



BANKING BRIEF

FOR PENNSYLVANIA, NEW JERSEY, AND DELAWARE

SPECIAL REPORT: COMMERCIAL BANKS IN 2003

Profits improved substantially both nationally and regionally at large banks in 2003. It appears that they are also beginning to put the asset quality problems of the past several years behind them. Small banks saw flat or decreasing profitability. This is explained in part by higher overhead costs and by generous increases in their loan-loss reserves.

Large Banking Organizations

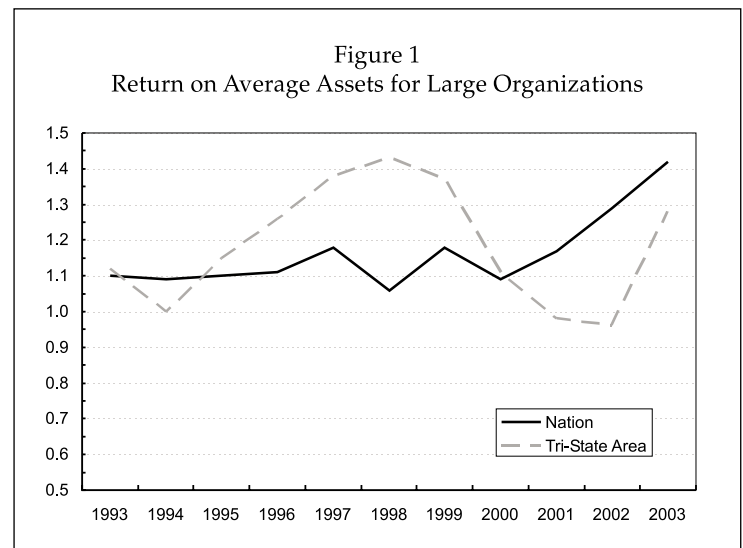
Profitability increased substantially at large organizations both in the tri-state area and nationally.¹ Return on average assets (ROA) increased from 0.96 percent to 1.28 percent for large organizations in the tri-state area (Figure 1).² Nationally, ROA increased from 1.29 percent to 1.42 percent. Return on average equity (ROE) was also up both locally and nationally (Figure 2). In the tri-state area, ROE increased from 11.73 percent to 15.30 percent. Nationally, ROE rose from 14.82 percent to 15.97 percent. The local figures for ROA and ROE don't quite match performance in the mid- to late 1990s, but they are at their highest since 1999.

Large banks in the tri-state area ex-

perienced their first appreciable growth in loans (4.9 percent) since 1999 (Figure 3). This is still slower than loan growth in the nation as a whole. Real estate loans were primarily responsible for the increase in lending, as the regional real estate market continued to show robust growth.³ Total real estate lending at large tri-state area banks increased over 10 percent in 2003. By contrast, commercial and industrial (C&I) lending decreased over 12 percent. There was a small increase (3.4 percent)

in consumer lending. Consumer lending was the main reason loan growth was slower in the region than nationally. In the nation as a whole, real estate lending grew almost 9 percent, C&I lending shrunk 6.6 percent, and consumer lending grew more than 11 percent.

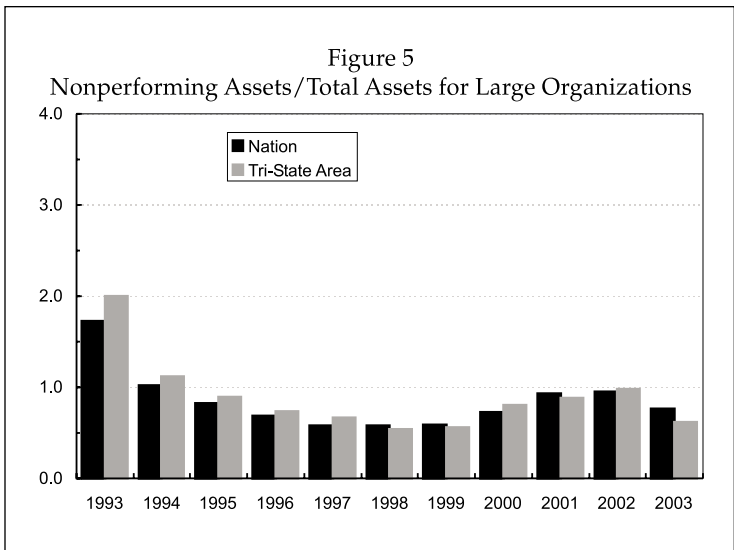
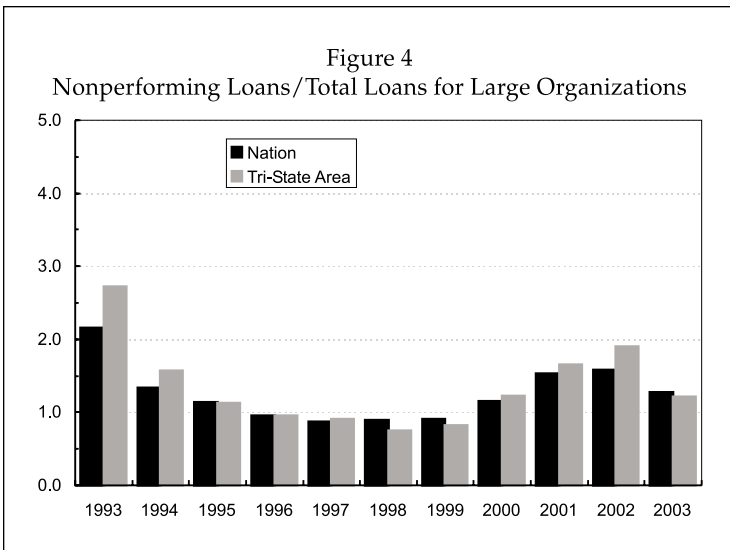
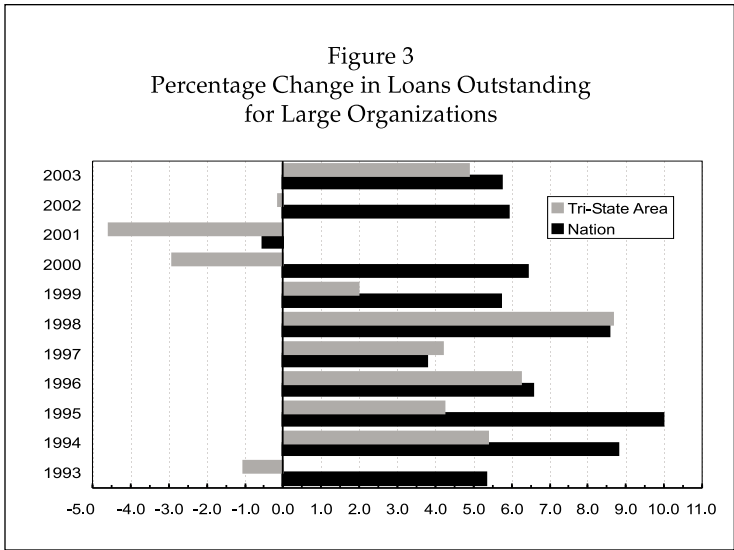
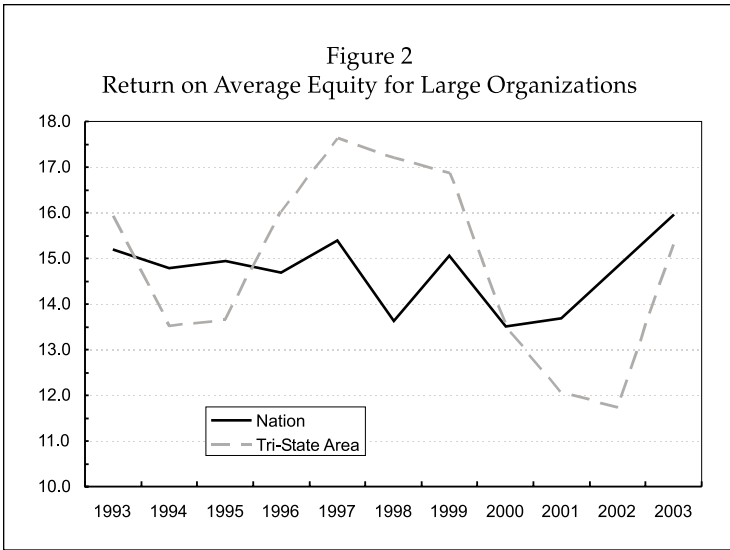
One of the major reasons for the increased profitability both locally and



¹ Large banking organizations are determined annually as those firms that are at least as large as the 100th largest bank holding company in the nation at year-end (here, 2002), ranked by total assets. A large bank defined as being in the tri-state area must have one of the following characteristics: 1) a market share of deposits of at least 5 percent in either the entire region or in any one of the states, or 2) at least 5 percent of the organization's total deposits located in the region. It should be noted that year-to-year ratios as presented are based on different samples, so the inclusion or exclusion of an organization can affect the numbers. See the Appendix for a description of the methodology used in grouping these banks.

