FEDERAL RESERVE BANK OF RICHMOND

MONTHLY REVIEW

Edge Act Corporations

Origins of Industries—Coal

Fifth District Banking Structure

The Fifth District

JUNE 1967

EDGE ACT CO
AND INTERNATION

Commercial banking in the United States has undergone almost revolutionary changes in the last decade. These include a growth of more than 80% in total assets, immense changes in the structure of assets and liabilities, and the development of new sources and outlets for funds. One of the more interesting developments during this period, however, has been the growth of international operations.

Several methods are available to United States banks for conducting business abroad, with the method chosen by a particular bank depending upon the size of the bank, the type of operations engaged in, and conditions in the countries in which business is conducted. Many banks use the services of correspondents, some establish foreign branches, while some find special subsidiary institutions to be especially suitable to certain types of operations or to operations in certain areas of the world. A few banks have large foreign departments and extensive overseas branch operations as well as special subsidiaries. This article discusses certain aspects of foreign banking and financing subsidiaries, or what are known as Edge Act and agreement corporations.

The Background United States commercial banks are relative newcomers to the field of international banking and finance. Prior to World War I, a large part of world trade was financed in sterling by London banks. Until the enactment of the Federal Reserve Act in 1913, national banks could not establish branches abroad nor were they authorized to create bankers' acceptances, the chief method of financing foreign trade. Several state banks did establish foreign branches, however, and by 1914 two foreign banking corporations were operating branches overseas.

The Federal Reserve Act authorized national banks to establish foreign branches, subject to approval by the Federal Reserve Board, and to accept drafts. This action contributed to a rapid increase in the number of foreign branches of U. S. banks during and after World War I, but soon after passage of this legislation concern was expressed over the inability of small banks to establish branches abroad. The idea was advanced that small banks could participate in foreign branching by joining with other banks in establishing special foreign banking corporations. Such participation was made possible in 1916 when Congress amended Section 25 of the Federal Reserve Act to authorize national banks with capital and surplus of $1 million or more to invest up to 10% of their capital and surplus in

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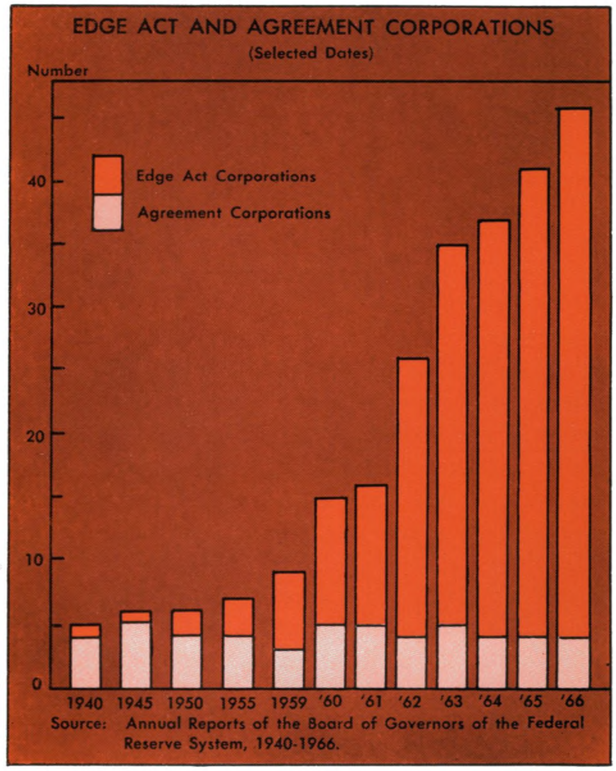


the stock of corporations chartered "under the laws of the United States or of any state thereof, and principally engaged in international or foreign banking. . ." The law did not provide for Federal chartering of the corporations, however, so the only corporations to which the amendment applied were those established under state laws.

Before any national bank would be permitted to buy stock of such corporation, the corporation had to enter into an agreement with the Federal Reserve Board to conduct its business in such manner or under such limitations and restrictions as the Board might prescribe. Because of this requirement, these came to be known as "agreement corporations."

World War I brought fundamental alterations in the international financial and trade position of the United States which contributed to the emergence of a sentiment in favor of a much more aggressive role for the United States in the world economy. The amendment of the Federal Reserve Act in 1919 by the addition of Section 25 (a) was partly a reflection of this development. A primary objective of this section, commonly known as the Edge Act after its sponsor, Senator Edge of New Jersey, was to encourage the expansion of U. S. exports by providing credit to European buyers.

