FRBSF WEEKLY LETTER

Number 95-36, October 27, 1995

Consolidation: California Style

In the last ten years, the number of banks in the U.S. has dropped sharply. This *Weekly Letter* examines the course of this trend in both the U.S. and California. We focus especially on California because its size and its longstanding liberal branching laws make it a good benchmark for what the national banking structure could eventually look like.

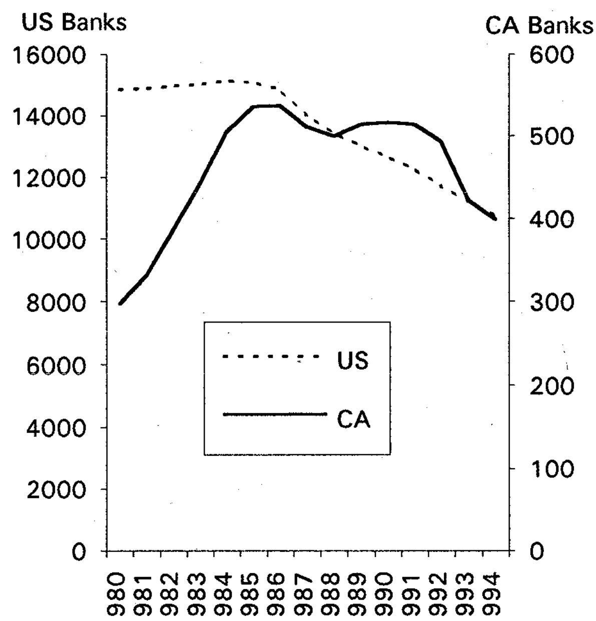
Number of banks

Between 1984 and 1994, the number of banking institutions in the U.S. fell from about 15,000 to 10,740, a dramatic 29 percent decline. Part of the explanation for the decline was the epidemic of bank failures—some 1,300 during that period, most of which were absorbed into other banking organizations. Most of the consolidation in banking, however, has been through other voluntary mergers and acquisitions. This trend generally is seen as part of the industry's adjustment to a changing competitive environment. It also reflects a changing regulatory environment including the liberalization of branching laws. In states like Illinois and Texas, for example, restrictions on intrastate branching had led to large numbers of small unit banks. Liberalizing such restrictions has allowed adjustments to more realistic banking structures. More recently, the liberalization of interstate branching is starting to open the way for further consolidation by allowing bank holding companies to merge their banks that operate in different states.

What will the nation's banking structure look like, once the restrictions on branching and other artificial barriers are removed? To get a preview, many analysts have looked to California because of its size and its longstanding statewide branching structure. California's banking structure is relatively free of artificial barriers, so what happens in the state should be a good predictor of what will happen nationally once artificial barriers are removed. The estimates typically use the number of banks per capita in California to infer where the structure of banking is headed nationally. Based on figures for the early 1990s, this approach would suggest a number for the U.S. of around 4,000 to 5,000 banks.

As Figure 1 shows, however, banking structure in California has changed in recent years. In the early 1980s, the number of banks in the state rose sharply and then remained relatively steady during the second half of the 1980s and into the early 1990s, largely because of the strong economy. But from mid-1990 through early 1993 California went through a severe recession, which took quite a toll on existing banks, particularly smaller community banks in the hard-hit Southern California area. With the combination of the

Figure 1
Number of Commercial Banks



WESTERN BANKING *Western Banking* is a quarterly review of banking developments in the Twelfth Federal Reserve District. It is published in the *Weekly Letter* on the fourth Friday of January, April, July, and October.

formation of fewer new banks, more failures, and a number of voluntary mergers, the number of banks operating in California dropped from 516 at the end of 1990 to 399 in 1994, about 23 percent in just four years, compared to a 29 percent decline in the nation over ten years.

This change along with the prospects for further adjustments in banking structure in a large, unrestricted branching state like California suggest the need to reassess the equilibrium structure of the U.S. banking system. While it still is likely that the number of banks will be in the thousands, it may well be less than had been predicted before the substantial changes in California.