² All data used in Figures 1-26 are from Federal Financial Institutions Examination Council (FFIEC) Call Reports. All ratios are weighted averages of all banks within the sample. This means that the numerator and denominator are summed across all banks, with the resulting aggregates divided to get the ratio.

³ See *Regional Highlights*, Fourth Quarter 2003, www.phil.frb.org/files/reghigh/rh0403.pdf.



nationally was improved loan quality. This was particularly true for banks in the tri-state area. The ratio of nonperforming loans to total loans fell from 1.90 percent in 2002, a nearly decade-long high, to 1.21 percent (Figure 4).⁴ This figure also fell for all banks in the nation, but for the first time since 1999, tri-state area organizations had better loan quality than banks nationally. The improved asset quality is also reflected in the ratio of nonperforming assets to total assets (Figure 5).⁵ Although the continuing strength of the residential real estate

market played a role in the decrease in nonperformers, the major factor was a decrease in nonperforming commercial and industrial loans. Nonperforming C&I loans at large banks in the nation decreased more than 32 percent from 2002 to 2003. Nonperforming real estate loans increased about 6.5 percent. Nonperforming consumer loans increased about 12.8 percent. These numbers, combined with the loan growth numbers above, are the result of large banks' tightening their lending standards for commercial borrowers in

the past few years. Recently, commercial loan officers have been reporting an easing of standards for C&I loans.⁶

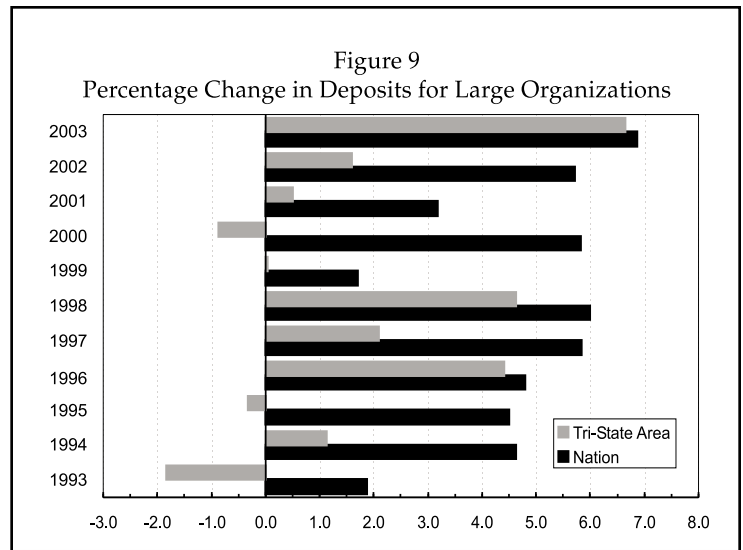
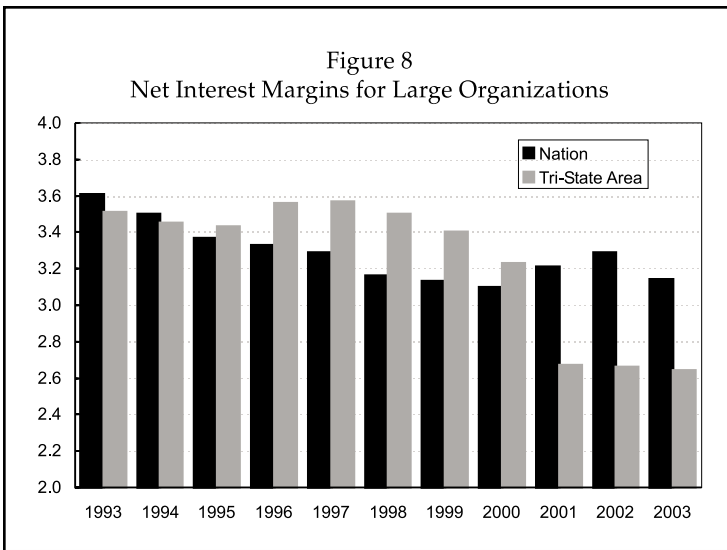
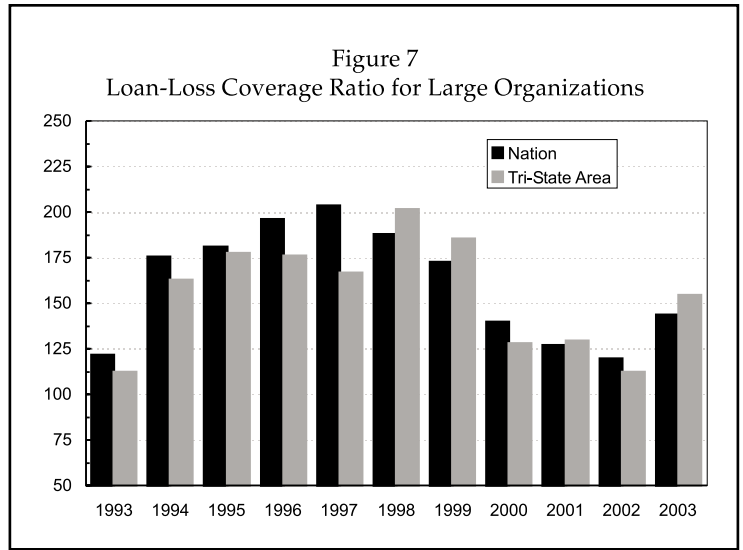
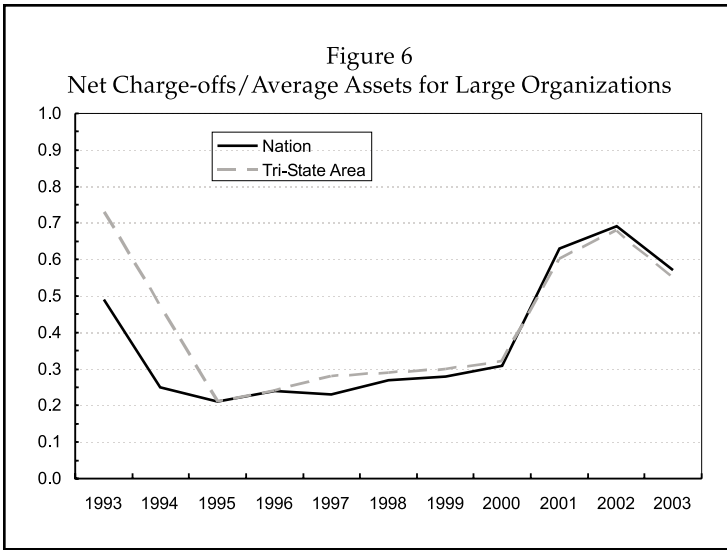
The decreases in nonperforming loans and assets are reflected in the charge-off rates as well. Net charge-offs as a percentage of average assets showed the first decrease in several years, both in the tri-state area and nationally (Figure 6). This improvement is also evident in the loan-loss coverage ratios, which increased for the first time since 1999 (Figure 7).⁷ This was accomplished even though loan-loss

⁴ Nonperforming loans are defined as loans past due 90 days or more plus nonaccruing loans.

⁵ Nonperforming assets are defined as nonperforming loans plus other real estate owned (OREO).

⁶ See the Board of Governors' *Senior Loan Officer Opinion Survey* for the previous several years at www.federalreserve.gov/boarddocs/snloansurvey. Lending standards are also discussed in the Fourth Quarter 2003 issue of *Banking Brief* at www.phil.frb.org/econ/bb/index.html.

