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Commercial Bank Profits: An Analysis of Variances in Bank Earnings from The Various Sources of Funds

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COMMERCIAL BANK PROFITS:

AN ANALYSIS OF VARIANCES IN BANK EARNINGS
FROM THE VARIOUS SOURCES OF FUNDS

by
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An Independent Study
Submitted to the Faculty
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This Independent Study, submitted by Frederick Droz Delboy in partial fulfillment of the requirements for the degree of Masters of Business Administration from the University of North Dakota, is hereby approved by the Faculty Advisor under whom the work has been done.

Advisor

PERMISSION

Title: COMMERICAL BANK PROFITS: AN ANALYSIS OF VARIANCES FROM THE VARIOUS SOURCES OF FUNDS

Department: College of Business and Public Administration

Degree: Master of Business Administration

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Date March 12, 1975

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F. D. D.

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ABSTRACT

This study examines the factors that affect the profit picture of commercial banks in the United States. Particular emphasis is placed on discovering whether or not the profits earned by commercial banks on government funds are at a great disparity with those profits earned on other sources of funds. The author concludes that banks today do appear to be making more money on government funds than on funds from individuals, partnerships, and corporations; that the latter activity is in effect the managing of liabilities by the least cost path and that government regulations do have a nullifying effect on run away profit.

CHAPTER I

INTRODUCTION

Pertinent Background Orientation

Often times today one reads many articles that ramble and enumerate assumption after assumption, statistics and more statistics, and of course predictions and conclusions based on the assumptions and statistics which commonly are not founded on fact. To the layman on the street, these inacuracies may be passed unnoticed or may not matter. To a business student, a scholar aspiring to actually become involved in dealing with and trying to control some of the realities and facts of this world, a cursory reading and blind acceptance of the unsubstantiated is or should be unthinkable.

As a business student and a scholar, this author has tried to be more inquisitive and demanding. Most of the graduate research papers this author has read always sought to make for a better understanding of some subject matter. The better understanding always resulted from more perfect knowledge. It was in the spirit of wanting to continue to discern fact from fiction that the author selected his Independent study theme.

A hypothesis has been advanced which states that commercial banks handling government cash flows (federal, state, and local) stand to reap more profits from this source than from other sources, ie. individuals, partnerships, and corporations (IPC). The reason for this phenomena, it is said, is that the cost to commercial banks for IPC funds in terms of interest paid is much higher than that of the government.[1] That is, higher interest rates would have to be paid for the acquisition of IPC funds than would have to be paid for the acquisition of IPC funds than would have to be paid for the acquisition of government funds. The higher the interest rate, the higher the cost and therefore the smaller the profit margin.[2] The hypothesis in it's present state is at fault in that it lacks breath and depth in terms of facts to substantiate the claims made. Correspondence with the proponent of the hypothesis, in the interest of obtaining more facts pertinent to the hypothesis, yielded little if no new information at all.

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[1]Roche, J. P., "Banks Reap Nice Profits on Government Deposits", Minot Daily News, Vol. 59, No. 285, (April 4, 1974), p. 4.

[2]Simple definition for profit in accountants terms is: Profit = Revenue - Expenses, as is evident in the following statement from The National Association of Accountants. (The emphasis by means of underlining and the insertion of words within parenthesis are this writer's action.) "A company's income statement reports the net profit for the period under review, as resulting from all sources of income (revenues) and offset by all items of cost (expenses) and expenses for all operations and functions of the company." Source: Marple, Raymond P., Editor, National Association of Accountants on Direct Costing, Selected Papers, The Ronald Press Company, (1965), p. 172. Additionally, Webster's defines financial profit as: "Profit 2: The excess of returns over expenditure in a transaction: As a: The excess of the price received over the price paid for goods sold--opposed to loss; b: The excess of price received over the cost of purchasing and handling or producing and marketing goods." Source: Webster's Third New International Dictionary of the English Language Unabridged, G. & C. Merriam Company, Springfield, Massachusetts, U. S. A., (1964), p. 1881.

Statement of the Problem

The problem was defined to be: whether or not the hypothesis that commercial banks earn more profits on government funds than they do on funds from individuals, partnerships, and corporations, because of the lower cost of acquisition in the former, is true or not.

Sub-objectives to finding a better understanding of the commercial banks' earning matter were:

1. To provide insight to the profit posture of commercial banks.

2. To provide guidance in better management of public monies, in the event that a case of mismanagement becomes uncovered.

Limitations of Study

The limitations imposed on this study were those of time, funds, and available research material. The author was limited to six months research time due to additional past and upcoming constraints and commitments. The nature of the University of North Dakota regulations prohibits financial assistance of any sort to students endeavoring to write an Independent Research Study. As a result, the author was unable to select a larger sample for the questionnaire and was in addition unable to travel, beyond a local range, for personal contacts concerning the topic matter and delivery of the questionnaire. Finally, the author was encumbered by the lack of pertinent research material within the local area.

CHAPTER II

THE TOO MUCH PROFIT HYPOTHESIS

Function and Purpose of Commercial Banks

Three schools of thought stood out when the question of excessive profits on government funds was researched. These were not named, so the author took the liberty of naming the hypotheses based on the gist of the arguments. The three are: The Too Much Profit Hypothesis, which claims excessive profit on government funds; The Too Much Regulation Represents A Net Loss Hypothesis, which claims that excessive profits do arise from government funds, but that these are annulled by the losses suffered due to government regulatory constraints; The Least Cost Path of Expansion of Funds Hypothesis, which claims that bankers, like any other profit oriented entrepreneur, will seek to maximize profit by selecting the cheapest source of funds. Hence, no discrimination against the governments per-se but rather discrimination by virtue of the least cost or most profitable source of funds.

Before analyzing the first of the three hypotheses, some informational data pertinent to commercial banks and to their cash flow posture is deemed warranted. In this vein, used here is some of the material on the "nature of banking" presented by Jackson in his Doctoral Dissertation and used in order to apprise the reader with commerical banks and their purpose.[3] His description made it clear

[3] Jackson, William, Commercial Bank Regulation, Structure and Performance, PHD University of North Carolina (1974).

that commercial banks exist to make money through the commission earned on or for services rendered to its customers, whomever they may be. He said:

> "Commercial banks are multiproduct, single, or multiple-plant firms which provide financial services. They can be identified by their ability to provide numerous personal and business services at one location . . . Banks essentially, match borrowers and lenders, to receive a 'commission' in their capacity as financial intermediaries. they additionally operate the payments mechanism by clearing checks, as well as offering other financial services."[4]

Figures were needed by Mr. Jackson to further dissect the body of commercial banks and show their functional makeup. These are borrowed here.[5] Figure 1 shows "Aggregated Balance Sheets". About this figure and the structure of commercial banks, Mr. Jackson comments:

> "Bank Assets are largely loans, while 'investments' (debt securities) and other assets are of seconday importance. Industry liabilities are mainly time and savings deposits ("TD"), which recently overpowered the traditional demand-deposit ("DD") source of banking funds. These firms are highly leveraged. Owners' capital accounts are only 7.4% of banking assets. Such a thin capital cushion is made acceptable in banking by the low risk nature of operations, including the reduction of depositor risk by FDIC insurance."[6]

The Charts in Figure 1 and the above quotation show that the prime source of funds (liabilities) are time and savings deposits--folowed closely by demand deposits; that because the majority of commercial banks' financing comes from depositor monies ("TD" and "DD") they are highly levered (financed by debt); but more important, that because the majority of the working capital (funds) is guaranteed by federal agencies, commercial banks are, as stated before, low (loss) risk nature operation. These three factors should be kept in mind

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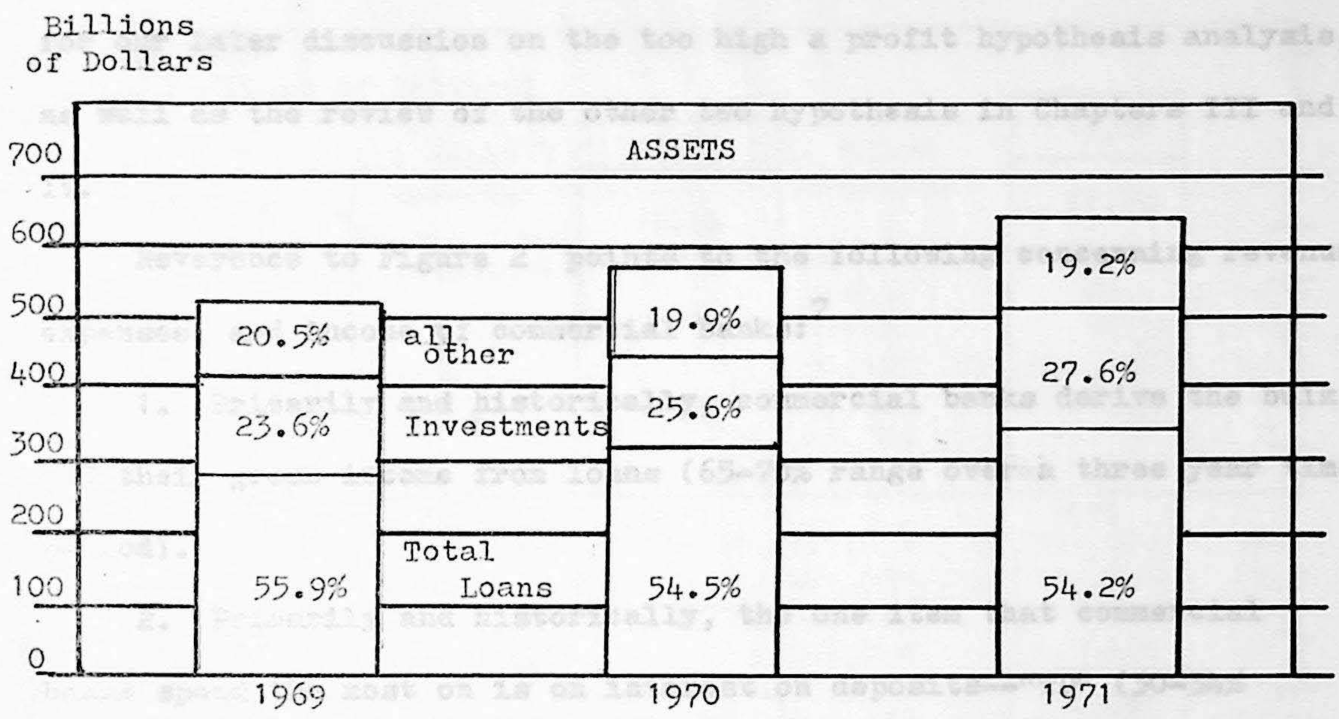
[4]Ibid, p. 1.

[5]Ibid, p. 2.

[6]Ibid, p. 1. The emphasis by underlining is the writers.



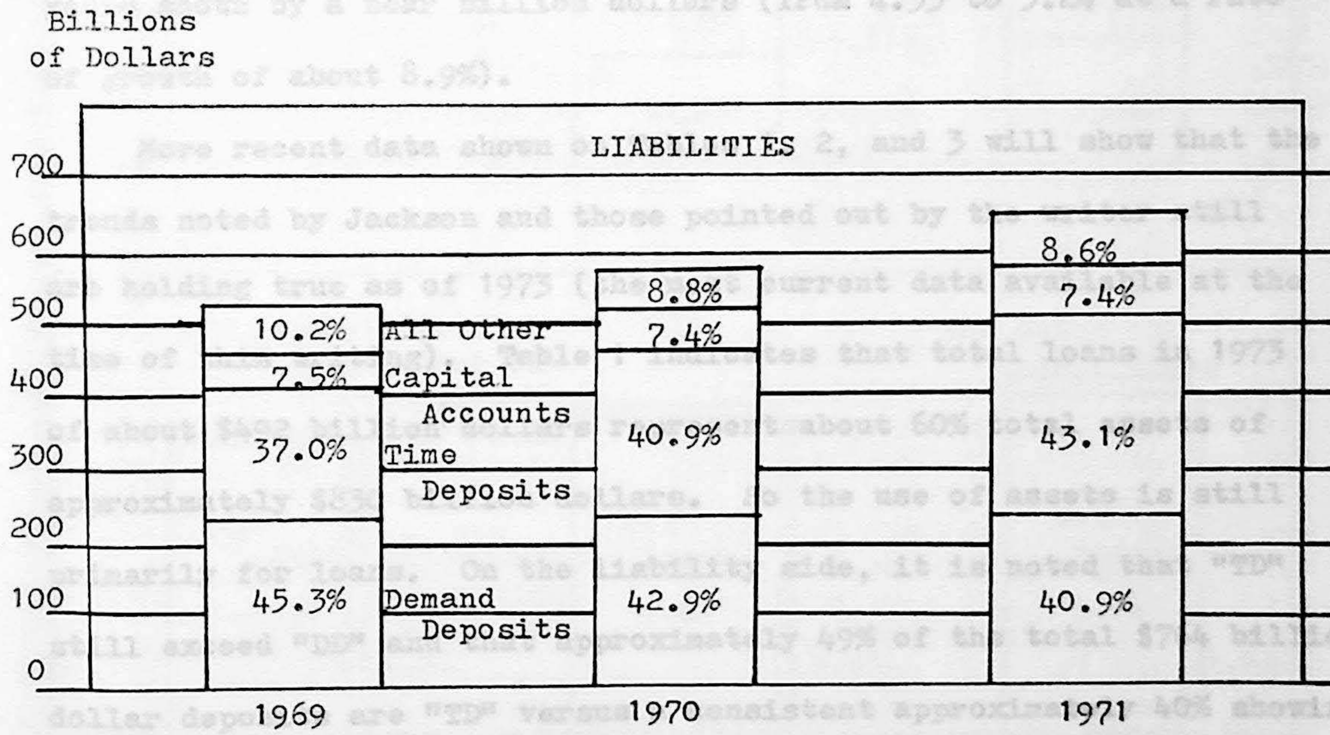


FIGURE 1

Assets and Liabilities of Insured Commercial Banks, 1969-1971

Source: FDIC, Bank Operating Statistics (Washington: FDIC, 1971), n.p.

for our later discussion on the too high a profit hypothesis analysis, as well as the review of the other two hypothesis in Chapters III and IV.