Section 25 (a) authorized the Federal Reserve Board to charter corporations 'for the purpose of engaging in international or foreign banking or other international or foreign financial operations. . . either directly or through the agency, ownership, or control of local institutions in foreign countries. . ." The Act required a minimum capital of $2,000,000 and provided that a majority of the shares of such corporations shall at all times be held and owned by citizens of the United States or by corporations or firms the controlling interest of which is owned by citizens of the United States.

The corporations were granted certain powers, subject to such rules and regulations as the Federal Reserve Board might prescribe. Regulation K, first issued by the Board in 1920 and revised several times since, sets forth general rules governing the operations of Edge corporations. This regulation was most recently revised in 1963. Thus, the chartering and regulation of Edge corporations was placed in the hands of the Federal Reserve Board.

Early Activities The passage of the legislation described above, the altered position of the United States in the international economy, and the growth of foreign trade and investment resulted in a rapid expansion of foreign banking and financing corporations in the decade following World War I. Between 1919 and 1929, 18 corporations were organized, of which 15 were agreement corporations operating under state charters and three were Edge corporations chartered by the Board of Governors.

For the most part, the corporations formed in this period were concerned with general foreign banking, and they established numerous branches in Europe, Latin America, and Asia. A few of the corporations were wholly-owned by large United States banks, but in a number of cases large banks in financial centers shared ownership with their domestic correspondents. Stockholders of one New York based corporation included more than 30 banks located in 20 odd states. A few were jointly owned with foreign interests. Some were designed to facilitate certain types of exports by providing better credit facilities. An example of this type was a corporation based in New Orleans and owned by banks in the South and Southwest. Its major objective was to provide better credit facilities for the export of cotton, tobacco, and lumber.

The history of these early ventures was not a particularly happy one. By the early thirties, most of those established in the postwar decade had been liquidated or absorbed by other corporations or by banks. Many of the liquidations involved losses to stockholders.

A number of developments contributed to the lack of success of the Edge Act and agreement corporations in this early period. A desire to get in on a new thing may have contributed to the establishment of more corporations than were called for by conditions in world trade and finance, while at the same time U. S. banks were expanding their foreign departments and adding to the competition for foreign business. A lack of personnel experienced in this type of operation also contributed to the unfavorable performance. Finally, many corporations were chartered shortly before or during the decline in world trade that accompanied the economic recession of 1920-21. This was followed by a period of unusual instability in world prices in the 1920's and the worldwide depression and breakdown of international economic relations in the 1930's.

Whatever the causes, by the early 1930's foreign banking through the establishment of Edge Act and agreement corporations had entered an hiatus that lasted until the late 1950's. As the accompanying chart shows, only one Edge corporation and 4 agreement corporations were in operation at the end of 1940. Three Edge corporations had been formed in the 1920's, but the last of these was liquidated in 1933, and the only one remaining in 1940 was an affiliate of Chase National Bank that had been chartered in 1930.

Recent Growth The rebirth of interest in foreign banking and financing affiliates, like so many of the major changes in international trade and finance since World War II, did not come about until after the general movement toward currency convertibility by the world's major nations in 1958. As late as 1959, for example, there were only 9 Edge Act and agreement corporations, as compared with a total of 6 in 1945. In 1960 the number more than doubled, and by the end of 1966 it had risen to 46. Growth since 1962 has been very rapid and all of the increase has been in Edge Act corporations.

This does not mean, of course, that the return to convertibility on current transactions was the cause of the rebirth of interest in foreign banking and financing subsidiaries. This move, while symbolic of a "return to normalcy" in international financial affairs after a quarter century of restrictions and controls, was only one of a number of developments contributing to the remarkable expansion of foreign operations of U. S. banks. Among these were the creation of a new monetary order, based on the International Monetary Fund, with the U. S. dollar occupying the position of key reserve and trading currency. Closely related to this was the emergence of the "Euro-dollar market," a true international money market in United States dollars. In addition, the creation of the Common Market in Europe and the drive toward economic development in many of the world's underdeveloped areas contributed to the doubling of world trade in the last decade, as well as the tremendous increase in the flow of investment funds from the United States to countries all over the world.

These developments required financing, and since the U. S. dollar was the world's chief trading and reserve currency, much of the financing was done through U. S. banks. Moreover, the rapidly expanding operations of United States businesses in foreign markets created a growing demand on the part of bank customers for advice concerning foreign markets and foreign laws and regulations. Many of these services were provided through expanded correspondent relationships and branch operations, but some banks elected to enter the foreign field through an Edge Act subsidiary.

Operations of Corporations From time to time there have been attempts to separate the banking and financing operations of Edge corporations.

Regulation K, as revised in 1957, required Edge corporations to operate as either banking or financial subsidiaries, with important differences in the powers enjoyed by each type. Because of these differences, some banks formed one of each. The 1963 revision of the Regulation eliminated the formal distinction between the two types, however, although there are still certain differences between the powers and privileges of corporations "engaged in banking" and those that are not.

