BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

Second Quarter 2002

A combination of high net-interest margins and growth in loan volume helped banks improve profitability in the second quarter of 2002. Large banks in the nation registered an average return on assets (ROA) of 1.12 percent, while community banks' ROA was 1.16.

Total assets grew across all bank categories. The largest factor contributing to asset growth was an increase of 19 percent (compounded growth rate) in available-for-sale securities over the quarter. Fueled by continued strength in refinancing activity, commercial banks' holdings of mortgage-backed securities (MBSs) rose 29 percent from last quarter.

Commercial lending was a weak spot this quarter for large banks in the nation, but strong growth rates in consumer and real estate loans offset this weakness. Consumer lending at tri-state area community banks decreased 2 percent since last quarter while real estate and business loans were up 12.4 and 4.1 percent, respectively.

Loan quality, although worse at large banks, remained stable at most banks in the nation. The nonperforming loan ratio has improved slightly at community banks and remained at 1.8 percent at large banks in the nation. The ratio rose from 1.5 percent to 1.7 percent at large banks in the tri-state area, but this was mainly due to an increase in nonperforming loans at only a few banks.

The bad news this quarter came from loan chargeoffs, particularly in the business loan category, where the charge-off rate rose from 1.6 percent in the first quarter to 1.81 percent in the second (see figure). The increase in this rate at large banks over the quarter contributed significantly to the overall rise of business loan chargeoffs. The charge-off rate for real estate loans remained constant at 0.17 percent, down from the record 0.28 percent registered in the third quarter of last year. Consumer loan charge-offs remained high but have dropped significantly, from 4.16 percent to 2.99 percent, since last quarter.

BANKS' EQUITY INVESTMENTS IN NONFINANCIAL COMPANIES

As required by the Gramm-Leach-Bliley Act (GLBA) of 1999, banks must file a report that allows the Federal Reserve to monitor the growth of domestic bank holding company (BHC) investments in nonfinancial companies and their contributions to capital, profitability, risk, and volatility.[1] The report, Y-12, must be filed by a domestic BHC with significant nonfinancial equity investments (aggregate nonfinancial investments of at least $200 million or 5 percent of the BHC's consolidated Tier 1 capital, whichever is smaller). A nonfinancial equity investment is an equity investment made by the BHC or any of its subsidiaries. The information is reported on a fully consolidated basis, reflecting all companies in which the BHC directly or indirectly owns or controls more than 50 percent of the outstanding voting stock.

Total equity investments in nonfinancial companies amounted to $49.4 billion as of December 31, 2001, of which 56 percent were direct investments in public and nonpublic companies and the rest were indirect investments.[2] As of year-end, 42 companies had filed the report, compared to 39 that filed in September. Practically all nonfinancial investments, close to 98 percent, were made by the 15 largest financial holding companies. Direct investments in nonpublic companies dominated investments made in public companies five to one. Despite the fact that GLBA eased merchant banking restrictions, only 17.5 percent of total nonfinancial investments came from merchant banking. More than nine in 10 of all merchant banking investments were made by the largest 10 reporting companies.

After years of adding to their parent companies' bottom line, nonfinancial equity investments are now reducing bank profits. As of the end of 2001, BHCs reported a total of $4.8 billion in losses from equity investments in nonfinancial companies.

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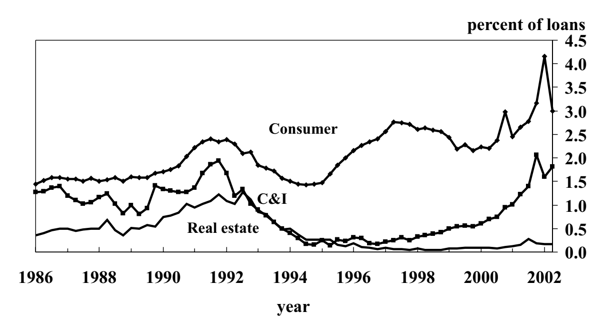
[1] Reporting form FR Y-12 is also called Consolidated Bank Holding Company Report of Equity Investments in Nonfinancial Companies. The report was first issued and filed in September 2001. Given the novelty of the report, some bank holding companies had to revise their original filings.