Reverence to Figure 2 points to the following concerning revenues, expenses, and income of commercial banks:[7]

1. Primarily and historically, commercial banks derive the bulk of their gross income from loans (65-70% range over a three year time period).

2. Primarily and historically, the one item that commercial banks spend the most on is on interest on deposits--"TD" (30-34% range over a three year time period).

3. That net income has been in the upswing and grown for the years shown by a near billion dollars (from 4.33 to 5.24 at a rate of growth of about 8.9%).

More recent data shown on Tables 1, 2, and 3 will show that the trends noted by Jackson and those pointed out by the writer still are holding true as of 1973 (the most current data available at the time of this writing). Table 1 indicates that total loans in 1973 of about $492 billion dollars represent about 60% total assets of approximately $830 billion dollars. So the use of assets is still primarily for loans. On the liability side, it is noted that "TD" still exceed "DD" and that approximately 49% of the total $764 billion dollar deposits are "TD" versus a consistent approximately 40% showing by "DD". The source, then, of working capital (funds) continues to be the depositor; the firm continues to be low risk.

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[7]Ibid, p. 3.

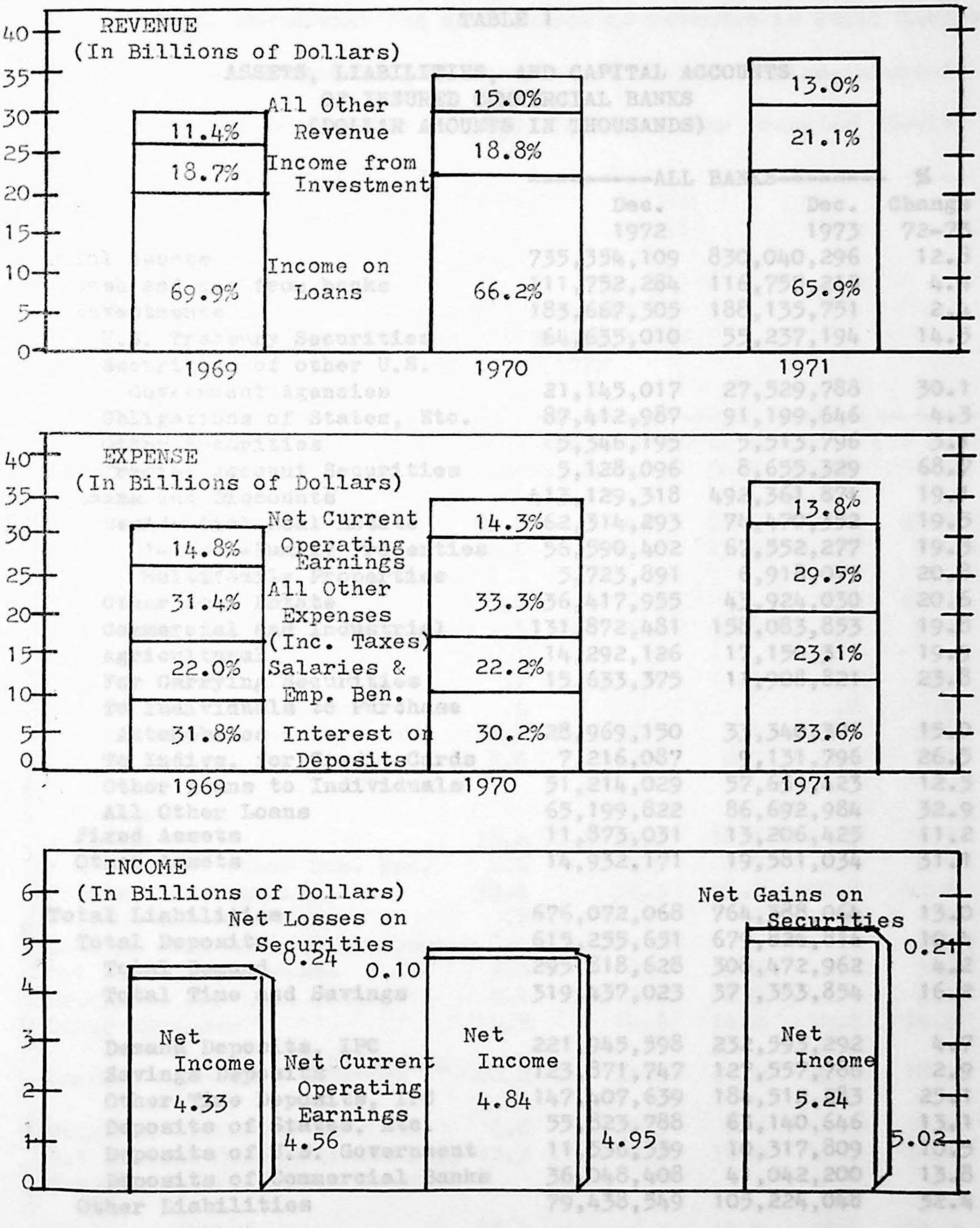

FIGURE 2

Revenue, Expense, and Income of Insured Commercial Banks, 1969-1971

Source: FDIC, Bank Operating Statistics (Washington: FDIC, 1971), n.p.

TABLE 1

ASSETS, LIABILITIES, AND CAPITAL ACCOUNTS
OF INSURED COMMERCIAL BANKS
(DOLLAR AMOUNTS IN THOUSANDS)

	---------ALL BANKS---------		%
	Dec. 1972	Dec. 1973	Change 72-73
Total Assets	735,354,109	830,040,296	12.8
Cash and due from banks	111,752,284	116,755,215	4.4
Investments	183,667,305	188,135,751	2.4
U.S. Treasury Securities	64,635,010	55,237,194	14.5
Securities of other U.S. Government Agencies	21,145,017	27,529,788	30.1
Obligations of States, Etc.	87,412,987	91,199,646	4.3
Other Securities	5,346,195	5,513,796	3.1
Trading Account Securities	5,128,096	8,655,329	68.7
Loans and Discounts	413,129,318	492,361,871	19.1
Residential Real Estate	62,314,293	74,470,352	19.5
1- to 4-Family Properties	56,590,402	67,552,277	19.3
Multifamily Properties	5,723,891	6,918,075	20.8
Other Real Estate	36,417,955	43,924,030	20.6
Commercial and Industrial	131,872,481	158,083,853	19.8
Agricultural	14,292,126	17,150,311	19.9
For Carrying Securities	15,633,375	11,908,821	23.8
To Individuals to Purchase Automobiles	28,969,150	33,340,301	15.0
To Indivs. for Credit Cards	7,216,087	9,131,796	26.5
Other Loans to Individuals	51,214,029	57,659,423	12.5
All Other Loans	65,199,822	86,692,984	32.9
Fixed Assets	11,873,031	13,206,425	11.2
Other Assets	14,932,171	19,581,034	31.1
Total Liabilities	676,072,068	764,388,064	13.0
Total Deposits	615,255,651	679,826,816	10.4
Total Demand	295,818,628	308,472,962	4.2
Total Time and Savings	319,437,023	371,353,854	16.2
Demand Deposits, IPC	221,945,598	232,593,292	4.7
Savings Deposits	123,871,747	127,557,786	2.9
Other Time Deposits, IPC	147,407,639	184,512,283	25.1
Deposits of States, Etc.	55,823,788	63,140,646	13.1
Deposits of U.S. Government	11,536,339	10,317,809	10.5
Deposits of Commercial Banks	36,048,408	41,042,200	13.8
Other Liabilities	79,438,549	105,224,048	32.4
Total Reserves on Loans and Securities	6,908,811	7,808,137	13.0
Total Capital Accounts	52,367,636	57,838,622	10.4
Number of Banks	13,733	13,976	

Source: FDIC, Bank Operating Statistics (Washington: FDIC, 1973), n.p.

Table 2, shows that the main source of revenues is still income on loans (ranging from 64-71% depending on bank size) and interest on deposit continued as the biggest single expense (ranging 33-41% depending on bank size).

TABLE 2

INCOME AND EXPENSES
OF INSURED COMMERCIAL BANKS
DECEMBER 31,1973

PERCENTAGE OF TOTAL OPERATING REVENUE	ALL BANKS	BANKS WITH TOTAL DEPOSITS (IN MILLIONS)				
	All Banks	Under 5	5-10	10-25	25-100	Over 100
Income						
Income on Loans	66.5	64.1	65.9	66.7	67.9	70.6
Interest on U.S. Treas. Sec.	12.6	18.0	13.9	11.7	9.1	6.7
Int. on Securities of U.S.Govt. Agencies	5.7	7.4	6.4	5.4	4.7	3.1
Int. on Obligations of States	7.5	3.6	6.8	8.7	9.6	8.5
Int. and Dividends on other Securities	.7	.8	.6	.7	.9	.8
Trust Department Income	.4			.2	.9	2.8
Service Charges on Deposits	3.2	2.7	3.1	3.5	3.5	2.6
All Other Revenue	3.0	2.9	2.7	2.8	3.0	4.6
Expenses						
Salaries	18.4	22.8	18.6	16.9	16.6	16.8
Pensions and Other Emp. Ben.	2.6	2.5	2.5	2.5	2.7	3.0
Interest on Deposits	38.4	33.3	38.2	40.1	40.8	38.3
Int. on Borrowed money	.7	.1	.2	.4	1.2	6.2
Int. on Cap. notes & Debentures	.1			.1	.3	.5
Net Occupancy Expense	2.8	2.5	2.6	2.8	3.2	3.6
Provision for Loan Losses	2.1	2.0	2.0	2.1	2.1	2.1
Other Expenses	14.3	14.6	14.2	14.2	14.5	13.8
Current Operating Earnings	20.2	21.8	21.2	20.4	18.2	15.4
Taxes on Operating Earnings	4.8	5.5	5.2	4.9	4.0	3.2
Net Current Operating Earnings	15.3	16.3	16.0	15.5	14.2	12.1
Other Charges against Earnings						
Net Income	15.4	16.3	16.1	15.6	14.2	12.1
Number of Banks	13,644	2,603	3,205	4,418	2,652	766

Source: FDIC, Bank Operating Statistics (Washington: FDIC, 1973) n.p.

Table 3 shows that net income continues to grow, more recently at a rate of 16.3%.

TABLE 3
INCOME AND EXPENSES
OF INSURED COMMERCIAL BANKS
(DOLLAR AMOUNTS IN THOUSANDS)

	--------ALL BANKS--------		%
	Dec. 1972	Dec. 1973	Change 72-73
Total Operating Revenue	40,249,895	53,036,327	31.7
Income on Loans	26,671,924	37,862,333	41.9
Int. on U.S. Treasury Securities	3,395,274	3,465,192	2.0
Int. on Securities of U.S. Govt. Agencies	1,146,244	1,472,467	28.4
Int. on Obligations of States, Etc.	3,494,402	3,864,785	10.5
Int. & Dividends on other Securities	321,926	371,987	15.5
Trust Department Income	1,366,455	1,459,879	6.8
Service Charges on Deposits	1,262,102	1,326,992	5.1
All other Revenue	2,591,568	3,212,692	23.9
Total Operating Expenses	32,998,570	44,329,800	34.3
Salaries and Wages	7,755,131	8,574,731	10.5
Pensions and Other Emp. Benefits	1,330,585	1,553,077	16.7
Interest on Deposits	13,845,015	19,834,817	43.2
Interest on Borrowed Money	1,544,276	4,402,957	185.1
Interest on Capital Notes & Deben.	213,662	254,458	19.0
Net Occupancy Expense	1,583,808	1,782,956	12.5
Provision for Loan Losses	973,296	1,264,695	29.9
Other Expenses	5,752,797	6,662,109	15.8
Current Operating Earnings	7,251,325	8,706,527	20.0
Taxes on Operating Earnings	1,707,664	2,121,100	24.2
Net Current Operating Earnings	5,543,661	6,585,427	18.7
Net Profit on Securities	92,467	27,135-	*
Other Additions or Deductions	19,840	22,220	*
Net Income	5,654,642	6,579,194	16.3
Dividends Paid on Common Stock	2,192,578	2,425,633	10.6
--Memorandum--			
Provision for Income Taxes	1,598,981	1,715,439	7.2
Number of Banks	13,733	13,976	

* Percentage changes are not meaningful for these items

Source: FDIC, <u>Bank Operating Statistics</u> (Washington: FDIC, 1973) n.p.

Cash Flows in Perspective

At the core of the problem, as previously defined, lies the basic ingredient cash flows (funds flow). In order for the reader to visualize in his mind the degree of size and impact of the cash flows involved in the discussions of the three hypothesis, which follow later, a cursory review of the cash flow posture is presented next.

Since most, if not all, of the government monies in commercial banks are in the form of demand deposits or time deposits (including in this latter category any monies in savings accounts), the discussion with highlight these two money categories.