Corporations enjoy rather broad powers under Section 25 (a) and Regulation K. They may acquire and hold shares of a foreign corporation if such acquisition is incidental to the extension of credit to the corporation, if the acquisition consists of shares in a foreign bank, or is otherwise likely to further the development of U. S. foreign commerce. Prior consent of the Board of Governors is required, however, if the acquisition results in the corporation holding 25% or more of the voting shares of a foreign bank or if the aggregate amount invested in the shares of another corporation exceeds $200,000.

Corporations are empowered to receive deposits outside the United States as well as demand and time (but not savings) deposits in the United States, if the latter are incidental to or for the purpose of carrying out transactions in foreign countries. They may issue letters of credit, accept bills and drafts drawn upon them, trade in foreign exchange, and in general carry on a banking business as it relates to foreign operations.

Actual operations of foreign subsidiaries vary considerably. Some carry on banking operations comparable to those of the foreign department of a large commercial bank. These include the acceptance of deposits, issuance of letters of credit, extension of loans, collections, and other banking operations. Such operations may be carried on directly or through ownership of foreign commercial banks. Other corporations go beyond the provision of short-term commercial bank credit and to an increasing extent in recent years they have served as holding companies for the stock of foreign nonbank corporations. The latter have consisted primarily of financial institutions, such as underwriting and brokerage firms, factors, and trust affiliates. Commercial and industrial concerns with activities ranging from steel to shipbuilding to electrical appliances have also been included, but these have been relatively unimportant, amounting to only about 5% of total investment.

Reasons for Revival It is easy to attribute the recent revival of interest in Edge corporations to the substantial growth in foreign trade and investment in the last decade. But this does not explain why banks chose to expand foreign operations through Edge corporations rather than through correspondent or branch operations.

The foregoing discussion of the operations of Edge corporations should indicate some of the advantages enjoyed by these affiliates. The fact of the matter is that United States banks can do a number of things through Edge affiliates that they cannot do directly. The most obvious of these is the ability to own equity shares in foreign banking or nonbank subsidiaries. This is particularly advantageous in carrying on banking operations in countries where foreign banks are not permitted to operate branches. This advantage of Edge corporations was somewhat reduced, however, by the recent revision of Regulation M which permits member banks, within certain limits and with prior approval of the Board of Governors, to purchase stock of foreign banks directly.

An Edge corporation's ability to acquire an equity interest in nonbank financial institutions and to engage in a variety of financing activities adds greatly to its flexibility. A type of operation of growing importance in recent years has been the joint venture, where the Edge corporation acquires a portion (and sometimes less than a controlling interest) of a foreign corporation in partnership with one or more foreign interests. In some instances two or more Edge corporations may join together to acquire part or all of the shares of a foreign corporation.

Another reason for using the Edge method of expanding foreign operations derives from the inability of commercial banks in the United States to establish branches outside the state in which the head office is located. Thus, a bank operating in North Carolina would not be able to establish a branch in New York City for the purpose of conducting foreign operations, but it could acquire such an office through the formation of an Edge Act subsidiary. Many banks have used this device for precisely this purpose.

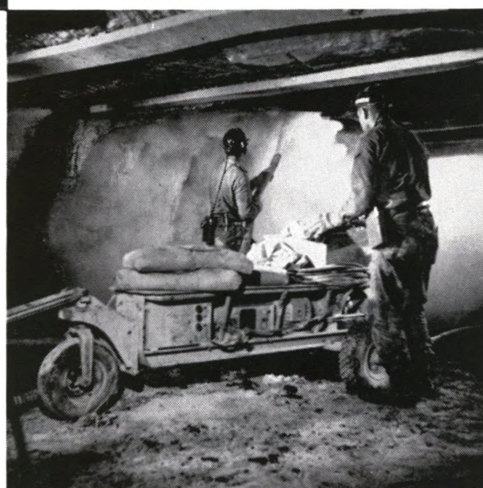
The historical section of this article draws heavily on "United States Banking Organization Abroad" by Frank M. Tamagna and Parker B. Willis in the *Federal Reserve Bulletin*, December 1956.

