COMMERCIAL BANK FINANCING THROUGH THE USE OF CAPITAL NOTES

by 3735

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I. INTRODUCTION

One of the most significant forces to have come about in the commercial banking industry in recent years has been the large demand for new sources of funds. The most important of these sources has been time and savings deposits. Over this same time period the growth in the total amount of time deposits and savings deposits has exceeded the growth in total bank capital. Time deposit growth especially has increased at a faster rate than the amount of growth in total bank capital.

Commercial bank capital ratios have been coming down for a century and a half. The capital to total assets ratio has stayed below 10% for the last 20 years. Also, the ratio of capital to deposits has closely paralleled this trend. Accompanying the downward drift of bank capital ratios has been a steady evolutionary change in attitudes of bankers and supervisory officials alike. These attitudes have focused on the amount of capital that is necessary for safe and efficient banking.

The pronounced changes in the standards of capital adequacy over the past half century have reflected not only the shifts that have occurred in the structure of banks' assets, but also the changes in the economic and financial environment in which banks operate. The broad economic environment in which banks operate today has also been affected by the ever changing

monetary and fiscal policies. Through the use of more efficient monetary and fiscal policies, such as the establishment of the Federal Deposit Insurance Corporation (FDIC), today's banker has discovered that the relative amount of capital that is necessary for the safe and efficient operation of the banking system is far less than was considered necessary prior to the 1930's.

One of the subjects most likely to engage the attention of bankers in future years is the amount of bank capital that will be needed to support the expansion of bank credit and deposits in a growing economy. Parallel to this question, bankers must also ask the question of how such capital should be provided.

Capital funds have been necessary in a commercial bank for three types of needs--(1) to obtain a charter and begin operations, (2) to provide funds to sustain operations, and (3) to provide protection for creditors in case of liquidation. Technically, the funds represented by a bank's capital stock have not been available for protection of creditors except in liquidation.[1]

With lower capital adequacy, one has been faced with the problem of how to increase capital at a faster rate than is

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[1]Richard V. Cotter, "Capital Ratios and Capital Adequacy," The National Banking Review, Vol. 3, No. 3, (March, 1966), p. 344.