DALLAS FED ROUNDUP

Federal Reserve Bank of Dallas September 1983

FCA Identifies Checking Trends

Interest-bearing checking accounts comprised 16 to 25 percent of all demand deposit accounts held at banks participating in the Dallas Fed's 1982 functional cost analysis (FCA) program. That figure represents an increase from the 10 to 16 percent range that existed in 1981.

The FCA reports, which provide a breakdown of average costs, income and expense data by size of institution, show that banks with deposits in the less than $50 million range had the greatest percentage of deposits in interest-bearing accounts. For this group, the percentage grew from 16 percent in 1981 to 25 percent in 1982.

The reports also indicate the increasing costs associated with maintaining demand deposit accounts. For 1982, banks with deposits over $200 million experienced a 23 percent increase in the average cost to maintain a demand deposit account, from $4.60 per month in 1981 to $5.65 in 1982. Nationwide, this figure was, on average, $4.67 for 1982. These increases can be attributed, in part, to the popularity of interest-bearing checking accounts and data processing expense.

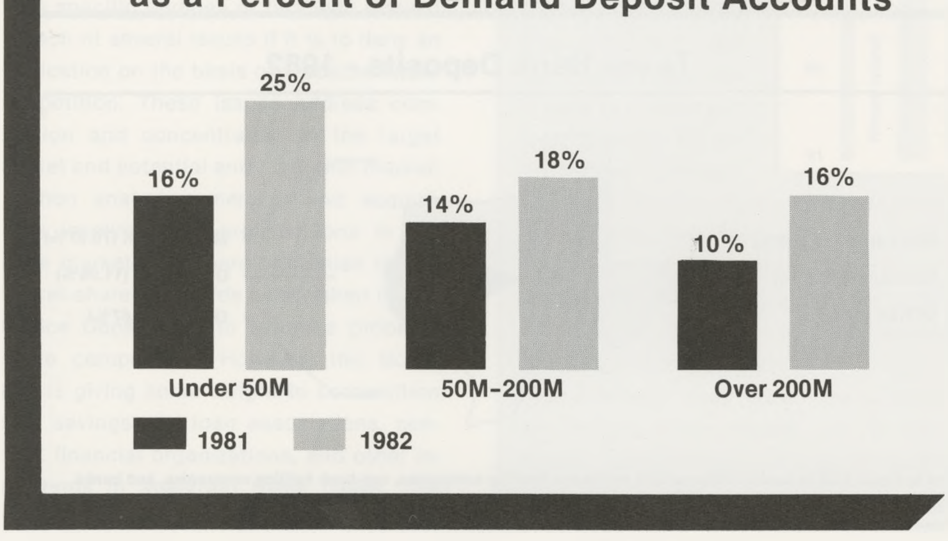
Earnings per demand deposit account were down in 1982 due to increased costs. The average monthly net loss on each account for all participating Eleventh District banks was $10.30, up 35 percent from $7.61 in 1981. However, after credit for income on funds deposited in the bank's portfolio was applied to demand deposit earnings, net earnings generally increased. The monthly net earnings per account after portfolio credit was $19.74. For all participating banks, however, the average net portfolio yield decreased from 13.25 percent in 1981 to 12.78 percent in 1982.

Banks in the over $200 million deposit range were the hardest hit in demand deposit account losses. The average net loss per account per month was $23.83, up 43 percent from $16.62. In addition, net earnings after portfolio credit for these banks decreased from $34.24 to $25.95 per account per month.

In addition to demand deposit account information, the FCA reports provide income and expense data which indicate, for example, the average cost to make an instalment loan, the average cost to process a savings account deposit, the average cost to process and cash a check, and thousands of other figures which deal with operating costs and ratios.

This year, for the first time, the report also contains separate information for thrift institutions. This report is compiled from data provided by 72 participating thrifts throughout the United States.