Coal mining operations in the Fifth District date back to the eighteenth century. As early as 1725, settlers in the backcountry of Virginia and Maryland were aware of the existence in those areas of sizable deposits of bituminous. Because of limited commercial demand and high transportation costs, however, these deposits were not exploited until much later in the century. The first commercial mining of soft coal in North America began in 1750, with the discovery of an unusually rich vein in the Richmond area of Virginia. By the end of the century, commercial operations were under way in Western Maryland and in what is now West Virginia. Domestic demand for coal soared with the industrial development of the country in the Civil War and post-Civil War period. Early industrial users of coal preferred anthracite to bituminous because anthracite contained less volatile matter and hence produced much less smoke. The great anthracite strike of 1902, however, encouraged industrial users to seek substitutes. It was at this time that the "smokeless coal" fields of West Virginia were developed. These coal fields yielded a low volatility bituminous coal, which was a reasonably close substitute for anthracite. From that time, West Virginia has been a major coal-producing state and today produces more than any other state. Virginia ranks sixth. Coal was first transported from the mines to industrial sites by flat boats and barges. By the middle of the nineteenth century, however, railroads were being run to the mines and by the turn of the century accounted for the bulk of coal transportation. Today 73 per cent of all domestic coal production is shipped by rail, with the remainder carried chiefly by water transportation and by truck. Coal production in the District centers in the Appalachian Coal Field, which extends through Western Maryland, Southwest Virginia, West Virginia, and the northwest corner of Georgia. The coal found in this area is bituminous or soft coal and is used widely by industry and for home heating. Coal of this type is also found in smaller quantities in North Carolina. Mining techniques have made rapid strides in the last several decades. Modern machinery and technology have increased output from six tons per day per miner in 1945 to about 16 tons in 1964. Safety standards and equipment also have been improved vastly. Coal production today is complementary to many major industries, including transportation, steel and other metals, and electric power production. In recent years it also has emerged as an increasingly important raw material for the chemical industry. It has also assumed increasing significance as an export commodity.

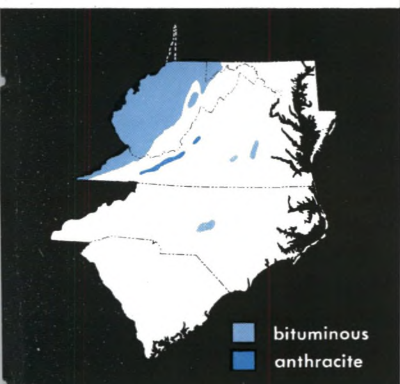
CREDIT: The National Coal Association

A towboat pushes six giant barge loads of coal along the Ohio River. In the background is the mine where the coal was produced and loaded. Lowcost water transportation helps keep coal competitive, particularly for plants located along inland waterways.

Exhibiting more teeth than a smiling shark, the ripper head of a continous mining machine moves up to the coal seam. These machines rip coal from the seams with steel bits, scoop it up and load it into shuttle cars or conveyor belts—thus eliminating the conventional steps of undercutting, drilling, blasting, and loading the coal.



Safety is a paramount consideration in bituminous coal mining. These miners use a special machine to spray rockdust—powdered limestone—over exposed coal surfaces in a mine in West Virginia. The rockdust covers the coal dust allaying the danger that a minor gas explosion could be multiplied by explosive coal dust.



Coal-producing areas in the Fifth District.

