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The Expansion of Banking in the Metropolitan Areas of the Southwest

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Banking expanded faster in the Southwest than in the United States during 1970-76. It also expanded faster in 1970-76 than in the previous six years. One obvious reason was the growth in the region's economy. However, the relationship between banking and economic growth has varied. After lagging behind income during 1964-70, bank deposits in two of the four states lying wholly or partly in the Eleventh Federal Reserve District increased faster than income in the 1970's. In the metropolitan areas in the four states—Louisiana, New Mexico, Oklahoma, and Texas—the relation of economic growth and banking expansion has also varied. In this article the diverse experiences of these southwestern metropolitan areas are explored. Two aspects in particular are analyzed: the expansion of bank deposits and the increase in the number of bank offices.[1]

1. In 1976, there were 37 standard metropolitan statistical areas in the four states, including Fort Smith, Arkansas-Oklahoma. Because its major city and a large share of its economic activity are in the Arkansas portion of this SMSA, Fort Smith has been excluded from the analysis. The 1976 definitions of the other 36 SMSA's are used throughout this article. The only change in the definitions since 1976 is the addition of Williamson County to the Austin SMSA. Las Cruces, New Mexico—defined as Dona Ana County—is covered in the analysis to add a second metropolitan area from New Mexico and another metropolitan area from a branching state. In SMSA's in Louisiana and New Mexico, bank offices include both banks and branches; in SMSA's in Oklahoma and Texas, where branches are prohibited, bank offices include only individual banks. Although Texarkana, Texas-Arkansas, includes two counties in Arkansas, where branching is permitted, this SMSA is considered a unit-banking SMSA in this article. Treating it as a branching SMSA does not significantly affect the results reported here.

As would be expected, economic growth was found to be the most important factor explaining the expansion of deposits. But it was not the most important factor explaining the increase in bank offices. The most important variable explaining the increase in bank offices was the number of bank offices per 100,000 persons. Bank offices increased fastest during 1970-76 in those standard metropolitan statistical areas (SMSA's) that had the fewest bank offices per 100,000 persons in 1970. Moreover, bank offices increased more rapidly in SMSA's with above-average net rates of return on bank assets.

The number of bank offices thus appears to have responded to a metropolitan area's potential to support new bank offices rather than to the current growth of its economy. An SMSA's market potential is presumed to be indicated by the number of bank offices per 100,000 persons and the net rate of return on bank assets.

Economic growth was found to be the most important factor explaining the expansion of deposits. But it was not the most important factor explaining the increase in bank offices.

In SMSA's in Louisiana and New Mexico, the two branch-banking states in the Eleventh District, the number of bank offices has been more responsive to economic growth and to the number of bank offices per 100,000 persons than in SMSA's in Oklahoma and Texas, reflecting the relative ease of establishing branches as compared with banks. Branches cost less to establish than banks

GROWTH OF PERSONAL INCOME, BANK DEPOSITS, POPULATION, BANKS, AND BANK BRANCHES IN ELEVENTH DISTRICT STATES AND UNITED STATES

Area	Average annual percent changes				
				Number of bank offices[1] December 31	
	Personal Income	Total bank deposits[1] June 30	Population	Banks	Banks and branches
1964-70					
Louisiana	8.5	8.9	0.7	1.7	5.8
New Mexico	6.4	7.5	.2	.8	4.9
Oklahoma	8.7	7.2	.7	.7	.7
Texas	9.3	7.1	1.2	1.0	1.0
United States	8.3	4.5	1.0	.0	3.8
1970-76					
Louisiana	11.1	12.8	1.0	1.7	6.1
New Mexico	12.1	14.8	2.4	3.7	6.9
Oklahoma	10.7	13.6	1.3	1.3	1.3
Texas	12.0	13.2	2.0	2.3	2.3
United States	9.5	10.2	.9	1.1	4.4

1. Insured commercial banks only.
SOURCES: Board of Governors, Federal Reserve System.
Federal Deposit Insurance Corporation.
U.S. Department of Commerce.
Federal Reserve Bank of Dallas.

and can be operated on a smaller scale. Moreover, the policies for chartering branches in branch-banking states are more liberal than the policies for chartering banks in unit-banking states. Deposit expansion, however, has not differed significantly between the two groups of SMSA's.

Growth of deposits

In this analysis, personal income is used as the measure of economic growth. Deposits are defined to include all categories of domestic deposits at commercial banks.

Deposits grew more than personal income in all but five SMSA's. Deposit growth was especially strong in the four SMSA's lying along the border with Mexico—Brownsville-Harlingen-San Benito, El Paso, Laredo, and McAllen-Pharr-Edinburg. The influx of foreign deposits associated with uncertainty over the value of the Mexican peso apparently explains some of the exceptional growth of deposits in these SMSA's. These four areas, therefore, were not included in the regression analysis of the expansion of deposits.

In the 33 nonborder SMSA's, a 10-percent growth of personal income was associated, on average, with a 9-percent expansion of deposits. (See the accompanying Appendix for analysis.) Apparently, deposit growth lags personal income somewhat; deposit growth was greater over 1970-76 in those SMSA's with lower ratios of deposits to income in 1970.

However, the ratio of deposits to personal income was not as important as the growth of income during 1970-76 in explaining the expansion of deposits. An SMSA with a ratio of 0.5 would experience only 6 percent more growth of deposits than an SMSA with a ratio of 0.6. Virtually all the SMSA's had a ratio that was between 0.40 and 0.65.

The growth of deposits was also affected by the net rate of return on bank assets. The measure used is the ratio of net income (before extraordinary items and before securities gains and losses) to bank assets, averaged over 1969-71. On average, an increase in the rate of return from 0.9 cent to 1.0 cent per dollar of assets was associated with a 4-percent increase in deposit expansion. As with the ratio of deposits to personal income in 1970, this factor is shown to have been less important than personal income in explaining the expansion of deposits.

The location of some SMSA's appears to have affected the expansion of their deposits. Above-average deposit growth occurred in the SMSA's in West Texas—Abilene, Amarillo, Lubbock, Midland, Odessa, and San Angelo. These SMSA's experienced, on average, about 22 percent more growth in deposits than an SMSA with similar

FACTORS EXPLAINING GROWTH OF COMMERCIAL BANK DEPOSITS IN SOUTHWESTERN METROPOLITAN AREAS, JUNE 1970-JUNE 1976

Standard metropolitan statistical area[1]	Percent changes 1976 from 1970		Difference	Deposits/ personal income[2]	Net income/ assets[3]
	Deposits June 30	Personal income			
Laredo, Texas	278.0	84.6	193.4	0.57	0.92
Brownsville-Harlingen-San Benito, Texas	185.5	124.0	61.6	.51	.92
McAllen-Pharr-Edinburg, Texas	185.4	131.8	53.6	.55	1.02
Lafayette, Louisiana	174.9	128.4	46.5	.42	1.16
Odessa, Texas	141.2	114.4	26.7	.39	.80
El Paso, Texas	138.7	87.9	50.8	.43	1.01
Abilene, Texas	135.1	94.1	40.9	.55	.87
Tyler, Texas	133.9	107.3	26.6	.53	1.02
Austin, Texas	129.9	108.4	21.5	.63	.82
Albuquerque, New Mexico	129.0	101.8	27.2	.49	1.11
Longview, Texas	126.8	103.8	23.0	.50	.83
Amarillo, Texas	125.0	89.2	35.8	.62	.70
Tulsa, Oklahoma	123.2	97.0	26.3	.60	1.10
Houston, Texas	123.1	120.3	2.8	.65	.98
Killeen-Temple, Texas	119.2	111.9	7.3	.30	.82
Monroe, Louisiana	117.8	95.8	21.9	.66	.97
Corpus Christi, Texas	116.1	87.2	28.9	.43	.92
Midland, Texas	113.4	112.3	1.2	.92	1.01
Lubbock, Texas	112.2	89.9	22.2	.69	.76
Las Cruces, New Mexico[4]	109.8	101.2	8.6	.37	.42
San Angelo, Texas	108.1	98.5	9.6	.64	.77
Shreveport, Louisiana	107.5	82.5	25.0	.59	1.04
Oklahoma City, Oklahoma	107.4	81.0	26.4	.61	.99
Baton Rouge, Louisiana	104.5	105.8	−1.3	.64	.93
San Antonio, Texas	102.2	86.4	15.8	.47	.97
Lawton, Oklahoma	101.2	56.4	44.8	.29	.74
Bryan-College Station, Texas	99.9	113.7	−13.8	.59	.91
Beaumont-Port Arthur-Orange, Texas	91.6	89.1	2.5	.42	1.00
Lake Charles, Louisiana	91.4	86.7	4.8	.50	1.25
Alexandria, Louisiana	91.2	79.8	11.5	.48	1.01
Dallas-Fort Worth, Texas	90.7	83.9	6.8	.65	.89
Texarkana, Texas-Arkansas	85.8	80.1	5.7	.50	.70
New Orleans, Louisiana	83.7	78.8	4.9	.55	.86
Galveston-Texas City, Texas	80.7	94.7	−13.9	.41	.78
Sherman-Denison, Texas	74.2	71.5	2.7	.58	1.03
Wichita Falls, Texas	73.5	88.9	−15.4	.64	.87
Waco, Texas	68.8	83.8	−15.0	.61	.66

1. With the exception of Las Cruces, New Mexico.
2. Ratio of June 30, 1970, bank deposits to 1970 personal income.
3. Ratio of net income of all banks to assets of all banks, averaged over 1969-71 and expressed as cents per dollar of assets.
4. Dona Ana County.