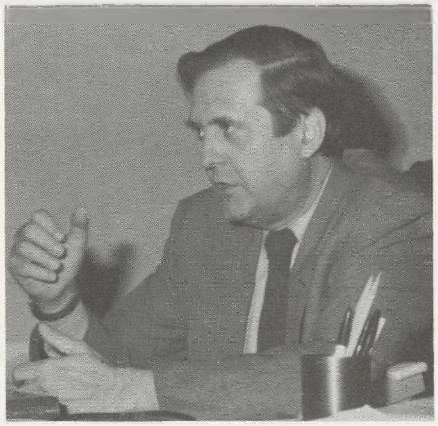
Interest-Bearing Checking Accounts as a Percent of Demand Deposit Accounts



A New Environment

Texas bank holding companies experience growth, join forces

Bank holding company activity is brisk in Texas. Formations of new bank holding companies have increased significantly over the past several years. Acquisitions by holding companies of additional institutions continually are announced. And mergers between large bank holding companies are being planned at a pace never before experienced in the state.



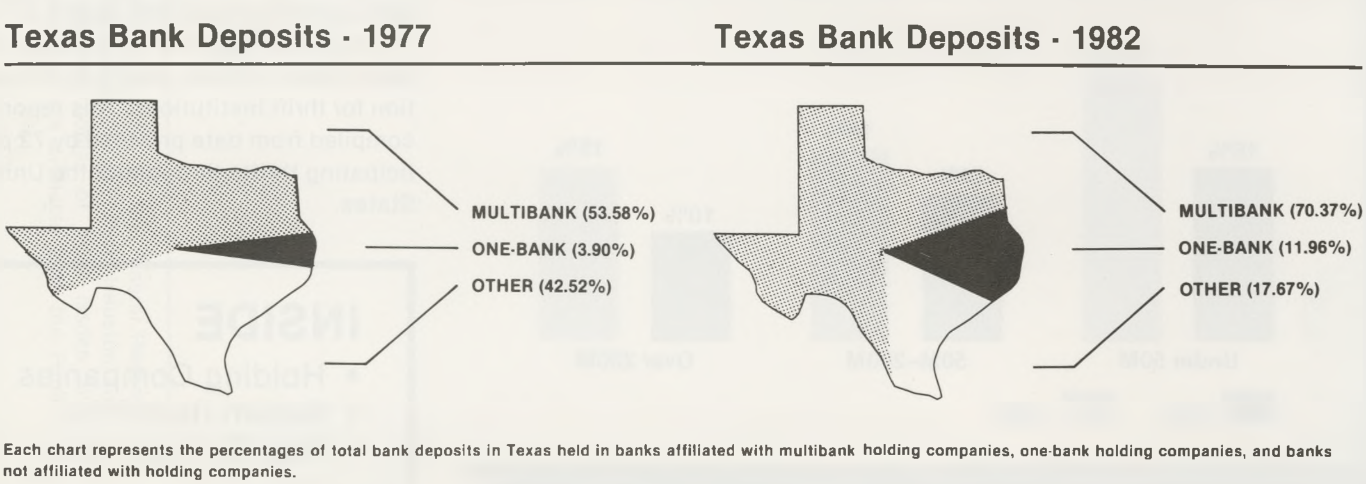
Cochran: a "turning point"

The reasons for these developments are many. Banks may form new holding companies to take advantage of certain tax benefits, and holding companies may acquire additional institutions as a means of growth and expansion. Mergers of larger holding companies, however, may be due to a general perception of major changes developing in the financial services market. According to Federal Reserve Bank of Dallas Senior Vice President George C. Cochran, interstate networks are being developed to prepare for interstate banking. "The perception among large bank holding companies is that they will have to grow larger to compete nationally. The perception among mid-sized bank holding companies is that merging with a larger company will better enable them to participate in the emerging financial environment," Cochran said.