⁷ Loan-loss coverage ratio is defined as the ratio of loan-loss reserves to nonperforming loans.



reserves did not increase appreciably for organizations in the nation as a whole and actually decreased somewhat (from \$21.6 billion to \$19.4 billion) for banks in the tri-state area. Less aggressive reserving also contributed to the rise in profits among these banks, because additions to loan-loss reserves come out of earnings.

One potential drag on future earnings, particularly for banks in the tri-state area, is net interest margins.⁸ Net interest margins at tri-state area banks decreased again in 2003, and they are now at their lowest levels in over a decade (Figure 8). Net interest margin also declined nationally, and it is now at the same level as in the mid- to late

1990s. One of the reasons for declining net interest margins is that deposits grew faster than loans. Deposits at tri-state area banks grew more than 6.6 percent in 2003, well above the growth rate of the previous several years (Figure 9). Deposits grew slightly faster nationally. Net interest margins decreased because of a disparity between growth of deposits and loans (compare Figures 3 and 9). This disparity was less nationally than locally; thus the net interest margins decreased more locally. Tri-state area banks also had lower loans-to-deposits ratios (Figure 10).

Another factor contributing to higher profits was the rise in 2003 of noninterest

(fee) income as a percentage of average assets (Figure 11). Nationally, fee income rose 0.22 percentage point, to 2.79 percent, while tri-state area banks saw an increase of 0.32 percentage point, to 3.00. Both of these figures are near historic highs for this ratio, but as the larger banks become more diversified, it is possible and even likely that these institutions will generate even higher income from fees in the future.

While noninterest income was rising as a percentage of average assets, large organizations were able to control their costs. Noninterest (overhead) expenses as a percentage of average assets increased slightly both regionally and nationally, but

⁸ Net interest margin is defined as the ratio of net interest income to average earning assets. Earning assets are defined as the sum of interest-bearing balances, net loans, securities, and fed funds sold and securities purchased under agreements to resell. The large drop in net interest margins for large tri-state area banks in 2001 was due in part to a change in the sample from 2000. For further information, see *Banking Brief Special Report: Commercial Banks in 2001* at www.phil.frb.org/bb/bbspecial01.pdf.

Figure 10
Loans/Deposits for Large Organizations

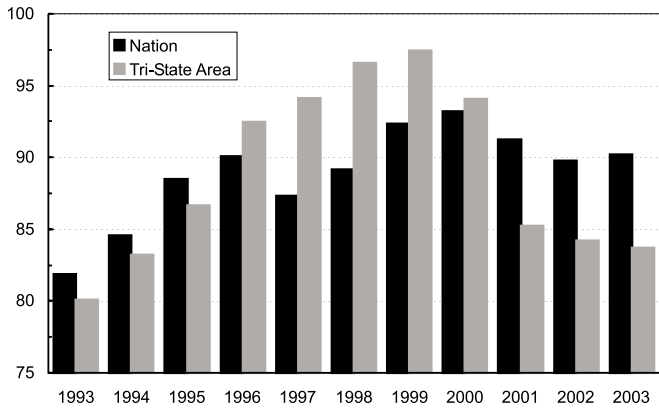


Figure 11
Noninterest Income/Average Assets for Large Organizations

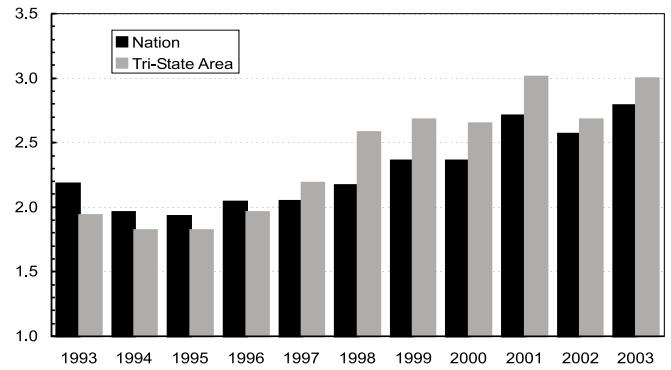


Figure 12
Noninterest Expense/Average Assets for Large Organizations

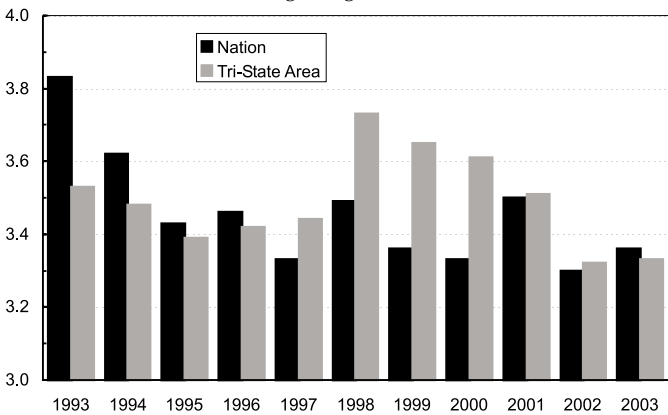
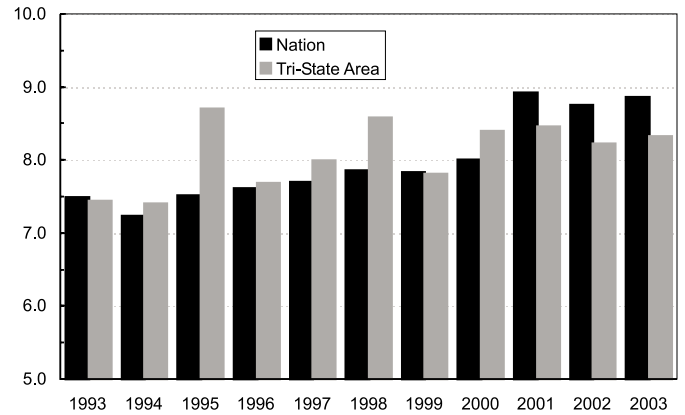


Figure 13
Equity/Assets for Large Organizations



they are still well below the levels of nearly every year in the 1990s (Figure 12). Finally, capital ratios were basically stable from to 2003 (Figure 13).

In summary, 2003 was a good year for large banking organizations. Profitability

increased both in the region and nationally. One major reason is that the asset quality problems of the last several years appear to be on the wane. Additionally, noninterest income increased, while banks were able to control their overhead. Both

loans and deposits showed strong growth in 2003 compared to the previous couple of years, especially in the tri-state area. One potential problem is a shrinking of interest rate spreads in the form of net interest margins.

Community banks did not perform as well as large banking organizations in 2003. ROA was basically flat nationally, and it decreased 0.07 percentage point at banks in the tri-state area (Figure 14). ROE decreased both nationally and in the region (Figure 15).

One reason why profitability dropped at community banks was that they were much less successful than the larger banks at controlling their overhead expenses. The ratio of noninterest expense to average assets for community banks increased substantially both nationally and in the tri-state area (Figure 16). In the region, the ratio increased nearly 0.2 percentage point, from 2.94 to 3.10 percent, and the ratio is now as high as it has been since 1994. Nationally, overhead to average assets increased 0.09 percentage point, from 3.23 to 3.32 percent.

Another reason for the decline in profitability is that community banks have been adding to their loan-loss reserves at a higher rate than large organizations. The loan-loss coverage ratio at community banks increased nearly one-third locally, to 203.0 percent, and almost 20 percentage points nationally, to 156.4 percent (Figure 17). Underlying these ratios, loan loss reserves increased at tri-state area banks 4.23 percent, from \$975.5 million to \$1.02 billion. The increase nationally was nearly identical: 4.24 percent. At the same time, ratios of nonperforming loans to total loans and nonperforming assets to total assets

decreased nationally and did not change at tri-state area banks in 2003 (Figures 18 and 19).

