916	2,322	15,449	62,687
1976	46,101	2,553	16,729	65,383
1977	47,911	2,781	17,848	68,540
1978	49,598	3,006	18,975	71,911
1979	51,590	3,338	20,192	74,788
1980	53,649	3,583	21,325	78,557
1981	55,440	3,583	22,135	81,158

Sources:
Commercial and Mutual Savings Banks: FDIC **Annual Report** (1940-1980), Federal Reserve System **Annual Report** (1981).
Savings and Loan Associations: U.S. League of Savings Associations, **Savings and Loan Fact Book.**

Table 4. Net Worth - Asset Ratio, Insured Depository Institutions (percent)

Year	Commercial Banks	Mutual Savings Banks	Savings and Loan Associations	Credit Unions
1960	7.99	8.54	6.94	4.81
1965	7.46	7.80	6.79	5.59
1970	6.58	7.35	6.96	6.27
1971	6.32	6.95	6.53	5.90
1972	5.95	6.80	6.22	5.71
1973	5.67	7.00	6.23	5.53
1974	5.65	7.14	6.19	5.58
1975	5.87	6.66	5.81	5.32
1976	6.11	6.42	5.58	5.07
1977	5.92	6.40	5.45	4.72
1978	5.80	6.53	5.51	4.39
1979	5.75	6.69	5.58	4.43
1980	5.80	6.25	5.26	4.32
1981	5.83	5.35	4.27	4.50

Sources: Commercial Banks - Federal Reserve Board
Mutual Savings Banks - FDIC, **Annual Report**
S&Ls - FHLBB, **Combined Financial Statements**
Credit Unions - CUNA, **Yearbook 1979** and Credit Union **Statistical Reports 1981**

proportions of securities of both the U.S. and state and local governments, mortgages, business loans and consumer loans. Mutual savings banks have continued to specialize in U.S. government and corporate securities and mortgages. S&Ls' asset portfolios remain dominated by mortgages, and credit unions still specialize in consumer loans.

Limitations on activities of the thrift institutions and credit unions made it impossible for them to expand their activities into business lending and in some cases, consumer lending and transactions deposit taking. These limitations have only been reduced since 1980. The 1980s will see whether dropping these limitations will induce the four types of institutions to be more similar in their portfolios and in the types of accounts they offer and hold.

Even before those limitations were reduced, however, broad similarities in balance sheet trends existed among the institutions. These similarities include decreased liquidity and capital for all institutions, increased use of nondeposit liabilities, declines in deposits subject to interest ceilings in the 1970s, declines in securities holdings, increases in total loans as proportions of assets and declines in mortgage loans to total loans for thrift institutions throughout most of the period.

As markets for short-term assets improved during the 1960s and 1970s, the quick availability of liquid assets induced financial institutions to decrease holdings of short-term easily marketable assets. Cash and securities as a percentage of assets at all four types of institutions declined. Taking their place were more loans and securities of other types. Capital as a percentage of total assets also fell during the 1960s and particularly during the 1970s (see Table 4). The late 1970s saw a leveling off of this decline for commercial banks and indeed in 1980 and 1981 commercial banks' capital-asset ratios increased. In the late 1970s and early 1980s, however, because of substantial earnings problems, capital asset ratios at the thrifts increased the steepness of their descent. Credit unions' net worth-assets ratios declined overall in the 1970s but rebounded slightly in 1981.

Limits on interest that could be paid for deposit liabilities induced commercial and mutual savings banks and S&Ls to increase nondeposit liabilities during the late 1960s and the 1970s (see Table 5). Commercial banks led in this movement, increasing nondeposit liabilities earlier and taking on a greater proportion of nondeposit liabilities than the thrifts by the mid 1970s. S&Ls jumped back into the lead as users of nondeposit funds in 1981. Commercial banks and mutual savings

Table 5. Nondeposit Liabilities to Total Liabilities Insured Depository Financial Institutions (percent)

Year	Commercial Banks	Mutual Savings Banks	Savings and Loan Associations
1960	2.83	1.84	6.49
1965	4.50	1.41	10.71
1970	7.40	1.57	10.74
1971	7.87	1.35	9.56
1972	8.87	1.36	9.29
1973	10.86	1.86	11.08
1974	10.93	2.20	12.51
1975	10.37	2.00	10.40
1976	10.65	1.84	9.35
1977	11.39	1.92	10.90
1978	13.18	2.71	12.90
1979	14.54	3.59	14.13
1980	15.27	4.00	14.45
1981	16.85	5.99	17.80