In Table 4, the figures presented are in billions of dollars and are expressed in terms of assets (shown as "A") and liabilities (shown as "L"). By Referencing this table one can get an idea of the amount of Federal Government Demand Deposits at commercial banks. Looking at transaction category number 9 and moving horizontally to the right, one finds:

1. That there were 13.3 billion dollars of U.S. Government Demand Deposits and Currency (shown as assets to U.S. Government) at the end of the calendar year 1972.

2. That of this amount, 10.9 billion dollars were held by commercial banks. (shown as liabilities to commercial banks). A breakdown of how much of that amount, if any, consisted of currency is not given. That the 10.9 billion represented about 5% of all demand deposits for that year (10.9 ÷ 220.9; for origin of 220.9 see Table 5 transaction category 16 of money supply sector for the year 1972.

	Financial Sectors										
	Federally Sponsored Credit Agency		Monetary Authority		Commercial Banks		Private Nonbank Finance		Total		Discrepancy
Transaction category	A	L	A	L	A	L	A	L	A	L	A
1. Total As	56.9	.....	96.4	.....	655.0	.....	1061.9	.....	5120.8	.....	13.9
2. Total Li	.....	55.8	.....	95.9	.....	618.3	.....	985.1	.....	3910.3	.....
3. Gold			10.4						55.9		
4. Officia exchar									.2	.2	.....
5. IMF Posi			-.1						.5	.5	.....
6. Treasury			8.7						8.7	7.0	-1.7
7. Demand D	.2		.....	60.4	.7	220.9	16.1	.....	264.6	281.4	16.8
8. Private	.2		.....	57.9	.7	202.5	16.1	.....	243.3	260.3	17.0
9. U.S. Go			.....	2.2	.....	10.9			13.3	13.1	-.3
10. Foreign			.....	.4	.....	7.6			8.0	8.0	.....
11. Time sav					.....	316.8	1.1	320.6	637.4	637.4	.....
12. At comm					.....	316.8	.4	.....	316.8	316.8	.....
13. At savi							.7	320.6	320.6	320.6	.....

Sour

In Table 5, the figures presented are still in terms of billions of dollars, but they are now depicted by year and deposit category. By referencing this table one will be able to discern state and local governments demand deposits; federal, state and local governments' time deposits; and other (IPC) time deposits. (It is noteworthy at this point to observe that the government and IPC's funds shown under transaction category 2 of the total held sector are not broken down by quantities in time deposits and quantities in savings deposits. The reader should be cognizant of the fact that not all of the time deposits at commercial banks are in the form of time deposits. Some consist of savings deposits.) Looking under transaction category 8 of the money supply sector for the year 1972 one finds:

1. That state and local governments had 14.6 billion dollars in demand deposits at commercial banks in 1972, and this represented about 7% of all demand deposits at commercial banks for that year (14.6 ÷ 220.9).

2. That IPC therefore had about 195.4 billion dollars of demand deposits or about 88% of the total for 1972.

Looking under transaction categories 5 and 6 of the total held sector for the year 1972 one finds:

1. That state and local governments had 37.2 billion dollars in time deposits and the federal government had .6 billion in time deposits. And this represented about 12% and .2%, respectively, of the total (316.8) time deposits at commercial banks in calendar year 1972.

2. That IPC therefore had about 279 billion dollars in time deposits or about 87.8% of the total for 1972.

TABLE 5

SUMMARY OF PRINCIPAL ASSETS AND LIABILITIES
(Amounts outstanding at end of year;
in billi9ns of dollars)

Transaction category	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
					Demand deposits and currency							
Money supply	154.6	158.5	163.8	172.2	180.5	184.7	198.6	214.6	222.3	234.0	248.3	268.3
Domestic Sectors	151.5	155.2	160.3	168.0	176.1	180.0	193.5	208.9	216.3	227.9	241.9	260.3
Households	76.1	78.4	81.7	86.5	94.2	98.1	109.4	121.7	123.3	132.8	143.7	156.5
Nonfinancial business	46.0	46.4	46.5	47.0	47.4	47.7	49.3	51.2	53.8	54.3	55.1	55.3
Corporate	27.7	28.0	28.3	28.6	28.9	29.2	30.7	32.4	34.9	35.2	35.9	36.0
Nonfarm noncorporate	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5
Farm	5.8	5.9	5.7	5.9	6.0	6.0	6.1	6.3	6.4	6.5	6.6	6.8
State and Local Govt.	8.8	9.4	10.9	12.5	12.1	13.0	14.1	13.9	15.3	13.7	12.8	14.6
Financial Sectors	10.3	11.2	11.2	11.5	11.8	11.6	12.4	13.3	13.0	14.0	15.0	17.0
. Mail Float	10.3	9.9	9.9	10.4	10.5	9.5	8.3	8.8	10.9	13.0	15.3	17.0
. Rest of the World	3.1	3.2	3.5	4.2	4.4	4.8	5.1	5.7	6.0	6.2	6.5	8.0
. U.S. Government	6.8	8.1	7.8	7.9	7.0	6.6	7.7	6.5	7.0	9.5	12.7	13.1
. Total Assets	161.4	166.6	171.6	180.2	187.4	191.3	206.3	221.1	229.3	243.6	261.0	281.4
. Net Banking system liability	161.4	166.6	171.6	180.2	187.4	191.3	206.3	221.1	229.3	243.6	261.0	281.4
. Monetary authorities	31.4	32.1	34.9	36.8	38.8	41.2	44.2	45.7	48.9	52.0	56.4	60.4
. Commercial banking	130.0	134.5	136.7	143.4	148.6	150.1	162.2	175.4	180.4	191.6	204.6	220.9
					Time deposits and savings accounts							
Total held	197.8	226.5	256.1	286.5	319.7	338.8	379.6	412.9	411.5	466.5	548.7	637.4
Commercial banking liability	83.0	98.6	113.0	127.6	147.7	159.8	183.7	204.5	195.1	233.1	274.5	316.8
Households	67.3	79.9	89.4	101.1	115.9	127.9	146.0	163.4	161.5	189.0	218.8	248.6
Corporate business	6.9	8.4	10.8	10.8	13.1	11.7	13.8	14.2	11.8	13.5	17.1	20.2
State & Local Govt.	5.5	6.5	8.1	9.8	12.2	13.5	15.9	19.1	13.2	23.2	30.4	37.2
U.S. Government	3	3	3	3	3	2	3	4	2	5	5	6

Source: Board of Governors of Federal Reserve System, Federal Reserve Bulletin, Vol. 59, Num. 9, (September 1973), P.A. 71-17.

The before mentioned statistics about the cash flow posture of commercial banks were presented in order to make the following points:

1. The federal government's share of the total demand deposits held by commercial banks is small.

2. The federal government's share of the total time deposits held by commercial banks is miniscule.

3. State and local governments' share of the demand and time deposits held by commercial banks, though larger than those of the federal government, are still small when compared to the total.

4. The combined federal, state and local governments' share of the total demand and time deposits held by commercial banks is small when compared to the total, and therefore <u>the prime source of funds for the banks are individuals, partnerships and corporations</u>.

Where the impact lies in terms of suppliers of funds, and thus who are the primordial customers and prime motivators of commercial banks' activities, should now be evident. The above general conclusions apply to the whole of the United States. When you seek a similar cash flow analysis for the commercial bank located in more rural areas, you find that the contributions of the federal government are even smaller and much of the state funds gravitate to banks in urban cities capable of a wider range of services. This point was driven home by a local North Dakota banker who was interviewed on the cash flow question, as well as other matters.[8] About the point, he said: "You take a bank like ours situated in a rural community that is Minot, North Dakota.

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[8] Union National Bank, A. L. Braaten, President: Interview conducted on February 21, 1975.

Then you throw in the state bank which we have in North Dakota, and you find that the local banks have little government funds of any kind. If you were to take away the state bank, we would probably have close to $200 million dollars injected into the rural commercial banks of this state. . . The big government monies are in big cities which is where you find the populace and so the welfare dollar, the federal agencies and their dollars, and the big banks that cater to them."

But whomever the prime customer is, the question still arises, on whose dollar do commercial banks net a larger profit on?

The Argument

The argument of the "too much profit on government funds" was given in the introduction above. Here we will simply try to enumerate some of the facts that have arisen as evidence or proof of the "if so, then so" logic of the hypothesis.

The question of excess profits from government funds as a plausible contention is further enhanced by Mr. George Wasem.[9] What follows are some of the comments of Mr. Wasem on the profit potential in catering to the government, followed by some of the facts he gives to convince his readers. Likewise, facts used by Mr. Kessler will be given. The intent is to show data which this writer will try to prove to be true or false. Mr. Wasem in his article is trying to convince fellow bankers that "government is our largest industry, and its banking business is big and growing all the time . . ." "As a cold reality of modern banking, government--and when we write 'government' we refer to all levels-- is a major bank customer . . ." "What's more, its banking business is virtually unlimited."[10]

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[9] Wasem, George, "Government - The Forgotten Market Segment", Bankers Monthly, Vol. 90, NO. 12, (December 15, 1973), p. 16-20.

[10] Ibid, p. 16.

He instructs his reader on how to tap this market through various means, one being the intermediary role for big tax paying national corporations. "National companies with headquarters in the money centers are requested to draw checks on their account with us for real estate and personal property taxes on their local plants. Ordinarily, the funds are transferred in about the same time the checks are mailed. It may take a few days before the check is processed through the city or county treasurer's office. The result is that we have use of the funds for those few days. (This is the case of free funds in the form of corporation demand deposit monies. Cost to the bank is only that of transaction handling only. Underlining is this writer's.) If we have the treasurer's accounts, we'll have the funds until a distribution is made to other governmental bodies . . . (case of governments' demand deposits).[11]

Facts on Mr. Wasem's article concerning treasury tax and loan account:[12]

* "TT & L depositories are divided into three groups for purposes of withdrawals, or 'calls' . . . A, B and C."[13]

* "Criteria are: For group A credits of less than $5 million; group B, credits of $5-50 million or credits of $50-100 million if total deposits are under $100 million on 12/31/71; . . . group C,

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[11]Ibid, p. 18.

[12]Ibid, p. 20. The writer would like to point out at this time that Mr. Wasem is a banker presently employed as the Vice President for the Commercial National Bank of Peoria, Illinois. Because of his candid attitude towards profits at banks, this writer chose to correspond with this banker. His response was less than friendly and cooperative.

[13]For the reader who is unfamiliar with them, "TT & L" (Treasury Tax and Loan accounts depositories) are banks which serve the Treasury by providing the intermediary function of collector, holder and distributor of tax funds. TT & L accounts are but one of government funds' sources to banks. They are a sizable source.

. . . credits of $100 million or more or credits of $50-100 million if total deposits were more than $100 million at year end."[14]

* "Normally, calls are made only once a month on A banks and twice a week on B and C banks. In addition, special calls, redeposits or cancellations may be made daily, as needed on C banks." . . . "Special calls and redeposits are managed so as to result in about the same average life of the accounts for C as for B banks. Success isn't penalized."

Facts in Mr. Kessler's article:[15]

* "The Federal government keeps an average of $3.9 billion of taxpayers' money in non-interest paying accounts at commercial banks here and throughout the county, losing $428 million in potential interest income each year or more than $1 million a day . . ." "The interest lost in one year on the accounts, which are maintained in 95 per cent of the nation's banks for the collection of U.S. taxes from corporations, could pay for a year's operation of the Federal Trade Commission, Securities and Exchange Commission, Maritime Commission, Smithsonian Institution, Secret Service, the Senate, and the Supreme Court."

* "Interest-free accounts for government and other funds have been a continuing source of controversy in recent years. The Washington Post has disclosed that balances ranging from $1 million to $30 million were kept at various times in noninterest-bearing checking accounts by

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[14] Banks are classified as A, B, and C, depending upon the total treasury tax and loan deposit maintained with a given bank and not by size of the bank itself.

[15] Kessler, Ronald, "U. S. Banks $3.9 Billion, Gets No Interest", The Washington Post, (November 17, 1974), p. 9-10.

the Maryland and Virginia state governments, Washington's Sibley Hospital, and Washington Hospital Center . . ." "Despite the Size of noninterest-paying accounts (those other than federal) disclosed to date, they are dwarfed by the federal government's accounts in the nation's banks, which receive about 80 per cent of the government's total annual revenues."

* "Following is a nationwide listing of the 10 largest government interest-free accounts held by banks as of February 1972, in millions of dollars:

"Chase Manhattan Bank	$177.3
"Bank of America	149.7
"First National City Bank	139.5
"Security Pacific National Bank	109.9
"Chemical Bank, N. Y.	102.5
"Manufacturers Hanover Trust Co.	87.2
"Morgan Guaranty Trust Co.	75.2
"Bankers Trust Co., N. Y.	71.6
"First National Bank of Chicago	68.7
"Mellon National Bank & Trust Co.	66.7"[16]

The above facts were presented to give an indication of the type of information upon which the allegation of excessive profits are based upon. Of course there are people on the other side of the fence who argue that there are no excessive profits being earned on government funds. (From what the writer obtained in his research, all those arguing the case against excessive profits were bankers.) For such arguments, the reader is referred to the February issue of the <u>Northwestern Banker</u>.[17] Proving who is correct and who is not correct in their allegations will be the goal of this independent study.

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[16] Ibid, p. 9.

[17] "Should Banks Pay Interest on T & L Accounts?, A Northwestern Banker Survey", <u>Northwestern Banker</u>, Vol. 80, Number 2, (February 1975), pp. 25-28.

CHAPTER III

THE TOO MUCH REGULATION REPRESENTS A NET LOSS HYPOTHESIS

The Rationale

In conducting research for the first hypothesis, a second and counter argument frequently arose. The author judged this second argument as indeed another facet of commercial bank profits which should be understood. It should be understood as a different postulation.