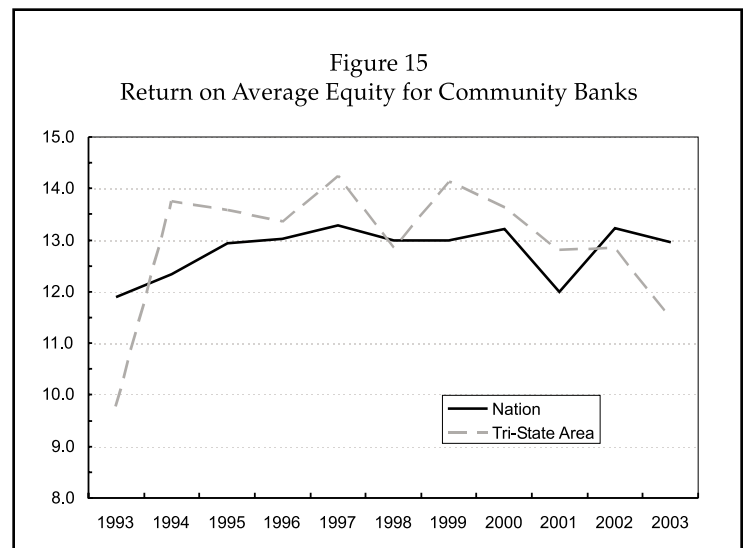
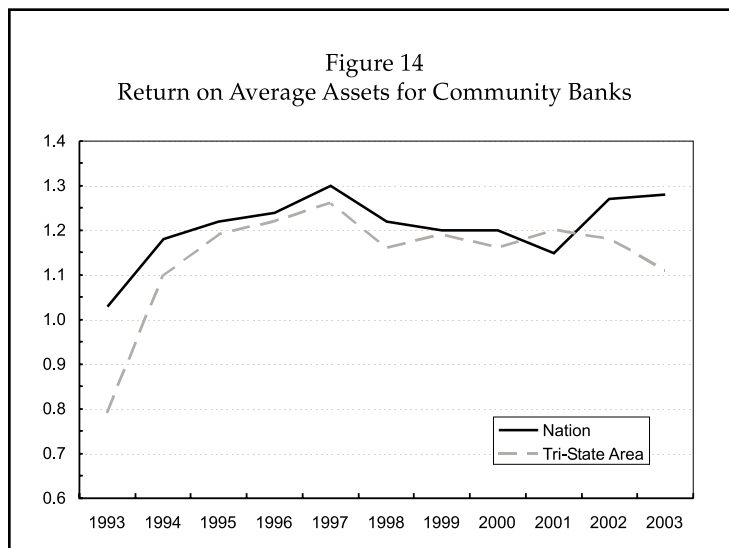
The ratio of net charge-offs to average assets (Figure 20), which was essentially flat nationally, appears to have more than tripled at banks in the tri-state area. However, this is due to sampling, as one or more banks that were considered large organizations last year are included in the community banks category in this year's report. If the 2003 sample had been used in 2002, net charge-offs to average assets would have shown a slight decrease in the tri-state area, from 0.48 percent to 0.42 percent. Taken together, Figures 17 through 20 show that even though the quality of their loan portfolios has improved, the smaller banks continue to make loan-loss provisions aggressively. These provisions could be hurting profitability, but there may be sound reasons for doing it (see below).

As in the large organizations, net interest margins also decreased at community banks in 2003 (Figure 21). However, the decrease was smaller than at the larger banks because loans grew at a faster rate than deposits at these banks both nationally and in the tri-state area (Figures 22 and 23). Deposit growth at the community banks was not substantially different from that of the large banks, but loans grew at a higher rate.

Underlying the loan growth rate is the fact that a much higher percentage of loans made by community banks are real

estate loans. Real estate loans at community banks increased at nearly the same rates both nationally and locally as those of the large organizations (11.8 percent nationally and 10.6 percent locally). However, real estate loans comprise approximately 68 percent of the loan portfolios of the nation's community banks. In the tri-state area, real estate loans comprise almost 73 percent of all loans. Additionally, while C&I loans were shrinking at the large organizations (see above), they increased over 18 percent at tri-state area community banks and over 11 percent nationally. This may indicate that the community banks are picking up some of the commercial customers of the large organizations. If these represent the more marginal (i.e., riskier) customers that the larger banks are no longer servicing, it could be a reason for the continued high loan-loss provisions. It is possible that if the smaller banks have relaxed their lending standards to attract some C&I business away from larger banks, they are anticipating that the loans to these new customers will not be of the same quality as those that are on their books now. Thus, the continued rate of loan-loss provisioning could be in preparation for the higher default rates that these loans are expected to generate.

Community banks continued to increase their capital ratios last year. The ratio of total equity to total assets increased about 0.3 percentage point both locally and nationally (Figure 24). This ratio is now at a 10-year high. The high capital ratios,



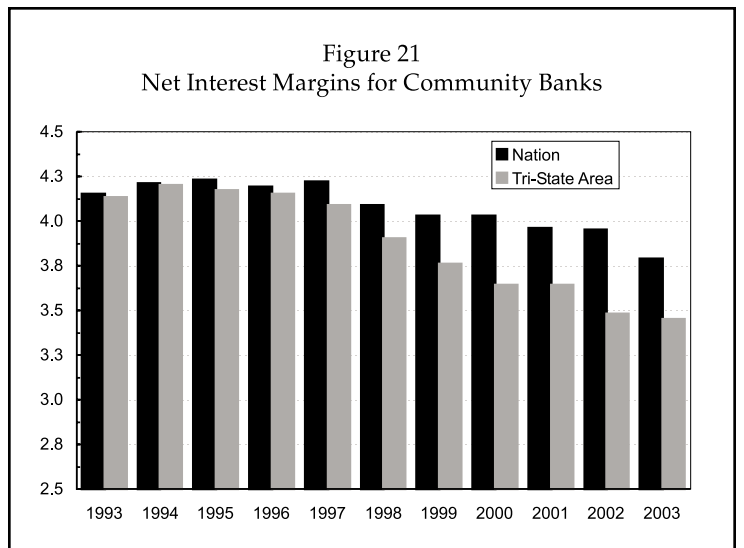
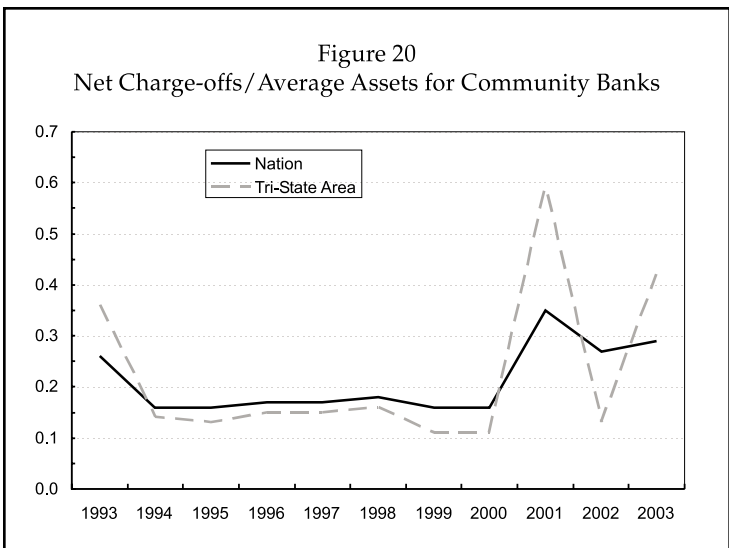
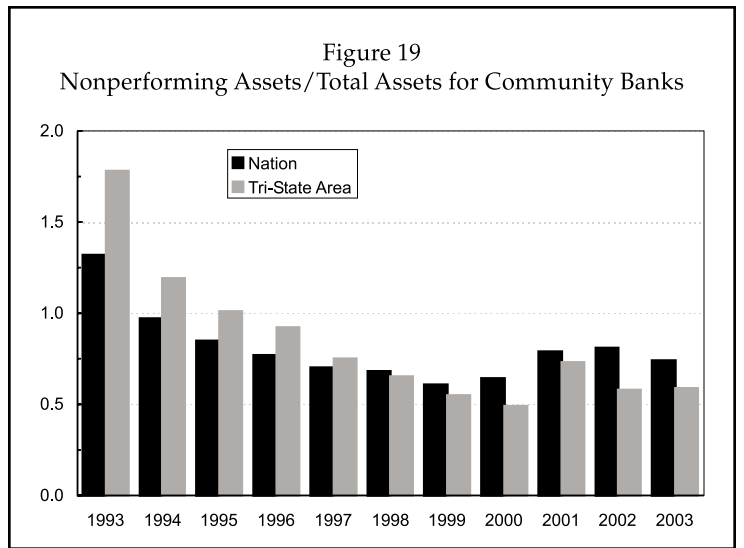
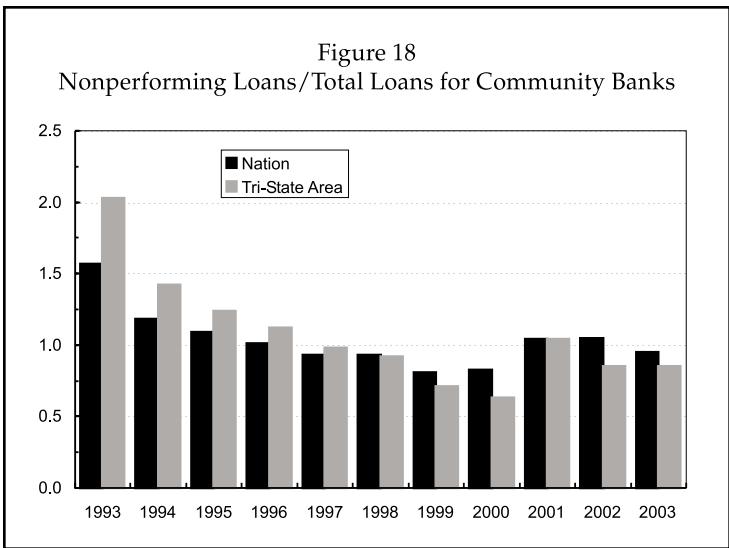
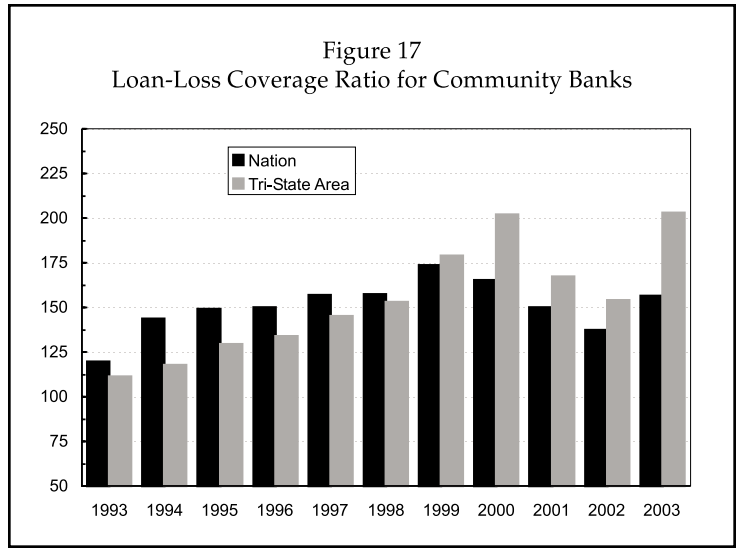
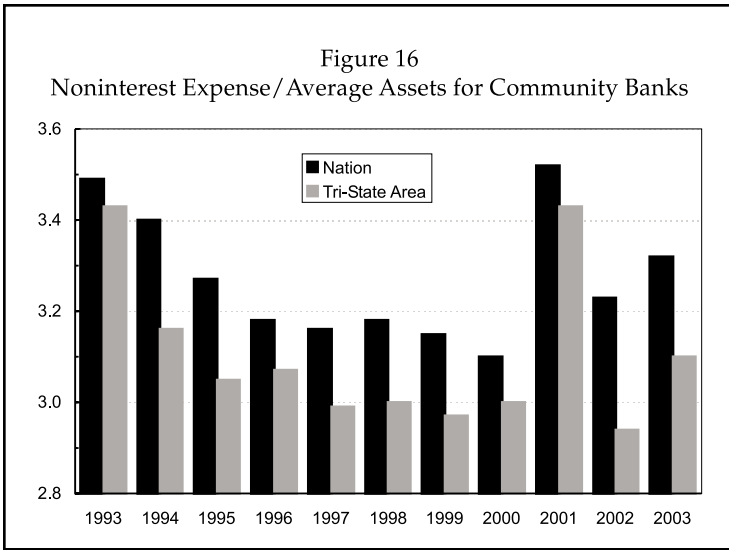


