

PERSPECTIVES ON FIFTH DISTRICT BANKING: 1960-1976

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The past decade and a half has seen significant changes in the organization, structure, and balance sheet composition of Fifth District banking. This article describes major developments that have occurred in these areas since the early 1960's. Some of the factors contributing to change, such as basic shifts in demand for bank services and Federal laws and regulations, are national in scope. Consequently, the pattern of change in the Fifth District has been similar to that in the U. S. banking industry as a whole.

In recognition of the similarity between changes in Fifth District and U. S. banking, measures of change taken across the entire banking industry are used in this article as benchmarks against which to evaluate District developments. Special regional factors are used to help explain differences in the nature and/or degree of banking change in the District as compared to the nation. These factors include regional economic differences and diverging state laws governing financial activities.

The question of how District banking has evolved in the period since the early 1960's is of special interest today, not only because the changes have been great but also because the banking environment may undergo major modifications in the years ahead. There is, for example, active consideration of Federal financial legislation having profound significance for banking. Examples of topics under consideration by the Congress include expanded thrift industry powers, NOW accounts, and revision of the Glass-Steagall Act and the McFadden Act. The evolution of the Fifth District banking industry during the period considered here will influence its response to possible future legislative changes.

BANKING ORGANIZATION AND STRUCTURE

Banking is organized under a variety of institutional forms, which include unit banking, branch banking, and group banking (bank holding companies). Federal and state banking laws prescribe

the types of organization under which banking can be conducted, while the actions of regulatory bodies determine the extent to which expansion is permitted under any given type. The number, size, and size distribution of these organizational types are among the chief determinants of banking structure. Banking structure reflects the degree of competition existing in banking markets and this, in turn, affects the efficiency with which a given market operates [2].

The concept of banking structure is relevant only when applied to a well-defined market for banking services. Market definition can be difficult since it depends on a number of factors including geography, commuting patterns, and the particular type of service being examined. When discussing the general array of banking services offered by a regional grouping of banks, a conventional simplification is to view banking markets in terms of political subdivisions. This approach is followed here, with the five Fifth District states and the District of Columbia taken as representing geographically distinct banking markets.

Common measures of banking market structure include: (1) the number of banks in the market, with consideration of their status as independent banks or holding company affiliates; (2) the number of banking offices in the market; (3) the extent of deposit concentration among the largest banking organizations; and (4) the absolute size of the banks operating in the market. Each of these four measures will be examined in this article. It is becoming increasingly important, however, to include nonbank thrift institutions among the competing firms when evaluating banking market structure. Since many of their services are substitutes [8], banks and thrifts enter into direct competition in a number of product areas. Therefore, the number, size, and growth of nonbank thrift institutions will also be reviewed.

Changes in U. S. Banking Organization and Measures of Banking Structure Between 1960 and 1976, the number of banks in the U. S. has increased by nine percent and now totals 14,697. As

shown on Table I, this increase is the net result of new bank formations offsetting mergers and liquidations. Although mergers have been numerous, a significant number of the merged banks have been converted to branches, thus mitigating the impact of merger activity on reduction in the number of banking offices. *De novo* branching has occurred at a rapid pace and, together with merger-conversions, has led to a 221 percent increase in the number of bank branches. A key factor in the increase in branches, of course, has been the prevalence of state laws permitting such activity. Currently, 21 states allow statewide branching, while 15 allow limited branching. Fourteen states have unit banking laws that prohibit or severely restrict branching.

Perhaps the most significant organizational development in commercial banking over the past decade and a half has been the spread of the bank holding company. From the passage of the Bank Holding Company Act of 1956, which significantly

expanded the degree of regulation of *multibank* holding companies, until 1965, no expansion in these organizations occurred. Table II shows 47 multibank holding companies in operation in 1960 with control over 8.0 percent of total commercial bank deposits.¹ Subsequent to 1965, however, bank holding company activity increased substantially. The share of total deposits controlled by bank holding companies climbed to 68.1 percent in 1974 before receding slightly to 66.1 percent in 1976. A recent study [6] concludes that the bank holding company movement has had procompetitive effects in both banking and nonbanking markets, and suggests that there has been an increase in the quantity and quality of services provided to the public.

¹ Data on the number and size of one-bank holding companies are not available for years prior to 1970. The 8.0 percent deposit share figure, therefore, somewhat understates the proportion of deposits controlled by all bank holding companies.

Table I
**CHANGES IN NUMBER OF COMMERCIAL BANKS AND BRANCHES
UNITED STATES AND FIFTH FEDERAL RESERVE DISTRICT
1960-1976**

	United States	Fifth District	District of Columbia	Maryland	North Carolina	South Carolina	Virginia	West Virginia
<u>All Commercial Banks</u>								
Number of banks (12-31-59)	13,486	957	12	140	192	145	309	159
New banks formed	3,602	254	7	27	31	22	130	37
Mergers and absorptions	2,239	421	3	54	130	75	156	3
Voluntary liquidations and suspensions	140	2	—	—	—	1	1	—
Other losses	12	—	—	—	—	—	—	—
Net change	+1,211	-169	+4	-27	-99	-54	-27	+34
Number of banks (12-31-76)	14,697	788	16	113	93	91	282	193
<u>Branches and Facilities</u>								
Number of branches and facilities (12-31-59)	9,790	1,131	64	226	452	134	255	—
New branches	20,630	3,005	73	529	1,115	422	839	27
Conversions, new facilities and replacements	2,356	440	5	59	131	79	166	—
Branches and facilities discontinued	1,707	216	8	25	86	35	62	—
Other gains	335	—	—	—	—	—	—	—
Net change	+21,614	+3,229	+70	+563	+1,160	+466	+943	+27
Number of branches and facilities (12-31-76)	31,404	4,360	134	789	1,612	600	1,198	27*

* Does not include four unmanned drive-in facilities.

Source: Federal Deposit Insurance Corporation and Federal Reserve Bank of Richmond.

Table II

**SUMMARY OF BANK HOLDING COMPANIES
UNITED STATES AND FIFTH FEDERAL RESERVE DISTRICT
1960 and 1976**

Area	December 31, 1960				December 31, 1976				
	Number of multibank ¹ companies	Number of banks controlled	Deposits controlled (million \$)	Deposits controlled/ total area deposits (percent)	Number of companies		Number of banks controlled	Deposits controlled (million \$)	Deposits controlled/ total area deposits (percent)
					Multibank	One-bank			
United States	47	426	18,274.0	8.0	298	1,504	3,791	553,649.0	66.1
Fifth District	2 ²	9	275.5	2.2	17 ²	34	169	31,878.4	62.1
District of Columbia	1	2	156.1	10.2	1	2	3	1,904.7	49.0
Maryland	1	1	27.2	1.1	4	8	25	6,833.3	72.1
North Carolina	—	—	—	—	1	9	13	9,127.0	69.4
South Carolina	—	—	—	—	1	5	7	2,223.9	50.2
Virginia	2	6	92.2	2.8	12	4	115	11,625.4	78.3
West Virginia	—	—	—	—	—	6	6	164.1	3.0

¹ Prior to passage of the 1970 amendments to the Bank Holding Company Act of 1956, only multibank holding companies were required to register with the Federal Reserve.