The essence of this new hypothesis is that:

1. Profits are made on government funds held in various deposit forms, as is to be expected since banks, like other firms, owe their existance to turning a profit.

2. Profits cannot be considered excessive since they are offset to a large extent by regulatory devices and similar other instruments.

Some commercial bank uncontrollables, so the argument goes, such as pledging or variable reserve requirements, effective discount rate, open market operations, deposit interest regulations, etc., result in the foregoing of profits--all directly or indirectly as a consequence of the federal government activities. If there is to be a handsome profit on the one hand, and a foregone or lost profit on the other, then one has either a normal or below normal net profit or yield. Such is the argument of those who adhere to this second school of thought on commercial bank profits.

The Case of Pledging of Bank Assets

Just how factors like pledging, discount rates, deposit interest regulation, etc., can result in the limitation of bank income are matters and questions that have been extensively researched and documented by economists in the past. Therefore, this study will review only one of these factors in order to show the logic to the claim of profit losses. Reviewed herein is the matter of pledging of bank assets.[18]

All of the above factors are so called "general" or "traditional" instruments of control usually applied by the Federal Reserve for monetary and fiscal policy purposes. All, it should be understood, are interrelated. For instance, when Regulation Q[19] limited interest payment on savings deposits to 4% and on time deposits to 4% on multiple maturity (30-89 day) deposits, to 5% on multiple maturity (90 day-1year, 1 year-2years, 2 years-and over) deposits and to 5.5% for single maturity deposits of over and under $100,000 (regardless of time held)--which was the case in mid 1966--"commercial banks experienced relatively sharp and substantial disintermediation[20] as

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[18]Most of the material for the discussion on pledging is based on a study by Charles F. Haywood. See: Haywood, Charles F., "The Pledging of Bank Assets, A Study of the Problem of Security for Public Deposits", Association of Reserve City Bankers, (March 6, 1967). For additional information and understanding of these factors of control, the reader is invited to review Mr. Haywood's other works. See: Haywood, Charles F., "The Regulation of Deposit Interest Rates", Association of Reserve City Bankers, (June 15, 1968); "Regulation Q and Monetary Policy", Association of Reserve City Bankers, July 30, 1971.

[19]Regulation Q is the designation of the regulation, 12 CFR 217, issued by the Board of Governors of the Federal Reserve System to fix the maximum rates payable on savings and time deposits at banks which are members of the Federal Reserve System.

[20]Banks are said to play the intermediation role or middleman function concerning money transactions between two parties. Disintermediation is the loss by banks of this intermediary role to another money instrument or money handling institution.

market rates of interest continued to rise while rate ceilings on deposits were held . . ."[21] Money will gravitate to where it stands to earn more; depending on economic conditions and regulatory constraints in effect, some control factor will bear more influence upon the others. This was the case in 1966. Commercial banks experienced a reduction in time and savings deposits as market rates on securities and the sale of these securities were on the rise. It is evident that many interrelated factors affect commercial banks' incomes.

Let us look at the factor pledging and try to understand its underpinnings and the effect that, according to Mr. Haywood, it has on banks, and on bank earnings. It should be understood that when we refer to pledging hereafter we are talking about pledging of bank assets as security for public deposits and certain other liabilities. The public deposits consist of deposits of the U.S. Government, the states and political subdivisions. ("These deposits account for approximately 80% of the total of secured liabilities."[22])

*The statues--"Commercial banks are required by law (12 USC 90; 31 USC 771) and by regulations of the U.S. Treasury Department (31 CFR 202; 31 CFR 203) to pledge <u>certain types</u> of assets to secure U.S. government deposits."[23] In addition, states require pledging against their deposits, and to confuse the issue for the banker, the state

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[21] Haywood, Charles F., "Regulation Q and Monetary Policy", Association of Reserve City Bankers, (July 30, 1971), p. 9.

[22] Haywood, Charles F., "The Pledging of Bank Assets, A Study of the Problem of Security for Public Deposits", Association of Reserve City Bankers, (March 6, 1967), p. 3.

[23] Ibid, p. 3. Emphasis by underlining this writers. Later under the subject of eligible collateral, the reader will learn about governments' limitations in what they will accept as collateral.

pledging requirements invariably vary from state to state. For instance, Mr. Haywood tells us that "in thirty states commercial banks are required by state laws to pledge certain assets against the deposits of the state government and, generally, the deposits of counties, cities and other political subdivisions. In eight states, pledging is required against the deposits of the state government, but, with a few exceptions, is not required for the deposits of political subdivisions. Pledging against state and local government deposits is prohibited or not practiced in twelve states."[24]

Apparent in the above discussion should be the fact that a banker today must incur some legal expenses just to determine which federal and regional laws he must abide by. This must be a consideration when we start to speak about increases or reductions of profits due to pledging.

* Pledging ratio--The same trend for inconsistence noted in statues of states is evident in ratio factor. The Treasury Department is stiff in their requirements, but states are even more demanding. "The Treasury Department requires that the value of the pledged assets be at least equal to the deposit at all times. That is, the minimum ratio is 100%."[25] Most states require a 100% like the U.S. government, with sixteen states requiring between 110-120%. Only one state--Kansas--allows a 70% rate for "deposit of political subdivisions". Additional conflict arises from the fact that the value of the collateral varies from state to state, some accepting face value of asset, others demanding and accepting only market value.

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[24]Ibid, p. 3.

[25]Ibid, p. 3.

Now, the assumption that the legal fees can be reasonably expected to be larger is suggested from the discussion on pledging ratio above.

* Eligible collateral--Further stringencies are applied by governments when they set specifications on what will and what will not be acceptable by them as collateral assets. The federal government is consistent in what it specifies as collateral; states are not identical in their specifications. Acceptable to federal government are: "Direct obligations of the U.S. government; commercial and agricultural paper, if not more than six months in maturity and if approved by the district Federal Reserve Bank, is elegible as security for U.S. government balances in Treasury Tax and Loan Accounts."[26] Acceptable to states are the U.S. government obligations of states and political subdivisions.

The eligible collateral represents a cost to the banker of the type which this writer categorizes as opportunity costs or forfeited costs. The banker cannot invest his capital in a higher earning asset because he has to have the lower yielding government security instrument as collateral. Additionally, the banker has less loanable funds which also represent a higher return foregone.

* Compliance procedure--The banker who possesses public funds in deposits may not hold the collateral pledged against the funds within his premises. He must deposit them with the depositing agency or a designated custodian. "Federal Reserve banks and correspondent banks are the major custodians."

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[26] Ibid, p. 4.

The cost to the banker here is in the form of handling expenses incurred in the transmission of the securities to the depositing agency or custodian.

If the reader looks at Table 6, he can follow the ensuing generalizations and observations.

1. In 1966 commercial banks held substantial amounts of federal deposits. This is evidenced by the fact that over half of all the assets held were U.S. government issued securities, and over half of these were frozen as collateral.

2. The deposits of states and political subdivisions in that same year were smaller than the federal government's, as evidenced by pledged assets of 14.6 vs. 28.8. In fact, the deposits of states may have been <u>much</u> smaller than the federal deposit when you consider that nearly half of the states require more than 100% collateral.

The table is depicted for purposes of showing magnitude of government deposits and of the correspondent collateral and the visualization or imagination of the impact from this trend on banks' costs.

TABLE 6

ESTIMATES OF PLEDGED SECURITIES INSURED COMMERCIAL BANKS
END OF MAY 1966
(Billions of Dollars)

	Total Holdings	Total Pledged	Per Cent Pledged
U. S. Government Obligations Direct and Guaranteed	\$ 56.5	\$28.8	51.0%
Obligations of States and Political Subdivisions	38.7	14.6	37.7
Other Securities	6.3	1.0	15.9
	\$101.5	\$44.4	43.8%

Source: Haywood, Charles F., "The Pledging of Bank Assets, A Study of the Problem of Security for Public Deposits", <u>Association of Reserve City Bankers</u>, (March 6, 1967), p. 5.

Mr. Haywood's conclusions about the general effect of pledging on banks were in consonance with this author's convictions about that phenomena. His analysis of costs, however, was more restricted to those of opportunity costs. His study led him to believe "that pledging requirements now exert adverse effects upon bank liquidity and the flexibility of asset management." Specifically, he stated:

> "Pledging requirements constrain in some degree of have begun to constrain the flexibility of asset management in a fairly significant segment of the commercial banking system. Although meaningful measurements of bank liquidity are difficult to make, it is clear that pledging of securities has seriously diminished the role of the securities portfolio as a source of liquidity in a large number of banks . . ."
>
> "It is difficult, also, to assess the extent to which pledging requirements have exerted a restrictive effect upon the availability of bank loans. By their nature, however, pledging requirements are, at least, a potential constraint upon the lending capacity of commercial banks."[27]

On the question of the effect of pledging on commercial banks' earnings per-se, however, Mr. Haywood is less conclusive. He tells us that:

> "Lack of data bars any attempt to estimate the effect of pledging requirements upon bank earnings, and even if data were available, the analysis would be complicated by a number of interacting factors. Although the <u>extent</u> of the actual or potential effects upon bank earnings cannot be assessed, the direction is clearly unfavorable . . ."[28]
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> "The evidence is not sufficient to argue that the adverse effect upon earnings is now significant. Further research on this point is needed."[29]

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[27] Ibid, p. 6.

[28] Ibid, p. 38.

[29] Ibid, p. 39.

The pledging factor was reviewed in representation of all the other so called instruments of control so as to make deductions about the validity of the rationale of the second hypothesis.

The review, it was hoped, pointed to the plausibility of this second hypothesis. There are, it is apparent, some costs to commercial banks when they have to comply with pledging requirements. The question is whether or not indeed the cost from it offsets any of the apparent excessive profits earned on government funds? To be remembered, particularly when the findings in the questionnaire on this specific item are revealed, is that pledging is but <u>one of the interacting affectors</u> (loss producing factors) of the net loss hypothesis. This means that if this item alone proves to be sizable, then the sum of all the affectors would make the cost respectable and the hypothesis would be a sound one.

CHAPTER IV

THE LEAST COST PATH OF EXPANSION OF FUNDS HYPOTHESIS

The Argument

The third hypothesis related to the funds analysis matter, addresses and expresses concern for the over influenced position that banks find themselves in today, and at the same time it offers a solution.[30]

The essence of the reasoning is as follows:

1. Over-control of a service oriented industry. The derived demand concept.

2. Change in perspective from "asset management" to "liability management"--the bank's role.

3. Loosening of controls--the goverment's role.

While expressing some concern about the changing mix of the source of bank deposits in the future, and in the process of analyzing and trying to project the expansion of bank funds for the seventies, Messrs. Haywood and Mcgee show greater concern about the lack of realization by many of the real or true position and purpose of commercial banks at the present and as a result worry about the misapplication of controls. This view is evident throughout their study and is partially reflected in the following passage:

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[30] The discussion that follows revolves around the thoughts and concepts advanced by Charles Haywood and L. Randolph McGee in a study they conducted for the Association of Reserve City Bankers. See: Haywood, Charles F. and McGee, L. Randolph, "The Expansion of Bank Funds in the Nineteen-Seventies", (September 2, 1969).

"Note should also be taken of the fact that the relative growth of bank deposits has lagged behind the relative growth of bank credit. The shift in the mix of deposits toward savings and time categories has, of course, reduced the relative amount of cash assets required. Banks have therefore been able to shift a larger proportion of funds into earning assets . . . The data tend to confirm the view that the demand of banks for deposits is a derived demand, i.e., a demand reflecting the intensity of demand in the credit markets in which commercial banks make loans and purchase securities. Though obviously reasonable, this view is often neglected in discussions of banking competition."[31]

Commercial banks, the authors feel, are governed by many uncontrollables that surround them. They speak of the state of the economy, the composition of debt--which includes "the maturity structure as well as the forms of debt and the type of borrowers"--,the level of interest rates--influenced in turn by "the international payments mechanism and the U.S. balance of payments", policy dictates about bank structure--about which they state: "The forces for change (technological and organizational innovations) in commercial banking in the 1970's will make for continuing, if not more intense, conflict with present tenor of public policy governing the industry's structure."[32] To counter this environmental posture, a change in the past way of doing things is required.

The authors felt that banks would, as a result of these external environmental pressures, have to depart from the traditional "asset management" point of view. This being in consonance, of course, with the derived demand theory. On this the authors write:

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[31] Ibid, p. 34.

[32] Ibid, pp. 43-48.

"The more prevalent approach focuses mainly upon the supply side. That is, a projection of the expansion of deposits is made, and it is assumed that the increase in deposits will be allocated among earning assets in such a way as to optimize the rate of increase of income. The implication is that the supply of bank funds is a datum or is determined by forces external to the policies of commercial banks. there is considerable basis, of course, for viewing the expansion of bank deposits as a datum. Monetary policy has traditionally been directed to controlling the expansion of demand deposits, and in recent years Regulation Q ceilings have been used as an instrument of monetary policy to influence the expansion of savings and time deposits. However, this view is short-run in its focus, whereas projecting the growth of bank funds over a decade is an exercise in long-term forecasting."

"Within the context of long-run change, expansion of bank funds should be viewed as a reflection of expansion in demand for bank credit. This is not to say that the expansion of bank funds will not be constrained by monetary policy. However, it is clear that a slow pace of growth in demand for bank credit will make for a slow rate of expansion of bank funds. The effect of a fast pace of growth in demand for bank credit may be constrained by monetary policy, but experience shows that commercial banks will seek new means of meeting the growth in demand."