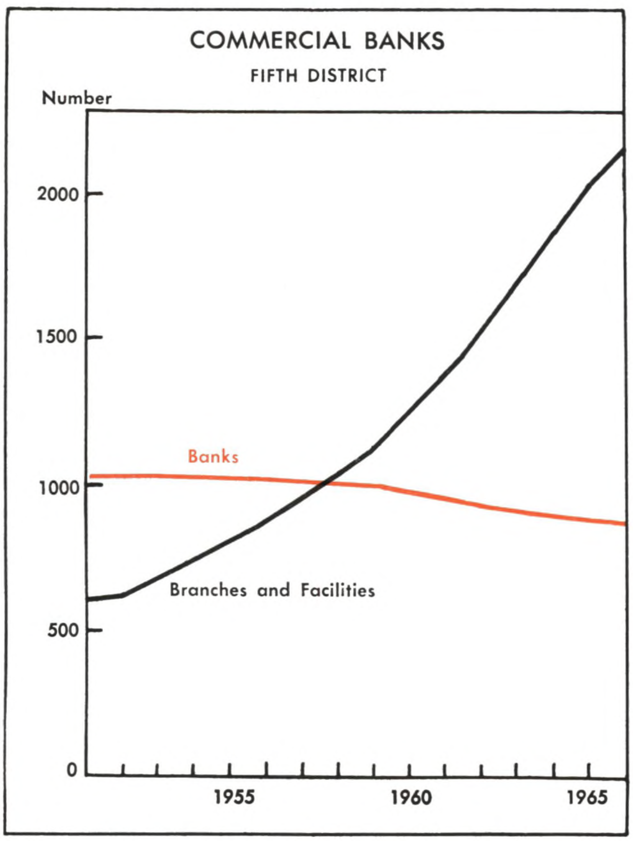
ORIGINS OF INDUSTRIES

COAL

Changes in Fifth District Banking Structure

The banking structure of the Fifth Federal Reserve District has changed with amazing speed in recent years. There are fewer banks, but many of them are much larger, and they operate more offices. Also, many of them are now affiliated with bank holding companies, and some have expanded their operations abroad. Fifteen years ago, in 1951, there were 1,049 commercial banks in the Fifth District, operating a total of 622 branches. All of the branches of each bank were in the same state as the home office, of course, since banking laws do not permit branching across state lines. Over the next ten years, the number of banks declined slowly to 960 in 1960, and the number of branches increased to 1,207. Then the movement began to gain momentum, and by the end of 1966 there were only 842 banks, but they operated a total of 2,169 branches.

Bank holding companies also have made rapid progress. Ten years ago, there was only one bank holding company operating in the District. Today there are four, with a total of 38 affiliated banks and 247 banking offices. The application of a fifth has just been approved by the Board of Governors, and another, which would have been the largest in the District, was denied recently. Holding company activity has been confined primarily to Virginia.



Restrictions on Branching The emerging banking structure has been shaped largely by state banking laws. Although all banks except nonmember, noninsured banks must secure the approval of a Federal agency in order to merge or open a branch, the extent to which banks may branch and the methods they may use are governed by state laws, except in the District of Columbia. Banks in the nation's capital are regulated by the Comptroller of the Currency under Federal legislation. Statewide branching is permitted in South Carolina, North Carolina, and Maryland. A bank in any of these three states may open a branch anywhere in the same state, with the approval of the proper authorities. West Virginia banks are not permitted to branch. Banks in the District of Columbia may branch, but not across the state lines into Virginia or Maryland.

In Virginia, statewide branching with certain limitations was permitted before 1948, but from 1948 to 1962, the formation of new branches was restricted to "the limits of the city, town, or county in which the parent bank is located," and branching through merger or absorption of an existing bank was permitted provided the merged bank was in the same or adjoining county or within 25 miles of the parent bank, and that each of the banks had been in operation five years or more. In 1962, the law was amended to allow banks to branch anywhere in the state through merger, but they could still open new branches only in their home territories.

The only Fifth District states in which bank holding companies are prohibited are South Carolina and West Virginia, but such companies have been most active in Virginia, apparently as a result of the 1962 amendment to Virginia's banking laws. The 1962 legislation made it possible for a bank to branch into any part of the state through merger, but upon consummation of a merger, one of the banks must become a branch in order to remain open. And since a branch office cannot open branches of its own, the branch operations of the parent bank in the new area are limited to the offices already operated by the bank which it acquires. No new branch offices of the bank may be opened in that territory. But if a bank undertakes statewide expansion by forming a holding company, it faces no such limitations. The holding company may acquire new banks anywhere in the state and those banks, in turn, may open new branches within their home territories.

Federal Legislation Prior to 1960, there was little Federal legislation relating to bank mergers. State banks needed approval of their respective state banking commissions to merge, but the only power exercised by Federal bank supervisors was indirect. They influenced mergers by taking the position that their approval was necessary for the establishment of branches arising out of mergers.

The Bank Merger Act of 1960 was passed by Congress after several years of debate on the subject and signed by the President on May 13, 1960. It gave the Federal authorities more direct control over structure changes. For the first time, all insured banks were required to obtain the specific approval of one of the three Federal bank supervisory agencies before they could merge. Applications of national banks had to be approved by the Comptroller of the Currency, those of state member banks by the Board of Governors of the Federal Reserve System, and those of insured state nonmember banks by the Federal Deposit Insurance Corporation. Only nonmember, uninsured banks could merge without some sort of Federal approval.

The Act set up specific factors which each of the three regulatory bodies had to consider in passing on a merger: (1) Financial history and condition of the banks involved. (2) Adequacy of capital structure. (3) Future earnings prospects. (4) General character of management. (5) Convenience and needs of community to be served. (6) Whether corporate power would be consistent with the FDIC Act. (7) The effect of the merger on competition. After considering all of these factors, the agencies were directed not to approve any merger unless it found the transaction to be in the public interest.

In an effort to encourage uniform application of the Act by the three Federal agencies, Congress provided that the two agencies which did not have authority to take final action in a particular merger nevertheless had to submit a report on the competitive factors to the agency taking action. The Department of Justice also was required to submit a report on the competitive factors.