SOURCES: Board of Governors, Federal Reserve System.
U.S. Department of Commerce.
Federal Reserve Bank of Dallas.

characteristics located elsewhere in the four Eleventh District states. (See the Appendix.) Among the possible explanations for the above-average deposit expansion in the six SMSA's in this sparsely populated region are the growth of manufacturing and trade, the rise in credit requirements of agriculture, and the increase in oil and gas activities.

It appears that branch banking did not significantly affect the expansion of deposits. Though a 10-percent increase in income was associated with an increase of 15 percent in deposits in Louisiana and New Mexico, compared with an increase of 7 percent in Oklahoma and Texas, statistical tests indicate the difference in behavior is probably due to chance.

Increase in number of bank offices

In analyzing the expansion of the number of bank offices, it is necessary to abstract from inflation. Personal income growth adjusted for price increases is probably the best measure of "real" economic growth. However, price indexes are not available for every SMSA. Instead, population growth is used as the measure of real economic growth.

In Louisiana and New Mexico the expansion of bank offices during 1970-76 was twice as responsive to the number of bank offices per 100,000 persons in 1970 as in Oklahoma and Texas.

In most SMSA's in the Eleventh District states, the number of bank offices grew relatively more than population during 1970-76. In only five SMSA's, all in Texas, did population growth exceed the increase in the number of bank offices. Relatively rapid growth of bank offices generally occurred in SMSA's in branch-banking states. The SMSA's in the branching states typically experienced larger percentage growth in the number of bank offices than SMSA's in the unit-banking states.

Population growth, however, was not the most important factor explaining the expansion in the number of bank offices during 1970-76. (See Appendix Table 2.) The most important factor was the number of bank offices per 100,000 persons (the ratio of bank offices to population) in 1970. The expansion of bank offices was higher over 1970-76 in SMSA's where there had been fewer bank offices per 100,000 persons in 1970. The bank offices-population ratio reflects an SMSA's market potential—that is, the extent to which the number of existing bank offices attains the potential number of offices an SMSA could support.

When just the 28 metropolitan areas in Oklahoma and Texas are included in the regression analysis, the ratio of bank offices to population, the net rate of return on bank assets, and population growth explain about 55 percent of the variation among these SMSA's in the expansion of bank offices. (See Appendix Table 2.) The analysis indicates that an SMSA with six bank offices per 100,000 persons would have experienced a 7 percent greater expansion of bank offices than an SMSA with eight bank offices per 100,000 persons, other things being equal. By comparison, the average expansion of bank offices for the 28 SMSA's was 15 percent during 1970-76. An SMSA with a net rate of return on bank assets of 1.0 cent per dollar of assets would have experienced 4 percent greater expansion of bank offices than an SMSA with 0.9 cent per dollar of assets. An additional 8 percent population growth, the least important factor, would have generated only 2 percent additional increase in bank offices. A statistical test shows that there is a 20-percent chance that population growth has no effect on the increase in bank offices in these SMSA's.

There was a significant difference in behavior between the 9 SMSA's in the branch-banking states and the 28 SMSA's in the unit-banking states. In Louisiana and New Mexico the expansion of bank offices during 1970-76 was twice as responsive to the number of bank offices per 100,000 persons in 1970 as in Oklahoma and Texas. In addition, the expansion of bank offices was significantly more responsive to population growth in the branching states. Over 1970-76, an additional 8 percent of population growth was associated with a 16-percent increase in bank offices. An SMSA with a net rate of return on bank assets of 1.0 cent per dollar of assets would have experienced 3 percent greater increase in bank offices than an SMSA with 0.9 cent per dollar of assets. Taking all these factors into consideration, an SMSA in a branch-banking state experienced, on average, about 96 percent more expansion of bank offices than an SMSA with similar characteristics in a unit-banking state.

FACTORS EXPLAINING INCREASE IN NUMBER OF COMMERCIAL BANK OFFICES IN SOUTHWESTERN METROPOLITAN AREAS, JUNE 1970-JUNE 1976

Standard metropolitan statistical area[1]	Percent changes 1976 from 1970		Difference	Bank offices/population[2]	Net income/assets[3]
	Bank offices June 30	Population			
In branch-banking states					
Albuquerque, New Mexico	110.3	15.6	94.7	11.6	1.11
New Orleans, Louisiana	57.0	5.8	51.2	10.9	.86
Lake Charles, Louisiana	52.2	4.9	47.2	15.8	1.25
Alexandria, Louisiana	45.0	4.2	40.8	15.1	1.01
Lafayette, Louisiana	41.2	13.3	27.9	15.2	1.16
Baton Rouge, Louisiana	40.7	11.6	29.1	15.7	.93
Shreveport, Louisiana	30.2	5.4	24.8	18.8	1.04
Las Cruces, New Mexico[4]	21.4	18.0	3.5	20.1	.42
Monroe, Louisiana	19.0	11.1	8.0	18.2	.97
In unit-banking states					
El Paso, Texas	58.3	17.9	40.4	3.3	1.01
Houston, Texas	45.5	19.2	26.2	6.6	.98
Brownsville-Harlingen-San Benito, Texas	44.4	27.4	17.0	6.4	.92
Austin, Texas	37.5	26.5	11.0	4.9	.82
Laredo, Texas	33.3	13.1	20.2	4.1	.92
Midland, Texas	33.3	8.7	24.6	4.6	1.01
San Antonio, Texas	30.8	10.8	20.0	4.4	.97
Dallas-Fort Worth, Texas	29.5	8.3	21.2	7.0	.89
Odessa, Texas	25.0	9.5	15.5	4.3	.80
Tyler, Texas	25.0	11.8	13.2	8.2	1.02
Beaumont-Port Arthur-Orange, Texas	22.7	2.4	20.3	6.3	1.00
Oklahoma City, Oklahoma	22.6	8.6	14.0	8.9	.99
Texarkana, Texas-Arkansas	22.2	4.4	17.8	8.0	.70
Tulsa, Oklahoma	21.8	8.0	13.8	10.0	1.10
Lubbock, Texas	20.0	10.9	9.1	5.6	.76
San Angelo, Texas	20.0	8.3	11.7	7.0	.77
McAllen-Pharr-Edinburg, Texas	18.8	26.4	−7.7	8.8	1.02
Longview, Texas	14.3	5.5	8.8	11.6	.83
Galveston-Texas City, Texas	14.3	9.3	5.0	8.2	.78
Killeen-Temple, Texas	13.3	27.6	−14.3	9.4	.82
Lawton, Oklahoma	10.0	.7	9.3	9.2	.74
Corpus Christi, Texas	8.3	4.4	3.9	8.4	.92
Sherman-Denison, Texas	8.3	−1.9	10.3	14.4	1.03
Waco, Texas	6.7	4.9	1.7	10.1	.66
Abilene, Texas	.0	7.3	−7.3	12.2	.87
Amarillo, Texas	.0	6.5	−6.5	6.2	.70
Bryan-College Station, Texas	.0	25.5	−25.5	8.6	.91
Wichita Falls, Texas	.0	−.9	.9	8.4	.87

1. With the exception of Las Cruces, New Mexico.
2. Ratio of bank offices as of June 30, 1970, to 1970 population, expressed as the number of bank offices per 100,000 persons.
3. Ratio of net income of all banks to assets of all banks, averaged over 1969-71 and expressed as cents per dollar of assets.
4. Dona Ana County.