"From the mid-1930's to the mid 1950's, growth in deposits, or bank funds, was generally taken for granted in analyses of commercial banking. The prevailing view was that the volume of demand deposits was determined by the monetary authorities, and savings and time deposits were passively accepted (at a low rate of interest) by commercial banks mainly as a convenience to customers. The problem facing commercial banks was not how to expand bank funds but how to achieve a composition of assets that would optimize earnings, liquidity, and safety. That is, analyses of commercial banking were oriented to "asset management".

"during the early 1960's a new view began to find expression among bankers, especially in the large money-center banks. The term 'liabilities management' began to gain currency, and today it is well established in the lexicon of banking. Actually, as discussed in Chapter II, it was in the mid-1950's that the commercial banks began to manage the expansion of their liabilities. The problem of liabilities that will optimize earnings, liquidity, and safety. It is to find, subject to the constraints of liquidity and safety, the least-cost path of expansion of bank funds."[33]

The authors conclude, then, that the solution is through liabilities management on the part of commercial banks until such a time that the uncontrollables become more controllable. In this vein, they say:

"The structure of monetary control poses a basic constraint upon financial innovation. Monetary policy is implemented, of course, through control of, traditionally, the volume of demand deposits but, more recently, the volume of savings and time deposits as well. Bank liabilities which are not deposits lie beyond the direct control or influence of the monetary authorities. In order to maintain the relevance of their control mechanism, the monetary authorities have sought to maximize the range of bank liabilities which are classified as deposits and to proscribe or closely circumscribe the issuance of liabilities not classified as deposits."

"With respect to the implementation of monetary policy though, the rationale for controlling the expansion of bank liabilities which are not demand deposits is not well defined. If the money supply, defined as demand deposits plus currency in circulation, is the crucial magnitude which the monetary authorities should seek to control, why should reserve requirements be maintained against savings and time deposits and why should banks be closely regulated in the types of nondeposit liabilities which they may issue? If the money supply is not the crucial magnitude which the monetary authorities should seek to control, the present structure of monetary control is badly in need of overhaul . . ."[34]

Stated another way, what those who follow this third hypothesis opine is that commercial banks must be more concerned with the liabilities of the balance sheet in order to maximize or optimize earnings, liquidity and safety, and that this is to be achieved by the "least cost path of expansion of bank funds". This activity is dictated by the state of the economy and other related environmental elements

[33] Ibid, pp. 48-49.

[34] Ibid, p. 51.

over which commercial banks have little or no control.

This argument, then, says that commercial banks are first service agents that try to satisfy all its customers' demands to the best of its abilities within the limitations imposed on it by many uncontrollable forces. The best way it can do this is through sound liability management; whatever source of funds it takes will be used, so long as its more efficient and in the interest of the customer. Implied, then is the idea that profit is an adjunct of sound management applied in the process of satisfying a customer's needs.

CHAPTER V

ATTITUDINAL SURVEY OF COMMERCIAL BANKS CASH FLOWS

Methodology

The universe or population that formed the basis of this survey consisted on the 13,790 (14,279 commercial banks--489 mutual savings banks) commercial banks listed in the Polk's World Bank Directory.[35] From this population, a sample of 100 banks was drawn, or about .7% of the population.

The sample that was drawn was selected at random--without the use of statistical tables or any scientific method--to fit an asset stratification. For a listing of the banks drawn in the sample, the reader is referred to the Appendix, Exhibit A. The listing is broken down first by asset category and then alphabetically by state where bank is located, and this is followed by the bank's name. The purpose of the stratified sample was to ensure equitable dispersion and representation of the various size banks, and by doing this to prevent the sample from being concentrated in any one asset size category. Twenty samples were pulled for each asset category.

The Questionnaire

The reader may wish to refer to the questionnaire, in order that he may follow the discussion that is presented hereafter.[36]

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[35] Polk's World Bank Directory, North American Section, 155th. Edition, R. L. Polk and Co. Publishers, Nashville, Tennessee, (March, 1972).

[36] See Appendix, Exhibit B.

* The cover letter--Each survey package contained a personalized letter addressed to the president of the bank. The names of the bank presidents were extracted from the Polk book.[37]

* Questionnair instructions--Included with the survey was an instruction sheet. The purpose of the instructions is readibly discernable to the reader.

* Questionnaire--The questionnaire's intent, overall, was to discern profit or losses accrued by commercial banks on government funds as compared to the profits or losses from other than government funds. This objective, however, was not emphasized in the title, which emphasized instead cash control. The reason for not emphasizing the objective of the survey in the title was so as not to jeopardize returns.

Question I--Used only to give the impression to the respondent that different financial institutions were participating in the survey. The questionnaire, however, was mailed only to commercial banks.

Questions II and III--Used to determine what has been in the past and is today the primary source of working funds to commercial banks. For any changes noted an explanation was sought.

Questions IV and V--Of the working funds given in II, these questions sought a breakdown by type of source for different years. Explanations for trends noted, if any, were sought.

Question VI--Presents the respondent with a sample profit and loss table and three unfilled profit and loss tables (one for each

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[37] Polk's World Bank Directory, North American Section, 155th. edition, R. L. Polk and Co. Publishers, Nashville, Tennessee, (March 1972).

of the three years covering the decade under study) broken down into government and non-government sections.

Question VII--General comments, subdivided into three questions. Question "a" addressed the matter of profits lost as a result of pledging and exact percentile figures for selection as an approximate answer were offered. No comments were requested, although by virtue of the questions' emplacement, they were implied as desired. In addition, requested were suggestions for alternatives to pledging. Question "b" asked for comments concerning the effect of controlled income on government funds with Question "c" requesting comments on the impact resulting from the complete loss of government funds as working funds to commercial banks.

The reader can readibly deduce that the heart of the questionnaire lies in the profit and loss statements. Questions II-IV will serve to validate the impact of, or degree of, government funds as a source of working funds, as previously pointed out in Chapter II. Additional to the discussion and facts and figures presented in that chapter, these questions should provide some explanation(s) for trends. But these inquiries will only point out the magnitude of number or quantity of dollars furnished by one source as compared to another. The primary question, however, is the matter of magnitude of profit on the different sources of funds. The "P & L" tables should provide this answer.

The remainder of the questionnaire is intended to obtain a validation of the discussions in Chapters II, III and IV directly from the main party concerned and to try to draw opinions about some alternatives. The comments, to be compared and contrasted with those of others, should assist in the recommendations to be made by this writer.

CHAPTER VI

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Findings, Questionnaire

The questionnaire findings are tallied and depicted in the findings displayed.[38] The reader is asked to refer to this exhibit as he reads the comments below.

Before the discussion on the return statistics, the writer wishes to point out the fact, previously omitted, that three questionnaires were sent out as "trial-balloon" items for purposes of improving the questionnaire format. These represented a 3% sampling of the total 100 samples. None of these three test samples were returned. As a result, the remaining 97 samples were sent out as per the original form.

The return statistics in Exhibit C speak for themselves. The writer was anticipating a maximum of 20% return based on the large size of the chosen sample and on the fact that the sample packages were individually addressed to the banks' presidents. This 20% was reasonable forecast based on returns of other bank studies. In a study which attempted to estimate the relationship of market structure to the performance of banks in supplying services to business (a highly scholarly endeavor not looked upon by bankers as intrusive or damning

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[38] See Appendix Exhibit C

in its results), Mr. Jacobs obtained about a 25% return to a sample of 600 banks.[39] On the other hand, more controversial studies have not enjoyed such good returns or willingness for support.[40] The theme of this paper had heavy leanings towards controversy, in view of the fact that the writer was trying to obtain answers to questions of profit; profit by clients of banks. This evidently is a sensitive nerve with bankers.

Of the returned samples, close to 50% were filled and the data given was in most cases usable data. Some respondents went further than required and gave balance sheet and income statements for the three years in question.

From the compiled data, one can note the following findings:

1. Demand Deposits have experienced a down-swing in the last decade; they have gone down from a better than 50% share of total deposit position to a close to 40% share.

2. Time deposits, in the same period, have taken over the loss experienced by the Demand Deposits.

3. There has been an insignificant growth in other kinds of deposits.

4. The two reasons given by bankers most often as causative of the facts mentioned in 1. and 2. above were: Higher interest rates in Time Deposits (included Time and Savings Deposits) and the increase in money supply.

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[39]Jacobs, Donald F., "Business Loan Costs and Bank Market Structure", National Bureau of Economic Research, Columbia University Press, New York, 1971, pp. 4-5

[40]"A Guide to Banking Services", Consumer Reports, Consumers Union of the United States, Mt. Vernon, New York, Vol. 40, No. 1, January 1975, p. 33.

5. Federal and state and local governments' share of the Demand Deposits is small when compared to the total Demand Deposits. State and local has shown decrease while federal has shown a slight increase. Those of others showed a substantial jump from 1964 to 1969 with a leveling thereafter.

6. The federal and state and local governments' share of the total Time Deposit has remained constant and small. Those of others still make up the bulk of this source.

7. Few other sources of funds exist for commercial banks other than Demand and Time Deposits.

8. The reasons given be bankers as causative of the trends noted in 5., 6., and 7 above are of the increase in money supply or other type nature.

9. Bankers are unwilling to fill detailed charts concerning income and expense data. <u>But they expressed a willingness to answer questions seeking the same data if posed differently</u>.

10. Most bankers indicated that pledging represented foregone income in the neighborhood of 1 to 5%. Yet, none expressed total opposition to this activity.

11. On the question of limiting earning power on government funds by regulation or eradication, <u>bankers spoke of the big impact on industry overall, but none expressed personal concern since all claimed the numbers of dollars in their cases were small</u>.

The writer wishes to clarify that the questionnaires received as part of this study will be retained for a period of one year from the date on this paper.

Conclusions

The questionnaire used as part of this study yielded the findings listed above and those findings can be used to draw the following conclusions: Governments, both federal and state and local, furnish very little working funds--in the way of Demand and Time Deposits--to commercial banks; commercial banks do not appear over-concerned, on an individual basis, about losing the government Demand and Time deposit source of working funds; individual earnings from the various clients of commercial banks are not obtainable by means of requesting completion of segregated (by client) profit and loss statements.

Now, the above conclusions, drawn from the questionnaire, still leave the problem as originally defined unanswered or solved. Had responses to Question VI been provided, then the writer would have been able to compare income from the various sources to determine whether or not government monies were a more profitable source. This was not possible in this case at this time. However, a different tact, by laymen can still furnish an answer. Bankers expressed willingness to cooperate so long as the gun was not aimed directly at them. The matter warrants further investigation. An easier answer can be obtained by government representatives by virtue of some of the data readibly available to them and not to a scholar. (This is something which may be occuring now as is evidenced by present legislation. See ahead, discussion on House of Representatives Bill 1016) By the use of reports such as the one shown in Exhibit D,[41] the

[41] The Consolidated Report of Condition shown as Exhibit D was furnished by one of the respondents of the questionnaire. The name of the bank involved and names of the officials have been crossed out in order to protect their rights to privacy.

government can prorate their share or contribution to a bank's working funds. This can be compared to the total source of funds. This can be compared to the total source of funds and these figures can both be compared to overall income from funds. For instance, under Schedule E--Demand Deposits Items 4 and 5 can be compared to Item 10 and the percent relationships from here and from Schedule F could then be compared to Item 1 (a) operating income, interest and levies on loans. This kind of analysis yields some idea of the government's contribution to income. The government can refine their analysis even more by requesting even more information on these reports required from banks. For instance, under Schedule of Other Liabilities, they could include other government type sources such as the Treasury Tax and loan accounts--currently a big and apparently profitable source of income to commercial banks. The pro-rating and comparison could continue on and on.

In essence, the point made above is that there are ways to determine inequities, if any do exist, whether pro or contra government or pro or contra banks. Once discrepancies are noted, actions can be taken to correct them.

One may ask at this junction, "Well, which of the three hypotheses most frequently advanced on this subject of profits on government funds is to be held as true?"

From the study and analysis of the subject matter, plus evidence uncovered, the writer feels that all three hypotheses are true. Some apparently with a larger degree of verdicality than others.

For the hypothesis about excess income from government funds, the writer confronted various writings replete with facts lending substantial truth to the hypothesis. The hearings conducted by the Senate on the subject of Government Deposit Insurance was one.[42] A for instance would be a summary of Dr. Blanken Beckler's article in May 1973 issue of Governmental Finance, given therein.[43]

> "Analyses of data taken from U.S. Government publications provided an estimate of forgone interest (pure income to commercial banks) by state and local governments of $453 million in 1967. Year-end balances, as reported by state and local governments, may understate the estimate of lost interest."

Another schollar who furnishes evidence favoring this first hypothesis is Mr. Aronson.[44] From his studies on cash balances of state and local governments, he concluded:

> "The model used in this study implicitly incorporates economies of scale in cash management. If economies of scale exist, then it might be argued that the combining of State and local fiscal operations results in overestimates of excess balances. It is not likely, however, that separation would produce a picture of efficient cash management. But even if upon separation there was evidence of efficient cash management, economies of scale imply that inefficiency is produced by decentralizing the handling of state and local funds. <u>Therefore, it seems clear that state and local governments are foregoing a significant amount of income because of either simple mismanagement or because of decentralization in the management of funds or a combination of these reasons. The solution to the problem of simple mismanagement rests in a more ambitious and enlightened investment program; the solution to the problem of decentralization may rest in the creation of a national financial institution to manage state and local funds.</u>"[45]

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[42] "Government Deposit Insurance", <u>Hearings Before the Subcommittee on Financial Institutions of the Committee on Banking, Housing and Urban Affairs</u>, United States Senate, Ninety-Third Congress, U.S. Government Printing Office, Washington, 1974.