It was widely assumed in 1960 that banks were exempt from the antitrust laws, and that the investigation of proposed mergers by the Justice Department was to be for purely advisory purposes, but in the next few years after the 1960 Act was passed, the Justice Department challenged a number of bank mergers on the grounds that they violated either the Clayton or the Sherman antitrust laws. The first of these cases was the proposed merger of the Philadelphia National Bank and the Girard Trust Corn Exchange Bank. In a highly controversial ruling, the Supreme Court held that the proposed merger would violate Section 7 of the Clayton Act, and that competition was the controlling factor in determining the legality of a bank merger. The Court also viewed competition as a function of market structure, rather than performance.

Subsequent court decisions followed the same line of reasoning. On April 6, 1964, the Supreme Court held that the elimination of a competitor through merger in Lexington, Kentucky, was a violation of Section 1 of the Sherman Act. On March 10, 1965, a U. S. District Court in New York ruled that the Manufacturers Trust-Hanover merger was illegal.

Many viewed these and similar decisions as in effect doing away with the Bank Merger Act, since the test under the antitrust laws is strictly the effect of a merger on competition, as compared to the consideration of the banking factors and the overall effect on the public interest which was the test under the Bank Merger Act. This situation led to pressures to get Congress to pass legislation which would explicitly recognize that banking, as a highly regulated industry insofar as entry and expansion are concerned, ought to be viewed differently from nonregulated industries for purposes of antitrust regulation. Nearly three years of effort in this direction led to the passage, in February of last year, of the Bank Merger Act of 1966.

The 1966 Act provides that a merger may not be approved if its effect will be substantially to lessen competition or tend to create a monopoly, unless it is found that the anticompetitive effect would be clearly outweighed by the probable effect of the merger in meeting the convenience and needs of the community to be served. A March 1967 Supreme Court ruling suggests that, in any merger challenged by the Justice Department, the finding of public benefit necessary to support the merger will have to be made not only by the supervisory agency but also by the courts.

The major benefit of the 1966 Act for merging banks seems to be in the provision that mergers may not take place for 30 days after approval by the appropriate Federal supervisory agency, and if the

Justice Department does not contest the merger within that 30-day period, it may not do so at a later date.

Changes by State As might be expected, banking structure in the Fifth District has changed the least in West Virginia and the most in Virginia in recent years. Since 1960, the only change in numbers in West Virginia has been the addition of eight new banks, raising the total from 182 to 190. In Virginia, 32 new banks were established, but 86 mergers and absorptions brought a net reduction of 54 banks, from 305 to 251. The number of branches more than doubled, however, rising from 265 to 593. All of the 86 merged banks were converted to branches, 248 new branches were opened, and six branches were discontinued.

In South Carolina, the total number of banks fell from 145 to 128 as 11 new banks were established and 28 were merged or absorbed. As in Virginia, the number of branches rose sharply, from 141 to 296. Five branches were discontinued, but 132 new ones were opened, and all of the 28 merged banks were converted to branches. Only two new banks were opened in North Carolina, the smallest number in the District, and with 48 mergers, the total dropped from 183 to 137. North Carolina still has the largest number of branches, but since 1960 the number has increased at a slower pace than in the other states which permit branching. With 244 new branches, 48 banks converted to branches, and 10 discontinued, the total rose from 504 to 786.

In Maryland, 14 new banks have been established since 1960, the second largest number in the District. There were 25 mergers, and the net change reduced the total from 133 to 122. The number of branches rose from 237 to 406, as 154 new branches were opened, all of the 25 banks were converted to branches, and 10 were discontinued. In the District of Columbia, the number of banks rose from 12 to 14, as four new banks were opened and two were merged. The number of branches went up sharply, from 60 to 88. There were 27 new branches, two banks converted, and one branch discontinued.

By states, banking offices per capita at the end of 1966 ranged from a low of one office for every 5,400 people in Virginia to a high of one office for every 9,500 people in West Virginia. Between these two extremes, there was one office for every 7,800 persons in the District of Columbia, one for every 7,000 in Maryland, one for every 5,500 in North Carolina, and one for every 6,200 in South Carolina.

The growth in the size of banks during this period has been almost as striking as the growth in the number of banking offices. At the end of 1950, only one bank in the District had deposits exceeding $300 million, while two others had deposits over $200 million. By the end of 1961, one bank had almost $800 million in deposits and 11 others had deposits of over $200 million. Five years later, at the end of last year, one bank in the District had passed the $1 billion mark, three were over $700 million, and nine others had deposits ranging from $300 million to $700 million.

