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Expansion and Performance of Multibank Holding Companies in Texas

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With branch banking prohibited in Texas, an increasing number of banks have formed multibank holding companies (MBHC's) as a means to expand their market area and accommodate growing demand for banking services. While the holding company device for controlling and managing banks is not new, its use has increased tremendously in Texas in the past decade. At the start of 1969, there were only three registered MBHC's in the state, with their 20 associated banks holding less than 6 percent of the state's total bank deposits.[1] In 1970, amendments to the Bank Holding Company Act not only eliminated many advantages of the one-bank holding company form many large Texas banks had been using but also encouraged chain-banking groups to register as multibank holding companies in order to continue operating as a group. As a result, by December 1978, 34 MBHC's had been formed, with 277 subsidiary banks and 55 percent of the state's deposits.[2]

When assessing the significance of this growth and its impact on Texas banking, it is important to realize that much of the apparent growth of the MBHC's resulted from formalization of chain-banking groups that had been operating prior to the changes in legislation in 1970. However, the rapid growth of the MBHC's has led to concern about the possibility of excessive concentration in banking in Texas. The primary reason for this concern is the allegation that the holding companies give considerable economic power to a relatively small number of banks. It is feared that acquisitions by holding companies in the major banking markets could reduce competition and allow the remaining firms to adopt practices that benefit themselves at the expense of the public.[3]

This article analyzes the effect of MBHC acquisitions on bank deposit concentration in Texas and on the performance of the acquired banks. The measures of deposit concentration show that although MBHC acquisitions have increased statewide deposit concentration, Texas banking re-

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1. An associated bank is defined here as a bank in which 5 percent or more of the outstanding stock is held by a registered holding company.

2. In this article, unless otherwise stated, numbers of holding companies and banks are based on approvals granted through December 1978; deposit data are from the June 1978 call report of condition and include domestic deposits only.

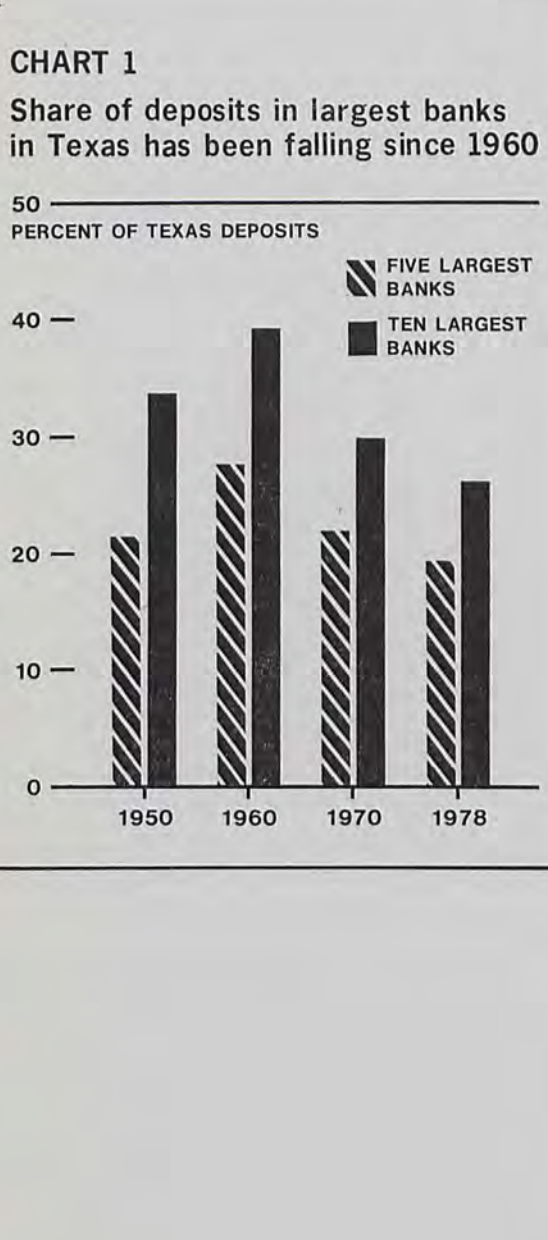
3. The U.S. Department of Justice has held the view that high concentration of state deposits adversely affects competition, and it has sought to limit the expansion of MBHC's by market extension. The Justice Department has brought several suits to adjudicate the issue but has not won a banking case on the grounds of statewide concentration alone. Also, several states have placed limits on the growth of MBHC's. In Texas the Independent Bankers Association supported a bill before the state legislature that would have limited any one MBHC to a maximum of 8 percent of the total deposits in the state.

mains among the least concentrated in the nation. Furthermore, in local markets, where deposit concentration has a greater potential effect on bank performance, deposit concentration has declined even though the MBHC's have been acquiring banks.

The performance of banks can be measured by the prices they charge and the services they provide, the type of assets they acquire, their efficiency and profitability, and their soundness. In this article, acquired banks are compared with nearby independent banks of similar size to determine how acquisition by holding companies affected their performance. The analysis indicates that banks owned by MBHC's in Texas perform about the same as independent banks. The main difference is that the holding company subsidiaries apparently maintain somewhat higher capital ratios, presumably because of the insistence of the Federal Reserve, whose approval must be obtained for any bank acquisition.