[43] Ibid, p. 198.

[44] Aronson, Richard J., "The Idle Cash Balances of State and Local Governments: An Economic Problem of National Concern", <u>The Journal of Finance</u>, Vol. 23, No. 3, June 1968.

[45] Ibid, pp. 507-508. Emphasis by underlining this writer's.

In addition to studies and writings such as those referenced above, evidence on this first hypothesis comes forth in the way of legislation. House of Representatives Bill Number 1016 was introduced to initiate interest payment on all tax and loan accounts.[46] Medicine such as this legislation is caused by some discovered ailment.

Similarly, arguments were found validating the second hypothesis. The questionnaire in this study showed that up to 5% of profit is foregone due to pledging. To what degree this 5% offset income from government funds and neutralized the profit posture was not determinable by the questionnaire data.

But this writer is convinced that regulatory constraints of various kinds do limit profits of commercial banks. A like feeling was expressed by Mr. Normand Bernard, Assistant Secretary of the Board of Governors of the Federal Reserve System.[47] Mr. Richard Bond, in doing research on deposit composition and commercial bank earnings, reached similar conclusions about regulations limiting effect on profits.[48] He concluded:

> "Regulation of the commercial banking industry affects the returns which commercial bnaks realize on their deposits and capital. The higher profit rate on Demand Deposits is to a large extent the result of the prohibition against the payment of interest on these deposits. The relatively low marginal rate of ret;rn on bank capital indicates that regulation induces banks to issue capital beyond the strict profit maximizing level."[49]

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[46] See Appendix, Exhibit E

[47] See Appendix, Exhibit F

[48] Bond, Richard E., "Deposit Composition and Commercial Bank Earnings", Journal of Finance, Vol. 26, No. 1, March 1971, pp. 39-50.

[49] Ibid, p. 50.

And as the above, other like arguments and discussions speaking about the profit lessening effect were found. This hypothesis cannot be ignored either.

The third hypothesis spoke of liability management and seeking the least cost path to fund acquisition. In a way, this is exactly the same argument as the first hypothesis. It is the same in that it calls for seeking that source of funds which is the cheapest. In doing this, it is saying, "Try to get government money." The reader must recall the discussions on how Demand Deposit money is very cheap--as no interests are paid for them; in fact, service charges are levied additionally on them by banks to cover the handling expense. Governments have most of their monies in commercial banks as Demand Deposits. Recall the fact that the governments have little money in interest bearing deposits (Time Deposits). Recall the fact that government has huge quantities of dollars earning no interest while being used by the bank for the benefit of the bank (Treasury Tax and Loan Accounts).

What this hypothesis means, again, is that banks are going to seek the most profitable source of cash, which is the government. The only added feature to this hypothesis is the fact that it allows for changing to another source when this other source becomes cheaper than the government funds. The hypothesis calls for profit maximization, whichever the source.

So it is felt that for now and until such a time as it appears that there is a cheaper source of funds than the government, the same evidence espoused above for the first hypothesis can be embraced and applied to this third school of thought.

It can be concluded, then, this author feels, that banks today do appear to be making more money on government money than on monies from individuals, partnerships and corporations; that the latter activity is in effect the managing of liabilities by the least cost path and that government regulations do have a nullifying effect on run-away profit.

In view of the above conclusions, some recommendations follow.

Recommendations

This author's feelings can be traced in the following passage from Mr. Longbrake's study in productive efficiency in commercial banking.[50]

> "Rapid changes are occuring currently in the structure of commercial banking. From the standpoint of the public interest, it is important to guide these structural changes so that competition is maintained or enhanced and productive efficiency is improved while, at the same time, the viability of commercial banking is maintained from the standpoint of bankers as well as the public."[51]

Of course, in the above passage the author addresses structure. This writer would prefer to choose the word orientation in lieu of structure, in order to express his feelings on the subject better.

On a platonic scale, the author's hypotheses would be:

If--commercial banks are allowed, like all institutions in a free enterprise system, to work towards the maximization of earnings, and

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[50] Longbrake, William A., "Productive Efficiency in Commercial Banking: The Impact of Bank Organizational Structure and Bank Size on The cost of Demand Deposit Services", Banking and Economic Research Section, Division of Research, Federal Deposit Insurance Corporation, Washington, D.C., Working Paper No. 72-10, pp. 1-39.

[51] Ibid, p. 35.

If--governmental institutions are allowed to work their funds to their maximum capacity

Then--through the symbiosis of the two premises you will benefit commercial banks and its private owners and the government and its contributing people.

To achieve this state of compatibility, it was the belief of the writer originally that a state or federal owned banking system might be the solution. Now, after extended study, it is felt that such a system might be advisable in years to come when banks become less dependent on the government for their sustenance, this even when a state owned bank is known to be operating very successfully in North Dakota.[52]

There has to be a transitional period. During this period, inequities caused by mismanagement must be reduced on a sequential step by step basis until the point is arrived where commercial banks make no more profit off the government source than they make off the individual, partnership and corporation source.

Perhaps the first steps in this direction have been taken by the state of Maryland in enacting statutes setting ceilings on the amount of interest-free money that major banks can have on hand and by the House of Representatives of the U.S. Congress in pursuing like legislation, which was mentioned before.[53] Maybe the second step might be the easing up or eradication of many regulations on the part of the government. This would ease the pinch on commercial banks. For instance, pledging

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[52]See article in January 15, 1975 Forbes entitled: 'Living in Sin and Liking it." pp. 38-39.

[53]See Hearings on Government Deposit Insurance, pp. 200-201, and Appendix, Exhibit E.

might be done away with, thus releasing those frozen assets to earn higher returns for commercial banks. The alternatives and suggestions can go on and on, many were read about in the literature, most could be implemented. However, in order for both parties to benefit, there must first be goodwill.

A P P E N D I X

EXHIBIT A

SAMPLE BANKS

Asset Category:

Under 5 Million

Alabama	American Bank & Trust Company
Arkansas	First National Bank of Brinkley
Colorado	Berthoud National Bank
Colorado	Buena Vista Bank & Trust Company
Connecticut	First Samford Bank & Trust Company
Delaware	The Felton Bank
Florida	The Cedar Key State Bank
Florida	The First National Bank of Alachua
Georgia	The People's Bank
Illinois	Capron State Bank
Illinois	First State Bank of Biggsville
Indiana	The Dale State Bank
Iowa	Manilla State Bank
Kansas	The Bank of Herington
Maine	Kezar Falls National Bank
Mississippi	Brookhaven Bank & Trust Company
Montana	Fairview Bank
South Carolina	The Bank of Bethune
Texas	Alvord National Bank
Utah	Bank of Northern Utah

5-10 Million

Alabama	First National Bank of Childersburg
Alaska	The First Bank of Cordova
Arkansas	Bank of Lake Village
California	American Pacific State Bank
Colorado	The Citizens State Bank of Cortez
Connecticut	The Chester Savings Bank
Connecticut	The Terryville Trust Company
Delaware	The Clayton Bank & Trust Company
Florida	Citizens Bank of Clermont
Georgia	The Bank of LaFayette
Idaho	First Bank of Troy
Idaho	Tri State National Bank of Montpelier

Illinois	Bartonville Bank
Illinois	The State Bank of Allerton
Iowa	The First National Bank of Missouri Valley
Maryland	The National Bank of Cambridge
Michigan	Central National Bank of Alma
Missouri	Columbia National Bank
Pennsylvania	Bedford County Bank
Washington, D.C.	United Community National Bank

10-25 Million

Alabama	Dothan Bank & Trust Company
Arkansas	First National Bank in Stuttgart
California	Peninsula National Bank
Colorado	The Burns National Bank of Durango
Connecticut	Branford Savings Bank
Delaware	The Milford Trust Company
Florida	Citrus & Chemical Bank of Barton
Florida	Bank of Fort Lauderdale
Florida	Orlando Bank & Trust Company
Georgia	The Citizens & Southern Bank of Cobb County
Idaho	Idaho Bank of Commerce
Illinois	First Arlington National Bank
Illinois	First National Bank in Carbondale
Indiana	The Franklin Bank & Trust Company
Kentucky	Bowling Green Bank & Trust Company
Michigan	Bank of Dearborn
Nebraska	The Guardian State Bank
Nevada	Valley Bank of Nevada
New York	The First National Bank of Norfolk
West Virginia	Bank of West Virginia

25-100 Million

Alaska	The First National Bank of Anchorage
Arkansas	The City National Bank of Fort Smith
California	Ahmanson Bank & Trust Company
California	Santa Barbara National Bank
California	Santa Monica Bank
Connecticut	Farmers & Mechanics Savings Bank
Florida	Coral Gables First National Bank
Georgia	The First National Bank & Trust Company
Hawaii	City Bank of Honolulu
Hawaii	Liberty Bank
Idaho	Idaho Bank & Trust Company
Illinois	Alton Banking & Trust Company
Illinois	The Old National Bank of Centralia

Indiana	First National Bank of East Chicago
Kentucky	The Peoples Liberty Bank & Trust Company
Louisiana	Bossier Bank & Trust Company
Maine	Augusta Savings Bank
Massachusetts	Andover Sabings Bank
New Hampshire	Concord National Bank
Washington, D.C.	Security National Bank

100+ Million

Alabama	The First National Bank of Birmingham
Arizona	The Arizona Bank
Arizona	Southern Arizona Bank
California	Bank of America
California	The Bank of California
Colorado	The Central Bank & Trust Company
Connecticut	The Connecticut National Bank
Delaware	Bank of Delaware
Florida	The Atlantic National Bank
Georgia	The Citizens & Southern National Bank
Hawaii	First Hawaiian Bank
Illinois	American National Bank & Trust Company
Illinois	Chicago Title & Trust Company
Indiana	The Citizens National Bank of Evansville
Iowa	Central National Bank & Trust Company
Louisiana	American Bank & Trust Company
Maryland	First National Bank of Maryland
Massachusetts	The First National Bank of Boston
Minnesota	The Marquette National Bank
New Jersey	Guarantee Bank

EXHIBIT B

107-2 Glacier Drive
Minot, North Dakota 58704
February 19, 1975

I am a graduate student at the University of North Dakota pursuing a Masters Degree in Business Administration. I am interested in the banking industry and have chosen this field in which to do an independent study. This study is a degree requirement.

We who are interested in banking and the banking industry are concerned with good management of all facets of the banking operation. My concern is with the kind of management afforded the cash flows--government and non-government--over the past decade. I hope to uncover any noticeable trends and analyze the cause(s) for these.

I need your cooperation in this important research project--one which is conducted as a joint effort with banking associations though-out the United States--and I am asking that you contribute your valuable opinions and suggestions by means of the accompanying brief questionnaire.

I hope to repay you for your kind assistance by using the survey findings to provide a better and more ample understanding of bank management practices, for you and your fellow bankers' use and benefit. Your answers will help me to help you.

Thank you very much.

Very Truly yours,

Frederick D. Delboy

QUESTIONNAIRE INSTRUCTIONS

1. Questionnaire has two basic types of questions: fill in the blanks, and the general comments/explain type. Action for the former will be self-evident. For the latter, kindly give a minimum of one sentence, but no more than six sentences.

2. When precise/exact percentile and dollar figures are not available, please furnish your best estimate.

3. Avoid personal identification and identification of the organization with whom you are associated. Anonymity is desired in the interest of candidness, accuracy and sufficiency of the information you furnish.

4. Request you return your responses as soon as possible.

5. Postage is provided for your convenience.

6. Mail the completed questionnaire to:

Mr. Frederick D. Delboy
107-2 Glacier Drive
Minot, North Dakota 58704

7. Definitions for terms used in this questionnaire:

Demand deposits--All those funds which represent working balances. That is, those funds kept with the bank to support credit requirements or to compensate the bank for the wide variety of banking services.

Time deposits--All those funds held in savings deposits, time certificates of deposit and time deposits open account.

Q U E S T I O N N A I R E

BANK MANAGEMENT/BANK CASH FLOWS

I. Would you consider your institution a:
(a.) Commercial bank
(b.) Savings and loan association
(c.) Mutual Savings and loan association
(d.) Thrift institution
(e.) Other, spedify
(circle one)

II. For the years listed, give a breakdown of the makeup of total deposits. (Enter percentage and dollar figures.)

Deposit Category	1964		1969		1974	
Demand Deposits:	______%	$______	______%	$______	______%	$______
Time Deposits :	______%	$______	______%	$______	______%	$______
Other, Spedify:	______%	$______	______%	$______	______%	$______
Total Deposit	100 %	$______	100 %	$______	100 %	$______

III. If any trend, upwards or downwards, is evident in any of the three Deposit Categories in Item II above, do you believe it was attributed to:

Influential Factors	Deposit Category
1. Increase in money supply	( )
2. Decrease in money supply	( )
3. Increase government expenditures .	( )
4. Decrease government expenditures .	( )
5. Increase in loan activity.	( )
6. Decrease in loan activity.	( )
7. Increase in investment opportunities	( )
8. Decrease in investment opportunities	( )
9. Higher interest yield on deposits (Demand Deposits excluded	( )
10. Lower interest yield on deposits (Demand Deposits excluded)	( )
11. Others, specify . .	( )
12. No trend evident	( )

(Mark as many influential factors per Deposit Category as you deem were causative of trend. List any others you feel were causative, but ...