Sources: Commercial Banks - Federal Reserve Board
Mutual Savings Banks - FDIC, **Annual Report**
S&Ls - FHLBB, **Combined Financial Statements**

Table 6. Average Annual Growth in Demand and Time and Savings Deposits

Insured Commercial Banks

Year	Demand Deposits	Time and Savings Deposits
1960-1981	4.40	12.57
1965-1970	6.07	9.65
1970-1975	5.37	14.35
1975-1980	6.12	16.55
1980-1981	−10.93	17.14

Source: Federal Reserve Board

banks held mainly private nondeposit liabilities in the forms of commercial paper, notes and debentures and other borrowings. Savings and loan associations' nondeposit liabilities came primarily through loans from the Federal Home Loan Banks, although their borrowings from other sources also increased as a proportion of assets.

As higher interest rates and innovation by nondepository institutions eroded interest rate control in the 1970s, the regulators were forced to remove interest rate ceilings for more and more types of deposits. This culminated in Congress ordering the Depository Institutions Deregulation Committee (DIDC) to remove the interest ceilings gradually through April 1986.

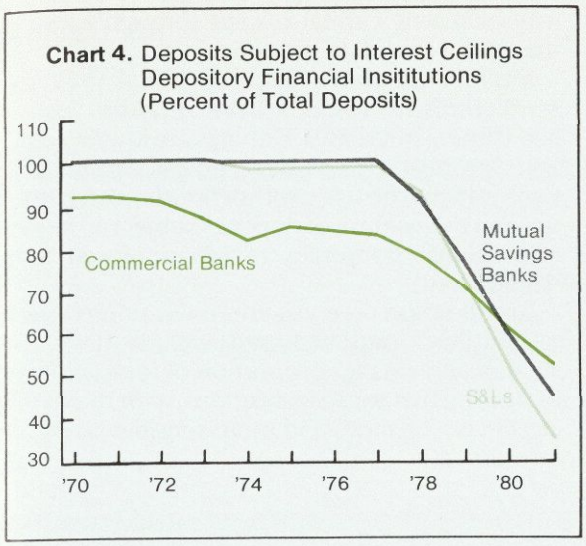
Predictably, deposits not subject to interest rate ceilings increased rapidly in the late 1970s with inflation and high interest rates. Those subject to interest rate ceilings declined quite rapidly (see Chart 4). Throughout the period, demand deposits at commercial banks grew at a much slower pace than time and savings deposits. The gap between growth rates increased in the latter part of the 1970s as interest rate ceilings were removed from time and savings deposits while demand deposits remained subject to an interest prohibition (see Table 6). The adoption of NOW accounts that lifted the ceilings on personal transactions deposits did little to stem the tide.

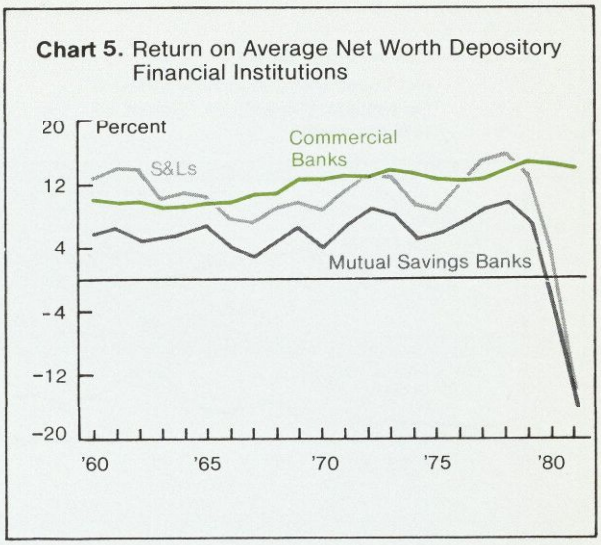
Thrift institutions, although limited to a great extent in the types of assets they could hold, steadily but slowly decreased the proportion of mortgages in their portfolios throughout the 1970s after increasing mortgage holdings in the 1960s. Mutual savings banks took on more corporate securities; S&Ls took on more consumer loans and government securities.

Income and Expense Trends

In contrast to the similar balance sheet trends among commercial and mutual savings banks, S&Ls and credit unions, quite different earnings trends evolved for these institutions during the 1960s and 1970s. Commercial banks' earnings were considerably more stable during this period than those of the other institutions. For the whole period, the difference between the high and low return on assets for commercial banks was only 14 basis points. The spread for savings and loan associations and mutual savings banks (even before the earnings debacle of 1979, 1980 and 1981) was at least three times that of commercial banks (see Chart 1). Similarly, return on equity (or return on net worth) varied much more greatly among S&Ls and mutual savings banks (see Chart 5).