CHART 1

Share of deposits in largest banks in Texas has been falling since 1960



Statewide banking concentration

As is true with most other unit-banking states, Texas has a large number of small banks but relatively few large banks. As of June 30, 1978, there were 1,389 banks in Texas, which was nearly 10 percent of the total number of banks in the United States. Almost two-thirds of the Texas banks held deposits of less than $25 million. Only 90 banks in Texas held deposits of more than $100 million, and only 6 of these held deposits over $1 billion. However, these two groups of large banks held 53 percent and 21 percent, respectively, of the state's total bank deposits. All but 3 of the 90 banks are located in the state's 25 standard metropolitan statistical areas (SMSA's). Moreover, 41 of the 90, including the 12 largest, are in the three largest SMSA's—Dallas-Fort Worth, Houston, and San Antonio. By contrast, most of the banks with less than $25 million in deposits are located outside the SMSA's.

Chart 1 shows bank deposit concentration for individual banks in Texas as a whole from 1950 to 1978. As measured by the percentage of domestic deposits in the five and ten largest banks in the state, concentration increased from 1950 to 1960 but declined thereafter. The largest banks in Texas, as the chart shows, held a smaller proportion of the state's total deposits in 1978 than in 1950.

To put into perspective the proportion of deposits in Texas held in the largest MBHC's in 1978, it

is useful to compare their deposits at that time with those held in the state's chain-banking groups at the end of 1970, when the movement to convert the groups to the MBHC form started.[4] In 1970 the five largest banking organizations in the state held 27.5 percent of total deposits; in 1978 the five largest MBHC's held 34.9 percent of total deposits. The share held by the ten largest organizations increased from 37.4 percent in 1970 to 47.5 percent in 1978.

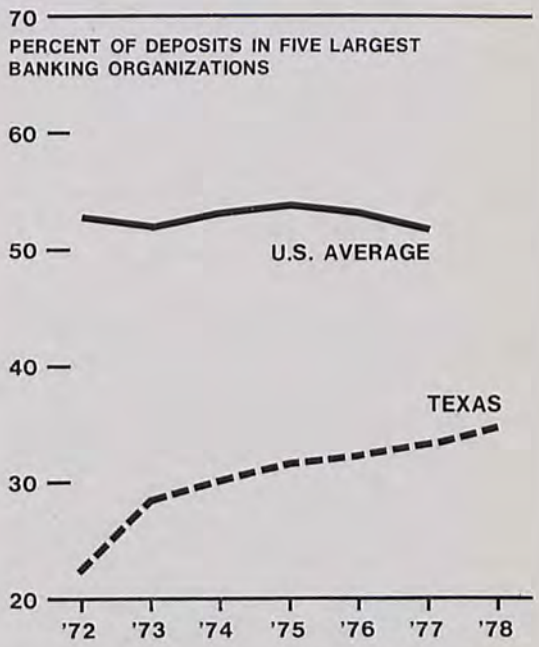
Although MBHC growth has concentrated a greater share of deposits in fewer banking organizations, Texas banking remains among the least concentrated in the country. As measured by the share of domestic deposits held in the five largest banking organizations in a state, Texas ranks 40th among the 50 states and the District of Columbia in the level of deposit concentration. Chart 2 compares the percentage of deposits in the five largest banking organizations in Texas with the average for the United States. Since 1972 the U.S. average has fluctuated between 52 and 54 percent. The percentage for Texas has been rising, but it remains well below the U.S. average. In 1978 the five largest MBHC's in Texas held less than 35 percent of the state's deposits.

As measured by the share of domestic deposits held in the five largest banking organizations in a state, Texas ranks 40th among the 50 states and the District of Columbia in the level of deposit concentration.

The increase in the concentration of deposits in Texas was due entirely to acquisitions by the MBHC's between 1970 and 1978. If the 1978 concentration ratio is adjusted for acquisitions made by the MBHC's after 1970, the resulting adjusted ratio for the five largest MBHC's is 14 percent, suggesting that concentration would have decreased after 1970 in the absence of the acquisitions. The adjusted ratio for the ten largest MBHC's is 19

CHART 2

Bank deposit concentration in Texas remains lower than in other states



SOURCES: Board of Governors, Federal Reserve System.
Federal Deposit Insurance Corporation.
Federal Reserve Bank of Dallas.

4. For a discussion of these chain-banking systems in Texas, see William H. Kelly, "Bank Structure—Consolidation of Banks Reshaping Texas Markets," *Business Review*, Federal Reserve Bank of Dallas, January 1972.

Table 1

GROWTH OF LARGE MULTIBANK HOLDING COMPANIES IN TEXAS

	Five largest MBHC's			Ten largest MBHC's		
	Subsidiary banks			Subsidiary banks		
		Total deposits			Total deposits	
Year	Number Dec. 31	June 30 (Millions of dollars)	Percent of state deposits	Number Dec. 31	June 30 (Millions of dollars)	Percent of state deposits
1972 . . .	[1]47	$ 6,827	22.5	[1]63	$ 9,432	31.0
1973 . . .	64	9,902	28.5	89	13,566	39.0
1974 . . .	86	11,760	30.2	127	16,221	41.7
1975 . . .	97	13,726	31.7	141	18,363	42.4
1976 . . .	[2]101	15,430	32.1	[2]156	21,176	44.0
1977 . . .	109	17,758	33.1	170	24,460	45.6
1978 . . .	125	21,744	34.9	188	29,618	47.5

1. As of March 30, 1973.
2. As of March 31, 1977.
NOTE: Prior to 1972, there were fewer than five MBHC's in Texas.

percent, also indicating a decrease in concentration without acquisitions. The primary reason for this decrease is that deposits in the very largest banks, which account for the biggest part of the deposits in MBHC banks, have not grown as fast as deposits in small- and medium-size banks in the state. This, of course, could have been one of the main incentives for forming the MBHC's.