SOURCES: Board of Governors, Federal Reserve System.
Federal Deposit Insurance Corporation.
U.S. Department of Commerce.
Federal Reserve Bank of Dallas.

Conclusions

During 1970-76, bank deposits in the four Eleventh District states expanded faster in metropolitan areas where personal income growth was greater, deposits per dollar of personal income in 1970 were lower, and the net rate of return on bank assets in 1970 was higher. In explaining the expansion of deposits, the most important factor was personal income growth. There was no significant difference in these relationships between the 24 nonborder SMSA's in unit-banking states and the 9 SMSA's in the branch-banking states.

By contrast, the most important factor explaining the increase in bank offices was the number of bank offices per 100,000 persons in 1970. Moreover, the experience of the SMSA's in unit-banking states differed significantly from that of the SMSA's in branch-banking states. A difference of one bank office per 100,000 persons in 1970 was associated with double the increase in bank offices over 1970-76 in SMSA's in branch-banking states compared with SMSA's in unit-banking states. Bank offices increased with population in SMSA's in branch-banking states but did not respond very strongly to differences in the net rate of return on bank assets. The opposite was true for SMSA's in unit-banking states.

The difference in the reported association of deposits and bank offices with economic growth is partly explained by the relative ease of expanding deposits. While management capabilities, the size of a bank's facilities, and the adequacy of its capital can restrain a bank's expansion of its deposits, banks generally are able to expand deposits as income growth increases the demand for deposits. Establishing a new bank office, however, takes time and resources. The importance of the number of bank offices per 100,000 persons in explaining the increase in bank offices suggests that the number of bank offices lagged behind market growth in some SMSA's.

Because bank regulation plays an important role in the establishment of bank offices, the pattern of expansion reflects the decisions of not only the applicants for bank charters but also the agencies regulating banking. The reported results may, therefore, provide only limited information about which metropolitan areas bankers find attractive for establishing a new bank or branch. Under existing banking laws, the regulatory agencies are required to evaluate the viability of and public need for a new bank office before granting a charter application. This process may explain the importance of the ratio of bank offices to population if the agencies take this ratio into account when deciding on charter applications. The greater responsiveness to economic growth and market potential of bank offices in Louisiana and New Mexico as compared with Oklahoma and Texas appears to reflect the more liberal chartering policies for branches in the two branch-banking states.

Appendix
Regression Analysis

Growth of deposits

A linear regression model of the form

$$Y = a_0 + a_1X_1 + a_2X_2 + a_3X_3 + a_4X_4$$

is used to establish the relationship between the growth of bank deposits and four explanatory variables, with data for the 33 nonborder metropolitan areas in Louisiana, New Mexico, Oklahoma, and Texas. These variables are defined thus:

%△PI—percentage change in personal income, 1970-76
(Mean = 94.7; standard deviation = 15.2)

D/PI—ratio of June 30, 1970, bank deposits to personal income in 1970
(Mean = .54; standard deviation = .13)

NI/A—ratio of net income of all banks to assets of all banks, averaged over 1969-71
(Mean = .9; standard deviation = .18)

WESTTX—equals 1 if the SMSA is Abilene, Amarillo, Lubbock, Midland, Odessa, or San Angelo; equals 0 otherwise

These four variables explain about 55 percent of the variation in the percentage change in deposits in the 33 nonborder areas during June 1970-June 1976. (See Table 1.) All four variables have the expected signs and are significantly different from zero with a 90-percent probability, indicating that faster income growth, fewer deposits per dollar of income, and higher return on assets were associated with greater expansion of deposits.

Personal income growth (*%△PI*) is the most important variable, according to the standardized regression coefficients. These coefficients, given in brackets, show the impact on deposit growth of a standard-deviation change in the explanatory variables, where this impact is expressed in terms of the standard deviation of deposit growth. For example, if personal income had increased by its standard deviation, deposit expansion would have increased by 14 percent—that is, by 0.61 times its standard deviation (22.4 percent). By comparison, one standard-deviation change in deposits/personal income and net income/assets would have generated changes in deposit growth of only 8 percent and 6 percent, respectively. The coefficient of *WESTTX* indicates that an SMSA located in West Texas experienced 22 percent more growth in deposits than an SMSA with similar characteristics located elsewhere in the four states.

Table 1

REGRESSION ANALYSIS OF BANK DEPOSIT GROWTH, JUNE 1970-JUNE 1976

(Dependent variable = Percent change in bank deposits)	Explanatory variables					$\bar{R}^2$	*SE*
	Constant	*%△PI*	*D/PI*	*NI/A*	*WESTTX*		
9 SMSA's, Louisiana and New Mexico	—35.98	1.47***	—30.94	24.86		.75	.018
	(—.76)	(4.58)	(—.57)	(1.18)			
		[.85]	[—.11]	[.22]			
24 nonborder SMSA's, Oklahoma and Texas	31.06	.67***	—60.27**	45.97	25.00***	.45	.023
	(1.09)	(2.96)	(—2.23)	(1.53)	(2.88)		
		[.49]	[—.39]	[.27]			
All 33 nonborder SMSA's	20.81	.91***	—62.28**	35.53*	21.54***	.55	.022
	(.93)	(4.99)	(—2.66)	(2.01)	(2.75)		
		[.61]	[—.35]	[.26]			

* Significantly different from zero with probability of 90 percent.
** Significantly different from zero with probability of 95 percent.
*** Significantly different from zero with probability of 99 percent.
NOTE: $\bar{R}^2$ is the measure of goodness of fit adjusted for degrees of freedom.
SE is the standard error of the regression.
Figures in parentheses are *t* statistics of the regression coefficients.
Figures in brackets are standardized regression coefficients (beta coefficients).

To test for a difference between the SMSA's in unit-banking states and branch-banking states in the relationship of deposit expansion to the explanatory variables, separate regressions were run for each group of SMSA's. (See Table 1.) Although the coefficients differ between the two groups, a Chow test indicates that there is a 95-percent probability that these differences would be observed by chance sampling even if the two groups did not differ.[1] The value of Chow's F ratio is 0.79, considerably below the critical value of $F_{.05,5,24} = 2.62$.

Increase in bank offices

The following three variables are used to explain the percentage change in the number of bank offices in all 37 southwestern metropolitan areas between June 1970 and June 1976:

$\%\triangle POP$—percentage change in population, 1970-76
(Mean = 10.8; standard deviation = 8.0)

B/POP—ratio of bank offices as of June 30, 1970, to population in 1970, expressed as the number of bank offices per 100,000 persons
(Mean = 9.6; standard deviation = 4.4)

NI/A—ratio of net income of all banks to assets of all banks, averaged over 1969-71
(Mean = .9; standard deviation = .16)

The regression results, reported in Table 2, reveal that in both unit-banking SMSA's and branch-banking SMSA's, the most important variable explaining the expansion of bank offices is the ratio of bank offices to population. In both regressions, this variable had the largest standardized regression coefficient. Net income/assets was significant for the SMSA's in Oklahoma and Texas. Population growth was not significant at a 90-percent confidence level in either regression equation.

A Chow test indicates that there is a significant difference in behavior between the two groups. The value of Chow's F ratio is 14.88, greater than the critical value of $F_{.01,4,30} = 4.02$. To evaluate the significance of the difference between the two groups of SMSA's in the relationship of the expansion of bank offices to the explanatory variables, a dummy variable, B (for branch), is introduced into the linear model in the following manner:

$$Y = a_0 + b_0B + a_1X_1 + b_1X_1B + a_2X_2 + b_2X_2B + a_3X_3 + b_3X_3B,$$

where B equals 1 if the SMSA is in Louisiana or New Mexico; B equals 0 if the SMSA is in Oklahoma or Texas.

Under this procedure, the coefficients of each explanatory variable for the SMSA's in the unit-banking states are a_1, a_2, and a_3. For the SMSA's in the branch-banking states, these coefficients are $(a_1 + b_1)$, $(a_2 + b_2)$, and $(a_3 + b_3)$. Although the values obtained for these coefficients are the same under this procedure as when the regressions are run separately, the significance of any difference in behavior can be tested directly by the application of t tests to the coefficients of the interaction terms, b_1, b_2, and b_3. The underlying assumption is that the variance of the error term is the same for both groups of SMSA's.[2]

The results are shown in Table 2. The expansion of bank offices was twice as responsive to bank offices/population in SMSA's in branch-banking states; the t statistic for the coefficient of $B/POP \times B$ is negative, indicating that the difference is significant at a 94-percent probability. The expansion of bank offices was significantly responsive to population growth in Louisiana and New Mexico but not in Oklahoma and Texas. The t statistic for the sum of the coefficients of $\%\triangle POP$ and $\%\triangle POP \times B$ $(a_1 + b_1)$ is 2.14, greater than the 95-percent critical value of the t statistic, while that for $\%\triangle POP$ is not significantly different from zero.