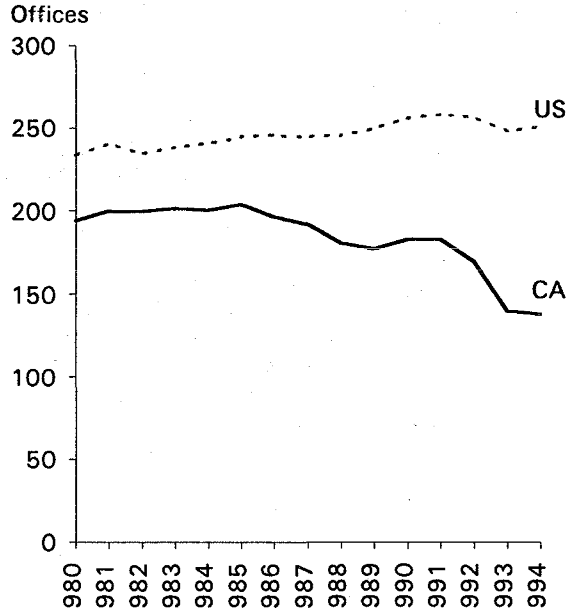
Effects on brick and mortar

While the number of banks nationally has declined steadily, another indicator of banking capacity suggests that consolidation in banking may be something of a misnomer, at least until recently. In particular, the number of banking offices nationally continued to expand into the early 1990s. By the end of 1992, banking offices totaled 65,577, almost 9,000 more than in 1984, the year that marked the recent peak in the number of banks. Figure 2 shows that even adjusting for population growth, the number of banking offices per capita was on the rise. One reason may be that the marked contraction in the thrift industry that started in 1989 temporarily eased pressures on some banks to trim branch networks. From 1988 to 1993, for example, the number of savings and loan offices fell from about 26,000 to about 16,000. Thus, much of the recent period of "bank consolidation" did not end up reducing the brick and mortar delivery system—an outcome that runs counter to many analysts, who predicted that banks would have to shrink the number of offices to remain competitive with other providers of financial services.

Banks also found other ways to adjust. Although bank employment did not decline as dramatically as the number of banks did, it generally has drifted downward. By 1995, employment in banking nationally had declined by about 6.3 percent from its peak in 1985. That decline contrasts with a 13.7 percent increase in total employment in the financial services industry. It also is consistent with bank efforts to automate banking services over the past decade, when banks nearly doubled the number of ATMs from about 60,000 to close to 110,000.

More recently, there are signs that consolidation will eventually mean fewer banking offices. At the national level, the number of offices fell by only a small fraction. The changes in California, however, have been quite pronounced. Figure 2 shows that offices per capita in California, which were trending downward after the mid-1980s, declined very sharply in the early 1990s. This change suggests that sizable adjustments in brick and mortar can be made in a relatively short time, especially when large mergers are involved. The recent peak in banking offices in the state was 5,555 in 1991. Just two years later, the number of offices dropped to 4,411, or about 20 percent.

Figure 2
Number of Bank Offices per 1 Million Population



Conclusion

Over the past ten years consolidation in banking primarily has been manifested in a decline in the number of banks. The shift to automation has allowed for some reduction in employment in banking, but the brick and mortar delivery system in banking actually expanded over most of the past ten years.

The recent experience in California, however, points to consolidation of banking in the future that is likely to entail not only fewer banks, but also fewer offices. Moreover, the prospects for further adjustments in banking structure in a large, unrestricted branching state like California suggest the need to reassess what the structure of the U.S. banking system will look like in the future. While it still is likely that the number of banks will be in the thousands, it may well be less than would have been predicted before the recent evidence on consolidation in California's banking structure.