MBHC's and the state's major banking markets

By almost any measure, the most important banking markets in Texas are located in its 25 standard metropolitan statistical areas. These metropolitan centers contain over 55 percent of all commercial banks in Texas and about 83 percent of total deposits. The SMSA's of Texas are also among the state's fastest growing areas. Total population in these areas rose more than 20 percent from 1970 to 1976, while population in the rest of the state rose less than 12 percent. The growth of Texas metropolitan areas has been somewhat uneven, however, with the larger SMSA's generally experiencing the most rapid gains. And reflecting these differences in growth, the greatest increases—both absolutely and relatively—in new banks have generally occurred in the fastest growing population centers.

Multibank holding company systems in Texas are concentrated in the metropolitan areas, especially in the largest population centers. Table 2 shows the number and relative importance of MBHC's in Texas metropolitan areas. Of the banks in such areas, 230—about 30 percent—are subsidiaries of MBHC's. These 230 banks hold about 64 percent of total metropolitan deposits. By contrast, there are only 47 subsidiaries of MBHC's outside SMSA's, comprising about 8 percent of all non-SMSA banks. And these 47 banks hold only about 15 percent of deposits outside SMSA's.

Multibank holding companies are present in all but two of the SMSA's but are concentrated in the state's largest population centers—Dallas, Fort Worth, Houston, and San Antonio. Of the 34 MBHC's registered in Texas, 16 are headquartered in these four metropolitan areas. Twenty MBHC's operate a total of 156 subsidiaries in these areas, or about a third of the area banks. Their banks hold about 72 percent of the area deposits.

Despite the growth of MBHC's, deposit concentration in Texas metropolitan areas, as measured by a three-bank concentration ratio, has declined considerably. Table 3 presents the percentage of deposits held by the three largest banks in each metropolitan area, ignoring the effect of MBHC subsidiaries. From 1960 to 1978, this measure of deposit concentration declined in all but one of the areas. On average, it dropped 15 percentage points during that period, from about 78 percent in 1960 to 63 percent in 1978.

Changes in concentration varied significantly among the SMSA's, with the greatest declines generally occurring in the largest- and moderate-size metropolitan areas. For the four largest areas, the concentration ratios declined, on average, by 21 percentage points.

Table 2

MULTIBANK HOLDING COMPANIES IN TEXAS METROPOLITAN AREAS

Population size[1] and standard metropolitan statistical area	Number of MBHC's Dec. 31, 1978	Subsidiary banks of MBHC's: Number Dec. 31, 1978	Subsidiary banks of MBHC's: Number Percent of total area banks	Subsidiary banks of MBHC's: Total deposits June 30, 1978 (Millions of dollars)	Subsidiary banks of MBHC's: Total deposits Percent of total area deposits
500,000 and over					
Dallas[2]	12	44	31.4	$ 9,043	74.3
Fort Worth[2]	9	20	37.0	3,097	79.5
Houston	13	73	37.1	10,882	69.8
San Antonio	7	19	35.8	2,325	68.1
100,000 to 499,999					
Abilene	2	4	23.5	355	50.4
Amarillo	1	1	10.0	148	15.2
Austin	6	7	18.9	1,750	77.3
Beaumont-Port Arthur-Orange	6	11	39.3	859	67.3
Brownsville-Harlingen-San Benito	3	3	23.1	362	63.1
Corpus Christi	5	5	19.2	604	55.5
El Paso	4	12	57.1	1,149	85.8
Galveston-Texas City	2	2	11.8	248	39.8
Killeen-Temple	4	6	33.3	145	32.8
Longview	3	3	17.6	202	34.5
Lubbock	1	1	8.3	124	11.0
McAllen-Pharr-Edinburg	1	1	5.3	112	15.9
Midland and Odessa	5	5	50.0	574	50.3
Texarkana[3]	1	3	37.5	110	53.7
Tyler	0	0	—	—	—
Waco	2	3	18.8	199	32.8
Wichita Falls	2	3	25.0	432	70.7
50,000 to 99,999					
Bryan-College Station	1	1	16.7	69	24.9
Laredo	0	0	—	—	—
San Angelo	2	2	33.3	207	51.1
Sherman-Denison	1	1	7.7	55	16.2

1. Census estimates for 1976.
2. Ranally Metro. Area (RMA) defined by Rand McNally & Company.
3. Texas portion only.

These figures do not, however, take into account the effect of MBHC acquisitions on the structure of the banking markets. The effect of this activity can be gauged with a measure of concentration that treats all subsidiaries of a single MBHC within a metropolitan area as a single banking firm. In this manner, the concentration of deposits in the three largest banking organizations in each area is measured in 1978.

As shown in Table 4, taking the MBHC subsidiaries into account boosted the concentration ratio in ten of the metropolitan areas, with most of the effect concentrated in the larger areas. Across all the areas, the concentration ratio in 1978 was 2 percentage points higher on average than if there had been no MBHC subsidiaries. In the four largest metropolitan areas, where the effect of MBHC acquisitions has been greatest, the concentration ratio averaged 7 percentage points higher.

By this measure, the effect of the MBHC movement has been to increase deposit concentration in Texas SMSA's. The effect, however, is small, especially when the 1978 concentration ratios for banking organizations are compared with earlier three-bank concentration ratios. The average concentration ratio for Texas SMSA's in 1978 remains 5 percentage points less than it was in 1970 even when the MBHC subsidiaries are included in the 1978 ratio. And the average concentration ratio is nearly 14 percentage points less than in 1960.

