PUBLIC SERVICE COMPANY OF NEW MEXICO

Sale and Leaseback Transactions
with respect to
Palo Verde Nuclear Generating Station Unit 2
(Docket No. STN-529)

Financial Information
with respect to
Prospective Equity Investors
(Supplementing June 10, 1986 Submission)

July 29, 1986

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

8.7616

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1985 — Commission file number 1-1177

Beneficial Corporation

15E44

(Exact name of registrant as specified in its charter)

176

Delaware	51-0003820
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
Beneficial Building 1100 Carr Road, Wilmington, Delaware	19899
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code 302-798-0800

DISCLOSURE INCORPORATED PROCESSED BY RECEIVED APR 2 1986

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

Title of each class	Name of each exchange on which registered
8.35% Debentures, Due February 15, 1988	New York Stock Exchange, Inc.
9¾% Notes, Due June 15, 1990	New York Stock Exchange, Inc.
13⅛% Debentures, Due July 15, 1991 (Series A)	New York Stock Exchange, Inc.
12.50% Debentures, Due December 15, 1993	New York Stock Exchange, Inc.
12.45% Debentures, Due January 15, 1994	New York Stock Exchange, Inc.
7½% Debentures, Due November 1, 1996	New York Stock Exchange, Inc.
7½% Debentures, Due May 15, 1998	New York Stock Exchange, Inc.
7.45% Debentures, Due February 1, 2000	New York Stock Exchange, Inc.
8% Debentures Maturing at Holder's Option Annually on June 15 Commencing in 1983 and Due June 15, 2001	New York Stock Exchange, Inc.
7⅜% Debentures, Due July 15, 2002	New York Stock Exchange, Inc.
8.30% Debentures, Due June 1, 2003	New York Stock Exchange, Inc.
Floating Rate Notes Due August 1, 1987, Convertible Prior to August 1 1986 into 8⅝% Debentures, Due August 1, 2004	New York Stock Exchange, Inc.
11.50% Debentures Maturing at Holder's Option January 15, 1984 or at 9% thereafter and Due January 15, 2005	New York Stock Exchange, Inc.
8.40% Debentures, Due December 1, 2007	New York Stock Exchange, Inc.
8.40% Debentures Maturing at Holder's Option Annually on December 15, Commencing in 1986 and Due May 15, 2008	New York Stock Exchange, Inc.
12⅛% Debentures, Due August 1, 2013	New York Stock Exchange, Inc.
12¾% Debentures, Due October 1, 2013	New York Stock Exchange, Inc.
5% Cumulative Preferred Stock, $50 Par Value	New York Stock Exchange, Inc.
$5.50 Dividend Cumulative Convertible Preferred Stock, No Par Value (Convertible into 4.5 shares of Common)	New York Stock Exchange, Inc.
$4.50 Dividend Cumulative Preferred Stock, $100 Par Value	New York Stock Exchange, Inc.
$4.30 Dividend Cumulative Preferred Stock, No Par Value	New York Stock Exchange, Inc.
Common Stock, $1 Par Value	New York Stock Exchange, Inc.

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT: NONE.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months, and (2) has been subject to such filing requirements for the past 90 days.

Yes ✓ No

The aggregate market value of the voting stock of the registrant held by non-affiliates of the registrant was approximately $1,247,387,883 at March 3, 1986.

The number of shares outstanding of each of the registrant's classes of common stock at March 3, 1986 was 22,235,591 shares, Common Stock, $1 par value.

DOCUMENTS INCORPORATED BY REFERENCE

(1) Parts I and II incorporate by reference portions of the Beneficial Corporation 1985 Annual Report to Shareholders.

(2) Part III incorporates by reference portions of the Beneficial Corporation Proxy Statement dated March 25, 1986.

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PART I

Item 1. Business.

General

Beneficial Corporation (the "Company" or "Beneficial") was organized under the laws of the State of Delaware on May 9, 1929, through the consolidation of three companies which had been operated under the same management. The Company is a holding company, subsidiaries of which are engaged principally in the consumer loan, sales finance, bank credit card, and insurance businesses. The Company traces its origin to 1914 when its first consumer loan office was opened.

The Company had also been in the merchandising business, but in 1985 Beneficial sold its Merchandising Division, Western Auto Supply Company and Subsidiaries, to Wesray Capital Corporation. Including the repayment of all intercompany accounts, the Company received proceeds of $343.9 million, comprised largely of cash ($302.7 million) with the remainder in Western Auto preferred stock and a note. The transaction resulted in a loss on disposal of $7.4 million (after an income tax benefit of $4.3 million), $.34 a share. For additional information on discontinued operations, see Note 2 to the Financial Statements of Beneficial Corporation and Consolidated Subsidiaries in the Beneficial Corporation 1985 Annual Report to Shareholders (the "Annual Report"), which information is incorporated herein by reference.

In 1982 Beneficial sold First Texas Financial Corporation, a savings and loan subsidiary, to individual investors for $14.0 million in notes. The sale resulted in a loss on disposal, after tax benefits, of $78.5 million or $3.51 per share.

For information concerning various factors that affected the Company's operations during 1985, see the information on pages 31, 33, and 35 of the Annual Report set forth under the captions "Management's Discussion and Analysis of Financial Condition," "Management's Discussion and Analysis of Results of Operations," and "Management's Discussion and Analysis of Changes in Financial Position" relating to Beneficial Corporation and Consolidated Subsidiaries, which information is incorporated herein by reference.

For information concerning supplemental quarterly data for the Company during 1985 and 1984, see page 47 of the Annual Report set forth under the caption "Data by Calendar Quarter," relating to Beneficial Corporation and Consolidated Subsidiaries, which information is incorporated herein by reference.

Segment Information

The Company's principal operations are comprised of the Consumer Finance Group and the Insurance Group. Intergroup eliminations are not material. For the past three years the Company had roughly 8,000 employees in the loan and finance and insurance operations of its subsidiaries. General descriptions of the Consumer Finance Group and the Insurance Group operations begin on pages 2 and 7. Information relating to these segments is also shown on pages 44 and 45 of the Annual Report, which information is incorporated herein by reference.

The relative contributions to income from continuing operations by the Consumer Finance Group and the Insurance Group are indicated in the following table. Administrative expenses and interest related to general corporate activities have not been allocated to Consumer Finance Group and Insurance Group segments as these costs are common expenses not applicable to a particular group.

	Years Ended December 31 (millions)				
	1985	1984	1983	1982	1981
Consumer Finance Group	$118.4	$111.7	$ 96.1	$ 64.2	$ 16.8
Insurance Group	5.0	1.9	18.2	22.2	50.3
Corporate Expenses	(23.5)	(23.9)	(24.2)	(20.7)	(12.9)
Income From Continuing Operations	$ 99.9	$ 89.7	$ 90.1	$ 65.7	$ 54.7

Operations

Consumer Finance Group

The Consumer Finance Group is comprised principally of subsidiaries engaged in the consumer loan, sales finance, and bank credit card businesses. The following table shows the composition of the Group's portfolio:

	Principal of Finance Receivables December 31 (millions)				
	1985	1984	1983	1982	1981
Real Estate Secured Loans	$3,127	$2,909	$2,704	$2,180	$2,035
Personal Unsecured Loans	1,361	1,209	1,257	1,411	1,832
Bank Credit Card Receivables	1,052	749	472	220	106
Sales Finance Contracts	417	311	218	184	241
Leasing and Commercial Finance Receivables	163	190	233	261	232
Total	$6,120	$5,368	$4,884	$4,256	$4,446

Consumer Loan Business

The Company's consumer loan subsidiaries operate through a loan office network spanning the United States, Canada, the United Kingdom and West Germany. In addition to making consumer loans, the loan office network purchases sales finance contracts and sells certain insurance products. The Company has reduced the number of offices in the network over the past five years as indicated by the following table:

	Number of Offices December 31				
	1985	1984	1983	1982	1981
United States	943	973	1,068	1,152	1,461
Canada	107	102	102	112	137
Other Foreign	68	80	177	180	195
Total	1,118	1,155	1,347	1,444	1,793

In 1981 the Company began to refine the concentration of its offices to locations offering better profit opportunities and attractive regulatory and economic environments by merging or selling offices. In keeping with this goal, operations in New Zealand and Ireland were sold in 1985, and operations in Australia and Japan were sold in 1981.

Loans are made upon promissory notes signed by borrowers subsequent to a thorough credit evaluation and a favorable evaluation as to the borrowers' willingness and ability to repay. The following table shows loans made, including loans made to customers with existing balances, and notes purchased:

	Loans Made and Notes Purchased (After Deducting Unearned Finance Charges)*						Total at End of Period*	
	Number**		Amount**		Average Amount**			
Period	Loans Made	Notes Purchased	Loans Made	Notes Purchased	Loans Made	Notes Purchased	Number	Principal of Finance Receivables
	(Thousands)		(Millions)		(Dollars)		(Thousands)	(Millions)
1985	599	544	$2,394.9	$470.3	$3,998	$865	1,555	$4,905
1984	602	510	2,136.8	417.4	3,550	818	1,505	4,429
1983	624	417	2,405.3	285.1	3,855	684	1,489	4,179
1982	533	300	1,524.7	194.7	2,861	650	1,662	3,775
1981	876	504	2,216.1	280.7	2,530	557	2,227	4,108

*Excluding credit card receivables and lease and commercial finance receivables.

**Amounts do not include bulk purchases of receivables totaling $202.4 million, $246.9 million, $168.4 million, $79.6 million and $172.5 million during 1985, 1984, 1983, 1982 and 1981.

In 1982 new lending operations were effectively ceased in states lacking reasonable profit potential. Also, throughout 1982, loan demand remained relatively weak. The increased number of loans made and notes purchased in 1983 stemmed from improved economic conditions, which increased demand for real estate secured loans. In 1984 intense rate competition for real estate secured loans was primarily responsible for the decline in loans made. However, as a result of favorable 1984 changes in the bankruptcy laws, a strong economy and changes in strategy, the Company renewed its commitment to its personal unsecured loan and sales finance markets, and 1985 reflects the first gain in personal unsecured loans since 1979. In 1985 the average amount of loans made increased as the Company's revolving real estate secured loan product achieved good acceptance in the marketplace. Revolving loans, both secured by real estate and unsecured, involve establishing a pre-approved line of credit accessible through checks issued to the consumer. Revolving loan programs are now being conducted in 38 states in the United States and in the United Kingdom. Total revolving receivables at December 31, 1985, 1984 and 1983 were $1,206.9 million, $682.2 million and $408.3 million of which 75.3%, 74.2% and 79.4% were secured by real estate.

The weighted-dollar average maturities of loan contracts written for 1985, 1984, 1983, 1982 and 1981, expressed in months, was 79.0, 74.7, 78.9, 56.0 and 68.6. Maturities decreased in 1982 reflecting a reduction in the maximum term on real estate secured loans from 180 months to 120 months during the latter part of 1981. During the latter part of 1982 and continuing through 1985, the Company made real estate secured loans with maximum terms of 180 months.

The following table shows the distribution by size of loans made:

	Principal Amount of Loans Made in Each Size Class as Percent of Total Principal Amount				
	Years Ended December 31				
	1985	1984	1983	1982	1981
Under $1,000	3.6%	4.3%	4.0%	4.8%	8.8%
1,000- 2,000	13.4	14.8	13.2	21.3	19.1
2,001- 3,000	15.0	14.8	12.1	15.8	14.7
3,001- 5,000	14.3	14.4	10.6	11.7	10.3
5,001-10,000	7.5	7.8	7.9	10.0	10.1
10,001-20,000	11.1	12.2	15.8	15.1	15.3
20,001-30,000	9.9	9.7	13.3	9.6	10.0
Over 30,000	25.2	22.0	23.1	11.7	11.7

The following table shows collection experience with respect to consumer receivables. Experience of the subsidiaries indicates that the borrower who qualifies for additional credit typically obtains a new loan (generally in an amount larger than his existing balance) and simultaneously refinances the balance of the existing loan. Of the approximately 600,000 loans made during the year, 43% were made to borrowers requiring additional funds at times when balances remained unpaid on their existing loans. Amounts shown do not include old balances refinanced through new loans:

	Cash Principal Collections		Average Monthly Cash Principal Collections as % of Average Receivables
Period	During the Year	Average per Month	
	(millions)		
1985	$2,093.1	$174.4	3.70%
1984	1,777.5	148.1	3.21
1983	1,792.7	149.4	3.63
1982	1,706.8	142.2	3.41
1981	1,915.8	159.7	3.75

The 1985 increase in average monthly cash principal collections as a percentage of average receivables was due to a larger amount of prepayments of higher-rate, closed-end real estate secured loans. The 1984 decrease reflects a reduction in prepayments and the increasing amount of longer-term real estate loans in the portfolio. The 1983 increase was due to prepayments of higher-rate real estate loans and sharply lower delinquency. The decrease in 1982 was caused principally by a greater proportion of larger loans with longer maturities.

The average annual rate of charge collected by subsidiaries on loan balances (real estate secured and personal unsecured) outstanding was 19.63%, 20.04%, 21.36%, 21.48% and 21.12% for 1985, 1984, 1983, 1982 and 1981. The decline in 1985 was due to a decrease in the rate of charge for real estate secured loans, particularly revolving variable-rate loans, which currently bear a lower interest rate than fixed-rate products. The decrease in 1984 from the prior year was a result of a greater percentage of lower-yielding real estate loans and lower rates of charge for both real estate secured loans and personal unsecured loans.

Real estate secured second mortgage loans are supervised under and regulated by state legislation. Such legislation generally requires that the lender be licensed and the interest rate be limited. Some states do not limit rate, but rate can be a competitive factor whether rate is limited or not. While the statutes of several states place no maximum limit on the period of loans, the Company generally limits its loans of this type to periods ranging from 60 to 180 months. Before second mortgage loans are made, independent appraisals are conducted. The Company's current policy provides that the total of the outstanding first and second mortgages generally shall not exceed 75% of the market value of the property. The average size of real estate loans made in 1985 was $22,133.

The consumer finance subsidiaries of the Company also operate under consumer finance acts (small loan statutes), which typically require that the lender be licensed, the loan not exceed a 60-month term and the interest rate be limited according to the size of the loan. Licenses to make consumer loans are subject to revocation for cause. Generally, loans under the consumer finance acts are made at the maximum rates allowable. Variations in these statutes occur from state to state. Typically, maximum rates are established for different portions of the loan, with progressively lower maximum rates on the higher portions. Consumer finance laws are subject to repeal and revision from time to time. The trend of consumer finance legislation in recent years has been either toward deregulating interest rates on such loans or increasing the rate, maximum size and term permitted. The Company also makes non-real estate secured instalment loans under statutes other than consumer finance acts. The average personal unsecured loan made in 1985 was $2,072.

The Company's consumer finance subsidiaries are required to comply with the Federal Equal Credit Opportunity Act, which prohibits discrimination in any aspect of a credit transaction on the basis of sex, marital status, race, color, religion, national origin, age, receipt of income from a public assistance program or the good faith exercise of rights under the Federal Consumer Credit Protection Act. In addition, the Federal Truth-in-Lending Act, as amended, requires, among other things, disclosure of pertinent elements of consumer credit transactions, including the finance charges and the comparative costs of credit expressed as the annual percentage rate.

Sales Finance Business

Many of Beneficial's subsidiaries also engage in the sales finance business. This business ranges from the purchase from dealers of instalment notes arising from the retail sale of personal computers, appliances and other goods or services to the issuance of private label revolving charge accounts. This business has been an important source of new customers for the consumer loan business, and during 1985 approximately 35% of new loan customers were developed by extending the customer relationship that began with a sales finance contract. Generally, notes are purchased only when the down payments by, and credit of, the makers of the notes appear satisfactory. The notes are repayable in instalments

over periods averaging 32 months. Subsidiaries purchasing the notes often withhold a portion of the purchase price as a reserve and/or obtain full or limited guarantees or repurchase agreements from dealers. In 1984 the Company expanded the offering of private label revolving charge accounts to computer, furniture, appliance and home improvement stores. In 1985 the Company offered additional merchant services including credit authorization via a toll-free number, on-line credit applications and statistical information.

Bank Credit Card Business

Beneficial National Bank USA, a subsidiary, provides financial services deliverable without in-person contact, principally through the issuance of Visa and MasterCard credit cards. At the end of 1985, about 60% of the bank credit card outstandings were premium card accounts carrying a variable-rate of interest floating 4 percentage points above the prime rate, subject to a minimum of 18.96%. Rates of charge on the standard credit card business range from 18%-21%. During 1985, 1984, 1983 and 1982, Beneficial National Bank USA acquired portfolios from other financial institutions totaling $292 million, $14 million, $24 million and $40 million.

	At End of Year		
	Number of Accounts (Thousands)	Average Balance (Dollars)	Principal of Credit Card Receivables (Millions)
1985	960	$1,036	$1,052
1984	769	1,222	749
1983	601	1,164	472
1982	405	879	220

The following table shows the collection experience with respect to credit card receivables:

Period	Cash Principal Collections During the Year (millions)	Cash Principal Collections Average per Month (millions)	Average Monthly Cash Principal Collections as % of Average Receivables
1985	$950.3	$79.2	10.36%
1984	751.1	62.6	10.47
1983	451.6	37.6	11.97
1982	160.4	13.4	12.36

Geographic Distribution

At December 31, 1985, finance receivables in each of the ten jurisdictions with the highest percentages were as follows:

Jurisdiction	Percent of Total Receivables
California	30.6%
Pennsylvania	6.4
New York	6.3
Texas	5.4
Ohio	5.1
Canada	4.4
Florida	3.6
New Jersey	3.2
United Kingdom	2.8
North Carolina	1.6

Finance receivables in the United States constituted 91.6% of total finance receivables at December 31, 1985. The ten states with the largest outstanding receivables collectively represented 65.2% of the U.S. total.

Foreign finance receivables by country are shown below:

	December 31 1985	1984	1983	1982	1981
	(millions)				
Canada	$270.4	$285.1	$277.7	$204.7	$231.1
United Kingdom	169.9	123.4	129.2	120.2	118.3
West Germany	74.7	54.9	59.7	63.8	64.0
Australia	–	–	209.5	206.5	234.6
New Zealand	–	23.8	27.4	18.2	14.5
Japan	–	–	13.5	12.4	14.3
Ireland	–	7.1	5.7	5.6	2.0
Total	$515.0	$494.3	$722.7	$631.5	$678.8
Percentage of Total Receivables	8.4%	9.2%	14.8%	14.8%	15.3%

The increases in finance receivables, as denominated in U.S. dollars, in the United Kingdom and West Germany in 1985 over 1984 were due principally to the weakening of the U.S. dollar versus the respective foreign currencies. Had the exchange rates remained unchanged from year to year, foreign finance receivables would have been $30 million lower at December 31, 1985. In 1984 receivables were adversely impacted by the strength of the U.S. dollar. Had the rates remained unchanged, the receivables would have been $67 million higher. For additional information on foreign operations, see Notes 6, 8, 11, 13 and 15 to the Financial Statements of Beneficial Corporation and Consolidated Subsidiaries incorporated herein by reference to the Annual Report.

Loss Experience and Delinquent Receivables

Chargeoffs and delinquencies generally increase during periods of adverse economic conditions, such as rising unemployment and increased inflationary pressures, which affect the ability of the borrower to repay. During such periods the Company has tightened its lending policies by instituting more stringent credit standards and has intensified its collection efforts. It is the policy of the Company generally not to renew delinquent accounts.

Receivables considered to be uncollectible or to require disproportionate collection costs are charged to the reserve for credit losses, but collection efforts are generally continued. In addition to the reserve for credit losses, the balance in dealer reserves related to sales finance receivables at December 31, 1985 was $16.3 million. Certain data regarding loss experience and delinquency of finance receivables were as follows:

	Finance Receivables Charged Off (a)			Reserve for Credit Losses at End of Year		Delinquency	
Year	Gross Amount of Receivables Charged Off	Net Chargeoffs	% of Average Gross Finance Receivables	Amount	% of Finance Receivables at End of Year(b)	Consumer Loan Receivables' More Than Two Months Delinquent(c)	Bank Credit Card Receivables More Than Two Months Delinquent(d)
				(millions)			
1985	$105.0	$ 77.3	1.31%	$234.4	3.83%	0.75%	1.36%
1984	90.3	70.4	1.27	212.4	3.96	0.74	1.28
1983	106.1	83.6	1.73	205.4	4.21	0.97	1.10
1982	130.4	114.3	2.45	188.3	4.42	1.37	1.40
1981	120.0	106.6	2.17	196.5	4.42	1.62	—

(a) Less offsetting recoveries.
(b) After deducting unearned finance charges.
(c) Recency basis. Includes real estate secured loans and personal unsecured loans.
(d) Contractual basis. Prior to 1982, bank credit card receivables were not a significant part of the receivable portfolio.

In 1985, chargeoffs as a percentage of average receivables were up slightly from 1984 due primarily to upward delinquency trends in the credit card segment. The Company has accelerated chargeoffs and has tightened credit standards and intensified collection efforts to counter this trend, which is experienced by the entire credit card industry.

Competition

In the consumer finance industry Beneficial faces strong competition from banks, credit unions, finance companies and other financial institutions. Rate competition among finance companies is minimal for small consumer loans made under state loan statutes which regulate interest rates, and the Company competes for these loans primarily on the basis of name recognition, service, and reputation. There is considerable rate competition within the second mortgage loan market and in those states where interest rates on small loans have been deregulated.

According to a tabulation made by the *American Banker* of the relative size of the 100 largest finance companies in the United States based on capital funds, the Company ranked eleventh as of December 31, 1984.

The Federal Reserve Board estimated instalment credit outstanding in the United States as of the end of each of the five years ended December 31, 1985 as follows:

	1985		1984		1983		1982		1981	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
					(millions)					
Commercial Banks	$246,898	43.3%	$212,391	44.5%	$177,252	45.7%	$150,643	43.9%	$146,792	44.1%
Finance Companies	150,477	26.4	112,548	23.6	97,683	25.2	94,322	27.4	89,218	26.8
Credit Unions	78,656	13.8	67,858	14.2	53,471	13.8	47,253	13.8	45,954	13.8
Retailers	38,926	6.8	39,873	8.4	33,183	8.6	30,202	8.8	30,717	9.2
Savings and Loans	41,366	7.2	31,905	6.7	18,568	4.8	13,891	4.0	11,598	3.5
Gasoline Companies	4,378	0.8	4,108	0.9	4,131	1.0	4,063	1.2	3,433	1.0
Mutual Savings Banks	9,971	1.7	8,331	1.7	3,634	0.9	2,998	0.9	2,751	0.8
Total	$570,672	100.0%	$477,014	100.0%	$387,922	100.0%	$343,372	100.0%	$333,063	100.0%

Beneficial is classified as a finance company in the above table. The amounts of Beneficial's total consumer instalment credit outstanding in the United States were as follows:

December 31,				
1985	1984	1983	1982	1981
		(millions)		
$5,442	$4,684	$3,928	$3,364	$3,535

The business of Beneficial, and of finance companies in general, is affected by inflation with its attendant increased costs, unemployment, and strong competition from banks, credit unions and others. In addition, such business may be adversely affected in the future by other unforeseen factors such as war or extensive conscription, rate reductions, credit restrictions, judicial decisions or legislative acts.

Insurance Group

Beneficial's Insurance Group is engaged primarily in writing credit life, credit accident and health, property and casualty insurance and annuities. As part of the service extended to borrowers, Beneficial's Insurance Group offers credit life insurance, credit accident and health insurance, all risk property insurance and extended coverage. Credit life insurance insures the life of the borrower, generally in an amount equal to the unpaid receivable balance. At December 31, 1985, the Consumer

Finance Group's gross receivables covered by credit life insurance totaled $2,308.5 million and those covered by credit accident and health insurance totaled $774.8 million, with $2,314.3 million of credit life insurance and $742.6 million of credit accident and health insurance insured or reinsured by wholly-owned subsidiaries. At December 31, 1984, such amounts were $2,312.3 million, $807.3 million, $2,240.6 million, and $765.7 million.

The mix of the business of the Insurance Group is indicated by the following table:

	Years Ended December 31,				
	1985	1984	1983	1982	1981
	(millions)				
Premium Revenue					
Annuities					
Non-Beneficial	$466.4	$347.9	$249.8	$195.8	$200.3
Life					
Beneficial	29.7	25.8	23.5	29.4	31.2
Non-Beneficial	55.7	12.6	94.6	58.8	51.0
Accident & Health					
Beneficial	17.7	18.1	21.1	20.0	25.8
Non-Beneficial	42.0	27.5	22.9	29.7	43.7
Property & Casualty					
Beneficial	22.3	20.7	21.8	21.8	32.5
Non-Beneficial	77.5	112.5	67.1	90.9	70.7
Total Premium Revenue	$711.3	$565.1	$500.8	$446.4	$455.2

The decrease in life premium revenue related to non-Beneficial business in 1984 is attributable to the termination of a large life reinsurance contract.

In 1985 approximately 90% of Insurance Group premium revenue came from sources other than the Consumer Finance Group, up from 89% and 87% in 1984 and 1983. While the proportion of premium revenue derived from the Consumer Finance Group is declining, such business continues to contribute significant profits to the Insurance Group. The insurance subsidiaries also write credit life and credit accident and health insurance for numerous unrelated consumer lenders such as banks, finance companies and retailers. In addition, the insurance subsidiaries have been engaged in the writing of insurance and reinsurance of ordinary life insurance, annuities and many lines of property and casualty insurance, both domestic and foreign.

However, in early 1985, the Insurance Group exited the property and casualty reinsurance market. Only contractual commitments to renewal premium have been accepted since then. The total premium written during 1985 for all lines of business was $720.8 million as compared with $598.0 million in 1984 and $505.7 million in 1983. The increase in 1985 was largely due to a higher volume of annuity premiums. In 1984, the increase in written premium was due primarily to higher annuity and property and casualty writings offset in part by the termination of a large life reinsurance contract that reduced life premium revenue. The 1983 increase in written premium was due primarily to higher annuity and life writings offset somewhat by lower property and casualty writings.

Beneficial's insurance operations are subject to regulation and supervision under laws and regulations of various states. The extent of such regulation and supervision has steadily increased within the last few years. Among other things, these laws and regulations govern the premiums which may be charged and the types of insurance which may be written. There are established guidelines for payment of dividends, and, in certain states, the insurer's ability to merge or effect a change in control is limited without prior approval of the state's insurance commissioner.

Insurance Group income (after deducting interest expense related to Beneficial's investment in the Insurance Group) is shown in the following table:

	Years Ended December 31				
	1985	1984	1983	1982	1981
			(millions)		
Net Income	$5.0	$1.9	$18.2	$22.2	$50.8

Beginning in 1982, the Insurance Group's net income began a downward slide as a result of problems in its property and casualty reinsurance business. In 1982, $30 million in reserves were provided by the Insurance Group, comprised of $19 million related to general reserve strengthening across the whole book of property and casualty business and $11 million established for insolvencies of companies that reinsure Beneficial. Earnings in 1983, 1984 and 1985 continued to suffer as a result of adverse loss development that necessitated further reserve strengthening. In addition, continued problems with reinsurers in poor financial condition required writeoffs and reserve provisions totaling $16 million in 1985, $15 million in 1984 and $3 million in 1983. To contain this problem, contracts of the managing general agents (MGA's) who generated the troubled property and casualty reinsurance writings were terminated, starting in 1983, as they came up for renewal. However, a significant amount of premium was generated in 1984 and 1985 as a result of the reporting lags inherent in this method of operation, delayed termination provisions in certain MGA contracts, and multi-year renewal provisions in the policies. Pre-tax income from the Insurance Group decreased from a profit of $15.9 million in 1983 to a loss of $49.5 million in 1984. The pre-tax loss in 1984 was mitigated by the effect of changes in the tax law for life insurance companies, commonly referred to as "fresh start" adjustment. These changes resulted in a tax benefit of $14.0 million. In addition, also in 1984, the amount of foreign income subject to taxes was reduced resulting in additional tax savings of $6.4 million.

1985 was a transitional year for the Insurance Group as net income improved modestly to $5.0 million. The Group made strides towards solving the problems of the property and casualty reinsurance operation by terminating all remaining contracts with MGA's producing this business and not accepting any new property and casualty reinsurance premiums from all sources. Also, in recognition of continued severe losses in the reinsurance industry, the Insurance Group executed a combination of reinsurance transactions and direct strengthening of loss reserves. The Insurance Group's net after-tax losses from property and casualty reinsurance were $39.0 million in 1985, reduced from 1984's $54.2 million.

Also in 1983, Insurance Group results were adversely impacted by the run-off of Beneficial's unsecured receivables (which generate higher insurance penetration than real estate secured loans) and by continuing high loss ratios in property and casualty reinsurance lines.

In addition in 1982, Insurance Group net income was depressed as a result of lower premium revenue. Premium revenue on Beneficial-related business declined due to the run-off of receivables and low insurance penetration on the real estate secured loans. The decline in premium revenue for non-Beneficial business resulted from lower insurance penetration in unaffiliated credit insurance business.

The Insurance Group has a modest investment in real estate development activities. For additional information see Note 16 to the Financial Statements of Beneficial Corporation and Consolidated Subsidiaries incorporated herein by reference to the Annual Report.

The proportionate distribution of the Insurance Group's investment portfolio, exclusive of investment in consumer finance subsidiaries, was as follows:

	December 31, 1985	December 31, 1984	December 31, 1983
U.S. Government Obligations	18.4%	24.4%	22.0%
Municipal Bonds	17.4	22.8	28.5
Foreign Government Obligations	1.6	2.8	3.8
Corporate Bonds	42.3	26.3	18.1
Preferred Stocks	3.1	3.6	5.0
Common Stocks	1.0	4.9	5.4
Policy Loans	1.4	1.3	1.4
Mortgages	11.4	13.1	12.3
Real Estate	1.6	0.6	0.8
Short-Term Holdings*	1.8	0.2	2.7
	100.0%	100.0%	100.0%
Total Investment Portfolio (in millions)	$1,988.1	$1,480.9	$1,098.2
Net Investment Income (in millions)**	$ 193.3	$ 142.1	$ 101.2

*Principally commercial paper.
**Investment income, excluding realized net investment gain, less investment expense.

Financing

The Company and its consolidated subsidiaries obtain funds both in the United States and abroad through the sale of long-term debt securities, from the sale of commercial paper and through short-term borrowings on unsecured lines of credit from banks. At December 31, 1985, long-term debt aggregated $3,921.1 million and short-term borrowings totaled $1,249.9 million (consisting of $1,054.9 million of commercial paper and $195.0 million of bank borrowings). At December 31, 1985, 110 foreign and domestic bank and revolving lines of credit were maintained amounting to $1,382.5 million of which $1,183.9 million was unused. The lines of credit are used to support the Company's commercial paper borrowings. Such lines of credit are generally reviewed annually by the banks, with the exception of $568 million which is in the form of committed two-year revolving credit facilities. During 1984 the Company renegotiated the fee structure for maintaining its credit lines, providing for a fee of 1/4% per annum on its domestic lines of credit and eliminating compensating balance requirements. The overall, weighted-average annual interest cost (after giving effect to bank compensating balances and commitment fees on commercial paper back-up lines of credit) of all short and long-term borrowings of the Company and consolidated subsidiaries was 10.19%, 10.73%, 10.16%, 10.88% and 11.53% in 1985, 1984, 1983, 1982 and 1981. See Notes 6 and 8 to the Financial Statements of Beneficial Corporation and Consolidated Subsidiaries, incorporated herein by reference to the Annual Report, for additional information on short and long-term debt.

Item 2. Properties.

Corporate headquarters in New Castle County, Delaware, are owned by the Company.

Substantially all the other property utilized by Beneficial and its subsidiaries is held under leases. Information as to minimum annual rent on leased property and periods of expiration is contained in Note 14 to the Financial Statements of Beneficial Corporation and Consolidated Subsidiaries and incorporated herein by reference to the Annual Report.

Item 3. Legal Proceedings.

There is no litigation pending which management and counsel for the Company consider to be material.

Item 4. Submission of Matters to a Vote of Security Holders.

Not applicable.

Executive Officers of the Registrant

Name	Age	Position and Offices Held as of March 15, 1986
Finn M. W. Caspersen....	44	Director (1975 to present), Chairman of the Board of Directors, Chief Executive Officer and Chairman of Executive Committee (1976 to present), Member of Executive Committee (1975 to present), Member of Finance Committee (1975 to present), Member (1980 to present), and Chairman (1980 to 1982) of Committee on Strategic Planning and Evaluation of the Company.
Gerald L. Holm	47	Director (1979 to present), Vice Chairman of the Board of Directors (1986 to present) and First Vice Chairman (1984 to 1985), Vice Chairman (1982 to 1984), Second Vice Chairman of the Board of Directors (1981 to 1982), Member of Executive Committee (1982 to present), Member of the Committee on Strategic Planning and Evaluation (1981 to present), and Member of the Finance Committee (1982 to present) of the Company; Executive Vice President (1979 to 1981), Member of Executive Committee (1978 to 1984) of Beneficial Management Corporation, a subsidiary of the Company.
Andrew C. Halvorsen.....	39	Director (1984 to present), Member of Office of the President, Chief Financial Officer (1986 to present), Second Vice Chairman of the Board of Directors (1984 to 1985), Member of Executive and Finance Committees and Committee on Strategic Planning and Evaluation (1984 to present), Senior Vice President - Finance (1982 to 1984), Assistant to Chairman of the Board of Directors (1978 to 1982) of the Company.

Name	Age	Position and Offices Held as of March 15, 1986
David J. Farris..........	50	Director (1982 to present), President and Chief Executive Officer (1982 to present), Executive Vice President (1979 to 1982) of Beneficial Management Corporation, a subsidiary of the Company; Member of Office of the President (1984 to present), Member of Executive Committee and Committee on Strategic Planning and Evaluation (1983 to present), Member of Management Development and Marketing Committee (1984 to present) of the Company.
James H. Gilliam, Jr.......	40	Director (1984 to present), Senior Vice President and General Counsel (1986 to present), Senior Vice President - Legal (1982 to 1985), Vice President - Legal (1979 to 1982), Member of Management Development and Marketing Committee (1984 to present) of the Company.
William H. H. Ely, Jr.......	42	Senior Vice President and Treasurer (1984 to present), Vice President and Treasurer (1983 to 1984), Vice President (1982 to 1984) of the Company; Assistant Vice President (1980 to 1982), of Beneficial Management Corporation, a subsidiary of the Company.
William A. Gross..........	57	Senior Vice President-Audit (1984 to present), Senior Vice President (1974 to 1984) of the Company.
Robert R. Meyer..........	49	Senior Vice President (1983 to present) and Controller (1982 to present), Vice President (1982 to 1983), Assistant Vice President (1980 to 1981) and Assistant Controller (1979 to 1981) of the Company; Vice President and Corporate Controller (1981) of Beneficial Management Corporation, a subsidiary of the Company.
Bruce A. Obiter..........	35	Senior Vice President-Tax (1984 to present), Vice President-Federal Taxes (1982 to 1984), Assistant Vice President (1979 to 1982), Associate Tax Counsel (1977 to 1981) of the Company.
Mark A. Peterson..........	44	Senior Vice President - Human Resources (1985 to present) of the Company; Senior Vice President (1981 to 1985) of Metropolitan Life Insurance Company.
Maryann W. Schneider	39	Senior Vice President - Corporate Strategy and Planning (1986 to present) of the Company; Director of Corporate Planning, Marine Midland Bank (1984 to 1986); Vice President of Strategic Services (1979 to 1984) Manufacturers Hanover Trust Co.
Kenneth J. Kircher	55	Vice President and Secretary (1978 to present) of the Company.
William V. Krause	43	Vice President (1982 to present), Director of Financial Projects (1977 to 1982) of the Company.
Ann Stephenson..........	39	Vice President-Public Affairs (1983 to present) of the Company, Manager of Public Affairs, First Interstate Bank of California (1980-1983).

Name	Age	Position and Offices Held as of March 15, 1986
Richard F. White........	57	Vice President-Field Audit (1985 to present) of the Company. Vice President-Field Audit (1983 to 1985), Assistant Vice President-Field Audit (1982 to 1983), Assistant Vice President-Business Development (1981 to 1982) of Beneficial Management Corporation, a subsidiary of the Company.

There are no family relationships between any of the executive officers of the Company. Officers named hold office until the next Annual Meeting of the Board of Directors, to be held May 5-7, 1986, or until their successors are otherwise elected as provided in the By-Laws.

PART II

Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters.

Information regarding Beneficial Common Stock set forth under the caption "Beneficial Corporation and Consolidated Subsidiaries, Data by Calendar Quarter–Common Stock" appearing on page 47 of the Annual Report is incorporated herein by reference. As of March 3, 1986, Beneficial Common Stock was held of record by 23,332 stockholders. The principal market on which Beneficial Common Stock is traded is the New York Stock Exchange. The information regarding restrictions on payment of dividends set forth in *Note 8 of the Notes to Financial Statements,* of Beneficial Corporation and Consolidated Subsidiaries appearing on page 39 of the Annual Report is incorporated herein by reference.

Item 6. Selected Financial Data.

The information set forth under the caption "Beneficial Corporation and Consolidated Subsidiaries, Eleven-Year Summary" appearing on pages 48 and 49 of the Annual Report is incorporated herein by reference.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The information set forth under the captions "Management's Discussion and Analysis of Financial Condition," "Management's Discussion and Analysis of Results of Operations," and "Management's Discussion and Analysis of Changes in Financial Position" relating to Beneficial Corporation and Consolidated Subsidiaries appearing on pages 31, 33 and 35 of the Annual Report is incorporated herein by reference.

Item 8. Financial Statements and Supplementary Data.

The Financial Statements appearing on pages 30 through 49 of the Annual Report are incorporated herein by reference.

Item 9. Disagreements on Accounting and Financial Disclosure.

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant.

The information set forth under the caption "Election of Directors" appearing on pages 1 through 5 of Beneficial's Proxy Statement dated March 25, 1986, is incorporated herein by reference. Information relating to executive officers of Beneficial set forth under the caption "Executive Officers of the Registrant" appearing on pages 11 through 13 of this report is incorporated by reference.

Item 11. Executive Compensation.

The information set forth under the captions "Executive Compensation" and "Compensation Plans and Arrangements" appearing on pages 7 through 13 of Beneficial's Proxy Statement dated March 25, 1986 is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The information with respect to the ownership of equity securities of Beneficial by Beneficial's directors and its directors and officers as a group set forth under the caption "Election of Directors" appearing on pages 4 and 5 of Beneficial's Proxy Statement dated March 25, 1986 is incorporated herein by reference. In addition, the information set forth under the caption "Principal Stockholders" appearing on page 6 of such Proxy Statement is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions.

The information set forth under the captions "Election of Directors" appearing on page 3 and "Compensation Plans and Arrangements" appearing on page 13 of Beneficial's Proxy Statement dated March 25, 1986 is incorporated herein by reference.

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.

(a) The following represents a listing of all financial statements, financial statement schedules, and exhibits filed as part of this report.

(1) Financial Statements

Included in Part II of this Report:

The following financial statements of Beneficial Corporation and Consolidated Subsidiaries and accountants' opinion are incorporated by reference to the Beneficial Corporation 1985 Annual Report to Shareholders.

Balance Sheet at December 31, 1985 and 1984.

Statement of Income and Retained Earnings for the three years ended December 31, 1985.

Statement of Changes in Financial Position for the three years ended December 31, 1985.

Notes to Financial Statements.

Beneficial Corporation and Consolidated Subsidiaries — Accountants' Opinion.

Supplemental Note to Financial Statements—Changes in Shares of Capital Stock.

(2) Financial Statement Schedules

Beneficial Corporation and Consolidated Subsidiaries.

I Marketable Securities.

VIII Valuation and Qualifying Accounts and Reserves.

(3) Exhibits

Exhibit Number	Exhibit
3.1	Copy of Beneficial's Restated Certificate of Incorporation, as amended, is incorporated by reference to Exhibit 3.1 of Beneficial's report on Form 10-K for the year ended December 31, 1983.
3.2	Copy of Beneficial's By-Laws, as amended.
4	The principal amount of debt outstanding under each instrument defining the rights of holders of long-term debt of Beneficial does not exceed 10% of the total assets of Beneficial and its subsidiaries on a consolidated basis.
10	(a) Copy of agreement among Beneficial Corporation, Western Auto Supply Company and John T. Lundegard, dated February 7, 1985, is incorporated by reference to Exhibit 10(b) of Beneficial's report on Form 10-K for the year ended December 31, 1984.

Exhibit Number	Exhibit
	(b) Copy of form of agreement entered into between Beneficial Corporation and key officers of the Company and its subsidiaries is incorporated by reference to Exhibit 10(e) of Beneficial's report on Form 10-K for the year ended December 31, 1981.
	(c) Copy of Agreement of Amendment dated November 15, 1984 between Beneficial Corporation and key officers of the Company and its subsidiaries, relating to Agreement referred to in Exhibit 10(b) hereto is incorporated by reference to Exhibit 10(d) of Beneficial's report on Form 10-K for the year ended December 31, 1984.
	(d) Copy of stock purchase agreement dated August 16, 1982, between Beneficial Corporation and Livingston Kosberg, et al. is incorporated by reference to Exhibit 2.1 of Beneficial's report on Form 10-Q for the quarter ended September 30, 1982.
	(e) Copy of First Amendment, dated November 3, 1982, to stock purchase agreement between Beneficial Corporation and Livingston Kosberg, et al. is incorporated by reference to Exhibit 2.2 of Beneficial's report on Form 10-Q for the quarter ended September 30, 1982.
	(f) Copy of Lease, dated as of June 28, 1982, between Hamilton Associates Limited Partnership and Beneficial Management Corporation is incorporated by reference to Exhibit 10(f) of Beneficial's report on Form 10-K for the year ended December 31, 1982.
	(g) Guaranty, dated as of June 28, 1982, of Beneficial Corporation relating to Lease included as Exhibit 10(f) hereto is incorporated by reference to Exhibit 10(h) of Beneficial's report on Form 10-K for the year ended December 31, 1982.
	(h) Copy of the Merger and Acquisition Agreement, dated September 5, 1985, by and among Beneficial Corporation, Western Auto Supply Company, Wesray Automotive, Inc., and Wesray Fashion, Inc., is incorporated by reference to Exhibit 2.1 of Beneficial's report on Form 8-K, dated December 20, 1985.
	(i) Copy of Amendment No. 1, dated as of October 31, 1985, to the Merger and Acquisition Agreement, by and among Beneficial Corporation, Western Auto Supply Company, Wesray Automotive, Inc., and Wesray Fashion, Inc., is incorporated by reference to Exhibit 2.2 of Beneficial's report on Form 8-K, dated December 20, 1985.
	(j) Copy of Amendment No. 2, dated as of November 1, 1985, to the Merger and Acquisition Agreement, by and among Beneficial Corporation, Western Auto Supply Company, Wesray Automotive, Inc., and Wesray Fashion, Inc., is incorporated by reference to Exhibit 2.3 of Beneficial's report on Form 8-K, dated December 20, 1985.
	(k) Copy of Amendment No. 3, dated as of November 8, 1985, to the Merger and Acquisition Agreement, by and among Beneficial Corporation, Western Auto Supply Company, Wesray Automotive, Inc., and Wesray Fashion, Inc. is incorporated by reference to Exhibit 2.4 of Beneficial's report on Form 8-K, dated December 20, 1985.
	(l) Copy of Amendment No. 4, dated as of November 29, 1985, to the Merger and Acquisition Agreement, by and among Beneficial Corporation, Western Auto Supply Company, Wesray Automotive, Inc., and Wesray Fashion, Inc. is incorporated by reference to Exhibit 2.5 of Beneficial's report on Form 8-K, dated December 20, 1985.
	(m) Copy of the Letter Agreement, dated December 20, 1985, by and among Beneficial Corporation, Western Auto Supply Company, Wesray Automotive, Inc., and Wesray Fashion, Inc. is incorporated by reference to Exhibit 2.6 of Beneficial's report on Form 8-K, dated December 20, 1985.

Exhibit Number	Exhibit
	(n) Copy of Amended and Restated Employment Agreement, dated December 21, 1985, by and among Beneficial Corporation, Western Auto Supply Company and John T. Lundegard, relating to the Agreement included in Exhibit 10(a) hereto.
	(o) Reference is made to information set forth under the caption "Compensation of Directors and Other Plans and Arrangements" appearing on page 12 of Beneficial Corporation's Proxy Statement, dated March 25, 1986, relating to a severance arrangement between Beneficial Corporation and John T. Lundegard.
	(p) Copy of agreement between Beneficial Corporation and Robert A. Tucker, dated December 24, 1985.
11	Computation of Earnings per Common Share of Beneficial Corporation and Consolidated Subsidiaries.
12	Computation of Ratios of Earnings to Fixed Charges of Beneficial Corporation and Consolidated Subsidiaries (continuing operations only).
13	Copy of the Beneficial Corporation 1985 Annual Report to Shareholders. Such Report shall not be deemed to be filed with the Commission as part of this Form 10-K Annual Report or otherwise subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, as amended (except for the portion thereof which is incorporated by reference in this Form 10-K Annual Report).
22	List of the names and states of incorporation of Beneficial's subsidiaries.
24	Consents of experts.
25	Powers of Attorney.
28	Form 11-K for the year ended December 31, 1985.

Beneficial agrees to furnish to the Securities and Exchange Commission, upon request, a copy of each instrument defining the rights of holders of Beneficial's long-term debt.

Beneficial will furnish to each shareholder, upon written request, copies of the exhibits referred to above at a cost of 10 cents per page. Requests should be addressed to Mr. Kenneth J. Kircher, Vice President and Secretary, Beneficial Corporation, P.O. Box 911, Wilmington, Delaware 19899.

(b) A report on Form 8-K was filed on December 20, 1985 with respect to the following matter:

The Merger and Acquisition Agreement dated September 5, 1985 as amended, and all amendments thereto, relating to the sale of Western Auto Supply Company and Subsidiaries, to Wesray Automotive, Inc., an affiliate of Wesray Capital Corporation, by Beneficial Corporation.

REPORTS OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

THE BOARD OF DIRECTORS
BENEFICIAL CORPORATION

We have examined the balance sheets of Beneficial Corporation and Consolidated Subsidiaries as of December 31, 1985 and 1984 and the related statements of income and retained earnings and changes in financial position for each of the three years in the period ended December 31, 1985 and have issued our opinion thereon dated February 4, 1986; such financial statements and opinion are included in your 1985 Annual Report to Shareholders and are incorporated herein by reference. We did not examine the financial statements of Beneficial Acceptance Corporation (a consolidated subsidiary), which statements reflect revenue of $10.2, $14.7 and $14.4 million, respectively, for each of the three years ended December 31, 1985. We also did not examine the financial statements of the Merchandising Division, the equity in net assets and net income of which are included in discontinued operations. Our examinations also comprehended the Supplemental Note to Financial Statements and Supplemental Schedule of Beneficial Corporation and Consolidated Subsidiaries, listed in Item 14. In our opinion, such Supplemental Note to Financial Statements and Supplemental Schedule, when considered in relation to the basic financial statements, present fairly in all material respects, the information shown therein.

Deloitte Haskins & Sells

DELOITTE HASKINS & SELLS

Morristown, New Jersey
February 4, 1986

THE BOARD OF DIRECTORS
BENEFICIAL CORPORATION

We have examined the consolidated balance sheet of Beneficial Corporation Merchandising Division as of November 23, 1985. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated balance sheet (not presented separately herein) presents fairly the financial position of Beneficial Corporation Merchandising Division at November 23, 1985, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

PEAT, MARWICK, MITCHELL & CO.

Kansas City, Missouri,
January 23, 1986

THE BOARD OF DIRECTORS
BENEFICIAL CORPORATION

We have examined the balance sheet of Beneficial Acceptance Corporation (a wholly-owned subsidiary of Beneficial Corporation) as of November 23, 1985 and the related statements of earnings and retained earnings and changes in financial position for the eleven months then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements (not presented separately herein) present fairly the financial position of Beneficial Acceptance Corporation at November 23, 1985 and the results of its operations and the changes in its financial position for the eleven months then ended in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Peat, Marwick, Mitchell & Co.

PEAT, MARWICK, MITCHELL & CO.

Kansas City, Missouri
January 23, 1986

THE BOARD OF DIRECTORS
BENEFICIAL CORPORATION

We have examined the consolidated balance sheets of Beneficial Corporation Merchandising Division as of December 29, 1984 and December 31, 1983 and the related consolidated *statements of income* and retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements (not presented separately herein) present fairly the financial position of Beneficial Corporation Merchandising Division at December 29, 1984 and December 31, 1983 and the results of its operations and changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

PEAT, MARWICK, MITCHELL & CO.