² District total does not equal the sum of state figures because it has been corrected for duplications; that is, holding companies that have subsidiary banks in more than one state are included in the total only once. One holding company controls banks in the District of Columbia, Maryland, and Virginia.

Source: Board of Governors of the Federal Reserve System and Federal Reserve Bank of Richmond.

There are two distinct divisions within the bank holding company movement, namely the multibank holding company and the one-bank holding company. The one-bank holding company, which was not brought under regulatory control until passage of the 1970 amendments to the Bank Holding Company Act, became a popular organizational form in the later 1960's. Their number increased rapidly, and these organizations moved into several types of non-banking activities prohibited to their multibank counterparts. The 1970 amendments to the Bank Holding Company Act, however, provided for equal regulatory treatment of multibank and one-bank holding companies and set guidelines to be followed by the Federal Reserve in approving lines of activity which bank holding companies might enter.²

Over the sixteen year period 1960 to 1976, total deposits held by U. S. commercial banks have increased at an annual rate of 8.4 percent (see Chart 1a). The average commercial bank deposit size has

increased from \$17.1 million to \$57.1 million (see Chart 1b). Over the same period total deposits of insured savings and loan associations rose at an annual rate of 10.2 percent, while the number of insured S&L's declined slightly, from 4,098 to 4,078. The average deposit size of insured savings and loan associations grew from \$14.3 million in 1960 to \$68.0 million in 1976.

Changes in Fifth District Banking Organization and Structure The number of commercial banks operating in the Fifth Federal Reserve District has declined by 18 percent since 1959, to a total of 788 at year-end 1976. This declining trend, shown in Table I, is in direct contrast to the moderately increasing trend that characterized U. S. banking over that period. The decline in the number of Fifth District banks has been the result of strong merger activity, which has been only partially offset by new bank formations. Branching in the District, however, has followed the expansionary trend reflected in banking statistics for the nation as a whole, only with greater strength. Since the end of 1959, there has been a 285 percent gain in the number of branches.

² A detailed discussion of the historical development of bank holding companies and of the legislative changes bringing them under supervisory control can be found in [7].

Chart 1a
PERCENTAGE ANNUAL RATE OF CHANGE IN TOTAL DEPOSITS: 1960-1976
COMMERCIAL BANKS AND INSURED SAVINGS & LOAN ASSOCIATIONS
U. S. and Fifth Federal Reserve District

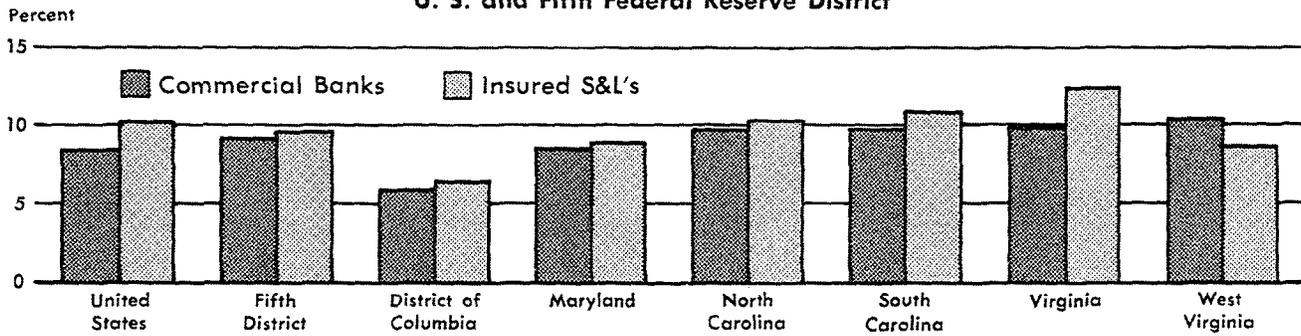


Chart 1b
AVERAGE COMMERCIAL BANK AND INSURED S&L DEPOSIT SIZE: 1960 AND 1976
U. S. and Fifth Federal Reserve District

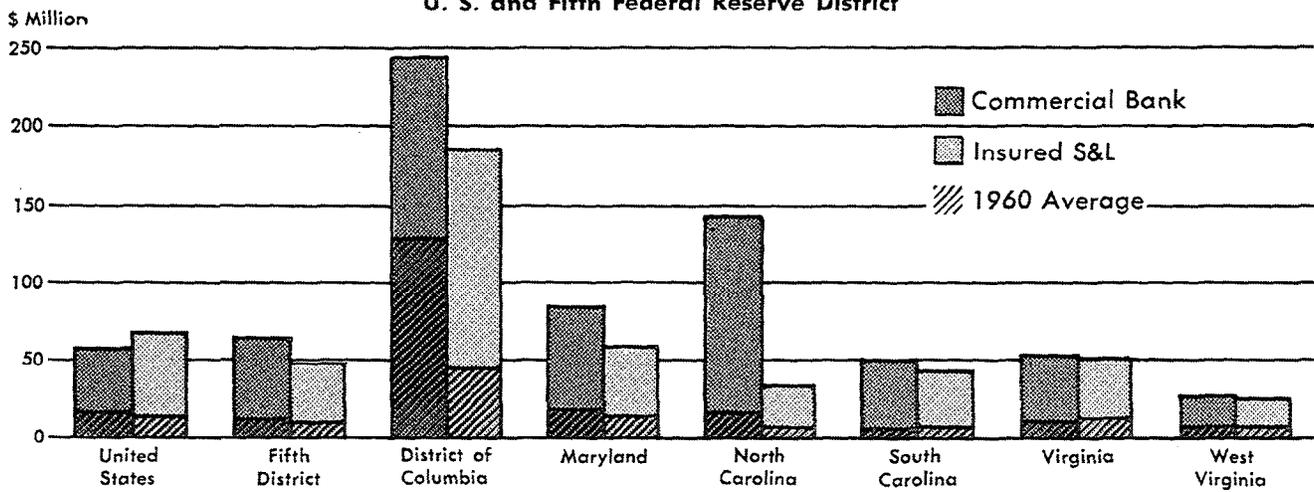
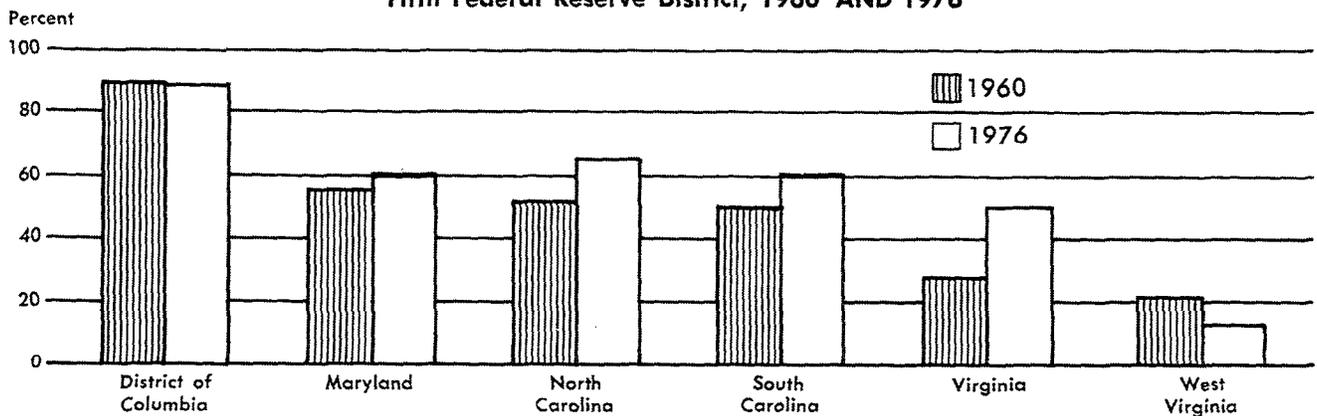