Figure 22
Percentage Change in Loans Outstanding for Community Banks

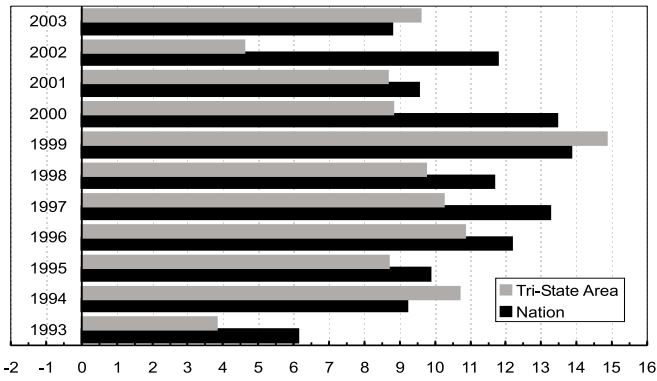


Figure 23
Percentage Change in Deposits for Community Banks

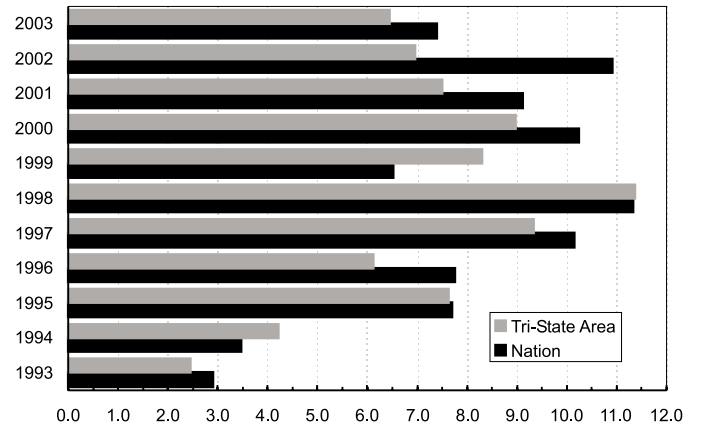


Figure 24
Equity/Assets for Community Banks

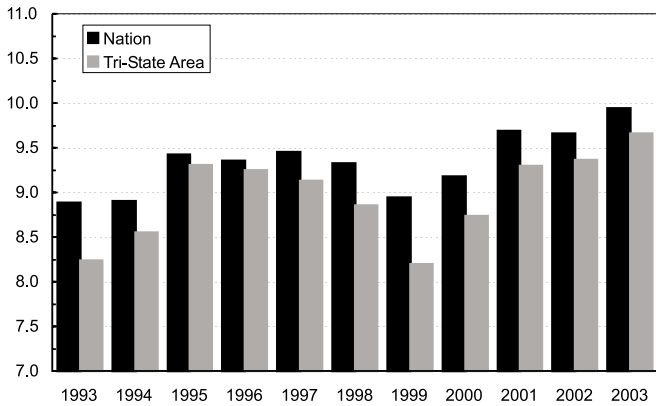


Figure 25
Noninterest Income/Average Assets for Community Banks

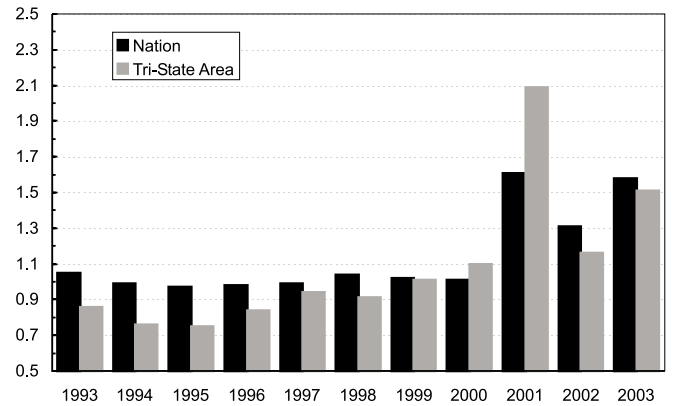
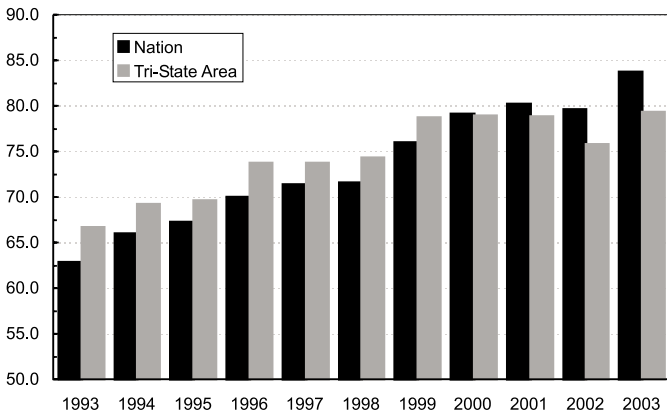


Figure 26
Loans/Deposits for Community Banks



together with the loan-loss coverage ratios discussed above, may indicate that community banks are not entirely convinced that the recovery of either the national or regional economy will be very strong.