Kansas City, Missouri
January 25, 1985

THE BOARD OF DIRECTORS
BENEFICIAL CORPORATION

We have examined the balance sheets of Beneficial Acceptance Corporation (a wholly-owned subsidiary of Beneficial Corporation) as of December 31, 1984 and 1983 and the related *statements of earnings* and retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements (not presented separately herein) present fairly the financial position of Beneficial Acceptance Corporation at December 31, 1984 and 1983 and the results of its operations and the changes in its financial position for the years then ended in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

PEAT, MARWICK, MITCHELL & CO.

Kansas City, Missouri
January 25, 1985

BENEFICIAL CORPORATION
SUPPLEMENTAL FINANCIAL DATA

The Financial Statements and Notes to Financial Statements of Beneficial Corporation and Consolidated Subsidiaries, incorporated herein by reference to the Annual Report, are supplemented by the information in the following Note 18, Schedule I and Schedule VIII. All other schedules are omitted because of the absence of the conditions under which they are required or because all material information called for is set forth in the Financial Statements and the Notes referred to in this Item

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTE TO FINANCIAL STATEMENTS

18. Changes in Shares of Capital Stock

	1985	1984	1983
Preferred			
9.25% Series Redeemable			
Outstanding Shares Beginning of Year	125,000	125,000	125,000
Redeemed During the Year	(16,666)	—	—
Outstanding Shares End of Year	108,334	125,000	125,000
5% Cumulative			
Outstanding Shares Beginning and End of Year	407,718	407,718	407,718
$5.50 Dividend Cumulative Convertible			
Outstanding Shares Beginning of Year	65,891	68,954	82,616
Conversion into Common	(7,974)	(3,063)	(13,662)
Outstanding Shares End of Year	57,917	65,891	68,954
$4.50 Dividend Cumulative			
Outstanding Shares Beginning and End of Year	103,976	103,976	103,976
$4.30 Dividend Cumulative			
Outstanding Shares Beginning and End of Year	836,585	836,585	836,585
Common			
Outstanding Shares Beginning of Year	22,335,519	22,321,740	22,241,884
Conversion of Preferred into Common	35,875	13,779	61,472
Conversion of Convertible Instalment Notes into Common	165,534	—	16,560
Distributions under Incentive Compensation Plan	—	—	1,824
Outstanding Shares End of Year	22,536,928	22,335,519	22,321,740

SCHEDULE I

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
MARKETABLE SECURITIES

December 31, 1985
(millions)

	Carrying Amount	Market Value
Debt Securities		
Commercial Paper	$ 35.0	$ 35.0
U.S. Government Obligations	373.3	401.1
Foreign Government Obligations	31.3	38.0
Municipal Bonds		
State	17.7	16.8
Municipal	31.0	29.3
Revenue	277.7	233.2
Other	19.5	20.2
Convertible Bonds	3.4	3.3
Non-Convertible Bonds		
Financial	44.0	44.7
Telephone Utilities	130.2	143.2
Gas & Electric Utilities	184.4	196.5
Oil & Gas	76.2	81.4
Collateralized Mortgage Obligations	255.1	302.7
Industrial & Other	148.3	161.8
Mortgages	226.0	226.0
Other	28.1	28.1
Equity Securities		
Preferred Stocks	82.4	82.4
Common Stocks	24.2	24.2
Other	36.4	36.4
Total Investments	$2,024.2	$2,104.3

SCHEDULE VIII

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS AND RESERVES
Years Ended December 31, 1985, 1984 and 1983
(millions)

Column A	Column B	Column C		Column D	Column E
		Additions			
Description	Balance at Beginning of Year	Charged to Costs and Expenses	Charged (Credited) to Other Accounts	Deductions	Balance at End of Year
YEAR ENDED DECEMBER 31, 1985					
Reserves shown separately:					
Insurance policy and claim reserves (applicable to risks other than finance receivables)	$1,243.7	$770.8	$14.4(A)	$331.1(B)	$1,697.8
Reserves deducted from assets to which they apply:					
Net unrealized loss on equity securities (C)	16.0			15.0	1.0
Reserve for credit losses on finance receivables	212.4	87.8	2.1(D) 10.2(F)	.8(E) 77.3(G)	234.4
Insurance policy and claim reserves (applicable to finance receivables)	117.6			14.4	103.2
YEAR ENDED DECEMBER 31, 1984					
Reserves shown separately:					
Insurance policy and claim reserves (applicable to risks other than finance receivables)	862.9	628.6	6.1(A)	253.9(B)	1,243.7
Reserves deducted from assets to which they apply:					
Net unrealized loss on equity securities (C)	12.7		3.3		16.0
Reserve for credit losses on finance receivables	205.4	88.3	(2.9)(D)	8.0(E) 70.4(G)	212.4
Insurance policy and claim reserves (applicable to finance receivables)	123.7			6.1	117.6
YEAR ENDED DECEMBER 31, 1983					
Reserves shown separately:					
Insurance policy and claim reserves (applicable to risks other than finance receivables)	620.9	482.7	5.2(A)	245.9(B)	862.9
Reserves deducted from assets to which they apply:					
Net unrealized loss on equity securities (C)	13.7			1.0	12.7
Reserve for credit losses on finance receivables	188.3	103.0	(2.3)(D)	83.6(G)	205.4
Insurance policy and claim reserves (applicable to finance receivables)	128.9			5.2	123.7

NOTES

(A) Amounts applicable to finance receivables.
(B) Claims paid during the period.
(C) Also, see Notes 1(d) and 4 of Beneficial Corporation and Consolidated Subsidiaries Financial Statements.
(D) Foreign exchange fluctuations.
(E) Amounts applicable to foreign consumer finance subsidiaries sold during the year.
(F) As a result of the acquisition of bank credit card portfolios.
(G) Finance receivables charged off (after offsetting recoveries) during the period.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BENEFICIAL CORPORATION
Registrant

By Andrew C. Halvorsen
(A. C. Halvorsen, Member of the Office of the President)

Date: March 27, 1986

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
Finn M. W. Caspersen (Finn M. W. Caspersen)	Chairman of the Board of Directors and Chief Executive Officer and Director (Principal Executive Officer)	March 27, 1986
Andrew C. Halvorsen (A. C. Halvorsen)	Member of the Office of the President and Director (Principal Financial Officer)	March 27, 1986
Robert A. Meyer (Robert A. Meyer)	Senior Vice President and Controller (Principal Accounting Officer)	March 27, 1986
Charles W. Bower (Charles W. Bower)	Director	March 27, 1986
Robert C. Cannada (Robert C. Cannada)	Director	March 27, 1986
David J. Farris (David J. Farris)	Director	March 27, 1986
James H. Gilliam, Jr. (James H. Gilliam, Jr.)	Director	March 27, 1986
J. Robert Hillier (J. Robert Hillier)	Director	March 27, 1986
Gerald L. Holm (Gerald L. Holm)	Director	March 27, 1986
Steven Muller (Steven Muller)	Director	March 27, 1986
Susan Julia Ross (Susan Julia Ross)	Director	March 27, 1986

Robert A. Tucker (Robert A. Tucker)	Director	March 27, 1986
E. Norman Veasey (E. Norman Veasey)	Director	March 27, 1986
Susan M. Wachter (Susan M. Wachter)	Director	March 27, 1986
Arthur T. Ward, Jr. (Arthur T. Ward, Jr.)	Director	March 27, 1986
Charles H. Watts, II (Charles H. Watts, II)	Director	March 27, 1986
Sigfried Weis (Sigfried Weis)	Director	March 27, 1986
L. Martin Worthy (L. Martin Worthy)	Director	March 27, 1986

A. C. Halvorsen, pursuant to Powers of Attorney (executed by each of the officers and directors listed above and indicated as signing above, and filed with the Securities and Exchange Commission, Washington, D. C.), by signing his name hereto does hereby sign and execute this report on behalf of each of the officers and directors named above and indicated as signing above in the capacities in which the name of each appears above.

Andrew C. Halvorsen
(A. C. Halvorsen)

March 27, 1986

[illegible] CORPORATION ANNUAL REPORT [illegible]

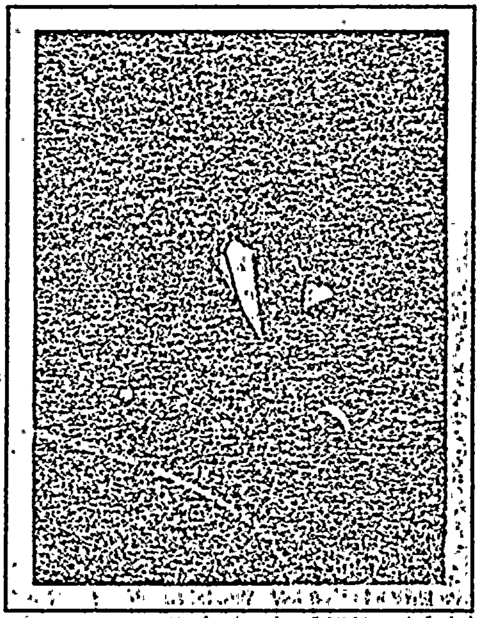
Years Ended December 31	1985	1984	1983	% Increase (Decrease) 1985 over 1984	% Increase (Decrease) 1984 over 1983
(in millions)					
Net Income					
Consumer Finance Group	$ 118.4	$ 111.7	$ 96.1	6.0	16.2
Insurance Group	5.0	1.9	18.2	163.2	(89.6)
Less Corporate Expenses	(23.5)	(23.9)	(24.2)	(1.7)	(1.2)
Income From Continuing Operations	99.9	89.7	90.1	11.4	(.4)
Income From Discontinued Operations	1.3	16.6	15.5	(92.2)	7.1
Net Income	101.2	106.3	105.6	(4.8)	.7
Earnings Per Common Share					
Continuing Operations	3.76	3.27	3.26	15.0	.3
Discontinued Operations	.06	.75	.70	(92.0)	7.1
Net Income	3.82	4.02	3.96	(5.0)	1.5
Dividends Per Common Share	2.00	2.00	2.00	—	—
Revenue	2,059.0	1,804.6	1,581.9	14.1	14.1
Shareholders' Equity at End of Year*	1,042.0	992.8	953.0	5.0	4.2
Principal of Finance Receivables**	6,119.5	5,367.5	4,884.3	14.0	9.9
Average Account Balance**	2,379	2,335	2,313	1.9	1.0
Reserve for Credit Losses as % of Principal of Finance Receivables**	3.83%	3.96%	4.21%	(3.3)	(5.9)

*Includes Redeemable Preferred Stock of $108.3 at December 31, 1985 and $125.0 at December 31, 1984 and 1983.
**At end of year

For Beneficial Corporation, 1985 was a year both of major strategic progress and of good earnings improvement in our on-going basic businesses. In December we completed the sale of Western Auto Supply Company, thereby concluding our program of divesting subsidiaries not consistent with our strategic thrust and clarifying our focus as a pure financial services company. In addition, through substantial reserve building and the arrangement of significant reinsurance transactions behind us, we succeeded in mitigating the future negative earnings impact of our property and casualty reinsurance operations. We have exited from the reinsurance market, and new exposure reinsurance premium writings are expected to continue their rapid decline. Beneficial Corporation is now specializing single-mindedly on what we do best—providing a broad array of financial services to consumers.

Restated for the divestiture of Western Auto, earnings from continuing operations rose 11% to $99.9 million from $89.7 million in 1984. Comparable earnings per share increased 15% to $3.76 from a restated $3.27 for the prior year. Total net income, including Western Auto's operating results and loss on disposal, was $101.2 million, down from $106.3 million in 1984. Earnings per share were $3.82, compared to $4.02 a year earlier.

Earnings of our core business, the Consumer Finance Group (CFG), increased for the fourth consecutive year to a record $118.4 million from $111.7 million in 1984. Insurance Group earnings, despite very substantial reserve building for the property and casualty lines, increased to $5.0 million from $1.9 million a year earlier. Moreover, and of prime importance, the groundwork has been laid for substantial earnings gains for the Insurance Group over each of the next several years.



Finn M. W. Caspersen

1985 was a transitional year for the Beneficial Insurance Group (BIG). Under a new top-management team, supported by realigned and expanded middle-management ranks, the Insurance Group made great progress toward mitigating the risk of future loss exposure resulting from our previously-written property and casualty reinsurance business. Concurrently, the BIG management team made major strides in refining and strengthening our powerful consumer credit insurance and annuity businesses. It also began development of other profitable personal line products that will enable the Beneficial Insurance Group to

reestablish itself as a highly profitable consumer insurance business, offering a broad line of retail insurance products.

Our primary corporate strength remains in consumer credit. Our customer franchise, built over our 72-year history of lending to consumers, is a very valuable corporate asset that we intend to nurture carefully. With more than $6 billion in receivables outstanding and over two million customers, we are one of America's largest diversified consumer lenders. Our exceptional ability to originate both high-yielding and high-quality consumer loans is at the very heart of our enterprise, and is the prime reason why the Consumer Finance Group generates a net aftertax return on average receivables in excess of 2%. In the future we plan to concentrate on this, our basic business, expanding its focus only with the insurance, deposit, and other complementary financial services that build profitable and enduring relationships with our customers.

Strategically, we are extremely well positioned to compete in the consumer financial services marketplace. We provide a variety of financial products and services to the consumer through three main marketing channels. The cornerstone of our distribution system is the 1,118 outlet consumer loan office network in the United States and three foreign countries. Through this office network we provide financial services, including credit, insurance, and tax preparation, to consumers on a personalized, face-to-face basis.

Equally valuable strategically is our primary consumer bank, Beneficial National Bank USA, which provides bank credit card, deposit, insurance, and related financial services by mail to over one million customers nationwide from its Wilmington, Delaware location. While BNB USA is, by far, our largest banking operation, other banking activities are conducted by our full-service commercial banking subsidiary in Delaware, our federal savings bank in Florida, and by other consumer thrift units in the United States and the United Kingdom. Deposit gathering provides a means of strengthening our relationship with our customers and is an attractive alternative source of funding for Beneficial Corporation.

Finally, we wholesale financial services (such as insurance and tax preparation services) to the customers of other financial institutions and retailers as well. Through our insurance subsidiaries we are able not only to sell, but also to underwrite insurance products directly.

Few competitors in the consumer financial services marketplace have, under one roof, the ability to offer such an extensive array of products through a diversity of marketing distribution channels. Our main task in the future is to continue to maximize the profitability of each individual unit, as well as to optimize the cross-selling opportunity of our products across the spectrum of our total customer base.

As indicated by the divestiture of our consumer lending operations in New Zealand and Ireland during the year, we remain committed to examining closely the profitability of each segment of our operations, down to the local office level, to ensure that all meet our profitability goals and

offer an opportunity for future growth and competitive advantage.

The year was also marked by significant investments in several areas central to our future success. Increased expenditures for marketing reflect the hiring of a team of experienced professionals who, armed with significantly improved market research about our customers, have embarked on a national advertising campaign to refine and differentiate Beneficial's image in the minds of consumers, particularly those consumers who do not have a relationship with us currently. Significant amounts were also invested in upgrading our current on-line data processing system to a new state-of-the-art computer software and hardware system which will enable us to distribute, simply and more efficiently, a broader array of financial services products to the consumer through the loan office system.

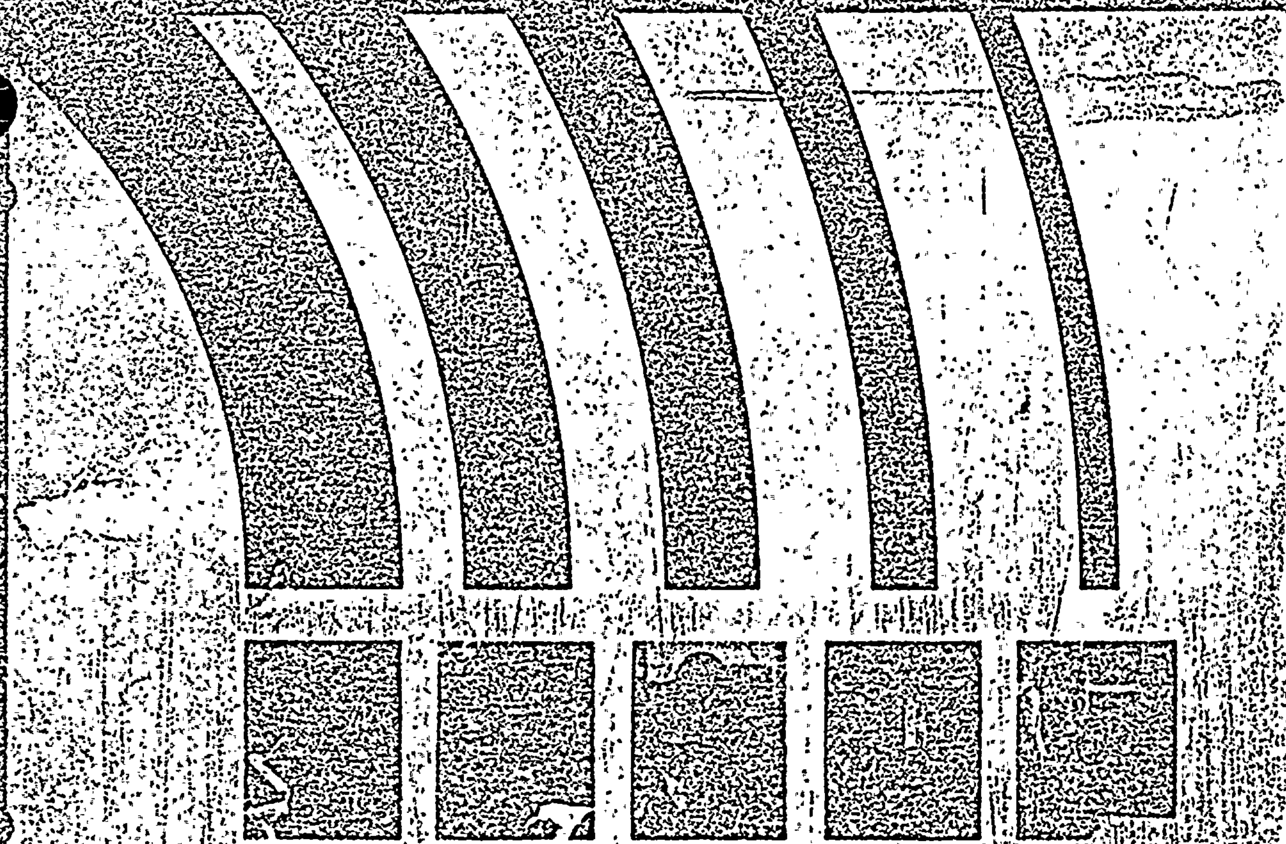
Financial services is "a people business." The quality of service for sales and support, product innovation, and the efficiency of delivery are linked directly to the quality and commitment of our people. People hold the key to our ability to capitalize on strategic opportunities in the marketplace; they are the primary element in our ability to compete now and in the future. Consequently, we have expanded our training activities, both related to product knowledge and management skills. Also, we have concentrated on increasing the depth of Beneficial's management team, both through promoting talented executives internally, and by hiring selectively from other major financial services companies.

As stated on the cover of this report: our goal is to achieve superior profits by expanding our financial services franchise, meeting consumers' needs with quality credit, deposit, and insurance products. We are confident that the right tools are assembled and the right people are in place to fulfill this goal, and we are confident that the result will be increased earnings in future years.

We are gratified that the Corporation's performance and the future value of our business were well recognized by the financial markets during 1985. Our debt issues were well received and the price of our common stock rose 44% during the year. This is a tribute to the efforts of our dedicated employees to whom we extend our sincere gratitude. Moreover, we thank you, our shareholders, for your continued support. Through strong corporate earnings growth in future years, we plan to increase significantly the value of your investment.

Finn M. W. Caspersen

Chairman of the Board
and Chief Executive Officer



Beneficial Corporation is one of the world's leading consumer financial services companies. We serve consumers through three basic businesses: consumer credit, banking, and insurance.

Pages 6 and 7 describe how Beneficial provides 2 million customers worldwide with consumer credit products, striving to provide the best personalized service. Pages 8 and 9 explain Beneficial's banking services offered through our consumer bank, our full-service commercial bank, and our savings and thrift institutions. And on pages 9 and 10, learn about our consumer insurance products.

Since 1914, consumer credit has been our business and continues to be our basic strength. Today, Beneficial Corporation has over $6 billion in receivables outstanding and serves over 2 million customers. We offer credit products through our 1,118 offices in the United States, Canada, the United Kingdom, and West Germany. This extensive office network enables Beneficial to provide excellent personalized service, including prompt credit decisions, flexible terms, and a wide array of credit products.

Beneficial extends credit on both a secured and unsecured basis. We provide first and second residential mortgages on a fixed or variable-rate basis. We offer the popular revolving line of credit secured by the equity in a borrower's residence. Customers can access available credit at economical rates by writing a check drawn on Beneficial National Bank or, in certain parts of the country, draw on their credit line through an ATM network. Consumers can also obtain an unsecured loan at Beneficial on a fixed-term or revolving credit basis.

Under the name Benecharge Credit Service, we purchase sales finance contracts from merchants through our loan offices and on a centralized basis. A growing portion of these accounts are private label retail revolving charge cards provided for national and regional retail chains, such as Radio Shack-Canada and Handy Andy Home Improvement Stores. Sales finance accounts continue to be an important source of new customer relationships for Beneficial.

Unsecured Personal Loans

Unsecured Revolving Credit Accounts

Second Mortgages

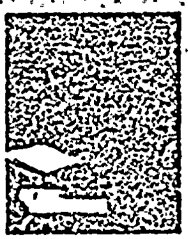
Second Mortgage Revolving Credit Accounts

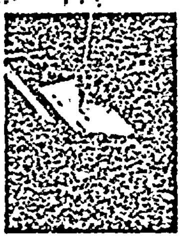
First Mortgages

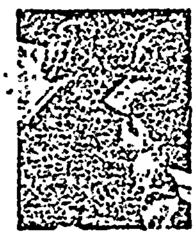
Sales Finance Contracts

ATM—Cash Access

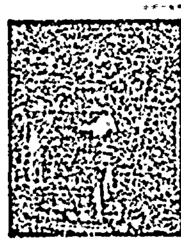
Income Tax Preparation Service







Concentrating on providing the best personalized service and meeting each customer's individual needs, Beneficial offers a variety of secured and unsecured credit products offering variable or fixed rates on either a revolving or fixed-term basis.



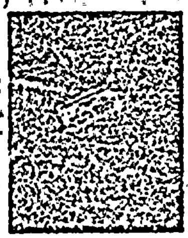
Beneficial provides banking services through: Beneficial National Bank USA, a consumer bank; Beneficial Savings Bank, F.S.B., a federally-chartered savings bank in Florida; Beneficial National Bank, a Delaware-based full-service commercial bank; and various other savings and thrift units.

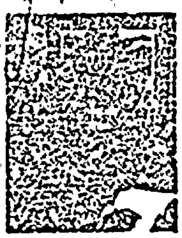
Beneficial National Bank USA ranks among the largest issuers of bank credit cards in the U.S. Nearly 60% of the Bank's outstandings are premium bank card accounts (requiring a household income in excess of $40,000 annually), with the remainder of the portfolio in standard cards. New cardholders are obtained through a sophisticated direct response program, as well as through selective acquisitions. We began a deposit program in 1983 and are pleased with our customers' response. BNB USA had $116 million in FDIC-insured deposits at year-end 1985.

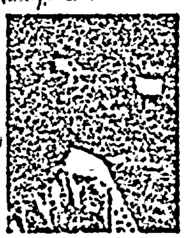
Beneficial obtained a federal savings bank charter in 1985 and opened branches in Orlando and Tampa during the year. A wide variety of deposit, transaction, and credit services are provided.

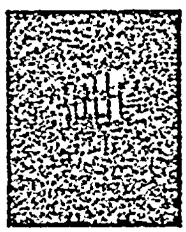
Beneficial National Bank is a full-service commercial bank located in Wilmington, Delaware. This bank meets the needs of businesses and consumers in the Wilmington area and acts as Beneficial Corporation's primary cash management bank, handling concentration and disbursement of funds for our domestic operations.

Standard Bank Credit Cards
Premium Bank Credit Cards
Savings Accounts
Checking Accounts
Individual Retirement Accounts
Certificates of Deposit
Keoghs
Cash Management Services









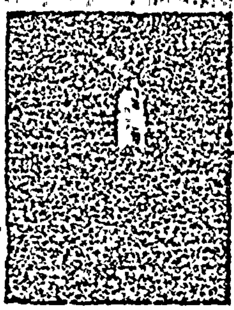
Consumer banking services, including a variety of savings instruments, checking accounts, and credit cards as well as other consumer credit products, are marketed through our banking, savings, and thrift units.

Beneficial Insurance Group underwrites a wide variety of consumer insurance products. It is a full-line credit insurance writer offering life, accident and health, and property coverages. Credit-related products are distributed through Beneficial consumer credit offices, as well as through unaffiliated finance companies, commercial banks, thrift institutions, automobile dealers and distributors, and other retailers. Credit life and disability insurance are available to consumers as part of virtually any type of credit transaction. The borrower chooses this protection against loss related to the death or disability of the borrower and to the loss or damage of property.

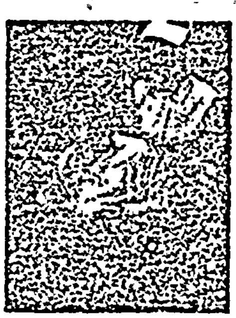
Beneficial Insurance also markets non-credit life and annuity products. Western National Life Insurance Company, our primary annuity writer, ranks among the leaders in the structured settlement annuity business. Structured annuities are usually sold to casualty companies for the settlement of disability claims. Western National also has a strong position in flexible annuities and conventional single premium deferred annuities, which are areas central to Beneficial Insurance Group's growth strategy. We currently market term and whole life products and are developing an interest-sensitive life product.

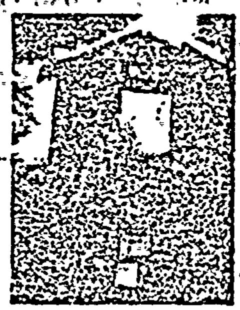
During 1985, Beneficial Insurance began test marketing a homeowners insurance product to Beneficial consumer credit customers. Plans are in place to test market an IRA annuity product through our consumer credit distribution system during the 1986 tax season.

Credit Life & Disability
Credit Property
Individual Term Life
Whole Life
Single Premium Deferred Annuities
Flexible Premium Deferred Annuities
Structured Settlement Annuities
Homeowners
Household Contents
Mortgage Life
Mortgage Disability
Vendors Single Interest
Group Term Life
Group Accidental Death
Group Accidental Death and Dismemberment
Supplementary Health
Travel Accident



Beneficial Insurance Group provides a wide array of coverages for consumers to protect them from loss related to death, disability, injury, and property damage. Additional products are being explored to provide even greater options for our customers.





In summary, Beneficial Corporation is one of the world's leading consumer financial services companies, concentrating on consumer credit, banking, and insurance.

Consumer credit is the cornerstone of Beneficial's business and the basis of the Company's market franchise. Credit products are provided to consumers through our 943 U.S. offices and 175 offices located in Canada, the U.K., and West Germany.

We have accumulated considerable direct response marketing expertise, for both credit and deposit products, through our consumer bank, Beneficial National Bank USA, one of the nation's largest issuers of bank credit cards. Beneficial also offers banking services through our commercial bank, a federal savings bank, and other consumer banking and thrift units.

The Beneficial Insurance Group provides consumer life, annuity, accident and health, and property and casualty insurance coverages, through Beneficial's credit and banking subsidiaries, unaffiliated financial institutions, automobile dealers, and through direct mail and telemarketing.

Beneficial's goal is to achieve superior profits by expanding our financial services franchise, meeting consumers' needs with quality credit, deposit, and insurance products.

Sale of Western Auto clarifies our focus as a pure financial services company.

Earnings per share from continuing operations increas[illegible]%.

Consumer Finance Group earnings increase for the fourth con[illegible]tive year, to a new record.

Insurance Group earnings increase as excellent credit insurance and annuity earnings offset property & casualty reinsurance losses.

Increased reserve capacity reduces continued exposure to property & casualty reinsurance risk.

Review of Fourth Quarter Results

Beneficial Corporation's fourth quarter earnings from continuing operations increased 15% to \$24.8 million from \$21.6 million for 1984. Comparable earnings per share were \$0.93 for the 1985 fourth quarter, up 18% from \$0.79 for the prior year.

Despite an increase in advertising expense to \$11.7 million in the 1985 quarter from \$3.3 million a year earlier, fourth quarter Consumer Finance Group earnings increased to \$26.7 million, from \$26.3 million reported in the 1984 quarter. The Group continues to benefit from receivables gains and good credit quality. Net income for the Insurance Group was \$3.0 million for the 1985 fourth quarter, up from \$1.5 million in the prior year period. The 1984 quarterly earnings included \$14.0 million in one-time tax benefits received under the "fresh start" provisions of the Deficit Reduction Act as they relate to life insurance companies. Unallocated corporate expenses, after income taxes, were \$4.9 million in the 1985 fourth quarter compared to \$6.2 million in 1984.

The sale of the Merchandising Division, Western Auto Supply Company and Subsidiaries, was completed on December 20.

[illegible]

1985. Accordingly, Western Auto earnings have been restated as discontinued operations. The sale resulted in an aftertax loss on disposal of \$7.4 million and was included in discontinued operations in the third quarter. Beneficial Corporation net income for the 1985 fourth quarter was \$24.8 million, or \$0.93 per share, compared to \$27.8 million, or \$1.07 per share in 1984. The 1984 results include Western Auto's earnings of \$6.2 million, or \$0.28 per share.

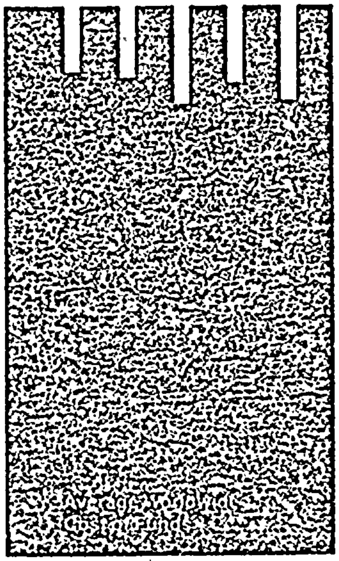
From the sale of Western Auto, Beneficial Corporation received cash proceeds of \$302.7 million (including the repayment of intercompany accounts), \$38 million in 9.2% preferred stock, redeemable in 8 years, and a \$3.2 million note due in January 1987. The charge included a capital loss (net of associated tax benefits), the subsidiary's October and November operating results, and severance payments and miscellaneous expenses related to the sale.

Financing

During 1985, Beneficial increased its level of interest-sensitive debt outstanding primarily through the issuance of commercial paper. This was done in response to growth in the level of variable-rate assets in the Corporation's receivables portfolio. During the year, the Company continued to refine its asset/liability management techniques and has maintained a conservative posture of "match funding," to the extent possible, to reduce sensitivity to interest rate fluctuations. Interest-sensitive assets are chiefly variable-rate revolving loans, written through the consumer finance office network. As this interest-sensitive segment of the loan portfolio increases, a somewhat greater reliance on interest-sensitive debt to finance the portfolio is appropriate.

Short-term debt outstanding at the end of 1985 totaled \$1.2 billion, 22.7% of the Company's funding base, compared to \$836 million or 16.5% of the total at the 1984 year end. Commercial paper outstandings were \$1.1 billion at the end of 1985, up from \$615 million at the prior year end. Beneficial maintains bank lines of credit in support of commercial paper outstandings. At year end, available lines were 112% of outstanding commercial

paper. Domestic bank lines at December 31, 1985, were $1.1 billion, including $568 million in the form of committed two-year revolving credit facilities. As this report went to press, over $900 million of Beneficial's bank lines had been converted to revolving credit facilities. Overseas bank lines totaled $236 million. The average cost of all short-term funds, including the cost of maintaining bank lines, was 9.17% during 1985, down from 11.33% during 1984. The lower cost of short-term funds in 1985 resulted primarily from substantial improvement in the money markets during the year. Additionally, the sale of the Company's foreign consumer finance subsidiaries located in Australia (in the fourth quarter of 1984) and New Zealand and Ireland (in the third quarter of 1985), which were financed with a large proportion of relatively high-rate short-term debt, contributed to the decline.



A modest, but growing, percentage of the Company's funding base consists of consumer deposits. At year end, deposits were $350 million, up 38% from $253 million in the prior year. The average cost of deposits was 10.43%, down from the 1984 level of 11.30%. These deposits are generated primarily through Beneficial National Bank USA ($116 million outstanding at the 1985 year end) and Beneficial's employee thrift plan ($84 million at year end), as well as through the Company's savings and thrift operations in Florida, Colorado, Ohio, and the United Kingdom. Although currently not a substantial funding source, consumer deposits are an important alternative future source of funds for the Company's consumer banking operations and another very attractive financial product to better serve our customers' needs.

Long-term fixed-rate debt remains the primary component of Beneficial's funding base. Representing 71% of debt outstanding, the Company's long-term debt portfolio provides a stable source of fixed-rate funds which at year-end 1985 had an attractive embedded cost of 10.21%, down from 10.41% at year-end 1984. The average cost of long-term debt is expected to decline noticeably in 1986. During 1985, $362 million in long-term debt, with an average rate of 10.33%, matured. Beneficial was modestly active in the long-term capital markets during the year, selling a total of $271 million in term debt at an average rate of 10.22%. During the first quarter, the Company sold $37 million in medium-term notes, of varying maturities, at an average rate of

Funding Base

(in millions)	12/31/85	% of Total	12/31/84	% of Total
Short-Term Debt				
U.S. Currency	$1,097.9	19.9%	$ 679.4	13.4%
Foreign Currencies	152.0	2.8	156.1	3.1
Total Short-Term Debt	1,249.9	22.7	835.5	16.5
Deposits Payable	350.3	6.3	253.0	5.0
Long-Term Debt	3,921.1	71.0	3,977.1	78.5
Funding Base	$5,521.3	100.0%	$5,065.6	100.0%

11.71%. In June, the Company sold $100 million of five-year notes at a rate of 9-3/8% and, in September, sold $100 million of ten-year notes at 10-5/8%. In December, a subsidiary, Beneficial Overseas Finance, N.V., called, at par, $100 million in 9-3/4% (annual coupon) Euro Notes which were issued in 1979 and due to mature in July 1987. As a result of notification requirements, the actual repayment of this issue occurred on January 9, 1986.

Reflecting generally declining interest rates and a higher proportion of lower cost short-term debt within the Company's capital structure, Beneficial's worldwide melded cost of funds, including the cost of bank commitment fees on lines of credit, declined to 10.19% from 10.73% in 1984. Excluding the higher cost of foreign borrowings, the cost of U.S. dollar debt for 1985 was 9.66%, compared to 10.10% in 1984. Beneficial's average quarterly borrowing cost for all debt during the past four years is presented above.

Beneficial's debt securities are rated "A" by Standard & Poor's, "6" (mid-range A) by Duff & Phelps, and "A-3" by Moody's Investor Service. The Company's commercial paper is rated "A-1" by Standard & Poor's, "D-1" by Duff & Phelps, and "P-1" by Moody's Investor Service. Significantly, in March 1986, Moody's Investor Service upgraded Beneficial's commercial paper rating to "P-1" from "P-2". This action was taken as a result of the substantial improvement in Consumer Finance Group operations during the past several years and the sale of Western Auto Supply Company and Subsidiaries.

Average Cost of Funds

	1985	1984	1983	1982	1981
1st Quarter	10.49%	10.49%	10.01%	11.29%	11.18%
2nd Quarter	10.38	10.70	10.03	11.29	11.27
3rd Quarter	9.98	10.96	10.27	10.94	12.15
4th Quarter	9.95	10.75	10.30	10.48	11.43
Full Year	10.19%	10.73%	10.16%	10.88%	11.53%

Consumer Finance Group

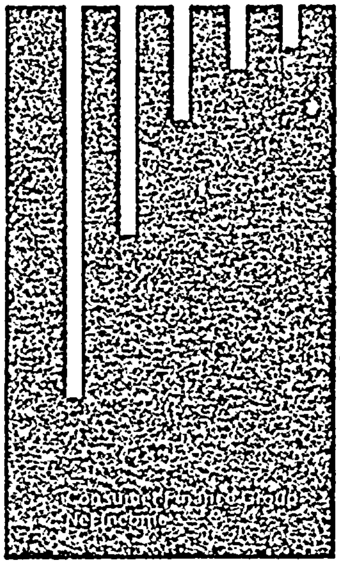
Beneficial Corporation, one of the nation's largest consumer finance companies, is best known for its large and very profitable consumer credit operation, the Consumer Finance Group (CFG). The cornerstone of this operation is the network of consumer finance offices located throughout the United States, Canada, the United Kingdom, and West Germany. Through this distribution network, the Consumer Finance System, Beneficial markets various types of loans and complementary products including insurance (underwritten by the Beneficial Insurance Group), first mortgages, income tax preparation services and, in certain regions, escrow and title services.

Also included in the CFG is our extremely successful nationwide issuer of bank credit cards, Beneficial National Bank USA, an FDIC-insured consumer bank. This operation, which has experienced rapid growth during the last several years, produces not only substantial profits but also presents the opportunity to merchandise other Beneficial Corporation products through the Bank's sophisticated direct response marketing program. Beneficial also operates several savings and thrift institutions, including Beneficial Savings Bank, F.S.B., a federally chartered savings bank located in Florida. Finally, while not consumer oriented, Beneficial's leveraged leasing activities are also included in CFG results.

In 1985, the CFG experienced its fourth consecutive year of increased earnings, with net income climbing 6% to a record $118.4 million from $111.7 million reported in 1984. The earnings increase is attributable to strong growth in receivables, continued excellent operating expense con-

trol, and good credit quality. The table below analyzes CFG profitability dynamics over the past four years, presenting major categories of income and expense as a percentage of the average principal balance of receivables. This table, which is a key analytical tool, illustrates the influences producing the positive trend in CFG profitability since 1982.

During 1985, total receivables outstanding topped $6 billion. The strength of the consumer economy, combined with the Company's active customer solicitation, has enabled Beneficial to continue its excellent trend of high-quality receivables growth. In 1985 receivables increased $752 million, or 14% to $6.1 billion, and averaged $5,580 million for the year, up 7% from the prior year average of $5,208 million. Real estate secured revolving credit accounts and bank credit card outstandings were the primary contributors to growth.



Consumer Finance Group — Profitability Analysis

	1985	1984	1983	1982
Average Receivables (a)	$5,579.8	$5,208.2	$4,479.9	$4,266.9
% of Average Receivables				
Finance Charges and Fees	19.47%	19.89%	20.53%	21.25%
Interest Expense	8.30	8.60	8.24	9.10
Lending Spread	11.17	11.29	12.29	12.15
Other Revenues	1.09	1.14	1.43	1.10
Gross Spread	12.26	12.43	13.72	13.25
Provision for Credit Losses	1.57	1.70	2.30	2.69
Salaries & Employee Benefits	3.16	3.24	3.70	3.90
Other Operating Expenses	3.63	3.68	4.06	3.89
Total Operating Expenses	8.36	8.62	10.06	10.48
Operating Income	[illegible]	3.81	3.66	2.77
Provision for Income Taxes	1.78	1.67	1.52	1.26
Net Income	2.12%	2.14%	2.14%	1.51%

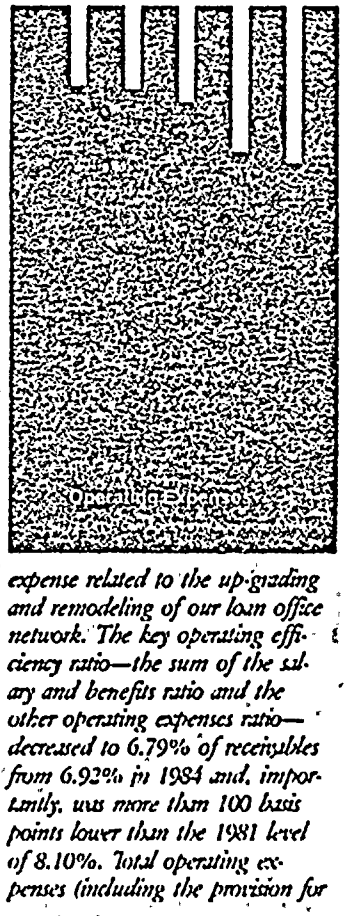
(a) In millions. Excludes unearned finance charges.

Beneficial's lending spread (roughly equivalent to a bank's net interest margin) declined slightly in 1985. The lending spread was 11.17% of average receivables, down from 11.29% in 1984. Finance charges and fees, as a percentage of average receivables, fell 42 basis points, to 19.47% from the prior year level of 19.89%, reflecting a greater proportion of lower-yielding variable-rate assets in the product mix and an extremely competitive environment, particularly as related to real estate secured lending. This decline was partially offset by a decrease in interest expense as a percentage of mean receivables to 8.30% from 8.60% in 1984. Other revenues also declined modestly to 1.09% of average receivables from 1.14% reported in the prior year, contributing to a decline in the gross spread to 12.26% from the 1984 level of 12.43%.

Improvements in operating efficiency and continued excellent credit quality combined to more

than offset the slight decline in lending margins. In 1985, net chargeoffs were $77.3 million, or 1.31% of average gross receivables, up slightly from $70.4 million, or 1.27% of receivables in 1984. Overall delinquency statistics were also excellent. Reflecting the high quality of the receivables base, the reserve for credit losses as a percentage of receivables declined marginally to 3.83%, a conservative three times annual chargeoffs. The provision for credit losses as a percentage of receivables declined to 1.57% from 1.70% in 1984 primarily because of lower internal receivables growth in 1985 compared to the prior year.

Since 1981, the CFG has demonstrated dramatic yearly improvements in operating efficiency measures. The Group has benefited not only from substantial operating leverage due to strong receivables growth on a base of largely fixed operating costs, but also from the elimination of operations that did not meet the Corporation's profitability goals. Salaries and employee benefits fell to 3.16% of average receivables in 1985 from the prior year's 3.24%, while other operating expenses, including rent, advertising, telephone, depreciation, and all other operating costs, declined to 3.63% of receivables from 3.68%. This decline occurred despite an increase in depreciation expense related to the upgrading and remodeling of our loan office network. The key operating efficiency ratio—the sum of the salary and benefits ratio and the other operating expenses ratio—decreased to 6.79% of receivables from 6.92% in 1984 and, importantly, was more than 100 basis points lower than the 1981 level of 8.10%. Total operating expenses (including the provision for credit losses) improved significantly to 8.36% from 8.62% in 1984 and 10.58% four years ago.



At the same time, it should be noted that 1986 will most likely bring a slight increase in the ratio of other operating expenses to average outstandings. This will stem from costs related to our nationwide advertising campaign, aimed at increasing the public's awareness of Beneficial, and to the implementation of a new on-line CRT-based data processing system throughout our network of loan offices. It is anticipated that the systems development will improve productivity and management information, as well as allow Beneficial to introduce new products more quickly.

Pretax operating income, expressed as a percentage of mean receivables, increased to 3.90% from 3.81% in 1984. Despite an increase in the effective tax rate due to fewer available tax credits, the CFG net income return on average receivables was an excellent 2.12%, compared to 2.14% in 1984.

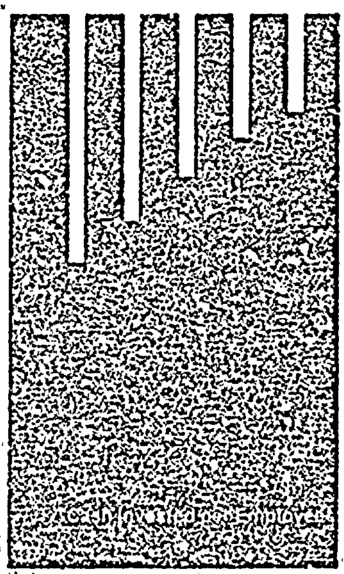
Principal of Finance Receivables

at December 31 (in millions)	1985	1984	1983	1982
Real Estate Secured Loans	$3,127	$2,909	$2,704	$2,180
Personal Unsecured Loans	1,361	1,209	1,257	1,411
Bank Credit Card Receivables	1,052	749	472	220
Sales Finance Contracts	417	311	218	184
Leasing and Commercial Finance Receivables	163	190	233	261
Total	$6,120	$5,368	$4,884	$4,256

Consumer Finance System

At year-end 1985, the Consumer Finance System (CFS), Beneficial's consumer loan office network, consisted of 943 offices (compared to 973 offices at the end of 1984) located in 38 states in the United States. Operations are focused on those states which have both good regulatory climates and strong economies, as well as populations large enough to permit economies of scale in operating costs. Outstandings are concentrated in several states, the largest of which is California, representing 30% of receivables outstanding, with other areas of concentration in Pennsylvania, New York, Ohio, Texas, Florida, and New Jersey.

The CFS also maintains a presence in three foreign countries including Canada (107 offices with year-end outstandings of $270 million), the United Kingdom (60 offices with receivables at December 31, 1985 of $170 million), and West Germany (8 offices with outstandings of $75 million at year end 1985). Foreign receivables represented 8.4% of Beneficial's total outstandings at year end. During 1985 consumer finance subsidiaries located in New Zealand and Ireland were sold. Beneficial recorded a $2.0 million aftertax loss on these transactions. Current and anticipated profitability was deemed inadequate and neither market was large enough to meet the Corporation's growth goals to allow adequate economies of scale.



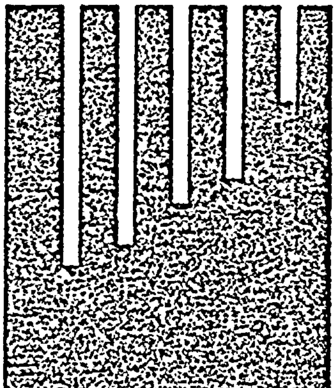
Reflecting the focusing of our office distribution network and continued receivables growth, direct measures of operating efficiency in the CFS improved during 1985. Cash invested (net receivables) per employee exceeded the one million dollar mark, reaching $1,011,800, up from the prior year level of $940,800. Cash invested per office was an excellent $4,261,000 compared to $3,630,000 in 1984.

Gains were reported in all consumer receivables categories in 1985. Real estate secured loans increased $217 million to total $3.1 billion at year-end 1985. All growth occurred in the extremely popular revolving real estate secured loan product, a key component in planned future growth. Revolving real estate secured receivables totaled $909 million at the end of the period compared to the 1984 year-end level of $506 million. These loans provide borrowers with a pre-approved line of credit secured by the equity in their homes. To efficiently access the credit, the borrower simply writes a check drawn on our commercial banking subsidiary, Beneficial National Bank, located in Wilmington, Delaware. This lending product is not only convenient for the customer, but is also extremely cost-effective for Beneficial. The average real estate loan made in 1985 increased to $22,133, up from $17,524 in 1984 and $16,403 in 1983.

A substantial portion of our real estate secured revolving loans are written on a variable-interest rate basis, generally tied to the prime rate. Although below our current average yield, these loans remain quite profitable since they can be funded with commercial paper borrowings at a substantially lower cost than long-term debt. The variable-interest rate portion of our receivables portfolio equalled $680 million at year-end 1985, up from $153 million at the prior year end.

Unsecured personal loans outstanding rose in 1985 to $1.4 billion, an increase of $153 million from the previous year. The primary contributor to growth within this loan segment was the revolving personal unsecured loan, which totaled $298 million at December 31, 1985 compared to $176 million in 1984. The average personal loan made increased in 1985 to $2,072 from an average of $1,959 in 1984.

Sales finance outstandings experienced strong growth in 1985, following a 43% increase in 1984. Sales finance outstandings were $417 million at year end, up 34% from the prior year level of $311 million. The average sales finance contract written in 1985 was $861, increased from $816 in 1984. Beneficial continues to place its emphasis on this very important product, marketed under the name Bencharge Credit Service. Sales finance contracts offer not only a profit opportunity for the Consumer Finance System, but also an excellent source of new customers. During the year, approximately 35% of new loan customers were developed by extending the customer relationship that began with a sales finance contract. The CFS directs its efforts toward high-quality merchants such as those selling computers, appliances, furniture, and home improvement supplies.



Merchants are offered a full-line credit service for their customers to enable the retailer to better market their products. The Company offers a wide variety of sales finance products ranging from small single purchase contracts to very successful private label revolving charge accounts. The private label program offers the merchant such features as credit authorization via a toll-free number, on-line credit applications through our state-of-the-art System for New Account Processing (SNAP) center, tips on improving credit sales techniques, and statistical information.

Income Tax Service

Income tax preparation services are provided in the United States and Canada through 1,296 outlets, including Beneficial consumer loan offices, free-standing offices, retailers (such as Montgomery Ward), and through unaffiliated financial institutions, under the name, "Tax Masters." In 1985, emphasis on improving customer service increased the percentage of return customers by more than 50% over the prior year. This was accomplished through better training and through provision of value-added enhancements to standard tax preparation, such as a tax tip newsletter and financial planning booklet.