In the ten metropolitan areas in which deposit concentration has been affected by MBHC acquisitions, the average 1978 deposit concentration ratio is boosted about 6 percentage points, from 59 percent to 65 percent, when the effect of the acquisitions is included. But even so, the 1978 concentration ratio averages 3 percentage points lower in these areas than it was in 1970 and 13 percent-

Table 3

BANK DEPOSIT CONCENTRATION IN TEXAS METROPOLITAN AREAS

Population size[1] and standard metropolitan statistical area	Percent of area deposits in three largest banks[2]			Change	
	1960	1970	1978	1978 from 1960	1978 from 1970
500,000 and over					
Dallas[3]	77.4	62.6	55.7	-21.7	-6.9
Fort Worth[3]	76.9	62.4	55.8	-21.1	-6.6
Houston	58.4	46.0	39.5	-18.9	-6.5
San Antonio	68.3	52.0	46.4	-21.9	-5.6
100,000 to 499,999					
Abilene	79.5	77.8	70.8	-8.7	-7.0
Amarillo	91.3	83.3	80.9	-10.4	-2.4
Austin	89.3	73.2	58.4	-30.9	-14.8
Beaumont-Port Arthur-Orange	56.6	53.9	43.6	-13.0	-10.3
Brownsville-Harlingen-San Benito	69.6	67.6	63.1	-6.5	-4.5
Corpus Christi	69.6	57.3	50.8	-18.8	-6.5
El Paso	90.4	80.3	70.5	-19.9	-9.8
Galveston-Texas City	66.5	49.1	50.1	-16.4	1.0
Killeen-Temple	—	61.5	50.3	—	-11.2
Longview	—	—	39.8	—	—
Lubbock	79.4	72.1	70.7	-8.7	-1.4
McAllen-Pharr-Edinburg	44.6	45.7	50.0	5.4	4.3
Midland and Odessa	73.6	73.9	68.1	-5.5	-5.8
Texarkana[4]	90.5	86.3	77.4	-13.1	-8.9
Tyler	93.9	84.1	72.7	-21.2	-11.4
Waco	83.5	72.7	66.8	-16.7	-5.9
Wichita Falls	92.2	84.4	76.2	-16.0	-8.2
50,000 to 99,999					
Bryan-College Station	—	82.5	68.6	—	-13.9
Laredo	100.0	100.0	95.0	-5.0	-5.0
San Angelo	100.0	90.9	86.3	-13.7	-4.6
Sherman-Denison	74.3	66.1	57.8	-16.5	-8.3

1. Census estimates for 1976.
2. Calculated from December call report data for 1960 and 1970 and June data for 1978.
3. The 1978 figures are for the Ranally Metro. Area (RMA) defined by Rand McNally & Company. As of April 1973, Dallas and Fort Worth were combined into one SMSA.
4. Texas portion only.

age points lower than in 1960. The reductions in the ratios indicate that the concentration of deposits in local markets in Texas has been decreasing despite aggressive acquisition activity by the Texas MBHC's.

The conclusion that deposit concentration is less than it was in the past holds true even in the state's four largest metropolitan centers, where MBHC acquisition activity has been greatest. The average concentration ratio for the largest metropolitan areas is about the same as it was in 1970 and is about 14 percentage points lower than in 1960.

The concentration of deposits in local markets in Texas has been decreasing despite aggressive acquisition activity by the Texas MBHC's.

Effect of holding company acquisitions on bank performance in Texas

To measure the effect of holding company acquisition on banks in Texas, each of 42 subsidiary banks of the state's ten largest multibank holding companies was paired with an independent bank of similar size in the same banking market. By comparing the performance of the holding company banks and similar independent banks, it is possible to separate the effect of acquisition from other factors that influence performance.

The subsidiary banks were acquired by holding companies between July 1971 and October 1975. The performance of each bank was measured by 20 operating ratios. Data from December call reports were collected for each bank to calculate the ratios at two points in time: the year before acquisition of the acquired bank and the year 1976. To measure the difference in performance between the two types of banks, the ratio of the independent

bank was subtracted from the ratio of the holding company bank. The difference was calculated for both the year before acquisition and 1976. Finally, the change in this difference was calculated for each banking ratio to assess the effect of acquisition by a holding company on different aspects of bank performance. Any change in the difference in performance is attributed to the affiliation of the acquired banks with their holding companies.

For example, if the loan-asset ratios for a holding company bank and its paired independent bank were 49 percent and 50 percent, respectively, in the year before acquisition, the difference would be -1 percent. If by 1976 the values of the ratios rose to 56 percent and 53 percent, the difference would then be 3 percent. The 4-percentage-point increase in the difference is attributable to the acquisition by the holding company, on the assumption that any other factors that caused the loan-asset ratio to change affected both banks equally.

The average change in difference was calculated to gauge the effect of acquisition on the 42 acquired banks. To determine whether the effect is statistically significant, the average change was compared with its standard error, which is a measure of variability. That is, if the average change is large relative to its variability, then the change is considered significant and indicates that acquisition by holding companies affected the performance of the acquired banks.[5]

The 20 ratios analyzed here are divided into five general groups in Table 5: portfolio composition, bank expenses, prices and services, bank profitability, and bank capital. The average difference for each ratio before and after acquisition is presented in the table, along with the average change in the difference.

Bank portfolio composition. There are a number of ways one would expect the acquisition of banks by holding companies to affect the operation of the acquired banks. Since the banks in a holding company system have access to the greater financial resources of the holding company, they could be expected to acquire assets that are less liquid. Moreover, the assets held by the banks in a holding company system operating throughout a large region are more diversified than those of an independent bank operating in a single community. This diversification lowers risk, so one could expect holding company subsidiaries to assume somewhat greater portfolio risk than if they were unaffiliated.