[2] A direct investment is any nonfinancial equity investment that the BHC or any of its subsidiaries holds directly in a nonfinancial entity. An indirect investment is an equity investment that the BHC or any of its subsidiaries has in an investment fund or similar entity that is engaged in the business of making equity investments in nonfinancial companies (for example, an investment in a private equity fund that makes merchant banking investments).

Charge-Off Rates by Type of Loan



Rates equal average chargeoffs divided by average outstanding loans by category.
Source: Quarterly Reports of Condition and Income, FRB

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	Community Banking Organizations						Large Banking Organizations						
	Tri-State			Nation				Tri-State			Nation		
	$Bill	% change from		$Bill	% change from			$Bill	% change from		$Bill	% change from	
	02Q2	02Q1	01Q2	02Q2	02Q1	01Q2		02Q2	02Q1	01Q2	02Q2	02Q1	01Q2
Total Assets	$77.6	13.8%	10.6%	$1286.1*	10.1%	9.6%	Total Assets	$901.8	6.6%	0.3%	$4967.2	15.5%	4.1%
Total Loans	47.6	10.2	9.2	825.1	12.9	9.0	Total Loans	535.7	-10.7	-6.6	2826.6	3.7	-0.3
Business	6.7	4.1	8.8	144.3	8.6	4.6	Business	163.7	-20.0	-14.4	765.1	-15.2	-11.8
Real Estate	35.3	12.4	10.6	554.0	14.6	12.7	Real Estate	241.7	1.0	-0.1	1253.2	12.7	4.7
Consumer	3.9	-2.2	-4.2	78.7	1.5	-3.1	Consumer	51.6	-10.0	-11.5	388.6	9.5	11.2
Total Deposits	61.2	13.8	11.3	1039.0	8.1	8.9	Total Deposits	594.4	2.1	-1.0	3155.4	7.4	2.5

Ratios (in %)	**02Q2**	**02Q1**	**01Q2**	**02Q2**	**02Q1**	**01Q2**	**Ratios (in %)**	**02Q2**	**02Q1**	**01Q2**	**02Q2**	**02Q1**	**01Q2**
Net Income/ Avg Assets (ROA)	1.2%	1.2%	1.2%	1.2%	1.1%	1.1%	Net Income/ Avg Assets (ROA)	1.1%	1.1%	1.4%	1.1%	1.1%	1.1%
Net Interest Inc/ Avg Assets (NIM)	3.7	3.6	3.6	3.9	3.9	3.9	Net Interest Inc/ Avg Assets (NIM)	3.1	3.2	3.3	3.2	3.1	3.1
Noninterest Inc/ Avg Assets	1.2	1.2	1.2	1.1	1.1	1.0	Noninterest Inc/ Avg Assets	2.4	2.4	2.7	2.2	2.2	2.3
Noninterest Exp/ Avg Assets	3.1	3.1	3.1	3.1	3.1	3.2	Noninterest Exp/ Avg Assets	3.2	3.2	3.4	3.2	3.2	3.2
Loans/Deposits	77.9	78.5	79.4	79.4	78.6	79.4	Loans/Deposits	90.1	93.2	95.5	89.6	90.4	92.0
Equity/Assets	9.2	9.2	9.2	9.6	9.6	9.5	Equity/Assets	9.3	9.3	8.6	8.7	8.7	8.3
Nonperforming Loans/ Total Loans	1.0	1.0	0.7	1.1	1.2	1.0	Nonperforming Loans/ Total Loans	1.7	1.5	1.3	1.8	1.8	1.5

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, 2001. 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 —201 for the tri-state area and 6067 for the nation; (2) large banking organizations —19 for the tri-state area and 100 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. Quarterly percentage changes are compound annualized rates.
* This quarter's sample excluded one bank that changed its charter from a thrift to a bank.

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.