Chart 2
PERCENTAGE OF TOTAL DEPOSITS HELD BY FIVE LARGEST COMMERCIAL BANKING ORGANIZATIONS
Fifth Federal Reserve District, 1960 AND 1976



Source: Federal Reserve Bank of Richmond.

Bank holding company formation and expansion, shown in Table II, has also been quite vigorous in the Fifth District. Holding company activity in the District in 1960 was negligible, with only two multibank holding companies operating nine subsidiaries and controlling only about two percent of total bank deposits in the District. By the end of 1976, 17 multibank and 34 one-bank holding companies operated 169 banking subsidiaries with control over 62 percent of District deposits. Nevertheless, the proportion of bank holding company controlled deposits in the Fifth District still fell short of the proportion of such deposits measured on a national basis by about four percentage points.

Deposits held by commercial banks in the Fifth District, as shown in Chart 1a, grew at an annual rate of 9.3 percent from 1960 to 1976, significantly faster than the national average. Whereas the average sized Fifth District bank in 1960 was, at \$13.0 million, smaller than the national average, the reverse is now true. Chart 1b shows that at year-end 1976 the average sized commercial bank in the District, measured in terms of total deposits, reached \$63.6 million. The annual rate of increase in deposits held by Fifth District insured savings and loan associations since 1960 has been 9.6 percent, somewhat faster than the commercial bank deposit growth rate. The number of insured S&L's has increased slightly, from 408 to 430, and at year-end 1976 the average size insured S&L in the Fifth District was \$48.1 million. Deposits held in S&L's totaled \$20.7 billion, roughly 40 percent of the \$52.0 billion held in commercial banks.

Consideration of the changing banking organization of the Fifth District tends to obscure some important differences between states. In fact, Tables I and II contain striking contrasts in terms of the patterns of change that have taken place among the five Fifth District states and the District of Columbia. These differences, and the factors underlying them, help explain changes in bank deposit concentration among the states, as shown in Chart 2.³

District of Columbia Washington, D. C. constitutes a rather special case from the bank structure standpoint. Its compact geographic limits, metropolitan character, and high degree of nonresident employment introduce special analytical considerations. Washington, D. C. is also unique in that the laws governing banking, and financial intermediation

more generally defined, are primarily Federal laws [1]. Enforcement of these laws is the responsibility of Federal authorities, i.e., the Comptroller of the Currency and the Federal Home Loan Bank Board. These laws permit unlimited branching throughout the District of Columbia, and do not prohibit bank holding company activities.

Sixteen banks operated in the District of Columbia at year-end 1976, an increase of four since 1960. While the limited geographic area provides less natural scope for branching than exists in other Fifth District states, the number of branches nevertheless increased by 109 percent over this period. The limited geographic scope, combined with liberal branching provisions, has tended to discourage holding company activity. At year-end 1960 one multibank holding company controlled two banks which held 10.2 percent of total deposits in the District of Columbia. At year-end 1976 the holding company population included one multibank holding company controlling only one District of Columbia bank,⁴ and two one-bank holding companies. The banking affiliates of these companies accounted for nearly half of all District of Columbia deposits at year-end 1976.

Total District of Columbia commercial bank deposits increased at an annual rate of 6.0 percent from 1960 to 1976, considerably below that for the entire Fifth District or the U. S. Nevertheless, in 1976 the average sized District of Columbia bank, at \$242.8 million, was still significantly larger than the \$63.6 million Fifth District average, and the \$57.1 million U. S. average as well.

The number of insured S&L's operating in the District of Columbia declined substantially between 1960 and 1976, falling from 24 to 16, while total deposits of these institutions grew at an annual rate of only 6.5 percent. At year-end 1976 the average deposit size for District of Columbia insured S&L's was \$183.9 million. This is by far the largest average size insured S&L for any Fifth District state.

The concentration of deposits in the District of Columbia has not changed materially between 1960 and 1976. The five largest banking organizations held 89.5 percent of total banking deposits at the end of 1976, down from 89.9 percent in 1960.

Deposit concentration figures for the District of Columbia, it should be noted, may not have the same significance for bank competition as comparable figures for other Fifth District states. It is estimated

³ For analytical purposes the District of Columbia will be considered the equivalent of a state.

⁴ This multibank company also owned banks in Virginia and Maryland.

that half of the District of Columbia's labor force resides outside the city limits and has easy access to the services of many Maryland and Virginia banks that do not operate in Washington, D. C. Hence District of Columbia banks clearly compete with these Maryland and Virginia banks and, from an analytical standpoint, it is misleading to consider the District of Columbia boundaries as strictly defining a banking market. A more realistically defined market would include with Washington, D. C. its surrounding metropolitan areas. Accordingly, the 89.5 percent concentration ratio probably overstates the degree of deposit concentration in the market in which District of Columbia banks compete. In fact, a recent study of Fifth District banking market concentration [10] taking this broader approach concludes that there has been a reduction in banking concentration in the Washington, D. C. Standard Metropolitan Statistical Area (SMSA), which includes parts of Maryland and Virginia, between 1970 and 1976.

Maryland The banking laws of Maryland permit statewide branching and merger. The code is silent on the subject of bank holding companies, but bank holding company formations and acquisitions are allowed in practice.

The number of commercial banks operating in Maryland has declined by about 19 percent from 1960 to 1976. Branching activity has been more vigorous than in the nation at large, but somewhat slower than the pace set for the entire Fifth District. Since 1960 the number of branches has increased by 249 percent.

