First Quarter 2000

For the ninth consecutive year the banking industry reported strong profitability, earning an average return on assets of 1.2 percent. The year-to-year figures for community banks displayed healthy growth in all loan categories and deposits. Large tri-state banks' negative growth in assets, loans, and deposits was not a sign of weakness but the result of ongoing integration efforts by two bank holding companies, FleetBoston and Deutsche Bank. Formed through the merger of Fleet and BankBoston, FleetBoston was required to sell branches in Rhode Island as part of the merger deal. Bankers Trust, which was purchased by Deutsche Bank in June of last year, has transferred certain assets to nonbank subsidiaries of its parent company. The strong economy has boosted business loan activity in this region, but rising mortgage interest rates have dampened mortgage lending somewhat. Although the rapid growth in business loans is broadly consistent with reports from bankers in this region, reported C&I lending has displayed substantial volatility over the last year.

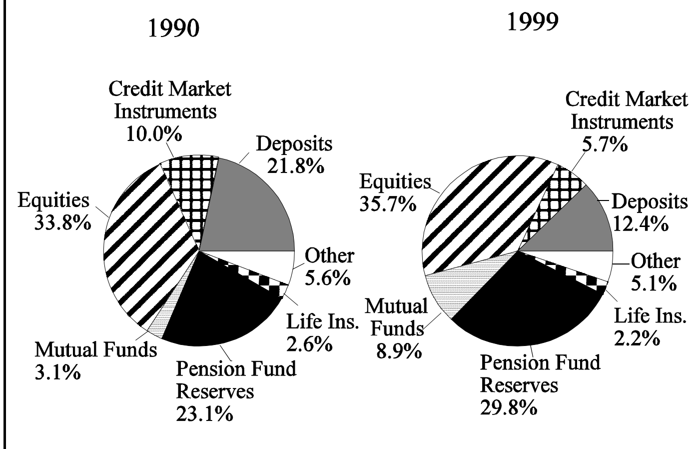
According to the May Senior Loan Officer Opinion Survey on Bank Lending Practices, many banks continued to report tighter lending standards, particularly higher premiums for riskier borrowers. These banks cited concerns about the economic outlook. This general tightening of terms for business loans continues a trend that began during the second half of 1998, following a four-year period in which banks had been easing terms and standards on C&I loans. Informal interviews with local bankers also provide evidence of their increasing caution in making loans. Bankers expect the growth in business lending to ease as both lenders and borrowers become more cautious about leverage ratios and debt service payments.

BANKS RELYING MORE ON NONINTEREST INCOME

Low household savings, competition from other banks and nonfinancial service providers, and alternatives such as mutual funds and the stock market have hindered interest income growth. The Flow of Funds Accounts indicate households have shifted their holdings of financial assets from deposits and credit market instruments to mutual funds, pension funds, and equities (see Figure). Banks, particularly large ones, have attempted to diversify income sources, enhance profitability, and mitigate pressures on net interest margins by generating more noninterest income. Banks have been promoting the buildup of fee-generating business by either increasing traditional fees or providing new services such as asset management, securities and insurance brokering, investment banking, venture capital investments, and investment advisory services.

Although large banks' scale and market reach give them an advantage over small banks in generating noninterest income, the FDIC's *Regional Outlook* for the first quarter of 2000 notes that many small banks are now following suit. The Financial Modernization Bill, signed by the President in November 1999, creates many new opportunities for both large and small banks to supplement their traditional lending business with newer fee-generating activities. The Gramm-Leach-Bliley Act allows banks to form financial holding companies, to provide insurance and

Financial Assets of Households



Includes nonprofit organizations. Data may not sum to 100% because of rounding.
Source: The Flow of Funds Account of the United States, Table L.100, June 9, 2000 release.

annuities as a principal, agent, or broker, and to underwrite and deal in securities.

Our research into the nonbanking activities of banks in the region conducted in March of this year revealed that banks were already making progress converting to financial holding companies, but many banks–particularly small banks–had yet to engage in many activities permissible even before the passage of the act. Among those banks offering nonbank services, only a small minority of larger banks (those with assets exceeding $10 billion) were offering insurance and annuities as an agent or a broker. Half of these large banks were operating their own mutual funds. A significant number of companies with assets between $1 billion and $10 billion were acting as agent or broker for insurance (particularly life and disability insurance), annuities, and mutual funds. Smaller companies were not generally engaged in nonbanking activities, but roughly 15 percent offered discount brokerage or insurance agency services, largely through a third party.