Fred Furlong
Vice President

Gary C. Zimmerman
Economist

REGIONAL BANK DATA

JUNE 30, 1995

(NOT SEASONALLY ADJUSTED, PRELIMINARY DATA)

		DISTRICT	ALASKA	ARIZ.	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES -- $ MILLION (ALL COMMERCIAL BANKS)											
ASSETS	TOTAL	563,761	5,498	44,539	358,423	22,237	12,378	25,887	28,904	18,531	47,365
	FOREIGN	59,906	0	0	57,586	2,274	0	0	0	0	47
	DOMESTIC	503,855	5,498	44,539	300,837	19,964	12,378	25,887	28,904	18,531	47,318
LOANS	TOTAL	382,629	2,957	30,159	236,494	14,511	9,080	19,332	21,380	11,753	36,964
	FOREIGN	34,853	5	0	33,357	1,408	0	0	0	0	83
	DOMESTIC	347,776	2,952	30,159	203,137	13,103	9,080	19,332	21,380	11,753	36,881
	REAL ESTATE	173,311	1,373	10,249	116,882	7,678	2,998	3,518	9,060	4,977	16,576
	COMMERCIAL	70,553	887	3,491	42,248	3,568	1,927	1,046	5,844	2,135	9,408
	CONSUMER	69,017	565	12,323	21,225	1,159	2,770	14,500	4,247	3,931	8,297
	AGRICULTURAL	6,488	3	389	3,232	34	941	21	491	171	1,206
	OTHER LOANS	28,407	123	3,707	19,550	664	443	248	1,738	540	1,394
INV. SECURITIES	TOTAL	75,257	1,886	7,528	45,530	4,717	1,819	3,355	2,916	3,635	3,872
	U.S. TREASURIES	18,115	818	1,329	11,772	1,064	426	865	563	430	847
	U.S. AGENCIES, TOTAL	22,190	483	2,277	12,916	1,620	632	853	951	1,672	785
	U.S. AGENCIES, MBS	13,506	353	1,923	7,753	836	283	492	729	768	379
	OTHER MBS	3,746	126	230	2,998	27	51	57	12	80	165
	OTHER SECURITIES	31,207	459	3,691	17,843	2,006	709	1,580	1,390	1,453	2,075
LIABILITIES	TOTAL	515,582	4,789	40,561	329,337	20,354	11,404	23,045	26,264	16,803	43,025
	DOMESTIC	455,675	4,789	40,561	271,751	18,080	11,404	23,045	26,264	16,803	42,977
DEPOSITS	TOTAL	417,263	4,083	33,387	276,982	13,892	8,991	9,805	21,788	12,756	35,578
	FOREIGN	50,743	0	0	48,299	2,193	0	0	0	184	67
	DOMESTIC	366,520	4,083	33,387	228,683	11,699	8,991	9,805	21,788	12,572	35,511
	DEMAND	99,140	1,245	7,973	65,985	2,321	1,817	3,217	5,289	2,684	8,610
	NOW	39,810	359	3,555	22,925	1,290	1,002	1,425	3,179	1,538	4,538
	MMDA & SAVINGS	124,050	1,318	10,782	79,173	4,014	2,416	3,396	7,121	3,969	11,861
	SMALL TIME	69,981	574	7,803	39,601	2,274	2,722	1,100	5,179	2,868	7,860
	LARGE TIME	33,122	524	3,274	20,746	1,795	1,034	666	1,007	1,489	2,586
	OTHER DEPOSITS	417	63	0	253	5	0	1	13	24	57
OTHER BORROWINGS		28,712	633	1,393	12,946	3,574	1,415	549	2,163	2,378	3,661
EQUITY CAPITAL		48,178	708	3,978	29,085	1,883	973	2,842	2,640	1,728	4,341
LOAN LOSS RESERVE		9,555	44	698	6,695	252	123	482	389	239	633