In 1960 only one multibank holding company that controlled 1.1 percent of statewide bank deposits operated in Maryland.⁵ By year-end 1976 the number of multibank holding companies grew to four with control over 17 banks. There were, in addition, eight one-bank holding companies. The percentage of total commercial bank deposits under bank holding company control at year-end 1976 stood at 72.1, the highest share for any Fifth District state except Virginia.

The average annual rate of increase in Maryland commercial bank deposits has been 8.7 percent since 1960. This is the lowest growth rate in the Fifth District except for Washington, D. C., but, nonetheless, above the national average. Whereas the average size Maryland commercial bank was only slightly larger than the average size U. S. bank in 1960, the

difference has widened considerably. At year-end 1976 the average size commercial bank in Maryland reached \$83.8 million.

Total deposits held by insured S&L's in Maryland have increased at an annual rate of 8.9 percent since 1960. Also, there has been a slight reduction in the number of S&L's, from 80 to 76. Maryland S&L's, with an average size of \$57.2 million at year-end 1976, now hold \$4.3 billion in deposits or roughly 46 percent of those held by banks. Maryland is the only state in the Fifth District that charters mutual savings banks, of which there were three at the end of 1976 holding \$1.2 billion in total deposits.⁶ The combined deposits of insured S&L's and MSB's equaled almost 60 percent of commercial bank deposits at year-end 1976.

The five largest banking organizations operating in Maryland at year-end 1960 were all commercial banks without holding company connections. These institutions collectively held 55 percent of commercial bank deposits in the state. By 1976 the five largest banking organizations included two multibank holding companies, two one-bank holding companies, and one commercial bank without holding company ties, and these together held 61.5 percent of total deposits in the state. Mergers and bank holding company acquisitions appear to have contributed to the increase in deposit concentration to an important extent [3].

North Carolina North Carolina banking law allows branch banking and mergers on a statewide basis and is silent on the subject of bank holding companies. Holding companies exist, however, and are a significant factor in the structure of the state's markets for financial services.

Large, but not generally statewide, branch banking systems operated in North Carolina well before 1960. Beginning in the early 1960's the pattern of branching changed as several of the larger banking organizations began to expand their networks throughout the state. This movement, although not in conflict with the letter of the state's banking law, was inhibited by the way the law was enforced, however. The result has been a somewhat unique pattern of branching and merger activity.

Until the mid-1960's the North Carolina banking commission followed a conservative policy with respect to the approval of branching applications. Emphasis was placed upon a provision of the branch-

⁵ This multibank company also owned banks in Virginia and Washington, D. C.

⁶ There is no provision for Federal chartering of mutual savings banks.

ing code calling for investigation of local market capacity to support existing and proposed new banking offices. This provision required disapproval of branch applications that might lead to excessive competition between, and resulting failure of, banks within a given local market. As a result, the state banking commission was reluctant to allow expanding banks entry into new markets through *de novo* branching [4]. The statewide expansion movement that began in the early 1960's, therefore, relied heavily on branching through merger. There were 192 banks operating in North Carolina in 1960, and 31 new banks began operation between that year and 1976. Over the same period 130 banks were merged out of existence, resulting in a net reduction of 99 banks. This 52 percent drop in the number of banks operating in the state was by far the largest such decline in the Fifth District. The merger activity that contributed so heavily to this decline was concentrated in the period 1960-1966.

The pace of *de novo* branching accelerated sharply in the later 1960's. 1,115 new branches were authorized between 1960 and 1976, 870 of these after 1966. The 257 percent increase in number of branches was somewhat below the Fifth District average, but still significantly above that of the U. S. banking industry. There is recent evidence of a shift by state regulatory authorities back to the earlier emphasis on local market capacity to support existing banks along with newly proposed branch facilities. A recent increase in the rate of branch application denial by the North Carolina banking commission suggests at least a temporary slowing in *de novo* branch expansion.⁷

There were no multibank holding companies operating in North Carolina in 1960, and only one, controlling 13 banks, in 1976. The combined deposits controlled by this one multibank holding company and nine one-bank holding companies accounted for 69.4 percent of statewide commercial bank deposits on December 31, 1976.

Developments leading to a greatly reduced number of banks have profoundly affected the average scale of operation of the North Carolina banking industry. Statewide commercial bank deposits grew at an annual rate of 9.8 percent between 1960 and 1976. Due to the large reduction in the number of banks, however, the average size North Carolina commercial bank increased at an unusually rapid 14.7 percent annual rate, from \$16.0 million to \$142.9 million. At

year-end 1976 the average bank size in North Carolina ranked second in the District only to the average bank size in Washington, D. C.

Insured S&L's are more numerous in North Carolina than in any other state in the Fifth District, although their numbers increased only slightly, from 157 in 1960 to 161 in 1976. Total deposits held by insured S&L's increased at an average annual rate of 10.2 percent between 1960 and 1976. Deposits held in North Carolina insured S&L's exceeded the individual totals of all the other Fifth District states at year-end 1976. At \$5.6 billion, these deposits equaled 43 percent of those held at commercial banks in the state.

As might be expected from the foregoing summary, the concentration of bank deposits in North Carolina has increased noticeably since 1960. The percentage of total deposits held by the five largest banking organizations rose from 52.8 in 1960 to 65.0 in 1976. Whereas all five of the largest organizations in 1960 were commercial banks with no holding company connections, in 1976 the four largest were one-bank holding companies. The multibank holding company form of organization does not appear to have contributed to banking concentration in North Carolina to any significant degree. The evidence suggests, however, that bank mergers may have been important in this respect [3].

South Carolina Statewide branching is permitted by the banking laws of South Carolina, as are bank mergers. Holding company activity is not addressed in the banking code but is permitted *de facto*.

Between 1960 and 1976 there were 75 bank mergers in South Carolina and 22 new bank formations. These developments, along with the loss of one bank that ceased operation, have resulted in a net decline of 37 percent from 1960, a percentage decline exceeded only by North Carolina among Fifth District states. At the same time branch expansion in South Carolina has been vigorous, with the number of branches increasing 348 percent. This is the largest proportionate increase for any state in the District and almost one and a half times the percentage increase in the nation.

The bank holding company movement has not been as important in South Carolina as in most of the other Fifth District states. There were no bank holding companies in the state in 1960, and in 1976 there was only one multibank holding company controlling two banks. There were also five one-bank holding companies operating in 1976. Together

⁷ *The News and Observer*, Raleigh, N. C., November 24, 1974.

these holding companies controlled 50.2 percent of commercial bank deposits.

Commercial bank deposits grew at an annual rate of 9.6 percent in this period, significantly higher than the national average and somewhat higher than the Fifth District average. The large decline in numbers of banks has led to a rapid 12.9 percent average annual rate of increase in the average commercial bank deposit size. At year-end 1976 the average size of a South Carolina commercial bank stood at \$49.2 million, compared to \$7.1 million in 1960.