During 1985, programming was completed to enable Beneficial's Income Tax Service to participate in a test, in conjunction with the U.S. Internal Revenue Service (IRS) in the 1986 tax season, allowing electronic filing of tax returns. We anticipate that this service will better serve our customers and give Beneficial a competitive advantage over other tax preparers, by speeding to our customer a refund (if one is due) two to three weeks earlier than if the return was filed by mail.

During the year, 315,000 returns were prepared in the U.S. and Canadian operations, producing increased revenues for the

fifth consecutive year. This compares to 304,000 returns prepared in 1984. Profitability for the domestic operation improved, with the average revenue from individual outlets increasing nearly 25% due both to increased returns per outlet and a rise in the average fee received for each return. In Canada consumers are able to obtain immediate cash upon verification of a tax refund due, less an appropriate fee. Our Canadian tax discounting operation reported another excellent year of increased profitability.

Beneficial Mortgage Corp.

Beneficial Mortgage Corporation, the Company's mortgage banking subsidiary, originates and services first mortgage loans, which are subsequently sold to investors. This operation allows Beneficial to offer an important additional product line to customers through our CFS loan office network, as well as through branches of Beneficial Mortgage. Loans are originated through five Beneficial Mortgage branches located in Delaware, North Carolina, Florida, and New Jersey. More than 300 Beneficial consumer loan offices originate first mortgages for regional processing centers located in California, Kansas, and Florida. Plans are in place to open an additional Beneficial Mortgage branch in Texas and four new regional processing centers in 1986.

At the end of 1985, the servicing portfolio totaled $144 million. Servicing volume is expected to increase dramatically in 1986 due to new office openings, increased participation of the consumer loan office network, and improved training related to the first mortgage origination process. Volume increases will allow Beneficial Mortgage the economies of scale that will aid the operation in meeting the Corporation's profitability goals.

Beneficial National Bank USA

Beneficial National Bank USA (BNB USA), located in Wilmington, Delaware, is Beneficial Corporation's primary consumer bank. BNB USA, a national bank regulated by the Comptroller of the Currency, is primarily engaged in the credit card business, issuing MasterCard and Visa cards to over one million consumers nationwide. With total credit card receivables in excess of $1 billion at year-end 1985, BNB USA is among the nation's very largest bank issuers of premium bank cards, including both the Gold MasterCard and the Premier Visa card. Net income increased to $13.0 million in 1985 from $12.0 million in the prior year.

About 60% of the Bank's credit card portfolio is premium bank card outstandings. Premium cards are designed to appeal to upscale consumers with incomes in excess of $40,000 per year, offering unsecured lines of credit of $5,000 or more and a variety of travel and entertainment benefits. Premium card account outstandings generally bear a variable-rate of interest, floating 4% above the prime rate, subject to a minimum of 18.96%. On most premium cards, BNB USA charges a monthly usage fee of $2.50 on each account that is active during the month. This feature is very attractive to consumers, in that, if the customer has not used the card, no fee is paid. This contrasts with the yearly fees of as much as $50 paid by customers to competing card issuers. Importantly, the premium card product affords Beneficial an entree to a growing,

convenience-oriented, upscale consumer market segment.

Growth has been achieved through aggressive pursuit of credit card portfolio acquisitions, as well as through sophisticated advertising and direct mail solicitation. To attract quality bank card customers in the present intensely competitive environment, the Bank continually refines the marketing techniques used to generate internal growth of accounts. Direct mail list testing, telemarketing programs, and price testing all play a part in maximizing the Bank's internal growth and profits.

During 1985, the Bank acquired credit card portfolios from Home Federal Savings and Loan Association of San Diego ($269.5 million in outstandings), First National Bank of Wilmington ($9.8 million), BancTEXAS Richardson N.A. ($8.2 million), and Tokai Bank of California ($4.8 million). New accounts added through portfolio acquisitions during the year totaled 224,000. The addition of the Home Federal portfolio in the fourth quarter brought the total outstandings of BNB USA to over $1 billion. The delinquency rate on the Home Federal portfolio, however, was higher than the previous rates of delinquency at BNB USA, and chargeoffs were taken upon acquisition to bring the rates to a satisfactory level. In addition, management has taken steps to improve the asset quality of this portfolio. This purchase will increase economies of scale for the Bank as well as provide significant income streams.

Over the past two years, the credit card industry has experienced a downward trend in asset quality and a consequent increase in delinquency and chargeoffs. BNB USA has increased its reserve against loan loss as this credit card industry trend is expected to continue in the near future. Management has taken corrective action, including tightening credit standards and increasing collection efforts, to insure that asset quality remains at an acceptable level. These actions have resulted in a dramatic decline in credit card delinquency levels to 1.36% of receivables at year end (including the Home Federal portfolio), from 1.83% at September 30, 1985.

During 1985, Beneficial National Bank USA prepared for continued growth. A new 72,000 square foot operations and data processing center was opened in May. Housing the Bank's data processing, operating, and human resources functions, the downtown Wilmington facility will provide the capacity required to meet the Bank's expansion plans through 1989. This expansion has enabled the Bank to perform data processing functions previously provided by an outside vendor. This move will significantly reduce expenses in the long run. The Bank's investments to provide for future growth had the short-term effect of raising operating expenses (excluding advertising) to 3.9% of average outstandings in 1985, from 3.6% in 1984.

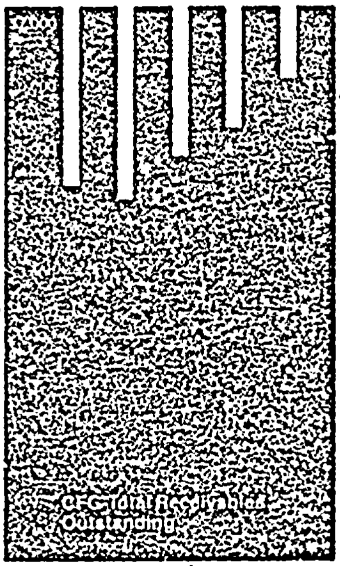
In 1983 the Bank began a test to offer certificates of deposit to the consumer via direct mail. Results showed a significant potential for the Bank to acquire deposits from remote locations by offering a slight premium over the competition's rates and by emphasizing FDIC insurance.

BNB USA has several competitive advantages, including substantial operating cost advantages, enabling it to offer interest rates on deposits higher than those of most branch banks and thrifts, name recognition resulting from

affiliation with a nationally known financial services parent company, and well developed direct response marketing skills. From a base of $10 million at the end of 1984, deposits have grown dramatically to $116 million, which now include both certificates of deposit (CD's) and Individual Retirement Accounts (IRA's). As the deposit instruments mature, aggressive retention efforts are employed to preserve the deposit base. Direct mail, print advertising and other customer solicitations are expected to generate continued growth.

Beneficial Commercial Corp.

Beneficial Commercial Corporation (BCC), Beneficial's leveraged leasing subsidiary, acts as a significant equity participant in large tax-advantaged leveraged leasing transactions. Although transportation equipment such as large airplanes, railroad rolling stock, and ocean-going vessels represent the major portion of the leveraged lease portfolio, a broad array of other capital equipment, including telephone switching equipment and various types of heavy industrial equipment, have been financed as well. Leveraged leasing activities have been quite profitable for companies such as Beneficial that have substantial taxable income to offset. While attractive opportunities remain under the current tax code, adoption of a major overhaul of the tax law would require a careful evaluation of leveraged leasing activities.



BCC had previously been active in the commercial finance and middle-market leasing markets but, reflecting a high level of delinquency and net chargeoffs in these areas, BCC exited those markets in 1984. These portfolios are now being liquidated. Accordingly, BCC achieved a turnaround and returned to profitability in 1985 after recording a substantial net loss in 1984.

Despite growth in leveraged lease activities, BCC's overall outstandings declined to $156 million at year-end 1985 from $181 million at the end of 1984. Commercial finance and middle-market net receivables were $32 million of the year-end total and are expected to decline significantly in 1986.

Beneficial National Bank

Based in Wilmington, Delaware, Beneficial National Bank (BNB) is Beneficial Corporation's commercial banking subsidiary. BNB, with five branches in the state, conducts a full-service commercial banking operation, emphasizing commercial lending to small and medium-sized businesses in its local market. The Bank had an excellent year in 1985 as net income increased 120% to $1.1 million from $0.5 million in 1984. Daily average assets increased to $101.4 million from $73.4 million in 1984. At December 31, the Bank's reserve for loan losses was a significant 1.29% of loans, despite the high quality nature of the portfolio with quite low delinquency at year end. Because of its distinct nature as a commercial bank, BNB is treated as a non-consolidated subsidiary on Beneficial Corporation's financial statements, with only the Bank's net income included on the equity method

(as part of CFG "other revenue").

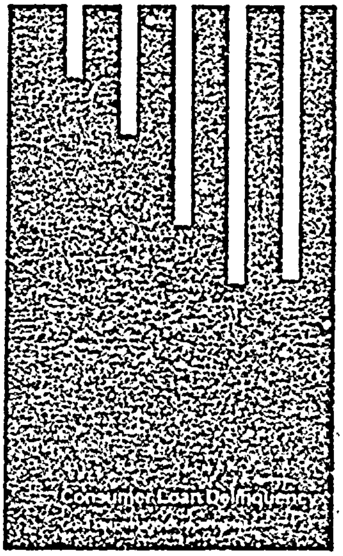
Beneficial's ownership of this full-service commercial bank enables the Corporation to enjoy cash management savings. All revolving credit lines developed by the CFG are accessed through customer checks drawn on BNB. Additionally, all other disbursements from the loan offices are made by the Bank. Finally, BNB provides a full range of commercial banking services such as deposit accounts, wire transfers, and check processing to the Corporation's operating subsidiaries, and the Corporation's deposit accounts are concentrated in BNB.

Credit Loss Experience—Condition of the Portfolio

Beneficial's credit loss experience remained excellent in 1985. Although net chargeoffs as a percentage of average receivables increased modestly to 1.31% from 1.27% of receivables in 1984, the 1985 level nevertheless represented Beneficial's second lowest net chargeoff percentage since 1969.

The delinquency levels in the loan office portfolio remain at historical lows. Consumer loan balances (including real estate secured and unsecured loans) more than two months delinquent, on a recency basis, totaled 0.75%, compared to 0.74% at year-end 1984. Reflecting Beneficial National Bank USA's aggressive chargeoffs and steps taken (such as tightened credit standards and increased emphasis on collection activities) to counter the sharp industry-wide increase in bank credit card delinquency, bank card delinquency improved sharply in the fourth quarter. At the year-end level of 1.36%, credit card delinquency, reported on a contractual basis, was only modestly higher than the 1984 year-end level of 1.28%, and was sharply improved from the September 30, 1985 level of 1.83%.

Reflecting the strong credit quality of the portfolio, Beneficial's reserve for credit losses was



Credit Quality Measures

(in millions)		Finance Receivables Charged Off (a)		Reserve for Credit Losses at End of Year		Delinquency	
Year	Gross Amount of Receivables Charged Off	Net Chargeoffs	% of Average Gross Finance Receivables	Amount	% of Net Finance Receivables at End of Year (b)	Consumer Loan Receivables More Than Two Months Delinquent (c)	Bank Credit Card Receivables More Than Two Months Delinquent (d)
1985	$105.0	$77.3	1.31%	$234.4	3.83%	0.75%	1.36%
1984	90.3	70.4	1.27	212.4	3.96	0.74	1.29
1983	106.1	83.6	1.73	205.4	4.21	0.97	1.10
1982	130.4	114.3	2.45	188.3	4.42	1.37	1.40
1981	120.0	106.8	2.17	196.5	4.42	1.62	—

(a) Less applicable recoveries.
(b) After deducting unearned finance charges.
(c) On a recency basis. Includes real estate secured loans and personal unsecured loans.
(d) Contractual basis. Prior to 1982, bank credit card receivables were not a significant part of the receivable portfolio.

3.83% of receivables at year end, compared to 3.96% at the end of 1984. At this level, the reserve remains among the more conservative in the consumer credit industry, both in relation to receivables outstanding and net chargeoffs. At its year-end level, the reserve covers 1985 net chargeoffs three times. Most major banking industry competitors maintain their consumer loan loss reserve at a level only slightly in excess of most recent year losses.

Beneficial Insurance Group

1985 was a year of substantial progress for the Beneficial Insurance Group (BIG). Although net earnings of the Group were only modestly improved to [illegible] million from $1.9 million in 1984, major strides were made toward solving the problems of the Group's property and casualty (P&C) reinsurance operation, which has been such a serious drag on BIG's recent results. BIG's operations were redirected and refocused during 1985, laying the groundwork for what is anticipated to be a dramatic recovery in Insurance Group profitability over the next several years.

BIG's principal business segments—credit insurance and annuities—continue to be quite profitable. BIG's total premium revenue rose 26% to $711.3 million in 1985 from the prior year's $565.1 million, led by increases in annuity writings and credit insurance. The reinsurance results, however, continue to offset the Group's otherwise excellent performance. The losses that emerge from reinsurance reflect the past mistakes of entering the reinsurance market at a point in its business cycle where premiums were insufficient in relation to risks insured, compounded by a business strategy focusing on the utilization of managing general agents (MGA's).

> *BIG's operations were redirected and refocused in 1985, laying the groundwork for a recovery in profitability over the next several years.*

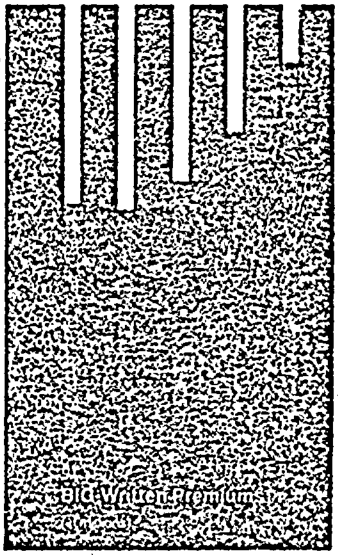
Contracts with the MGA's producing the troubled reinsurance business have all been terminated, and BIG has exited the P&C reinsurance market. Because of contractual rights to multi-year renewals, delayed termination provisions in certain MGA agreements, and reporting lags inherent in this mode of operation, BIG recorded $71.7 million in reinsurance premium in 1985. A sharp decline is expected for 1986. Considering BIG has recorded this run-off premium at an approximate 160% combined ratio, reflecting its commitment to a realistic and conservative reserving philosophy, it is apparent that the significant reduction in writings projected for 1986 will have a highly beneficial impact on profitability.

Also, it should be noted that the 1985 and anticipated 1986 premium levels are inflated by specific factors, including elimination of retrocessional arrangements with reinsurers of questionable financial quality (a sound policy which effectively increases net new writings), commutations of specific blocks of business where BIG reassumes premium previously ceded, and a price increase in new risk premiums as a result of the upturn in the industry's general pricing structure.

During 1985 the reinsurance industry continued to experience severe losses, as evidenced by the number and size of insolvencies, regulatory supervision projects, and liquidations of insurance companies. Recognition of these problems resulted in the execution of a multi-faceted program whereby BIG insulated its exposure to continued significant losses from the reinsurance segment. Through a combination of reinsurance transactions and direct

strengthening of loss reserves, BIG effectively increased its reserve capacity for P&C reinsurance risks (relating both to reinsurer insolvencies and loss development) by more than $150 million. Accordingly, BIG's exposure to continued significant losses from this troubled business has been substantially reduced.

Reflecting the aforementioned conservative reserving methodology, BIG's net aftertax losses from property and casualty reinsurance were $39.0 million in 1985, reduced from 1984's net loss of $54.2 million. A significantly reduced reinsurance loss is anticipated in 1986.


BIG Written Premiums

Annuity Operations

BIG's largest life insurance subsidiary, Western National Life Insurance Company, grew to nearly $1.4 billion in assets at year-end 1985, an increase in excess of $500 million from the prior year. This growth is attributable to record sales of structured settlement annuities and other tax-sheltered annuity products. Western National is one of the nation's leading writers of structured settlement annuities (generally related to the settlement of large disability claims). Western is also a major writer of conventional single premium deferred annuities, and has a particularly strong position in sales of flexible tax-deferred annuities sold to teachers (and others working for not-for-profit institutions) through payroll deduction plans. Western National's total premiums written increased to $412.5 million in 1985 compared to $281.4 million in 1984. As indicated in the table below, the annuity product line in total for BIG (modest amounts are produced by BIG's Northwestern Security Life Insurance Company as well) represented 65% of BIG's total premiums written.

This growth, although dramatic, has been accomplished in a controlled environment characterized by highly conservative underwriting and investment philosophies. Western National's major marketing advantages in the annuity business are its strong financial position (rated A+ (contingent) by A.M. Best & Co.), its efficient service and processing operations, its long-standing relationships with the major producers and, most importantly, its investment and underwriting expertise. Western's net aftertax operating income (before capital gains) more than doubled to a record $9.1 million in 1985 from $4.5 million in 1984, excluding from the 1984 amount the one time "fresh start" tax benefits related to the change in taxation of life insurance companies.

Credit Insurance Operations

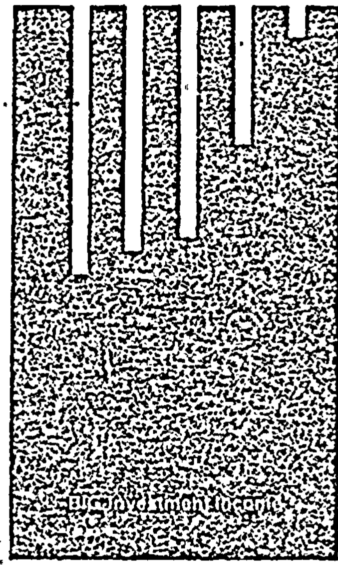
The credit insurance operation is the solid foundation upon which the Beneficial Insurance

Written Premiums—Lines of Business

(in millions)	1985	1984	1983	1982
Annuities	$466.5	$347.9	$244.2	$211.3
Life	88.9	42.0	124.1	83.4
Accident & Health	83.8	69.5	46.6	47.9
Property & Casualty	81.6	138.6	90.8	110.6
Total	$720.8	$598.0	$505.7	$453.2

Group was built and continues to be extremely profitable. Total gross credit related premium writings increased to $156.9 million in 1985 from $145.5 million the prior year, due to excellent growth in writings for outside accounts. Total credit insurance premiums written in connection with loans made by Beneficial's Consumer Finance Group declined to $56.3 million from $62.9 million in 1984, reflecting the increasing proportion of revolving credit loans in CFG volume. Although improving significantly, insurance penetration on revolving credit loans is less than on closed-end credit and, more importantly, premiums are collected monthly over the life of the loan rather than as a single up-front charge at the time a closed-end loan is made. Nevertheless, reflecting the marketing economies inherent in selling through our own distribution channels, profitability of the in-house business remains excellent.

Total independent creditor insurance premiums written rose sharply (for the second consecutive year) to $98.0 million from $81.0 million in 1984. Independent creditor premium has almost doubled since 1983. Marketing efforts continue to focus on the consumer loan operations of commercial banks, thrift institutions, automobile dealers and distributors, and other finance companies. While less profitable than the



Beneficial-related business because of commissions paid to the producers, the independent creditor line of business nevertheless makes a substantial contribution to corporate profitability. In addition, it provides alternative distribution outlets for new insurance product entries. BIG ranks among the industry leaders in the highly specialized consumer credit insurance market, providing a full range of credit related products.

Investment Activities

Boosted mainly by the substantial cash inflows from annuity premiums written, BIG's investment portfolio increased to $2.0 billion at December 31 from $1.5 billion a year earlier. Investment income increased an excellent 36.0% to $193.3 million from $142.1 million in 1984. The dramatic rally in the bond markets during the year substantially increased the market value of the fixed-income portfolio, and at year end, the market value of the entire securities portfolio was $77 million in excess of its carrying value. This is despite the fact that during the year the portfolio produced $12.8 million in net after-tax capital gains, up from $6.2 million in 1984. As indicated in the table on the following page, the portfolio continues to be chiefly invested in high quality fixed-income obligations.

The substantial growth in long-term annuity reserves was carefully matched on the asset side by investments in long-term corporate bonds, the "long" tranches of collateralized mortgage obligations, and by high quality long-term commercial mortgages. Structured settlement annuity reserves (a major portion of BIG's premiums) are contractually locked in for long periods (often, scheduled payment outflows continue for periods in excess of 20 years), creating the need to generate an attractive compound yield with equally long-term investments. Nevertheless, quality guidelines were not compromised, and new investments in Western National, as well as throughout

the rest of BIG, continue to center on A-rated or better credits. Unlike some of Western National's competitors in the annuity market, Western has chosen not to make use of low-rated "junk bonds" to match annuity reserves. Almost 90% of BIG's bond portfolio is "A"-rated or better, with fully 50% of the portfolio rated "AAA" (reflecting the heavy proportion of Treasury securities, Ginnie Maes, and collateralized mortgage obligations in the total).

Generally, BIG's investment portfolio is managed in a quite conservative, risk averse manner, both to match long-term annuity reserves and to generate a predictable stream of steadily increasing income at least partially offsetting the substantial underwriting risk inherent in the previously-written property and casualty reinsurance book. Accordingly, commitment to the equity markets has been modest. This investment strategy has been successful, and investment income for BIG has increased at a compound rate in excess of 30% annually since 1979.

Investment management activities represent a potentially important strategic market and product line for Beneficial Corporation in the 1990's. In anticipation of that, investment management expertise within BIG is being carefully developed. BIG already manages the Beneficial Corporation retirement plans in-house, and further development of investment management expertise and product lines is anticipated in future years.

Beneficial Insurance Group, primarily through its subsidiary Harbour Island Inc., also invests in real estate for residential and commercial development. Harbour Island, the Company's primary development project, is a mixed-use, master-planned development located in Tampa, Florida, just south of the city's central business district. The first phase, conducted in partnership with Lincoln Property Company of Dallas, was completed during 1985. This portion of the project consists of office and retail space, and a 300-room hotel. At year end, 80% of the commercial space was under lease and the occupancy rates for the hotel were trending steadily upward since its opening in July, 1985. Currently, 72 luxury and 128 moderate-priced condominiums are under construction. Initial occupancy of luxury units is expected in mid-1986. The development and sell-out of the entire property is anticipated to take place over a 20-year period.

Insurance Group Investment Portfolio

(in millions) at December 31	1985	% Total	1984	% Total	1983	% Total
U.S. Government Obligations	$ 366.5	18.4%	$ 360.9	24.4%	$ 241.4	22.0%
Municipal Bonds	345.9	17.4	337.8	22.8	312.8	28.5
Foreign Government Obligations	31.3	1.6	41.0	2.8	41.8	3.8
Corporate Bonds	841.5	42.3	388.8	26.3	198.7	18.1
Preferred Stocks	61.2	3.1	53.3	3.6	54.7	5.0
Common Stocks	20.2	1.0	72.6	4.9	59.6	5.4
Policy Loans	28.1	1.4	19.7	1.3	15.2	1.4
Mortgages	226.0	11.4	193.4	13.1	135.4	12.3
Real Estate	32.4	1.6	9.0	.6	9.0	.8
Short-Term Holdings*	35.0	1.8	4.4	.2	29.6	2.7
Total	$1,988.1	100.0%	$1,480.9	100.0%	$1,098.2	100.0%

*Chiefly commercial paper

Beneficial Corporation and Consolidated Subsidiaries

Balance Sheet

(in millions) December 31	1985	1984
Assets		
Cash and Equivalents	$ 139.6	$ 138.2
Finance Receivables	6,471.9	5,721.7
Less Unearned Finance Charges	(352.4)	(354.2)
Principal of Finance Receivables (Note 3)	6,119.5	5,367.5
Less Reserve for Credit Losses	(234.4)	(212.4)
Insurance Policy and Claim Reserves (applicable to finance receivables)	(103.2)	(117.6)
Net Finance Receivables	5,781.9	5,037.5
Other Receivables	223.9	271.2
Investments (Note 4)	2,024.2	1,528.3
Property and Equipment (at cost, less accumulated depreciation of $51.7 and $40.0)	132.8	116.5
Investment in and Advances to Discontinued Operations (Note 2)	—	311.8
Other Assets (Note 5)	415.8	330.9
Total	$8,718.2	$7,734.4
Liabilities and Shareholders' Equity		
Short-Term Debt (Note 6)		
U.S. Currency	$1,097.9	$ 679.4
Foreign Currencies	152.0	156.1
	1,249.9	835.5
Deposits Payable (includes employee thrift deposits)	350.3	253.0
Accounts Payable and Accrued Liabilities (Note 7)	457.1	432.3
Insurance Policy and Claim Reserves (applicable to risks other than finance receivables)	1,697.8	1,243.7
Long-Term Debt (Note 8)	3,921.1	3,977.1
Total Liabilities	7,676.2	6,741.6
Redeemable Preferred Stock (Notes 9 and 10)	108.3	125.0
Other Preferred Stock (Note 9)	115.7	115.8
Common Stock (60.0 shares authorized, 22.5 and 22.3 shares issued and outstanding) (Note 9)	22.5	22.3
Additional Capital (Note 9)	68.4	63.5
Net Unrealized Loss on Equity Securities (Note 4)	(1.0)	(16.0)
Accumulated Foreign Currency Translation Adjustments (Note 11)	(13.6)	(18.4)
Retained Earnings (Note 8)	741.7	700.6
Total	$8,718.2	$7,734.4

See Notes to Financial Statements.

Management's Discussion and Analysis of Financial Condition (amounts in millions)

During 1985 Beneficial's principal of finance receivables grew $752 or 14% and topped the $6,000 mark. The largest increase was in credit card receivables ($303 or 41%) as a result of portfolio acquisitions in the fourth quarter. Other increases were in real estate secured loans ($217), personal unsecured loans ($153) and sales finance contracts ($105). This is the first gain in personal unsecured loans since 1979, as the Company reemphasized this product. Lease receivables declined $26 as the planned run-off continued. The receivable portfolio mix at December 31, 1985 was 51% real estate secured loans, 22% personal unsecured loans, 17% credit card receivables, 7% sales finance contracts and 3% lease receivables.

The reserve for credit losses as a percentage of finance receivables was 3.83% at December 31, 1985 and 3.96% at year-end 1984. Conservative by industry standards, the reserve for credit losses at year end covers 1985 net chargeoffs three times. The overall credit quality of the portfolio remains high as total chargeoff and delinquency rates continued at historically low levels. Consumer finance loan balances more than two months delinquent (on a recency basis) were .75% at December 31, 1985, as compared to .74% and .97% at the end of 1984 and 1983. Credit card balances more than two months delinquent (on a contractual basis) were 1.36% at December 31, 1985, up from 1.28% and 1.10% at year-end 1984 and 1983. The Company has accelerated chargeoffs and has tightened credit standards and intensified collection efforts to counter increasing delinquency, a trend experienced by the entire credit card industry.

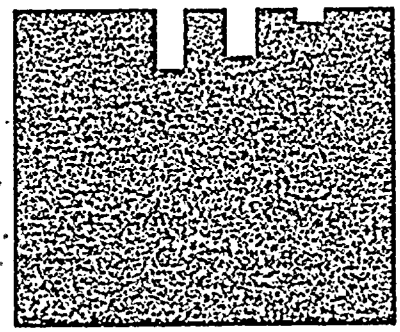
Investments grew $496 and insurance policy and claim reserves increased $440, both up 32% during 1985 due largely to annuity writings.

Short-term debt (including consumer deposits) was $1,600 at December 31, 1985 and comprised 29% of total debt, up from 21% at December 31, 1984. The shift to a larger percentage of short-term funding continued as the Company's origination of variable-rate receivables increased during 1985. During 1985 long-term debt of $271 was issued having a weighted average interest rate of 10.22%, while $362 of long-term debt, having a weighted average rate of 10.33%, was repaid.

Net unrealized loss on equity securities decreased 94%, from $16 at December 31, 1984 to $1 at December 31, 1985, as the market turned upward.

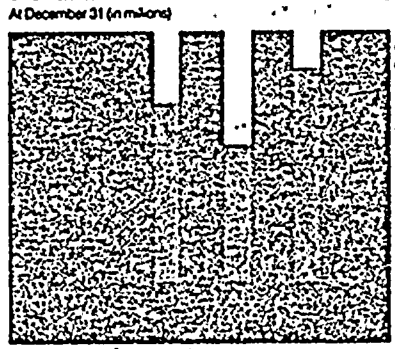
The Company's debt to equity ratio (including redeemable preferred stock) was 5.30 to 1 and 5.10 to 1 at December 31, 1985 and 1984. A significant part of the receivables growth in 1985 was financed by borrowings.

Principal of Finance Receivables
At December 31 (in millions)

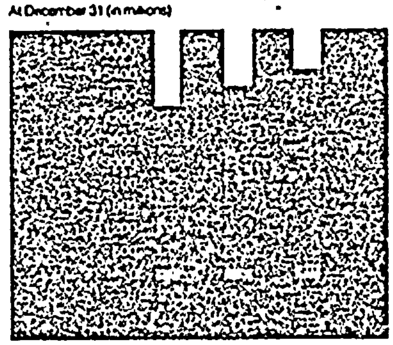


- Real Estate Secured
- Personal Unsecured
- Bank Credit Card
- Sales Finance
- Lease Receivables

Growth in Finance Receivables
At December 31 (in millions)



Short-Term and Long-Term Borrowings
At December 31 (in millions)



- Long-Term Debt
- Commercial Paper
- Bank Notes
- Deposits Payable

Statement of Income and Retained Earnings

(Unaudited) Three Months Ended December 31			Years Ended December 31		
1985	1984	(in millions)	1985	1984	1983
$444.1	$472.9	Revenue	$2,059.0	$1,804.6	$1,581.9
		Expenses			
101.4	194.0	Insurance Benefits and Policy Reserve Increase	770.8	628.6	482.7
134.6	134.5	Interest	520.2	503.9	423.7
49.6	42.9	Salaries and Employee Benefits	198.1	189.9	183.8
30.2	30.0	Provision for Credit Losses (less recoveries)	87.8	88.3	103.0
92.0	76.6	Other	324.7	303.2	268.9
407.8	478.0	Total	1,901.6	1,713.9	1,462.1
36.3	(5.1)	Income (Loss) Before Income Taxes	157.4	90.7	119.8
11.5	(26.7)	Provision for Income Taxes (Note 13)	57.5	1.0	29.7
24.8	21.6	Income From Continuing Operations	99.9	89.7	90.1
		Discontinued Operations, After Income Taxes (Note 2)			
—	6.2	Income	8.7	16.6	15.5
—	—	Loss on Disposal	(7.4)	—	—
—	6.2	Income From Discontinued Operations	1.3	16.6	15.5
24.8	27.8	Net Income	101.2	106.3	105.6
730.8	687.3	Retained Earnings, Beginning of Period	700.6	655.2	610.8
13.9	14.5	Dividends Paid	60.1	60.9	61.2
$741.7	$700.6	Retained Earnings, End of Period	$ 741.7	$ 700.6	$ 655.2
		Earnings Per Common Share			
$ .93	$ .79	Continuing Operations	$ 3.76	$ 3.27	$ 3.26
—	.28	Discontinued Operations	.06	.75	.70
$ .93	$ 1.07	Net Income	$ 3.82	$ 4.02	$ 3.96
$ 20.7	$ 23.7	Earnings Available for Common Shares	$ 84.5	$ 89.3	$ 88.6
.50	.50	Dividends Per Common Share	2.00	2.00	2.00
22.1	22.2	Average Outstanding Common Shares	22.1	22.2	22.4

See Notes to Financial Statements.

Management's Discussion and Analysis of Results of Operations (amounts in millions)

Revenues were up 14% in both 1985 and 1984 and 6% in 1983. The 1985 and 1983 increases were primarily a result of increased premium revenue. In 1984 the increase was due to both higher finance charges and fees as well as greater premium revenue.

Insurance premium revenue was up 26% in 1985 and approximately 13% in both 1984 and 1983. The increase in 1985 was largely due to a higher volume of annuity premiums. The 1984 increase resulted from higher annuity and property and casualty writings, offset in part by the termination of a large life reinsurance contract that reduced life premium revenue. The increase in 1983 was due to higher annuity and life writings offset somewhat by lower property and casualty writings.

Finance charges and fees also contributed to the revenue gains, increasing 5% in 1985, 13% in 1984 but showing little change in 1983. The 5% gain in 1985 resulted from a 7% growth in average receivables offset somewhat by a decline in the annual percentage rate of finance charges and fees from 19.89% in 1984 to 19.47% in 1985. The decline is largely due to a decrease in the rate of charge for real estate loans. In 1984 the growth in finance charges was less than the growth in receivables because of a smaller percentage of higher yielding unsecured loans in the portfolio and lower rates of charge on real estate loans.

Insurance investment income was $193, $142 and $101 in 1985, 1984 and 1983, increasing mainly due to a higher level of investments.

Insurance benefits and policy reserve increase is comprised of two elements. One element, insurance benefits, declined 9% in 1985 because of decreases in the Company's property and casualty reinsurance business, partially offset by increased annuity payments. Insurance benefits were up 62% in 1984 versus a 31% decrease in 1983 primarily because of poor underwriting experience in the property and casualty business as well as an increase in annuity benefit payments emanating from the higher levels of annuity premium writings in recent years. The 1983 decline was mainly attributable to a lower level of non-property and casualty reinsurance. The property and casualty loss ratios were 126%, 134% and 101% in 1985, 1984 and 1983. The increases in 1984 and 1983 were a result of adverse loss development. The other element, policy reserve increase, grew 72% in 1985 entirely due to higher annuity writings. The 1983 increase was because of higher ordinary life and annuity premium writings, which substantially offset the decline in insurance benefits.

Interest expense increased 3% in 1985 and 19% in 1984 after decreasing 6% in 1983. The 1985 increase occurred as higher average borrowings versus the prior year more than offset lower interest rates. About 69% of the increase in 1984 resulted from more borrowings with 31% due to higher interest rates. The preponderance of the 1983 decline was due to lower average interest rates.

The provision for credit losses was flat in 1985 after declining 14% in 1984 and 10% in 1983. In 1985 higher chargeoffs were offset by reduced reserve requirements as a result of lower internal growth in receivables, while the improvement in 1984 resulted from lower chargeoffs. During 1983, a drop in chargeoffs was partially offset by reserve requirements on the increase in receivables. Chargeoffs as a percentage of average receivables were 1.31% in 1985, up slightly from 1.27% in 1984 but down from 1.73% in 1983. The increase in the chargeoff percentage is primarily due to upward delinquency trends in the credit card segment.

The effective income tax rates were 36.5%, 1.1% and 24.8% in 1985, 1984 and 1983. These rates are lower than the U.S. statutory tax rate of 46% principally because investment income includes interest on tax-free municipal bonds and dividends (only 15% of dividends are taxable). For 1984, taxes were further reduced by $14.0 representing the effect of 1984 changes in the tax law for life insurance companies ("fresh start" adjustment) and, additionally, by $6.4 resulting from reduced foreign income subject to taxes. Further fluctuations were primarily because non taxable items and tax credits did not increase in the same proportion as pre-tax income.

Income from continuing operations rose 11% in 1985, was flat in 1984 and increased 37% in 1983. The increase in 1985 was primarily due to Consumer Finance earnings and secondarily to an increase in Insurance Group income. The Consumer Finance Group's income was up $6.7 (6%) over 1984, and the Insurance Group's earnings increased to $5.0 in 1985 from $1.9. In 1984 a 16% increase in consumer finance income was entirely offset by lower insurance earnings. The increase in 1983 resulted from improved earnings of the Consumer Finance Group offset in part by lower Insurance earnings.

The Company's overall net income declined 5% in 1985 as income from discontinued operations declined sharply and offset improvement in continuing operations. The 1984 net income results were flat as improvement in consumer finance operations and Merchandising Division earnings was negated by the earnings decline in insurance operations.

The ratio of earnings to fixed charges (based on income from continuing operations) was 1.29 to 1 in 1985, 1.20 to 1 in 1984 and 1.30 to 1 in 1983. The 1985 improvement was due to higher pre-tax income. The 1984 decline was the result of higher interest expense and lower insurance earnings.

Statement of Changes in Financial Position

(Unaudited) Three Months Ended December 31			Years Ended December 31		
1985	1984	(in millions)	1985	1984	1983
		Cash Provided by Operations and Retained in the Business			
$ 24.8	$ [illegible]	Income From Continuing Operations	$ 99.9	$ 89.7	$ 90.1
		Add (Deduct) Items Not Requiring Cash Outlay			
39.6	128.3	Increase in Insurance Reserves	439.7	374.7	236.8
45.3	34.5	Provision for Credit Losses (before recoveries)	115.4	108.2	125.5
24.5	(21.0)	Provision for Deferred Income Taxes	43.0	(23.8)	18.6
(18.3)	(19.6)	Other	38.0	38.6	65.1
115.9	143.8	Cash Provided by Operations	736.0	587.4	536.1
		Dividends Paid			
(4.0)	(3.7)	Preferred	(16.7)	(16.9)	(17.1)
(9.9)	(10.8)	Common	(43.4)	(44.0)	(44.1)
102.0	129.3		675.9	526.5	474.9
		Financing Transactions			
310.4	249.3	Increase (Decrease) in Short-Term Debt	414.4	376.8	79.6
17.6	175.2	Long-Term Debt Issued	271.1	846.8	538.3
(62.6)	(121.2)	Long-Term Debt Paid	(361.9)	(580.3)	(252.3)
(16.7)	—	Redemption of Preferred Stock	(16.7)	—	—
9.2	33.3	Increase (Decrease) in Accounts Payable	(31.9)	76.3	(32.3)
57.8	7.7	Increase (Decrease) in Deposits Payable	97.3	22.5	6.9
315.7	344.3		372.3	742.1	340.2
		Investments in Operations			
(263.8)	(273.5)	Decrease (Increase) in Principal of Finance Receivables (before chargeoffs and foreign currency fluctuations)	(524.2)	(852.8)	(752.0)
(284.1)	—	Purchases of Credit Card Portfolios	(292.3)	(13.8)	(24.1)
(20.7)	(81.8)	Decrease (Increase) in Other Receivables	14.0	(98.1)	(72.7)
(92.1)	(125.0)	Decrease (Increase) in Investments	(459.6)	(338.3)	(43.4)
283.5	6.8	Net Proceeds From Discontinued Operations (including sale of foreign subsidiaries)	330.2	(6.0)	42.9
—	—	Proceeds From Pension Plan Restructuring	—	50.6	—
(7.6)	(10.6)	Additions to Property and Equipment (net)	(31.8)	(29.7)	(7.5)
(43.7)	2.6	Other	(83.1)	19.0	(4.8)
(428.5)	(481.5)		(1,046.8)	(1,269.1)	(861.6)
(10.8)	(7.9)	Increase (Decrease) in Cash	1.4	(.5)	(46.5)
150.4	146.1	Cash at Beginning of Period	138.2	138.7	185.2
$139.6	$ 138.2	Cash at End of Period	$ 139.6	$ 138.2	$ 138.7

See Notes to Financial Statements.

Management's Discussion and Analysis of Changes in Financial Position (amounts in millions)

Beneficial's principal sources of cash generally are collections of finance receivables, proceeds from the issuance of long and short-term debt, and cash provided by operations.

During 1985, in addition to the above, a major source of cash was proceeds received from the sale of the Company's Merchandising Division, Western Auto Supply Company and Subsidiaries. While the acquisition of credit card portfolios temporarily increased the level of short-term debt, the Western Auto proceeds brought short-term debt roughly back to the pre-acquisition level.

As a percentage of average monthly balances, monthly cash principal collections from customers increased to 4.63% in 1985 from 4.05% in 1984 due mainly to a larger percentage of credit card receivables in the portfolio. A large portion of these receivables are paid off in less than a year. The percentage of monthly cash principal collections to average monthly balances decreased to 4.05% in 1984 from 4.22% in 1983 due to a reduction in prepayments and an increasing amount of l[illegible]ger-term real estate secured loans in the portfolio.

The Company finances its operations largely through the issuance of long-term debt. One of the Company's major financial strengths is its ability to raise long-term debt in [illegible] wide variety of domestic and international markets. The [illegible]mpany has strong liquidity because of its substantial [illegible]ccess to worldwide credit sources as well as regular cash collections.

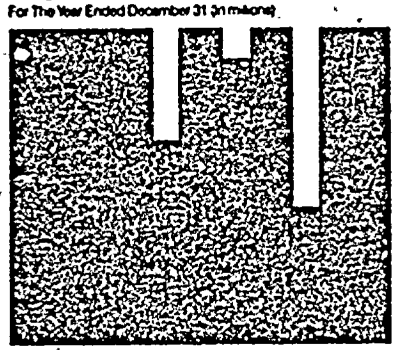
The primary source of short-term funds for the Company is commercial paper supported by bank lines of credit and revolving credit lines. The tota[illegible] [illegible] lines of credit [illegible] in excess of $1 300, with $563 in [illegible] [illegible]rm of committed two-year revolving credit facilities. At December 31, 1985, the unused portions of all lines of credit were $1,184.

In 1984 the Company received $50 6 in excess assets from restructuring its domestic pension plan. This gain is being amortized against future pension expense.

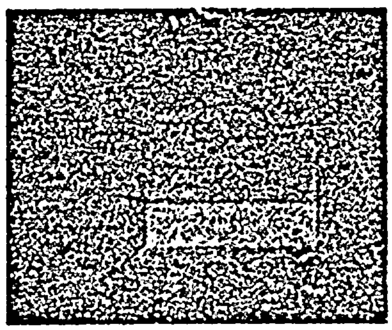
Beneficial's principal uses of cash generally are loans to customers, repayments of maturing debt, purchases of investments, and dividends paid to shareholders.

Supplementary Financial Data Adjusted for General Inflation is on page 46

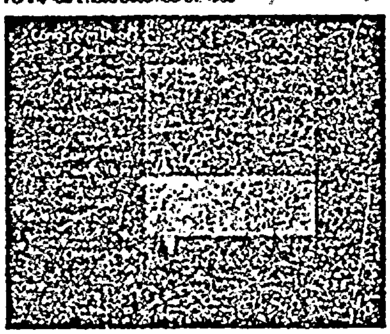
Long-Term Debt Issued During The Year
For The Year Ended December 31 (in millions)



Sources of Cash
For the Year Ended December 31, 1985



Uses of Cash
For the Year Ended December 31, 1985



Notes to Financial Statements
(amounts in millions)

1. Summary of Significant Accounting Principles and Practices

a) Basis of Consolidation. The consolidated financial statements include, after inter-company eliminations, the accounts of all significant subsidiaries except discontinued operations.

Certain prior period amounts have been reclassified to conform with the 1985 presentation.

b) Finance Operations. The financial statements except for certain consumer finance revenue are prepared on the accrual basis.

Finance charges on discounted loans are generally taken into income as earned and collected under the sum-of-the-digits method. Interest from interest-bearing direct cash loans is taken into income as collected. Finance charges on bank credit card receivables are taken into income as earned.

Receivables considered to be uncollectible or to require disproportionate collection costs are charged to the reserve for credit losses, but collection efforts are generally continued.

c) Insurance Operations. Insurance subsidiaries are engaged primarily in writing credit life, credit accident and health, property and casualty insurance, and annuities. Premiums on credit life insurance are taken into income on the sum-of-the-digits method when the insured amounts decrease with collections, or on the straight-line method over the lives of the policies in the case of level-term contracts. Premiums on credit accident and health contracts are generally taken into income on an average of the sum-of-the-digits and the straight-line methods. Property and casualty premiums are taken into income on the straight-line method. Premiums on life insurance and annuities are recognized as income when due.

Policy reserves for credit life, credit accident and health, and property and casualty are equal to related unearned premiums. Credit accident and health reserves are adjusted to reflect claim experience. Liabilities for future life insurance benefits and annuity policies are accrued when premium revenue is recognized and have been computed using assumptions as to investment yields, mortality, morbidity and withdrawals and are presented net of reinsurance ceded.

Liabilities for policy and contract claims are based upon estimates of payments to be made for individual claims and claim expenses reported and for those losses and claim expenses incurred but unreported. Such estimates are reviewed regularly, and any changes in the estimates are recognized in income currently.

Insurance policy acquisition costs are deferred and amortized over the lives of the policies in relation to premium revenue.

d) Valuation of Investments. Debt securities are carried at amortized cost; equity securities (substantially all marketable) are generally carried at market value, and other investments are carried at cost. The adjustment of the carrying amount of marketable equity securities from cost to market value is not reflected in the income statement but is recorded directly in shareholders' equity through a valuation allowance.

e) Corporate Expense. Administrative expenses and interest related to general corporate activities have not been allocated to Consumer Finance Group and Insurance Group segments as these costs are common expenses not applicable to a particular group. A reconciliation of the Consumer Finance Group's and Insurance Group's net income to total net income appears in the Eleven-Year Summary on pages 48-49.

f) Amortization of Excess Cost of Net Assets Acquired. Excess cost applicable to acquisitions is generally being amortized over 40 years.

g) Earnings Per Common Share. Earnings per common share are computed by deducting from net income dividend requirements on preferred stocks and dividing the remainder by average shares outstanding and their equivalents. None of the preferred stocks are common stock equivalents.

2. Discontinued Operations

In 1985, the Company sold its Merchandising Division, Western Auto Supply Company and Subsidiaries, to Wesray Capital Corporation. Including the repayment of all intercompany accounts, the Company received proceeds of $343.9, comprised largely of cash ($302.7) with the remainder in Western Auto preferred stock and a note. The transaction resulted in a loss on disposal of $7.4 (after an income tax benefit of $4.3), $.34 a share. The loss on disposal and the income from operations prior to September 30, 1985, are included in discontinued operations in the income statement. Revenues from non-consolidated discontinued operations were: $549.2 (for nine months), $697.7 and $650.3 in 1985, 1984 and 1983.

3. Finance Receivables

The principal of finance receivables and maximum term (in months from origination) are as follows:

	Amount		Maximum Term	
December 31	1985	1984	1985	1984
			(months)	
Real Estate Secured Loans	$3,127	$2,909	180	180
Personal Unsecured Loans	1,361	1,209	120	120
Bank Credit Card Receivables	1,052	749	135	135
Sales Finance Contracts	417	311	60	60
Lease Receivables	163	190	216	300
Total Principal of Finance Receivables	$6,120	$5,368		

Scheduled contractual payments of finance receivables to be received after December 31, 1985 are as follows:

	1986	1987	1988	1989	Beyond
Real Estate Secured Loans	18%	13%	13%	13%	43%
Personal Unsecured Loans	43	30	16	5	6
Bank Credit Card Receivables	17	14	12	10	47
Sales Finance Contracts	59	20	10	5	6
Lease Receivables	13	7	4	3	73
Overall	26	17	13	10	34

The above tabulation of scheduled contractual payments is not a forecast of collections. Collections of principal of finance receivables amounted to $3,043.5 for 1985 and $2,528.6 for 1984.

The percentage of monthly cash principal collections to average monthly balances was 4.63% for 1985 and 4.05% for 1984.

4. Investments

Investments are principally Insurance Group long-term investments.

Investments consist of the following:

December 31	1985		1984	
	Carrying Amount	Market Value	Carrying Amount	Market Value
Debt Securities				
Commercial Paper	$ 35.0	$ 35.0	$ 18.3	$ 18.3
U.S. Government Obligations	373.3	401.1	365.5	365.9
Foreign Government Obligations	31.3	38.0	44.0	38.9
Municipal Bonds	345.9	299.5	339.8	259.9
Convertible Bonds	3.4	3.3	3.8	3.4
Non-Convertible Bonds	838.2	930.3	400.8	403.5
Other	254.1	254.1	213.1	213.1
	1,881.2	1,961.3	1,385.3	1,303.0
Equity Securities				
Preferred Stocks	82.4	82.4	53.3	53.3
Common Stocks	24.2	24.2	76.5	76.5
	106.6	106.6	129.8	129.8
Other	36.4	36.4	13.2	13.2
Total Investments	$2,024.2	$2,104.3	$1,528.3	$1,446.0

Equity securities had a cost of $107.6 at December 31, 1985 and $145.8 at December 31, 1984. Realized gains and losses are determined on the specific cost identification basis. Net unrealized loss on equity securities is as follows:

December 31	1985	1984
Unrealized Losses	$(8.8)	$(19.0)
Less Unrealized Gains	7.8	3.0
Net Unrealized Loss	$(1.0)	$(16.0)

Notes to Financial Statements (continued)
(amounts in millions)

5. Other Assets

December 31	1985	1984
Accrued Interest	$ 64.1	$ 41.6
Excess Cost of Net Assets Acquired	50.8	53.1
Property Acquired by Foreclosure	19.9	16.4
Unamortized Account Acquisition Costs	57.9	8.9
Unamortized Insurance Policy Acquisition Costs	119.2	98.8
Unamortized Long-Term Debt Expense	19.9	31.8
Other	84.0	80.3
Total Other Assets	$415.8	$330.9

6. Short-Term Debt

December 31	1985	1984
Bank Borrowings	$ 195.0	$220.8
Commercial Paper	1,054.9	614.7
Total Short-Term Debt	$1,249.9	$835.5

Average interest rates (including the costs of maintaining lines of credit) on borrowings outstanding at year end are as follows:

	1985	1984	1983
Bank Borrowings	9.94%	11.01%	11.53%
Commercial Paper	8.23	9.38	9.65

The unused portion of bank lines of credit at December 31, 1985 and 1984 is $1,183.9 and $567.3. Generally, domestic lines of credit provide for a fee of ¼% per annum on the lines.