The community banks were more successful in generating fee income in 2003 (Figure 25). Also, the strong loan growth resulted in a higher loans-to-deposits ratio in 2003 (Figure 26).

In summary, profitability at community banks declined slightly in 2003. In part, this was due to higher overhead costs. Also, it appears that community banks are continuing to build up reserves and capital at the expense of profits. Loans and deposits grew at a robust rate, and the smaller banks were able to increase their fee income last year.

Since the mid-1990s, the credit card industry has experienced significant consolidation. While a small number of firms have always led the market, as shown in Figure 27, the four-firm, 10-firm, and 25-firm concentration ratios have increased substantially since their low points in 1992-93.⁹ Today, the top 10 firms control nearly 80 percent of the market, while the top 25 control well over 95 percent.

Another measure of industry concentration is called a Herfindahl-Hirschman index (HHI), which is the sum of the squared market shares for every firm in a particular industry.¹⁰ As shown in Figure 28, this number has also increased rapidly since 1993. Until about 1997 the credit card industry was unconcentrated. By 2002 it was well on its way to being heavily concentrated. Although both the concentration ratios and HHIs dipped slightly in 2003, the trend is clear. It should be noted that this number does not include loans that were securitized.¹¹

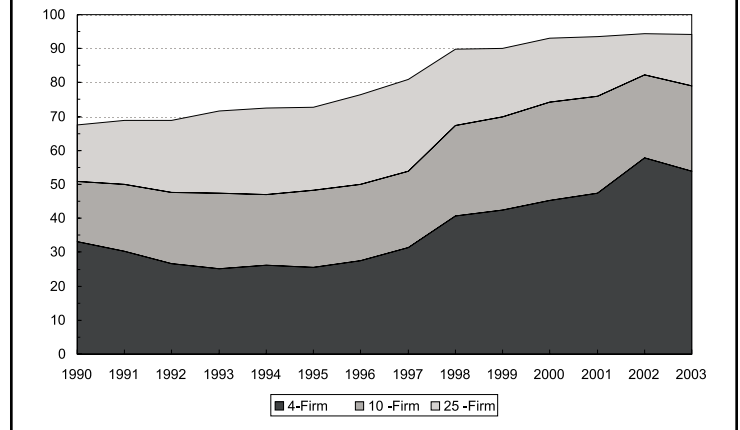
Not only are the largest firms in the industry controlling a larger share of loans than ever before, but the number of lenders has decreased quite a bit as well. In 1993, there were over 5,300 banks and thrifts engaging in credit card lending. Today, there are about 4,600, a decline of about 10.3 percent. This number includes firms that offer only "related plans" (see footnote 8 above). In actuality, the number of firms offering pure credit card loans is now less than 2,000.

Moreover, the types of firms engaging in credit card lending on a large scale are changing, with a number of "monoline"

lenders becoming significant players in the market.¹² Figure 29 shows the top 10 credit card lenders in 1990, 1995, 2000, and 2003. In 1990, all of the major lenders except one were large commercial banking organizations. The exception was a department store that owned a bank. By year-end 2002, four of the top 10 lenders were monoline firms. These firms' impact on the credit card industry will be discussed below.

Why is the credit card industry consolidating? There are several reasons. First, the banking industry as a whole underwent significant consolidation in the 1990s. Revisiting Figure 28, the HHI for bank and thrift loans increased nationally more than 200 percent between 1990 and 2003, from 79 to 247.¹³ In the same period, the HHI for credit card loans increased approximately 200 percent. Between 1993 and 2003, the number of depository institutions declined over 28 percent, from 11,500 to about 8,300. Some of this decline can be attributed to the demise of the thrift industry, but there was also substantial consolidation among banks, especially large banks. Thus, if we

Figure 27
Industry Concentration Ratios



look at Table 1 for 1990, at least seven of the firms listed engaged in at least one large merger since then, some of them with each other. This trend is continuing today with the announcement last fall of the merger of Bank of America Corporation and Fleet Financial Group, and the recent announcement of the merger of J.P. Morgan Chase & Company and Bank One Corporation (see Mergers and Acquisitions below). Thus consolidation across the entire banking industry accounts for part of the increase in concentration in credit card lending. However, other factors unique to credit card are also important.

First, there are risks in credit card lending that are different from other types of lending. In most cases, credit card loans are

⁹ A concentration ratio is the sum of the market shares for that number of firms. Thus, the four-firm concentration ratio is the combined market shares of the top four firms in an industry, the 10-firm concentration ratio is the combined market shares of the top 10 firms, and so on. Unless otherwise noted, all of the numbers in this section are based on outstanding loans from Call Reports, and they include all credit card loans made by banks and thrifts. Until 2001, this item was reported as "Credit Cards and Related Plans," which includes, among other things, overdrafts on accounts with overdraft protection. This item was split in 2001 into "Credit Card Loans" and "Related Plans." For the sake of consistency, these items are combined for the years 2001-03. Until 2002, information on loans securitized and sold was not available on the Call Reports. Again, unless otherwise noted, for consistency's sake this is not included. Finally, credit card loans do not include commercial credit cards or lines of credit secured by real estate.

¹⁰ According to Department of Justice guidelines, an HHI of less than 1000 is considered an unconcentrated market, while an HHI of greater than 1800 is considered a heavily concentrated market.

¹¹ Data on securitizations of credit card loans were not reported on bank Call Reports until 2001. An analysis of data on securitized credit card portfolios obtained from a private company, ABSNet, suggests that HHIs were higher than shown in Figure 28 in the late 1990s, but the increase in the HHI was smaller.

¹² A monoline lender is a bank that does a large portion of its business only in credit cards. An example of this would be MBNA Corporation.

¹³ The HHI for all loans is for comparison purposes only. While credit cards are generally considered to be a national market, the markets for other types of loans may be considerably smaller. In fact, when speaking about concentration in the banking industry, most analysts are concerned with concentration in local markets (generally counties and metropolitan statistical areas). While it is clear that concentration nationally has been increasing since the late 1980s, it is less certain that concentration in local banking markets has increased over that period.

unsecured, so it is more difficult to recover any losses from a default. Also, there is a high rate of fraud compared to other types of loans. Credit card loans have a much higher rate of both nonperformance and charge-off than other loans. As demonstrated in Figure 29, with the exception of the early 1990s, when real estate nonperformers were at a historic high, the ratio of nonperforming credit card loans to all credit card loans was consistently higher than the rate of nonperformers for all other types of loans. This is also true for the ratio of credit card charge-offs to average credit card loans. Between 1993 and 2002, the ratio of net charge-offs to average loans averaged approximately 4.8 percent for credit card loans; for all other types of lending, the corresponding figure was 0.37 percent. While credit card lending has always been more risky than other types of loans, what has changed is the exposure banks face.

Revolving credit outstanding at commercial banks increased 63 percent from 1990 to 2003, to \$217.5 billion.¹⁴ This does not take into account securitizations of revolving credit loans (see below). Other types of consumer credit increased 47 percent during that period.

Another factor driving the increased concentration in credit card lending is that lenders are increasingly securitizing and selling their credit card loans rather than holding them as receivables. This was first done in 1987 and since then has become increasingly popular. As shown in Figure 30, securitizations' share of revolving credit increased steadily in the mid- to late 1990s.¹⁵ In 1990, the amount of revolving credit in securitized portfolios was \$44.6 billion; by 2003 this number had risen to \$396.8 billion. Securitizing requires a large portfolio of loans, so it is done only by about 30 companies.