This issue of *Banking Brief* introduces our new format. Over the past few years, the growing number of interstate mergers, acquisitions, and consolidations in the banking industry has made the location of a bank's headquarters a less important indicator of where a bank is doing business. In our new format, we follow two groups of banks: large banks, those that are among the largest 100 banking organizations in the nation and have a significant presence in the region; and community banks, those that are not among the largest 100 banking organizations in the nation but are headquartered in the region. For more information on our methodology, please refer to our web site at www.phil.frb.org/econ/bb/index.html.

First Quarter 2000

	Community Banking Organizations						*Large Banking Organizations*						
	Tri-State			*Nation*				*Tri-State*			*Nation*		
	$Bill	**% change from**		**$Bill**	**% change from**			**$Bill**	**% change from**		**$Bill**	**% change from**	
	00Q1	**99Q4**	**99Q1**	**00Q1**	**99Q4**	**99Q1**		**00Q1**	**99Q4**	**99Q1**	**00Q1**	**99Q4**	**99Q1**
Total Assets	$74.5	7.5%	11.1%	$1110.6	8.9%	10.1%	Total Assets	$876.0	-6.0%	-1.0%	$4407.2	6.5%	6.4%
Total Loans	46.2	10.3	14.1	702.6	12.3	15.2	Total Loans	550.7	-1.1	2.3	2635.5	6.9	7.5
Business	6.5	23.5	22.7	130.4	15.7	15.7	Business	195.3	4.7	3.7	852.7	11.0	6.8
Real Estate	32.8	7.5	12.5	444.9	15.3	17.4	Real Estate	219.4	-1.6	2.6	1065.6	9.0	14.3
Consumer	5.2	7.2	11.4	84.3	5.9	9.3	Consumer	51.9	-7.8	-1.6	316.4	-0.4	-4.7
Total Deposits	58.3	9.9	8.9	907.5	9.7	8.5	Total Deposits	567.0	-5.5	0.0	2827.3	2.7	4.9
Ratios (in %)	**00Q1**	**99Q4**	**99Q1**	**00Q1**	**99Q4**	**99Q1**	**Ratios (in %)**	**00Q1**	**99Q4**	**99Q1**	**00Q1**	**99Q4**	**99Q1**
Net Income/ Avg Assets (ROA)	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	Net Income/ Avg Assets (ROA)	1.2%	1.2%	1.2%	1.2%	1.2%	1.1%
Net Interest Inc/ Avg Assets (NIM)	3.8	3.8	3.9	4.1	4.1	4.1	Net Interest Inc/ Avg Assets (NIM)	3.3	3.3	3.2	3.2	3.2	3.2
Noninterest Inc/ Avg Assets	1.0	1.0	1.0	1.0	1.0	1.0	Noninterest Inc/ Avg Assets	2.8	2.8	2.5	2.4	2.4	2.2
Noninterest Exp/ Avg Assets	3.0	3.0	3.0	3.2	3.2	3.2	Noninterest Exp/ Avg Assets	3.8	3.9	3.7	3.4	3.4	3.5
Loans/Deposits	79.1	79.1	75.5	77.4	77.0	72.9	Loans/Deposits	97.1	96.0	95.0	93.2	92.3	91.0
Equity/Assets	8.2	8.2	9.1	8.9	8.9	9.5	Equity/Assets	8.3	8.3	8.5	7.9	7.9	8.1
Nonperforming Loans/ Total Loans	0.8	0.7	0.8	0.8	0.8	1.0	Nonperforming Loans/ Total Loans	1.1	0.9	0.8	1.0	0.9	1.0

A banking organization is an independent bank or all the banks within a highest-level bank holding company; however, banks less than five years old and those whose credit card loans make up greater than 50 percent of their total loans are excluded. The large banking organization sample is based on banking organizations whose total assets were at least as large as those of the 100th largest banking organization in the United States as of December 31, 1999. The community banking organization sample is based on the remaining banking organizations. Tri-state large banking organizations are those large banking organizations that have either at least 5 percent of the deposits of the region or any state therein or at least 5 percent of their deposits in the region. Tri-state community banking organizations are those community banking organizations that are headquartered in the region. The numbers of banking organizations in the categories are as follows: (1) community banking organizations -- 194 for the tri-state area and 6173 for the nation; (2) large banking organizations -- 18 for the tri-state area and 99 for the nation. Ratios are aggregates, that is, the numerators and denominators are summed across all banks in the group, then divided. Data are adjusted for mergers.

Any questions or comments should be directed to Victoria Geyfman at (215) 574-6431 or victoria.geyfman@phil.frb.org. Detailed documentation on the methodology used in constructing this document, back issues, and the current issue of *Banking Brief* are available on our web site at www.phil.frb.org/econ/bb/index.html. To subscribe to this publication, please contact the Publications Desk at (215) 574-6428 or lois.newell@phil.frb.org.

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