The weighted average annual interest rates (including the costs of maintaining lines of credit) and additional data for short-term debt are as follows:

	1985	1984	1983
Maximum Amount at Any Month End	$1,310.0	$841.3	$583.0
Daily Average Amount	965.9	632.4	436.3
Average Interest Rates on Borrowings During the Year			
U.S. Dollar	8.69%	10.72%	10.24%
Foreign Currency	11.28	12.50	11.43
Overall	9.17	11.33	10.78

The Company has effectively fixed the rate of interest paid on $117.0 of short-term borrowings at an average melded rate of 11.54% by entering into interest exchange agreements having contractual terms ranging from seven to ten years.

7. Accounts Payable and Accrued Liabilities

December 31	1985	1984
Accounts Payable	$103.2	$117.5
Accrued and Deferred Compensation	27.2	22.7
Accrued Interest	120.0	116.0
Deferred Income Taxes	34.2	—
Taxes Payable	40.6	27.3
Dealer Reserves	16.3	16.4
Insurance Premiums Payable	53.5	67.3
Unamortized Proceeds from Pension Plan Restructuring	39.4	44.3
Other	22.7	20.8
Total Accounts Payable and Accrued Liabilities	$457.1	$432.3

8. Long-Term Debt and Restrictions on Additional Capital and Retained Earnings

Long-term debt outstanding is as follows:

December 31	1985	1984
By Currency		
United States	$3,760.8	$3,790.0
British	75.7	70.0
Canadian	76.3	87.6
Other	70.1	102.8
Unamortized Discount	(61.6)	(73.3)
Total Long-Term Debt	$3,921.1	$3,977.1
By Maturity		
1985	$ —	$ 375.3
1986	452.4	311.8
1987	491.3	590.8
1988	427.4	394.9
1989	272.4	253.6
1990	347.6	234.9
1991–1995	1,202.6	1,102.6
1996–2000	252.0	252.0
2001–2005	234.5	234.5
2006–2013	302.5	300.0
Unamortized Discount	(61.6)	(73.3)
Total Long-Term Debt	$3,921.1	$3,977.1
Subordinated Debt Included Above	$ 50.0	$ 50.0
Weighted Average Annual Interest Rate on Debt Outstanding at End of Year	10.21%	10.41%

Long term debt at December 31, 1985 includes $392.7 for which the holder may elect payment prior to maturity. Such debt is shown above in the earliest year it could become payable.

Certain indentures and agreements relating to the Company's long-term debt contain covenants restricting payment of dividends (other than stock dividends) and the purchase and retirement of the Company's capital stock. At December 31, 1985 and 1984, the amounts of all unrestricted additional capital and retained earnings, under the most restrictive of these covenants, are approximately $158.4 and $349.7.

9. Capital Stock

The number of shares of capital stock is as follows:

Issued and Outstanding	December 31 1985	December 31 1984
Preferred—no par value (issuable in series). Authorized, 500,000 9.25% Series Redeemable Preferred—, $1,000 stated value.	108,334	125,000
Preferred—$1 par value Authorized, 2,500,000	—	—
5% Cumulative Preferred—$50 par value. Authorized, 585,730	407,718(a	407,718(a
$5.50 Dividend Cumulative Convertible Preferred—no par value—$20 stated value (each share convertible into 4.5 shares of Common; maximum liquidation value, $5,791,700 and $6,589,100) Authorized, 1,164,077	57,917	65,891
$4.50 Dividend Cumulative Preferred—$100 par value. Authorized, 103,976	103,976	103,976
$4.30 Dividend Cumulative Preferred—no par value—$100 stated value. Authorized, 1,069,204	836,585	836,585
Common—$1 par value. Authorized, 60,000,000	22,536,928(b	22,335,519(b
After deducting treasury shares		
a) 5% Cumulative Preferred	178,012	178,012
b) Common	4,585,478	4,751,012

At December 31, 1985, a total of 676,373 shares of Common Stock were reserved for conversion of the $5.50 Preferred and the 10.5% Convertible Instalment Notes. During the year, 165,534 treasury shares were issued upon conversion of the Notes, thereby increasing Additional Capital by $4.0.

Notes to Financial Statements (continued)
(amounts in millions)

10. Redeemable Preferred Stock

Dividends on the 9.25% Series Redeemable Preferred Stock, which are cumulative, are payable quarterly at $23.125 per share. Beginning November 15, 1985 and annually through November 15, 1999, the Company is required to redeem 8,333 shares of the stock through a sinking fund at $1,000 per share. Sinking fund payments are cumulative. The Company may, at its option, increase the sinking fund payment by 8,333 shares annually up to an aggregate of 43,750 shares. During 1985, the Company redeemed 16,666 shares. The Company has the right to redeem the stock beginning November 15, 1989 at an initial redemption price of $1,043.82 per share, declining ratably thereafter to $1,000 per share. Unless dividend and sinking fund payments on this stock are current, the Company may not pay dividends or make other distributions or purchase, redeem, or retire any issues of stock junior to this issue. Upon the arrearage of six quarterly dividends on any series of the Preferred Stock, the holders of the 9.25% Series Preferred Stock with the holders of other series of the Preferred Stock voting as a class would be entitled to elect two members of the Board of Directors.

11. Accumulated Foreign Currency Translation Adjustments

Assets and liabilities in foreign currencies are translated at the market rate at each balance sheet date. Foreign operating results are translated at the average market rate for each period covered by the statement of income.

An analysis of changes in accumulated foreign currency translation adjustments follows:

December 31	1985	1984
Balance at Beginning of Year	$(18.4)	$(15.9)
Adjustments for the Year	(3.1)	2.6
Related Income Taxes	5.7	(12.2)
Sales of Subsidiaries (net of taxes)	2.2	7.1
Balance at End of Year	$(13.6)	$(18.4)

12. Employee Retirement Plans

During 1983 the Company terminated its domestic retirement plan and replaced it with a restructured program providing the participants with equal or increased future retirement benefits. The restructured program covers substantially all employees in the United States. All participants in the terminated plan were 100% vested, and annuity contracts were purchased to provide benefits. Excess assets of $50.6 were returned to the Company and are being amortized against future retirement plan costs.

Net pension expense for domestic operations was $1.8, $1.1, and $.3 for 1985, 1984 and 1983. The Company has made annual contributions to the plans at least equal to the amounts accrued for retirement expense. Pension expense for the Company's foreign subsidiaries is immaterial.

Accumulated plan benefits and plan net assets for the Company's domestic retirement plan are:

January 1	1985	1984
Actuarial Present Value of Accumulated Plan Benefits		
Vested	$ 3.4	$ .5
Nonvested	7.2	4.1
Total Actuarial Present Value of Accumulated Plan Benefits	$10.6	$4.6
Net Assets Available for Benefits	$ 5.2	$1.1

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 9% in 1985 and 1984.

13. Income Taxes

The Company files a consolidated U.S. federal income tax return with all eligible subsidiaries, including the Merchandising Division prior to its disposition. Income taxes, whether payable currently or in the future, are provided on reported earnings. U.S. income taxes have not been

provided on retained earnings of foreign subsidiaries, as these earnings are expected to be permanently invested in foreign countries.

The provision for income taxes is comprised of:

	1985	1984	1983
Current			
U.S.	$ (6.3)	$ 8.6	$(11.4)
Foreign	10.9	7.9	16.3
Total	4.6	16.5	4.9
Deferred			
U.S.	39.4	(26.0)	17.4
Foreign	3.6	2.2	1.2
Total	43.0	(23.8)	18.6
Investment Tax Credit Deferred	1.9	2.0	—
State and Local	8.0	6.3	6.2
Total Provision for Income Taxes	$57.5	$ 1.0	$ 29.7

Deferred income taxes result from timing differences in the recognition of income and expense for tax and financial statement purposes and relate to:

	1985	1984	1983
Differences Between Cash and Accrual Basis	$ 5.0	$ 1.7	$ 7.5
Insurance Benefits Provided	4.5	(11.2)	4.2
Leasing Transactions	14.9	8.5	18.4
Provision for Credit Losses	(.5)	(.7)	(.6)
Tax Credits Applied to Deferred Taxes	—	9.0	(9.0)
Insurance Policy Acquisition Costs	2.0	4.6	.5
Recomputation of Insurance Reserves	—	14.0	—
Deferred Retirement Plan Credits	2.3	(20.5)	—
Reinsurance Transactions	6.8	—	—
Life Insurance Operating Losses	5.6	(2.6)	(4.5)
Other	2.4	1.3	2.1
Total Provision for Deferred Income Taxes	$43.0	$(23.8)	$18.6

A reconciliation of the provision for income taxes at the statutory U.S. income tax rate to the tax provision as reported follows:

	1985	1984	1983
Statutory U.S. Tax Rate	46.0%	46.0%	46.0%
Increase (Decrease) Resulting From:			
Differences Between U.S. Rate and Effective Foreign Tax Rates	(4.1)	(6.8)	(3.3)
Non-Taxable Investment Income	(6.6)	(11.0)	(8.1)
Deduction for Life Insurance Companies	(1.1)	(1.6)	(1.9)
Foreign Tax Credit	—	(3.4)	(2.8)
Investment Tax Credit	(1.6)	(2.4)	(5.8)
State and Local Income Taxes, After Federal Income Taxes	2.7	3.7	2.8
Recomputation of Insurance Reserves	—	(19.6)	—
Other	1.2	(3.8)	(2.1)
Effective Tax Rate	36.5%	1.1%	24.8%

14. Leases

The Company's consumer finance system operates from premises under leases generally having an original term of five years with a renewal option for a like term. The Company also leases an office complex with a primary term expiring in 2010 and renewal options totaling forty-seven years. Data processing equipment lease terms range from two to five years and are generally renewable. The minimum rental commitments under noncancelable operating leases at December 31, 1985 are as follows:

1986	$ 26.4
1987	28.0
1988	30.2
1989	27.2
1990	25.0
1991–1995	120.1
1996–2015	393.8
Total	$650.7

Notes to Financial Statements (concluded)
(amounts in millions)

15. Segment Information

The Company's principal operations are comprised of the Consumer Finance Group and the Insurance Group for which segment data is presented on pages 44 and 45. Inter-group eliminations are not material.

Operations of the Company are primarily in the United States. Foreign operations are conducted through subsidiaries in Canada, the United Kingdom and West Germany. In 1985 the Company sold operations in New Zealand and Ireland with finance receivables of $32.7, and in 1984 the Company sold operations in Australia and Japan with finance receivables of $216.3. These operations were sold for approximately net book value.

The Company generally attempts to limit its after-tax exposure to foreign exchange fluctuations by borrowing or selling forward in the same currencies as its assets. In the aggregate, amounts denominated in foreign currencies after translation to U.S. dollar equivalents are:

December 31	1985	1984
Assets	$ 652.6	$ 642.2
Liabilities	799.7	804.2
Net Assets (Liabilities)	$(147.1)	$(162.0)

Data by geographic area follows:

	Revenue			Income Before Income Taxes			Identifiable Assets	
	1985	1984	1983	1985	1984	1983	1985	1984
Geographic Area								
United States	$1,925.0	$1,592.0	$1,411.5	$142.0	$68.8	$ 90.6	$8,137.1	$6,941.9
Foreign	229.2	309.4	244.5	15.4	21.9	29.2	1,442.5	1,602.3
Intersegment Eliminations	(95.2)	(96.8)	(74.1)	—	—	—	(861.4)	(809.8)
Total	$2,059.0	$1,804.6	$1,581.9	$157.4	$90.7	$119.8	$8,718.2	$7,734.4

The assets above are classified by their identification with operations in each geographic area without regard to currency denominations.

16. Commitments and Contingent Liabilities

At December 31, 1985 Beneficial was contingently liable under agreements relating to the financing and development of a condominium project in Texas, entered into by Wasco Properties, Inc., a non-consolidated subsidiary. Pursuant to such agreements, and subject to certain terms and conditions, the subsidiary would be obligated to a maximum of $75.0 plus accrued interest to purchase condominium units which at the time had not been sold to third parties by the project developer or others should certain events occur.

17. Selected Financial Data

Selected unaudited financial data required by the Securities and Exchange Commission are included in the Data by Calendar Quarter—Supplemental Information, page 47 and in the Eleven-Year Summary—Supplemental Information, page 48.

The Board of Directors and Shareholders
of Beneficial Corporation

We have examined the balance sheets of Beneficial Corporation and Consolidated Subsidiaries as of December 31, 1985 and 1984 and the related statements of income and retained earnings and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Beneficial Acceptance Corporation (a consolidated subsidiary), which statements reflect revenue of $10.2, $14.7 and $14.4 million, respectively, for each of the three years ended December 31, 1985. We also did not examine the financial statements of the Merchandising Division, the equity in net assets and net income of which are included in discontinued operations. The financial statements of the aforementioned company and division were examined by other auditors whose reports thereon have been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for such company and division is based solely upon the reports of the other auditors.

In our opinion, based upon our examinations and the reports of other auditors referred to above, such statements present fairly the financial position of Beneficial Corporation and Consolidated Subsidiaries at December 31, 1985 and 1984 and the results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1985 in conformity with generally accepted accounting principles applied on a consistent basis.

DELOITTE HASKINS & SELLS
Deloitte Haskins & Sells
Morristown, New Jersey
February 4, 1986

Statement of Income

(Unaudited) Three Months Ended December 31			Years Ended December 31		
1985	1984	(in millions)	1985	1984	1983
		Net Finance Revenue			
$ 285.3	$271.3	Finance Charges and Fees	$1,086.4	$1,035.7	$ 919.7
122.1	119.4	Interest Expense	463.0	448.0	369.1
163.2	151.9	Gross Margin	623.4	587.7	550.6
15.3	7.6	Other Revenue	61.0	59.3	64.2
178.5	159.5	Total	684.4	647.0	614.8
		Operating Expenses			
43.5	36.5	Salaries and Employee Benefits	176.3	169.0	165.6
30.2	30.0	Provision for Credit Losses (less recoveries)	87.8	88.3	103.0
12.5	12.2	Rent	48.5	49.0	47.1
11.7	3.3	Advertising	27.4	21.1	21.7
4.3	2.7	Depreciation	15.1	11.0	11.2
2.4	2.0	Postage and Express	9.0	8.0	8.1
3.3	2.8	Printing and Stationery	10.6	10.5	8.5
4.5	3.6	Telephone	16.2	16.0	15.0
2.8	2.5	Travel	10.0	9.6	10.2
18.9	16.2	Other	66.0	66.3	59.4
134.1	111.8	Total	466.9	448.8	450.7
44.4	47.7	Income Before Income Taxes	217.5	198.2	164.1
17.7	21.4	Provision for Income Taxes	99.1	86.5	68.0
$ 26.7	$ 26.3	Net Income	$ 118.4	$ 111.7	$ 96.1
		Supplemental Information			
		During the Period			
$1,039.5	$851.7	New Funds Lent to Customers	$3,466.4	$3,172.5	$2,804.0
339.1	49.8	Principal of Finance Receivables Purchased	500.2	249.6	188.2
23.3	22.3	Finance Receivables Charged Off (less recoveries)	77.3	70.4	83.6
19.54%	19.92%	Annual Percentage Rate of Finance Charges and Fees Collected	19.47%	19.89%	20.53%
		Average Amount of Transaction (in dollars)	$ 2,530	$ 2,306	$ 2,589
		At End of Period			
		Total Assets	$6,323.4	$5,629.1	$5,136.5
		Number of Consumer Finance Offices	1,118	1,155	1,347

Statement of Income

(Unaudited) Three Months Ended December 31			Years Ended December 31		
1985	1984	(in millions)	1985	1984	1983
		Revenue			
$ 93.6	$151.7	Premium Revenue	$ 711.3	$ 565.1	$ 500.8
55.4	39.6	Investment Income (net)	193.3	142.1	101.2
2.6	2.2	Other Income	8.7	8.9	7.7
151.6	193.7	Total	913.3	716.1	609.7
		Benefits and Expenses			
59.6	126.8	Policy Benefits	353.3	366.2	238.2
41.8	67.2	Policy Reserve Increase	417.5	242.4	244.5
26.4	20.2	Commissions and Brokerage	116.3	104.2	81.6
5.2	4.8	Salaries and Employee Benefits	17.8	15.8	13.8
		Decrease (Increase) in Unamortized Policy			
(.2)	4.5	Acquisition Costs	(20.4)	(14.3)	(14.4)
1.1	1.8	Licenses and Taxes	5.9	6.3	5.9
9.2	7.2	Other Expenses	31.5	25.0	24.2
143.1	232.5	Total	921.9	765.6	593.8
8.5	(38.8)	Income (Loss) Before Income Taxes	(8.6)	(49.5)	15.9
[illegible]	(41.5)	Provision for Income Taxes	(15.4)	(58.0)	(10.2)
[illegible]	2.7	Income Before Realized Net Investment Gain	6.8	8.5	26.1
		Realized Net Investment Gain (Loss),			
(.3)	2.6	After Income Taxes	12.8	6.2	3.5
6.7	5.3	Income Before Interest Allocation	19.6	14.7	29.6
		Interest Expense Related to Investment in Insurance			
(3.7)	(3.8)	Group, After Income Taxes	(14.6)	(12.8)	(11.4)
$ 3.0	$ 1.5	Net Income	$ 5.0	$ 1.9	$ 18.2

		Supplemental Information			
		During the Period			
$ 93.2	$161.4	Premiums Written	$ 720.8	$ 598.0	$ 505.7
		Ratio of Premiums Written to			
.78	1.42	Shareholder's Equity (annualized)	1.47	1.31	1.29
		At End of Period			
		Investments	$1,988.1	$1,480.9	$1,098.2
		Unamortized Policy Acquisition Costs	119.2	98.8	84.5
		Total Assets	2,541.5	1,921.1	1,519.0
		Insurance Policy and Claim Reserves	1,801.0	1,361.3	986.6
		Shareholder's Equity	491.1	455.5	393.2
		Life Insurance in Force	7,861.8	7,230.2	7,115.6

Supplementary Financial Data Adjusted for General Inflation (amounts in millions)

The Financial Accounting Standards Board in its Statements No. 82 and No. 33 requires that selected historical financial data be restated to reflect the effects of inflation using one of two methods of measurement: the constant dollar method or the current cost method. The constant dollar method requires that the historical cost data of the primary financial statements be adjusted for general inflation using the Consumer Price Index for All Urban Consumers (CPI-U). The current cost method requires that the historical cost data of the primary financial statements be adjusted for the effects of changes in values of specific assets: property and equipment, the specific asset of the Company affected by the requirement, is relatively insignificant to the operations of the Company. Current cost amounts do not differ materially from constant dollar amounts presented below.

The table below shows the effect of adjusting selected financial data to average 1985 dollars. As most of the Company's assets and liabilities are monetary in nature and fixed in terms of the amount of cash to be received or paid, they require no adjustment to income from continuing operations. Property and equipment was restated to average 1985 dollars using the CPI-U, which resulted in higher depreciation expense and, consequently, reduced income from continuing operations by $2.6. SFAS No. 33 requires that no adjustment be made to the provision for income taxes for the additional depreciation expense. Revenue and other expense items were not restated as they are assumed to have occurred proportionately to the CPI-U over the course of the year.

The decline in purchasing power of net monetary assets held is shown as a separate line item and is not included as an adjustment to income from continuing operations.

Net assets at year-end 1985 were calculated by reducing shareholders' equity by the historical cost of property and equipment and converting the remaining shareholders' equity to average 1985 dollars. To this figure is added the constant dollar property and equipment balance. The data presented herein should not be viewed as a precise calculation of the effects of inflation.

Management Strategies for Coping With Inflation

The current year results benefited from a moderate inflationary environment. Implementation of various corporate programs has ensured that resources are efficiently utilized and costs are adequately controlled. To minimize the impact of inflation and the effects of volatile interest rates, the Company is originating an increasing amount of variable-rate receivables which are funded by short-term debt. In addition, the Company is rapidly expanding its bank credit card business, which also provides protection in some cases against volatility in short-term interest rates. Management believes these practices will help contribute to the maximization of profits in an inflationary environment and will reduce the impact of any significant rise in interest rates.

Five-Year Summary of Selected Supplementary Financial Data Adjusted for General Inflation (Unaudited)
(in 1985 dollars)

Years Ended December 31	1985	1984	1983	1982	1981
Revenue	$2,059.0	$1,869.0	$1,708.1	$1,669.1	$1,785.9
Income From Continuing Operations	97.3	90.8	95.1	71.7	60.1
Net Assets at Year End	1,045.3	1,031.7	1,045.7	1,021.3	1,183.8
Per Common Share					
Income From Continuing Operations	3.65	3.30	3.42	2.35	1.79
Cash Dividends	2.00	2.07	2.16	2.23	2.37
Market Price at Year End	48.50	34.95	36.44	27.31	23.80
Decline in Purchasing Power of Net Monetary Assets Held	28.4	24.2	21.9	16.0	40.3
Average Consumer Price Index	322.2	311.1	298.4	289.1	272.4

ta by Calendar Quarter

pplemental Information	1985				
millions, except per share figures)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
venue	$ 561.1	$ 560.7	$ 493.1	$ 444.1	[illegible]
ome Before Income Taxes	$ 37.4	$ 38.5	$ 45.2	$ 36.3	$ 157.4
Income					
ncome From Continuing Operations	$ 24.4	$ 24.7	$ 26.0	$ 24.8	$ 99.9
ncome (Loss) From Discontinued Operations	2.7	3.9	(5.3)	—	1.3
Total	$ 27.1	$ 28.6	$ 20.7	$ 24.8	$ 101.2
rnings Per Common Share					
Continuing Operations	$ .91	$ .93	$ .99	$ [illegible]	$ 3.76
Discontinued Operations	.13	.17	(.24)	—	.06
Total	$ 1.04	$ 1.10	$ .75	$ .93	$ 3.82
mmon Stock					
High Sales Price	$ 37.50	$ 45.50	$ 45.00	$ 49.50	
Low Sales Price	31.625	36.375	37.00	38.125	
Dividends Paid Per Share	.50	.50	.50	.50	$ 2.00

	1984				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
venue	$ 445.1	$ 480.1	$ 406.5	$ 472.9	$1,804.6
come (Loss) Before Income Taxes	$ 35.0	$ 32.6	$ 28.2	$ (5.1)	$ 90.7
t Income					
Income From Continuing Operations	$ 23.1	$ 20.7	$ 24.3	$ 21.6	$ 89.7
Income From Discontinued Operations	3.1	4.0	3.3	6.2	16.6
Total	$ 26.2	$ 24.7	$ 27.6	$ 27.8	$ 106.3
rnings Per Common Share					
Continuing Operations	$ .84	$ .73	$ .91	$ .79	$ 3.27
Discontinued Operations	.14	.18	.15	.28	.75
Total	$ .98	$ .91	$ 1.06	$ 1.07	$ 4.02
mmon Stock					
High Sales Price	$ 35.50	$27.875	$ 32.25	$ 34.00	
Low Sales Price	25.25	23.00	24.125	27.75	
Dividends Paid Per Share	.50	.50	.50	.50	$ 2.00

Eleven-Year Summary

Supplemental Information (amounts in millions, except where noted)	1985	1984
During The Year		
Net Income		
Consumer Finance Group	$ 118.4	111.7
Insurance Group	$ 5.0	1.9
Corporate Expenses	$ (23.5)	(23.9)
Income From Continuing Operations	$ 99.9	89.7
Income (Loss) From Discontinued Operations	$ 1.3	16.6
Net Income (Loss)	$ 101.2	106.3
Earnings Per Common Share (dollars)		
Continuing Operations	$ 3.76	3.27
Discontinued Operations	$ .06	.75
Net Income (Loss)	$ 3.82	4.02
Average Number of Common Shares	22.1	22.2
Dividends Paid Per Common Share (dollars)	$ 2.00	2.00
Revenue	$2,059.0	1,804.6
Interest	$ 520.2	503.9
Provision for Credit Losses (less recoveries)	$ 87.8	88.3
Total Expenses	$1,901.6	1,713.[illegible]
Income Before Income Taxes	$ 157.4	90[illegible]
% Return on Average Assets (a)	1.24	1.2[illegible]
% Return on Average Equity (includes redeemable preferred stock) (a)	12.43	12.35
% of Monthly Cash Principal Collections to Average Monthly Balances	4.63	4.05
% of Finance Receivables Charged Off (less recoveries) to Average Monthly Balances	1.31	1.27
At Year End		
Principal of Finance Receivables	$6,119.5	5,367.5
Reserve for Credit Losses	$ 234.4	212.4
Total Assets	$8,718.2	7,734.4
Short-Term Debt (bank notes and commercial paper)	$1,249.9	835.5
Long-Term Debt	$3,921.1	3,977.1
Redeemable Preferred Stock	$ 108.3	125.0
Shareholders' Equity (includes redeemable preferred stock)	$1,042.0	992.8
% of Reserve for Credit Losses to Principal of Finance Receivables	3.83	3.96
% of Finance Receivables with Payments More Than Two Months Delinquent:		
Loans Only (based upon recency of payment) (b)	.75	.74
Bank Credit Cards (based upon contractual terms) (c)	1.36	1.28
Number of Accounts	2.6	2.3
Average Loan Balance (dollars) (b)	$ 4,563	4,069
Average Credit Card Balance (dollars) (c)	$ 1,036	1,222
Average Account Balance (dollars)	$ 2,379	2,335
Number of Holders of Common Shares	23,700	25,700
Number of Employees (a)	8,300	8,000

(a) Continuing operations only.
(b) Loans include real estate secured and personal unsecured loans.
(c) Prior to 1982 bank credit cards were not a significant part of the receivable portfolio.

1983	1982	1981	1980	1979	1978	1977	1976	1975
96.1	64.2	16.8	54.8	57.3	66.0	60.4	55.6	43.5
18.2	22.2	50.8	50.4	46.2	38.7	28.3	19.5	16.4
(24.2)	(20.7)	(12.9)	(10.1)	(11.6)	(9.2)	(7.8)	(7.5)	(6.7)
90.1	65.7	54.7	95.1	91.9	95.5	80.9	67.6	53.2
15.5	(97.1)	(62.4)	(1.3)	8.4	2.8	4.8	32.8	20.2
105.6	(31.4)	(7.7)	93.8	100.3	98.3	85.7	100.4	73.4
3.26	2.17	1.69	3.50	3.83	4.06	3.42	2.92	2.29
.70	(4.34)	(2.80)	(.06)	.38	.13	.22	1.60	1.05
3.96	(2.17)	(1.11)	3.44	4.21	4.19	3.64	4.52	3.34
22.4	22.4	22.3	22.3	22.2	22.1	21.8	20.4	19.1
2.00	2.00	2.00	2.00	1.95	1.70	1.60	1.4375	1.25
1,581.9	1,497.6	1,509.9	1,473.1	1,009.7	769.5	640.4	536.5	460.3
423.7	449.2	484.1	423.7	271.1	181.7	140.6	111.8	97.7
103.0	114.9	108.3	107.2	102.4	70.9	65.7	60.4	54.8
1,462.1	1,414.6	1,424.2	1,344.9	882.2	612.5	499.9	415.5	359.2
119.8	83.0	85.7	128.2	128.1	154.8	140.5	116.3	95.0
1.47	1.12	.96	1.73	2.05	2.96	3.04	2.97	2.30
13.77	11.20	10.13	18.85	19.02	19.48	18.03	17.04	14.72
4.22	3.64	3.85	4.01	4.37	4.43	4.34	4.35	4.28
1.73	2.45	2.17	2.34	1.87	1.57	1.74	2.04	2.42
4,884.3	4,256.3	4,445.8	4,252.9	4,264.0	3,015.4	2,526.2	2,065.0	1,828.4
205.4	188.3	196.5	194.8	203.7	147.8	126.3	106.3	95.0
6,718.9	6,047.9	6,373.2	6,031.4	6,029.2	3,881.1	3,321.2	2,727.9	2,545.0
509.6	432.0	1,042.3	746.7	926.8	478.9	375.3	267.4	279.4
3,841.7	3,558.9	3,357.3	3,336.0	3,324.7	2,210.0	1,861.7	1,492.9	1,355.3
125.0	125.0	125.0	125.0	103.0	—	—	—	—
953.0	910.3	1,003.5	1,079.7	1,029.1	886.5	835.1	791.2	723.8
4.21	4.42	4.42	4.58	4.78	4.90	5.00	5.10	5.20
.97	1.37	1.62	1.57	1.26	1.15	1.08	1.19	1.29
1.10	1.40	—	—	—	—	—	—	—
2.1	[illegible]	2.5	3.2	3.7	3.0	2.5	2.1	2.0
3,741	2,889	2,366	1,802	1,508	1,333	1,289	1,186	1,327
1,164	879	—	—	—	—	—	—	—
2,313	2,048	1,811	1,344	1,154	1,013	1,031	995	911
27,400	27,700	29,400	31,200	32,000	33,200	32,700	31,700	29,900
8,000	8,000	10,400	12,100	13,500	10,300	9,700	8,900	8,600

Beneficial Corporation

Officers

Finn M. W. Caspersen	Chairman of the Board of Directors and Chief Executive Officer	Robert R. Meyer	Senior Vice President and Controller
Gerald L. Holm	Vice Chairman	Bruce A. Olster	Senior Vice President —Tax
David J. Farris	Member of the Office of the President	Mark A. Peterson	Senior Vice President —Human Resources
Andrew C. Halvorsen	Member of the Office of the President and Chief Financial Officer	Maryann W. Schneider	Senior Vice President —Corporate Strategy and Planning
William H. H. Ely, Jr.	Senior Vice President and Treasurer	Kenneth J. Kircher	Vice President and Secretary
James H. Gilliam, Jr.	Senior Vice President —General Counsel	William V. Krause	Vice President
William A. Gross	Senior Vice President —Audit	Ann Stephenson	Vice President —Public Affairs
		Richard F. White	Vice President —Field Audit

Beneficial Management Corporation

Executive Committee

David J. Farris	President and Chief Executive Officer, Chairman of the Executive Committee
Frederick M. Dawson	
J. Edward Kerwan	
W. James Murphy	
Joseph N. Scarpinato	
David B. Ward	

Senior Vice Presidents

Robert M. Grohol	Operating
Charles E. Hance	General Counsel
J. Edward Kerwan	Data Processing
Richard P. Kotz	Marketing
Thomas P. McGough	Financial Controls
W. James Murphy	Operating
David B. Ward	Government Relations

Group Presidents

James L. Arpin	Midwest Group
Pierre E. Bashe	Northwest Group
John France	United Kingdom Group
James L. Frans	Southern Group
Peter J. Gimino, Jr.	Southwest Group
J. C. Heywood	North Central Group
Forrest B. Kinney	Gulf Coast Group
Francis X. Mohan	Northeast Group
Manfred E. Niebisch	Canadian Group
Kendall D. Kelley	Mid-Atlantic Group
Anthony T. Yesenofski	Beneficial Business Credit

Beneficial Insurance Group

Executive Committee

Frederick M. Dawson	Chairman of the Board and Chief Executive Officer
Thomas B. Leonardi	Executive Vice President
Daniel R. O'Brien	Executive Vice President
Robert Rothman	Executive Vice President and Chief Financial Officer

Beneficial National Bank USA

Joseph N. Scarpinato — Chairman of the Board and Chief Executive Officer

Beneficial National Bank

James W. Wright — President and Chief Executive Officer

Beneficial Mortgage Corporation

Rolf F. Eriksen — Chairman of the Board and Chief Executive Officer

Beneficial Commercial Corporation

Larry K. Morris — President and Chief Executive Officer

Board of Directors

Charles W. Bower [3]
Retired; former Senior Vice President and Treasurer of Beneficial Corporation

Robert C. Cannada [3,6,7]
Attorney at Law, Butler, Snow, O'Mara, Stevens & Cannada, Jackson, Mississippi

Finn M. W. Caspersen [1,2,5]
Chairman of the Board of Directors and Chief Executive Officer

David J. Farris [1,5,6]
Member of the Office of the President; Chief Executive Officer, Beneficial Management Corporation, a subsidiary

James H. Gilliam, Jr. [6]
Senior Vice President-General Counsel

Andrew C. Halvorsen [1,2,5]
Member of the Office of the President and Chief Financial Officer

J. Robert Hillier [4,5,6]
Architect and businessman, The Hillier Group, Inc. Princeton, New Jersey

Gerald L. Holm [1,2,5]
Vice Chairman

Steven Muller [5,6]
President, Johns Hopkins University Baltimore, Maryland

Susan Julia Ross [5]
Attorney at Law, Natelson and Ross, Taos, New Mexico

Robert A. Tucker [1,2]
Retired; former Member of the Office of the President and Chief Financial Officer of Beneficial Corporation

E. Norman Veasey [3,6,7]
Attorney at Law, Richards, Layton & Finger, Wilmington, Delaware

Susan M. Wachter [5,6]
Associate Professor of Finance
The Wharton School
University of Pennsylvania
Philadelphia, Pennsylvania

Arthur T. Ward, Jr. [4,5]
Medical Doctor and businessman, Baltimore, Maryland

Charles H. Watts, II [1,3,5,7]
General Director, educational and business consultant, McLean, Virginia

Sigfried Weis [4,6]
President, Weis Markets, Inc. Sunbury, Pennsylvania

K. Martin Worthy [4,7]
Attorney at Law, Hamel & Park, Washington, D.C.

Directors Emeriti
Cecil M. Benadom
Elbert N. Carvel
Freda R. Caspersen
George R. Evans
J. Thomas Gurney
Modie J. Spiegel
Ralph B. Williams

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(1) Member of Executive Committee (Finn M. W. Caspersen, Chairman)
(2) Member of Finance Committee (Andrew C. Halvorsen, Chairman)
(3) Member of Audit Committee (Charles H. Watts, II, Chairman)
(4) Member of Compensation Committee (K. Martin Worthy, Chairman)
(5) Member of Strategic Planning and Evaluation Committee (J. Robert Hillier, Chairman)
(6) Member of Management Development and Marketing Committee (E. Norman Veasey, Chairman)
(7) Member of Corporate Policy Committee (E. Norman Veasey, Chairman)

Beneficial Corporation is a direct issuer of commercial paper to institutional and other corporate investors. Notes are sold in amounts of $100,000 or more, for maturities of 5 to 270 days, at competitive market rates. Daily rates for Beneficial commercial paper are posted nationally on the TELERATE SYSTEM next to the symbol "BNL." For further information call (201) 781-3614.

Media representatives and others seeking general information about the Company should contact Ms. Ann Stephenson at (201) 781-3880.

Security analysts, portfolio managers, and other investors seeking financial information about the Company should contact Mr. William H. H. Ely at (201) 781-3609 or Ms. Claire R. Leonardi at (201) 781-3607.

Stockholders seeking information about the dividend reinvestment service, securities transfer matters, and dividend payments should contact Mr. Kenneth J. Kircher at (302) 798-7102.

Copies of the company's 10-K report to the SEC are available upon request from Mr. Kenneth J. Kircher, Beneficial Corporation, P.O. Box 911, Wilmington, Delaware 19899.

The Annual Meeting of the shareholders of Beneficial Corporation will be held on Wednesday, April 30, 1986 at 11 a.m. in the Company's headquarters, Beneficial Building, 1100 Carr Road, Wilmington, Delaware.

Morgan Guaranty Trust Company of New York, New York is both registrar and transfer agent for all classes of Beneficial Corporation common and preferred stock.

EXHIBIT 22

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

Quarterly Report Under Section 13 or 15(d)

of The Securities Exchange Act of 1934

For Quarter Ended March 31, 1986 — Commission File No. 1-1177

BENEFICIAL CORPORATION

Delaware — 51-0003820

(State of Incorporation) — (I.R.S. Employer Identification No.)

Beneficial Building, 1100 Carr Road, Wilmington, Delaware 19899

(Address of principal executive offices)

Telephone: (302) 798-0800

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of March 31, 1986.

Common Stock, $1 par value (only one class) — 22,606,780 shares outstanding

PROCESSED BY DISCLOSURE INCORPORATED

RECEIVED MAY 15 1986

PART I. FINANCIAL INFORMATION
BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
BALANCE SHEET

	March 31 1986	December 31 1985
	(in millions)	
ASSETS		
Cash and Equivalents	$ 172.8	$ 139.6
Finance Receivables	6,556.1	6,471.9
Less Unearned Finance Charges	(336.3)	(352.4)
Principal of Finance Receivables	6,219.8	6,119.5
Less Reserve for Credit Losses	(234.9)	(234.4)
Insurance Policy and Claim Reserves (applicable to finance receivables)	(87.5)	(103.2)
Net Finance Receivables	5,897.4	5,781.9
Other Receivables	286.4	223.9
Investments	2,231.9	2,024.2
Property and Equipment (at cost, less accumulated depreciation of $47.0 and $51.7)	140.6	132.8
Other Assets	413.0	415.8
TOTAL	$9,142.1	$8,718.2
LIABILITIES AND SHAREHOLDERS' EQUITY		
Short-Term Debt		
U.S. Currency	$1,095.8	$1,097.9
Foreign Currencies	219.7	152.0
Less Temporary Investment of Excess Funds	(107.5)	—
	1,208.0	1,249.9
Deposits Payable (includes employee thrift deposits)	414.8	350.3
Accounts Payable and Accrued Liabilities	502.9	457.1
Insurance Policy and Claim Reserves (applicable to risks other than finance receivables)	1,890.2	1,697.8
Long-Term Debt	4,063.9	3,921.1
TOTAL LIABILITIES	8,079.8	7,676.2
Redeemable Preferred Stock	108.3	108.3
Other Preferred Stock	115.6	115.7
Common Stock (60.0 shares authorized, 22.6 and 22.5 shares issued and outstanding)	22.6	22.5
Additional Capital	70.3	68.4
Net Unrealized Gain (Loss) on Equity Securities	2.5	(1.0)
Accumulated Foreign Currency Translation Adjustments	(12.2)	(13.6)
Retained Earnings	755.2	741.7
TOTAL	$9,142.1	$8,718.2

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES

STATEMENT OF INCOME

	Three Months Ended March 31 1986	1985
	(in millions)	
REVENUE	$619.2	$561.1
EXPENSES		
Insurance Benefits and Policy Reserve Increase	264.2	246.7
Interest	138.7	128.7
Salaries and Employee Benefits	57.2	50.3
Provision for Credit Losses (less recoveries)	21.6	20.2
Other	92.7	77.8
Total	574.4	523.7
INCOME BEFORE INCOME TAXES	44.8	37.4
Provision for Income Taxes	15.6	13.0
INCOME FROM CONTINUING OPERATIONS	29.2	24.4
INCOME FROM DISCONTINUED OPERATIONS	–	2.7
NET INCOME	$ 29.2	$ 27.1
EARNINGS PER COMMON SHARE		
Continuing Operations	$ 1.14	$ .91
Discontinued Operations	–	.13
Net Income	$ 1.14	$ 1.04
DIVIDENDS PER COMMON SHARE	$ .50	$ .50

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF CHANGES IN FINANCIAL POSITION

	Three Months Ended March 31 1986	1985
	(in millions)	
CASH PROVIDED BY OPERATIONS AND RETAINED IN THE BUSINESS		
Income From Continuing Operations	$ 29.2	$ 24.4
Add (Deduct) Items Not Requiring Cash Outlay		
Increase in Insurance Reserves	176.7	170.1
Provision for Credit Losses (before recoveries)	25.6	24.4
Provision for Deferred Income Taxes	6.2	11.8
Other	22.0	24.9
CASH PROVIDED BY OPERATIONS	259.7	255.6
Dividends Paid	(15.7)	(15.8)
	244.0	239.8
FINANCING TRANSACTIONS		
Increase (Decrease) in Short-Term Debt	(41.9)	39.3
Long-Term Debt Issued	274.7	47.4
Long-Term Debt Paid	(139.9)	(84.2)
Increase (Decrease) in Accounts Payable	30.6	(.6)
Increase (Decrease) in Deposits Payable	64.5	25.7
	188.0	27.6
INVESTMENTS IN OPERATIONS		
Decrease (Increase) in Principal of Finance Receivables (before charge-offs and foreign currency fluctuations)	(116.8)	(94.3)
Decrease (Increase) in Other Receivables	(62.5)	(3.3)
Decrease (Increase) in Investments	(204.2)	(195.5)
Additions to Property and Equipment (net)	(12.4)	(9.4)
Proceeds From Sale of Subsidiary	-	27.6
Other	(2.9)	(13.2)
	(398.8)	(288.1)
INCREASE (DECREASE) IN CASH	33.2	(20.7)
Cash and Equivalents at Beginning of Period	139.6	138.2
CASH AND EQUIVALENTS AT END OF PERIOD	$ 172.8	$ 117.5

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS
(amounts in millions)
(continued)

Material Changes in Financial Condition

The Company experienced consistent receivable growth during the quarter and the prior twelve months. Finance receivables grew $100 in the current quarter and $779 over the March 1985 level. The first quarter growth occurred in real estate secured loans ($71), leveraged leases ($14), personal revolving loans ($13), and sales finance contracts ($10). Credit card receivables declined $8 due to reduced customer card usage. Of the real estate secured loan growth, $47 was in revolving real estate loans and the remainder was the result of a portfolio acquisition.

The reserve for credit losses as a percentage of finance receivables at March 31, 1986 was 3.78% as compared to 3.83% at December 31, 1985. Net charge-offs for the 1986 first quarter were $20.2 or .31% of average receivables and $16.8 or .29% in the prior year first quarter. Consumer loan balances more than two months delinquent (on a recency basis) were .91% of loan receivables, up from .75% at December 31, 1985 and .83% at March 31, 1985. Credit card balances more than two months delinquent (on a contractual basis) were 1.49%, up from 1.36% at December 31, 1985 but down from the first quarter 1985 level of 1.71%.

Investments and insurance policy and claim reserves both increased 10% since December 1985 primarily because of additional annuity writings.

During the first three months of the year, $275 of long-term debt was issued having a weighted-average interest rate of 8.63%, while $140 of long-term debt was paid off having a weighted-average interest rate of 10.04%.

Material Changes in Results of Operations

Revenues increased 10% in the first quarter of 1986 as compared to the 1985 first quarter. The increase was largely due to higher finance charges and fees generated by a higher level of outstandings with the remainder resulting from increased annuity writings. The annual percentage rate of finance charges and fees declined from 19.49% for the three months ended March 31, 1985 to 19.18% for the 1986 first quarter. The decline results from changes in portfolio mix and a higher percentage of revolving loans outstanding, which currently bear lower rates of charge.

Insurance benefits and policy reserve increase grew 7% in the 1986 first quarter as compared to the corresponding period in 1985 primarily due to growth in annuity writings.

Despite lower interest rates, interest expense increased 8% in the first quarter of 1986 versus the first quarter of 1985 as the Company borrowed to finance its receivable growth.

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS.
(concluded)

The provision for credit losses increased $1.4 or 7% during the first quarter of 1986 as compared to the same period in 1985 largely because of the increased receivable growth occurring in 1986.

The effective tax rate on income before income taxes was 34.8% in both the 1986 and 1985 first quarters. These rates are lower than the U.S. statutory tax rate of 46% principally because investment income includes interest on tax-free municipal bonds and dividends (only 15% of dividends are taxable).

Income from continuing operations was up $4.8 or 20% over the first quarter of 1985. The Consumer Finance Group's income was up $1.5 or 5%, and the Insurance Group's income was up $2.8 from earnings of $.1 in the first quarter of 1985. The Consumer Finance Group increase was due to a higher level of finance charges and fees, which more than offset an increase in expenses, primarily advertising. The Insurance Group's increase is entirely due to realized net investment gains. Operating losses in the property and casualty reinsurance line of business continue to more than offset the income generated by other lines of insurance business. The overall loss ratio for the property and casualty business was 192% and 126% for the three months ended March 31, 1986 and 1985.

Beneficial's overall net income increased $2.1 or 8% over the prior year first quarter as increases in Insurance and Consumer Finance Group net income were partially offset by the absence of income from discontinued operations. The absence of such income, which amounted to $3.9 in the second quarter of 1985, will continue to impact the quarterly income comparisons.

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS

(amounts in millions)

1. The financial statements have been prepared from the books and records of the companies and reflect all adjustments which, in the opinion of management, are necessary for a fair presentation. Certain prior year amounts have been reclassified to conform with the 1986 presentation.

2. The results for interim periods are not necessarily indicative of results to be expected for the year primarily because of changes in interest rates and other expenses.

3. In 1985, the Company sold its Merchandising Division, Western Auto Supply Company and subsidiaries, to Wesray Capital Corporation. For the three months ended March 31, 1985, income from the Merchandising Division of $2.7, after income taxes of $2.2, was reclassified to discontinued operations.

4. As a result of accommodating purchasers of the Company's short-term debt, the Company had temporary excess liquidity at March 31, which was invested short-term and thereafter used to meet the Company's funding needs.

5. Administrative expenses and interest related to general corporate activities have not been allocated to Consumer Finance Group and Insurance Group segments as these costs are common expenses not applicable to a particular group. A reconciliation of the Consumer Finance Group's and Insurance Group's net income to total net income follows:

	Three Months Ended March 31	
	1986	1985
Net Income		
Consumer Finance Group	$32.0	$30.5
Insurance Group	2.9	.1
Less Corporate Expenses	(5.7)	(6.2)
Income From Continuing Operations	29.2	24.4
Income From Discontinued Operations	-	2.7
Total	$29.2	$27.1

(continued)

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS
(amounts in millions)

6. At March 31, 1986, Beneficial was contingently liable under agreements relating to the financing and development of a condominium project in Texas, entered into by Wasco Properties, Inc., a non-consolidated subsidiary. Pursuant to such agreements, and subject to certain terms and conditions, the subsidiary would be obligated to a maximum of $75.0 plus accrued interest to purchase condominium units which at the time had not been sold to third parties by the project developer or others should certain events occur.

7. Earnings per common share are computed on the basis of average shares outstanding and equivalents thereof, after deducting shares reacquired (both those deducted from shareholders' equity and those reflected as an asset). Conversions of $5.50 Dividend Cumulative Convertible Preferred Stock and 10.5% Serial Notes will not result in a material dilution of earnings. The computation of earnings per common share is as follows:

	Three Months Ended March 31	
	1986	1985
Income from Continuing Operations	$29.2	$24.4
Dividend Requirements on Preferred Stock	3.8	4.2
Earnings Available for Common Stock	$25.4	$20.2
Average Outstanding Common Shares	22.3	22.0
Earnings Per Common Share		
Continuing Operations	$1.14	$ .91
Discontinued Operations	—	.13
Net Income	$1.14	$1.04

(continued)

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO FINANCIAL STATEMENTS (concluded)
(amounts in millions)

8. In computing the ratios of earnings to fixed charges set forth below, earnings consist of income from continuing operations to which have been added dividends from discontinued operations, income taxes and fixed charges. Fixed charges consist principally of interest on all indebtedness and that portion of rentals considered to represent an appropriate interest factor.

Three Months Ended March 31		Years Ended December 31				
1986	1985	1985	1984	1983	1982	1981
1.30	1.27	1.29	1.20	1.30	1.22	1.17

PART II. OTHER INFORMATION

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

11 Computation of Earnings per Common Share of Beneficial Corporation and Consolidated Subsidiaries.

12 Computation of Ratio of Earnings to Fixed Charges of Beneficial Corporation and Consolidated Subsidiaries (continuing operations only).

(b) Reports on Form 8-K

Reports on Form 8-K were filed on January 8, 1986 and March 17, 1986, with respect to the following matters:

(1) The Form of Underwriting Agreement, dated as of January 8, 1986, relating to the issuance and sale by Beneficial Corporation of $125,000,000 aggregate principal amount of its 8-1/2% Notes due January 15, 1989, and the Form of 8-1/2% Note; and

(2) The Form of Underwriting Agreement, dated as of March 17, 1986, relating to the issuance and sale by Beneficial Corporation of $100,000,000 aggregate principal amount of its 8% Notes due April 1, 1991 and the Form of 8% Note.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BENEFICIAL CORPORATION

Date May 12, 1986

RRMeyer

Robert R. Meyer
Senior Vice President
and Controller
(Chief Accounting
Officer)

Date May 12, 1986

Andrew C. Halvorsen

Andrew C. Halvorsen
Member of the Office
of the President and
Director (Chief
Financial Officer)

EXHIBIT INDEX

Exhibit Number	Description
11	Computation of Earnings per Common Share of Beneficial Corporation and Consolidated Subsidiaries.
12	Computation of Ratio of Earnings to Fixed Charges of Beneficial Corporation and Consolidated Subsidiaries (continuing operations only).