CHANGES IN NUMBER OF BANKS AND BRANCHES
Fifth District
1960 — 1966

All Commercial Banks	District of Columbia	Maryland	North Carolina	South Carolina	Virginia	West Virginia	Total
Number of Banks (beginning of period)	12	133	183	145	305	182	960
New Banks	4	14	2	11	32	8	71
Mergers and Absorptions	2	25	48	28	86	0	189
Number of Banks (end of period)	14	122	137	128	251	190	842
Net Change							− 118
Branches							
Number of Branches (beginning of period)	60	237	504	141	265	....	1,207
New Branches	27	154	244	132	248	....	805
Banks Converted to Branches	2	25	48	28	86	....	189
Branches Discontinued	1	10	10	5	6	....	32
Number of Branches (end of period)	88	406	786	296	593	....	2,169
Net Change							+ 962
Change in Banking Offices							+ 844

THE FIFTH DISTRICT

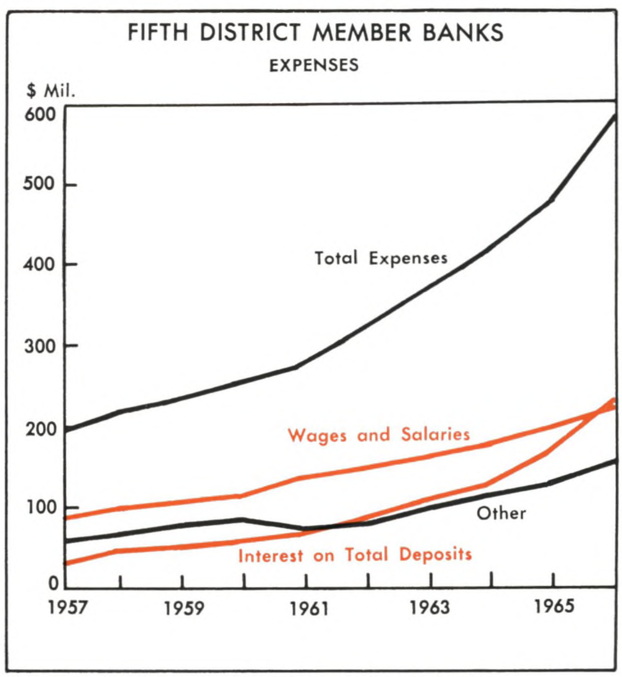
MEMBER BANK EARNINGS AND EXPENSES

Gross earnings of the 397 member banks in the Fifth Federal Reserve District reached an all-time high in 1966. Expenses also climbed to a record level, however, and net income after taxes rose only from 8.6% to 8.9% of total capital accounts. Cash dividends declared remained at 3.1% of total capital for the fourth consecutive year. The new gross earnings high of $805 million was the result of a record $121 million increase for the year, compared with a $74 million rise in 1965. Total current operating income averaged 5.39% of assets, up from 5.17% in 1965. Net income rose from .75% of total assets in 1965 to .77% last year. As usual, the banks with deposits of over $100 million received the major portion of total operating revenues. Although only 23 out of the 397 member banks in the District are in the over-$100 million class, they earned $522 million of the $805 million total. Member banks in Virginia, which outnumbered those of other District states by a wide margin, received almost one-third of the total revenues in the District. The 165 Virginia member banks earned $264 million. The next largest share went to North Carolina's 30 member banks.

Earnings by Source Income on loans provided $558 million for District member banks last year. Loans comprised 51.6% of total assets, but provided 67.1% of total earnings, down slightly from 67.4% in 1965. The average rate of return on loans rose from 6.99% in 1965 to 7.09% in 1966. Income on loans was relatively most important for the largest banks. Banks with deposits of over $100 million earned over six times as much on loans as they received from the next largest source, interest on Government securities. Banks in the smallest classification earned less than four times as much on loans.

District member banks earned $99 million in interest on U. S. Government securities in 1966. This amounted to 18.2% of total earnings, down from 18.5% in 1965. Interest rates averaged 4.50% in 1966, up from 3.93% the previous year, but banks trimmed their holdings of Governments from 23.4% of total assets in 1965 to 21.4% last year. Interest earned on other securities totaled $53 million in 1966, rising to 6.8% of total earnings from 6.0% in 1965 as holdings went up from 9.5% of total assets to 10.9%. Trust Department earnings, as might be expected, were concentrated heavily in the larger banks. The 321 member banks with deposits under $25 million earned less than $1 million of the $29 million total.