IV. For the percentiles listed in II. above, give an additional breakdown of how much constituted federal, state and local, and other sources of deposit funds. (Fill in the spaces.)

	1964	1969	1974	
Demand Deposits: of the	%	%	%,	given in II above...
	%	%	%	constituted federal funds
	%	%	%	constituted state and local
	%	%	%	constituted other sources
	100%	100%	100%	

	1964	1969	1974	
Time Deposits: of the	%	%	%	given in II above...
	%	%	%	constituted federal funds
	%	%	%	constituted state and local
	%	%	%	constituted other sources
	100%	100%	100%	

	1964	1969	1974	
Other Deposits: of the	%	%	%	given in II above...
	%	%	%	constituted federal funds
	%	%	%	constituted state and local
	%	%	%	constituted other sources
	100%	100%	100%	

V. For any trend, upward or downward evident in any of the 3 Deposit Categories shredouts in Item IV above, place the applicable influential factor number(s) in the parenthesis. (See Item III for Influential Factors.)

Deposit Category Shredout	Influential Factor
Demand Deposits - Federal Funds, trend due to . .	( )
Demand Deposits - State and local funds, trend due to	( )
Demand Deposits - Other sources, trend due to . .	( )
Time Deposits - Federal funds, trend due to . . .	( )
Time Deposits - State and local funds, trend due to	( )
Time Deposits - Other sources, trend due to . . .	( )
Other Deposits - Federal funds, trend due to . .	( )
Other Deposits - State and local funds, trend due to	( )
Other deposits - Other sources, trend due to . .	( )

VI. For the years listed in Tables A, B and C, give a breakdown of the expenses, income and taxes per $1,000.- of deposit. (See attachments; use Sample Table for suggested form.)

VII. General comments:

a.) The law and regulating agencies require banks to pledge certain types and amounts of assets to secure government deposits. What extent of additional net profit are lost because of this requirement? (Consider the income from collateral now held as compared to the income from other investments and loans forgone.)

1-5% ( )	10-20% ( )	35%+ ( )
5-10% ( )	20-35% ( )	

Explain what alternatives you would propose in lieu of pledging which would be more beneficial to both the banker and the government.

b.) Explain what impact would be felt by your bank if all government funds deposited at your bank were to be held for payment and as trust assets not investable/loanable, producing only service charge income?

c.) Explain what impact would be felt by your bank and the banking industry at large if all government monies and transactions were removed from privately owned banks and were handled by federal and/or state owned (not to be confused with state or federal chartering) banks?

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	Government				Non-Government			
	Time Deposits		Demand Deposits		Time Deposits		Demand Deposits	
Income from Portfolio	$ XX.XX		$ XX.XX		$ XX.XX		$ XX.XX	
Other Deposit Income	.XX		.XX		.XX		.XX	
Total Income		$ XX.XX		$ XX.XX		$ XX.XX		$ XX.XX
Processing Wages	X.XX		X.XX		X.XX		X.XX	
Other Direct	X.XX		X.XX		X.XX		X.XX	
Total Direct Expenses	X.XX		X.XX		X.XX		X.XX	
Administrative Salaries & Directors' Fees	.XX		.XX		.XX		.XX	
Indirect Expenses	X.XX		X.XX		X.XX		X.XX	
Total Operating Expenses	X.XX		X.XX		X.XX		X.XX	
Interest on Deposit	XX.XX				XX.XX			
Less Activity Charges on Demand Deposits			<X.XX>				<X.XX>	
Total Expenses		XX.XX		XX.XX		XX.XX		XX.XX
Net Earnings		X.XX		X.XX		X.XX		X.XX
Federal Taxes		X.XX		X.XX		X.XX		X.XX
Earnings After Federal Taxes		$ X.XX		$ X.XX		$ X.XX		$ X.XX

TABLE A
1964

	Government		Non-Government	
	Time Deposits	Demand Deposits	Time Deposits	Demand Deposits
Income From Portfolio				
Other Deposit Income				
Total Income				
Processing Wages				
Other Direct				
Total Direct Expenses				
Administrative Salaries & Directors' Fees				
Indirect Expenses				
Total Operating Expenses				
Interest on Deposit				
Less Activity Charges on Demand Deposits				
Total Expenses				
Net Earnings				
Federal Taxes				
Earnings After Federal Taxes				

1969

	Government		Non-Government	
	Time Deposits	Demand Deposits	Time Deposits	Demand Deposits
Income from Portfolio				
Other Deposit Income				
Total Income				
Processing Wages				
Other Direct				
Total Direct Expenses				
Administrative Salaries & Directors'Fees				
Indirect Expenses				
Total Operating Expenses				
Interest on Deposit				
Less Activity Charges on Demand Deposits				
Total Expenses				
Net Earnings				
Federal Taxes				
Earnings After Federal Taxes				

TABLE C
1974

	Government		Non-Government	
	Time Deposits	Demand Deposits	Time Deposits	Demand Deposits
Income From Portfolio				
Other Deposit Income				
Total Income				
Processing Wages				
Other Direct				
Total Direct Expenses				
Administrative Salaries & Directors'Fees				
Indirect Expenses				
Total Operating Expenses				
Interest on Deposit				
Less Activity Charges on Demand Deposits				
Total Expenses				
Net Earnings				
Federal Taxes				
Earnings After Federal Taxes				

EXHIBIT C

THE FINDINGS DISPLAYED

Return Statistics:

Total Questionnaires Mailed	100
Total Returns	15
Per Cent of Survey Returns	15%
Negative Responses	8
Per Cent Negative Responses	53%
Positive Responses	7
Per cent Positive Responses	47%

Questionnaire Statistics:

Question I - All seven responses where marked as commercial banks.

a) Question II -	1964 %	1964 $000	1969 %	1969 $000	1974 %	1974 $000
Demand Deposit						
Range	48-72	1,153-108,793	43-70	1,393-156,024	34-55.7	1,897-274,034
Mean	61	22,908	52	32,831	42	58,404
Time Deposit						
Range	28-52	658-99,897	30-56	1,293-201,541	44-66	2,743-529,738
Mean	39	19,510	47	38,922	57	103,970
b) Other						
Range	1	159	4	449	4.3	820
Mean	.2	27	1	75	1	137

a) One of the seven positive respondents did not answer Question II. This zero response is not accounted for in the matrix above in computing the mean.

b) Only one of the positive respondents gave figures for "Other" for the years 1964, 1969. Two gave data for the year 1974.

Question III - Reasons given for trend were as follows:

	Reason	No. Given as Reason	
2.	Decrease in Money Supply	1	Demand 69
9.	Higher Interest Yield on Deposits (Demand Deposits Excluded	5	
1.	Increase in Money Supply	3	Demand and Time

5. Increase in Loan Activity . . . . 2 . . . 1 Demand
1 All Categories

11. Others * . . . . 1 . . . Natural Growth of New Bank; Bank in Agricultural Community, Reflects trend of Farm prices.

c) 12. No Trend Evident 1

7. Increase in Investment Opportunities . . . . 2 . . . Time Deposits

c) Resident indicated no trend evident, when a definite decrease in Demand Deposits and increase in Time Deposits were evident in the figures he furnished in answer to Question II.

	Question IV -	1964 %	1969 %	1974 %
d)	Demand Deposit			
	*Federal Funds			
	Range	1-2.2	1.3-3	1.5-6
	Mean	1.7	2.1	2.4
	*State and Local			
	Range	12-27	6.4-10	3-21
	Mean	18.4	10.8	10.5
	Other			
	Range	71-87	81-92.3	73-95
	Mean	79.9	87.1	87.1
d)	Time Deposit			
	*Federal Funds			
	Range	-----	-----	0-3
	*State and Local			
	Range	2-12	3-11	0-12.4
	Mean	6.4	7.5	6.1
	*Other			
	Range	88-98	89-97	87.6-97
	Mean	93.6	92.8	93.2
b)	Other Deposits			
	*Federal Funds	-----	-----	-----
	*State and Local	-----	-----	-----
	*Other			
	Range	-----	-----	100
	Mean	-----	-----	25

d) Demand Deposit and Time Deposit data of two respondents were not in accordance with instructions. These were unusable. Another respondent did not answer this question. One of the usable respondents gave data for 1974 only. This dropped averaging factor to four for 1974, and to three for 1964 and 1969.

e) Other Deposit of the same two respondents (See "D") above) were not in accordance with instructions. These were unusable. A third respondent (Same as "d)" above) did not answer this question IV. One of the usable respondents (four) gave data for 1974 only. This dropped averaging factor to four for 1974.

Question V - Reasons given for trend were as follows:

*Demand Deposit - Federal Funds . . .	12. No Trend = 1 1. Increase in money supply = 1
*Demand Deposit - State and Local Funds	1. Increase in Money supply = 1 11. Other - Account Rotation; Population = 1
*Demand Deposit - Other Funds	1. Increase in money supply = 1 11. Other - Account Rotation; Population = 1
*Time Deposits - State and Local . .	1. Increase in money supply = 2
*Time Deposits - Other Sources . . .	1. Increase in money supply ==1 9. Higher interest yield on deposit = 1

Question VI - This question was not answered by any of the seven positive respondents.

Question VIII -

(a.) 1 - 5 = 3 No Response = 4

Comments:

- "Banks could agree to hold a trading account with Federal and keep a certain balance at all times" = 1
- "Pooled pledging would be a desireable enhancement." = 1
- "We have no complaints about the required reserves. We feel that for a bank to be in a sound condition it must carry a certain amount of government securities. (To be in a fairly liquid condition) We use this for our reserves. I would recommend no changes." = 1

(b.) Comments:

- "Nearly 15% of our deposits are government accounts. (City, county, state and U.S.) If these were removed it would, of course, effect our earning power by this much and since the accounts are very large, our expenses would not be lowered in proportion. The size of the accounts are such that no service charges are now charges." = 1
- "Unless the service charges were drastically increased, we couldn't afford the business." = 1
- "Minor impact - Low balance carried." = 2
- "Would reduce gross income - 6-9% - in our bank." = 1
- "Loss of loanable funds at going rates." = 1

(c.) Comments:

- "Loss of loanable fund and profits." = 1
- "Our bank would not suffer greatly - but industry would lose greatly, my estimate - 12-16% of investment money or funds used as chas reserves." = 3
- "We would lose the role of financial intermediary with respect to these funds. This would result in reduced earnings in the bank and would disrupt the flow of funds to borrowers." = 1

E X H I B I T D

(Including Domestic Subsidiaries)

CALL NO. 110 FOURTH 1974 CALL

Name and Address of Bank

RETURN ORIGINAL AND ONE COPY TO FDIC, WASHINGTON, D.C. 2

[redacted] 09245-2 13-1890 295 0

PLEASE READ CAREFULLY "INSTRUCTIONS FOR THE PREPARATION OF REPORT OF INCOME."

Every item and section must be FILLED in.
Printed items must not be amended.

SECTION A – SOURCES AND DISPOSITION OF INCOME	Dollars		
1. OPERATING INCOME:			
(a) Interest and fees on loans	1	028	192
(b) Income on Federal funds sold and securities purchased under agreements to resell		104	372
(c) Interest and dividends on investments (exclude trading account income):			
1. U. S. Treasury securities		153	616
2. Securities of other U. S. Government agencies and corporations		17	500
3. Obligations of States and political subdivisions		213	857
4. Other securities		29	200
(d) Trust department income		NONE	
(e) Service charges on deposit accounts		62	323
(f) Other service charges, collection and exchange charges, commissions, and fees		1	418
(g) Other operating income (itemize net income on trading account, net earnings from foreign branches and other amounts over 25% of total)		6	081
(h) Total operating income	1	616	561

2. OPERATING EXPENSE:					
(a) Salaries and wages of officers and employees (Number on payroll at the end of period ________)				215	145
(b) Pensions and other employee benefits				48	932
(c) Interest on deposits				561	815
(d) Expense of Federal funds purchased and securities sold under agreements to repurchase				NONE	
(e) Interest on other borrowed money				NONE	
(f) Interest on capital notes and debentures				NONE	
(g) Occupancy expense of bank premises, net				20	305
Gross occupancy expense	$ 21,625.33				
Less rental income	$ 1,320.00				
(h) Furniture and equipment, depreciation, rental costs, servicing, etc.				20	000
(i) Provision for loan losses (or actual net loan losses)				58	942
(j) Other operating expenses (itemize amounts over 25% of total)				176	347
(k) Total operating expense			1	101	483
3. INCOME BEFORE INCOME TAXES AND SECURITIES GAINS OR LOSSES (Item 1(h) minus 2 (k))[1]				515	073
4. APPLICABLE INCOME TAXES				136	425
5. INCOME BEFORE SECURITIES GAINS OR LOSSES (Item 3 minus 4)[1]				378	648

	(1) Gross				(2) Net of Tax Effect	
	Dollars			Cts.	Dollars	
6. NET SECURITIES GAINS OR LOSSES (show net loss as minus or in parentheses)			700	00		525
7. INCOME BEFORE EXTRAORDINARY ITEMS (Item 5 plus or minus 6)[1]	XXX	XXX	XXX	XX	379	173
8. EXTRAORDINARY CHARGES OR CREDITS (show net charges as minus or in parentheses and itemize each charge and credit)		NONE			NONE	
9. MINORITY INTEREST IN CONSOLIDATED SUBSIDIARIES					NONE	
10. NET INCOME (Item 7 plus or minus 8, minus 9)[1]					379	173

[1] If a loss, indicate by a minus sign or in parentheses.