As measured by the changes in the differences shown in Table 5, holding company acquisition did not have an important effect on the composition of the asset portfolios of the acquired banks in Texas. The first four ratios provide a measure of the overall liquidity and risk in bank portfolios. There were no significant differences between the two groups of banks in the year preceding acquisition, nor were there any significant changes by 1976. Although the holding company banks held significantly fewer U.S. Government securities in 1976, the changes in the differences were not statistically significant.

Texas holding company subsidiaries do not manage their asset portfolios in a manner substantially different from the way independent banks do.

The second set of portfolio ratios measures bank investment in four major types of loans: residential real estate loans, farm loans, business loans, and consumer loans. There were no significant differences between the two groups of banks before or after acquisition.

The ratios indicate that Texas holding company subsidiaries do not manage their asset portfolios in a manner substantially different from the way independent banks do. This may reflect a similarity of management goals, with management of both independent banks and holding company banks being equally profit-oriented and risk-averse. It may be that holding company affiliation, at least in Texas, does not change management's perception of asset risk.

The ratios indicate also that holding company banks make about as much credit available to their local communities as do independent banks. The smaller ratio of Government securities for holding company banks could mean more funds are available for loans, and the lack of change in consumer credit and farm loans suggests that the Texas holding company banks and independent banks meet local credit needs about equally well.

5. More specifically, any average change that is more than twice its standard error is considered statistically significant—that is, significantly different from zero at the 95-percent confidence level. (For 42 observations, a t value of 2.02 corresponds to a 95-percent level of significance.)

Table 4

EFFECT OF MULTIBANK HOLDING COMPANY ACQUISITIONS ON BANK DEPOSIT CONCENTRATION IN TEXAS METROPOLITAN AREAS

Population size[1] and standard metropolitan statistical area	Percent of area deposits June 30, 1978		
	Three largest banks	Three largest banks or bank groups	Difference
500,000 and over			
Dallas[2]	55.7	61.4	5.7
Fort Worth[2]	55.8	65.8	10.0
Houston	39.5	46.0	6.5
San Antonio	46.4	51.9	5.5
100,000 to 499,999			
Abilene	70.8	76.6	5.8
Amarillo	80.9	80.9	.0
Austin	58.4	59.0	.6
Beaumont-Port Arthur-Orange	43.6	49.9	6.3
Brownsville-Harlingen-San Benito	63.1	63.1	.0
Corpus Christi	50.8	50.8	.0
El Paso	70.5	79.9	9.4
Galveston-Texas City	50.1	50.1	.0
Killeen-Temple	50.3	50.3	.0
Longview	39.8	39.8	.0
Lubbock	70.7	70.7	.0
McAllen-Pharr-Edinburg	50.0	50.0	.0
Midland and Odessa	68.1	68.1	.0
Texarkana[3]	77.4	82.3	4.9
Tyler	72.7	72.7	.0
Waco	66.8	66.8	.0
Wichita Falls	76.2	79.7	3.5
50,000 to 99,999			
Bryan-College Station	68.6	68.6	.0
Laredo	95.0	95.0	.0
San Angelo	86.3	86.3	.0
Sherman-Denison	57.8	57.8	.0

1. Census estimates for 1976.
2. Ranally Metro. Area (RMA) defined by Rand McNally & Company.
3. Texas portion only.

Bank expenses. It is not clear whether holding company affiliates should have higher or lower operating costs than independent banks. Economies of scale accruing from integrating many operations of the subsidiary banks could increase the operating efficiency of the banks and thereby lower their operating costs. On the other hand, if being part of a holding company enables the banks to reduce their holdings of securities and increase their loan portfolio, their costs may rise. Administering loans is more costly than buying and holding Government securities.

Table 5 presents two ratios intended to measure the overall operating efficiency of the banks: total operating expenses/total operating income and total operating expenses/total assets. Neither ratio indicates a significant difference between the two groups of banks before acquisition. Although the ratio of operating expenses to operating income was lower for the holding company banks in 1976, the change in the difference between the two groups was not significant.

Prices and services. Even if the Texas holding company subsidiaries have lower operating costs, it is not obvious whether these banks would set higher or lower prices for their services. On the one hand, lower costs would enable them to charge lower prices in an attempt to expand their market. On the other hand, if being part of a holding company increased their market power, they conceivably could charge higher prices without loss of market position.

Table 5

PERFORMANCE OF TEXAS HOLDING COMPANY BANKS RELATIVE TO PAIRED INDEPENDENT BANKS

Ratio	Average difference between holding company banks and independent banks[1] (Percent)		Average change in difference[2]
	Year preceding acquisition	1976	
Bank portfolio composition			
Cash and due from banks/total assets	1.52	−0.08	−1.60
	(.82)	(.74)	(.95)
U.S. Government securities/total assets	−.38	−3.51*	−3.13
	(1.78)	(1.52)	(1.89)
State and municipal securities/total assets	−.37	1.69	2.06
	(1.00)	(1.16)	(1.30)
Total loans, gross/total assets	−.34	2.36	2.70
	(1.95)	(1.34)	(1.58)
Residential real estate loans/total assets	−1.05	−.73	.32
	(.63)	(.50)	(.69)
Farm loans/total assets	.18	−.17	−.35
	(.33)	(.26)	(.26)
Business loans/total assets	−.51	3.13	3.63
	(2.31)	(1.60)	(1.81)
Consumer loans/total assets	.25	.57	.31
	(1.95)	(1.53)	(1.45)
Bank expenses			
Total operating expenses/total operating income	−5.33	−6.48**	−1.15
	(3.31)	(2.18)	(3.36)
Total operating expenses/total assets	−.35	−.33	.03
	(.26)	(.17)	(.25)
Other expenses/total assets	−.03	.03	.06
	(.08)	(.06)	(.08)
Interest on deposits/total assets	−.05	−.18*	−.13
	(.09)	(.08)	(.09)
Salaries and employee benefits/total assets	−.05	−.02	.04
	(.06)	(.06)	(.06)
Prices and services			
Service charges/demand deposits of individuals, partnerships, and corporations	−.19	−.15	.05
	(.16)	(.15)	(.08)
Interest on deposits/time and savings deposits	.01	−.13	−.14
	(.16)	(.08)	(.16)
Interest and fees on loans/total loans, gross	.10	.20	.10
	(.16)	(.16)	(.20)
Bank profitability			
Net income/total assets	.23	.23*	.00
	(.18)	(.11)	(.19)
Net income/equity capital	3.47	1.38	−2.09
	(2.50)	(1.30)	(2.50)
Bank capital			
Equity capital/total assets	−.11	.86**	.97**
	(.31)	(.24)	(.29)
Equity capital/total deposits	−.20	1.01**	1.20**
	(.38)	(.28)	(.35)