EXHIBIT 11

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
COMPUTATION OF EARNINGS PER COMMON SHARE
Three Months Ended March 31, 1986 and 1985
(amounts in thousands)

	Three Months Ended March 31 1986	Three Months Ended March 31 1985
Primary		
Earnings		
Income from continuing operations	$29,163	$24,376
Deduct dividends on preferred stock	3,841	4,236
Income from continuing operations applicable to common stock	25,322	20,140
Income from discontinued operations applicable to common stock	-	2,700
Net income applicable to common stock	$25,322	$22,840
Shares		
Weighted average number of common shares outstanding	22,299	22,044
Primary earnings per common share		
Continuing operations	$ 1.14	$ .91
Discontinued operations	-	.13
Net income	$ 1.14	$ 1.04
Fully Diluted*		
Earnings		
Income from continuing operations	$29,163	$24,376
Deduct dividends on non-convertible preferred stock	3,763	4,148
Add interest expense related to convertible debt	225	206
Income from continuing operations as adjusted	25,52[illegible]	20.434
Income from discontinued operations	-	2,700
Net income as adjusted	$25,5[illegible]	$23,134
Shares		
Weighted average number of common shares outstanding	22,299	22,044
Assuming conversion of convertible debt	352	581
Assuming conversion of convertible preferred stock	258	286
Assuming vesting of common shares under employee stock purchase plan	13	18
Weighted average number of common shares outstanding as adjusted	22,922	22,929
Earnings per common share assuming full dilution		
Continuing operations	$ 1.11	$ .89
Discontinued operations	-	.12
Net income	$ 1.11	$ 1.01

* This calculation is submitted in accordance with Securities Exchange Act of 1934 Release No. 9083 although not required by footnote 2 of paragraph 14 of APB Opinion No. 15 because it results in dilution of less than 3%.

EXHIBIT 12

BENEFICIAL CORPORATION AND CONSOLIDATED SUBSIDIARIES
(CONTINUING OPERATIONS ONLY)

RATIOS OF EARNINGS TO FIXED CHARGES

FIVE YEARS ENDED DECEMBER 31, 1985

THREE MONTHS ENDED MARCH 31, 1986 AND 1985

(amounts in thousands)

	Three Months Ended March 31		Years Ended December 31				
	1986	1985	1985	1984	1983	1982	1981
Income From Continuing Operations	$ 29,163	$ 24,376	$ 99,907	$ 89,746	$ 90,098	$ 65,663	$ 54,681
Add: Dividends from Discontinued Operations	-	-	8,714	15,000	14,000	25,000	15,201
	29,163	24,376	108,621	104,746	104,098	90,663	69,882
Add:							
Fixed Charges							
Interest	141,097	132,077	533,083	514,052	433,403	464,067	507,453
Interest factor portion of rentals	3,736	4,074	16,609	16,683	16,005	13,558	10,737
Total Fixed Charges	144,833	136,151	549,697	530,735	449,408	477,625	518,190
Provision for Income Taxes	14,031	12,834	52,854	369	29,261	15,635	19,912
Total Income From Continuing Operations, Fixed Charges and Taxes on Income—"Earnings"	$188,027	$173,361	$711,172	$635,850	$582,767	$583,923	$607,984
Ratio of Earnings to Fixed Charges	1.30	1.27	1.29	1.20	1.30	1.22	1.17

END

FIRST CHICAGO

F417600
FORM 10-K
(SEE F.69)
250 12-31-85

80852

1985 FINANCIAL HIGHLIGHTS

FIRST CHICAGO CORPORATION AND SUBSIDIARIES

In thousands, except for per share and nonfinancial data	1985	1984	Change
FOR THE YEAR			
Net interest income—tax-equivalent basis	$1,148,172	$900,033	[illegible]
Provision for loan losses	[illegible]	401,870	[illegible]
Noninterest income	825,011	477,178	[illegible]
Noninterest expense	1,125,07[illegible]	641,320	[illegible]
Net income	168,[illegible]	85,258	[illegible]
Return on assets	0.43%	0.22%	
Return on common stockholders' equity	8.23%	3.38%	
AT YEAR-END			
Total assets	[illegible]	[illegible]	[illegible]
Total deposits	27,127,723	29,521,917	[illegible]
Loans	24,126,280	25,675,753	[illegible]
Stockholders' equity	2,139,044	1,924,460	[illegible]
COMMON SHARE DATA			
Net income	$2.54	$1.13	+125%
Dividends declared	1.92	1.82	[illegible]
Common stockholders' equity	34.10	34.12	[illegible]
NONFINANCIAL DATA (YEAR-END)			
Number of employees	14,270	13,510	
Number of stockholders	14,553	14,[illegible]	

FIRST CHICAGO CORPORATION COMMON STOCK PRICE

December 31, 1984 21¾ December 31, 1985 28½

NYSE Symbol: FNB

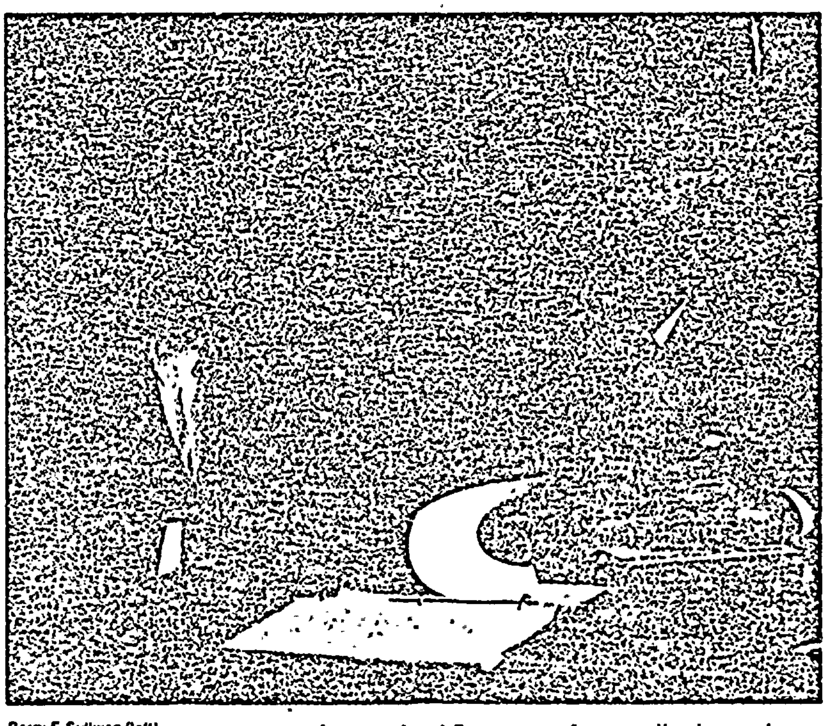
TABLE OF CONTENTS

THIS ANNUAL REPORT INCLUDES THE SEC REPORT ON FORM 10-K.

To the owners of First Chicago Corporation: Our goal is to optimize your investment in First Chicago by improving our financial returns. Despite the unexpected setback from the loss involving our Brazilian affiliate, we made significant progress toward that goal during 1985 by strengthening your company's financial structure and by making healthy progress toward our strategic goal of being the premier bank holding company in the Midwest, with a reputation for excellence in serving our customers nationwide and throughout the world.

REVIEWING 1985

Net income for the year recovered to $169.0 million, up 96 percent from the disappointing 1984 level of $86.4 million. Earnings per share were $2.84, compared with $1.19 in 1984. Return on average assets and return on average common equity rose to 0.43 percent and 8.33 percent, respectively, from 0.22 percent and 3.38 percent in 1984.



Barry F. Sullivan (left)
Richard L. Thomas

We strengthened the balance sheet structure considerably in 1985. The primary capital-to-assets ratio, as defined by regulators to include shareholders' equity, the allowance for loan losses, equity contract notes and equity commitment notes, rose to 7.24 percent at year-end 1985, compared with 6.08 percent a year earlier, putting our ratio among the highest in our peer group. Stockholders' equity as a percentage of assets as of year-end also grew in 1985, to 5.37 percent from 4.83 percent. The allowance for loan losses increased to 1.78 percent of outstanding loans, also among the highest ratios in the peer group, compared with 1.14 percent a year earlier.

However, 1985 earnings were lower than expected because of the $131.1 million loss incurred on our investment in Banco Denasa de Investimento S.A., a Brazilian investment

bank. Severe strains in the financial and real estate sectors of the Brazilian economy caused significant deterioration in Banco Denasa's cruzeiro credit portfolio. The majority shareholder was unable to provide additional capital to cover further deterioration in the cruzeiro credit portfolio existing at the time of our investment, as required in our contract. As a result, we assumed management control and a controlling shareholder interest. In connection with a plan of disposition of our investment in Banco Denasa, we established a special reserve to cover the present and estimated future financial impact of Denasa on our earnings.

This loss was more than offset by higher net interest income, increased noninterest revenues, particularly gains from the sale of equity securities, and a lower provision for loan losses. Noninterest expenses, excluding the Denasa loss, also grew in 1985.

Net interest income on a tax-equivalent basis rose to a record $1.145 billion, from $0.990 billion in 1984, reflecting our active balance sheet management. While earning asset volume only increased 2 percent, the net interest margin (the difference between the yield on earning assets and the cost of liabilities funding them) increased by 38 basis points to 3.27 percent.

Our strategy to diversify revenues by emphasizing a variety of financial and service products is reflected by the 39 percent growth in noninterest income during 1985. Noninterest income for 1985 totaled $658.0 million, compared with $472.2 million in 1984. Gains on sales of equity securities, primarily venture capital investments, accounted for $146.7 million of noninterest income, compared with $56.7 million in 1984. Other noninterest income categories also demonstrated healthy growth, including trading account and foreign exchange trading profits, fiduciary and investment management fees, credit card fees, and service charges and commissions.

Noninterest expense increased to $1.110 billion in 1985 from $0.842 billion in 1984. Almost half of this increase was due to the loss on our investment in Banco Denasa. Other factors included higher salary and employee benefit expense largely due to the resumption of profit-sharing and certain incentive compensation plan benefits in 1985, and increases in occupancy, equipment and other overhead expenses. These increases were partially offset by the adoption of Financial Accounting Standards Board Statement 87 governing accounting for pension costs. The adoption of the new standard had the effect of reducing salary and benefit costs by $12.4 million in 1985.

The provision for loan losses declined to $411.2 million from $464.8 million in 1984, despite the fact that we built the allowance for loan losses by $139.9 million during 1985. At December 31, 1985, the allowance for loan losses was $431.6 million, compared with $291.7 million a year earlier.

Net loan charge-offs declined to $271.3 million, compared with $414.9 million in 1984. Net charge-offs on commercial loans dropped to $179.9 million in 1985 from $374.8 million in 1984. On the other hand, net charge-offs on consumer loans, primarily credit card outstandings, rose to $91.4 million in 1985 from $40.1 million the prior year, as a result of the strong growth in new credit card accounts.

Nonperforming assets, which are the sum of nonaccrual loans, renegotiated loans and other real estate assets owned, declined to $657 million at year-end from $758 million a year ago. As a percentage of loans and real estate assets owned, nonperforming assets at year-end were 2.7 percent, one of the lowest ratios among our peer group, compared with 3.0 percent at the prior year-end. This declining trend, coupled with the growth in the allowance for loan losses, has resulted in an allowance for loan losses equal to 66 percent of nonperforming assets at year-end, one of the highest ratios among our peer group.

Clearly, we made significant progress in many facets of our business in 1985, as demonstrated in many fundamental components of our earnings.

LOOKING AHEAD

In 1985, the economic, competitive and regulatory trends we discussed in last year's report continued and, in certain respects, accelerated. These trends are having a dramatic impact on the financial services industry, particularly on traditional institutional banking activities. Anticipating that these trends will continue, we have been refining our strategies in order to meet these challenges successfully and profitably.

The economic environment continues to be difficult. Despite a general recovery, some sectors of the domestic economy have not participated. Continued low inflation, in fact deflation in some cases, has caused serious financial problems in such domestic industries as agriculture, mining, energy, heavy manufacturing and certain areas of real estate. Internationally, similar forces are at work, affecting corresponding sectors, as well as shipping and contracting businesses. Although the third world's credit problems continue to be largely unresolved, Treasury Secretary Baker's initiative tying financial support for developing countries to structural changes is a welcome development.

Simultaneously, the competition in our basic businesses is rapidly intensifying, particularly in the global financial business in which we serve large corporate, institutional and government customers. We operate today in a global marketplace where banking barriers are disappearing, although regulation of banks' activities varies from country to country. Many large corporate customers increasingly find it is less expensive and more efficient to borrow in public debt and commercial paper markets than to borrow from banks. Consequently, we are competing not only with major money center banks and larger numbers of super-regional banks, but also more frequently with investment banking firms and other financial institutions.

Because of these factors, the nature of banking is changing. Bank credit is increasingly being used by large corporations only for temporary bridge financing, rather than for working capital or for fixed asset investments. A growing portion of bank lending to these customers is for financial transactions, such as acquisitions, tender offers, stock purchases and other financial restructurings. Many relationships are becoming more transaction

oriented, with the loyalties of longstanding relationships declining and transaction execution growing in importance.

Legislators and bank regulators are recognizing these economic and competitive trends. Fortunately, banks are gaining broader geographic powers for expansion Regional interstate banking legislation has been passed in a number of states, including Illinois. However, despite the encroachment of many nonbank competitors, the Glass-Steagall Act, which restricts banks' product offerings, has not been updated. Meanwhile, regulators are requiring higher capital ratios and more stringent operating standards.

These economic, competitive and regulatory factors are reducing the profitability of traditional lending in the large institutional market. The intense challenge from a growing number and variety of competitors has resulted in narrow margins on loans. Narrow margins, with greater capital requirements and higher credit losses resulting from troubled sectors, have made it increasingly difficult to earn adequate returns for shareholders.

We are attacking this new environment by pursuing a three-pronged strategy, balanced among our global financial business, serving large institutional customers, and our more profitable, but currently smaller, consumer and middle-market businesses. We believe a diversified strategy will yield consistently strong financial performance, given prevailing economic, competitive and regulatory pressures.

Because of the success of our consumer and middle-market businesses, we are devoting resources to expanding them. Meanwhile, we are working aggressively to raise the profitability of the global financial business by providing "state-of-the-art" financial and service products that will enhance revenues, by improving trading and distribution capabilities, by focusing on well-defined market segments to ensure acceptable returns, by improving the credit quality of our asset portfolio, and by reducing the costs of delivering products and services.

The following section of this report describes in detail the strategies we are pursuing in our three major business lines, our strategic and financial performance in 1985 in these businesses, and the reasons we expect to achieve our strategic and financial goals.

We are confident that we will be in the forefront as the financial services industry evolves. We have already made significant progress and believe that our forward momentum will accelerate in 1986 and the years that follow.

Sincerely,

Barry F. Sullivan   R L Thomas

Barry F. Sullivan
Chairman

Richard L. Thomas
President

Chicago, Illinois
February 14, 1986

CORPORATE GOALS

First Chicago's *strategic goal* is to be the premier bank holding company in the Midwest, with a reputation for excellence in serving customers nationwide and throughout the world. We intend to be the preferred supplier of financial products and services in the Midwest, yet we do not intend to be limited by regional boundaries. The demands of our customers and our own financial goal are the driving forces of our strategy.

Our *financial goal* is to optimize our shareholders' investment in First Chicago by improving our financial returns. Our goal is for our common stock to sell at a price equal to or exceeding its book value. We believe that achieving this goal over time will require a sustained return on common equity of 14 to 16 percent. In 1985, our return on common equity was 8.33 percent, and at year-end the market value of our common stock equaled 87 percent of its book value.

CORPORATE STRATEGY

Our corporate strategy is intended to produce four results that support the achievement of our financial goal:

- increase net interest income by aggressively managing the mix of the asset portfolio,
- increase noninterest income by offering a carefully selected array of financial, trading and service products,
- improve credit quality by applying sound credit judgment and adhering to intensive credit selection, approval, management and review processes, and
- control expense growth rigorously.

We believe we can most effectively generate consistently high returns by pursuing a strategy that is balanced among three major business lines:

- Global Financial Business
- Consumer Financial Business
- Middle-Market Financial Business

Given the rapid deregulation of the financial services industry and the challenges of the economic environment, we believe a diversified strategy will provide consistent returns. At the same time, we are focusing our efforts within these three business lines on specific markets in which we believe we can excel.

The following sections of the report describe First Chicago's strategies and performance in each of these business lines. We made significant progress toward our strategic

objectives in each of these businesses in 1985, although partially obscured by the loss sustained on our Brazilian affiliate. We expect this progress to gain momentum in 1986.

GLOBAL FINANCIAL BUSINESS

First Chicago's global financial business serves the needs of large corporations, institutions and governments throughout the world. During the past few years this market has been rapidly changing. The demand for traditional credit products is diminishing as customers are able to raise funds in public commercial paper and debt markets less expensively than by borrowing from banks. The pricing of traditional credit products is becoming increasingly competitive as more financial institutions pursue this shrinking market.

At the same time, customers are demanding a new range of global services. This provides an opportunity to replace the declining revenues from traditional products with increasing revenues from new products and services, such as capital markets transactions, electronic payment and receipt systems, trading instruments and investment management services.

The Euro-Commercial paper program provided U.S. customers with the means of delivering commercial paper to investors in key financial markets, such as London.

The overall profitability of the global financial business was disappointing in 1984 and 1985, primarily as a result of large loan losses in 1984 and the loss related to our Brazilian affiliate in 1985. Even apart from those events, profitability has not been high enough, reflecting the competitive environment. For example, in 1985, excluding the loss on our Brazilian affiliate, the return on assets of our global financial business was 0.47 percent.

However, many of our activities in this market are very profitable. Our challenge is to nurture the growth of these more profitable activities while improving the returns on the remaining activities. We will make significant strides toward our corporate financial goal by improving the total profitability of the global financial business.

Global Financial Business

(Dollars in Millions)

	1985	1984
Net interest income, tax-equivalent basis	$659	$645
Provision for loan losses	270	390
Noninterest income	451	299
Noninterest expense, excluding 1985 loss on affiliate investment	606	528
Loss on affiliate investment	131	—
Pre-tax income, tax-equivalent basis	94	26
Net income	76	23
Return on average assets	0.24%	0.07%
Net interest margin	2.36%	2.28%

See page 28 for summary table.

To improve the overall profitability of our global financial business, we are pursuing a strategy of:

- focusing on specifically defined customer market segments in order to assure acceptable returns,
- reducing the costs of delivering our services to customers,
- improving the credit quality of our asset portfolio,
- acting as intermediary wherever possible, by selling assets that do not generate acceptable returns, and
- providing "state-of-the-art" products to customers to enhance revenues.

As evidence of our progress to date, net interest income grew slightly, despite a decrease in earning asset volume, and noninterest income increased 51 percent from 1984.

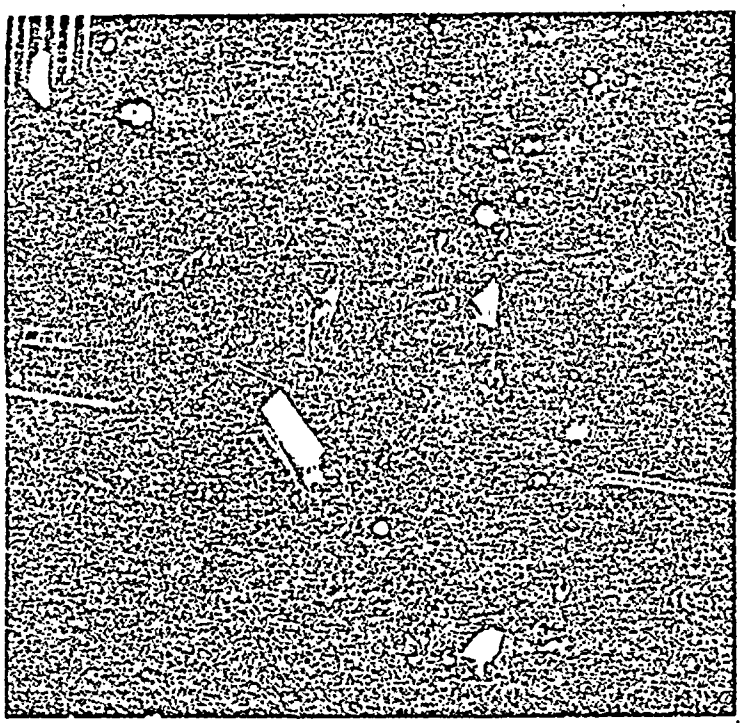
Serving Our Markets

Our strategy is being implemented by sales and product specialists who work together to provide a range of products and services to our customers. As our customers' needs become more and more globally integrated, this unique teamwork gives First Chicago a distinct competitive edge.

From our Chicago headquarters, 8 regional offices in the United States and 36 foreign installations, we offer financial products that range from traditional credit products, such as loans, to sophisticated capital markets transactions, such as Eurocurrency instruments and interest-rate swap transactions. In response to the rapid evolution of global markets, customer relationships are managed on a worldwide basis in order to identify customers' needs effectively and respond to them. Additionally, teams specializing in certain industries—real estate, retailing, communications, financial institutions, health

care, energy, nonprofit entities and transportation—service customers from Chicago and several regional offices. This industry specialization and expertise have long been First Chicago's strengths; we have a particularly strong reputation in the real estate, health care and communications markets.

Clearly, a key component of success is having high-quality, well-trained people representing First Chicago to our customers. During the past four years, we have devoted substantial resources to recruiting and training. The success of these efforts is reflected by the 280 new relationships added in 1985, especially in the Midwest and New York areas, and in the real estate, energy, government and health care services industries. Also, we have continued to improve our position with a growing number of customers, particularly in the Midwest.



The International Financial Institutions Group provided clients such as the Bank of China with a diverse array of funding sources and asset sales opportunities, including access to U.S. capital markets.

Improving Our Cost Effectiveness

As competition increases, the ability to be a cost-effective provider of services will enable us to achieve superior profitability. We have already taken several steps to improve our effectiveness.

We have redefined the role of our experienced relationship managers, delegating administrative tasks and basic analytic projects to more specialized members of the staff. Also, comprehensive customer and product profitability reporting systems enable us to focus our marketing efforts more effectively.

Because many of our customers have extensive international operations and because many need access to foreign capital markets, a strong international network is important to us. Responding to the rapid [illegible]tion of global financial markets, we are also emphasizing an orientation toward transaction execution and capital markets activities overseas, rather than toward traditional lending.

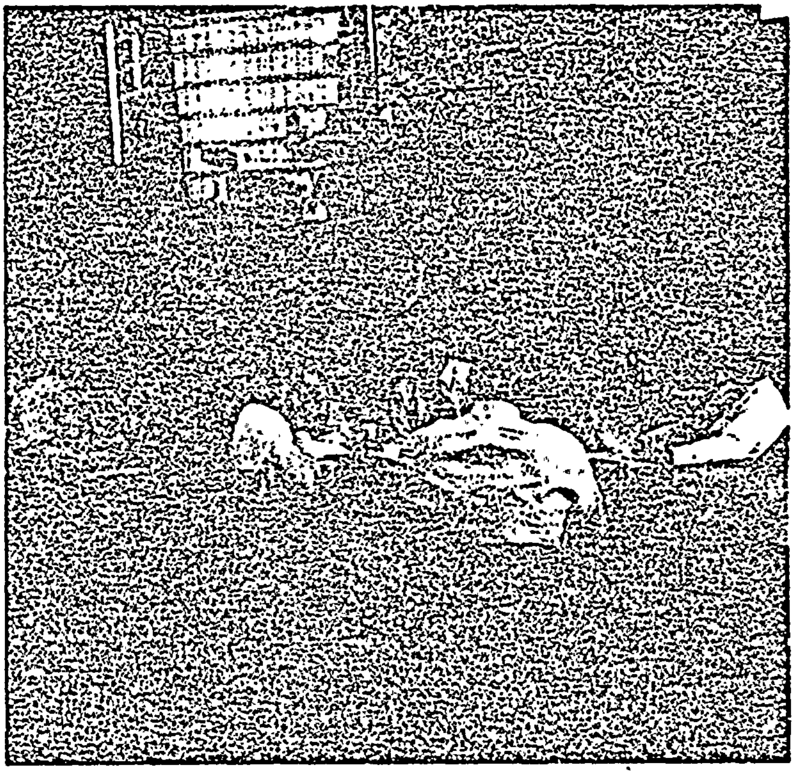
The results of these steps will improve our effectiveness and reduce our costs.

Managing Credit Risk

While First Chicago has changed its product offerings significantly in response to the changes in the market described above, traditional lending remains the most important segment of our global financial business.

Reducing credit losses will also improve the profitability of this business. Consequently, enhancing our credit selection, approval, management and review processes has been a top priority of senior management during 1984 and 1985.

In order to control the level of risk, the loan portfolio, as well as credit exposure in other instruments such as interest-rate swaps and foreign exchange forward contracts, must be sufficiently diversified by industry, geography, collateral and size. To assure adequate diversification, each business unit has clearly defined criteria that must be satisfied in order for any credit, whether in the form of loans, swaps or contingent liabilities, to be extended. The criteria include qualitative and quantitative measures of the customers, as well as relationship profitability goals.



The implementation of First Chicago's key asset and liability management policies is coordinated through an interdepartmental committee.

Sales and financial product specialists work with customers and prospects with appropriate risk characteristics. This selective approach, along with our credit risk ratings, is designed to assure that our new and existing loans are sufficiently diversified and of attractive credit quality. We have also taken steps to improve our management of problem loans. A more disciplined process for managing emerging problems, including intensified senior management review and early decisions as to action plans, was implemented within the corporate lending groups.

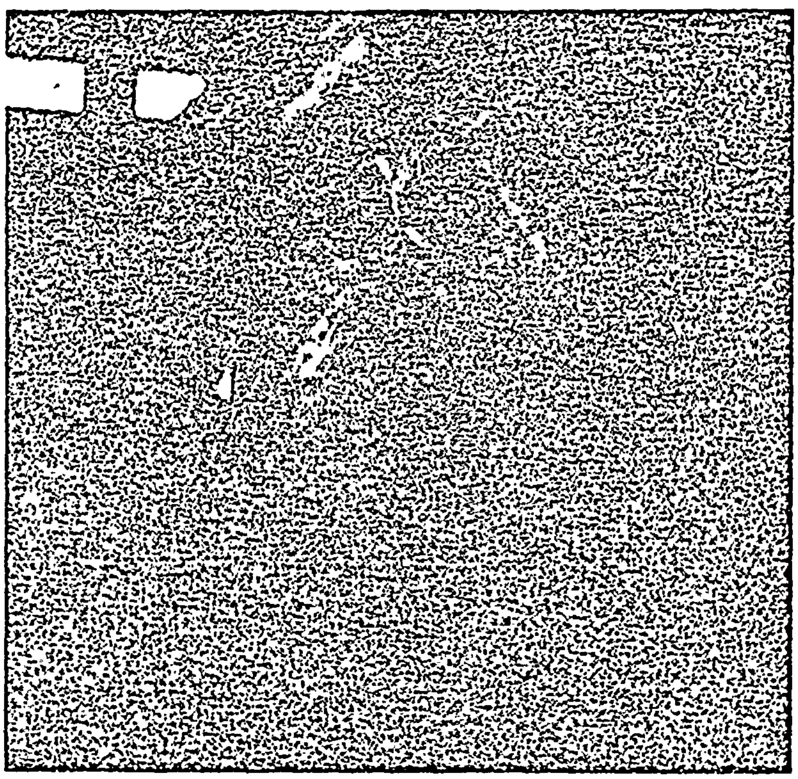
The results of our intensified credit processes are demonstrated by the declining trend of nonperforming assets. Nonperforming assets at year end 1985 totaled $657 million, or 2.7 percent of loans and real estate owned, one of the lowest levels among our peer group. This level represents a significant decline from $758 million, or 3.0 percent, at

year-end 1984, and $854 million, or 3.8 percent, at year-end 1983. The economic environment, however, suggests that this favorable trend may be reversed in 1986.

Net charge-offs from the global financial business declined to $169.1 million in 1985, compared with $366.3 million in 1984. While this represents a significant drop, the level is still unacceptably high, and we are working toward achieving an even lower level.

Offering Sophisticated Financial Products

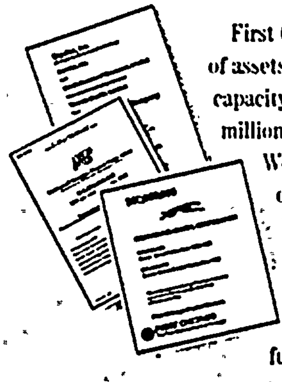
As financial markets have evolved, First Chicago has seized new opportunities to diversify revenues by adding net interest income, trading profits, fees and commission revenues from innovative financing transactions, trade finance products, trading activities and investment advisory services. To accomplish this, we made significant investments in recruiting experienced, professional product specialists in these areas, emphasizing transaction execution expertise. This investment is yielding favorable results. Our market research data show strong improvements in market penetration with respect to interest-rate swaps, private placements, and merger, acquisition and divestiture advisory services.



First Chicago Leasing Corp., completing its most successful year with $600 million in assets leased, served as the financial advisor and key equity contributor to the largest facility lease completed to date—the Basin Electric Power Cooperative

We anticipated the trend toward capital markets and nontraditional sources for financing in 1981 and, since then, have established active capital markets and global securities groups. Our products include Eurosecurities, interest rate and currency swaps, private placements, revolving underwriting facilities and leveraged leases.

Domestically, we are responding to the streamlining and refinancing of many industries by providing merger and acquisition consulting and leveraged lease financing.

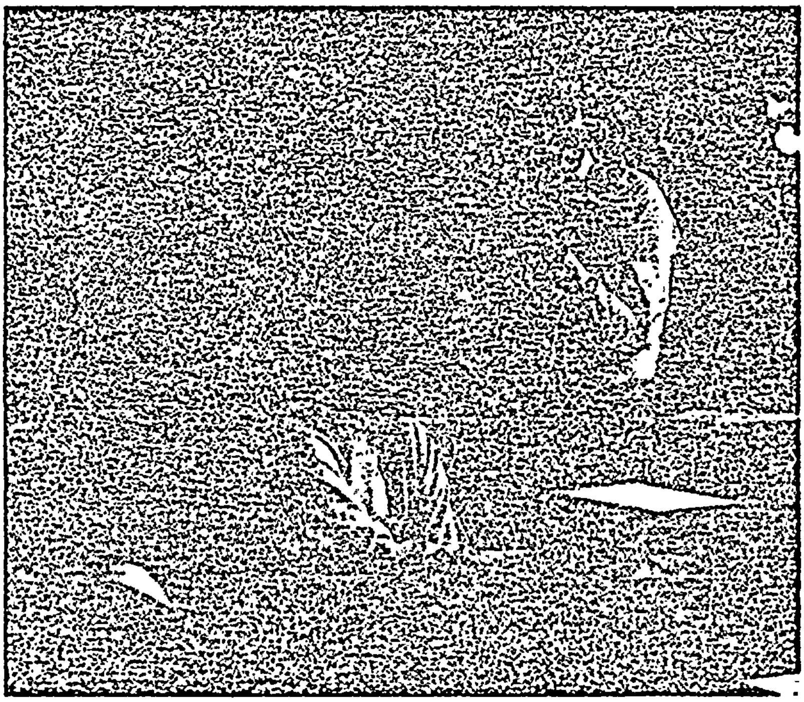


First Chicago Leasing Corporation provides leveraged lease financing for a wide variety of assets and industries. By advising other investors, we have expanded our investment capacity beyond our own tax capacity. Consequently, during 1985, we closed nearly $600 million in leveraged leases, compared with $285 million in 1984 and $125 million in 1983.

We are also successfully capitalizing on the renaissance of American industry through our venture capital operations, one of the largest and most profitable among U.S. banks. With investments in 145 companies and a book value of approximately $380 million at year-end, our two venture capital companies contributed a record $121 million in gains on the sale of equity securities in 1985.

In addition to the gains recognized, the portfolio still holds the potential for further gains. Our experienced venture capital team and diversified portfolio suggest continuing growth and profitability.

Our activities overseas are more diverse than in the U.S. since we are generally subject to fewer regulatory restrictions. In both London and Geneva we have a well-established position in underwriting Euro-securities. In 1985, we were one of the first to bring Eurodollar commercial paper offerings to the market for major U.S. customers.



First Chicago's New York Capital Markets team meets with counsel to finalize the terms of a recently completed offshore securities offering and currency swap

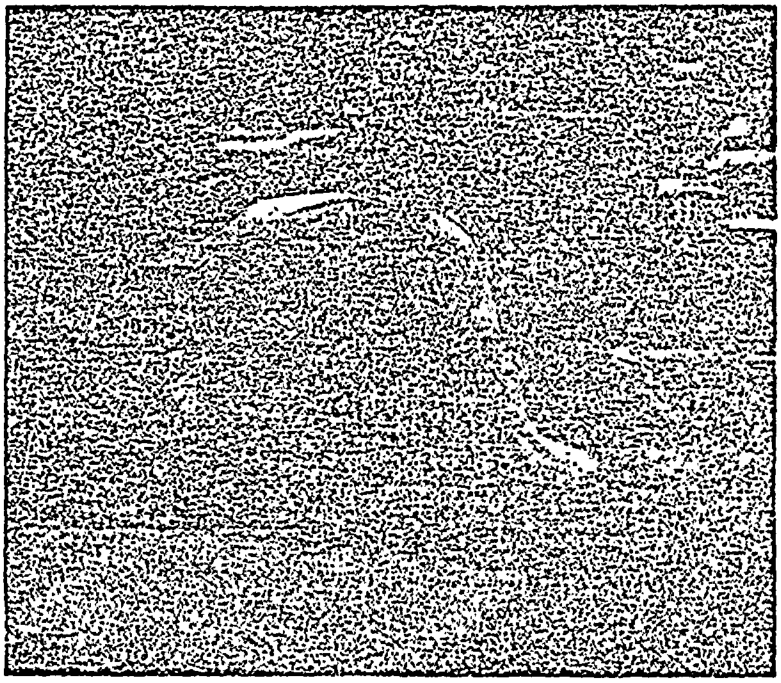
As the capital markets evolve unevenly worldwide, arbitrage opportunities are created. Our global arbitrage group arranges transactions such as interest-rate and foreign currency swaps to enable our customers to take advantage of arbitrage opportunities. During the past two years, we have arranged more than $12 billion in interest-rate and foreign currency swaps.

The growth in international trade has also created opportunities for First Chicago. We actively underwrite U.S. and foreign government guaranteed and subsidized export facilities. In 1985, we were especially active in U.S., Italian and Brazilian programs. We also provide a range of trade related documentary products, such as letters of credit and acceptances, generating over $50 million in fees in both 1985 and 1984.

Enhancing Our Distribution Capability

With loans increasingly being sold to investors or replaced by capital market instruments, a broad distribution network for these products is of growing importance. Over the past ten years, First Chicago has built an effective worldwide funding network to distribute its liability instruments. More recently, we have been enhancing that distribution network to build our trading and asset sales capabilities.

With the margins on loans to many large borrowers narrowing, we have developed the capability to sell certain low credit risk, low-margin loans to third-party investors. Selling these loans enables us to meet our customers' borrowing needs and generate revenues without providing the funds and related capital from our own resources.



FX options, the newest innovation in managing corporate hedging techniques in foreign exchange markets, contributed to record foreign exchange earnings.

From installations in Chicago and the other major international money centers—New York, London, Geneva, Tokyo, Singapore and Hong Kong—we trade foreign currencies, U.S. government securities, money market instruments, interest-rate futures and municipal securities for our customers.

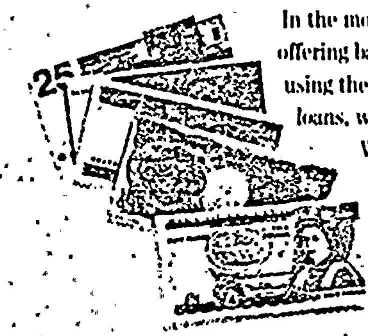
In 1983, First Chicago made a major commitment to building these trading activities and since then has put experienced personnel in place to execute the strategy.

The trends toward global capital flows and increasing international trade have spurred the growth of foreign exchange activities worldwide. Banks historically have been the major source for foreign exchange liquidity, providing a competitive edge over other financial institutions entering these markets. Our aggressive efforts to exploit this competitive advantage are demonstrated by the growth in foreign exchange revenues. Foreign exchange trading profits grew to $46.3 million in 1985 from $24.5 million in 1984. We will continue to pursue foreign exchange business with aggressive marketing and product innovations, such as foreign currency options, which enable customers to limit the risk of their foreign currency hedging transactions.

The U.S. government securities market is the largest capital market in the world and an essential market in which to trade in order to understand the movements of all domestic markets. First Chicago has a long history as one of 36 primary dealers, and we are

building on that experience to increase our market share and expertise.

In the money markets, we are building our secondary market trading capabilities by offering bankers' acceptances and certificates of deposit of other major banks. We are using the futures markets to offer new risk management products, such as cap-rate loans, which allow customers to limit the interest rate volatility of their borrowings.



We focus our municipal underwriting and trading activities on our natural market, the Midwest. We are a leader in that market, acting as senior managing underwriter for more than $1.2 billion in securities in 1985, and serving as financial advisor for several major state and local projects.

In 1985, our government securities, money market, futures and municipal trading activities generated $26.9 million in trading account profits, compared with $11.6 million in 1984.

Offering Innovative Service Products

In addition to financial products and trading products, we also provide an array of service products, such as payment systems, remittance processing services and information products, all of which generate available demand deposit balances and/or noninterest revenues. Given the intense competition in this market, we have elected to concentrate on those activities in which we can differentiate our product or in which we have the large scale of operations necessary to achieve cost advantages through economies of scale. Our activities center on three types of customer services: transactions between corporate buyers and sellers, securities-related transactions, and information products.

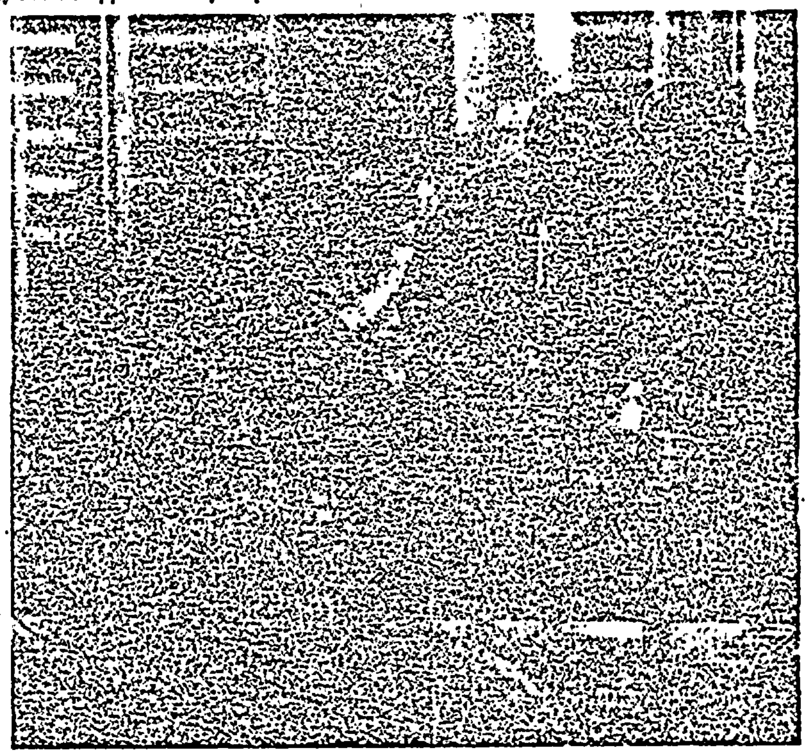
Having successfully converted what were formerly back-office activities into profit-generating products, we are now transforming today's products into tomorrow's products. For example, First Chicago established the first network of multiple-site processing centers owned by a single entity, enhancing yesterday's product (single-location lockbox services) to meet today's needs. Now we are leading a group of banks in developing an all-electronic automatic invoicing and payment system for a major U.S. company and its suppliers. This system is a prototype of tomorrow's product.

Payment management services for specific industries are also a growth activity. For example, First Chicago is a leader in the freight payment market. By integrating our freight payment activities with freight rating systems that provide mileage and tariff data, we not only streamline customers' freight bill payments, but we also enable customers to plan their shipments, maximizing efficiencies and minimizing costs.

First Chicago has also established itself as the leading clearer of Eurodollar certificates of deposit in London. Daily, we process approximately 70 percent of the transaction volume of this market, which had approximately $90 billion in outstandings at year-end 1985.

With the emergence of the new Eurodollar commercial paper market, we are leveraging our position as the leading certificate of deposit clearinghouse in London to gain a significant share of this new, but similar, market.

Our market research data indicate that we are already successful in many of these businesses. For example, we currently handle approximately 20 percent of total domestic lockbox volume through our subsidiary, First Chicago National Processing Corporation, which operates remittance processing centers across the nation. Also, we are a leading competitor in a variety of cash management services, particularly in the Midwest.



The Service Products Department's internally designed and developed corporate account reconcilement system, AccuTrak, provides a substantial market advantage due to built-in quality controls and peerless electronic delivery features.

We are confident that our momentum in these businesses will continue to build. As an industry leader, we are in a strong position to withstand increasing competition and have taken steps to further differentiate our service. We have built a strong reputation for quality control and will continue to emphasize product efficiency and quality. Weekly, senior managers review more than 500 key operating performance statistics to ensure that top-quality service is maintained. We are proud of our performance and share the data with our customers.

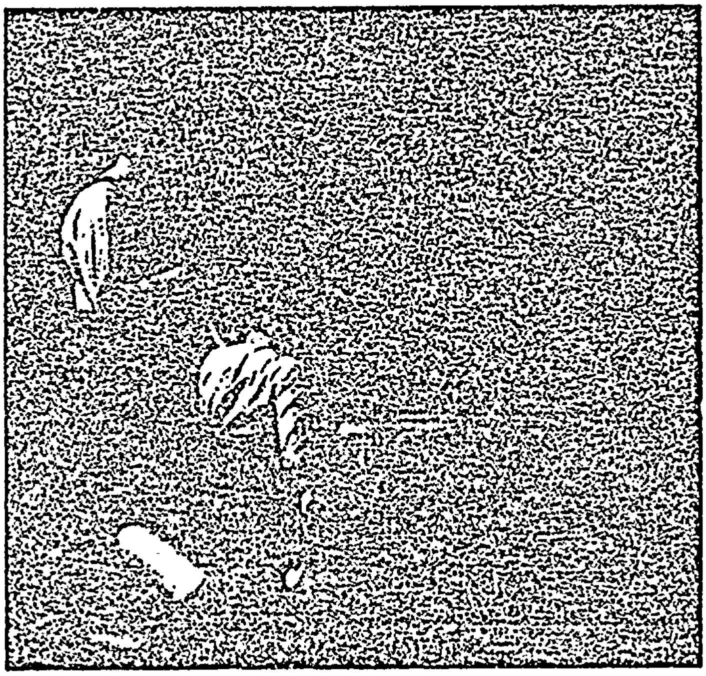
During 1985, service products generated approximately $48 million in fee revenues, compared with approximately $49 million in 1984, and generated $1.4 billion in demand deposit balances compared with $1.1 billion in 1984.

Providing Investment Management Services

First Chicago provides investment management services to institutional customers, generating noninterest revenues, through First Chicago Investment Advisors, N.A. (FCIA), a subsidiary. FCIA manages more than $7 billion of employee-benefit and other institutional assets for 260 clients, including corporations, states and municipalities, unions, endowments and foundations.

FCIA uses a distinct management style that focuses on total portfolio asset allocation, emphasizing inter-relationships among major world asset markets. Portfolios are invested in domestic and international stocks and bonds, real estate and venture capital. The success of this approach is demonstrated by our top-tier investment performance, as measured by national surveys, and a strong new business record. Assets from new clients and significant new commitments from existing clients have been impressive, culminating in a record volume of new business in 1985 of more than $1 billion.

Our global investment approach and our experienced teams of investment managers should enable this success to continue.



Investment strategies, developed by members of First Chicago Investment Advisors, are implemented across all asset classes in world markets

Summary

By diversifying our product offerings to meet the evolving needs of our customers, reducing the cost of delivering our products, focusing our attention on attractive customer segments and lowering credit losses, we can substantially increase the profitability of the global financial line of business. Because this business line represents approximately 80 percent of our assets, improved profitability will translate into significant progress toward our corporate financial goal. We have already made considerable progress. And we are confident that we are gaining momentum and will demonstrate even greater progress in 1986.

CONSUMER FINANCIAL BUSINESS

First Chicago continues to serve the changing needs of consumers by offering a full range of retail banking services. Despite increasing competition from within banking and other sectors of the financial services industry, we have emerged as a leader in the consumer market, both in the Chicago area and nationwide. Our excellent reputation has been established by providing high-quality core products, utilizing new technology and pursuing innovative marketing programs. In turn, the stability and profitability of this market segment significantly enhance overall corporate performance. The importance of consumer banking is reflected in the 1984 and 1985 financial results.

Consumer Financial Business

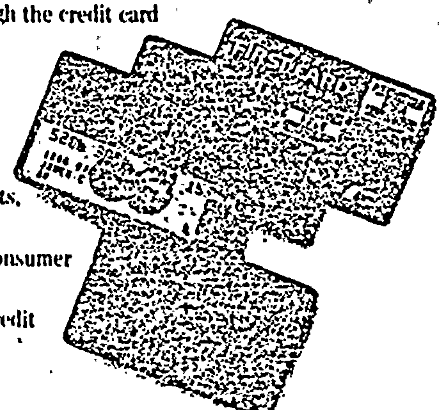
(Dollars in Millions)

	1985	1984
Net interest income, tax-equivalent basis	$332	$243
Provision for loan losses	120	63
Noninterest income	161	146
Noninterest expense	239	225
Pre-tax income, tax-equivalent basis	134	101
Net income	65	50
Return on average assets	1.44%	1.21%
Net interest margin	7.81%	6.27%

See page 25 for summary table.

Consumer business is vital to First Chicago, and our success in this area depends on a focused strategy. Our goals are aimed at strengthening our position as:

- the premier consumer bank in the Chicago area; and,
- a major participant in the national consumer market through the credit card (FirstCard).



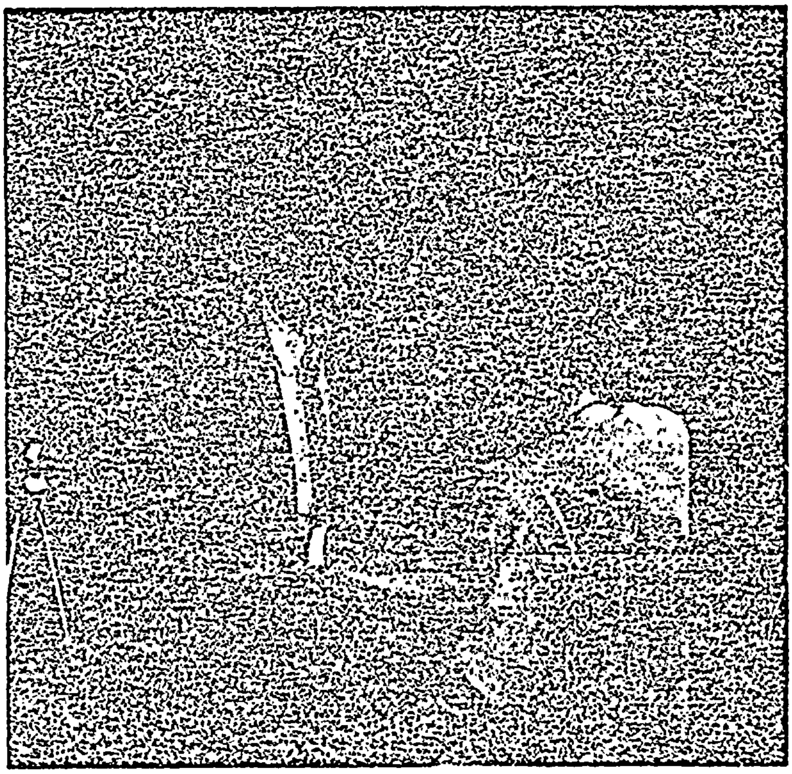
Commitment to the four key elements of our corporate strategy is essential in the implementation of the consumer strategy and is demonstrated in the following actions in support of our goals:

- change the mix of the portfolio toward more profitable assets, with growth in FirstCard loans being emphasized,
- target specific personal banking products toward defined consumer market segments,
- improve credit management controls in FirstCard so that credit quality will exceed industry standards, and
- reduce expenses as percentages of deposits and assets.