The expansion of bank offices was not significantly responsive to the net rate of return

1. Gregory C. Chow, "Tests of Equality Between Sets of Coefficients in Two Linear Regressions," *Econometrica* 28 (July 1960): 591-605.

2. See Potluri Rao and Roger LeRoy Miller, *Applied Econometrics* (Belmont, Calif.: Wadsworth Publishing Company, 1971), pp. 88-93.

Table 2

REGRESSION ANALYSIS OF INCREASE IN BANK OFFICES, JUNE 1970-JUNE 1976

(Dependent variable = Percent change in number of bank offices)	Explanatory variables								$\bar{R}^2$	SE
	Constant	B	$\%\Delta POP$	$\%\Delta POP \times B$	B/POP	$B/POP \times B$	NI/A	$NI/A \times B$		
9 SMSA's, Louisiana and New Mexico	100.66		1.93		—6.67**		31.91		.60	.029
	(1.75)		(1.44)		(—3.11)		(1.04)			
			[.36]		[—.75]		[.28]			
28 SMSA's, Oklahoma and Texas	5.00		.30		—3.36***		43.29**		.55	.010
	(.32)		(1.29)		(—4.36)		(2.67)			
			[.18]		[—.60]		[.35]			
All 37 SMSA's	5.00	95.65**	.30	1.63*	—3.36***	—3.31*	43.29**	—11.38	.71	.013
	(.28)	(2.25)	(1.11)	(1.73)	(—3.76)	(—1.96)	(2.31)	(—.41)		
			[.11]	[.38]	[—.70]	[—1.09]	[.32]	[—.23]		

* Significantly different from zero with probability of 90 percent.
** Significantly different from zero with probability of 95 percent.
*** Significantly different from zero with probability of 99 percent.
NOTE: $\bar{R}^2$ is the measure of goodness of fit adjusted for degrees of freedom.
SE is the standard error of the regression.
Figures in parentheses are *t* statistics of the regression coefficients.
Figures in brackets are standardized regression coefficients (beta coefficients).

on bank assets in the two branch-banking states, unlike in the two unit-banking states. The *t* statistic for the sum of the coefficients of NI/A and $NI/A \times B$ is 1.55, less than the 90-percent critical value of the *t* statistic, while that for NI/A is significant at the 95-percent level. Taking all these factors into account, an SMSA in a branch-banking state would have experienced, on average, about 96 percent greater expansion of bank offices than an SMSA with similar characteristics in a unit-banking state.

New state member bank

Bank of Kerrville, Kerrville, Texas, located in the territory served by the San Antonio Branch of the Federal Reserve Bank of Dallas, was admitted May 29, 1979, as a member of the Federal Reserve System. The bank has a capital structure of $916,000, consisting of capital stock of $400,000, surplus of $300,000, and undivided profits and reserves of $216,000. The officers are: J. D. Brance, Chairman of the Board; James Y. Eliot, President; Rick Choffel, Vice President and Cashier; John McCollom, Vice President (Inactive); Nita Bryant, Bank Officer; and Dodie Hill, Assistant Cashier.

"Fed Quotes"

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

"Consumers and Producers in America"

"A business will prosper if it can produce a better mousetrap that the consumer wants. It will have to go out of business if it insists on turning out goods that the consumer does not want, or if it just cannot compete. We do not allow the Government to make decisions as to what is to be produced and consumed, give or take a few qualifications. The consumer, by casting dollar votes in a free market, makes those decisions. That is what a free enterprise, market economy is all about."

"The fundamental truth is, of course, that the consumer cannot live without the producer. In fact, most consumers are also producers, as businessmen, workers, farmers, and in every other endeavor. The notion, therefore, that the consumer should be protected against the producer is *prima facie* open to logical challenge. The law, and even the language of the law, seems to ignore this obvious fact."

"The adverse treatment and experience of the saver in the American economy must properly be viewed as part of our general tendency to penalize the producer and favor the consumer. Without saving, production is bound to suffer. To grow, the economy needs investment. To invest, there must be savings. The United States has become a low saving country, compared to other nations. The personal saving rate in the United States is in the range of 5 per cent of disposable personal income. This compares with about 14 per cent in Germany and 24 per cent in Japan. Accordingly, investment and growth in those countries historically have been on a much larger scale than in our own country. Savers are, in fact, among the most important producers, since they produce capital. Their neglect, to the benefit of the consumer, is part of the syndrome of favoring consumption at the expense of production."

"A few days ago, *The Washington Post* ran an editorial entitled 'Regulation, Regulation, Regulation,' in which they took to task the Congress and the Federal Reserve Board for producing 3,000 pages of interpretations and explanations on one single regulation, dealing with Truth in Lending. Few regulations had a better purpose, and few have ended up creating so much difficulty for bankers and other lenders. Not long ago a banker told me that he could not spend time with customers anymore because he was so busy studying Federal Reserve regulations. Since he can be sued and penalized for failing to obey them, he is probably making a wise allocation of his time. But it is not clear that the customer gains.

"In Washington, there exists a built-in momentum of regulatory activity that is a cause for deep concern. . . . Many people's careers, in Congress and in the agencies, depend on their success in accomplishing more regulation. Their families' livelihood depends on more regulation being written. This way, the supply of new regulations becomes independent of the need for it."

"The institutionalized outpouring of regulation needs to be restrained. Whether this overpowering proliferation of Government activitiy is consistent with a free society may be debatable, but it certainly is not consistent with a productive society."

Henry C. Wallich, Member, Board of Governors of the Federal Reserve System
(At Salt Lake City, Utah, April 24, 1979)

"What Inflation Has Done to Us"

"If the family is young, and has small children, there may be the question of how to prepare for college. With the price of college education going up 10 per cent per year, as it has been doing, there is no way of setting aside, from today's pay, an annual sum that will be of much use 18 years from now. At today's rate of inflation, the half-time life of money is only 7.2 years. Many people seem to think that the best way to save for college expenses is to buy a house and hope that its value will have risen enough when the time comes so that they can put a second mortgage on it. Few parents will be happy to have to gamble in this way for the future of their children."

"The saver who hopes to retire on his or her savings is in a losing game. Such persons might ask what depreciates faster—people or money."

"But it is not only the consumer who suffers from inflation. The businessman . . . also [is] victimized. . . . The tax system . . . makes nonsense of normal business calculations. The businessman is not allowed to charge off what it would cost to replace the wear and tear on his machinery and equipment. Rather, he can charge only at the price at which he bought the equipment, perhaps many years ago. When the times comes to replace it, he must go out to borrow new money because the money the tax law allowed him to set aside via depreciation has become inadequate."

"If inflation is so universally damaging, why is it that we have made so little headway against it? In particular, why is it that in the year in which the Government made the fight against inflation its number-one priority, inflation has once more accelerated into the double-digit range? The basic reason, I believe, is that in fighting inflation we are still violating the first rule of economics that there is no such thing as a free lunch. We delude ourselves if we believe that a cure will not be painful and costly. But the ultimate pain and cost of letting inflation go on is far greater. There is no way of 'living with inflation.' Unattended, it will accelerate in the future as it has done in the past, contrary to many predictions, and will end up by destroying our market economy.

"What we shall have to do, in broadest terms, is this:

"(1) Allow for somewhat greater slack in the economy in the form of more excess capacity and unemployment than we would ordinarily want to accept. . . .

"(2) We must end the many activities of the Federal Government that spawn inflation, including numerous forms of regulation.

"(3) We must bring Government expenditures under better control. While I do not believe that a Constitutional amendment for an ever-balanced budget is a practical answer, we can and should set firm limits on Government expenditures.

"(4) We should pursue a strong anti-inflationary monetary policy, taking advantage of the fact that while monetary policy works only with a lag on employment and output, its effect on prices, which works by affecting people's expectations, can be much quicker.

"(5) We should implement guidelines of the kind established by the President and support them, together with a real wage guarantee or some other use of the tax system to restrain the wage-price spiral.

"(6) We should reform the tax system to strengthen our productive forces and eliminate the existing bias against productive activities.

"The execution of such a policy would have to take many forms. It will encounter resistance and will require courage and steadfastness. I have no doubt that the solution to the problem of inflation is in our hands. The cost of victory in this struggle may be high, but the cost of losing would be incalculable."