1. Calculated from December call report data.
2. The 1976 difference less the difference for the year preceding acquisition.
* Significantly different from zero at 95-percent level of confidence.
** Significantly different from zero at 99-percent level of confidence.
NOTE: Figures in parentheses are standard errors of the averages.

The ratios in Table 5 measure three price variables: service charges, interest paid on deposits, and interest charged on loans. As shown in the table, there were no significant differences between the two groups before acquisition, nor were there any significant changes by 1976.

Bank profitability. The ratios in Table 5 measure bank profitability as a return on assets and as a return on equity capital. Prior to acquisition, there were no significant differences between the two groups. By 1976 the sample of Texas holding company banks earned a higher rate of return on assets (possibly as a result of their lower holdings of U.S. Government securities), but the change in the difference was not significant.

Bank capital. It might be expected that holding company subsidiaries would have better capital positions than independent banks because holding companies generally have better access to capital markets. Alternatively, it could be presumed that the greater diversification attained by a holding company system would allow the subsidiary banks to maintain lower capital ratios. Hence, it is not clear whether banks affiliated with holding companies would have higher or lower capital ratios.

The capital ratios presented in Table 5 reveal no significant differences between the two groups of banks in the year preceding acquisition. By 1976, however, both capital ratios were significantly higher for Texas holding company subsidiaries. The change in the difference between the two groups before and after acquisition was also significant. After being acquired, Texas subsidiary banks strengthened their capital positions much more than did their paired independents.

Summary

Bank deposit concentration and bank performance in Texas have apparently been only slightly affected by the expansion of MBHC's in the past ten years. Although the impact of the holding companies may be significantly greater in the future, acquisitions by the holding companies have not reversed the trend toward less concentration of banking in the state's metropolitan areas. While deposit concentration in the state as a whole has increased because of the holding companies, Texas banking remains among the least concentrated in the country.

Operations of MBHC affiliates in Texas apparently are not significantly different from those of independent banks. An analysis of their asset portfolios indicates that the affiliates manage their assets no differently than independent banks. Fears that MBHC's use their affiliates to drain funds out of local communities by reducing consumer loans and farm loans appear to be unfounded. There do not seem to be significant differences between the prices and services, the expenses, or the profitability of holding company banks and those of independent banks. Affiliates of Texas MBHC's are apparently better capitalized than their independent counterparts.

Booklet Available on Open Market Operations

Open Market Operations, a booklet describing the making of monetary policy, is available, free of charge, from the Federal Reserve Bank of Dallas. Copies of the booklet, which explains the Federal Reserve's open market operations in U.S. Government securities, may be obtained from the Bank and Public Information Department of this Bank, (214) 651-6267.

Rules Changed for Money Market Certificates

Two changes have been made to reduce the cost incurred by financial institutions offering six-month money market certificates of deposit. The compounding of interest will not be permitted for certificates issued on or after March 15, 1979; and for certificates paying 9 percent or more, the extra 0.25 percentage point of interest that thrift institutions could pay on the certificates over what banks pay has been eliminated. The changes were adopted by the Federal Reserve Board, the Federal Home Loan Bank Board, the Federal Deposit Insurance Corporation, and the National Credit Union Administration.

The money market certificates, created last June to help maintain a flow of funds into mortgage markets, have been very popular. At the end of January, certificates outstanding at the nation's financial institutions totaled $104.4 billion. The certificates are time deposits of $10,000 or more with maturities of 182 days, whose ceiling rate of interest at banks is equal to the discount rate (auction average) on the most recently issued six-month U.S. Treasury bills.

For further information, contact the Consumer Affairs Division of this Bank, (214) 651-6171.

"Fed Quotes"

Brief Excerpts from Recent Federal Reserve Speeches, Statements, Publications, Etc.

"In my opinion the first and foremost threat to the economic, financial and political power of the United States is the high and rising rate of inflation. History tells us that when people begin to spend their money at an accelerating velocity and seek new investment havens from inflation, even at the risk of borrowing beyond their means, their nation is approaching the danger point of runaway inflation and serious deterioration in the value of their currency. I think we are traveling this road and without firm action to combat inflation we may suffer the ultimate consequences. None of us want a serious recession with its financial and social penalties. Nor do we want the traumatic experience of a severely depreciating currency. So our only real choice is to force a slowdown in credit extensions and real growth rates until the acceleration and expectations of inflation subside."