The integration of these strategies resulted in earnings of $65 million in 1985 for the consumer financial business, representing a 38 percent contribution to First Chicago's net income.

Serving Our Local Consumer Market

First Chicago has built a strong relationship with the Chicago-area consumer, and is the preferred area bank of the upscale market. While offering a full array of products, deposit-gathering is the main thrust of our local retail operation. Consumer deposit balances increased to $4.3 billion during 1985, a 9 percent increase over 1984. First Chicago has the largest bank share of these local deposits, second only to one savings and loan association, which is not subject to branching limitations.



First Chicago's new deposit software system offers retail banking customers instant access to account history and transactions, an example of leveraging technology to increase efficiency.

The majority of our consumer deposits are held as certificates of deposit (CDs), money market accounts and individual retirement accounts (IRAs). First Chicago's success in attracting these deposits results from intensive consumer marketing programs. At year-end 1985, First Chicago ranked fourth nationally in the level of IRA deposits held with $764 million. This volume was accumulated through our three locations in Chicago, while all other top-ten IRA banks have extensive branch networks. In addition, the First Money Market Account, introduced in December 1982, grew to $964 million at year-end 1985.

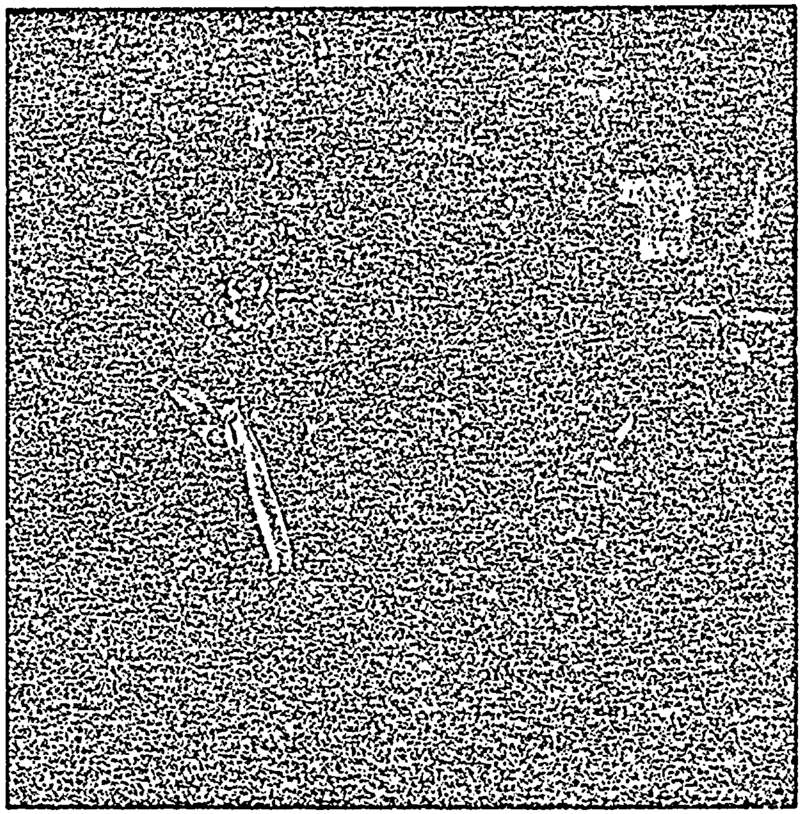
First Chicago intends to enhance its position as a cost-effective competitor in the local consumer market. Concurrent with our deposit growth, we have achieved significant efficiency gains in the costs of gathering, processing and maintaining deposit accounts. Expenses as a percent of deposits fell to 1.68 percent in 1985 from a level of 2.50 percent in 1981, and are expected to decline further as we complete conversion to a new

retail-banking computer system.

Lending and other consumer services are priority businesses in the local market. First Chicago continues to provide mortgages, specialized lending, trust services, installment credit, student loans and discount brokerage services to the Chicago-area consumer.

Cash Station, our automated teller network, provides customers easy access to their accounts at 560 locations throughout the Chicago area. First Chicago is the largest of 180 banks in this network, which has been extended via a link-up with CIRRUS, a nationwide automatic teller system.

Our goal of strengthening our position as the premier local consumer bank was attained in 1985. However, as restrictions are eased and the market continually changes, First Chicago will face increasing competitive pressures on deposit-gathering and other retail services. We are confident that our leading position will remain strong.



The FirstCard business sustained one of the industry's lowest average expenses per card through low overhead processing operations and "state-of-the-art" technology.

Expanding in the National Consumer Market

First Chicago has established a major and successful presence in the national consumer market with the credit card. With more than 3 million cardholders and outstanding loans of $3.3 billion, we are among the largest bank credit card issuers nationwide. Our FirstCard operation has been a significant contributor to corporate earnings, and this will continue in 1986.

FirstCard is one of our most strategically important and well-managed businesses. During 1985, we added 300,000 new accounts and increased outstandings from all cardholders

by 27 percent. While this pace of growth has been less rapid than that experienced in recent years, we will continue to promote and expand our FirstCard product through account solicitation and portfolio acquisitions as market opportunities arise.

FirstCard is an attractive, profitable business for First Chicago for two important reasons. Income is earned on the outstanding balances, with additional income realized from cardholder fees, interchange fees and merchant fees. And First Chicago has an advantage on the expense side. Our facilities in Elgin, Illinois, and suburban New York City, employing a combined staff of 1,200, process customer and merchant transactions with low-cost efficiency. Consequently, our expenses per card are lower than the industry average, and we have the capacity to handle greater volume and lower our costs further.

The credit quality of FirstCard loans has always been closely monitored at First Chicago, and even tighter management controls were undertaken in 1985. FirstCard charge-offs increased to $90.7 million, a level that is consistent with the performance of the largest credit card issuers. Due to the successful solicitations during the past two years, we anticipate that the charge-off rate will remain high in the next two years. However, the implementation of new borrowing and collection policies, coupled with more rigorous screening of new accounts, should result in better-than-average credit performance.

First Chicago is proud of FirstCard's achievements and recognition in the national consumer market. We look to even greater profitability in 1986.

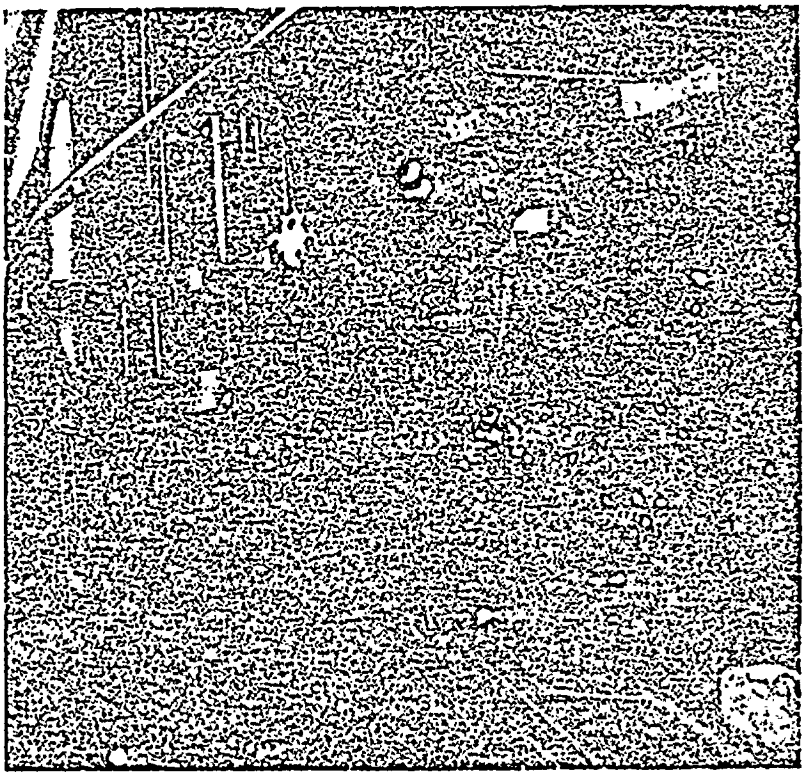
Summary

In 1985, First Chicago made significant progress toward the achievement of the dual goals for the consumer market. Going forward, sophisticated consumers will be presented with alternatives to traditional banking services. Our performance in both the local and national segments will be under pressure, but First Chicago will remain a leading consumer bank.

MIDDLE-MARKET FINANCIAL BUSINESS

First Chicago's middle-market financial business serves smaller Midwestern companies, generally defined as businesses with annual sales of approximately $115 million or less. While The First National Bank of Chicago has an established base of customers among Chicago middle-market firms, our acquisition of American National Corporation in 1984 represented a major step in building our share of this growing market. Together, The First National Bank of Chicago and American National Corporation captured close to a 35 percent market share of all banking services to area middle-market firms in 1985.

The middle market is an attractive one due to favorable margins earned on its loans and high levels of demand deposit balances maintained by its customers. Middle-market customers are often closely held or family businesses, with an entrepreneurial spirit, whose banking needs are largely traditional credit products. Success in the market requires close contact with customers and consistent, long-term relationships. Therefore, the market is difficult to penetrate without a strong local presence and an institutional culture geared toward smaller companies. American National has a proven expertise in serving these distinctive needs and is the predominant middle-market bank in the Chicago area.



American National Corporation's strong relationships with middle-market companies such as L. Karp & Sons, Inc., a Chicago-area manufacturer of specialty products for the bakery and dairy industries, combined with First Chicago to gain dominance in this key Midwest market.

We plan to continue to build our position in the middle market primarily by acquiring banks similar to American National with strong positions in their local markets. In November 1985, Governor James Thompson of Illinois signed a law that will allow us, after July 1, 1986, to acquire banks in Indiana, Michigan, Kentucky, Wisconsin, Iowa and Missouri, if state statutes include reciprocal privileges. This legislation affords us the opportunity to extend our middle-market presence throughout the Midwest.

Our first criterion in evaluating acquisition candidates will be the impact the purchase would have on shareholder value. We will not expand merely for the sake of size; the terms

of a purchase must be attractive to our shareholders. The operating philosophy of centralized strategy and decentralized operations that we adopted with American National will be the model we apply for future acquisitions. We believe such a philosophy will appeal to the management, customers and shareholders of acquired banks, and will increase the value of the acquired bank to our shareholders.

Our 1984 acquisition of American National Corporation, holding company of American National Bank and Trust Company of Chicago and three suburban banks, was our first middle-market acquisition. We are extremely pleased with the outcome of this venture; American National's 1984 and 1985 financial results were excellent.

Middle-Market Financial Business
(American National Corporation only)

(Dollars In Millions)

	1985		1984*
	As reported by ANC	As reported by First Chicago**	As reported by First Chicago**
Net interest income, tax-equivalent basis	$172	$163	$102
Provision for loan losses	21	21	12
Noninterest income	45	46	27
Noninterest expense	117	134	89
Pre-tax income, tax-equivalent basis	80	54	28
Net income	42	28	13
Return on average assets	1.13%	0.75%	0.56%
Net interest margin	5.32%	5.07%	5.13%

*Eight months only, except rates that are annualized

**American National's reported results have been adjusted to reflect necessary purchase accounting adjustments and related costs of acquisition.

See page 28 for summary table.

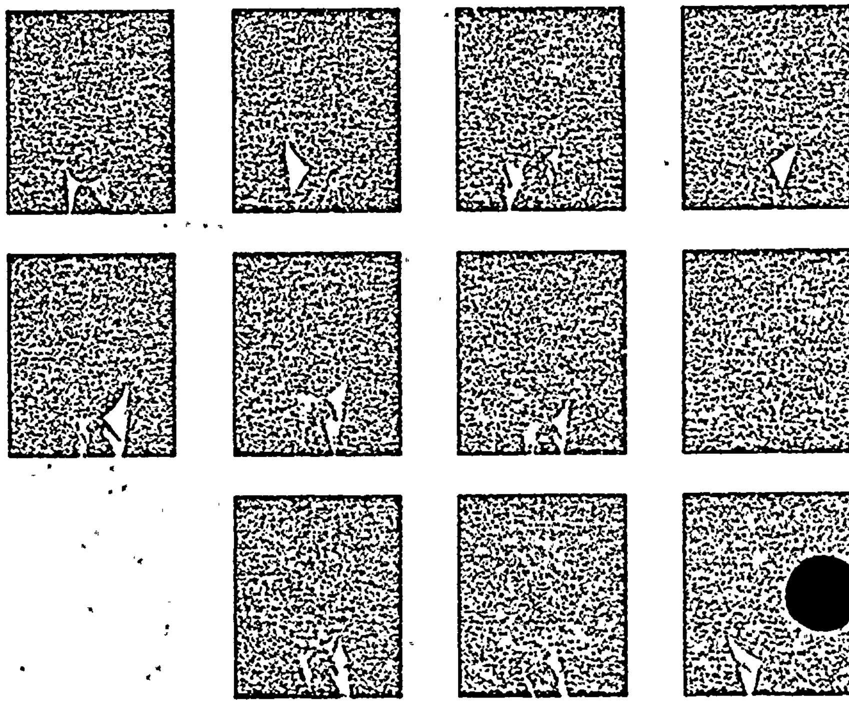
1985 was a record earnings year for American National. Assets grew 9 percent to $3.7 billion and deposits increased to $2.8 billion. American National's success can be attributed to its marketing orientation, as it seeks primary relationships with all its corporate customers. First, target markets are carefully defined to the point where specific companies or individuals are identified as prospects. A marketing approach that focuses on demand deposit generation, competitive pricing, flexible loan structures and top management involvement with customers is then undertaken. American National's experienced staff of calling officers is highly regarded in the middle market, maintaining frequent contact with customers and making decisions on a timely basis. Its effectiveness in establishing primary relationships and attracting demand deposits distinguishes American National competitively. Finally, American National operates under tight expense controls, contributing to the overall success and profitability of this middle-market business.

While American National concentrates on lending to the corporate middle market, smaller businesses, considered to be the emerging middle market, and high net-worth, self-employed individuals are also important customers. These relationships are served effectively through the network of suburban affiliate banks and facilities. In addition, American National provides a wide range of banking services to all its customers. Foremost among these are consumer deposits and loans, correspondent banking, cash management, and corporate and individual trust. American National also serves the national market through its investment management business. In 1985, this group managed $8.5 billion in assets.

American National is pursuing a strategy to increase middle-market share further through its known success factors, highlighted above. This requires expanding the network of affiliates and facilities throughout the Chicago area. Movement into other market locations, notably Rockford, Illinois and Northwest Indiana, is also a future priority. And, superior credit quality and rigorous expense control will continue to be emphasized.

American National Corporation and The First National Bank of Chicago will work together to provide high-quality products and services to all our middle-market customers. Merging the goals of American National with First Chicago's acquisition strategy, we expect to experience rapid growth in our middle-market financial business over the next few years. With the advent of regional interstate banking, First Chicago is well positioned to move into premier status in the Midwest middle market.

BOARD OF DIRECTORS



(left to right)
Barry F. Sullivan
Richard L. Thomas
Thomas G. Ayers
John H. Bryan, Jr.

Frank W. Considine
Marshall Field
William B. Graham
Ben W. Heineman

Donald P. Jacobs
Frederick G. Jaicks
Charles S. Locke

Thomas G. Ayers
Retired Chairman of the Board
Commonwealth Edison Company
production, distribution and sale of electric energy

John H. Bryan, Jr.
Chairman of the Board and
Chief Executive Officer
Sara Lee Corporation
manufacturer and distributor of a diversified line of consumer products and a major supplier to the food service industry

Frank W. Considine
Chairman of the Board,
President and
Chief Executive Officer
National Can Corporation
packaging manufacturer

Marshall Field
Chairman
The Field Corporation
publishing

William B. Graham
Senior Chairman
Baxter Travenol Laboratories, Inc.
manufacturer of health care products

Ben W. Heineman
Private Investor

Donald P. Jacobs
Dean of the
J. L. Kellogg Graduate School
of Management
Northwestern University
education and research

Frederick G. Jaicks*
Retired Chairman
Inland Steel Company
production, warehousing and sale of steel and related products

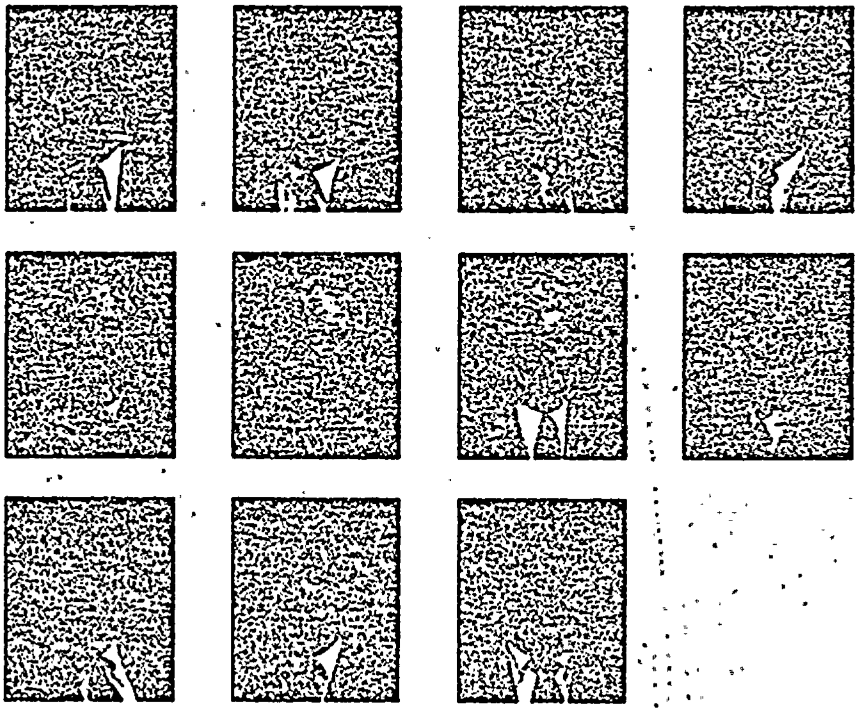
Charles S. Locke*
Chairman of the Board and
Chief Executive Officer
Morton Thiokol, Inc.
manufacturer and marketer of propulsion systems, specialty chemicals, and salt

Walter E. Massey
Vice President of
The University of Chicago
for Research and for
Argonne National Laboratory
education and research

Richard M. Morrow
Chairman and Chief Executive Officer
Amoco Corporation
exploring for, producing, purchasing, manufacturing, transporting and marketing of petroleum and petroleum products

John J. Nevin
Chairman, President and
Chief Executive Officer
The Firestone Tire & Rubber
Company
manufacturer of tires and related products

Jerry K. Pearlman*
Chairman, President and
Chief Executive Officer
Zenith Electronics Corporation
manufacturer and distributor of a diversified line of electronics products



(left to right)
Walter E. Massey
Richard M. Morrow
John J. Nevin
Jerry K. Pearlman

William Wood Prince
Ernestine M. Raclin
Patrick G. Ryan
George A. Schaefer

Roger W. Stone
Fred L. Turner
Arthur W. Woelfle

William Wood Prince*
Vice Chairman
F. H. Prince & Co., Inc.
investments and real estate

Ernestine M. Raclin*
Chairman of the Board
1st Source Corporation
a bank holding company

Patrick G. Ryan
President and
Chief Executive Officer
Combined International
Corporation
a broad based insurance
holding company

George A. Schaefer
Chairman and Chief Executive
Officer
Caterpillar Tractor Co.
manufacturer of a wide range
of construction, earthmoving
and material handling
equipment and engines

Roger W. Stone*
Chairman of the Board and
Chief Executive Officer
Stone Container Corporation
manufacturer of paper,
paper related products, and
packaging systems equipment

Barry F. Sullivan
Chairman of the Board
First Chicago Corporation and
The First National Bank of Chicago

Richard L. Thomas
President
First Chicago Corporation and
The First National Bank of Chicago

Fred L. Turner*
Chairman and
Chief Executive Officer
McDonald's Corporation
restaurant licensor

Arthur W. Woelfle
Retired Vice Chairman
Dart & Kraft, Inc.
multinational manufacturer
of consumer products

*member of the Audit Committee

Five members of the Board of Directors are not standing for reelection in 1986. First Chicago would like to extend its appreciation to these retiring directors, all of whom have served First Chicago with dedication and commitment throughout their tenure.

Thomas G. Ayers, retired Chairman of the Board of Commonwealth Edison Co., has been a director since 1966.

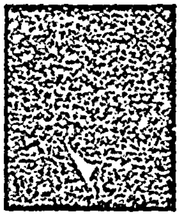
Marshall Field, Chairman of The Field Corporation, has been a director since 1970.

Ben W. Heineman, founder and later Chief Executive Officer of Northwest Industries, Inc., has been a director since 1965.

Frederick G. Jaicks, retired Chairman of Inland Steel Co., has been a director since 1971.

Arthur W. Woelfle, retired Vice Chairman of Dart & Kraft, Inc., has been a director since 1975.

DIRECTOR NOMINEE



James J. Hartigan
President and
Chief Executive Officer
United Air Lines, Inc.
diversified transportation services

FIRST TEAM LEADERSHIP

MANAGEMENT COMMITTEE

The senior policy setting and decision making body of First Chicago. This committee provides executive leadership and management at the most senior level of the Corporation.

Barry F. Sullivan
Chairman of the Board

Richard L. Thomas
President

Curtis G. Anderson
Executive Vice President
Financial Products

George L. Davis
Executive Vice President
Corporate Banking

A. D. Frazier, Jr.
Executive Vice President
Corporate Resources

Donald R. Hollis
Executive Vice President
Corporate Services

William J. McDonough
Executive Vice President
and Chief Financial Officer
Asset & Liability
Management Committee

Leo F. Mullin
Executive Vice President
Personal Banking

Lawrence C. Russell
Executive Vice President
Service Products

D. John Stavropoulos
Executive Vice President
Credit Strategy Committee

Michael E. Tobin
Chairman
American National
Corporation

POLICY COMMITTEE

The primary forum for review of corporate policy decisions, and for communication and implementation of these decisions. Members include the Management Committee and the executive officers at right.

Kenneth G. Arnesen
Secretary and General Counsel
Law

Gary P. Brinson
First Chicago Investment Advisors

A. Ray Einsel
National Banking Services

George T. Guernsey IV
Corporate Planning

Barbara B. McNear
Communications

Charles H. Montgomery
Comptroller
Control

Norman Ross
Community Affairs

Jeffrey P. Tassani
Administration

Douglas E. Van Scoy
General Auditor
Audit

SENIOR VICE PRESIDENT COUNCIL

This council explores and researches issues of corporate scope upon referral by the other committees.

M. James Alef, Jr.
Wallace R. Anker
J. Lynn Aylsworth III
John W. Ballantine
Scott E. Bates
William E. Bennett
George C. Bergland
James D. Best
James S. Brannen
Robert H. Bucke
Clark Burrus
F. Gerald Byrne
John A. Canning, Jr.
Leonard Caronia
James S. Cunningham
William G. Curran, Jr.
Alan F. Delp
Stephen C. Diamond
Lawrence E. Fox
Timothy R. Gallagher
Donald H. Gibbins
John E. Gilchrist
Earl W. Glazier, Jr.
Donald Glickman
Sherman I. Goldberg
Nicholas M. Graves
Peter C. Hagan
William J. Hagenah
Stephan L. Harris
Richard C. Hartnack
David M. Harvey
John B. Haseltine
Paul C. Hennessy
Thomas H. Hodges
Robert Hultgren
Abdul K. Jallad
Michael S. Kessler
William S. Lear
Benjamin F. Lenhardt, Jr.
Michael R. Leyden
Daniel A. Lupiani
William R. Lyman
Scott P. Marks
Arthur J. Massolo
Norman McClave III
G. Edward Means
M. Peter Miller
William E. Moeller
Philip D. Parkinson
David J. Paulus
James Y. Robertson
Gordon J. Sepstead
Ian L. Schmiegelow
Geoffrey L. Stringer
James K. Suhr
J. Mikesell Thomas
E. Neal Trogdon
Bruce A. Turkstra
David J. Vitale
Richard L. Wood
Robert R. Yohanan

Index to Financial Review

FINANCIAL PERFORMANCE BY MAJOR BUSINESS LINES

First Chicago is pursuing a strategy focused on three major business lines: global financial business, consumer financial business and middle-market financial business. As shown on the following table, the net income and return on average assets for each of these businesses increased in 1985 from 1984.

The consumer financial business provides a broad array of financial and service products to the Chicago-area consumer market and offers credit card accounts nationally. Net income increased 30 percent from 1984 as a result of growth in the loan portfolio, higher fee revenues and lower funding costs. These positive factors were partially offset by a higher provision for loan losses and increased noninterest expense.

FINANCIAL PERFORMANCE BY MAJOR BUSINESSES

(Dollars in Millions)

	Global Financial Business		Consumer Financial Business		Middle Market* Financial Business		Consolidated	
	1985	1984	1985	1984	1985	1984	1985	1984
Net interest income, tax-equivalent basis	$650	$645	$332	$243	$163	$102	$1,145	$990
Provision for loan losses	270	390	120	63	21	12	411	465
Noninterest income	451	299	161	146	46	27	658	472
Noninterest expense, *excluding 1985 loss on* affiliate investment	606	528	239	225	134	89	979	842
Loss on affiliate investment	131	—	—	—	—	—	131	—
Pretax income, tax-equivalent basis	94	26	134	101	54	28	282	155
Net income	76	23	65	50	28	13	169	86
Return on average assets	0.24%	0.07%	1.44%	1.21%	0.75%	0.56%**	0.43%	0.22%
Net interest margin	2.36%	2.28%	7.81%	6.27%	5.07%	5.13%**	3.27%	2.89%

*Represents American National Corporation, acquired May 1, 1984.
**Eight months, annualized

The amounts in the preceding table are estimated on the basis of internally developed assignment and allocation procedures, which are, to an extent, subjective. The data shown for the middle-market financial business represents American National Corporation's earnings for the period it was owned by First Chicago, adjusted for related costs of acquisition and purchase accounting adjustments. Interest expense has been allocated to the global financial and consumer financial businesses based on internal matched-funding principles, such that the expense reflects the cost to issue liability instruments with interest-rate sensitivity characteristics matching those of the corresponding assets. The allocation of corporate overhead expense is based upon internal allocations appropriate to individual activities.

The global financial business provides a variety of financial and service products to large corporations, institutions and governments throughout the world. Net income was depressed by the loss on a Brazilian affiliate investment in 1985 and a high provision for loan losses in 1984. Net interest income increased slightly in 1985, as a higher net interest margin offset a 2 percent decline in earning asset volume. Noninterest income included a $90 million increase in gains on sales of equity securities, a $39 million increase in trading account and foreign exchange trading profits, as well as a 12 percent increase in other financial and service product revenues. Noninterest expense, excluding the loss on the affiliate investment, increased 15 percent.

As shown in the preceding table, middle-market financial business results include only the results of its subsidiary, American National Corporation. While The First National Bank of Chicago engages in some middle-market activities, the financial performance for those activities is included in the global financial business results.

The financial results for 1984 shown in the table reflect American National's performance subsequent to its acquisition by First Chicago on May 1, 1984. The 1985 results reflect full-year performance. Underlying trends at American National during 1985 included higher net interest income due to growth in loan and deposit volume, increased noninterest revenue, particularly fiduciary and investment management fees, a higher provision for loan losses and increased noninterest expense.

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
FIVE-YEAR SUMMARY OF SELECTED FINANCIAL INFORMATION

(Dollars in Millions, except per share and nonfinancial data)	1985	1984	1983	1982	1981
SELECTED FINANCIAL DATA FOR THE YEAR					
Net interest income	$1,033.0	$895.0	$709.1	$615.8	$494.1
Tax-equivalent adjustment	92.2	95.0	76.0	65.3	63.7
Net interest income—tax-equivalent basis	1,145.2	990.0	785.1	681.1	557.8
Provision for loan losses	411.2	464.8	150.0	112.5	90.0
Net income	169.0	86.4	183.5	136.8	118.7
Earnings per common share	2.84	1.19	3.92	3.33	2.98
Dividends declared per common share	1.32	1.32	1.26	1.20	1.20
AT YEAR-END					
Total assets	$38,893	$39,846	$36,323	$35,876	$33,562
Total deposits	27,148	28,592	27,680	27,419	25,555
Loans	24,190	25,576	22,250	22,192	20,568
Long-term debt	842	431	298	311	182
Stockholders' equity	2,090	1,924	1,742	1,491	1,272
Primary capital	2,846	2,441	2,060	1,795	1,458
AVERAGE BALANCES					
Total assets	$39,572	$38,551	$34,543	$34,733	$30,244
Earning assets	34,979	34,206	30,502	30,548	26,236
Loans	24,976	23,901	21,499	20,588	17,787
Total deposits	27,704	26,958	23,395	24,662	22,164
Common stockholders' equity	1,677	1,604	1,428	1,319	1,233
Stockholders' equity	2,002	1,917	1,658	1,342	1,233
FINANCIAL RATIOS					
Return on stockholders' equity	8.44%	4.51%	11.07%	10.19%	9.63%
Return on common stockholders' equity	8.33%	3.38%	11.37%	10.18%	9.63%
Return on assets	0.43%	0.22%	0.53%	0.39%	0.39%
PRIMARY CAPITAL AT YEAR-END					
As a percentage of adjusted total assets	7.24%	6.08%	5.64%	4.98%	4.32%
COMMON STOCK AND STOCKHOLDER DATA					
Market price, end of year	$ 29½	$ 21⅛	$ 25⅜	$ 18⅛	$ 19¼
Book value, end of year	34.10	34.12	35.80	33.55	31.87
Common dividends	65,274	60,969	52,080	48,388	47,862
Preferred dividends	29,256	32,143	21,192	2,483	—
Dividend payout ratio	46.48%	110.92%	32.14%	36.01%	40.27%
Number of common stockholders	14,458	14,529	14,462	14,003	14,207
Average common shares outstanding	49,220,034	45,663,214	41,399,116	40,166,418	39,851,991

EARNINGS ANALYSIS

SUMMARY

First Chicago Corporation's net income for 1985 rose to $169.0 million, from the depressed earnings of $86.4 million in 1984. These results, although adversely affected by a charge of $131.1 million in connection with a plan of disposition of a Brazilian affiliate, Banco Denasa de Investimento S.A., represent a return to the positive trends of 1983 when net income was $183.5 million. Earnings for 1985 also reflect management's commitment to strengthen the balance sheet by building the allowance for loan losses. During the year, $139.9 million was added to the allowance, which stood at $431.6 million, or 1.78 percent of loans outstanding, at year-end.

Earnings per common share were $2.84 in 1985 compared with $1.19 in 1984 and $3.92 in 1983. Per-share results are computed by dividing net income less preferred dividends, by the average number of common and common equivalent shares outstanding.

The 1985 profitability ratios were weakened by the loss from the affiliate investment, but reflect significant improvement from 1984. Return on average assets was 0.43 percent in 1985, higher than 1984's 0.22 percent, but down from 0.53 percent in 1983. The return on average common stockholders' equity was 8.33 percent in 1985, compared with 3.38 percent and 11.37 percent in 1984 and 1983, respectively.

Management's emphasis on a stronger balance sheet is evidenced by 1985's higher capital ratios and increased allowance for loan losses as a percent of loans.

While the earnings and profitability ratios are indicative of the Corporation's overall financial performance in 1985, they do not reflect the significant progress made in the fundamental aspects of the business. Closer analysis of the components of earnings demonstrates continued strength and improvement. Further discussion of trends in specific earnings categories is found on pages 30-32.

For Year Ended December 31 (Dollars in millions, except per share amounts)	1985	1984	1983
Net Income	$169.0	$86.4	$183.5
Earnings per common share	2.84	1.19	3.92
Return on assets	0.43%	0.22%	0.53%
Return on common stockholders' equity	8.33%	3.38%	11.37%

Other key factors affecting 1985 financial performance include:

- the full-year inclusion of American National Corporation's results;
- an increase in net interest income resulting from a shift in the portfolio to higher-yielding assets and lower funding costs;
- substantial growth in noninterest income, particularly in venture capital gains and trading account and foreign exchange trading profits; and
- higher noninterest expense (excluding the loss on the affiliate investment), due primarily to an increase in salaries and benefits and generally higher operating costs.

Changes in the composition of the balance sheet influenced 1985 financial performance. In seeking to strengthen the balance sheet, management has been increasingly more selective in pursuing asset growth. Traditional loans to large institutional customers, especially in the global financial business, have become less profitable. These loans, along with overseas loans and low-spread deposit placements, have been reduced while such assets as credit card outstandings and middle-market loans have grown significantly during the year. Although total assets declined 2 percent in 1985, a greater portion of earning assets is now concentrated in higher-yielding loans.

Specifically, trends in assets and deposits include:

- an increase in domestic short-term liquid assets, particularly Federal funds sold and trading account assets;
- domestic loan growth, primarily in American National middle market loans and credit card outstandings;
- reduction in the level of overseas loans and deposit placements; and
- growth in demand deposits.

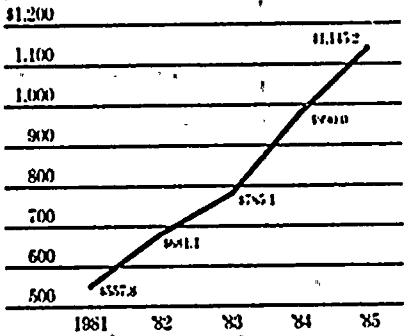
The emphasis on a strong balance sheet resulted in higher primary capital ratios. At year-end 1985, primary capital as a percent of adjusted assets for the Corporation was 7.24 percent versus 6.08 percent at the end of 1984. The primary capital ratio for The First National Bank of Chicago was 6.61 percent, well above the 6.00 percent goal to be attained by March 31, 1986 pursuant to an agreement with the Comptroller of the Currency. A more detailed discussion of the Corporation's capital management policies appears in the Asset and Liability Management section on pages 38-39.

For comparative purposes, it should be noted that American National Corporation was acquired on May 1, 1984, and, therefore, financial results for 1984 incorporate American National Corporation data for eight months only. American National Corporation's full year operating results are included in the Corporation's consolidated financial statements for 1985.

NET INTEREST INCOME

Net interest income is a function of net interest margin and earning asset volume. The Corporation has shown consistent growth in net interest income over the past five years, reflecting its fundamental operating strength. In 1985, net interest income on a tax-equivalent basis increased to $1.1 billion, a 16 percent increase over 1984. The $990.0 million net interest income in 1984 represented growth of 26 percent over the prior year.

NET INTEREST INCOME
Tax Equivalent Basis
(in millions)



The net interest margin for the Corporation averaged 3.27 percent during the year, reflecting continuing improvement from 2.89 percent in 1984 and 2.57 percent in 1983. American National Corporation, with its higher yields on loans and larger proportion of low-cost deposits, achieved a net interest margin of 5.32 percent in 1985, contributing significantly to the increase in the consolidated net interest margin.

Earning asset volume was $35.0 billion in 1985, compared with $34.2 billion in 1984 and $30.5 billion in 1983. As noted previously, the composition of earning assets has shifted to higher-yielding assets.

AVERAGE EARNING ASSETS AND NET INTEREST MARGIN

For the Year Ended December 31 (Dollars in Billions)	1985	1984	1983
First Chicago Consolidated			
Average earning assets	$35.0	$34.2	$30.[illegible]
Net interest margin	3.27%	2.89%	2.[illegible]
Excluding American National			
Average earning assets	$32.9	$32.3	$30.5
Net interest margin	2.99%	2.75%	2.57%

Approximately 85 percent of total net interest income was generated from domestic operations. Domestic net interest income increased 19 percent over 1984, following 32 percent growth from 1983. The trend toward a greater proportion of credit card outstandings and middle-market loans accounts for much of the increase. Higher loan fees also contributed to the growth.

Overseas net interest income was relatively unchanged from 1984, after growing 3 percent from 1983. Overseas loans and deposit placements fell significantly in 1985, consistent with the Corporation's strategy of moving away from lower-yielding assets. Spreads on overseas assets increased slightly, however, offsetting the impact of the volume decline.

PROVISION FOR LOAN LOSSES

The changes in the allowance for loan losses are presented in the following table:

(Dollars in Millions)	1985	1984	1983
Allowance for loan losses, at beginning of year	$291.7	$218.0	$203.1
Charge-offs	309.0	438.0	160.0
Recoveries	37.7	23.1	24.7
Net charge-offs	271.3	414.9	135.3
Provision for loan losses	411.2	464.8	150.0
Acquisitions and dispositions	—	23.8	0.2
Net additions to allowance	139.9	73.7	14.9
Allowance for loan losses —at year end	$431.6	$291.7	$218.0
—as a percentage of loans outstanding	1.78%	1.14%	0.98%

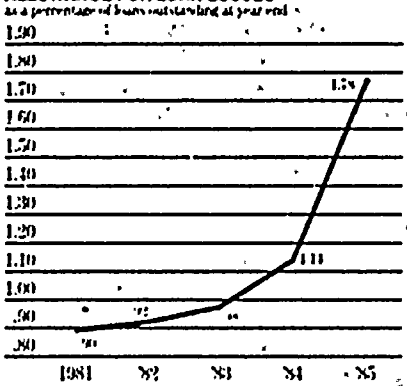
The provision for loan losses was $411.2 million in 1985, down from $464.8 million in 1984, but greater than the $150.0 million provision in 1983. Net charge-offs were $271.3 million in 1985, compared with $414.9 million in 1984 and $135.3 million in 1983.

The allowance for loan losses increased to $431.6 million, or 1.78 percent of loans outstanding at December 31, 1985, compared with $291.7 million, or 1.14 percent at year-end 1984, and $218.0 million, or 0.98 percent, at the end of 1983.

In maintaining an adequate allowance for loan losses, the Corporation estimates and reserves for potential losses in its credit portfolio. The amount of the allowance results from management's analysis of factors generally affecting the credit portfolio, and the application of that analysis to the results of a specific credit-by-credit review undertaken quarterly. The resulting allowance reflects a reasonable estimate of potential losses, based on the specific composition of the Corporation's loan portfolio and the experienced credit judgment of the Corporation's management. Among the many factors reviewed by management in establishing an adequate allowance level are the historical and projected performance of specific credit segments, estimates of future economic activity and guidance from the Corporation's regulators.

ALLOWANCE FOR LOAN LOSSES

As a percentage of loans outstanding at year end



The Corporation's policy is to charge off loans or portions of loans it deems to be uncollectible. In 1985, gross charge-offs amounted to $309 million, compared with $438 million in 1984, and net additions of nearly $140 million were made to the allowance for loan losses in 1985. One of the Corporation's key objectives is the prudent management of credit risk in the portfolio. Additional discussion of credit risk management may be found on pages 33-36.

NONINTEREST INCOME

Noninterest income totaled $658.0 million in 1985, up 39 percent from $472.2 million in 1984. Noninterest income for 1983 totaled $382.8 million. This sustained growth reflects management's continued emphasis on providing a growing range of financial and noncredit services focusing on venture capital, investment banking, credit cards, and service products.

Noninterest Income (In Millions)	As Reported 1985	Excluding American National 1985	As Reported 1984	Excluding American National 1984	As Reported 1983
Trading account profits	$ 29.0	$ 26.9	$ 12.2	$ 11.6	$ 3.5
Foreign exchange trading profits	47.2	46.3	25.5	24.5	35.5
Fiduciary and investment management fees	90.2	70.0	77.4	65.6	53.9
Credit card fees	123.6	122.6	112.3	112.0	90.6
Other service revenue and fees	106.5	86.8	77.9	65.7	47.9
International fees	68.4	68.4	78.0	78.0	64.1
Equity securities gains (losses)	146.7	146.7	56.7	56.4	52.5
Investment securities gains (losses)	1.0	1.0	—	—	(0.1)
Other	45.4	43.5	32.2	31.5	31.9
Total	$658.0	$612.2	$472.2	$445.3	$382.8

Equity securities gains reached a record level of $146.7 million in 1985 compared with gains of $56.7 million in 1984 and $52.5 million in 1983. These gains come in part from the sale of maturing investments in the venture capital group and in part from the sale of securities taken in connection with problem loans, both part of the ongoing business of lending and investing. The substantial increase in 1985 was due primarily to the efforts of the venture capital group, which produced equity securities gains of $121.0 million in 1985, compared with $48.0 million in 1984 and $25.8 million in 1983.

Credit card fees made a significant contribution to the increase in noninterest income in both periods, primarily as a result of an increase in the number of active accounts and the level of usage by cardholders. The sustained growth in the cardholder base in recent years has been achieved through both successful market solicitation and credit card portfolio acquisitions.

Average credit card balances grew to $3.1 billion in 1985 from $2.4 billion in 1984 and $1.8 billion in 1983.

Foreign exchange trading profits reached a record level of $47.2 million in 1985 compared with $25.5 million in 1984. The improved 1985 performance was achieved through increased marketing efforts directed at corporate customers and the ability of First Chicago traders to take advantage of unprecedented market volatility. Foreign exchange trading profits in 1984 were down compared with 1983 profits, primarily because of reduced customer demand in the long-term foreign exchange markets.

Trading account profits reached a record level in 1985 of $29.0 million, up from $12.2 million in 1984 and $3.5 million in 1983. The growth in trading account profits resulted from improved performance across all trading activities, including government and municipal securities, and interest-rate futures, as well as secondary trading in money market securities.

International fees declined by $9.6 million in 1985, or 12 percent, from $78.0 million a year ago. This decrease can be attributed to a lower level of fees on international financings, as well as decreased fees on letters of credit because of lower volume.

Other service revenue and fees increased 37 percent to $106.5 million in 1985 after increasing 63 percent to $77.9 million in 1984. Key factors in this continued growth were the increasing range of service products; increased levels of fee income generated by the investment banking group in activities such as mergers and acquisitions, other consulting and advisory services, and acting as intermediary in interest rate swap agreements; and by American National in servicing its middle-market clientele.

NONINTEREST EXPENSE

Effective control of expense growth is a key determinant of the profitability of all major bank holding companies. Management must be willing to incur expenses to optimize future earnings (investment in systems or consolidation of backroom operations, for example), while limiting expense growth in less profitable areas.

In 1985, the Corporation established a plan of disposition for its investment in Banco Denasa de Investimento S.A., a Brazilian investment bank. In connection with this plan of disposition, the Corporation wrote off its investment in Banco Denasa and accrued management's estimate of losses through the anticipated disposition date. The $131.1 million charge relating to this plan is shown as a separate component of noninterest expense.

Noninterest Expense	As Reported	Excluding American National	As Reported	Excluding American National	As Reported
(In Millions)	1985	1985	1984	1984	1983
Salaries and employee benefits	$ 505.6	$441.5	[illegible]	[illegible]	[illegible]
Occupancy expense of premises, net	102.8	90.6	[illegible]	[illegible]	[illegible]
Equipment rentals, depreciation and maintenance	65.7	54.0	[illegible]	[illegible]	[illegible]
Loss from an affiliate investment	131.1	131.1	–	–	–
Other	304.5	258.1	[illegible]	[illegible]	[illegible]
Total	$1,109.7	$975.3	$842.0	[illegible]	[illegible]

Noninterest expense for 1985 totaled $1.110 billion, up from $842.0 million in 1984. Without American National and the special provision established for the estimated loss on the disposition of Banco Denasa, noninterest expense totaled $844.2 million, a 12 percent increase, compared with the 11 percent rate of increase experienced in 1984.

Apart from the special provision, salary and employee benefits expense was the primary contributor to the growth in noninterest expense in both periods for the following reasons:

- Salary expense increased because of higher salary levels and planned staff increases in both periods, and
- Profit sharing and incentive compensation expense increased in 1985 because of the resumption of profit sharing and certain incentive compensation plans.

Partially offsetting higher salary and profit-sharing expense in 1985 was a reduction in pension costs of $12.4 million resulting from the adoption of Financial Accounting Standards Board Statement No. 87 governing accounting for pension costs.

Occupancy expense increased in both periods because of increased costs associated with renewed lease contracts and the rental of new facilities. In addition, continued enhancement of existing facilities has been made through leasehold improvements to achieve a long-term stabilization of occupancy costs.

Equipment costs also increased in both periods, reflecting a continued high level of investment in data processing, communication and other equipment.

In both periods, there was a higher level of general operating costs, such as marketing, consulting services, communications and travel, resulting from an increased level of business activity and higher costs for such services.

APPLICABLE INCOME TAXES

The following table shows the Corporation's income before income taxes and applicable income taxes for each of the three years ended December 31, 1985.

	Year Ended December 31		
(Dollars in Millions)	1985	1984	1983
Income before income taxes	$190.1	[illegible]	[illegible]
Applicable income taxes (benefit)	$ 21.1	$(26.0)	[illegible]

The increase in income before income taxes and higher levels of tax exempt income in 1985 were the primary reasons for change in the tax provision from a tax benefit of $26.0 million in 1984 to a tax expense of $21.1 million in 1985.

The significant provision for loan losses made by the Corporation in 1984 produced a lower level of income before income taxes that year. This, coupled with a high level of tax exempt income, resulted in a tax benefit of $26.0 million in 1984.

CREDIT RISK MANAGEMENT

OVERVIEW

During 1985 the Corporation significantly enhanced its credit risk management process, especially in the area of front-end guidance. By providing additional resources and clearer definition of portfolio objectives in the credit initiation phase, management can better control the quality of the Corporation's portfolio.

The credit process at First Chicago has three functional elements—*portfolio management, implementation, and compliance quality review*. The Credit Strategy Committee (CRESCO), which includes members of senior management, provides to line departments front-end guidance that defines the Corporation's risk appetite. This guidance includes general credit policies and diversification guidelines for portfolio concentrations by customer relationships, industry, country and product portfolio profile targets. Not less than quarterly, based on its review of problem credits and other input from line units, CRESCO tests the adequacy of the Corporation's allowance for loan losses.

The line departments use CRESCO's broad guidelines to define target markets and risk acceptance criteria for each business unit. The target market definitions and risk acceptance criteria include both qualitative and quantitative measures of credit quality and profitability and are subject to CRESCO review and approval. Within this strategic framework, the line departments, with credit authority delegated from CRESCO, are responsible for the construction, management and administration of the credit risk portfolio. Activities include credit initiation, approval, documentation, and relationship and product management.

The Audit Department independently reviews compliance with CRESCO's guidance and line departments' policies and procedures to assure the integrity and effectiveness of the Corporation's credit risk management process. Credit risk management, including portfolio quality and internal controls, is also examined by regulatory agencies, including the Comptroller of the Currency and Federal Reserve Board. As part of their examination of the Corporation's annual financial statements, the independent auditors perform a review of loan procedures, the portfolio, and the adequacy of the allowance for loan losses. The combination of these activities provides management a continuous surveillance of the loan portfolio.

LOAN PORTFOLIO RISK ANALYSIS

PORTFOLIO CONCENTRATIONS

In order to manage and control credit risk, the Corporation utilizes a strategy of diversification in its credit exposure on geographic, industry, product and customer bases. As indicated in the table below, the loan portfolio at December 31, 1985 was comprised of 72 percent domestic loans and 28 percent foreign loans. Commercial loans are the largest segment of the portfolio, amounting to $10 billion, or approximately 42 percent of total domestic and foreign loans. Reflected in the commercial loan totals were approximately $1.9 billion in energy-related loans, primarily domestic. Energy markets continue to be extremely volatile. The Corporation periodically reviews its energy exposure thoroughly to determine its sensitivity to lower oil prices. Such information is considered in CRESCO's test of the adequacy of the allowance for loan losses. Most of our energy portfolio represents customers among the largest and most financially sound in the energy sector. The most vulnerable element of the energy portfolio relates to customers performing drilling services, as the uncertainties in energy pricing generate a slowdown in exploration and development activities. The Corporation's portfolio in this area totals approximately $200 million and harbors the potential for increases in nonperforming assets and loan losses.

Consumer loans, primarily credit card outstandings, have become the second largest segment of the domestic loan portfolio, with $3.8 billion outstanding at December 31, 1985. This represents an annual growth rate of approximately 37 percent since December 31, 1981. The Bank's aggressive program of cardholder solicitation and portfolio acquisition with respect to credit cards began in 1982. In 1985 the Bank further refined its credit screening criteria to ensure the continued creditworthiness of new cardholders.