[redacted], PRESIDENT of the above-named bank, hereby certify that the foregoing

(Name of officer authorized to sign report) (Title)

[illegible]

Consolidated Report of Condition of " [redacted]
(Legal title of bank)

of [redacted] (City), [redacted] (County), [redacted] (State) [redacted] (Zip Code), **and Domestic Subsid**

at the close of business on DECEMBER 31, 19 74.   74

State Bank No. 64-318   *Federal Reserve District No.* 6

	Dollars			Cts
ASSETS				
1. Cash and due from banks (including $ NONE unposted debits) (Schedule D, item 7)	2	833	326	03
2. (a) U.S. Treasury securities $ 1,843,448.33 } Total (items	xxx	xxx	xxx	xx
(b) Obligations of Federal Financing Bank $ NONE } 2(a) & (b)) =	1	843	448	33
3. Obligations of other U.S. Government agencies and corporations		200	000	00
4. Obligations of States and political subdivisions	4	645	886	41
5. Other securities (including $ NONE corporate stocks)		NONE		
6. Trading account securities		NONE		
7. Federal funds sold and securities purchased under agreements to resell	1	800	000	00
8. Other loans (Schedule A, item 8)	10	306	670	37
9. Bank premises, furniture and fixtures, and other assets representing bank premises		237	777	46
10. Real estate owned other than bank premises		NONE		
11. Investments in subsidiaries not consolidated		NONE		
12. Customer's liability to this bank on acceptances outstanding		NONE		
13. Other assets (item 6 of "Other Assets") (including $ NONE direct lease financing)		16	058	66
14. TOTAL ASSETS	21	883	167	26
LIABILITIES				
15. Demand deposits of individuals, partnerships, and corporations (Schedule E, item 3)	5	594	346	96
16. Time and savings deposits of individuals, partnerships, and corporations (Schedule F, item 5)	10	219	199	01
17. Deposits of United States Government (Schedule E, item 4 and Schedule F, item 6)		481	218	10
18. Deposits of States and political subdivisions (Schedule E, item 5 and Schedule F, item 7)	2	321	931	49
19. Deposits of foreign governments and official institutions (Schedule E, item 6 and Schedule F, item 8)		NONE		
20. Deposits of commercial banks (Schedule E, items 7 and 8 and Schedule F, items 9 and 10)		NONE		
21. Certified and officers' checks, etc. (Schedule E, item 9)		147	031	70
22. TOTAL DEPOSITS $ 18,763,727.26	xxx	xxx	xxx	xx
(a) Total demand deposits (Schedule E, item 10) $ 7,918,983.27	xxx	xxx	xxx	xx
(b) Total time and savings deposits (Schedule F, item 11) $ 10,844,743.99	xxx	xxx	xxx	xx
23. Federal funds purchased and securities sold under agreements to repurchase		NONE		
24. Other liabilities for borrowed money		NONE		
25. Mortgage indebtedness		NONE		
26. Acceptances executed by or for account of this bank and outstanding		NONE		
27. Other liabilities (item 7 of "Other Liabilities" schedule)		596	446	00
28. TOTAL LIABILITIES	19	360	173	26
29. MINORITY INTEREST IN CONSOLIDATED SUBSIDIARIES		NONE		

RESERVES ON LOANS AND SECURITIES

30. Reserve for bad debt losses on loans (set up pursuant to Internal Revenue Service rulings)		186	074	64
31. Other reserves on loans		NONE		
32. Reserves on securities		NONE		
33. TOTAL RESERVES ON LOANS AND SECURITIES		186	074	64

CAPITAL ACCOUNTS

34. Capital notes and debentures		NONE		
35. Equity capital, total (items 36 to 40 below)	2	336	919	36
36. Preferred stock-total par value (No. shares outstanding NONE)		NONE		
37. Common stock-total par value (No. shares authorized 50,000) (No. shares outstanding 50,000)		500	000	00
38. Surplus	1	000	000	00
39. Undivided profits		836	919	36
40. Reserve for contingencies and other capital reserves		NONE		
41. TOTAL CAPITAL ACCOUNTS (items 34 and 35 above)	2	336	919	36
42. TOTAL LIABILITIES, RESERVES, AND CAPITAL ACCOUNTS (items 28, 29, 33, and 41 above)	21	883	107	26

MEMORANDA

1. Average of total deposits for the 15 calendar days ending with call date	18	304	733	33
2. Average of total loans for the 15 calendar days ending with call date	10	252	928	56
3. Unearned discount on instalment loans included in total capital accounts		NONE		
4. Standby letters of credit		NONE		

I, [redacted] PRESIDENT, of the above-named bank do solemnly {SWEAR / AFFIRM} that this report of cond
(Name and title of officer authorized to sign report)

(including the information on the reverse side hereof) is true and correct, to the best of my knowledge and belief. [redacted]

(Signature of officer authorized to sign report)

[redacted]

Correct—Attest:

[redacted]

} D

Place for official seal to ... by officer before ... acknowledged. Notary must not be an officer or director of the bank.

State of [redacted] *, County of* [redacted]

Sworn to and subscribed before me this 10th *day of* January

and I hereby certify that I am not an officer or director of this bank.

My commission expires July 25, 1976 Barbara J. Howard *, Notary*

SCHEDULE A—LOANS AND DISCOUNTS (including rediscounts and overdrafts)		Dollars		Cts.
1. Real estate loans (include only loans secured primarily by real estate):	xxx	xxx	xxx	xx
(a) Secured by farm land (including improvements)		444	690	95
(b) Secured by 1- to 4-family residential properties (other than farm):	xxx	xxx	xxx	xx
(1) Insured by the Federal Housing Administration		NONE		
(2) Guaranteed by the Veterans Administration		NONE		
(3) Not insured or guaranteed by FHA or VA (conventionally financed)	2	308	921	40
(c) Secured by multifamily (5-or-more) residential properties:	xxx	xxx	xxx	xx
(1) Insured by the Federal Housing Administration		NONE		
(2) Not insured by FHA (conventionally financed)		NONE		
(d) Secured by nonfarm non-residential properties (e.g., business, industrial, hotels, office buildings, churches)	1	350	907	04
2. Loans to financial institutions:	xxx	xxx	xxx	xx
(a) To domestic commercial and foreign banks		NONE		
(b) To other financial institutions (*include* loans to sales finance, personal finance, insurance and mortgage cos., factors, mutual savings banks, savings and loan assns., Federal lending agencies, and all other business and personal credit agencies)		NONE		
3. Loans for purchasing or carrying securities (secured or unsecured):	xxx	xxx	xxx	xx
(a) To brokers and dealers in securities		NONE		
(b) Other loans for the purpose of purchasing or carrying stocks, bonds, and other securities		NONE		
4. Loans to farmers (secured and unsecured except loans secured by real estate above, but including loans for household and personal expenditures)		227	939	48
5. Commercial and industrial loans (*include* all loans for commercial and industrial purposes, secured or unsecured, except those secured by real estate above)		786	088	87
6. Loans to individuals for household, family, and other personal expenditures (*exclude* business loans, loans to farmers, and loans secured by real estate above; include purchased paper):	xxx	xxx	xxx	xx
(a) To purchase private passenger automobiles on instalment basis	2	386	517	17
(b) Credit cards and related plans: (1) Retail (charge account) credit card plans		12	326	57
(2) Check credit and revolving credit plans		NONE		
(c) To purchase other retail consumer goods on instalment basis:	xxx	xxx	xxx	xx
(1) Mobile homes, not including travel trailers		594	676	25
(2) Other retail consumer goods		307	497	17
(d) Instalment loans to repair and modernize residential property		94	288	94
(e) Other instalment loans for household, family, and other personal expenditures		637	440	12
(f) Single-payment loans for household, family, and other personal expenditures		865	598	76
7. All other loans (incl. overdrafts) (To churches, hospitals, charitable or educational institutions, etc., not secured by real estate above)		289	670	37
8. TOTAL LOANS AND DISCOUNTS (items 1 to 7) (must agree with item 8 of "Assets")	10	306	670	37

SCHEDULE D—CASH, BALANCES WITH OTHER BANKS, AND CASH ITEMS IN PROCESS OF COLLECTION				
1. Cash items in process of collection and unposted debits drawn on the reporting bank		594	481	23
2. Demand balances with banks in the U.S.		715	668	85
3. Other balances with banks in the United States (including all balances with American branches of foreign banks)	1	005	000	00
4. Balances with banks in foreign countries (including balances with foreign branches of other American banks)		NONE		
5. Currency and coin		518	175	95
6. Reserve with Federal Reserve Bank (banks members F. R. System only)		NONE		
7. TOTAL of items 1 to 6 (must agree with item 1 of "Assets")	2	833	326	03

SCHEDULE E--DEMAND DEPOSITS

1. Deposits of mutual savings banks		NONE		
2. Deposits of other individuals, partnerships, and corporations	5	594	346	96
3. Total of items 1 and 2 (must agree with item 15 of "Liabilities")	5	594	346	96
4. Deposits of United States Government		481	218	10
5. Deposits of States and political subdivisions	1	696	386	51
6. Deposits of foreign governments and official institutions, central banks and international institutions		NONE		
7. Deposits of commercial banks in the U.S.		NONE		
8. Deposits of banks in foreign countries (including balances of foreign branches of other American banks)		NONE		
9. Certified and officers' checks, travelers' checks, letters of credit, etc. (must agree with item 21 of "Liabilities")		147	031	70
10. TOTAL DEMAND DEPOSITS (items 3 to 9) (must agree with item 22(a) of "Liabilities")	7	918	983	27

SCHEDULE F--TIME AND SAVINGS DEPOSITS

1. Savings deposits	5	449	419	04
2. Deposits accumulated for payment of personal loans		NONE		
3. Deposits of mutual savings banks		NONE		
4. Other time deposits of individuals, partnerships, and corporations	4	769	779	97
5. Total of items 1 to 4 (must agree with item 16 of "Liabilities")	10	219	199	01
6. Deposits of United States Government		NONE		
7. Deposits of States and political subdivisions		625	544	98
8. Deposits of foreign governments and official institutions, central banks and international institutions		NONE		
9. Deposits of commercial banks in the United States		NONE		
10. Deposits of banks in foreign countries (including balances of foreign branches of other American banks)		NONE		
11. TOTAL TIME AND SAVINGS DEPOSITS (items 5 to 10) (must agree with item 22(b) of "Liabilities")	10	844	743	99

SCHEDULE OF OTHER ASSETS

1. Securities borrowed	$	NONE	
2. Income earned or accrued but not collected		NONE	
3. Insurance and other expenses prepaid		NONE	
4. Cash items not in process of collection	11	622	55
5. All other (itemize):			
E Bonds		18	75
Auto & Promotional Assets	4	417	36
6. TOTAL (must agree with item 13 of "Assets")	16	058	66

SCHEDULE OF OTHER LIABILITIES

1. Securities borrowed	$	NONE		1
2. Dividends declared but not yet payable		NONE		2
3. Income collected but not earned	596	446	00	3
4. Expenses accrued and unpaid		NONE		4
5. Amounts due F. R. bank or other banks (transit account)		NONE		5
6. All other (itemize):		NONE		6
7. TOTAL (must agree with item 27 of "Liabs.")	596	446	00	7

EXHIBIT E

94TH CONGRESS
1ST SESSION

H. R. 1016

IN THE HOUSE OF REPRESENTATIVES

JANUARY 14, 1975

Mr. SEIBERLING introduced the following bill; which was referred to the Committee on Banking, Currency, and Housing

A BILL

To amend the Federal Deposit Insurance Act to terminate the insurance of any bank which fails to pay a certain rate of interest on all tax and loan accounts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Tax and Loan Account Interest Act of 1974".

SEC. 2. The second sentence of section 8 (a) of the Federal Deposit Insurance Act (12 U.S.C. 1818 (a)) is amended by inserting "or fails to pay interest (to the United States) at the Federal funds interest rate on all tax and loan accounts maintained at such bank," immediately before "the Board of Directors shall first give to the Comptroller of the Currency".

SEC. 3. The Secretary of the Treasury may enter into agreements with banks which render banking services to the Federal Government for charges to be made for the banking services which the bank performs on behalf of the Federal Government.

94TH CONGRESS
1ST SESSION

H. R. 1016

A BILL

To amend the Federal Deposit Insurance Act to terminate the insurance of any bank which fails to pay a certain rate of interest on all tax and loan accounts.

By Mr. SEIBERLING

JANUARY 14, 1975

Referred to the Committee on Banking, Currency, and Housing

EXHIBIT F

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

February 25, 1975

Mr. Frederick D. Delboy
107-2 Glacier Drive
Minot, North Dakota 58704

Dear Mr. Delboy:

I am pleased to respond to your recent letter requesting information to be used in the preparation of your dissertation.

I am enclosing copies of several Federal Reserve Bulletin reprints, as your letter requested. Unfortunately, much of the information you have asked for is not available; for example, we have no information relating to Board studies of cash flows of banks. However, the enclosed Report of Income of Commercial and Mutual Savings Banks may be useful to you.

Your letter also requested information relating to legislation enacted to impose restrictions on the profit margins of banks. There have never been any restrictions aimed at directly controlling the profit margins of banks, with the exception of the temporary influence of the Committee on Interest and Dividends (established as part of the Nixon Administration's economic stabilization plan). I am enclosing a copy of the statement of criteria established by this committee, which you may find of interest. However, existing Board regulations, such as Regulation D (reserve requirements of member banks and Regulation Q (interest rate ceilings on deposits) can affect a bank's general profit position.

I hope the enclosed material is helpful in your research.

Very truly yours,

Normand Bernard

Normand Bernard
Assistant Secretary of the Board

Enclosures

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