A bank holding company is a corporation which controls 25 percent or more of a bank's stock. Two types of holding companies exist—those which control the ownership of only one bank and those which control the ownership of more than one bank. The Bank Holding Company Act of 1956—which is considered the first comprehensive legislation regarding holding companies—defined bank holding companies, controlled their expansion, and required divestiture of certain nonbanking activities. This act also designated the Federal Reserve Board as the agency directly responsible for regulation, supervision and examination of holding companies. Prior approval from the Board was required before a holding company could be formed or before an existing holding company could acquire more than five percent of the voting shares of an additional bank. The 1956 act addressed only those companies which controlled two or more banks. One-bank holding companies were not subject to the same requirements until amendments to the act were passed in 1970.

Over the past several years, both types of bank holding companies have experienced substantial growth in Texas. Dallas Fed statistics indicate that there are 401 one-bank holding companies in Texas (July 1983) with over $14 billion in deposits (year-end 1982) representing 11.96 percent of the state's total deposits. Comparable statistics for 1977 show only 61 one-bank companies with approximately $2 billion in deposits representing 3.9 percent of the state's deposits (see chart). Multibank holding companies total 85 with 621 subsidiary banks (July 1983) and over $85 billion in deposits (year-end 1982) representing 70.37 percent of the state's deposits. In 1977, there were 34 multibank companies with 250 subsidiaries and over $28 billion in deposits representing 53.58 percent of the state's deposits.

The tax advantage afforded bank holding companies, which can facilitate debt service, is the major reason for the formation



Each chart represents the percentages of total bank deposits in Texas held in banks affiliated with multibank holding companies, one-bank holding companies, and banks not affiliated with holding companies.

of most one-bank holding companies. "But we've seen one-bank companies form for other reasons," explains Robert D. Hankins, assistant vice president in the Bank's Holding Company Supervision Department. Holding companies also are used for estate planning purposes, to engage in nonbank activities, and to serve as a vehicle for raising capital. While similar advantages exist for multibank companies, these organizations are formed primarily as a means of growth and expansion into new markets. The fact that Texas does not allow branch banking clearly contributed to much of the growth.

In addition to the formation of holding companies and acquisitions of subsidiary banks, Texas this year has witnessed a number of mergers and proposed mergers among the state's largest bank holding companies. To date, the most significant was the InterFirst/First United Bancorporation merger approved by the Federal Reserve Board in April. Since that time, other top tier banking organizations in the state have initiated similar merger proposals. Such mergers not only allow the organizations to make larger loans and thus more effectively serve large businesses, but also represent a repositioning of the industry to prepare for future developments in banking.

Cochran said that the Board's approval of the acquisition of PanNational Group by Mercantile Texas Corporation in December 1981 was the turning point. Originally denied because of possible adverse effects on probable future competition, Mercantile petitioned the U.S. Fifth Circuit Court of Appeals. The court directed the Board to make more specific findings of fact with respect to each of several issues if it is to deny an application on the basis of probable future competition. These issues address competition and concentration in the target market and potential entry into that market.

When analyzing mergers and acquisitions involving two organizations in the same market, the Board continues to use market share standards established by the Justice Department to evaluate probable future competition. However, the Board also is giving some weight to competition from savings and loan associations, nonbank financial organizations, and other institutions in analyzing these cases. The Board often is willing to accept divestitures of banks or branches in the market to resolve competitive problems.

According to Cochran, the Mercantile/PanNational court decision created a legal environment more conducive to mergers. "The large number of large bank holding companies in Texas with expansion capabilities is the primary factor," Cochran said. Eventually, however, the point could be reached where this environment no longer exists. Hankins agrees: "As we have more and more consolidations at the top level, the number of potential entrants into a given market will diminish."

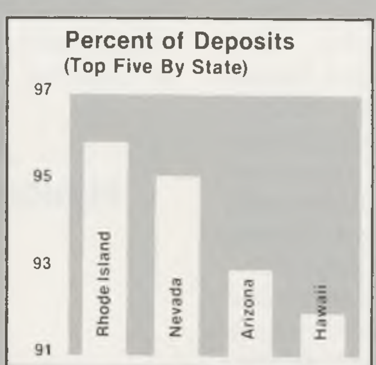
In spite of all the proposed merger activity in Texas, concentration of bank deposits in a few organizations does not appear to be a problem to the Board at this time, Hankins says. The top five multibank holding companies in the state, for example, have 261 subsidiary banks (July 1983) with over $54 billion in deposits (year-end 1982) representing 45.28 percent of the state's deposits. With all pending acquisitions taken into account, those five companies would have 302 subsidiaries, over $60 billion in deposits, and 50.39 percent of the state's total deposits. Compared to other states, however, these concentration levels are not high (see box).