Henry C. Wallich, Member, Board of Governors of the Federal Reserve System
[At Ogden, Utah, April 23, 1979]

Automatic Transfer Accounts: Slow Start! Early Demise?

By Mary G. Grandstaff

Beginning November 1, 1978, commercial banks were permitted to offer automatic transfer of funds from personal savings accounts to checking accounts upon written authorization of customers. The automatic transfer from savings (ATS) service involves two separate accounts—a checking account and a savings account. Checks may be drawn only on the checking account, and interest may be paid only on the savings account.

ATS accounts were expected to increase the efficiency and convenience of savings accounts for individuals. Although banks already were permitted to make transfers from savings by telephone, the new ATS service provided automatic transfers to maintain a specified level of funds in a checking account or to cover overdrafts. Such arrangements would lower the individual's cost of maintaining a checking account balance and, at the same time, maximize the return available on his excess funds. The overdraft protection feature would enable both merchants and participating depositors to avoid the costs, as well as embarrassment, of having checks returned because of insufficient funds.

ATS accounts are available only to individuals. And since these accounts are savings, bankers are permitted to pay an interest rate no greater than the maximum allowable on regular savings accounts. Banks also must retain the right of requiring at least 30 days' notice of intended withdrawal from an ATS account.

Most of the other terms for ATS accounts, however, are left to the discretion of the banks. For example, a bank makes its own decisions on minimum balance requirements for checking and savings accounts, minimum sizes or increments of transfers, the interest rate to be paid on the savings accounts (up to the maximum permissible on savings deposits), and the maintenance fees and other charges for the various aspects of the service.

The regulation authorizing ATS accounts permits banks to arrange the accounts either to maintain some predetermined minimum balance in the checking account or to transfer funds from the savings account to the checking account as checks are written. In the latter arrangement the checking account balance remains at zero.

The ATS service, which is voluntary for both banks and customers, did not meet with immediate widespread popularity. Nevertheless, the volume of funds in these accounts has grown slowly but rather steadily since their introduction late last year.

On the basis of a random sample of 351 commercial banks, the Board of Governors of the Federal Reserve System estimates that the volume of funds in savings accounts authorized for automatic transfer at all insured commercial banks in the nation (excluding banks in Massachusetts, New Hampshire, Connecticut, Rhode Island, Maine, and Vermont) totaled about $6.4 billion on the last

Wednesday of April 1979. That amounted to just over 2 percent of total demand deposits at those banks and less than 6 percent of consumer demand deposits.

Weekly data obtained from a random sample of 22 banks in the Eleventh District indicate that 20 of the banks offer ATS accounts. By the end of the first week following the introduction of ATS plans, these banks had opened only 161 of these accounts. By the last Wednesday of November, the number of ATS accounts rose to 514 and by the last Wednesday of December, to 758. Although the reporting of weekly data on the number of accounts was discontinued at year-end, information volunteered by several of the weekly reporting banks indicates that the growth in number of accounts has abated sharply in 1979.

The volume of funds in ATS accounts has shown similar growth patterns. By the last Wednesday of November 1978, ATS balances had grown to $5.1 million at weekly reporting banks in the Eleventh District and an estimated $2.0 billion at banks nationwide. In both instances, growth tapered sharply thereafter.

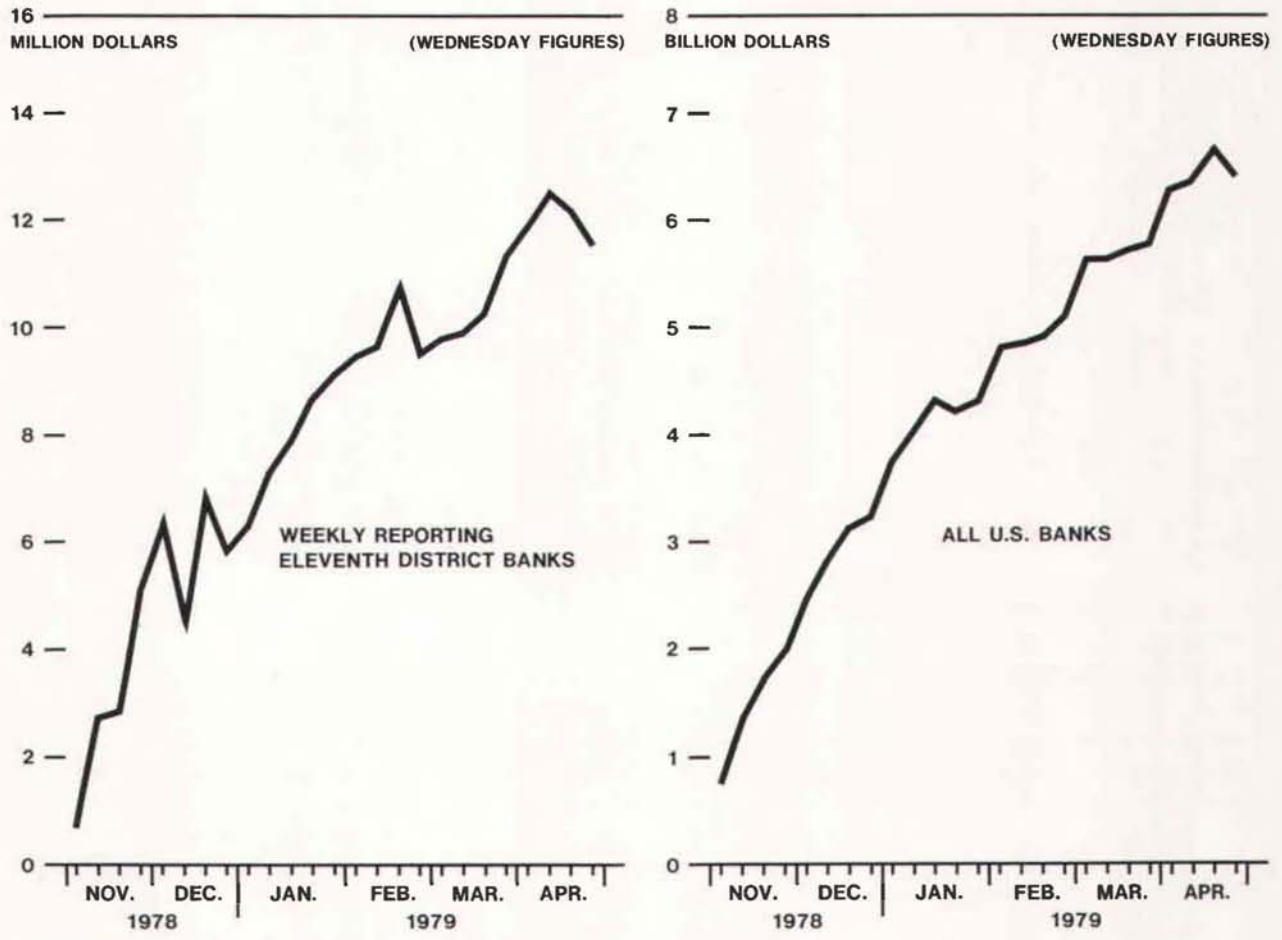
On April 25, 1979, the volume of funds in savings accounts authorized for automatic transfer at weekly reporting banks in the Eleventh District—which are included in the Board's nationwide sample—amounted to $11.4 million, or almost 2 percent of total demand deposits at those banks. The terms of ATS plans being offered vary widely from bank to bank. Most banks apparently are paying the maximum interest rate allowed on savings accounts and do not require interest forfeitures. However, minimum balance requirements, minimum transfer amounts, and pricing vary greatly.

Some banks require a relatively high savings account balance ($2,000 or more in many instances) to open an ATS account, while others offer the service for as little as $200 in the savings account. The minimum amounts transferable also vary widely, and—except for the plans in which checking accounts are maintained with a zero balance —transfers usually are made in increments of some specified dollar amount. (In the case of zero-balance checking accounts, the minimum amount transferable obviously is the amount of the check that the transfer must accommodate.)

Pricing of ATS plans provides the widest variations. Many banks offer maintenance-free ATS accounts and transactions without charge if a specified minimum balance is maintained in the savings portion and/or checking account portion of the ATS account. Below that minimum, however, pricing varies widely.

Banks generally charge a monthly maintenance fee or a per-transaction fee or both when the balance in the savings or the savings and checking accounts falls below the specified maintenance-free minimum balance. At some banks, these

Savings account balances authorized for automatic transfer have grown slowly



NOTE: Figures for U.S. banks were estimated on the basis of a random sample of 351 commercial banks.