The reasons for securitizing credit card loans are the same as for mortgages and other types of loans, that is, to spread the risk (both default and interest-rate) among many parties, to raise funds to make additional loans, to gain flexible asset-liability management, and possibly to engage in capital arbitrage. The credit card loans are usually sold to a trust that issues bonds with the receivables as the underlying assets. The trusts are, in most cases, managed by the banks or their holding companies, and the customers are most often institutional investors. Unlike other types of asset-backed securities, such as mortgages, credit cards can either be paid down or added to at the customer's (i.e., cardholder's) discretion. This tends to make the value of the underlying pool of loans more difficult to control, and the lender must replenish the pool from new receivables.

¹⁴ Source: Board of Governors of the Federal Reserve, G.19 Report.

¹⁵ Ibid.

Table 1
Top 10 Credit Card Lenders

1990	Pct.	1995	Pct.	2000	Pct.	2003	Pct.
1. Citicorp †	14.2	Citicorp †	11.9	Citigroup †	22.5	Citigroup †	30.3
2. Chase Manhattan †	7.8	Chase Manhattan †	4.7	Discover*	8.6	Bank of America †	9.5
3. BankAmerica †	6.3	BankAmerica †	4.6	J.P. Morgan Chase †	7.5	MBNA*	8.4
4. American Express	4.9	First Chicago	4.4	MBNA*	6.7	Discover*	5.7
5. Sears (Discover)	4.6	Sears (Discover)	4.0	Bank of America †	5.9	J.P. Morgan Chase †	5.7
6. Bank of New York	3.0	Bank of New York	3.9	Providian*	5.2	Bank One †	4.5
7. First Chicago Corp. †	2.8	Chemical †	3.8	American Express	4.9	Capital One*	4.4
8. Manufacturers Hanover †	2.6	American Express	3.7	Household Financial	4.5	Wells Fargo †	3.5
9. Wells Fargo †	2.5	Banc One †	3.6	Capital One*	4.3	FleetBoston †	3.5
10. Banc One †	2.1	MBNA*	3.5	FleetBoston †	4.1	American Express	3.4
Total	50.8	Total	48.1	Total	74.2	Total	78.9

* Monoline lender.

† Engaged in a merger since 1990.

The entire process of securitizing and managing these assets is a highly sophisticated and specialized area. Thus, relatively few large credit card lenders engage in it. These firms are mainly monoline lenders or large bank holding companies with subsidiaries that are typically monoline banks.¹⁶ These banks' balance sheets look quite different from those of other banks (Table 2).

Compared to full-service banks, monoline banks have a much higher percentage of their assets in loans and a much lower percentage in securities. On the liability side, monoline banks are much less dependent on deposits for funding. The deposits they do gather are mostly large (at least \$100,000) certificates of deposit. Thus, these banks are dependent on funding sources

that are relatively more sensitive to factors such as the financial condition of the bank and the state of the local economy. Monoline banks also tend to maintain capital ratios about double those of other banks. The higher loan loss reserves reflect the higher rate of nonperforming loans depicted in Figure 30. Finally, monoline banks are more likely to securitize their credit card portfolios than other banks.

Key questions that arise from a policy standpoint are: (1) has this consolidation led to fewer choices for consumers; and (2) has it led to more monopoly power for the large credit card lenders, i.e., do their higher market shares give them the ability to raise prices (interest rates and fees) over and above what they would otherwise charge?

The answer to the first question is almost definitely negative. First, as mentioned above, there are still nearly 2,000 card issuers in the United States. Moreover, the issuers are offering many more features for the consumer. Many cards today come with lower introductory rates, rewards for card usage such as frequent flyer miles or discount phone calls, a debit feature (the ability to use the card as an ATM or check card), or identity theft protection.

There is little evidence that prices have been adversely affected. In fact, many studies show that credit card annual percentage rates have decreased.¹⁷ Also, the economic forces that would lead to an increase in prices are not present. For example, entry into the industry is relatively easy. Both of the major card networks, Visa and Mas-

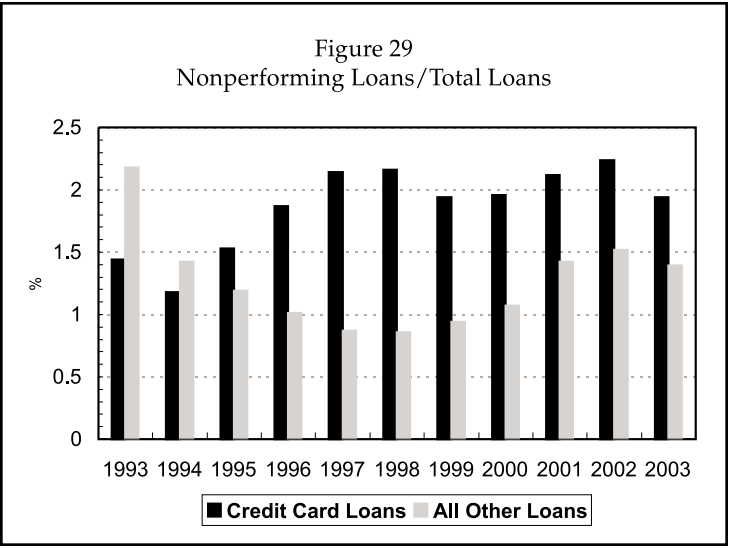
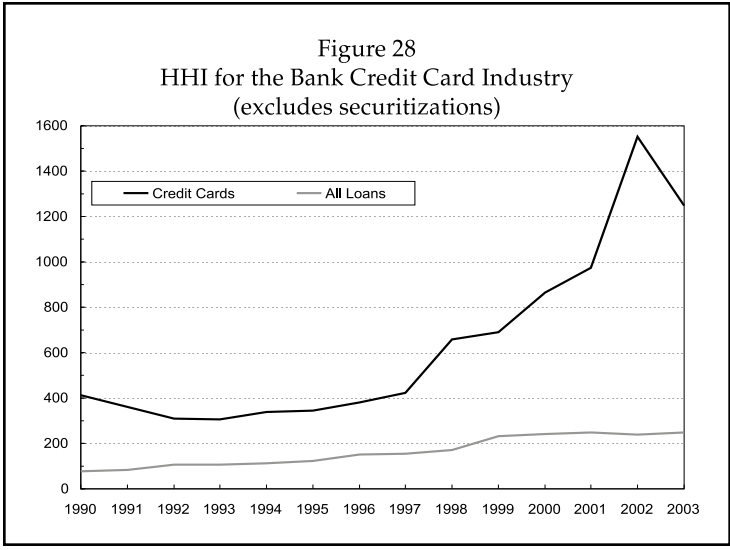
¹⁶ There are also several nonbanking firms that engage in credit card securitization.

¹⁷ For example, see "Credit Card Pricing Dynamics and Their Disclosure," *Federal Reserve Bank of Philadelphia Payment Cards Center Discussion Paper #03-02*, www.phil.frb.org/pcc/discussions/discussion0103.pdf.

Table 2
Comparison of Assets and Liabilities of Monoline Banks versus Full-Service Banks*
As of June 30, 2003

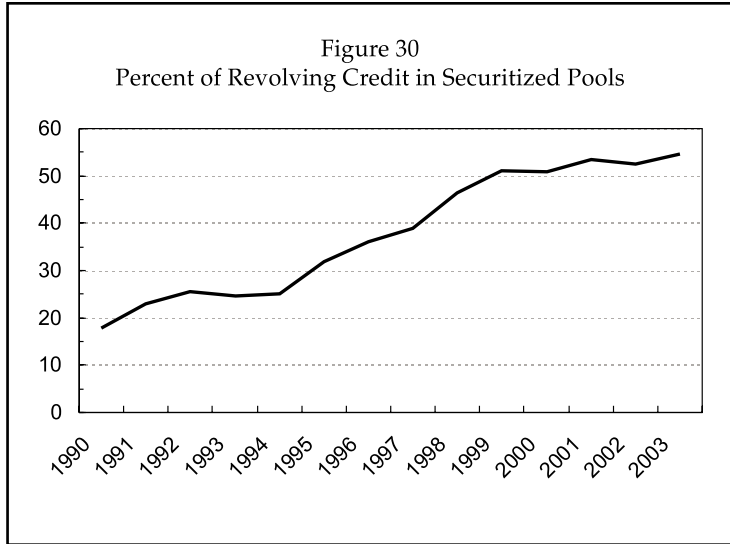
	Monolines	Other Banks
As a % of total assets		
1. Loans	93.0	57.1
Credit card loans	81.4	2.8
2. Securities	1.3	19.2
3. Other assets	5.7	23.6
As a % of liabilities		
1. Deposits	52.9	72.8
a. Transaction accounts in domestic offices	1.0	10.9
b. Nontransaction accounts in domestic offices	46.9	51.8
(1) MMDAs	6.9	23.8
(2) Other savings accounts	1.0	9.2
(3) CDs < \$100,000	3.7	10.1
(4) CDs ≥ \$100,000	35.5	8.6
c. Accounts in foreign offices	5.0	10.1
2. Other borrowed money	37.2	8.8
3. Subordinated debt	0.0	1.4
4. Other liabilities	9.9	17.0
Loan Loss Reserve/Total Loans	5.2	1.8
Equity/Assets	14.9	9.0
Securitized Credit Card Loans/Total Credit Card Loans	46.8	33.3

*A monoline institution is defined as a company with credit card loans at all affiliated banks totaling greater than 50 percent of assets on an aggregate basis.



terCard, have relatively open membership policies and low entry fees. In fact, an institution need not be a bank to offer credit cards.¹⁸ From the demand side, the cost to most consumers of switching card providers is minimal. Therefore, it would seem that the credit card industry is still pretty competitive.