Growth in the thrift industry was very rapid in South Carolina in the 1960-1976 period. Insured S&L deposits rose at an annual rate of 11.1 percent, a rate higher than the national average and exceeded in the Fifth District only by Virginia. The number of insured S&L's increased by three to reach 70 in 1976. At year-end 1976 the average deposit size of South Carolina insured S&L's stood at \$43.6 million.

The concentration of deposits among the five largest banking organizations rose from 51.3 percent at year-end 1960 to 61.3 percent at the end of 1976. The four largest banking organizations in 1976 were unaffiliated commercial banks, and the fifth largest was a multibank holding company. This suggests that the increase in concentration has been primarily due to mergers [3].

Virginia Early in this century Virginia enacted banking laws permitting statewide branching, either *de novo* or through merger. These provisions were made more prohibitive in subsequent years, however. From 1948 to 1962 branching was limited to the home office city, town or county, while mergers were restricted to banks located in the home office city or county and in adjoining counties. Mergers were also permitted with any banking institution located within 25 miles of the acquiring bank. The law required, however, that each party to a merger must have been in operation at least one year. Legislation passed in 1962 substantially liberalized existing banking laws and led to profound changes in the organization and structure of Virginia banking. A primary factor leading to the 1962 changes was a feeling that laws restricting expansion placed Virginia banks at a competitive disadvantage vis-a-vis larger banks in contiguous jurisdictions that allowed unlimited branching [5].

The 1962 changes permitted *de novo* branching: (a) within the city or county of the parent bank; (b) within cities contiguous to the city or county of the parent bank; (c) within counties contiguous to the city of the parent bank, up to five miles from the

city limits; and (d) at certain Federal and state installations. Also, branching through merger was permitted statewide. The law remains silent on the subject of bank holding companies, but such activity has been allowed *de facto*.

Virginia banking structure at the beginning of the 1960's was characterized by a large number of small banks. Enactment of the 1962 legislation led to a wave of mergers resulting in the disappearance of many of these small banks. Between 1960 and 1976 a total of 156 mergers occurred. This consolidating trend was largely offset, however, by the proliferation of newly formed banks, the net result being a modest nine percent reduction in banks. Although geographically limited, *de novo* branching nonetheless progressed rapidly, there being a 270 percent gain in number of branches over the period.

Multibank holding company activity has been more evident in Virginia than in any other Fifth District state. This is largely due to the nature of the laws governing mergers. Briefly, merged banks themselves become branches of the lead bank in the merger and therefore lose their ability to expand geographically. Banks acquired by bank holding companies, on the other hand, retain their *de novo* branching privileges. The multibank holding company form of organization has, therefore, offered advantages to expanding financial institutions unavailable with the merger technique. The number of multibank holding companies operating in Virginia has increased from two in 1960 to 12 in 1976. These 12 multibank holding companies controlled 111 banks and, when combined with the four one-bank holding companies operating on the same date, accounted for 78.3 percent of statewide commercial bank deposits. The proportion of bank holding company controlled commercial bank deposits is thus substantially higher than the national average and the highest in the Fifth District.

The healthy financial climate that supported heavy new bank formation concurrent with merger and bank holding company consolidating trends is reflected in the rate of Virginia's bank deposit growth since 1960. Commercial bank deposits increased at an annual rate of 9.9 percent, second in the Fifth District only to West Virginia and much higher than the national average. The average size Virginia bank in terms of deposits is now \$52.3 million, which represents a 10.4 percent annual rate of increase from 1960.

While the banking climate in Virginia has been healthy, that for the thrift industry has been robust. Total deposits held by insured S&L's have increased at an annual rate of 12.5 percent, the fastest growth rate for any group of financial intermediaries in the

Fifth District, and substantially above the national average for either banks or S&L's. Virginia insured S&L's have increased in number from 53 in 1960 to 77 in 1976. State law permits S&L's to branch on an unlimited geographic basis, and this factor may have aided Virginia thrifts in their efforts to compete with commercial banks for deposits [8]. At year-end 1976 the average size for an insured S&L stood at \$52.0 million, approximately the same as that for commercial banks.

On December 31, 1960, the five largest banking organizations in Virginia, all commercial banks, accounted for 27.7 percent of total deposits. This concentration measure subsequently rose to 51.6 percent in 1976, the degree of change being the largest of any state in the Fifth District. All five of the largest banking organizations are now multibank holding companies. External growth, or growth attributable to mergers and acquisitions, accounted for two-thirds of the deposit increase at the three largest Virginia banking organizations between 1961 and 1971. This is the largest proportion of deposit growth due to external factors for any Fifth District state [3]. Although the degree of change in concentration of bank deposits in Virginia has been larger than that for any other Fifth District state, the current concentration percentage of 51.6 percent is nonetheless relatively low. In fact, among the Fifth District states it is lower only in West Virginia, the District's only unit banking state.

West Virginia The banking laws of West Virginia regarding branching, merger, and holding company activity are among the most restrictive in the nation. Branching is prohibited, except that banks may open one deposit-taking facility within 2,000 feet of the home office location. The change in code allowing such facilities was passed in 1972. Mergers are not explicitly prohibited by law, but are approved only on the condition that the resulting bank operate from one location only. Until 1975 the banking code did not deal with the subject of bank holding companies, and in the early 1970's two West Virginia banking groups seeking to form multibank holding companies obtained a ruling from the State Attorney General sanctioning their plans. The legislative reaction to this development was passage of a law in 1975 explicitly prohibiting the formation of multibank holding companies.

As a result of these restrictive legal provisions, the organization and structure of West Virginia banking has changed very little since 1960. Only three mergers occurred, and 27 branch-type facilities were

opened. Demand for bank deposit services has been quite strong, however, leading to the formation of 37 new banks. The net increase of 34 banks between 1960 and 1976 represents a gain of 21 percent, the only increase in the Fifth District except for that in Washington, D. C. Six one-bank holding companies have been formed since 1960, and at the end of 1976 they controlled three percent of commercial bank deposits in the state.

Total commercial bank deposits increased at an annual rate of 10.4 percent between 1960 and 1976, the fastest rate in the District and far above the national average. At year-end 1976 the average size commercial bank in West Virginia was \$28.5 million, the smallest in the Fifth District and only about half the national average.

Insured S&L's have not enjoyed the same deposit growth as have West Virginia commercial banks. Insured S&L deposits have increased at an annual rate of 8.7 percent, the lowest rate of increase for any Fifth District state except Washington, D. C. and well below the national average. The number of insured S&L's has increased from 27 to 30, and the average deposit size has risen from \$7.0 million to \$24.1 million. The rules governing branching by Federally chartered S&L's, which are administered by the Federal Home Loan Bank Board, allow what amounts to statewide branch expansion. State chartered West Virginia S&L's, like banks, are prohibited from branching [8]. It is no surprise, therefore, that 29 of the 30 insured S&L's operating in the state as of year-end 1976 were Federally chartered.⁸ These 29 institutions operated 40 branches and in this respect held a distinct competitive advantage over commercial banks and state chartered S&L's.