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

charges are a flat specified sum for any month in which the balance falls below that level, while other banks utilize a series of graduated costs at various intervals of savings deposit funds. For example, suppose that several hypothetical banks have a $3,000 minimum savings balance for which ATS accounts are maintained and serviced free of charge. Some banks would charge a flat rate—say $4 per month for account maintenance, with no transaction fees when the savings balance fell to any level below $3,000. Others might charge both the $4 monthly maintenance fee and a transaction fee either for each check written or for each transfer made.

Still other banks would use a graduated scale of fees and/or charges as the savings balance fell to various levels below $3,000. Using further illustrative figures, banks might charge $3 per month for maintenance fees and no transaction fees or the $3 per month and 25 cents per transaction if the savings balance remained between $2,000 and $2,999. If the balance falls below $2,000, the charges might rise to perhaps $4 per month and/or 50 cents between $1,000 and $1,999 and $5 and/or 75 cents

MAXIMUM INTEREST PERMISSIBLE ON ATS SAVINGS ACCOUNTS

ATS savings balance	Annual interest[1]	ATS savings balance	Annual interest[1]
$200	$10	$2,000....	$103
$400	21	$2,500....	128
$600	31	$3,000....	154
$800	41	$4,000....	205
$1,000...	51	$5,000....	257
$1,500...	77	$10,000...	513

1. Compounded daily and rounded to nearest dollar.

for accounts with savings balances below $1,000. (As stated previously, these prices are purely illustrative.)

The costs associated with maintaining ATS accounts make them relatively unattractive to many customers. For those individuals who maintain relatively small demand deposit accounts (such as minimum balances for free checking), the interest gained from placing the funds in a savings account likely would be more than offset by the ATS account maintenance costs and transfer fees. For these individuals the only real advantage might well be the avoidance of ordinary checking account service charges and overdraft costs. But maintenance of proper records should accomplish the same results less expensively.

Depositors with small to moderate checking accounts and little activity in those accounts might not deem the small interest income worth the effort of opening a new account. And some savers undoubtedly prefer not to have such ready access to their savings funds for unplanned purposes.

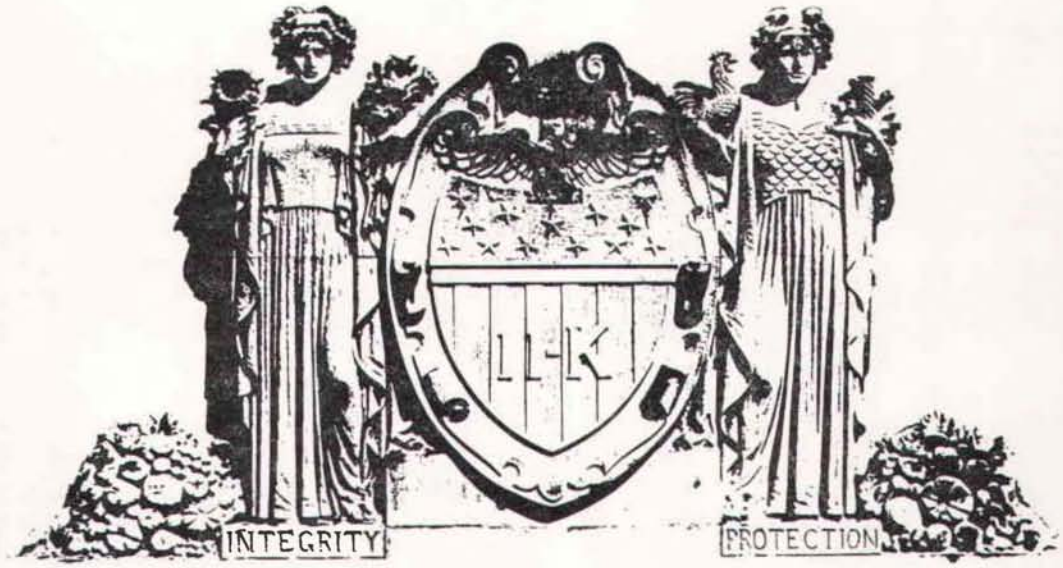
Those individuals who regularly maintain relatively large checking account balances probably find ATS accounts somewhat more attractive, and these depositors apparently hold most of the current ATS accounts. The average balance in ATS accounts at weekly reporting banks in the Eleventh District, for example, was $7,712 on December 28, 1978—about the same as the $7,671 average estimated for all commercial banks in the nation.

ATS accounts also have not met with a great deal of popularity among banks. Although some banks offer the service, most have not promoted their plans at all because of the general belief that costs will deter most of their customers from opening these accounts.

The shifting of funds from demand accounts to savings accounts would provide banks that are members of the Federal Reserve System some additional funds for investment in income-producing assets because of smaller reserve requirements on the savings accounts. But for the small- to moderate-size deposit balance, the cost of servicing the accounts would generally be considerably greater than the income from the freed funds. Thus, in the short run, it seems probable that ATS accounts will continue to appear primarily to those bank customers who already have and plan to maintain a rather sizable checking account and/or savings account at the bank. And considering the current availability of high alternative interest rates on money market securities, the greatest attraction for those customers may well be convenience.

In the longer run, popularity of ATS accounts could be affected by other innovations in the financial community. For example, if NOW (negotiable orders of withdrawal) accounts were to be authorized nationwide for all depository institutions, these might be more attractive than ATS accounts. NOW accounts normally provide the convenience of third-party transfers and are interest-bearing. The relatively lower pricing schedules generally offered on NOW accounts probably would make them more attractive to depositors who maintain smaller balances.

Subsequent changes in ATS and other essentially interest-bearing payments accounts appear imminent. The U.S. Court of Appeals in Washington, D.C., ruled on April 20, 1979, that such accounts are illegal because they blur the distinction between separate and distinct types of financial institutions. The effective date of that ruling was cited as January 1, 1980. Continued use of these accounts beyond that time apparently will depend on new enabling congressional legislation.



Dallas Fed Designated Historic Landmark

The Federal Reserve Bank Building in Dallas was officially designated a historic landmark by the Historic Landmark Preservation Committee of the city of Dallas on May 10, 1979. The committee is appointed by the city's Planning Commission and is composed of members of the Planning Commission, architects, members of city, county, and state historical associations, educators, and others.

The cornerstone of the Federal Reserve Building was laid April 2, 1920, and construction was completed in 1921. Although several alterations have been made to the original structure, the building still retains the character of the original architecture.

The Historic Landmark Preservation Committee noted that the building was designated a historic landmark both for the richness of its architectural design and because of the role the Federal Reserve Bank has played in the development of the city of Dallas. Dallas City Councilman Steve Bartlett dedicated the building in an out-of-doors between-showers ceremony. He stated, "Landmark status reflects the real as well as symbolic value of the Bank in the maturation of the city of Dallas."

Ernest T. Baughman, President of the Federal Reserve Bank of Dallas, accepted the historic landmark designation with the following remarks.

"In the name of the Federal Reserve Bank of Dallas, its employees and directors, I am pleased to accept the marker denoting that this building bears historical significance. We are indebted to the Historic Landmark Preservation Committee for making this ceremony possible. The ceremony acknowledges that the architects and the builders did their jobs well, as have those who have maintained the structure during the near threescore years it has stood here. I am advised that during those years the Guardian Angels positioned above the entrance to the building have observed in the ongoing parade on Akard Street some of the best of Dallas and some which, while possibly not the very best, were nevertheless both human and virile.

"While this building may serve as a monument to the foresight, judgment, and dedication of those who designed and built it, its main purpose, of course, is to facilitate the performance of those essential activities that are conducted within it. During a 24-hour period the building provides work stations for about 800 persons. Last year, there were processed here over 400 million checks with an aggregate value of nearly $250 billion; more

than 500 million pieces of currency and coin with an aggregate value well over $1 billion; more than 13 million U.S. Government securities with an aggregate value of nearly $50 billion; more than 1 million wire transfers of funds with an aggregate value over $1 trillion; and more than 1,000 loans to member banks with an aggregate amount of nearly $9 billion. In addition, numerous other activities were performed here, ranging, for example, from the processing of nearly 50 million food stamps to the examination and supervision of banks and the administration of numerous laws and regulations, to the holding and servicing of over $1 billion of member bank reserves.

"The Federal Reserve banks are unusual establishments, basically public but with important representation on their boards of directors of the banking, business, and general public interests, with roots deep in their regions, and a significant degree of independence within the Government. They are not designed or operated for the purpose of earning profits, but they are profitable. The Federal Reserve Bank of Dallas had net earnings last year of nearly $362 million, most of which was paid to the U.S. Treasury as interest on Federal Reserve notes issued by the Bank.