LOANS—COMPOSITION

December 31 (In Millions)	1985	1984	1983	1982	1981
Domestic					
Commercial	$ 6,888	$ 7,523	$ 6,518	$ 6,423	$ 6,213
Secured by real estate*	3,379	3,470	2,770	2,732	2,731
Financial institutions	1,437	1,334	1,338	1,638	1,641
Consumer	3,750	3,333	2,336	1,875	1,058
Lease financing	428	386	340	345	340
Other	1,648	1,558	1,067	1,513	1,597
Domestic	17,530	17,611	14,399	14,526	13,616
Foreign	6,660	7,962	7,851	7,666	6,952
Loans	$24,190	$25,576	$22,250	$22,192	$20,568

*Includes residential and other mortgages

RISK ASSESSMENT POLICIES

It is the Corporation's policy to charge off any loan, or portion thereof, which has been determined to be uncollectible. During 1985, the Corporation charged off loans totaling $309.0 million, compared with $438.0 million in 1984. Charge-offs, net of recoveries, were $271.3 million in 1985, compared with $414.9 million in 1984.

During the year, the provision for loan losses was $411.2 million, adding $139.9 million to the allowance for loan losses after net charge-offs, bringing it to $431.6 million at December 31, 1985. The allowance for loan losses as a percentage of total loans was 1.78 percent as of December 31, 1985, up from 1.14 percent at year-end 1984.

Specific components of the Corporation's credit portfolio are analyzed to test the adequacy of the allowance for loan losses. First, identified risk in the commercial loan portfolio is assessed on an asset-by-asset review to identify all probable and possible loss potential. Second, the credit card portfolio is analyzed to estimate loss potential. Third, loss potential related to transfer risk is analyzed to reserve for the possibility of losses resulting from the difficulties in obtaining foreign exchange in various developing countries. Finally, a reserve level is established for losses which, although not currently identified, may occur in the segment of the commercial loan portfolio that does not have specifically identified loss exposures.

CREDIT EXPOSURE

Various sectors of the world's economy continued to experience difficulties in 1985. Approximately 60 percent of the Corporation's gross commercial charge offs were experienced in four sectors—energy, manufacturing, construction, and shipping. During 1986, the Corporation anticipates that its non consumer charge-offs will be lower than its 1985 experience.

The following paragraphs discuss the Corporation's expectations concerning loan loss and nonperforming asset trends for 1986. Specific unforeseen events or circumstances affecting certain borrowers or industries can have significant effects on these expectations and trends, despite a stable or improving economy. Therefore, since these expectations are based on current analyses and information, they are subject to modification at any time.

LOAN STATISTICS

(Dollars in Millions)	1985	1984	1983	1982	198[illegible]
Beginning of the year allowance for loan losses	$ 291.7	$ 218.0	$ 203.1	$ 185.1	$ 156.[illegible]
Provision for loan losses	411.2	464.8	150.0	112.5	90.[illegible]
Net charge-offs for the year	271.3	414.9	135.3	103.7	61.[illegible]
Acquisitions and dispositions	—	23.8	0.2	9.2	—
End of the year allowance for loan losses	431.6	291.7	218.0	203.1	185.[illegible]
Loans outstanding at year-end	24,190	25,576	22,250	22,192	20,5[illegible]
Average loans outstanding for the year	24,976	23,901	21,499	20,588	17,78[illegible]
Allowance for loan losses loans outstanding	1.78%	1.14%	0.98%	0.92%	0.9[illegible]
Net charge offs average loans	1.09%	1.74%	0.63%	0.50%	0.3[illegible]
Analysis of Net Charge-Offs					
Charge-offs					
Domestic					
Commercial	$102.4	$219.1	$ 65.6	$ 52.7	$20[illegible]
Secured by real estate	3.9	3.5	19.1	25.3	15[illegible]
Consumer	104.3	50.9	32.8	30.7	31[illegible]
Other	5.4	24.7	16.2	8.2	1[illegible]
Foreign	93.0	139.8	26.3	9.3	11[illegible]
Total charge offs	309.0	438.0	160.0	126.2	92[illegible]
Recoveries					
Domestic					
Commercial	13.5	5.8	8.7	4.5	13[illegible]
Secured by real estate	1.8	0.7	0.5	0.9	4[illegible]
Consumer	12.9	10.8	12.2	11.3	[illegible]
Other	0.7	0.6	1.6	3.7	3[illegible]
Foreign	8.8	5.2	1.7	2.1	3[illegible]
Total recoveries	37.7	23.1	24.7	22.5	32[illegible]
Net charge offs	$271.3	$414.9	$135.3	$103.7	$9[illegible]

DOMESTIC CREDIT EXPOSURE

Commercial and Financial Institutions

Commercial loans represent the largest segment of domestic loans and include a variety of industries, such as industrial manufacturing, energy, consumer products, retailing and transportation. Most of the loans in the financial institutions segment are to finance companies, mortgage companies and banks.

Approximately $23.1 million of the $88.9 million in net domestic commercial charge-offs during 1985 were to energy-related companies. The industry sectors that the Corporation will continue to monitor closely in 1986 are energy, metals, and financial institutions.

Secured by Real Estate

Total domestic real estate-related loans are approximately $3.4 billion, or 14.0 percent, of the total loan portfolio. The real estate loan portfolio is comprised of mortgage loans on residential properties and income-producing commercial properties, as well as construction loans that are diversified both geographically and by type of construction project. Although substantial over-building has taken place in many parts of the country, real estate charge-offs are expected to remain relatively low during 1986. Real estate, however, remains a volatile industry and borrowers in certain geographic markets may be adversely affected by local market conditions.

Consumer

Domestic consumer loans are primarily composed of credit card outstandings, with the remainder being loans for household, family and other personal expenditures. At December 31, 1985, domestic consumer loans totaled 15.5 percent of total loans.

Net charge-offs associated with credit cards were higher in 1985. Principal factors causing the increase in credit card losses were growth in the overall size of the portfolio, slight deterioration in consumer creditworthiness, as well as the age profile of the portfolio. Losses in the credit card portfolio are fairly predictable based upon statistical experience, and, as such, represent an estimable cost of doing business. The charge-off rate on credit card outstandings is expected to peak in 1986 at a level somewhat higher than in 1985. However, it is anticipated that charge-off experience will continue to compare favorably with that of other large bank credit card issuers.

Other

The domestic other loan category is principally composed of loans to securities dealers and brokers as of December 31, 1985. Prior to 1985, this category also included exposure to the production agriculture industry. Net charge-offs decreased significantly during 1985 to $4.7 million from $21.1 million during 1984. The decrease is attributable to the Corporation's decision to reduce its exposure to the production agriculture industry. Charge-offs for this category in 1986 are expected to be essentially unchanged from 1985.

FOREIGN CREDIT EXPOSURE

Because of the special risks associated with loans, investments or deposits overseas, the Corporation's Country Risk Management Council evaluates and reviews the significant components of risk for each country. After determining a composite rating for the various risks associated with lending in each country, exposure limits are established. Higher limits are allocated to heavily industrialized, highly developed countries. Lower limits are established for other countries, based upon an analysis of each country's ability to support its level of foreign debt. The analysis includes a review of the cash flow position, foreign exchange reserves, socio-economic environment, availability of external credit guarantees and political situation of each country.

This analysis is updated for certain developing countries and used to evaluate the adequacy of the allowance for loan losses as it pertains to transfer risk. Included in foreign charge-offs for 1985 is approximately $14.1 million related to transfer risk. It is anticipated that 1986 charge-offs related to transfer risk will be approximately the same.

Of the foreign portion of the portfolio at year-end 1985, approximately $3.2 billion, or 18 percent, were loans to foreign governments, official institutions and banks and other financial institutions. The remainder of the portfolio is diversified among a variety of commercial borrowers in different industries and geographic areas. The following table shows the composition of foreign loans for the past five years.

Foreign Loans December 31 (In Millions)	1985	1984	1983	1982	1981
Commercial	$3,156	$3,642	$3,741	$3,782	$3,259
Governments and official institutions	1,255	1,353	1,643	1,724	1,951
Banks and other financial institutions	1,965	2,552	2,209	1,852	1,556
Other	284	415	258	308	186
Foreign loans	$6,660	$7,962	$7,851	$7,666	$6,952

The international shipping and construction markets remained depressed during 1985. The Corporation anticipates that 1986 charge-offs will be substantially lower in the shipping sector. In the construction sector the Corporation expects charge-offs in 1986 similar to the 1985 experience.

The following table summarizes, for the last three years, changes in the portion of the allowance for loan losses attributable to foreign loans, including transfer risk.

(In Thousands)	1985	1984	1983
Balance, beginning of year	$101,443	$ 57,504	$ 69,907
Additions (deductions)			
Charge-offs	(92,997)	(109,889)	(26,298)
Recoveries	8,760	5,253	1,735
Net charge-offs	(84,237)	(104,636)	(24,563)
Provision for loan losses	136,169	147,718	12,160
Acquisitions and dispositions	–	467	–
Balance, end of year	$153,375	$101,443	$57,504

For further information concerning the Corporation's cross-border foreign outstandings see pages 39-40.

NONPERFORMING ASSETS

Nonperforming assets include loans on which the Corporation does not accrue interest ("nonaccrual basis"); loans that bear a rate of interest that has been reduced below market rates due to the deteriorating financial condition of the borrower ("renegotiated loans"); and real estate assets acquired in satisfaction of debt ("other real estate").

Total nonperforming assets decreased by $101 million during 1985. However, given the economic uncertainties in the real estate, energy, and metals industries, nonperforming assets are likely to increase significantly in 1986, beginning as early as the end of the first quarter. In addition, see page 39 for a discussion of the Corporation's foreign outstandings and the possible impact on nonperforming assets.

The following table shows the foreign and domestic components of nonperforming assets at December 31, 1985 and 1984, respectively.

	1985			1984		
(In Millions)	Domestic	Foreign	Total	Domestic	Foreign	Total
Nonaccrual loans	$351	$285	$636	$486	$205	$691
Renegotiated loans	4	–	4	9	–	9
Nonperforming loans	355	285	640	495	205	700
Other real estate	17	–	17	58	–	58
Nonperforming assets	$372	$285	$657	$553	$205	$758

For loans that were nonperforming at year-end 1985 and 1984, interest at original contract rates (based on average outstanding balances) and interest actually recorded for those periods were as follows:

	1985			1984		
(In Millions)	Domestic	Foreign	Total	Domestic	Foreign	Total
Interest at original contract rates	$48	$35	$83	$54	$41	$95
Interest actually recognized	8	10	18	16	12	28
Interest shortfall, before income tax effect	$40	$25	$65	$38	$29	$67

As of December 31, 1985, loans that were 90 days o[illegible]st due and still accruing interest amounted to $52.7 m[illegible] which $10.4 million were foreign loans. This compares with a total of such loans at December 31, 1984 of $60.7 million, of which $26.7 million were foreign loans.

At December 31, 1985 and 1984, the Corporation was committed to lend additional funds of approximately $14 and $29 million, respectively, in connection with nonperforming loans.

Nonperforming Assets December 31 (In Millions)	1985	1984	1983	1982	1981
Nonaccrual loans	$636	$691	$800	$693	$355
Renegotiated loans	4	9	12	85	143
Nonperforming loans	640	700	812	778	498
Other real estate	17	58	42	69	66
Nonperforming assets	$657	$758	$854	$847	$564
Nonperforming assets as a percentage of loans and other real estate	2.7%	3.0%	3.8%	3.8%	2.7

ASSET AND LIABILITY MANAGEMENT

OVERVIEW

Maintaining the Corporation's financial strength has been, and remains, a primary goal of the Corporation. Overall financial management policies are formulated and monitored through the Asset and Liability Management Committee, comprised of senior members of management. The Committee meets regularly to address specific issues related to three general topics of financial management: liquidity, interest-rate sensitivity and capital adequacy.

LIQUIDITY MANAGEMENT

Liquidity is the ability to meet all present and future financial obligations in a timely manner. The Corporation's goal is to maintain a high degree of liquidity in the balance sheet through active management of both assets and liabilities. The Corporation's liability management policies emphasize continuing its direct access to money markets and monitoring the level of future funding requirements; its asset management policies guide the proportion of readily marketable assets to total assets.

LIABILITIES

The First National Bank of Chicago and American National Corporation and its bank subsidiaries have direct access to the Chicago-area retail market as a source of funds. Despite Illinois state banking laws limiting branch facilities, consumer deposits continued to grow in 1985. Money market accounts totaled $1.7 billion at December 31, 1985, up 12 percent from year-end 1984 following an increase of 57 percent from year-end 1983 to year-end 1984. Individual retirement accounts grew 29 percent to $887 million at the end of 1985, following an increase of 32 percent from year-end 1983 to year-end 1984.

However, because of the restrictions on branch banking, the majority of liabilities funding The First National Bank of Chicago are raised from nonretail sources, which are considered to be more volatile than retail deposits. The inherent benefits of retail deposit gathering stem from the capability to directly access the consumer market, dealing with a diversified group of customers. In order to enhance the stability of "purchased funds," management seeks to replicate these benefits by stressing direct distribution and diversification of funding sources for wholesale liabilities.

The First National Bank of Chicago establishes direct relationships with large institutional depositors through an established distribution network. Domestically and overseas, money market traders and salespeople raise funds through direct contact with customers, rather than using brokers' services. This approach has proved to be successful in creating reliable sources of funds. In 1985, over 85 percent of nonretail certificates of deposit and 95 percent of Federal funds purchased from domestic sources were raised directly. And, overseas, liability instruments are predominantly distributed to government and official institutions and corporations, rather than within the interbank market.

The First National Bank of Chicago benefits from a diversified institutional customer base. The Bank's purchased funds customer list currently includes over 3,500 institutional names. Industry and geographic concentrations among funding sources are closely monitored to maximize diversification and reduce volatility.

The First National Bank of Chicago and American National Corporation and its subsidiaries obtain demand deposits from large corporations, middle-market customers, and individual consumers.

First Chicago Corporation's year-end deposit balances for the last three years are shown below:

Deposits December 31 (In Millions)	1985	1984	1983
Domestic			
Demand	$ 5,421	$ 4,896	$ 3,191
Savings	2,542	2,228	1,619
Time	6,477	7,513	8,297
Foreign offices			
Banks in foreign countries	4,408	5,558	4,684
Foreign governments and official institutions	1,597	1,191	1,733
Other time and savings	6,469	7,009	7,813
Other demand	234	294	210
Total deposits	$27,148	$28,572	$27,680

Federal funds purchased, securities under repurchase agreements and commercial paper are other major nonretail sources of funds. Details on the outstandings and rates of these instruments during each of the last three years follow:

(In Millions)	1985	1984	1983
Federal funds purchased and securities under repurchase agreements			
Outstanding at year end	$5,168	$4,797	$2,323
Highest outstanding at any month end	5,929	5,607	6,364
Average interest rate at year end	9.70%	9.07%	10.14%
Commercial paper			
Outstanding at year end	$ 362	$ 359	$ 451
Highest outstanding at any month end	588	570	589
Average interest rate at year end	8.12%	9.67%	9.51%
Other funds borrowed			
Outstanding at year end	$1,467	$1,714	$1,584
Highest outstanding at any month end	1,846	1,714	1,651
Average interest rate at year end	10.01%	10.01%	10.46%
Total funds borrowed			
Daily average outstanding during the year	$7,069	$7,051	$6,918
Approximate daily average interest rate during the year	8.47%	10.40%	9.38%

Other funds borrowed as of year-end 1985 totaled $1.467 billion, compared with $1.714 billion at year-end 1984. The maturities of other borrowings as of December 31, 1985 were (in millions):

Other Funds Borrowed	
1986	$1,226
1987	105
1988	132
1989	1
1990 and beyond	3
Total	$1,467

The daily balances of Federal funds purchased and securities under repurchase agreements fluctuate considerably, depending on the Corporation's liquidity position and interest rate sensitivity. The year-end 1985 balances increased 8 percent from 1984. The average balance of these instruments was $5.1 billion in 1985 and $5.2 billion in 1984.

At December 31, 1985, the Corporation had $362 million of commercial paper outstanding, with maturities ranging from one to 270 days, compared with $369 million at December 31, 1984. The average volume for 1985 was $378 million compared with $431 million in 1984.

Finally, long-term debt, defined as borrowings with original maturities of seven or more years, was $842 million as of 1985 year-end, an increase of $410 million from the prior year.

ASSETS

Liquidity management can be implemented through the sale or maturity of existing assets. The Corporation aims to maintain at least 20 percent of the total balance sheet in liquid assets. These short-term, readily-marketable assets include deposit placements, Federal funds sold, securities under resale agreements, and trading account securities. At December 31, 1985, liquid assets comprised 21 percent of total assets, one of the strongest ratios among large bank holding companies. Throughout the year, the Corporation consistently met or exceeded the 20 percent objective. This relatively high degree of liquidity allows greater flexibility in balancing the fluctuating borrowing requirements of customers with the Corporation's daily funding needs.

The investment securities portfolio also provides a secondary source of liquidity to the balance sheet and is shown below.

Investment Securities December 31 (In Millions)	1985	1984	1983
Debt securities			
U.S. Government and Federal Agency	$ 799	$ 576	$ 886
States and political subdivisions	539	584	571
Other bonds, notes and debentures	168	137	137
Total debt securities	1,506	1,297	1,594
Equity securities	506	453	380
Total	$2,012	$1,750	$1,974

Finally, the Corporation has developed the capability to sell loans in order to meet key corporate customers' borrowing requests that do not meet the Corporation's profitability targets. The loans sold generally are of high credit quality and have narrow interest spreads. This capability adds flexibility to the Corporation's liquidity management practices.

INTEREST-RATE SENSITIVITY MANAGEMENT

A key element of the Corporation's asset and liability management is the effective management of interest rate risk. During the past several years, the Corporation has instituted policies and procedures designed to minimize the impact of changes in interest rates on earnings. This has been achieved through both asset pricing strategies and disciplined funding procedures.

Whenever possible, assets are funded with liability instru[illegible] of similar maturity structure and interest rate sensitivity. This "matching" of assets and liabilities enhances liquidity and stabilizes returns. Pricing policies were developed to facilitate this matching concept, so that an asset yield would be set as a spread over the cost of the corresponding liability. Certain assets of the portfolio have indefinite maturities or interest rate sensitivities that are not readily matched with specific liability instruments. In these instances, primarily in domestic floating rate and credit card loans, a target liability pool is created based on estimates of maturities and interest-rate fluctuations. The composition of this liability pool is tracked daily and adjusted as needed. Overall, this matched funding strategy has resulted in a higher, more stable net interest margin for the Corporation.

While generally attempting to eliminate structural interest-rate risk, the Corporation strives to take advantage of the profit opportunities available in short-term interest rate movements. Active trading in short-term money-market instruments is employed, with interest-rate risks and maturity mismatches being carefully controlled within the Corporation's disciplined system of risk parameters.

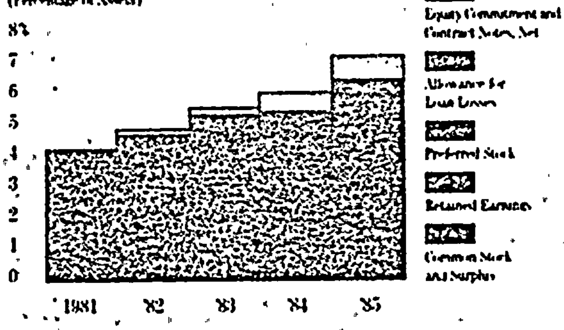
CAPITAL MANAGEMENT

Effective capital management is essential to the Corporation's achievement of its financial objectives. Capital serves several purposes: it supports growth, provides protection to depositors, and represents, in part, the investment of stockholders, on which management has the responsibility to achieve adequate returns. The capital adequacy objectives for the Corporation and its principal bank subsidiaries have been developed to meet these needs. The principal objective is to achieve strong capital ratios relative to the average of the Corporation's money center peers and against the minimum regulatory capital guideli[illegible]o facilitate these objectives, the Corporation has establish[illegible] capital management policies to ensure that the consolid[illegible] entity and each of its subsidiaries have capital structures consistent with prudent financial management principles and applicable regulatory requirements.

The principal focus of the capital management of the Corporation and its bank subsidiaries emphasizes growth through internal capital generation and effective balance sheet management. In support of this focus, the Corporation has established a dividend policy for its common stock, with a payout ratio over the long-term of 20 to 30 percent of earnings available to common stockholders, which approximates the average payout of the money center peer banks and others in the financial services sector. This dividend policy is augmented by a dividend reinvestment plan for shareholders, offering a 5 percent discount from the market price of the Corporation's stock for reinvested dividends. Other sources of capital, such as equity commitment and contract notes, are important for regulatory capital management, but do not provide the same fundamental capital base for supporting growth opportunities of the Corporation.

Also, the Corporation adheres to the "building block" approach to the capitalization of nonbank subsidiaries: each subsidiary's capital structure is to be comparable to that which the market would require if it were an independent, yet similar company. Under this approach, the Corporation's policy is to limit the use of double leverage, which is the use of holding company debt to finance equity investments in its subsidiaries. The Corporation's capital structure included only $8 million of double leverage at year-end 1985.

PRIMARY CAPITAL COMPONENTS
at year-end
(Percentage of Assets)



Under these policies, the Corporation's capital position improved significantly in 1985. Total consolidated assets at December 31, 1985 declined slightly from a year ago, the allowance for loan losses increased significantly, and retained earnings improved, although below expectations for the Corporation. In addition, First Chicago issued $800 million of primary capital securities: $200 million of equity contract notes, and $100 million from the proceeds of the issuance of common stock in connection with the dividend reinvestment plan. Also, the Corporation issued $200 million of long-term debt during the year, which qualifies as secondary capital for regulatory capital purposes. At December 31, 1985, the Corporation's primary capital ratio was 7.24 percent compared with 6.08 percent a year ago. The total capital ratio at year-end 1985 was 8.51 percent compared with 6.50 percent at year-end 1984.

Primary and Total Capital Ratios
(Dollars in Millions)

	1985	1984
Preferred stock	$ 325	$ 325
Common equity	1,765	1,599
Total stockholders' equity	2,090	1,924
Allowance for loan losses	432	292
Equity contract notes	199	–
Equity commitment notes, net*	124	221
Minority interest	1	1
Total primary capital	2,846	2,441
Floating rate subordinated notes due 1992	199	–
7½% notes due 1986	125	125
8½% notes due 1991	31	26
Other long-term debt*	147	18
Total capital	$3,348	$2,610
Primary capital ratio	7.24%	6.08%
Total capital ratio	8.51%	6.50%

*In 1985 the Corporation dedicated $100 million proceeds from the issuance of common stock since 1982 to partially fulfill the note funding requirements of its outstanding equity commitment notes. This reduction in long-term debt qualifying as primary capital is reclassified as secondary capital for regulatory reporting purposes.

In November 1984, The First National Bank of Chicago entered into an agreement with the Comptroller of the Currency requiring The First National Bank of Chicago to achieve and maintain a primary capital ratio of 6.00 percent by the end of the first quarter of 1986. The Bank's ratio was in excess of 6.00 percent by the end of the third quarter of 1985. At December 31, 1985, the Bank's primary capital ratio was 6.61 percent.

FOREIGN OUTSTANDINGS

The Corporation's cross-border outstandings, consisting of loans (including accrued interest), acceptances, interest-bearing deposits with other banks, other interest-bearing investments and other non-local currency monetary assets, to countries where such outstandings exceeded 0.75 percent of the Corporation's total assets ($291 million as of December 31, 1985, $298 million as of December 31, 1984, and $272 million as of December 31, 1983) are shown in the following tables:

(In Millions) Country	Total	Foreign Outstandings: Governments and Official Institutions	Banks and Other Financial Institutions	Commercial and Industrial	Other
December 31, 1985					
Japan	$1,460	$ –	$1,318	$135	$ 7
Mexico	912	141	339	429	3
Brazil	806	73	411	318	4
Italy	688	–	661	19	8
Canada	525	2	403	109	11
United Kingdom	516	53	269	85	109
South Korea	408	95	143	165	5
France	388	10	332	41	5
December 31, 1984					
Japan	$1,612	$ –	$1,318	$292	$ 2
Canada	1,010	1	804	183	22
Mexico	926	140	419	366	1
Brazil	846	88	416	342	–
France	679	12	583	70	14
United Kingdom	570	4	365	195	6
Italy	544	18	475	51	–
South Korea	487	121	115	250	1
December 31, 1983					
Japan	$1,395	$ –	$1,056	$335	$ 4
France	894	12	825	50	7
Mexico	870	119	358	558	5
Canada	856	–	664	188	4
Brazil	689	99	366	224	–
United Kingdom	589	5	430	149	5
Italy	585	36	510	39	–
South Korea	475	91	188	196	–
Fed. Rep. of Germany	404	4	353	47	–

Several countries are experiencing foreign exchange liquidity problems that have disrupted the timely payment by private and public sector borrowers in those countries of principal and interest on loans from the Corporation and its subsidiaries. The aggregate amount of outstandings extended by the Corporation and its subsidiaries to public and private sector obligors in each country that is experiencing liquidity problems is less than 1.0 percent of the Corporation's total assets at December 31, 1985, with the exception of Mexico and Brazil.

Total outstandings in Mexico at December 31, 1985 represented approximately 2.3 percent of the Corporation's total assets. Approximately $13.0 million was classified as nonperforming as of this date, and no loans were past due 90 days or more and still accruing interest.

Public sector outstandings in Mexico at December 31, 1985 were approximately $652 million, or approximately 71 percent of total outstandings. These outstandings included term loans of approximately $426 million and approximately $218 million of short-term advances, bankers' acceptances, time deposits, and other investments, compared with approximately $416 million and approximately $216 million, respectively, at December 31, 1984.

Revenue generated from Mexican public sector outstandings approximated $82 million in 1985. Interest payments of approximately $69 million were made in respect to public sector outstandings in Mexico during 1985. The Corporation collected no principal payments in respect to term loans to Mexican public sector borrowers during 1985.

During 1985, Mexico signed an agreement with its creditor banks that completed an additional phase of its public sector term debt restructure program, affecting outstanding loans due to the Corporation of approximately $424 million. Under this agreement, the Corporation has rescheduled the principal maturities of outstanding loans totaling approximately $424 million over periods varying from 10 to 13 years. Interest rates on these restructured term loans have been adjusted downward retroactive to January 1985. The weighted average interest rate on such loans at December 31, 1985 is 9.18 percent as a result of the restructure agreement. The rate, without such restructure arrangements, would have been 10.72 percent.

The Corporation is not committed to lend any new funds to Mexico; however, due to continued deterioration in the Mexican economy caused in large part by the 1985 earthquake and the sharp fall in oil prices, Mexico is expected to request its creditor banks to make significant new loans or to renegotiate the terms of its current loans to the Mexican government. The ability of Mexico to continue to service existing loans is largely dependent upon additional loans being made available by international banks, including the Corporation.

Total outstandings in Brazil at December 31, 1985 represented approximately 2.1 percent of the Corporation's total assets. As of this date, loans totaling $8.0 million were nonperforming, and no loans were past due 90 days or more and still accruing interest. Outstandings included approximately $449 million of term loans and approximately $341 million of short-term advances, bankers' acceptances, time deposits, and other investments, compared with approximately $480 million and $363 million, respectively, at December 31, 1984. Public sector borrowers accounted for approximately 70 percent of outstandings at December 31, 1985.

During 1985, additional term loans of $8 million were extended to Brazil and the Corporation collected approximately $2 million in principal payments. Brazilian term loans were reduced by approximately $37 million due to the use of Brazilian term loans to partially fund the losses incurred by Banco Denasa, as discussed in Note 2 on page 49.

During 1985, interest accrued and cash payments represe[illegible] interest collected on the Corporation's term loans to borro[illegible] in Brazil totaled approximately $66 million and $68 million, respectively. Accrued interest receivable on these loans was approximately $13 million at December 31, 1985, compared with approximately $15 million at December 31, 1984.

The Brazilian government is currently conducting negotiations to restructure term loans to Brazilian obligors falling due during 1985 and 1986, as well as to obtain adequate trade finance and interbank deposit placement facilities for Brazilian banks. In the interim, the Corporation has agreed to extend temporarily its current commitments to maintain trade finance facilities of approximately $263 million, and to provide interbank deposits of approximately $92 million.

The restructure arrangements described above are intended to assist Mexico and Brazil in alleviating their liquidity problems. However, continuing uncertainties in Mexico, Brazil and other foreign countries that have experienced liquidity problems make it possible that further deterioration could occur, and that additional loans could be classified as nonperforming, with a resulting adverse impact on the Corporation's earnings.

INFLATION AND CHANGING PRICES

Changing prices of goods, services and capital, whether caused by inflation or other economic conditions, affect the Corporation's financial position and results of operations. Many of the effects of changing prices are reflected in the consolidated financial statements; some are not. The following discussion and data are intended to provide further insight.

NET INTEREST INCOME

Interest rates are the prices of funds loaned and borrowed. Unlike many prices, which only rise during inflationary periods, interest rates may rise and fall in reaction to various factors, including changes in the rate of inflation. Changing interest rates affect the demand for credit from financial institutions and the sources of funds available to them. The analysis of changes in interest differential on page 68 gives further data on changes in interest income and expense due to interest rate variations. In the five-year summary on page 42 net interest income is adjusted to reflect changes in the relative purchasing power of the dollar, which may not be indicative of interest rate changes.

NONINTEREST INCOME AND EXPENSE

In the Corporation's historical cost financial statements, noninterest income and expense generally reflect current prices for the periods covered. Service revenues and various operating expense categories include the effects of rising prices as well as changes in the levels of operations, productivity and other such factors. Depreciation and amortization of premises and equipment, however, are based on prices paid for such assets at the time of purchase. Since the dates of acquisition, prices for such goods have generally risen. To approximate the effects of changing prices on 1985 depreciation and amortization, the adjustments in the following table are based on changes in the U.S. Department of Labor's Consumer Price Index for all Urban Consumers. The resulting adjustments to 1985 consolidated earnings are also shown.

(In Thousands)	Depreciation and Amortization Expense	Net Income
As reported in consolidated income statement	$51,732	$168,999
Adjustments to restate depreciation and amortization expense for effects of general inflation		
Occupancy expense of premises	9,255	(9,255)
Equipment	3,180	(3,180)
As adjusted, in dollars of average 1985 general purchasing power	64,167	156,564

No adjustment of recorded income tax expense is included in the adjusted earnings amounts, despite the increased depreciation and amortization. Under current tax laws no tax relief is allowed for such items.

Another method of adjusting for the effects of changing prices would be to restate depreciation and amortization in terms of current costs, i.e., as if specific 1985 prices had been paid for the Corporation's premises and equipment. The results would not differ significantly from those shown in the table.

BALANCE SHEET

The depreciated or amortized cost of premises and equipment included in the consolidated balance sheet is based on historical prices paid. To approximate the effects of changing prices on those assets, their historic dollar or translated foreign currency amounts have been restated in dollars of average 1985 purchasing power using the U.S. Consumer Price Index. The adjusted amounts are included in total average assets and net assets (total stockholders' equity) shown in the table on page 42. Since inflation reduces the general purchasing power of the dollar, all other assets and liabilities for earlier years have also been adjusted to reflect comparable units of average 1985 purchasing power.

A large portion of the Corporation's total stockholders' equity is invested in net monetary assets represented by cash and fixed amounts of money to be received or paid in the future. As the general purchasing power of the dollar is eroded by inflation, the Corporation's net investment in monetary assets can be said to decline in terms of general purchasing power of those fixed amounts. The loss (gain) of general purchasing power on the Corporation's net monetary assets, as shown in the table on page 42, is based on changes in the U.S. Consumer Price Index.

In the following table, all adjusted amounts, including translated foreign currency amounts, are stated in dollars of average 1985 purchasing power based on the U.S. Consumer Price Index shown. Monetary amounts are indexed from the dates indicated; premises and equipment and related depreciation and amortization are indexed from acquisition dates.

In summary, the effects of changing prices on the Corporation's operations in a volatile and inflationary environment are varied and generally adverse. The foregoing discussions and data are intended to provide some insight as to the effects of inflation and changing prices. Using an index of prices for consumer ty goods and services to adjust reported amounts is only one way of viewing and attempting to measure the possible impact of general inflation on the Corporation's financial condition and results of operations. As such, the results are experimental in nature.

(In millions except per share amounts and index)	1985	1984	1983	1982	1981
As Reported					
Total average assets	$39,572	$38,551	$34,543	$34,733	$30,244
Net assets at year-end	2,090	1,924	1,742	1,491	1,272
Net interest income	1,053	895	709	616	494
Net income	169	86	184	137	119
Per common share:					
Net income	2.84	1.19	3.92	3.33	2.98
Dividends declared	1.32	1.32	1.26	1.20	1.20
Market price at year-end	29½	21¼	25¾	18⅛	19¼
As Adjusted					
Total average assets	$39,852	$40,210	$38,061	$39,042	$36,103
Net assets at year-end	1,830	2,242	2,165	1,969	1,789
Decline (increase) in purchasing power of net monetary assets	(8)	22	24	29	72
Net interest income	1,053	927	766	686	584
Net income	156	76	198	137	125
Per common share:					
Net income	2.59	0.94	3.87	3.33	3.14
Dividends declared	1.32	1.37	1.36	1.34	1.42
Market price at year-end	29	21¾	27	20	22
Consumer Price Index, average (1967 = 100.0)	322.2	311.1	298.4	289.1	272.4

Index to the Financial Section

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET

December 31 (In Thousands)	1985	[illegible]
ASSETS		
Cash and due from banks—noninterest bearing	$ 2,408,621	$ 2,274,[illegible]
Due from banks—interest bearing	4,743,061	4,801,756
Federal funds sold and securities under resale agreements	1,294,401	2,127,630
Trading account assets	2,187,146	1,001,163
Investment securities (market values—$2,053,393 in 1985 and $1,653,755 in 1984)	2,011,694	1,750,478
Loans	24,190,368	25,575,778
Less Allowance for loan losses	431,643	291,726
Loans, net	23,758,725	25,284,052
Premises and equipment	462,375	447,900
Accrued income receivable	409,504	459,584
Customers' acceptance liability	850,306	1,116,805
Other assets	766,670	582,401
Total assets	$38,892,506	$39,845,731

LIABILITIES		
Deposits		
Demand	$ 5,420,424	$ 4,695,774
Savings	2,541,630	2,327,982
Time	6,477,086	7,513,388
Foreign offices	12,708,395	14,054,773
Total deposits	27,147,535	28,591,917
Federal funds purchased and securities under repurchase agreements	5,167,931	4,797,089
Commercial paper	362,399	369,182
Other funds borrowed	1,467,307	1,713,564
Long-term debt	841,690	431,431
Acceptances outstanding	850,306	1,118,071
Other liabilities	965,294	900,318
Total liabilities	36,802,462	37,921,572
STOCKHOLDERS' EQUITY		
Preferred stock—without par value, authorized 10,000,000 shares		
Issued and outstanding:		
Series A ($50 stated value) —2,500,000 shares	125,000	12[illegible]
Series B ($100 stated value)—1,250,000 shares	125,000	125,000
Series C ($100 stated value)— 750,000 shares	75,000	75,000
Common stock—$5 par value	259,792	235,078

	1985	1984
Number of shares authorized	80,000,000	52,000,000
Number of shares issued	51,958,347	47,015,559
Number of shares outstanding	51,764,586	46,899,771

Surplus	881,309	805,310
Retained earnings	642,718	568,219
Translation adjustments	(15,328)	(7,076)
Total	2,093,491	1,926,561
Less Treasury stock at cost, 193,761 shares in 1985 and 115,788 shares in 1984	3,447	2,402
Stockholders' equity	2,090,044	1,924,159
Total liabilities and stockholders' equity	$38,892,506	$39,845,731

The accompanying notes to consolidated financial statements are an integral part of this balance sheet.

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
CONSOLIDATED INCOME STATEMENT

For the Year (In Thousands)	1985	1984	1983
INTEREST INCOME			
Interest and fees on loans	$2,856,739	$3,004,399	$2,463,023
Interest on bank balances	444,586	608,976	585,459
Interest on Federal funds sold and securities under resale agreements	173,273	171,746	89,392
Interest on trading account assets	107,504	69,306	39,251
Interest on investment securities			
United States Government and Federal Agency	56,462	116,933	47,497
States and political subdivisions	34,536	43,013	34,135
Other (including dividends)	39,199	39,125	33,099
Total	3,712,299	4,053,498	3,291,856
INTEREST EXPENSE			
Interest on deposits	1,995,597	2,376,495	1,909,409
Interest on Federal funds purchased and securities under repurchase agreements	421,073	542,232	459,283
Interest on commercial paper	33,831	44,462	42,087
Interest on other funds borrowed	143,810	161,048	144,866
Interest on long-term debt	65,030	34,290	27,124
Total	2,659,341	3,158,527	2,582,769
NET INTEREST INCOME	1,052,958	894,971	709,087
Provision for loan losses	411,200	464,800	150,000
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	641,758	430,171	559,087
NONINTEREST INCOME			
Trading account profits	29,005	12,234	3,508
Foreign exchange trading profits	47,200	25,476	35,462
Fiduciary and investment management fees	90,186	77,421	53,941
Credit card fees	123,593	112,331	90,582
Service charges and commissions	174,953	155,910	112,018
Equity securities gains (losses)	146,738	56,670	52,540
Investment securities gains (losses)	964	(34)	(137)
Other income	45,372	32,161	34,867
Total	658,011	472,178	382,781
NONINTEREST EXPENSE			
Salaries	439,372	366,316	305,412
Employee benefits	66,228	57,267	59,509
Occupancy expense of premises, net	102,795	89,540	70,207
Equipment rentals, depreciation and maintenance	65,656	53,411	41,772
Loss from an affiliate investment	131,100	—	—
Other expense	304,519	275,446	203,034
Total	1,109,670	841,980	680,334
INCOME BEFORE INCOME TAXES	190,099	60,369	261,534
Applicable income taxes (benefit)	21,100	(26,000)	78,000
NET INCOME	$ 168,999	$ 86,369	$ 183,534
NET INCOME ATTRIBUTABLE TO COMMON STOCKHOLDERS' EQUITY	$ 139,743	$ 54,226	$ 162,342
EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE	$2.84	$1.19	$3.92
Average Number of Common and Common Equivalent Shares Outstanding	19,220,034	15,663,244	41,399,116

The accompanying notes to consolidated financial statements are an integral part of this statement.

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

For the Three Years Ended December 31, 1985 (In Thousands)	Preferred Stock	Common Stock	Surplus	Retained Earnings	Translation Adjustments	Treasury Stock (at Cost)
Balance, December 31, 1982	$125,000	$204,117	$702,658	$464,730	$ (3,710)	$(1,162)
Net income	—	—	—	183,534	—	—
Issuance of preferred stock	125,000	—	(2,686)	—	—	—
Issuance of common stock	—	4,844	15,334	—	—	—
Cash dividends declared						
Preferred stock	—	—	—	(21,192)	—	—
Common stock	—	—	—	(52,080)	—	—
Translation adjustments	—	—	—	—	(1,904)	—
Other	—	—	228	—	—	(341)
Balance, December 31, 1983	250,000	208,961	715,534	574,992	(5,614)	(1,803)
Net income	—	—	—	86,369	—	—
Issuance of preferred stock	75,000	—	(1,621)	—	—	—
Issuance of common stock	—	26,117	91,165	—	—	—
Cash dividends declared						
Preferred stock	—	—	—	(32,143)	—	—
Common stock	—	—	—	(60,969)	—	—
Translation adjustments	—	—	—	—	(1,462)	—
Other	—	—	232	—	—	(599)
Balance, December 31, 1984	325,000	235,078	805,310	568,249	(7,076)	(2,402)
Net income	—	—	—	168,999	—	—
Issuance of common stock	—	24,714	76,004	—	—	—
Cash dividends declared						
Preferred stock	—	—	—	(29,256)	—	—
Common stock	—	—	—	(65,274)	—	—
Translation adjustments	—	—	—	—	(8,252)	—
Other	—	—	(5)	—	—	(1,045)
Balance, December 31, 1985	$325,000	$259,792	$881,309	$642,718	$(15,328)	[illegible]7)

The accompanying notes to consolidated financial statements are an integral part of this statement.

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the Year (In Thousands)	1985	1984	[illegible]
SOURCES OF FINANCIAL RESOURCES			
Provided from operations			
Net income	$ 168,999	$ 86,369	$ 183,53
Provision for loan losses	411,200	464,800	150,00
Deferred income taxes (benefit)	(32,100)	(56,400)	30,30
Depreciation and amortization	74,931	61,879	34,25
Resources provided from operations	623,030	556,648	398,08
Increase in:			
Deposits	—	911,877	261,39
Federal funds purchased and securities under repurchase agreements	370,842	2,473,791	—
Commercial paper	—	—	139,47
Other funds borrowed	—	120,303	—
Long-term debt	410,259	133,233	—
Decrease in:			
Cash and due from banks—noninterest bearing	—	—	460,29
Due from banks—interest bearing	58,695	912,209	663,52
Federal funds sold and securities under resale agreements	833,226	—	—
Investment securities	—	223,833	—
Loans, net	1,114,127	—	—
Issuance of preferred stock	—	73,379	122,31
Issuance of common stock	100,718	117,282	20,17
Other, net	—	—	26,94
Total	$3,510,897	$5,531,555	$2,092,2
APPLICATIONS OF FINANCIAL RESOURCES			
Increase in:			
Cash and due from banks—noninterest bearing	$ 134,059	$ 696,316	$ —
Federal funds sold and securities under resale agreements	—	410,322	804,4
Trading account assets	1,185,983	247,843	176,6
Investment securities	261,216	—	659,5
Loans, net	—	3,716,526	193,6
Decrease in:			
Deposits	1,444,382	—	—
Federal funds purchased and securities under repurchase agreements	—	—	79,9
Commercial paper	6,783	81,473	—
Other funds borrowed	246,257	—	64,7
Long term debt	—	—	12,3
Additions to premises and equipment, net	66,807	168,043	27,5
Cash dividends declared on preferred stock	29,256	32,143	21,1
Cash dividends declared on common stock	65,274	60,969	52,0
Other, net	70,880	117,920	—
Total	$3,510,897	$5,531,555	$2,092,2

The accompanying notes to consolidated financial statements are an integral part of this statement.

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1—Summary of Significant Accounting Policies

The consolidated financial statements for First Chicago Corporation ("the Corporation") and subsidiaries have been prepared in conformity with generally accepted accounting principles. A description of those accounting policies of particular significance follows:

(a) Principles of Consolidation

The consolidated financial statements of the Corporation include the accounts of all subsidiaries more than 50 percent owned, except Banco Denasa, which is subject to a plan of disposition (see Note 2 on page 49). American National Corporation was acquired in a purchase transaction as of May 1, 1984. All significant intercompany accounts and transactions have been eliminated in consolidation.

(b) Investments in Affiliated Companies

Investments in affiliated (20 percent to 50 percent owned) companies are accounted for by the equity method of accounting. The amount of undistributed earnings of these companies that is included in stockholders' equity aggregated $41 million at December 31, 1985.

(c) Intangible Assets

Goodwill, representing the cost of investments in subsidiaries and affiliated foreign companies in excess of the fair value of net assets acquired at acquisition, is amortized over periods ranging from 15 to 40 years.

Other acquired intangible assets, such as the value of customer lists, core deposits and credit card relationships, are amortized over the periods benefited, ranging from 5 to 15 years.

(d) Investment Securities

Investment securities include both debt and equity securities. Debt securities are stated at cost, adjusted for amortization of premium and accretion of discount. Gains and losses are computed using the specific identification method.

Equity securities (which include both venture capital securities and securities acquired in satisfaction of debt) are stated at the lower of cost or market. Unrealized valuation adjustments and realized gains and losses are included in noninterest income in the consolidated income statement.

(e) Trading Account Assets

Trading account assets are stated at market value. Gains and losses on the sale of trading account assets and unrealized valuation adjustments to these assets are included in trading account profits.

(f) Futures Contracts

The Corporation utilizes interest rate futures contracts in connection with trading account activities and to hedge interest rate risk positions created by both existing assets and liabilities.

Changes in the market value of futures contracts used in connection with trading account activities are reflected in trading account profits as they occur.

Changes in the market value of futures contracts identified as hedges are reflected as an adjustment to the carrying amount of the hedged assets or liabilities, and are reflected in either interest income or interest expense over the remaining life of the hedged assets and liabilities.

(g) Interest Rate Swap Agreements

The Corporation enters into interest rate swap agreements as a financial intermediary, to produce fee revenue, and as a principal, to manage its own interest rate exposure.

As a financial intermediary, the Corporation's policy is to limit its exposure by matching offsetting swap agreements. Until matched, the agreements are marked to market value, with chang[illegible] in value reflected in trading account profits. When matched, the Corporation identifies the resulting income stream and defe[illegible] amounts for its fees relating to credit risk and ongoing servicin[illegible] which are taken into income over the term of the matched swap agreements. The balance of the income stream is recorde[illegible] currently in noninterest income.

Income or expense on interest rate swap agreements used to manage interest rate exposure is recorded as an adjustment to the yield on the underlying assets or liabilities.

(h) Nonperforming Loans

Loans, including lease financing, are considered nonperformin[illegible] when placed on a nonaccrual status or when terms are renegoti[illegible]ed to below current market rates.

Loans, other than credit card loans, are placed on nonaccrual status when principal or interest is past due 90 days or more, and the loan is not well secured and in the process of collectio[illegible] or when, in the opinion of management, there are significant doubts as to collectibility. Interest previously accrued but not collected is reversed and charged against income at the time the related loan is placed on nonaccrual status. Principal and accrued interest on credit card loans are charged to the allowan[illegible] for loan losses when 180 days past due.

Interest payments received on nonaccrual loans [illegible]ed as having doubtful principal repayment are recorded as reduction[illegible] of principal.

Loans are considered to be renegotiated when their interest rates are reduced below current market rates by an agreement with the borrower because the cash flow of the borrower was insufficient to service the loan under its original terms. Subjec[illegible] the above nonaccrual policy, interest on these loans is accrue[illegible] at the reduced rates.

(i) Allowance for Loan Losses
The allowance for loan losses is maintained at a level that in management's judgment is adequate to provide for potential losses in the loan portfolio. The amount of the allowance is based on management's formal review and analysis of the loan portfolio as well as prevailing and anticipated economic conditions. The allowance is increased by provisions charged to earnings and reduced by charge-offs, net of recoveries.

(j) Premises and Equipment
Premises and equipment are stated at cost less accumulated depreciation and amortization, which is computed essentially on the straight-line method over the estimated useful lives of the related assets. Gains and losses on dispositions are reflected in other income. Maintenance and repairs are charged to expense as incurred.

(k) Foreign Currency Translation
The Corporation's translation policies are based on a determination of the primary operating currency ("functional currency") for each foreign installation. If a foreign installation's functional currency is the U.S. dollar, assets and liabilities carried in local currency are translated to U.S. dollars at current exchange rates except for premises and equipment, which are translated at historic rates. Translation effects and results of related hedging transactions are included in other income.

If the foreign installation's functional currency is its local currency, all assets and liabilities are translated at current exchange rates. Translation adjustments, related hedging results, and applicable income taxes are included in the translation adjustments account within stockholders' equity. When a foreign installation is sold or liquidated, the related accumulated translation adjustment balance is transferred to other noninterest income and applicable income taxes.

Operating results of foreign installations are translated at weighted averages of rates prevailing during the year. The interest element of all hedging transactions is included in interest expense.

Active trading in many currencies is an integral part of the Corporation's international operations. Open trading positions in these currencies are valued at the prevailing rates of exchange and the resulting profits and losses are included in foreign exchange trading profits.

(l) Loan Fees
Fees representing compensation for services provided are generally recognized when the related services are performed. Fees representing adjustments of interest-rate yield are deferred and amortized into interest and fees on loans over the term of the loan. Fees received in connection with restructured international loans are deferred and amortized over the term of the loan.

(m) Accounting for Pensions
The Corporation adopted the provisions of Statement of Financial Accounting Standards No. 87—Employers' Accounting for Pensions—for the year ended December 31, 1985, which reduced noninterest expense by $12.4 million in 1985. In accordance with this Statement, prior years' amounts have not been restated. For further information see Note 13 on page 55 relating to employee benefits and incentive plans.

(n) Income Taxes
Certain income and expense items are accounted for in different time periods for financial reporting purposes than for income tax purposes. Appropriate provisions are made in the financial statements for deferred taxes in recognition of these timing differences.

Foreign tax credits are applied, as permitted, to reduce Federal income tax.

Investment tax credits related to leasing transactions are accounted for by the deferral method. Investment tax credits arising from acquisitions of premises and equipment are used to reduce the current year's provision for income taxes.

(o) Earnings Per Share
Earnings per share amounts are computed by dividing net income, after deducting dividends on preferred stock, by the average number of common and common equivalent shares outstanding.

Common equivalent shares consist of shares issuable under the employee stock purchase plan, outstanding stock options, performance share grants, and restricted shares.