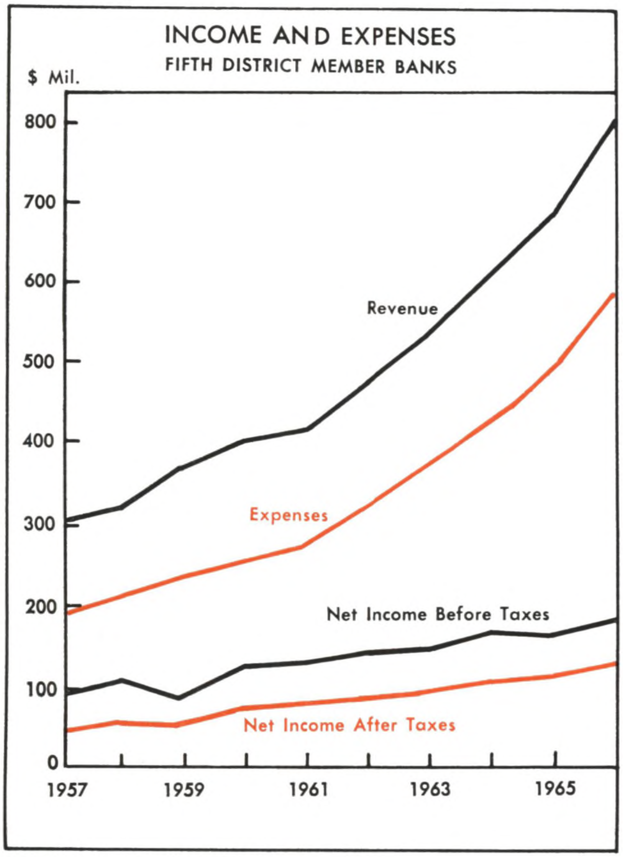
Expenses Current expenses of Fifth District member banks also reached a record high in 1966, totaling $577 million. They amounted to 73.9% of current earnings for the second consecutive year. Typically, the largest bank expenses are related to employment, but in 1966, for the first time, interest on time and savings accounts exceeded the total of wages, salaries, and benefits for all employees, including officers. Interest paid totaled $213 million compared with $165 million in 1965 and only $67 million five years ago. The increase was due to vigorous competition for deposits, with rising interest



rates and increased participation in the money market through the issuance of certificates of deposit.

Paradoxically, although the largest banks issued most of the certificates of deposit, the over-$100 million group was the only size class in which the sum of wages, salaries, and benefits exceeded interest payments in 1966. The 23 largest banks paid out $138 million to officers and employees compared with $128 million for interest payments. The other 374 member banks paid a total of $71 million in wages, salaries, and benefits; substantially less than the $85 million they paid in interest on deposits.

Interest on time and savings deposits averaged 37% of the current operating expenses at all member banks in the District, but the proportion varied substantially from state to state. The percentage was highest at Virginia banks, with 42%, then came West Virginia, 41%; District of Columbia, 38%; North Carolina, 36%; Maryland, 33%; and South Carolina with only 16%. Interest expense at South Carolina banks was a considerably smaller proportion of total expenses than at other District banks because most South Carolina banks paid lower rates on deposits and had much lower ratios of time deposits to demand deposits. The average interest rate on time and savings deposits at South Carolina banks was 3.36%, compared with an average for the Fifth District of 3.74%, and an average for banks in the District of Columbia of 4.17%. Time and savings deposits averaged 28.1% of total deposits at South Carolina banks, compared with an average of 48.8% for all member banks in the Fifth District.



Profits When current operating earnings rise rapidly, bank profits frequently lag. The same changes which bring higher earnings may bring higher costs. Strong loan demand forces banks to sell securities, and in a period of rising interest rates, securities sales result in losses. Of course, some losses on security sales are due to tax swapping—selling depreciated securities for losses which are deductible from taxable income, and buying other issues at a discount, on which the appreciation is taxed as capital gains; but the effects on current year profits are the same as any other losses. Rising interest rates, which usually accompany strong loan demand and rising operating earnings, also raise the cost of funds to banks.

In 1966, Fifth District member banks earned a total of $122 million after taxes. They declared cash dividends of $57 million and retained $65 million. Although profits reached a record high, as a percentage of current operating income they declined, as in the past two years. In 1963, after-tax income was 16.3% of current operating income. That figure dropped to 16.1% in 1964, 15.0% in 1965, and 14.9% in 1966. Over half of the total, $83 million, went to the District's 23 largest banks; but the smallest banks converted the highest proportion of current operating income into net profits. For banks with deposits of under $2 million, after-tax net income was 17.5% of current operating income. The next largest proportion, 16.5%, was for banks with deposits of $100 million or over. Banks in the $50-100 million class had the lowest percentage of profit, 12.9%. Average for all District banks was 14.9%.

Fifth District banks had a total of 36,383 employees at the end of 1966, 7,128 of which were bank officers. The average pay of officers ranged from a low of $6,800 at the smallest banks to $11,100 at banks in the $25-100 million class. The average pay of other employees ranged from $3,200 at the smallest banks to $4,100 at banks in the $100 million and over class.