"I would close these brief remarks with the hope that if the ceremony conducted here today were to be recalled threescore years hence, it would be done in a setting in which the parade of life on Akard Street still would be described as 'some of the best of Dallas' and that the activities conducted within this building would still be described as essential, designed to serve the people's needs, and performed efficiently and well. Finally, that life on Akard Street will continue to be sufficiently robust that our Guardian Angels will not become bored or too relaxed with the roles assigned to them by the architects and builders of this structure."

Net Earnings on Demand Deposits Vary Widely

By Mary G. Grandstaff

Regulations impose a larger reserve requirement on demand deposits than on time and savings deposits. But since banks are not permitted to pay interest on checking accounts, handling charges represent the only expense in obtaining these demand deposit funds, and most banks recover at least part of such expenses through monthly service charges and fees on these accounts. Thus, commercial banks generally have a higher rate of net earnings on demand deposits than any other source of funds.

The rate of profitability on demand deposit funds, however, varies widely from bank to bank. An analysis of demand deposit data obtained from the latest functional cost analysis (FCA) study by the Federal Reserve Bank of Dallas provides some indication of the variability of individual-bank net earnings from these accounts.

The FCA study, covering 1977 operations of participating members of the Federal Reserve System, includes 83 Texas banks. (A few member banks in the Eleventh Federal Reserve District portion of Louisiana also participated in the study. But for the purposes of this analysis, these banks were excluded because differences in state banking laws may cause the data to be somewhat incompatible.)

Overall, net earnings on demand deposit accounts at the 83 banks ranged from a net loss of almost 1 percent to a net profit of more than 6 percent. In examining demand deposit data for the individual banks, a great divergence in bank management and/or philosophy is evident. For example, it is a fact that banks must retain cash to cover day-to-day operations. And the member banks are required to retain a percentage of their total demand deposits as reserves in the form of either vault cash or deposits at their Federal Reserve Bank.

Reserve requirements on demand deposits range from 7 to 16¼ percent, based on total deposit size of a bank, and cash on hand can be counted toward the total requirement. Thus, it might be expected that the proportion of demand deposit funds invested in the portfolio of loans and securities—which ranged from 57 percent to 88 percent at the 83 banks—would be highest for small banks.

Small banks, in general, did have a somewhat larger portion of demand deposit funds invested in their portfolio than did the largest banks. However, the individual bank that had the lowest proportion of demand deposit funds invested in the portfolio—57 percent—was one of the smallest, and apparently most conservative, banks. On the whole, intermediate-size banks tended to have a higher ratio of demand deposits invested in their portfolio than small banks, despite the former's higher reserve requirements.

The individual-bank ratios of income from funds invested in the portfolio to total demand deposits also show a wide variation in the ability of banks to maximize return on invested funds. For example, the highest ratio—7.196 percent—was realized by a relatively small bank that had about 84 percent of its demand deposit funds invested in its portfolio. The lowest ratio—2.865 percent—was realized by a fairly large bank with almost 69 percent of its demand deposits invested. For comparison, portfolio income at the bank that had only 57 percent of its demand deposit funds

invested amounted to 3.701 percent of total demand deposits—or considerably more than the bank that had 69 percent of such funds invested.

Income from service and handling charges ranged from 0.147 percent to 5.455 percent of total demand deposits at the 83 banks in 1977. In general, this income as a percentage of total demand deposits tended to be progressively higher at smaller banks, but a few relatively small banks had very low income from service and handling charges in relation to total demand deposits.

It is not surprising that larger banks generally have lower service and handling charge ratios. In general, the FCA study indicates a higher average demand deposit account balance for these banks, and most banks impose service and handling charges on a graduated basis as account balances decline to progressively lower specified levels. Thus, it would be logical to expect higher charges at those banks with smaller average balances.

Income is not the sole criterion in gauging the earnings ratio on demand deposits: expenses are equally important. The importance of cost efficiency is well evidenced by the fact that only two of the top ten banks in terms of total income managed also to be among the ten most profitable banks. In addition, one bank that ranked 67th in total income had the lowest operating expenses among the 83 banks and moved up to 7th position in profitability.

Of the ten banks with lowest net earnings on demand deposits, two ranked among the top ten in terms of total income to total demand deposits. Because of high expenses, however, their net earnings dropped to near the bottom. Overall, six of the ten least profitable banks ranked among the top ten in terms of total expenses. Among the most profitable banks, only two were in the top ten in terms of total expenses.

The relative profitability of demand deposits appears to be little affected by size of bank. Some larger banks ranked rather high in terms of net earnings on demand deposits, while others ranked low. And the same is true of small- and medium-size banks.

Further analysis of the 1977 FCA study suggests that age and location of a bank might have a slight effect on net earnings. Eight of the ten banks that obtained the highest profitability ratio on demand deposits were organized prior to World War II, compared with only four of the ten least profitable banks. And six of the most profitable banks were located in fairly small urban areas, while all of the ten least profitable were located in or near relatively large metropolitan areas. This would seem to suggest that competitive pressures—in both obtaining and investing funds—may have a greater impact on banks located in the larger metropolitan areas.

Nevertheless, further analysis of the FCA study also indicates that cost efficiency and overall management philosophy are the predominant factors affecting profitability on demand deposits. For example, the most profitable bank was the second smallest among the 83 reporting banks. In addition, it was located in a fairly large metropolitan area and was organized in the 1970's. Moreover, the second and third most profitable banks ranked in

DEMAND DEPOSIT INCOMES AND COSTS IN 1977 AT TEN TEXAS BANKS WITH HIGHEST OR LOWEST NET EARNINGS ON DEMAND DEPOSITS

(Member banks participating in Functional Cost Analysis Program, Eleventh Federal Reserve District)

Rank of bank's total deposits	As percent of total demand deposits[1]					
	Funds invested in portfolio	Portfolio income	Service, handling charges	Total income	Total expenses	Net earnings
Highest banks						
82	83.59 (9,10)	5.328 (51)	4.751 (2)	10.281 (2)	3.976 (21)	6.305 (1)
51	76.99 (43)	6.177 (23)	2.393 (8)	9.102 (5)	3.561 (26)	5.541 (2)
53	80.24 (26)	6.210 (21)	.821 (43)	7.193 (35)	1.683 (76)	5.510 (3)
31	80.90 (23)	6.823 (3)	.565 (58)	7.434 (25)	2.020 (68)	5.414 (4)
52	73.23 (54)	6.344 (18)	.334 (72)	6.713 (44)	1.368 (79)	5.345 (5)
60	79.18 (30)	6.598 (8)	1.201 (29)	7.835 (16)	2.560 (44)	5.275 (6)
12	83.16 (13)	5.576 (46)	.182 (81)	5.769 (67)	.582 (83)	5.186 (7)
40	84.87 (4)	6.486 (11)	.822 (42)	7.338 (29)	2.260 (58)	5.078 (8)
78	84.78 (5)	6.378 (16)	.376 (69)	6.962 (41)	1.897 (72)	5.065 (9)
16	82.52 (15)	6.503 (10)	.538 (60)	7.056 (39)	2.076 (65)	4.980 (10)
Average...	80.95	6.242	1.198	7.568	2.198	5.370
Lowest banks						
7	59.60 (82)	4.643 (76)	.361 (70)	5.027 (79)	2.310 (56)	2.717 (74)
6	69.91 (63)	4.950 (62)	.499 (67)	5.584 (69)	2.921 (38)	2.662 (75)
49	80.61 (25)	6.230 (20)	2.194 (11)	8.600 (7)	6.008 (4)	2.592 (76)
69	72.74 (59)	4.906 (65)	1.644 (19)	6.623 (49)	4.310 (14)	2.314 (77)
76	73.29 (53)	4.749 (72)	2.954 (4)	8.321 (10)	6.032 (3)	2.288 (78)
79	68.49 (67)	4.847 (68)	1.381 (22)	6.351 (56)	4.802 (10)	1.550 (79)
13	68.81 (65)	2.865 (83)	.303 (75)	3.664 (83)	2.357 (53)	1.308 (80)
83	75.45 (50)	4.854 (67)	2.441 (7)	7.495 (22)	6.898 (2)	.597 (81)
81	57.01 (83)	3.701 (81)	1.758 (18)	5.601 (68)	5.485 (7)	.115 (82)
50	77.81 (34)	3.181 (82)	1.041 (31)	4.306 (82)	5.269 (9)	−.963 (83)
Average...	70.37	4.493	1.458	6.157	4.639	1.518

1. Figures in parentheses indicate rank among the data for all 83 participating Texas banks.

the 50's in terms of total deposit size, both were located in suburbs near large metropolitan areas, and one was organized in the 1960's.