BALANCE SHEET COMPOSITION

As financial intermediaries, commercial banks supply financial services to both providers of funds and users of funds. Changing patterns of demand for these financial services have provided part of the impetus behind the changes in banking organization and structure discussed earlier. For example, the trend toward increased numbers of banking offices and increased bank size evidently have been responses to growing customer demands for deposit and loan services. Moreover, consolidation trends leading to increased concentration have in part resulted from a

⁸ At year-end 1976 there were also seven state chartered S&L's not insured by the Federal Savings and Loan Insurance Corporation.

desire to achieve the increased scale of operation needed to service a growing number of large corporate customers.

Examination of the bank balance sheet provides one of the most direct means of viewing changing patterns of demand for bank services. Such an examination is undertaken here through an analysis of key ratios that explain the changing composition of bank sources and uses of funds. Bank capital adequacy, which has attracted increased attention in recent years as a result of balance sheet changes, will also be examined. The influence of the business cycle on the bank balance sheet is substantial and may distort long-term, or trend, analysis that is based on comparison of only two data points. Since the economy was near a business cycle trough at the end of 1960, the base point used in these comparisons is year-end 1962. Year-end 1962 and year-end 1976 are similarly situated in cyclical recoveries.

Changes in Sources of Funds Deposits, of course, constitute the fundamental source of the commercial banking industry's loanable funds. While deposits remain vitally important, they have since 1962 declined as a proportion of the industry's total liabilities. This trend is illustrated in Table III, which shows that total deposits of all U. S. commercial banks constituted 96.0 percent of total liabilities in 1962 but only 88.0 percent in 1976. The extent to which this trend has developed is of interest because it signals a change in the nature of banking, away from almost total reliance on deposits toward increasingly aggressive competition for funds in more interest rate sensitive markets.

The decline in importance of deposits as a source of funds has also taken place in the Fifth District, but not to the extent that it has in banking in general. Total deposits of Fifth District commercial banks equaled 97.0 percent of total liabilities in 1962, but this ratio fell to 92.6 percent in 1976. Thus, District banks rely upon deposits to a greater extent than do U. S. banks generally, a condition that also holds for every state in the District. Only in North Carolina does the ratio of total deposits to total liabilities fall below 90 percent. South Carolina and Virginia are the states that continue to rely most heavily on deposits as a source of funds.

Important changes have occurred not only with respect to total deposits, but also with respect to the makeup of the deposit base. Demand deposits as a proportion of total deposits at all U. S. commercial banks have declined dramatically from 62.5 percent in 1962 to 40.2 percent in 1970, with a symmetrical

increase in the importance of time and savings deposits. This is also shown in Table III. The trend toward substitution of time for demand deposits has been of greater significance in the Fifth District than in the U. S. While the year-end 1976 ratio of demand deposits to total deposits is the same for the District as for the U. S., the Fifth District ratio declined from a higher year-end 1962 ratio.

There is a good deal of variety, however, in the composition of deposits among Fifth District states. In Washington, D. C. and South Carolina, for example, demand deposits remain relatively more important than time deposits. North Carolina held a significantly greater proportion of demand deposits to total deposits in 1962 than did a number of other states, but subsequently its ratio has moved closer to the national and District averages. Developments in Maryland have been roughly parallel to those in the U. S., while in Virginia demand deposits continue to play a less important role than is the case in most other Fifth District states and in the U. S. The most dramatic change in deposit composition has taken place in West Virginia. Whereas demand deposits accounted for nearly two-thirds of total deposits in 1962, they fell to less than one-third of total deposits in 1976.

The strong credit demands prevailing through the 1960's and into the 1970's have encouraged banks to develop sources of funds supplementing the traditional base deposits. The result has been the widespread acceptance of liabilities management, the practice of relying upon purchased funds such as large negotiable CD's and Federal funds, to support credit expansion. While primarily a large bank phenomenon, liabilities management is nonetheless reflected in consolidated regional balance sheets. The bottom line of Table III shows managed liabilities, defined to include net purchases of Federal funds, the balance sheet item "other liabilities for borrowed funds," and large negotiable CD's, as a percent of total liabilities. For all U. S. commercial banks this proportion at year-end 1976 was 18.2 percent, almost twice the Fifth District average. The three Fifth District states having the largest average size commercial banks, Washington, D. C., Maryland, and North Carolina, each had managed liability to total liability ratios above the District average.

Negotiable CD's, which are issued mainly by large banks, represent the most important source of managed funds in the Fifth District. At the same time, large District banks maintain limited reliance on net Federal funds purchases as a source of lendable balances. The year-end 1976 balance sheet shows four

Table III

CHANGES IN SOURCES OF FUNDS, 1962 AND 1976¹
ALL COMMERCIAL BANKS
UNITED STATES AND FIFTH FEDERAL RESERVE DISTRICT

Measure	United States		Fifth District		District of Columbia		Maryland		North Carolina		South Carolina		Virginia		West Virginia	
Total deposits/Total liabilities	96.0	88.0	97.0	92.6	98.0	93.7	98.3	91.4	94.6	89.7	97.3	94.7	97.3	94.7	98.5	93.2
Demand deposits/ Total deposits	62.5	40.2	65.6	40.2	70.3	53.0	65.5	39.9	69.3	41.3	79.8	53.4	56.9	35.7	62.0	31.6
Time & savings deposits/ Total deposits	37.5	59.8	34.4	59.8	29.7	47.0	34.5	60.1	30.7	58.7	20.2	46.6	43.1	64.3	38.0	68.4
Managed liabilities ² / Total liabilities	-	18.2	-	9.5	-	10.6	-	10.2	-	14.3	-	5.6	-	9.5	-	8.4

¹ In each category, figures to the left are for December 28, 1962; figures to the right are for December 31, 1976.

² Managed liabilities = net purchases of Federal funds + other liabilities for borrowed funds + large negotiable CD's.

Source: Federal Reserve Bank of Richmond.

Fifth District states, Washington, D. C., South Carolina, Virginia, and West Virginia, as *net suppliers* of Federal funds. In Maryland and North Carolina, however, net purchases of Federal funds equaled about 20 percent of total managed liabilities, considerably above the U. S. average of 14 percent.⁹

Changes in Uses of Funds In the years since 1962 the asset side of the banking industry's balance sheet has also undergone significant change. Demand for bank loans has led to a balance sheet shift in favor of loans as opposed to other investments, and banks have attempted to minimize nonearning assets such as cash balances. Fifth District developments along these lines have roughly paralleled national developments.