"In my opinion the United States is rapidly approaching full utilization of its resources, unsustainable consumer demands, accelerating inflation and threatened further exchange market turmoil. If I am correct, then action will be forced upon us whether we like it or not. The most extreme actions could include mandatory wage and price controls, an allocative credit policy, import surcharges or quotas, limits on foreign lending and other exchange controls. But such extreme measures are incompatible with the basic philosophy of U.S. policy. We attempt to operate in a free market system, both at home and abroad, and would accept such draconian measures only under the most severe conditions. But to insure that such conditions do not develop requires a high degree of self discipline and an intensive use of the aggregate restraints of monetary and fiscal policy."

"I have a list of government actions which I think are needed to stabilize our financial affairs. Among these are:

"1. Creating a new energy program to stimulate production of oil and gas and develop new sources of energy.
"2. Making a further cut in government spending by at least $20 billion beyond that proposed in the budget document.
"3. Eliminating ceilings on interest rates so that savings will be encouraged and subsidies to borrowers discouraged.
"4. Creating new U.S. inflation bonds with 9 percent interest in $1,000 denominations.
"5. Encouraging capital investment by rapid write-offs and capital gains tax reductions.
"6. Imposing reserve requirements on all deposits for all depository institutions and restricting availability of credit.
"7. Encouraging wage moderation by limiting minimum wage increases and creating a teenage minimum.
"8. Enforcing anti-dumping laws and countering foreign export subsidies.

"In summary, in my opinion we must pull together to solve this nation's inflationary problem and restore our country's financial health."

Philip E. Coldwell, Member, Board of Governors of the Federal Reserve System
(At Atlanta, Georgia, February 15, 1979)

"Our chances of solving the problem of inflation would also be enhanced if we can slow the growth of Federal spending and thereby reduce the size of the government sector in the economy. This would do much to improve the climate for private capital formation. The modification of our tax structure to encourage saving and investment would have a similar salutary effect."

G. William Miller, Chairman, Board of Governors of the Federal Reserve System (Before the Committee on the Budget, U.S. House of Representatives, January 25, 1979)

"The recent, low rate of productivity growth adds a more serious dimension to our inflation problem. Demands for the type of real income gains achieved a decade ago are inconsistent with current productivity trends. Pressures to achieve unrealistically large increases in real incomes in the face of slow productivity growth threaten to result in an escalation of inflation. Moreover, even if real wage demands are brought into line with productivity, inflation will not automatically diminish. Forceful efforts additionally must be made to break into the vicious circle in which prices determine wages and wages determine prices."

Henry C. Wallich, Member, Board of Governors of the Federal Reserve System (Before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, February 8, 1979)

"Some years ago, it was widely believed that stable economic growth was assured. Productivity would advance steadily, work effort could be relaxed as man increasingly relied upon the machine. Shorter hours, longer vacations, higher wages, less discipline and effort devoted to the chores of production seemed to be the road of the future. Experience since has taught us that hard work is still necessary, that progress comes slowly, and that facile belief in easy solutions brings diminishing productivity, rising inflation, and declining quality of output. These tendencies must be reversed if economic progress is to be achieved."

Henry C. Wallich, Member, Board of Governors of the Federal Reserve System (At Lisbon, Portugal, February 14, 1979)

Expanded Powers for Edge Act Corporations Proposed by the Fed

Regulation changes that would greatly expand the powers of Edge Act corporations, corporations engaged in international banking and finance, have been proposed for public comment by the Board of Governors of the Federal Reserve System. The changes, implementing portions of the International Banking Act of 1978, would permit Edge corporations to compete more effectively with foreign banks in the United States and abroad and would provide more banking services to help promote exports. The final regulation must be issued by June 14, 1979.

The proposed revisions would allow Edge corporations, for the first time, to offer a full range of deposit and other banking services to customers that have more than two-thirds of their purchases or sales in international commerce. Currently, every transaction by a U.S customer with an Edge corporation must be directly related to international commerce.

In addition, the corporations would be allowed to finance the production of goods in the United States for export. Currently, they may finance only the shipment and storage of goods for export.

The proposals would allow Edge corporations to establish branches across the United States. Under current regulations, they may only establish branches abroad.

Under the proposals, investment procedures of Edge corporations would be simplified. Specific prior approval by the Board of Governors would no longer be necessary for investments of up to $2 million in foreign subsidiaries and joint ventures in certain permissible activities.

The existing limitation on the aggregate liabilities of Edge corporations (currently, ten times capital and surplus) would be changed. The units would be required, instead, to have capital and surplus of not less than 6 percent of total assets.

Other major proposed changes affecting the Edge corporations would allow foreign ownership, permit transactions in Federal funds, and lift requirements for prior Board approval for long-term borrowings.

These sweeping changes would amend Regulation K, Corporations Engaged in Foreign Banking and Financing Under the Federal Reserve Act, and Regulation M, Foreign Activities of National Banks. The two regulations would be revised and combined in a single comprehensive regulation entitled "International Banking Operations."

New member banks

Texas National Bank of Midland, Midland, Texas, a newly organized institution located in the territory served by the El Paso Branch of the Federal Reserve Bank of Dallas, opened for business March 23, 1979, as a member of the Federal Reserve System. The new member bank opened with capital of $1,000,000 and surplus of $1,000,000. The officers are: John L. Cox, Chairman of the Board; William J. Mewhorter, President; Charles Danley, Executive Vice President; and Jerry Foote, Vice President and Cashier.

Texas Commerce Bank–Katy Freeway, National Association, Katy, Texas, a newly organized institution located in the territory served by the Houston Branch of the Federal Reserve Bank of Dallas, opened for business April 2, 1979, as a member of the Federal Reserve System. The new member bank opened with capital of $850,000 and surplus of $850,000. The officers are: G. M. Jinks, President and Chief Executive Officer; Ronald C. Whetsell, Vice President; and Greg Murray, Vice President and Cashier.