LOAN COMMITMENTS		326,391	767	56,217	133,428	8,093	4,393	70,797	14,676	17,522	20,498
TIER1 CAPITAL RATIO		0.096	0.195	0.109	0.091	0.102	0.099	0.113	0.100	0.127	0.091
TOTAL CAPITAL RATIO		0.124	0.206	0.131	0.123	0.120	0.116	0.135	0.116	0.142	0.116
LEVERAGE RATIO		0.078	0.130	0.082	0.073	0.081	0.079	0.104	0.087	0.092	0.083
QUARTERLY EARNINGS AND RETURNS (ANNUALIZED) -- $ MILLION (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	13,609	123	1,160	8,084	492	282	1,088	735	498	1,147
	INTEREST	10,681	105	947	6,481	417	239	634	555	383	920
	FEES & CHARGES	791	7	64	508	12	17	20	55	26	84
EXPENSES	TOTAL	10,785	95	960	6,597	402	222	727	546	399	837
	INTEREST	4,292	40	340	2,663	207	114	199	214	164	350
	SALARIES	2,386	27	166	1,634	88	35	61	115	73	189
	LOAN LOSS PROVISION	627	2	121	312	8	6	120	15	18	25
	OTHER	3,479	27	334	1,989	98	67	347	202	144	273
TAXES		1,111	9	79	625	34	21	130	69	37	107
NET INCOME		1,713	20	120	861	56	39	231	120	63	203
ROA (% ANNUALIZED)		1.23	1.46	1.12	0.97	1.02	1.31	3.84	1.69	1.40	1.76
ROE (% ANNUALIZED)		14.22	11.01	12.10	11.85	11.90	16.12	32.55	18.11	14.51	18.69
NET INTEREST MARGIN (% ANNUALIZED)		4.60	4.86	5.63	4.28	3.80	4.20	7.23	4.80	4.91	4.93
ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)											
LOAN LOSS RESERVE		2.53	1.40	2.32	2.88	1.74	1.33	2.52	1.84	1.93	1.77
NET CHARGEOFFS, TOTAL		0.80	0.11	1.41	0.81	0.24	0.18	2.29	0.17	0.34	0.30
	REAL ESTATE	0.75	0.14	0.19	1.10	0.14	-0.07	0.03	-0.17	-0.05	0.05
	COMMERCIAL	0.25	-0.10	0.44	0.32	0.31	0.03	-0.06	0.23	-0.24	-0.04
	CONSUMER	2.23	0.42	3.07	2.18	1.33	0.54	2.97	1.48	1.34	1.18
	AGRICULTURAL	-0.06	0.00	-0.12	-0.13	-1.58	0.34	-0.07	-0.21	-0.04	-0.06
PAST DUE & NON-ACCRUAL, TOTAL		2.48	2.14	2.09	2.76	2.65	1.40	3.40	1.35	1.77	1.52
	REAL ESTATE	3.38	2.26	1.67	4.18	2.62	1.05	2.25	1.25	1.14	1.63
	CONSTRUCTION	8.67	7.76	2.08	14.32	2.52	1.47	4.54	1.91	0.80	4.60
	COMMERCIAL	4.33	2.19	2.96	5.69	2.36	0.54	3.11	1.36	1.34	1.60
	FARM	5.83	0.00	6.19	6.46	5.39	5.84	0.00	4.02	9.45	3.05
	HOME EQUITY LINES	1.23	0.67	0.74	1.38	1.25	0.39	1.31	0.36	0.41	1.14
	MORTGAGES	2.30	1.86	1.17	2.64	3.63	1.37	1.22	1.25	1.25	0.96
	MULTI-FAMILY	8.30	0.81	4.62	12.43	1.02	0.00	0.01	0.33	0.23	0.14
	COMMERCIAL	1.84	1.91	2.58	1.78	3.19	1.52	4.18	1.74	2.01	1.21
	CONSUMER	2.49	2.12	2.87	2.17	2.74	1.46	3.65	1.19	2.58	1.51
	AGRICULTURAL	2.67	0.00	2.08	2.39	22.46	2.61	1.52	2.32	3.16	3.17
NUMBER OF BANKS		663	8	34	391	15	19	22	42	44	88
NUMBER OF EMPLOYEES		222,286	2,736	27,484	129,309	8,270	4,854	7,950	13,338	8,847	19,498