After the introduction of market indexed certificates in mid-1978, rising interest rates pulled thrift institutions' interest costs up much more rapidly than interest revenues could rise. Thus, thrifts' earnings plummeted from 1979 through 1981. Thrifts' problems would not have been avoided had market rates not been introduced. Without market rates, thrifts could not have bid for deposits. This would have forced nondeposit borrowing at market rates or induced a liquidity crisis.





As might be expected, thrifts' earnings appeared to be driven mainly by changes in interest rates. Bank earnings, on the other hand, do not appear to have been so sensitive to interest rates as they were to activity in the economy. Recession, which brings on more business failures and more loan delinquencies, was more closely related to earnings declines at commercial banks than were higher interest rates (see Chart 6). And expansion in the real economy was closely related to expansion in bank earnings. Thus, while thrifts' earnings appeared to be interest rate driven, commercial banks' appeared to be loan-loss driven.

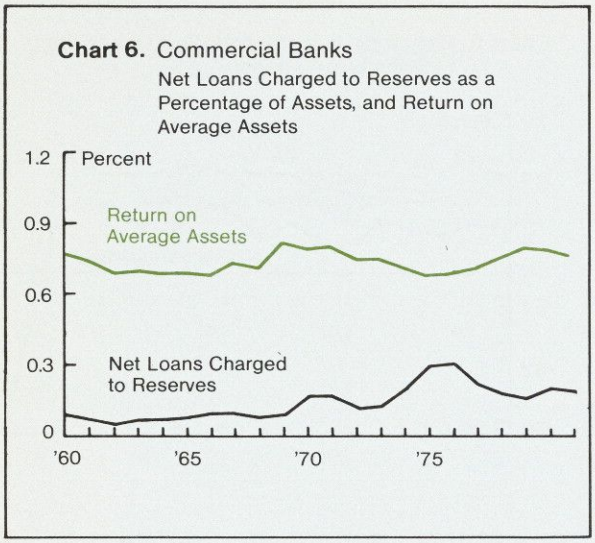
Throughout the period, interest revenue increased as a proportion of total revenue for commercial banks and S&Ls but not for mutual savings banks. This increase in interest revenue as a proportion of total revenue continued into the late 1970s and early 1980s, when depository financial institutions were urged to unbundle financial services and to generate revenues through fees rather than through interest.

For the entire period, interest costs rose more rapidly than interest revenue for these institutions. The difference in cost and revenue growth rates was sufficient to keep net interest margin in the same range until the thrifts' problems hit in 1979 (see Chart 2). Even in the 1979-82 period, commercial banks' earnings remained stable. Thrift institutions, because of their asset and liability mismatch, suffered from rising interest rates and decontrol of deposit interest ceilings through sharply declining earnings. These earnings declines brought massive losses and cut thrifts' capital severely. Commercial banks weathered the high interest rates in relatively good shape with continued stable earnings, net interest margin and return on assets and with rising capital-asset ratios. Much of their financial advantage going into the latter part of the 1980s stems from this particular period.

How Now?

Currently, commercial banks appear to be in good shape compared to thrift institutions. Earnings of the industry have not fallen, although recessions plagued the economy in 1980 and 1982. Capital increased more than assets in the 1980-1981 period. Several of the 1970s trends, however, appear to be continuing. Deposits subject to interest ceilings have continued to fall in the last three years. New MMDA and Super NOW accounts bid fair to continue this trend. Commercial banks are becoming more dependent on liabilities whose costs fluctuate with the market. The interest dependence of commercial banks does not seem to be declining despite moves to unbundle and charge fees. Non-interest expenses also continue to rise.

Thrift institutions, however, appear much more seriously harmed by the recent period of high interest rates and recession. As a result of negative net interest margins and returns on assets, thrift institutions' capital has declined to historically low levels. Since most are mutual institutions and, short of stock conversions, have no practical



way of raising capital except through earnings, their net worth has dropped.

Interest rates have fallen since mid 1982, and some thrift institutions have reported second half earnings increases. Earnings are low, however, and borrowing from the Federal Home Loan Bank is high. The use of other nondeposit funds is up, and the volume of deposits subject to interest rate ceilings continues to fall rapidly at these institutions.

Credit union reserves are down since the mid 1970s. Their deposit-type liabilities make up a smaller and smaller proportion of total liabilities, indicating that these institutions, with the others, are becoming more and more sensitive to market interest rates.

—**B. Frank King**