In summary, we can say that the credit card industry has become more concentrated from the mid-1990s to the present. The factors contributing to this increased concentration include bank mergers, industry specialization, and securitization. However, the increase in concentration has not, at least as yet, led to increased market power for the remaining issuers or decreases in choices for the consumer.



¹⁸ See Evans and Schmalensee, *Paying With Plastic*, MIT Press, 2000, pp. 236-41.

Legal Developments

On May 1, New Jersey Governor McGreevey signed the Home Ownership Security Act into law. The bill is an anti-predatory lending law. It places restrictions on “high-cost home loans,” defined as loans for which the principal amounts to less than \$350,000 and that have a high annual percentage rate or high total points and fees. For these loans, the bill prohibits balloon payments and negative amortization schedules, and other practices are prohibited as well. Also, the bill prohibits the practice of “loan flipping,” that is, refinancing loans

originated within the previous 60 months, and it places restrictions on fees for such things as late payments, prepayments, and balance inquiries. The bill also prohibits mortgage lenders from financing health, life, debt cancellation, and debt suspension insurance. Finally, the bill requires lenders making high-cost loans to notify customers that they could likely find a lower cost loan elsewhere, and a high-cost loan cannot be originated unless the consumer has seen a United States Department of Housing and Urban Development approved credit counselor.

Subprime lending was also an issue in Pennsylvania in 2003, but no new legislation was enacted. On April 1, the Secretary of Banking sent a letter to all state-chartered banks, trust companies, savings banks, and savings and loan associations warning them to avoid relationships with third-party payday lenders. Payday loans are unsecured, small dollar, short-term loans. Federal regulators had previously expressed concern about the safety and soundness of this type of lending, and Pennsylvania was following the agencies’ lead.

Mergers and Acquisitions

Merger activity increased in 2003, but it was still slow compared to the late 1990s. In Pennsylvania, Fulton Financial Corpo-

ration (Lancaster) merged with Premier Bancorp, Inc. (Doylestown), National Penn Bancshares, Inc. (Boyertown) ac-

quired FirstService Bank (Doylestown) and Hometowne Heritage Bank (Intercourse); Univest Corporation of Pennsylvania

(Souderton) acquired First County Bank (Doylestown) and Suburban Community Bank (Chalfont); First Commonwealth Financial Corporation (Indiana) merged with Pittsburgh Financial Corporation (Pittsburgh). Also, Keystone Savings Bank (Bethlehem) acquired First Colonial Group, Inc. (Nazareth), with First Colonial changing its name to KNBT Bancorp, Inc. and the combined Keystone-Nazareth National Bank and Trust being renamed Keystone Nazareth Bank and Trust Company. Finally, Legacy Bank (Harrisburg) merged with Northern State Bank (Towanda).

Some deals of note announced but not yet completed are the merger of Susquehanna Bancshares, Inc. (Lititz) and Patriot Bank Corporation (Pottstown), the merger of Sovereign Bancorp, Inc. (Philadelphia) and Waypoint Financial Corporation (Harrisburg), the acquisition of Millennium Bank (Malvern) by Harleysville National Corporation (Harleysville), and the acquisition of GA Financial, Inc. (Pittsburgh) by First Commonwealth Financial Corporation (Indiana).

In New Jersey, Interchange Financial Services Corporation (Saddle Brook) acquired Bridge View Bank (Englewood Cliffs); Lakeland Bancorp, Inc. (Oak Ridge) merged with CSB Financial Corporation (Teaneck); and Synergy Federal Savings

Bank (Cranford) merged with First Bank of Central Jersey (North Brunswick). One merger of note that has been announced is the merger of Sun Bancorp, Inc. (Vine-land) and Community Bancorp, Inc. (Freehold).

There were also a number of interstate and out-of-area transactions involving institutions either headquartered in the tri-state area or with significant operations here. First, M&T Bancorp, Inc. (Buffalo, New York) merged with AllFirst Financial, Inc. (Baltimore, Maryland). AllFirst was the domestic subsidiary of Allied Irish Banks, Ltd. (Dublin, Ireland). PNC Financial Services Group, Inc. (Pittsburgh, Pennsylvania) merged with United National Bancorp, Inc. (Bridgewater, New Jersey); Susquehanna Bancshares, Inc. (Lititz, Pennsylvania) acquired The Woodstown National Bank (Woodstown, New Jersey); Community Bank System, Inc. (DeWitt, New York) acquired Grange National Bank Corporation (Tunkhannock, Pennsylvania); NSB Holding Corporation (Staten Island, New York) merged with Liberty Bancorp, MHC (Avenel, New Jersey), and Woori America Bank (New York) merged with Pansia Bank (Fort Lee, New Jersey).

In other transactions involving organizations with a substantial presence in the tri-state area, F.N.B. Corporation

(Naples, Florida) acquired Charter Banking Corporation (St. Petersburg, Florida); Mercantile Bankshares Corporation (Baltimore, Maryland) merged with F&M Bancorp, Inc. (Frederick, Maryland), and Community Bank System, Inc. (DeWitt, New York) acquired Peoples Bancorp, Inc. (Ogdensburg, New York).

Several major interstate transactions have been announced but were not completed by year-end 2003. JPMorgan Chase & Company, Inc. (New York, New York) announced that it was merging with Bank One Corporation (Chicago, Illinois). This merger will form the largest bank in the United States. Also, Bank of America Corporation (Charlotte, North Carolina) is merging with FleetBoston Financial Group, Inc. (Boston, Massachusetts). Sovereign Bancorp, Inc. (Philadelphia, Pennsylvania) is in the process of acquiring two Massachusetts institutions: First Essex Bancorp, Inc. (Lawrence) and Seacoast Financial Corporation (New Bedford). Also, Fulton Financial Corporation (Lancaster, Pennsylvania) is in the process of acquiring Resource Bankshares Corporation (Virginia Beach, Virginia), and Community Bank System, Inc. (DeWitt, New York) is acquiring First Heritage Bank (Wilkes-Barre, Pennsylvania).

Appendix-Methodology for Selecting Bank Categories

This publication divides banks into two categories: large banking organizations and community banks. It further divides these categories into the tri-state area and the nation. First, all credit card banks (defined as any bank with more than 50 percent of its loans classified as credit card loans), other limited-purpose banks, banks less than five years old, and wholesale banks (defined as any bank whose ratio of retail deposits to total deposits is

less than 5 percent) have been dropped from the sample.

Large banking organizations are determined annually as those firms that are at least as large as the 100th largest bank holding company in the nation at the beginning of that year, ranked by total assets. Thus, the banks in the 2003 sample are selected based on their year-end 2002 total assets, updated for mergers that occurred in 2003. A large bank defined as being in the tri-state

area must also have one of the following characteristics: 1) a market share of deposits of at least 5 percent, in either the region as a whole or in any one of the states; or 2) at least 5 percent of the organization's total deposits are located in the region.

Community banks in the tri-state area are either headquartered here or are subsidiaries of bank holding companies that are headquartered here.

NOTE: This report is not a statement of the Federal Reserve System's opinion of the condition of any banking firm or firms, but rather a summary of the results as the banking organizations themselves have reported them.

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