On average, the income ratio on demand deposits at the ten most profitable banks exceeded that for the ten least profitable banks by about a fifth—largely because of the higher percentage of funds invested in loans and securities at the most profitable banks. In addition, the most profitable banks, on average, were able to hold their expense ratio on demand deposits to less than half that of the least profitable banks and, thus, further improved their relative profitability performance.

Seasonal Borrowing Available from Fed

Seasonal borrowing, a credit arrangement that involves a commitment from the Federal Reserve to lend a member bank sufficient funds to carry it through periods when deposits are seasonally low and/or loan demand is seasonally high, is available to member banks that serve specialized communities, such as agricultural, resort, or college areas. Because the Eleventh Federal Reserve District, which includes Texas and parts of Louisiana, New Mexico, and Oklahoma, contains a number of such areas, approximately 60 percent of the member banks in the District qualify for seasonal credit.

To qualify, a member bank must have a recurring seasonal need for credit. Seasonal needs could result from a variety of factors, such as those related to crop or livestock production cycles. For example, in many rural towns, farmers typically borrow from their community bank to finance the planting of crops. During the growing season, farmers' deposits at the bank fall continuously while their financing needs grow. As a result, the community's financing needs are often greatest when bank deposits are lowest. This puts a financial strain on the bank. After the crops are harvested and sold, however, financing needs decrease, loans are repaid, and excess funds are deposited in the bank. This cycle occurs every year, and every year the bank goes through alternating periods of financial pressure and ample funds. To help banks cope with these seasonal pressures, the Federal Reserve provides a seasonal borrowing privilege for member banks.

Any member bank with deposits under $500 million that experiences seasonal variations in its loans or deposits may be eligible for a seasonal credit line. To identify banks that may qualify for seasonal credit, the Federal Reserve analyzes available deposit and loan data from preceding years. Member banks that appear to qualify are contacted. However, other data or recent changes in an area may qualify other banks as well. Therefore, any member bank that is interested in a seasonal line of credit or would like further information about the seasonal borrowing program should contact the Loan Department at its Federal Reserve Bank or Branch.

Automatic Transfer Accounts Ruled Illegal

Automatic transfers of funds between savings and checking accounts at banks and third-party payments from accounts at savings and loan associations and credit unions were declared illegal by the U.S. Court of Appeals in Washington, D.C., on April 20, 1979.

The court, in rendering its decision, said that the Federal regulators violated banking laws in authorizing the practices. Specifically, the court said the Federal Reserve Board, the Federal Home Loan Bank Board, and the National Credit Union Administration have violated laws prohibiting payment of interest on checking accounts.

The court also noted that each type of financial institution had won approval from its own regulatory agency to install the automatic transfer accounts "in order to gain a competitive advantage, or at least competitive equality." The result has been three separate types of financial institutions rapidly becoming identical in services "without the benefit of Congressional consideration and statutory enactment."

The case was brought to court as a result of three separate lawsuits. The American Bankers Association challenged the legality of the credit union "share draft" program, the Independent Bankers Association of America brought suit against savings institution offerings of checklike accounts, and the U.S. League of Savings Associations challenged the legality of the Federal Reserve's approval of automatic fund transfer accounts at commercial banks.

The effective date of the court's order was delayed until January 1 in order that Congress might have time to pass new legislation, if it is so inclined, approving such accounts. Banks may continue to offer the service until the January 1 effective date.

Banks were first permitted to offer automatic transfer of funds on November 1, 1978. The Board has estimated that as of April 25, savings deposits totaling over $6 billion were authorized for automatic transfer accounts at 351 commercial banks.

New nonmember banks

Equitable Bank, Dallas, 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 May 7, 1979.

Klein Bank, Houston, 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 May 21, 1979.

Liberty State Bank, Lubbock, 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 May 21, 1979.

Regulatory Briefs

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

• **A PLAN TO RESTRUCTURE RESERVE REQUIREMENTS** on certain borrowings by member banks and Edge Act corporations has been proposed for public comment by the Federal Reserve Board. Under the proposal, member banks would be required to maintain a 3-percent reserve against borrowings from domestic offices of nonmember banks and other depository institutions whose liabilities are not subject to reserve requirements. Also covered by the proposal are member bank borrowings from the U.S. Government, principally in the form of Treasury tax and loan account note balances, and certain repurchase agreements on U.S. Government and agency securities. These liabilities are currently exempt from the Board's reserve requirements.

The proposed actions are designed to establish more effective control over growth of bank credit. Approximately 20 percent of the growth in commercial bank credit during the past six months has been financed by exempt borrowings in the form of Federal funds and repurchase agreements on U.S. Government and agency securities. It is anticipated that the proposed reserve requirements would moderate the growth of commercial bank credit financed by these types of bank liabilities.

Under the Board's proposal, the only types of repurchase agreements and Federal funds borrowings that would not be subject to reserve requirements would be borrowings from another member bank, a U.S. branch or agency of a foreign bank, or an Edge Act corporation.

• **AMENDMENTS TO REGULATION Q** to permit member banks to pay higher rates on small time and savings deposits have been proposed for public comment by the Board of Governors. Specifically, the Board is considering one or more of the following actions:

1. Creation of a new time deposit category with a five-year maturity and a minimum denomination of $500.

2. Creation of a new eight-year category of rising-rate time deposit with a minimum denomination of $500.

3. Authorization for member banks to pay an interest bonus on savings funds held by individuals or certain nonprofit organizations.

4. Reduction of the $1,000 minimum-denomination requirements currently imposed on certain time deposits by Regulation Q to $500.

Comments were received through May 4, 1979.

• **A UNIFORM POLICY FOR CLASSIFICATION OF DELINQUENT CONSUMER INSTALMENT LOANS** has been proposed by the Federal bank regulators. The Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board issued the proposed interagency policy for the purpose of promoting improved and uniform treatment for the classification of delinquent consumer loans. The proposal would replace widely varying policies among the three agencies.

The proposed policy would establish the following standards:

1. Consumer instalment loans and mobile home loans treated as consumer instalment loans would be considered delinquent when 30 days or more overdue.

2. All consumer loans overdue for more than 60 days but less than 120 days would be classified as substandard.

3. Consumer instalment loans overdue more than 120 days for which there is a recent record of regular contractual payments would be classified as substandard.

4. Consumer instalment loans overdue for more than 120 days would be classified as losses unless the two most recently due instalments have been paid in full on time. There are two exceptions to this classification. Mobile home loans treated as consumer instalment loans on which payments have been overdue for more than 180 days would be excepted if the two most recently due instalments have been paid in full or if the collateral pledged for such a loan has been repossessed within the 180-day period. The other exception would be the uninsured portion of loans made under Federal Housing Authority Title I when

claims have been filed or, in the absence of claims, that are overdue 180 days.

Credit extended on the basis of bank credit cards, check credit, and overdraft credit would be treated the same as consumer instalment loans.

The proposed policy does not apply to business instalment loans.

• **THE BOARD OF GOVERNORS HAS ENDORSED A LEGISLATIVE PROPOSAL** that would enable each regional Federal Reserve Bank to add three new Class C directors. Currently, the Board appoints three Class C directors at each Reserve Bank. Class C directors cannot be officers, directors, employees, or stockholders of any bank. The increase would enable the Board to comply more quickly with the Federal Reserve Reform Act of 1977, which urged greater representation on Reserve Bank boards of directors from consumer, labor, and service groups.

In addition to the Class C directors, each Federal Reserve Bank has three Class A and three Class B directors. Class A and B directors are elected by the member banks in the Federal Reserve District. Class A directors are usually active officers of member banks. Class B directors are elected to represent the public.

The same legislative proposal would align the terms of the Chairman of the Federal Reserve Board and the President of the United States. The change would formally align the four-year terms of the Chairman and the President on the condition that the Chairman take office one year after the inauguration of the President.

The one-year lag should effectively prevent the Chairman from becoming entangled in the politics of the presidential election. The alignment of terms with a one-year lag period would afford the President the widest choice possible in selecting a Chairman with views compatible with his own.

The proposal would allow the outgoing Chairman or Vice Chairman to continue in office. The Vice Chairman's term would not be aligned with the President's.