New nonmember banks

American Bank of Arlington, Arlington, Texas, a newly organized insured nonmember bank located in the territory served by the Head Office of the Federal Reserve Bank of Dallas, opened for business March 22, 1979.

Bank of Pasadena, Pasadena, Texas, a newly organized insured nonmember bank located in the territory served by the Houston Branch of the Federal Reserve Bank of Dallas, opened for business April 2, 1979.

1979 Bank Telephone Directory Available

The 1979 Directory for the Federal Reserve Bank of Dallas and its branches in El Paso, Houston, and San Antonio is now available, without charge. Copies of the directory may be obtained from the Bank and Public Information Department of this Bank, (214) 651-6261.

Regulatory Briefs

Review of Recent Actions of the Board of Governors of the Federal Reserve System

• **A NEW RATING SYSTEM FOR BANK HOLDING COMPANIES** has been adopted by the Board of Governors. The system, which closely resembles that currently used for banks and bank trust departments, rates bank holding companies on a scale of 1 (best) to 5 (worst) on the basis of the performance of bank and nonbank subsidiaries, the parent company, and consolidated earnings and capital. In addition to the numerical score, which reflects financial strength, each company also receives a letter rating evaluating its management. This is based on management's competence, leadership, administrative ability, depth, succession, experience, planning ability, internal controls, attitude toward risk, and knowledge of and compliance with the Bank Holding Company Act and related regulations. Questions about the rating system may be directed to the Bank Holding Company Inspection Division of this Bank, (214) 651-6258.

• **REGULATION V, LOAN GUARANTEES FOR DEFENSE PRODUCTION,** has been revised, effective February 20, 1979. The revisions simplified the language, included administrative rules not previously available in published form, increased the maximum rate of interest allowed on V-loans from 7½ percent to the rate currently charged on creditworthy loans of comparable maturity, and modified the fee scale for guaranteeing such loans. Although the loan guarantee program was important during World War II and later conflicts, the program has been used very little in recent years. Therefore, the Board is considering recommending legislative or other changes in the program and has invited comment through April 30 on whether the program should be restructured or eliminated.

• **RULES COVERING CHANGES IN CONTROL OF BANKS AND BANK HOLDING COMPANIES,** effective March 10, have been issued by the Board of Governors, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation. The rules, which implement the Change in Bank Control Act of 1978, generally require persons seeking control (10 percent or more) of a bank or bank holding company to file 60 days' advance notice with the appropriate supervisor. Questions about the rules should be referred to the Attorneys' Section of the Holding Company Supervision Department, (214) 651-6182.

• **RULES LIMITING A BANK'S EXTENSION OF CREDIT TO INSIDERS** have been adopted by the three Federal bank regulators. The rules place certain restrictions on extensions of credit to bank executive officers, directors, and principal shareholders and prohibit preferential treatment to insiders at correspondent banks. Reporting and disclosure requirements are also established for insured banks. The rules, required by the Financial Institutions Regulatory and Interest Rate Control Act of 1978, became effective March 10. However, because the final regulation published by the Board of Governors differs from the proposed regulation issued for public comment in December, comments on the proposed rules are still being reviewed.

• **ELECTRONIC FUNDS TRANSFER (EFT) REGULATIONS** have been adopted by the Board of Governors. Implementing the EFT Act, the rules limit consumer liability for unauthorized use of EFT cards, specify conditions for their unsolicited distribution, and include steps to bring outstanding cards under the rules. For further information, contact the Consumer Affairs Division, (214) 651-6171.

Money, Interest Rates, and Inflation

Excerpt from the 1978 Annual Report of the Governor, Bank of Canada, to the Minister of Finance

"Other things being equal, there is an inescapable interrelationship between changes in the quantity of money and changes in interest rate levels. The central bank cannot take action to affect the one without affecting the other. It is not possible, for example, for the Bank of Canada to exert increased restraint on the growth of the money supply without at the same time putting immediate upward pressure on interest rates. Similarly if the central bank takes action to raise the level of interest rates, such action is bound to put increased restraint on the growth of the money supply over time. The converse is also true. Central bank action to speed up monetary growth involves putting temporary downward pressure on short-term interest rates. Action to lower interest rates, or even to prevent them from rising in the face of an increase in total spending in the economy, will work only to the extent that monetary expansion accelerates.

"Whatever their object, however, central bank actions that have the effect of speeding up or slowing down the trend over time in the rate of growth of the money supply have longer run effects on the level of interest rates that can be quite the opposite of the effects produced in the short run. A stepped-up rate of monetary expansion that temporarily lowers interest rates will, if it is sustained, lead eventually to a higher rate of price increase than would otherwise have occurred. With money losing its value more rapidly, borrowers will be less reluctant to incur debt since they can repay in dollars of lesser value, while savers and lenders will for the same reason be more reluctant to provide loans. The consequence of rising inflation will thus be a growing excess demand for credit in relation to the supply which will put increasing upward pressure on interest rates. Thus the eventual result of letting the money supply grow too rapidly is not low interest rates but high interest rates.

"If a country wants to have and maintain low interest rates, there is no secret about how to achieve that. Monetary growth must be reduced until it is only just sufficient to finance the expansion in production that the economy is capable of achieving over the longer run without putting pressure on the over-all level of prices, and it must be kept there. The immediate effect of this policy will be to raise interest rates but the longer term effect will be to lower them. The low interest rate countries of the world are the ones that have had the greatest success over the years in resisting the temptation to allow inflationary pressure to be underwritten by excessive monetary expansion. The countries that have experienced less success in controlling the process of domestic monetary expansion have higher rates of inflation and higher interest rates."

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