As shown in Table IV, banks generally have undertaken policies to minimize holdings of nonearning assets. Cash and due from banks as a percent of total assets for all commercial banks in the U. S. declined from 18.2 percent in 1962 to 13.2 percent in 1976. Cash minimization has been even more

intensively followed in the Fifth District, every state holding a lower proportion of cash balances to total assets than the national average at year-end 1976. This aspect of balance sheet management seems especially important in West Virginia, cash constituting only 8.4 percent of total assets at year-end 1976.

Total net loans, or total loans adjusted to exclude valuation reserves against possible loan losses, have grown more rapidly than securities holdings since 1962. Total net loans equaled 47.2 percent of total assets at all U. S. banks in 1962, and increased to 51.2 percent of total assets in 1976. The movement of this ratio for all Fifth District banks has closely paralleled the movement in the U. S. ratio. Within the Fifth District, Maryland and Virginia are the states where loans constitute the largest fraction of total bank credit. On the other hand, loans play a substantially less important role in West Virginia than in the District or in the nation.

A number of changes have developed among the major types of loans made by commercial banks. Real estate loans, defined to include all loans secured by real property, have become much more important between 1962 and 1976. The ratio of real estate loans to total gross loans has risen even faster in the Fifth District than in the nation as a whole. Real estate loans now account for more than a third of the average bank loan portfolios in Washington, D. C., Maryland, Virginia, and West Virginia.

At the same time, there seems to have been some decline in importance in business lending relative to other types of lending, both in the nation and in the

⁹ It may initially appear confusing to speak of a positive net Federal funds position for the banking industry as a whole. This is a result of thinking of the Federal funds market in the limited traditional sense of transfers of reserves, in the form of deposits at the Federal Reserve, between commercial banks. Today, Federal funds transactions involve a number of different types of institutions, including nonbank financial institutions, e.g., savings and loan associations, and even nonfinancial businesses. Transactions need not even go through a Federal Reserve deposit account to be classified as Federal funds. The banking industry's positive net position, therefore, represents borrowings from nonbank participants in the market for Federal funds.

Fifth District.¹⁰ At year-end 1976 one-third of all bank loans on a national basis were made for commercial and industrial purposes, a reduction from 34.1 percent at year-end 1962. One-quarter of all bank loans in the Fifth District were for commercial and industrial purposes at year-end 1976, down from 27.1 percent at year-end 1962. Among the Fifth District states, commercial lending approaches the importance it has nationally only in North Carolina. In West Virginia, business lending accounts for an unusually low portion of the average bank's portfolio.

Loans to individuals, or consumer loans, have been and remain much more important to Fifth District banking than to U. S. banking. In the District such loans as a percent of total loans have increased slightly since 1962 and now account for almost one-third of all loans outstanding. For the U. S. banking industry, loans to individuals remained fairly steady,

¹⁰ The declines in the national and Fifth District commercial and industrial loan to total gross loan ratios at least partly reflect the unusually strong cyclical depression in business loans existing near the end of 1976. Taking the cyclical factor into account suggests the importance of commercial and industrial loans may have remained fairly steady over the years.

between 21 and 22 percent of total gross loans from 1962 through 1976. Washington, D. C. and Virginia have experienced declines in the relative importance of consumer lending over the period being considered, while the other Fifth District states have experienced increases. The magnitude of the increase has been especially important in South Carolina, where consumer loans now make up over 40 percent of the loan portfolio.

The involvement of banks in farm lending for purposes other than acquisition of real estate has remained steady on a national basis since 1960, operating loans accounting for a little over four percent of total loans at both year-end 1962 and year-end 1976. In the Fifth District, however, the relative importance of farm lending has declined from its initially low 2.2 percent in 1962 to only 1.5 percent in 1976.

Lending to financial institutions other than banks, a category that includes REIT's and S&L's, is not of major importance in the U. S. as a whole or in the Fifth District. It should be noted, however, that such lending is almost twice as important to District banks as is, for instance, farm lending. Washington,

Table IV

CHANGES IN USES OF FUNDS, 1962 AND 1976¹
ALL COMMERCIAL BANKS
UNITED STATES AND FIFTH FEDERAL RESERVE DISTRICT

Measure	United States		Fifth District		District of Columbia		Maryland		North Carolina		South Carolina		Virginia		West Virginia	
Cash & due from banks/ Total assets	18.2	13.2	17.4	10.7	17.9	12.6	16.4	10.2	19.7	11.5	18.9	12.2	15.9	10.4	15.6	8.4
Net loans, total/ Total assets	47.2	51.2	46.8	52.5	49.2	49.8	46.1	57.1	47.7	50.4	42.0	50.6	48.7	55.6	40.8	46.2
Real estate loans/ Gross loans, total	24.0	27.3	26.5	33.7	27.4	34.1	33.8	39.9	15.8	22.2	20.1	24.6	29.4	38.6	37.4	42.0
Commercial & industrial loans/ Gross loans, total	34.1	33.4	27.1	25.2	24.0	22.4	24.1	22.4	34.6	33.3	31.4	27.5	25.2	23.5	18.3	16.2
Loans to individuals/ Gross loans, total	21.4	21.6	31.4	32.6	26.5	21.0	27.0	28.4	32.3	34.6	32.4	41.2	34.2	31.8	37.1	38.6
Farm loans/ Gross loans, total	4.2	4.2	2.2	1.5	0.0	0.0	1.9	0.8	2.7	2.6	2.9	2.3	2.9	1.5	1.7	0.8
Loans to other financial institutions/Gross loans, total	5.9	4.9	5.6	2.8	13.6	13.6	6.1	3.0	4.7	2.6	4.2	0.7	3.7	1.8	2.4	0.4
Total securities/Total assets	32.2	24.2	33.8	26.6	31.1	26.8	35.5	22.0	30.2	27.0	37.2	28.9	33.5	25.0	41.8	34.5
U. S. Government securities/ Total securities	69.4	55.4	73.0	49.3	86.7	50.4	73.9	42.2	65.1	52.8	69.5	52.4	70.1	46.8	81.9	52.3
Municipal securities/ Total securities	25.9	41.9	20.5	49.0	10.9	48.0	20.0	56.5	24.5	43.5	22.3	47.3	22.9	52.6	15.5	46.6

¹ In each category, figures to the left are for December 28, 1962; figures to the right are for December 31, 1976.

Source: Federal Reserve Bank of Richmond.

D. C. banks are heavily involved in lending to non-bank financial institutions. This contrasts sharply with the West Virginia situation, where loans to financial institutions other than banks were almost nonexistent at year-end 1976.

A primary method employed by banks to satisfy secularly increasing loan demand has been liquidation of securities. Across the U. S. banking industry between December 28, 1962 and December 31, 1976, holdings of securities as a percent of total assets have declined from 32.2 to 24.2, with a comparable decline occurring in the Fifth District. Substitution of loans for securities has been especially strong in Maryland, where the total securities to total assets ratio fell by 13.5 percentage points. West Virginia banks held an unusually large proportion of securities to total assets at year-end 1976.