And, while there are certain advantages to the large organizations that are created by mergers, small independent banks will continue to exist and be successful. "These banks have a place in the industry," Cochran said. "There is a market for that kind of bank. Some people do not want to do business with a large organization."

Fertile Ground for Mergers

Texas appears to be a state where merger activity is thriving among large bank holding companies. According to Dallas Fed Senior Vice President George C. Cochran and Assistant Vice President Robert D. Hankins, other states where such activity is taking place include Florida, Pennsylvania, and, to a certain extent, Illinois.

Texas may be fertile ground for multibank holding company mergers and acquisitions because, in a state which does not allow branch banking, there is no other means for a bank to expand into new markets. Illinois is another unit banking state, and Pennsylvania allows only limited branching. Both states recently have passed legislation permitting multibank holding companies and both are experiencing a high level of merger and acquisition activity.



In addition, Texas has a large number of banking organizations and is not highly concentrated. With 1,154 such organizations in the state (year-end 1982), Texas ranks second only to Illinois for having the most. Texas ranks 32nd among the 50 states and the District of Columbia in terms of the percent of deposits held by the five largest banking organizations. Illinois, Pennsylvania, and Florida each have over 300 banking entities and do not rank among the most concentrated of the states.

The states with the highest concentration of bank deposits held by the five largest organizations each have over 90 percent of deposits held by these organizations (see graph). However, three of these states—Rhode Island, Nevada, and Hawaii—have fewer than 20 banking organizations each. Arizona has 41. The four states with less than 20 percent of deposits held by the five largest organizations—Kansas, West Virginia, Arkansas, and Louisiana—each have over 200 banking organizations.

Return Item Pilot Continues

The Federal Reserve Bank of Dallas has received approval to implement the second phase of the return item pilot program which began on February 24, 1983. The second phase will be divided into two parts—Phase IIA and IIB. During Phase IIA, Eleventh District offices will continue to accept only those items originally presented for collection through Federal Reserve Banks. Effective October 3, however, items will be returned directly to the institution of first deposit if located within the Eleventh District. Otherwise, the items will be returned to the Reserve Bank of last endorsement. Telephone notification will continue to be provided on nonpayment of all returns of $2,500 or more, but will be provided directly to the financial institution of first deposit.

Price break

In Phase IIA, the Dallas Fed will introduce a price break of 25 cents per item for returns deposited that are prepared for automated processing.

Phase IIA is expected to be completed by the first quarter of 1984. At that time, implementation of Phase IIB will involve the acceptance of returns endorsed by Eleventh District institutions whether or not the items were originally presented for collection through the Federal Reserve System.

Service benefits

The return item service offers financial institutions several benefits such as a reduced sorting burden for returns, immediate credit for qualified return items deposited with the Dallas Fed, expedited collection of return items, reduced risk of loss because of notification of all large return items, and reduced costs for other check processing services. After successful completion of the return item pilot program in the Eleventh District, a similar nationwide program is planned.

Penalties Lifted

The Board of Governors has granted a temporary suspension of early withdrawal penalties associated with Regulation Q for depositors who have incurred losses as a result of Hurricane Alicia. This action permits any member bank to pay a time deposit before maturity to depositors in Brazoria, Chambers, Fort Bend, Galveston, Harris and Matagorda counties (retroactive to August 19, 1983) and in Liberty, Montgomery and San Jacinto counties (retroactive to August 29, 1983). The action is effective until midnight, February 18, 1984.

Depositors seeking to withdraw time deposit funds must submit a signed statement, approved by an officer of the bank, describing the disaster-related loss.

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