Research Department

Federal Reserve Bank of San Francisco

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MARKET SHARE STATISTICS

DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS

PERCENT OF COMBINED MARKET TOTAL FOR AUGUST 1995, BY REGION

	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII			IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	58	34	8	72	3	25	92	1	7	51	42	7	68	24	9	92	4	4	79	16	5	76	13	10	81	3	16	57	33	11
DEMAND	91	6	4	97	0	3	98	0	2	89	6	4	94	1	5	97	0	3	97	3	0	91	6	4	91	3	6	90	9	1
NOW	66	24	10	62	5	33	88	0	11	61	31	8	68	27	5	88	4	8	77	14	9	80	10	10	81	2	18	66	20	14
SAVINGS & MMDAS	63	25	11	58	4	38	88	1	11	60	31	9	62	24	14	91	3	6	75	15	10	74	13	13	76	1	22	55	26	18
SMALL TIME	35	59	6	70	6	24	93	2	5	25	69	6	54	40	6	90	8	2	44	49	7	70	20	11	80	5	15	41	51	8
LARGE TIME	50	41	8	93	2	6	91	2	7	42	48	10	76	18	6	95	4	1	92	8	0	66	27	7	86	4	10	46	52	2

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND SAVING BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

INTEREST RATES ON DEPOSITS AND LOANS

TYPE OF RETAIL DEPOSIT ACCOUNT OR LOAN		MAY 1993	AUG 1993	NOV 1993	FEB 1994	MAY 1994	AUG 1994	NOV 1994	FEB 1995	MAY 1995	AUG 1995
SAVINGS ACCOUNTS AND MMDAS	U.S	2.65	2.55	2.48	2.43	2.50	2.63	2.80	3.09	3.21	3.14
	DISTRICT	2.78	2.67	2.58	2.56	2.65	2.81	2.88	2.96	3.36	3.30
92 TO 182 DAYS CERTIFICATES	U.S	2.98	2.96	2.92	2.93	3.28	3.61	4.22	4.83	4.93	4.77
	DISTRICT	2.88	2.85	2.81	2.83	3.03	3.34	3.84	4.47	4.61	4.58
2-1/2 YEARS AND OVER CERTIFICATES	U.S	4.45	4.40	4.28	4.35	4.89	5.33	6.08	6.52	6.11	5.63
	DISTRICT	4.27	4.19	4.09	4.13	4.58	4.96	5.52	6.02	5.98	5.53
COMMERCIAL SHORT TERM FIXED	U.S	3.91	4.02	3.95	4.03	4.68	5.28	5.67	6.89	6.95	6.64
	DISTRICT	4.19	4.75	4.43	4.95	6.78	5.39	6.32	6.39	7.32	6.51
COMMERCIAL SHORT TERM FLOATING	U.S	5.58	5.53	5.56	5.49	6.32	6.83	7.36	8.50	8.88	8.64
	DISTRICT	5.40	6.48	6.46	6.36	6.38	7.34	7.78	9.17	8.94	8.87
COMMERCIAL LONG TERM FIXED	U.S	6.02	6.21	5.38	5.41	6.17	6.66	7.30	8.20	8.87	8.13
	DISTRICT	10.86	8.05	6.62	6.58	N/A	9.82	N/A	N/A	N/A	N/A
COMMERCIAL LONG TERM FLOATING	U.S	6.47	6.05	5.70	5.98	6.61	6.99	7.59	9.00	8.94	8.40
	DISTRICT	8.55	8.77	7.68	8.16	N/A	N/A	N/A	N/A	N/A	N/A
CONSUMER, AUTOMOBILE	U.S	8.17	7.98	7.63	7.54	7.76	8.41	8.75	9.70	9.78	9.44
	DISTRICT	8.23	8.09	7.70	7.68	7.86	8.15	8.41	9.63	9.94	9.71
CONSUMER, PERSONAL	U.S	13.63	13.45	13.22	12.89	12.96	13.33	13.59	14.10	14.03	13.84
	DISTRICT	13.87	12.69	13.00	12.02	12.26	13.37	12.87	14.55	14.67	14.81
CONSUMER, CREDIT CARD	U.S	17.15	16.59	16.30	16.06	16.15	16.25	15.91	16.24	16.15	15.98
	DISTRICT	17.60	17.58	17.00	17.17	17.61	17.34	16.33	15.60	16.44	16.33

SOURCES: MONTHLY SURVEY OF SELECTED DEPOSITS, SURVEY OF TERMS OF BANK LENDING, AND TERMS OF CONSUMER CREDIT
MOST COMMON INTEREST RATES ON RETAIL DEPOSITS, WEIGHTED AVERAGE INTEREST RATE ON LOANS