Within the securities portfolio itself, substitution of tax-free municipal securities for U. S. Government securities has been important. These changes are shown on the bottom two lines of Table IV. Although still dominant in the banking industry's security portfolio, holdings of U. S. Government securities nevertheless declined substantially from 69.4 percent of total securities at year-end 1962 to 55.4 percent at year-end 1976. Holdings of municipal securities rose from 25.9 percent of total securities to 41.9 percent over the same period. This substitution process has been even stronger in the Fifth District, so that at year-end 1976 holdings of municipals almost equaled holdings of U. S. Government securities in importance. It appears that municipal securities

now play an especially important role in Maryland and Virginia banking.

Capital Adequacy Since 1962 banking assets have grown rapidly, and there have been important changes in the risk characteristics of these assets. At the same time, management philosophy at larger banks has shifted toward the concept of liabilities management. While these developments have been important in helping meet the nation's capital needs, they have also introduced a new dimension of risk into banking. As fiduciaries, banks are necessarily sensitive to changes in risk. The same is true for regulatory authorities, who are charged with insuring that banking is conducted in a fundamentally sound manner. A central issue in consideration of the soundness of the banking industry is capital adequacy.

Since the early 1960's the banking industry as a whole has suffered a decline in the relation between capital and assets. This decline is illustrated in Table V for two key capital ratios, equity capital to total assets and equity capital to risk assets.¹¹ The equity capital to total asset ratio for all U. S. commercial banks declined from 8.9 percent on December 28, 1962 to 7.6 percent on December 31, 1976, while the equity capital to risk asset ratio declined from 14.9 percent to 10.4 percent. Similar changes have occurred in these ratios in the Fifth District but with differences in degree.

¹¹ The ratios and their meaning are described in detail in [9].

Table V

CHANGES IN CAPITALIZATION, 1962 AND 1976¹
ALL COMMERCIAL BANKS
UNITED STATES AND FIFTH FEDERAL RESERVE DISTRICT

Measure	United States		Fifth District		District of Columbia		Maryland		North Carolina		South Carolina		Virginia		West Virginia	
	8.9	7.6	9.0	8.0	7.6	9.2	8.9	7.9	8.9	7.4	9.4	8.6	9.0	8.0	10.9	8.7
Equity capital ² /Total assets	8.9	7.6	9.0	8.0	7.6	9.2	8.9	7.9	8.9	7.4	9.4	8.6	9.0	8.0	10.9	8.7
Equity capital ² /Risk assets ³	14.9	10.4	15.4	10.5	13.7	12.4	15.5	9.8	14.6	9.9	17.0	11.9	14.8	10.2	21.5	11.7
Equity capital ² + senior debt/ Total assets	8.9	8.1	9.0	8.5	7.6	9.5	8.9	8.0	8.9	8.6	9.4	9.2	9.0	8.3	10.9	8.8
Equity capital ² + senior debt/ Risk assets ³	14.9	11.0	15.4	11.2	13.7	12.8	15.5	10.0	14.6	11.5	17.0	12.6	14.8	10.6	21.5	12.0

¹ In each category, figures to the left are for December 28, 1962; figures to the right are for December 31, 1976.

² Includes stock, surplus, undivided profits, and valuation reserves.

³ Risk assets = total assets - cash and due from banks - U. S. Government securities.

Source: Federal Reserve Bank of Richmond.

The Fifth District equity capital to total asset ratio has declined less than the national average. This indicates that bank assets in the District have grown faster than capital, but that the historical capital/asset relationship has been better preserved in the District than in the nation as a whole. Washington, D. C. departs from the declining pattern, equity having grown faster than total assets over the period in question. Consequently, banks in Washington, D. C. averaged an unusually high 9.2 percent equity capital to total asset ratio on December 31, 1976. All other District states had average equity capital to total asset ratios above the national norm on that date except for North Carolina, whose ratio equaled 7.4 percent.

The decline in the Fifth District equity capital to risk asset ratio is greater than the decline in the national average ratio. Nevertheless, the December 31, 1976 ratios for the District and the nation are still quite close. The size of the Fifth District decline is directly related to unusually sharp reductions in holdings of cash and U. S. Government securities relative to total assets, both key components of the risk asset computation. These declines are shown in Table IV. Maryland and North Carolina are the Fifth District states having the lowest equity capital to risk asset ratios at year-end 1976.

In the years following 1962, senior debt has been used increasingly by banks to supplement capital positions. Debt, however, is not a perfect substitute for equity [9]. As a result, bank regulators have generally not viewed debt on an equal footing with equity in assessing the adequacy of bank capital. The extent of debt utilization is shown in the bottom two lines on Table V.

The average December 31, 1976 equity capital to total asset ratio for all U. S. banks is raised by 0.5 percentage points to 8.1 percent when senior debt is included in the computation. The Fifth District ratio is also increased by 0.5 percentage points, to 8.5 percent. Inspection of the equity plus debt ratios by state shows that the utilization of debt as a capital account supplement has been very limited in Maryland and West Virginia, but of somewhat greater importance in Washington, D. C. and Virginia. In North Carolina and South Carolina debt has been utilized to a much greater extent than in the Fifth District or in the nation as a whole.

CONCLUSION

The organization and structure of Fifth District banking has been significantly influenced since 1960 by deposit growth trends, branching, mergers, and bank holding company activity. Changes in these factors have not been uniform across the five District states and Washington, D. C., however. Their combined effect has been to sharply increase the scale of banking operations in Maryland and North Carolina, and to increased deposit concentration in these two states plus South Carolina and Virginia. Deposit concentration has declined in West Virginia, and there is evidence that suggests that this has also occurred in a broadly defined District of Columbia banking market.

The Fifth District bank balance sheet has undergone a number of important changes since 1962, including changes in sources and uses of funds and in capital structure. Again, however, the changes have not been entirely uniform across the five states and Washington, D. C. Deposits remain more important as the primary source of funds in District banking than in U. S. banking, although the composition of deposit funds is quite similar for the region and the nation. Important exceptions are the District of Columbia and South Carolina, where demand deposits make up an unusually large portion of total deposits. Loans have increased in importance throughout the District, as they have in U. S. banking, but play a smaller part in total bank credit in West Virginia than in other areas. Real estate and consumer loans play an unusually strong role in Fifth District bank lending, except that in North Carolina real estate loans are of lesser importance and business loans of greater importance. Investment in securities has declined in importance, although Fifth District bank holdings of tax-free municipal securities have increased in importance.

The ratio of capital to total assets at Fifth District banks has declined since 1962, but not by as much as the decline for all U. S. banks. Among the five District states and Washington, D. C., only North Carolina had a 1976 capital to total asset ratio lower than the national average. While debt has been employed as a capital supplement in the District, its utilization has been almost entirely limited to North Carolina and South Carolina.

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