Note 2—Loss from an Affiliate Investment
During 1985 the Corporation established a plan of disposition for its investment in Banco Denasa de Investimento S.A., a Brazilian investment bank of which the Corporation has assumed management control. Management expects the actions taken as a result of this plan to be completed during 1986.

In 1985, the Corporation wrote off its investment in Banco Denasa and accrued management's estimates of losses relating to Banco Denasa's assets, as well as estimates of future operating losses and disposition costs. A charge of $131.1 million relating to this plan is reflected as "Loss from an affiliate investment", a separate component of noninterest expense in the consolidated income statement. On an after-tax basis, the loss was $70.8 million or $1.14 per common share. Exclusive of the asset write-offs, the results of operations of Banco Denasa were not material to 1985 or 1984 operating results.

Note 3—Operating Segments

The Corporation is engaged primarily in the banking business. Significant foreign operations are conducted by the Corporation through the head office, foreign branches, foreign and Edge Act subsidiaries, and foreign representative offices. The following tables show the approximate amounts of consolidated revenues, expenses, income before income taxes and net income for each of the three years ended December 31, 1985, and the amounts of consolidated total assets at December 31, 1985, 1984, and 1983, attributable to domestic operations and foreign operations by geographic area (in millions):

1985	Revenues*	Expenses**	Income Before Income Taxes	Net Income	Total Assets
DOMESTIC OPERATIONS	$3,024.5	$2,670.5	$354.0	$254.1	$27,005
FOREIGN OPERATIONS					
Continental Europe	268.9	268.5	0.4	0.3	2,384
British Isles-Scandinavia	220.8	215.1	5.7	3.6	2,231
Latin America	378.4	484.4	(106.0)	(57.8)	3,046
North America-Caribbean	108.5	95.7	12.8	6.6	1,052
Middle East-Africa	90.4	142.3	(51.9)	(24.1)	710
Asia-Pacific	278.8	303.7	(24.9)	(13.7)	2,465
TOTAL FOREIGN OPERATIONS	1,345.8	1,509.7	(163.9)	(85.1)	11,888
CONSOLIDATED	$4,370.3	$4,180.2	$190.1	$169.0	$38,893

1984	Revenues*	Expenses**	Income Before Income Taxes	Net Income	Total Assets
DOMESTIC OPERATIONS	$2,920.6	$2,803.2	$117.4	$113.2	$27,99[illegible]
FOREIGN OPERATIONS					
Continental Europe	335.1	374.0	(38.9)	(20.3)	2,48[illegible]
British Isles-Scandinavia	230.3	226.9	3.4	2.9	1,95[illegible]
Latin America	406.8	391.8	15.0	7.3	3,06[illegible]
North America-Caribbean	166.8	156.5	10.3	5.4	1,28[illegible]
Middle East-Africa	143.0	190.3	(47.3)	(21.5)	1,02[illegible]
Asia-Pacific	323.1	322.6	0.5	(0.6)	2,93[illegible]
TOTAL FOREIGN OPERATIONS	1,605.1	1,662.1	(57.0)	(26.8)	12,74[illegible]
CONSOLIDATED	$4,525.7	$4,465.3	$ 60.4	$ 86.4	$39,84[illegible]

1983	Revenues*	Expenses**	Income Before Income Taxes	Net Income	Total Assets
DOMESTIC OPERATIONS	$2,226.8	$2,001.1	$225.7	$161.2	$22,7[illegible]
FOREIGN OPERATIONS					
Continental Europe	319.5	337.6	(18.1)	(10.0)	3,19[illegible]
British Isles-Scandinavia	251.2	240.3	10.9	7.5	2,31[illegible]
Latin America	298.5	278.5	20.0	10.1	2,51[illegible]
North America-Caribbean	205.0	184.4	20.6	9.8	1,8[illegible]
Middle East-Africa	135.0	126.7	8.3	7.4	1,21[illegible]
Asia-Pacific	238.6	244.5	(5.9)	(2.5)	2,5[illegible]
TOTAL FOREIGN OPERATIONS	1,447.8	1,412.0	35.8	22.3	13,5[illegible]
CONSOLIDATED	$3,674.6	$3,413.1	$261.5	$183.5	$36,3[illegible]

*Includes interest income and noninterest income.
**Includes interest expense, provision for loan losses, and noninterest expense.

Because many of the resources employed by the Corporation are common to both its foreign and domestic activities, it is difficult to segregate assets, related revenues and expenses into their foreign and domestic components. The amounts in the preceding tables are estimated on the basis of internally developed assignment and allocation procedures, which to an extent are subjective. The principal internal allocations used to prepare this information are described below.

The allocation of corporate overhead expense is determined based upon internal allocations appropriate to individual activities.

Total assets and revenues reflect the allocation of loans and related interest income among geographic areas based upon the domicile of the customer. Deposit placements and related revenues are allocated among geographic areas based on the domicile of the depository institution.

Net income reflects the allocation of contractual interest spreads among geographic areas on the bases described above. Differences between contractual spreads and actual funding results are reflected in the earnings of the areas providing the funding. Distribution of certain fee income among geographic areas is reflected on the basis of services rendered.

Expenses incurred for the benefit of another geographic area, including certain domestic administrative expenses, are allocated to the area benefited.

See page 39 for a discussion of the Corporation's foreign outstandings in excess of 1 percent of consolidated total assets to countries that have been experiencing liquidity problems.

Note 4—Investment Securities

Investment securities in the consolidated balance sheet at December 31, 1985 and 1984 are summarized as follows (in thousands):

December 31, 1985	Book Value	Market Value
U.S. Government and Federal Agency	$ 798,717	$ 811,675
States and political subdivisions	538,529	481,277
Other securities*		
Bonds, notes and debentures	168,524	16 ,816
Equity securities	505,921	591 575
Investment securities	$2,011,691	$2,053,393

December 31, 1984		
U.S. Government and Federal Agency	$ [illegible]	$ [illegible]
States and political subdivisions	[illegible]	[illegible]
Other securities*		
Bonds, notes and debentures	[illegible]	[illegible]
Equity securities	[illegible]	[illegible]
Investment securities	$[illegible]	$[illegible]

*The market values for certain securities for which market quotations are not available have been estimated.

Net debt investment securities gains (losses) after taxes were $557,000, $(17,000), and $(67,000), for the years ended December 31, 1985, 1984, and 1983, respectively. The applicable income taxes (benefit) were $407,000, $(17,000), and $(70,000) for the years ended December 31, 1985, 1984, and 1983, respectively.

Note 5—Loans

The following is a breakdown of loans included in the consolidated balance sheet as of December 31, 1985 and 1984 (in thousands):

	1985	1984
Domestic loans		
Commercial	$ 6,888,342	$ 7,532,967
Secured by real estate		
Construction	1,490,739	1,608,197
Mortgage	1,888,569	1,862,050
Financial institutions	1,437,125	1,333,065
Consumer	2,750,014	3,333,110
Lease financing	427,621	385,601
Other	1,648,015	1,537,627
Domestic loans	17,530,485	17,613,847
Foreign loans		
Commercial	3,156,348	3,642,473
Governments and official institutions	1,254,513	1,351,161
Banks and other financial institutions	1,964,989	2,551,522
Other	284,033	411,775
Foreign loans	6,659,883	7,961,931
Loans	$24,190,368	$25,575,778

See page 36 for tables setting forth nonaccrual and renegotiated loans, interest on such loans at original contract rates, interest actually recognized, and commitments to lend additional funds in connection with such loans.

In 1980 the Corporation extended a loan to Mr. Barry F. Sullivan in the amount of $1,512,500 to finance the purchase of 100,000 shares of common stock of the Corporation. This loan is repayable on November 19, 1987, or upon his voluntary termination of employment with the Corporation. Interest on the loan is payable quarterly at a rate of 8 percent per annum.

Note 6—Allowance for Loan Losses

The changes in the allowance for loan losses for the three years ended December 31, 1985 were as follows (in thousands):

	1985	1984	1983
Balance, beginning of year	$291,726	$217,967	$203,147
Additions (deductions)			
Charge-offs	(308,994)	(437,987)	(160,033)
Recoveries	37,711	23,094	24,666
Net charge-offs	(271,283)	(414,893)	(135,367)
Provision for loan losses	411,200	464,800	150,000
Acquisitions and dispositions	—	23,852	187
Balance, end of year	$431,643	$291,726	$217,967

Note 7—Pledged and Restricted Assets

Assets, primarily investments, carried at $3.1 billion in the consolidated balance sheet at December 31, 1985 were pledged as collateral for borrowings, to secure government and trust deposits, and for other purposes as required by law.

Based on the types and amounts of deposits received, banks must maintain an appropriate amount of noninterest bearing cash balances in accordance with Federal Reserve Bank reserve requirements. In 1985 the average noninterest bearing cash balance maintained to meet reserve requirements was approximately $538 million.

Note 8—Lease Commitments

The Corporation has entered into a number of noncancelable operating lease agreements for premises and equipment. The minimum annual rental commitments [illegible]der these leases at December 31, 1985, are shown below ([illegible] thousands):

Lease Commitments	
1986	$ 45,854
1987	42,283
1988	36,231
1989	33,134
1990	30,612
1991 and beyond	218,742
Total	$406,256

Occupancy expense has been reduced by rental income from premises leased to others of $15.1 million in 1985, $18.9 million in 1984, and $21.4 million in 1983.

Note 9—Long-term Debt

Long-term debt consists of borrowings havin[illegible]inal maturity of seven years or more. Long term debt a[illegible]ecember 3[illegible] 1985 and 1984 is as follows (in thousands):

	1985	19[illegible]
7¾% notes due 1986	$124,932	$121,[illegible]
3½% notes due 1993	30,993	26,[illegible]
Subordinated floating rate notes due 1992	199,317	—
Other long term debt	63,106	56,[illegible]
Equity commitment notes		
Subordinated floating rate due 1994	100,000	100,[illegible]
Subordinated floating rate due 1996	121,150	121,[illegible]
Equity contract notes		
Subordinated floating rate capital notes due 1997	198,892	—
Total	$841,690	$441,[illegible]

7¾% Notes

These notes are direct, unsecured obligations of the Corporati[illegible] and are not subordinated to any other indebtedness of the Corporation. These notes are currently redeemable at the option of the Corporation at their principal amounts plus a[illegible]crued interest.

3½% Notes

These notes are obligations of First Chicago Overseas Finan[illegible] N.V. ("FCOF"), a wholly-owned subsidiary of the Corporati[illegible] They are unconditionally guaranteed by the Corporation and rank equally with other direct issues of the Corporatio[illegible] These notes are denominated in Swiss Francs (SF), with the initial principal amount totaling SF 70 million. These no[illegible] may be redeemed prior to their maturity if certain changes in existing income tax laws occur. Commencing in 1984, FC[illegible] has the right to redeem all or part of these [illegible]OF redeemed SF 3 million in both 1985 and 19[illegible] SF 6[illegible] million and SF 67 million outstanding at Decem[illegible], 1985, 1984, respectively.

Subordinated Floating Rate Notes Due 1992

These notes are direct obligations of the Corporation, subordinated to other indebtedness of the Corporation. The interest rate on the notes changes quarterly and is based on the average of offered rates quoted to leading banks in the London interbank market for three month Eurodollar deposits plus 10 basis points. The effective interest rate on these subordinated notes was 8.28 percent at December 31, 1985. These notes may be redeemed by the Corporation, in whole or in part, on any interest payment date, beginning in May 1987, at their principal amounts.

Other Long-term Debt

Other long-term debt includes various notes with maturities ranging from 1987 to 2026 and interest rates at December 31, 1985, from 6.18 percent to 13.70 percent.

Equity Commitment Notes

The subordinated notes maturing in 1994 were issued by FCOF and are guaranteed by the Corporation, while the subordinated notes maturing in 1996 are direct obligations of the Corporation. In both instances such notes are subordinated to other indebtedness issued by the Corporation. Both issues are floating rate notes, with the interest rate changing quarterly based on the average of offered rates quoted to leading banks in the London interbank market for three-month Eurodollar deposits. The pricing on the subordinated notes maturing in 1994 is 1/4 percent above such average rate, while the subordinated notes maturing in 1996 are priced at 1/8 percent over such average rate. The effective interest rate as of December 31, 1985, was 8.43 percent for both issues.

The subordinated notes maturing in 1994 may be wholly or partially redeemed at FCOF's option on any interest payment date at their principal amounts. The subordinated notes maturing in 1996 may be wholly or partially redeemed at the Corporation's option beginning in July 1986, at their principal amounts plus accrued interest.

The agreements under which these notes were issued require the Corporation, prior to maturity, to issue common stock, perpetual preferred stock, or other forms of equity approved by the Federal Reserve Board in an amount equal to the original aggregate principal amount of the notes. These equity commitment notes qualify as primary capital under the Federal Reserve Board guidelines. As of December 31, 1985, the Corporation has set aside proceeds of $100 million from the issuance of common stock under the Dividend Reinvestment Program and Employee Stock Purchase Plan to partially satisfy the agreements under which these notes were issued.

Equity Contract Notes

The subordinated capital notes maturing in 1997 are direct obligations of the Corporation, and are subordinated to other indebtedness of the Corporation. The interest rate on the notes is reset quarterly at 3/16 percent over the average offered rates quoted to leading banks in the London interbank market for three month Eurodollar deposits. The effective interest rate on this issue was 8.43 percent at December 31, 1985.

The agreement under which these notes were issued requires the Corporation to redeem these notes at maturity with common stock, perpetual preferred stock, or other forms of its equity approved by the Federal Reserve Board equal to the original aggregate principal amount of the notes. These equity contract notes qualify as primary capital under the Federal Reserve Board guidelines.

Earnings per common and common equivalent shares would have been $2.58 for 1985 and unchanged for 1984 had common stock been issued at the year-end market value to satisfy the requirements of the equity commitment and contract note indentures.

Original discount and deferred issuance costs are amortized over the terms of the related notes.

Note 10—Preferred Stock

The Corporation is authorized to issue 10,000,000 shares of preferred stock, without par value. The Board of Directors is authorized to fix the particular designations, preferences, rights, qualifications, and restrictions for each series of preferred stock issued.

The outstanding adjustable rate cumulative, Series A, Series B, and Series C preferred stocks were issued in October 1982, February 1983, and February 1984, respectively. The dividend rate on each series is adjusted quarterly, based on a formula that considers the interest rates for selected short-and long-term U.S. Treasury securities prevailing at the time the rate is set. All preferred shares rank prior to common shares both as to dividends and liquidation, but have no general voting rights.

The Series A preferred stock is subject to a minimum and maximum dividend rate of 7.00 percent and 15.00 percent, respectively. The dividend rate for the dividend period through December 31, 1985 was 9.80 percent. Shares of this series are redeemable on or after October 1, 1987, through September 30, 1992, at the option of the Corporation, at a redemption price equal to $51.50, per share and thereafter at its stated value per share ($50.00) plus accrued and unpaid dividends.

The Series B preferred stock is subject to a minimum and maximum dividend rate of 6.00 percent and 12.00 percent, respectively. The dividend rate for the period through February 1986 is 6.55 percent. Shares of this series are redeemable on or after March 1, 1988, through February 28, 1993, at the option of the Corporation, at a redemption price equal to $103.00 per share, and thereafter at its stated value per share ($100.00) plus accrued and unpaid dividends.

The Series C preferred stock is subject to a minimum and maximum dividend rate of 6.50 percent and 12.50 percent, respectively. The dividend rate for the period through February 1986 is 8.50 percent. Shares of this series are redeemable on or after March 1, 1989 through February 28, 1994, at the option of the Corporation, at a redemption price equal to $103.00 per share, and thereafter at its stated value per share ($100.00) plus accrued and unpaid dividends.

Note 11—Translation Adjustments

The following table shows an analysis of the changes in translation adjustments for the years ended December 31, 1985 and 1984 (in thousands):

	1985	1984
Balance, beginning of year	$ (7,076)	$(5,611)
Translation hedge for the year	(12,943)	4,862
Applicable income taxes (benefit)	(4,686)	6,586
Net translation hedge for the year	(8,257)	(1,721)
Transferred to income on dispositions	5	262
Balance, end of year	$(15,328)	$(7,076)

Translation hedge gains (losses) included in other noninterest income were $1,635,000, $1,016,000 and $(746,000), for the years ended December 31, 1985, 1984 and 1983, respectively.

Note 12—Income Taxes

Total applicable income taxes (benefit) reported in t[illegible] solidated income statement for the years ended Dec[illegible], 1985, 1984 and 1983 included the following componen[illegible] thousands):

	1985	1984	1983
Current tax expense (benefit)			
Federal	$ 17,100	$ (1,200)	$10,500
Foreign	28,900	27,800	27,300
State	7,200	3,800	9,800
Total	53,200	30,400	47,700
Deferred tax expense (benefit)			
Federal	(30,600)	(53,700)	18,400
Foreign	1,000	1,300	11,800
State	(2,500)	(1,000)	—
Total	(32,100)	(56,400)	30,200
Applicable income taxes (benefit)	$ 21,100	$(26,000)	$78,000

Not included in the above table but *charged directly to* translation adjustments in stockholders' equity were taxes related to translation hedging activities. These taxes were as follows for the three years ended December 31, 1985 (in thousands):

	1985	1984	1983
Current tax expense (benefit)	$ (200)	$1,100	$1,200
Deferred tax expense (benefit)	(4,500)	2,500	2,100
Total tax expense (benefit)	$(4,700)	[illegible]	[illegible]

Deferred tax expense results *from* certain income and expense items being accounted for in different time periods for financial reporting purposes than for income tax purposes. The tax effects of these differences were as follows (in thou[illegible]ds):

	1985	1984	1983
Deferred income on lease financing	$ 41,000	$ 20,200	$11,100
Provision for loan losses	(11,100)	(77,300)	(8,000)
Investment tax credits deferred, less amortization	500	8,200	100
Investment tax credit carryover	(5,200)	(8,000)	200
Deferred fee income	(4,100)	(3,500)	900
Accretion on investment securities	1,700	200	200
Foreign tax credit carryover	—	—	27,200
Sale of real estate related assets	(9,100)	18,000	(7,200)
Loss from affiliate investment	(60,300)	—	—
Pension accrual	3,000	—	—
Other	12,500	(9,200)	6,000
Total	$(32,100)	$(56,400)	$30,200

The accumulated deferred income taxes and investment tax credits included in other liabilities in the consolidated balance sheet were approximately $97 million and $21 million at December 31, 1985 and $134 million and $20 million at December 31, 1984. For tax return purposes the consolidated investment tax credit carryover totaled approximately $55 million at December 31, 1985.

The reasons for the differences between applicable income taxes (benefit) and the amount computed at the applicable statutory Federal tax rate of 46 percent were as follows (in thousands):

	1985	1984	1983
Taxes at statutory Federal income tax rate	$ 87,400	$ 27,800	$120,300
Increase (decrease) in taxes resulting from			
Tax exempt income	(61,000)	(47,300)	(37,000)
State income taxes, net of Federal income tax benefit	2,300	(100)	5,400
Investment tax credit	(9,600)	(6,700)	(4,100)
Capital gains	—	—	(6,200)
Equity earnings of foreign affiliates	(2,300)	(3,600)	(3,200)
Other	4,100	3,900	3,100
Applicable income taxes (benefit)	$ 21,100	$(26,000)	$ 78,000

Note 13—Employee Benefit and Incentive Plans

(a) Pension plans

Substantially all eligible, salaried, domestic employees of the Corporation are covered by noncontributory defined benefit pension plans. Employees in foreign offices participate to varying degrees in local pension plans, which in the aggregate are not significant.

Under the plans, retirement benefits are primarily a function of both the years of service and the level of compensation during either the last five years of employment or the highest five consecutive salary years occurring during the last 10 years before retirement.

It is the Corporation's policy to fund the plans on a current basis to the extent deductible under existing tax regulations. Such contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future.

The Corporation has adopted the provisions of Statement of Financial Accounting Standards No. 87, Employers' Accounting for Pensions, for the year ended December 31, 1985. This change in accounting principle had the effect of reducing 1985 employee benefits expense by $12.4 million, principally as a result of the amortization of the initial excess of plan assets over the projected benefit obligation over a 17 year period. The resulting net periodic pension cost for 1985 was a credit of $10.9 million. In accordance with the provisions of Statement No. 87, pension expense has not been restated for prior periods. Pension expense for 1984 was $1.3 million. No pension expense accrual was required for 1983.

The following table sets forth the plans' funded status at December 31, 1985 and 1984:

(In Thousands)	1985	1984
Projected benefit obligation		
Vested benefits	$(168,581)	$(144,289)
Nonvested benefits	(27,764)	(23,119)
Accumulated benefit obligation	(196,345)	(167,408)
Effect of projected future compensation levels	(91,721)	(82,927)
Projected benefit obligation	(288,066)	(250,335)
Plans' assets at *fair value*	537,951	447,850
Plans' assets in excess of projected benefit obligation	249,885	197,515
Unrecognized net gain due to past experience different from assumptions made	(54,029)	—
Unrecognized net asset being recognized over 17 years	(196,637)	(209,230)
Unfunded accrued pension cost	$ (781)	$ (11,715)

The plans' assets consist primarily of listed common stocks and units of certain trust funds administered by The First National Bank of Chicago. At December 31, 1985, the plans' assets included shares of the Corporation's common stock with a market value of $21.2 million.

Net periodic pension cost for 1985 included the following:

(In Thousands)	1985
Service costs—benefits earned during period	$ 15,339
Interest cost on projected benefit obligation	21,922
Return on plan assets	(106,152)
Net amortization and deferral	58,057
Net periodic pension cost (credit)	$ (10,934)

In determining the projected benefit obligation, the weighted average assumed discount rate used was 8.1 percent in 1985 and 8.7 percent in 1984, while the rate of increase in future salary levels ranged from 6.5 to 7.5 percent for both years. The expected long-term rate of return on assets, used in determining net periodic pension cost was 8 percent.

(b) Profit-sharing plan

As of December 31, 1985, there were approximately 6300 participants in The First National Bank of Chicago's profit-sharing plan. Profit-sharing expense included in employee benefits expense in the consolidated income statement was $20.8 million in 1985, $2.8 million in 1984 and $18.6 million in 1983.

(c) Stock purchase and savings plan
During 1980 an employee stock purchase and savings plan was established. Eligible employees authorize payroll deductions for deposit in savings accounts during a two year savings period. At the end of the savings period, employees may receive savings balances in cash, or use them to purchase shares of the Corporation's common stock at a price fixed by the plan.

During 1984, 477,143 shares of common stock were purchased by employees under the plan at a price of $14.625 per share. The current savings period began September 1, 1984, with a stock purchase price of $20.082 per share. As of December 31, 1985, approximately 2,000 employees were participating in the plan, and the level of savings deposits and payroll deductions for the current savings period, including projected interest thereon, represented potential purchases of approximately 565,000 shares of common stock. The maximum number of shares issuable under the plan is limited to 2.25 million. The Corporation makes no charge to expense in connection with this plan, other than interest on savings accounts.

(d) Other incentive plans
The Corporation adopted in 1983 a new stock option plan and redefined existing stock and cash incentive compensation plans.

Stock incentives include grants to key officers of shares of the Corporation's common stock, restricted as to sale based upon continued employment for three or four years depending upon the individual grant. The market value of restricted shares as of the date of grant is amortized to expense over the restriction period. As of December 31, 1985, 730,005 restricted shares were outstanding. Stock incentives also include performance share grants made to senior officers that will be settled in stock and cash upon attainment of specified financial goals during a three-year period. The estimated cost of performance share grants is charged to expense over the performance period.

Cash incentive plans, including certain specialized departmental incentives, are based on attainment of certain financial goals and a combination of departmental and corporate objectives.

The 1983 stock option plan reserves 1,000,000 shares of common stock of the Corporation for issuance to senior officers, and also provides for granting stock appreciation rights under the plan.

Stock options may be granted under the plan until April 1993. Options may be granted at a price not less than the market value on the date of grant, and are exercisable beginning at least one year following the date of grant and no later than 10 years from the date of grant.

Under the plan stock options may be granted with or without a related stock appreciation right.

A stock appreciation right entitles the optionee, in lieu of exercising an option, to receive an amount equal to the excess of the market value of the shares for which the right is exercised, on the exercise date, over the option price of the shares. The stock appreciation right can be exercised subject to the same conditions as the related stock option. Upon exercise of the stock appreciation right, the related stock option shall be canceled. The estimated cost of the stock appreciation rights is charged to expense during the period between the grant and exercise dates.

The following table summarizes activity under the 1983 stock option plan for 1985, and its status as of December 31, 1985.

	Outstanding Options		Exercisable Options	
	Shares	Option Price	Shares	Option Price
Balance, December 31, 1984	361,700	$26	51,511	$26
Granted	251,760	$26-$26.[illegible]	—	—
Became exercisable	—	—	130,211	$26
Exercised	—	—	—	—
Expired or canceled	1,067	$26	—	—
Balance, December 31, 1985	612,393	$26-$26.[illegible]	181,711	[illegible]

Stock appreciation rights are attached to 152,867 of exercisable stock options and 301,080 of outstanding stock options.

The expense for the above stock and cash incentive plans was $38.8 million in 1985, $12.2 million in 1984 and $23.7 million in 1983.

In connection with the above incentive plans, the 1974 stock option plan was curtailed as of January 1, 1980. All options under this plan were granted to salaried key employees of the Corporation and its subsidiaries to purchase shares of its common stock at prices not less than market value at the date granted. The Corporation makes no charge against income with respect to the granting or exercise of these options. Options outstanding under the 1974 plan are nonqualified options. None were exercisable within one year of the date of grant, and none expire later than 10 years after the date of grant.

The following table summarizes activity under the 1974 stock option plan for 1985, and the plan's status as of December 31, 1985.

Outstanding and Exercisable Options	Shares	Option Price
Balance, December 31, 1984	440,150	$18-$21
Became exercisable	—	—
Exercised	48,450	$18-$19
Expired or canceled	7,300	$18-$21
Balance, December 31, 1985	384,400	$18-$21

(e) Postretirement benefits

Upon reaching normal retirement age and meeting certain vesting requirements, substantially all employees currently qualify for postretirement health care and life insurance benefits. Foreign office and subsidiary employees of the Corporation are essentially not covered under this plan. Life insurance benefits are provided at no cost to the employee/retiree, while health care benefits are partially contributory and are coordinated with Medicare benefits.

The cost of the retiree life insurance benefits is based on an estimate of each year's expected claims plus administrative costs, and is accrued on a level basis each year. Accrued life insurance costs are funded annually, and amounted to approximately $0.4 million in 1985 and $0.1 million in 1984. A trust has been established to provide retiree health care benefits. The trust is funded based on an actuarial projection of each year's incurred claims plus administrative costs less trust income. The health care costs are accrued on a level basis each year and funded annually. The retiree health care costs amounted to approximately $1.6 million in 1985 and $1.3 million in 1984.

Condensed Statement of Changes in Financial Position

For the Year (In Thousands)	1985	1984	1983
SOURCES OF FINANCIAL RESOURCES			
Provided from operations			
Net income	$168,999	$ 86,369	$183,534
Excess (deficit) of equity in earnings of subsidiaries over dividends received	(86,703)	43,217	(117,962)
Other	(771)	86	(136)
Resources provided from operations	81,525	129,672	65,436
Increase in:			
Funds borrowed	—	67,651	—
Long-term debt	404,303	137,757	—
Decrease in:			
Cash and due from banks	—	58,573	—
Issuance of preferred stock	—	73,379	122,314
Issuance of common stock	100,718	117,282	20,178
Total	$586,546	$584,314	$207,928
APPLICATIONS OF FINANCIAL RESOURCES			
Increase in:			
Cash and due from banks	$ 28,315	$ —	$ 18,058
Loans	179,314	139,617	54,686
Investment in wholly-owned subsidiaries	125,502	329,424	3,153
Decrease in:			
Funds borrowed	135,672	—	42,089
Long-term debt	—	—	11,390
Cash dividends declared on preferred stock	29,256	32,143	21,192
Cash dividends declared on common stock	65,274	60,969	52,080
Other, net	23,213	22,161	5,280
Total	$586,546	$584,314	$207,928

The Parent Company Only Statement of Changes in Stockholders' Equity is the same as the Consolidated Statement of Changes in Stockholders' Equity (see page 46).

Dividends that may be paid by bank subsidiaries are subject to legal limitations. This limitation is equal to net profits, as defined for the current year, combined with retained net profits for the preceding two years. At December 31, 1985, bank subsidiaries could have declared additional dividends of up to approximately $221 million without the approval of the Comptroller of the Currency. As a practical matter dividend payments are restricted to lesser amounts because of the desire to maintain strong capital positions in the bank subsidiaries.

Federal banking law also restricts the bank subsidiaries from extending credit to the Parent company in excess of 10 percent of their capital stock and surplus, as defined. Any such extensions of credit are subject to strict collateral requirements.

In connection with issuances of commercial paper, the Corporation has agreements providing future credit availability (back-up lines of credit) with various banks. The agreements with nonaffiliated banks aggregated $250 million at December 31, 1985, and $146 million at December 31, 1984. The Corporation also had agreements for back-up lines of credit with The First National Bank of Chicago aggregating $150 million at December 31, 1985, and December 31, 1984. In 1985, the Corporation had agreements to pay a 0.25 percent per annum commitment fee on any unused lines. The back-up lines of credit, together with overnight money market loans, short term investments and other sources of liquid assets, exceeded the amount of commercial paper issued at December 31, 1985.

Note 15—Commitments

In the normal course of business, there are various commitments and contingent liabilities outstanding, such as standby letters of credit and other letters of guarantee, commitments to extend credit, foreign exchange forward contracts, and interest rate swap agreements, which are not reflected in the accompanying financial statements. The following is a brief description of some of these activities as of December 31, 1985.

Standby letters of credit and other guarantee instruments

Standby letters of credit and other guarantee instruments are issued by the Corporation to ensure its customers' performance in dealings with others. As of December 31, 1985, the Corporation has issued standby letters of credit and other guarantee instruments, net of cash collateral deposits, for the following purpose (in millions):

Purpose	Amount	Typical Maturity Ranges
Commercial paper	1,235	2 to 3 years
Tax-exempt securities	1,501	5 to 20 years
Bid or performance guarantees	541	1 to 2 years
Other	1,897	1 to 8 years
Total	5,174	
Less: Risk participations	509	
	$4,665	

Net outstanding standby letters of credit and other guarantee instruments as of December 31, 1984, aggregated approximately $4.5 billion.

Income is generally recognized on a straight line basis over the term of the standby letter of credit or other guarantee instruments in noninterest income. The amount of unearned income related to these activities was approximately $2.7 million at December 31, 1985.

The credit risk associated with these instruments is reviewed on an individual customer basis and considered in assessing the adequacy of the Corporation's allowance for loan losses.

Interest-Rate Swap Agreements

The Corporation enters into interest rate swap agreements both as a financial intermediary to produce fee revenue and as a principal to manage its own interest rate exposure. As a financial intermediary, it is the Corporation's policy to limit interest rate risk by matching offsetting swap agreements.

The Corporation's risk in these transactions is the cost of replacing at current market rates all those outstanding contracts where there is such a cost. At December 31, 1985, this approximated $493 million. This amount fluctuates as a function of maturity and market interest rates.

Long-term Foreign Exchange Contracts

In addition to establishing customer limits for short-term foreign exchange activity, the Corporation monitors the credit risk associated with its participation in long-term foreign exchange contracts (over 1 year). The Corporation's risk in these long-term foreign exchange contracts can be calculated by valuing such foreign exchange contracts at the prevailing rates of exchange and determining all positions which result in net exposure on an individual customer basis. The amount of such risk, calculated in this manner, approximated $54 million at December 31, 1985. This amount fluctuates as a function of forward foreign exchange rates.

Note 16—Contingencies

The Corporation and certain of its subsidiaries are defendants in various lawsuits arising out of normal banking activities, including certain class actions, and the Corporation has received certain tax deficiency assessments. On November 9, 1984, the staff of the Securities and Exchange Commission (the "Commission") issued a formal order of investigation of the Corporation concerning the Corporation's decision to increase its provision for loan losses in the third quarter of 1984, and to determine whether there had been certain violations of United States Federal securities laws. The Commission has since subpoenaed records of the Corporation pursuant to its investigation. In addition, The First National Bank of Chicago ("FNBC") entered into an agreement dated November 13, 1984, with the Comptroller of the Currency that primarily addresses FNBC's capital, funding and asset quality. In the opinion of management and the Corporation's general counsel, the ultimate resolution of the matters described above will not have a material effect on the Corporation's consolidated financial statements.

AUDITORS' REPORT

To the Stockholders and the Board of Directors of First Chicago Corporation:

We have examined the consolidated balance sheet of First Chicago Corporation (a Delaware corporation) and subsidiaries as of December 31, 1985, and 1984, and the related consolidated statements of income, changes in stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of First Chicago Corporation and subsidiaries as of December 31, 1985, and 1984, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

Arthur Andersen & Co.

Chicago, Illinois,
January 14, 1986. Arthur Andersen & Co.

CONSENT OF INDEPENDENT PUBLIC ACCOUNTANTS

To First Chicago Corporation:

As independent public accountants, we hereby consent to the incorporation of our report dated January 14, 1986, incorporated by reference in the Form 10-K, into the Corporation's previously filed Form S-8 Registration Statement No. 2-83105, Form S-8 Registration Statement No. 2-68153, Form S-8 Registration Statement No. 2-50411, Form S-3 Registration Statement No. 2-76715, Form S-3 Registration Statement No. 2-77079 and Form S-3 Registration Statement No. 2-92143.

Arthur Andersen & Co.

Chicago, Illinois,
March 7, 1986. Arthur Andersen & Co.

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
SELECTED STATISTICAL INFORMATION

Investment Securities

As of December 31, 1985, investment securities had the following maturity and yield characteristics:

(In Millions)	Book Value	Market Value	Yield
U.S. GOVERNMENT AND FEDERAL AGENCY			
Maturing in one year	$ 97	$100	9.89%
Maturing after one but within five years	173	179	9.47
Maturing after five but within ten years	427	437	9.18
Maturing after ten years	102	96	8.76
	$799	$812	9.28
STATES AND POLITICAL SUBDIVISIONS*			
Maturing in one year	$ 4	$ 4	9.28%
Maturing after one but within five years	128	122	9.68
Maturing after five but within ten years	150	141	12.22
Maturing after ten years	257	214	12.39
	$539	$481	11.68
OTHER BONDS, NOTES AND DEBENTURES			
Maturing in one year	$ 96	$ 96	9.88%
Maturing after one but within five years	43	42	8.89
Maturing after five but within ten years	23	23	8.05
Maturing after ten years	6	8	9.23
	$168	$169	9.24

*Yields for obligations of states and political subdivisions are calculated on a tax-equivalent basis using a tax rate of 46 percent.

Maturity Distribution of Loans

The following table shows a distribution of the maturity of loans excluding domestic consumer loans, residential mortgage loans and domestic lease financing receivables, at December 31, 1985:

(In Millions)	One Year or Less	One to Five Years	Over Five Years	Total
Domestic				
Commercial	$2,598	$2,657	$1,633	$ 6,888
Secured by real estate	950	997	649	2,596
Financial institutions	986	308	144	1,438
Other	1,252	259	119	1,630
Total domestic	5,786	4,221	2,545	12,552
Foreign	3,619	1,933	1,108	6,660
Total	$9,405	$6,154	$3,653	$19,212
Percentage of total	49%	32%	19%	100%

Interest Sensitivity of Loans

For those loans due after one year (excluding domestic consumer loans, residential mortgage loans and domestic lease financing receivables), the following table shows a breakdown between those loans that have floating interest rates and those that have predetermined interest rates.

	Maturing		
(In Millions)	After One Year but Within Five	After Five Years	Total After One Year
Loans with predetermined interest rates	$ 708	$ 567	$1,275
Loans with floating interest rates	5,446	3,086	8,532
	$6,154	$3,653	$9,807

Deposits

The following tables show a maturity distribution of domestic time certificates of deposit of $100,000 and over, other domestic time deposits of $100,000 and over, and deposits in foreign offices, predominantly in amounts in excess of $100,000, at December 31, 1985:

Domestic Certificates of Deposit (In Millions)	Amount	Percent
Three months or less	$ 2,746	69%
Over three months but less than six months	390	10
Over six months but less than twelve months	343	9
Over twelve months	499	12
Total	$ 3,978	100%

Domestic Other Time Deposits (In Millions)	Amount	Percent
Three months or less	$ 122	32%
Over three months but less than six months	15	4
Over six months but less than twelve months	106	28
Over twelve months	137	36
Total	$ 380	100%

Foreign Offices (In Millions)	Amount	Percent
Three months or less	$11,603	91%
Over three months but less than six months	538	4
Over six months but less than twelve months	461	4
Over twelve months	106	1
Total	$12,708	100%

The following table shows the breakdown of deposits on an average basis for the past three years.

Deposits—Average Balances (In Millions)	1985	1984	1983
Domestic			
Demand deposits	$ 4,162	$ 3,337	$ 2,833
Savings and time deposits	4,907	3,685	3,212
Time certificates of deposits of $100,000	4,227	6,178	5,967
Total domestic	13,296	13,200	12,012
Foreign offices	14,408	13,758	11,384
Total deposits	$27,704	$26,958	$23,396

IRST CHICAGO CORPORATION AND SUBSIDIARIES
SLECTED STATISTICAL INFORMATION

ollars in Millions, except per share data)	1985	1984	1983	1982	1981
NANCIAL RATIOS					
et income as a percentage of:					
Average stockholders' equity	8.44%	4.51%	11.07%	10.19%	9.63%
Average common stockholders' equity	8.33	3.38	11.37	10.18	9.63
Average total assets	0.43	0.22	0.53	0.39	0.39
Average earning assets	0.48	0.25	0.60	0.45	0.45
ockholders' equity at year end as a percentage of:					
Total assets at year-end	5.4	4.8	4.8	4.2	3.8
Total loans at year-end	8.6	7.5	7.8	6.7	6.2
Total deposits at year-end	7.7	6.7	6.3	5.4	5.0
verage stockholders' equity as a percentage of:					
Average assets	5.1	5.0	4.8	3.9	4.1
Average loans	8.0	8.0	7.7	6.5	6.9
Average deposits	7.2	7.1	7.1	5.4	5.6
ncome to fixed charges					
Excluding interest on deposits	1.2x	1.1x	1.4x	1.2x	1.2x
Including interest on deposits	1.1x	1.0x	1.1x	1.1x	1.0x

OMMON STOCK AND STOCKHOLDER DATA					
arket price					
High for the year	$30 [illegible]	$27	$28	$23 [illegible]	$20 [illegible]
Low for the year	20 [illegible]	18 [illegible]	17 [illegible]	13 [illegible]	15 [illegible]
At ye	29 [illegible]	21 [illegible]	25 [illegible]	18 [illegible]	19 [illegible]
ividen ratio	46.48%	110.92%	32.14%	36.04%	40.27%
rice ea atio (year-e market)	10.4	18.0	6.5	5.4	6.5
ommon stockholders' equity per share (at year end)	$34.10	$34.12	$35.80	$33.55	$31.87
umber of stockholders	14,458	14,529	14,162	14,003	14,207

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
QUARTERLY DATA

QUARTERLY EARNINGS AND MARKET PRICE SUMMARY

	Net Income (Loss)		Stock Market Price Range**		Price Earnings Range***	
	Amount (In Millions)	Per Share	Low	High	Low	High
1985						
First Quarter	$ 39.9	$0.68	$20¼	$26¾	22.4	29.2
Second Quarter	11.7	0.08	21	26⅝	*	*
Third Quarter	58.0	1.04	21⅝	25⅝	7.5	9.1
Fourth Quarter	59.4	1.04	20¼	30⅛	7.1	10.6
Year	169.0	2.84	20¼	30⅛	7.1	10.6
1984						
First Quarter	$ 49.8	$0.97	$23	$26¼	5.9	6.8
Second Quarter	53.0	0.98	18⅞	25¼	4.7	6.3
Third Quarter	(71.8)	(1.79)	19¼	27	16.5	23.3
Fourth Quarter	55.5	1.03	19¼	25¼	16.3	21.3
Year	86.4	1.19	18⅞	27	15.9	22.7

*Not meaningful

**The principal market for First Chicago Corporation common stock is the New York Stock Exchange.

***Computation made by dividing market prices by the per share earnings of the latest twelve month period ending with the current quarter.

CONSOLIDATED SUMMARY OF QUARTERLY FINANCIAL INFORMATION

1985 (In Millions)	December 31	September 30	June 30	March 31
Interest Income	$879.5	$878.2	$981.5	$973.1
Net Interest Income	258.6	259.2	270.1	265.1
Provision for Loan Losses	90.0	150.4	90.8	80.0
Noninterest Income	178.3	193.6	179.1	107.1
Noninterest Expense	267.2	244.9	367.1	230.5
Net Income	59.4	58.0	11.7	39.9
Earnings Per Common and Common Equivalent Share	$1.04	$1.04	$0.08	$0.68

1984 (In Millions)	December 31	September 30	June 30	March 31
Interest Income	$1,057.8	$1,121.7	$990.8	$883.1
Net Interest Income	255.4	231.3	221.6	186.7
Provision for Loan Losses	60.0	308.0	49.3	47.5
Noninterest Income	128.5	118.9	113.7	111.1
Noninterest Expense	241.2	210.3	209.4	181.1
Net Income (Loss)	55.5	(71.8)	53.0	49.8
Earnings Per Common and Common Equivalent Share	$1.03	$(1.79)	$0.98	$0.97

COMMON DIVIDENDS

Declared	Record Date	Payable	Cents Per Share
1/13/84	3/2/84	4/1/84	33
4/13/84	6/1/84	7/1/84	33
7/13/84	9/7/84	10/1/84	33
11/9/84	12/7/84	1/1/85	33
1/11/85	3/1/85	4/1/85	33
4/12/85	6/7/85	7/1/85	33
7/12/85	9/6/85	10/1/85	33
11/8/85	12/6/85	1/1/86	33
1/10/86	3/7/86	4/1/86	33

NOTE: The Corporation has adopted Statement of Financial Accounting Standard No. 87—Employers' Accounting for Pensions. As a result, the above statistical information, where applicable, has been restated for the first three quarters of 1985 to reflect the necessary changes. As a result of adopting this change, net income increased by $1.6 million, or approximately $0.03 per common share, for each of the first three quarters of 1985.

FIRST CHICAGO CORPORATION AND SUBSIDIARIES
AVERAGE BALANCES/INTEREST DIFFERENTIAL/RATES

Year Ended December 31	1985			1984		
(Income and rates on tax equivalent basis) (Dollars in Millions)	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
ASSETS						
Due from banks—interest bearing (A)	$ 4,968	$ 444.6	8.95%	$ 5,611	$ 609.0	10.85%
Federal funds sold and securities under resale agreements	2,067	173.3	8.38	1,596	171.7	10.76
Trading account assets*	1,232	113.3	9.20	748	78.1	10.44
Investment securities						
United States Government and Federal Agency	581	56.5	9.72	1,130	116.9	10.35
States and political subdivisions*	536	61.5	11.47	653	76.0	11.64
Other*	619	55.9	9.03	567	55.2	9.74
Loans (B)(C)						
Domestic*	17,597	2,089.4	11.55	15,973	2,072.7	12.69
Foreign	7,379	810.0	10.94	7,928	968.8	12.16
Loans	24,976			23,901		
Total earning assets	34,979			34,206		
Cash and due from banks—noninterest bearing	1,920			1,647		
Allowance for loan losses	(346)			(258)		
Other assets	3,019			2,956		
Total assets; Total interest income (D)	$39,572	$3,604.5		$38,551	$4,148.4	
LIABILITIES AND STOCKHOLDERS' EQUITY						
Depos[illegible]						
De[illegible]	$ 4,162			$ 3,337		
Sav[illegible]	2,440	$ 158.6	6.50	1,880	$ 146.2	7.69
Tim[illegible]	6,694	613.6	9.17	7,963	842.8	10.58
Foreign offices (E)	14,408	1,223.4	8.49	13,758	1,387.1	10.08
Total deposits	27,704			26,938		
Federal funds purchased and securities under repurchase agreements	5,095	421.1	8.26	5,187	542.2	10.45
Commercial paper	378	33.8	8.94	431	44.5	10.32
Other funds borrowed	1,596	143.8	9.01	1,433	161.0	11.24
Long-term debt	743	65.0	8.75	353	34.3	9.72
Other liabilities	2,054			2,272		
Preferred stock	325			313		
Common stockholders' equity	1,677			1,604		
Total liabilities and stockholders' equity; Total interest expense	$39,572	$2,659.3		$38,551	$3,158.4	
Interest Income Earning Assets		$3,604.5	10.87		$4,148.4	12.13
Interest Expense Earning Assets		2,659.3	7.60		3,158.4	9.24
Interest Differential		$1,145.2	3.27%		$ 990.0	2.89%

*Includes tax equivalent adjustment based on 46 percent Federal income tax rate.

(A) Principally balances in overseas offices.

(B) Includes fees on loans of [illegible] for 1985, [illegible] for 1984, [illegible] for 1983, [illegible] for 1982, and [illegible] for 1981. Rates are calculated exclusive of fee income.

1983			1982			1981		
Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate	Average Balance	Interest	Average Rate
$ 5,954	$ 585.5	9.83%	$ 7,297	$ 978.4	13.41%	$ 5,953	$ 962.6	16.17%
962	89.4	9.29	844	97.7	11.58	732	84.7	15.92
528	49.2	9.32	371	50.3	13.56	314	46.2	14.71
497	47.5	9.56	553	52.1	9.42	746	73.0	9.79
557	62.3	11.18	514	55.0	10.70	564	59.9	10.62
505	46.5	9.21	381	34.5	9.06	340	30.4	8.94
13,856	1,641.1	11.61	13,551	1,867.8	13.44	11,360	1,791.0	15.37
7,643	846.4	11.00	7,037	1,020.3	14.44	6,127	1,057.8	16.41
21,499			20,588			17,787		
30,502			30,548			26,236		
1,564			1,890			1,972		
(221)			(202)			(172)		
2,698			2,497			2,208		
$34,543	$3,367.9		$34,733	$4,156.1		$30,244	$4,105.6	
$ 2,833			$ 3,030			$ 2,897		
1,600	$ 118.1	7.38	720	$ 38.1	5.29	715	$ 37.2	5.20
7,579	738.1	9.74	7,971	1,019.0	12.78	6,488	953.5	14.70
11,383	1,053.2	9.25	12,941	1,639.6	12.67	12,064	1,784.2	14.79
23,395			24,662			22,164		
5,064	459.3	9.07	4,451	543.7	12.22	3,383	550.2	16.26
469	42.1	8.98	635	74.1	11.67	556	87.4	15.72
1,385	141.9	10.46	1,129	141.0	12.49	867	122.1	14.08
308	27.1	8.80	230	19.5	8.48	177	13.2	7.46
2,264			2,284			1,864		
230			23			—		
1,428			1,319			1,233		
$34,543	$2,582.8		$34,733	$3,475.0		$30,244	$3,517.8	
	$3,367.9	11.04		$4,156.1	13.61		$4,105.6	15.65
	2,582.8	8.47		3,475.0	11.38		3,517.8	13.52
	$ 785.1	2.57%		$ 681.1	2.23%		$ 587.8	2.13%

Includes amortization of investment tax credits on a tax equivalent basis of [illegible] for [illegible] and [illegible] for [illegible]. Rates are calculated on balances reduced by deferred liability for taxes and deferred investment tax credits.

Includes tax equivalent adjustments based on [illegible] percent Federal income tax rate of [illegible] for [illegible] and [illegible] for [illegible].

Includes International Banking Facilities deposit balances in domestic offices and balances of Edge Act and overseas offices.

RST CHICAGO CORPORATION AND SUBSIDIARIES
ALYSIS OF CHANGES IN INTEREST DIFFERENTIAL

following table shows the approximate effect on the interest differential of volume and rate changes for the years 1985 and 4. For purposes of this table, changes that are not solely due to volume or rate changes are allocated to volume.

Ended December 31	1985 over 1984			1984 over 1983		
Millions)	Volume	Rate	Total	Volume	Rate	Total
rease (decrease) in						
Interest income						
Due from banks—						
Interest bearing	$ (57.5)	$(106.9)	$(164.4)	$(37.2)	$ 60.7	$ 23.5
Federal funds sold and securities under resale agreements	39.5	(37.9)	1.6	68.2	14.1	82.3
Trading account assets	44.5	(9.3)	35.2	23.0	5.9	28.9
Investment securities						
United States Government and Federal Agency	(53.4)	(7.0)	(60.4)	65.5	3.9	69.4
States and political subdivisions	(13.4)	(1.1)	(14.5)	11.2	2.5	13.7
Other	4.7	(4.0)	0.7	6.0	2.7	8.7
Loans						
Domestic	192.8	(176.1)	16.7	274.7	156.9	431.6
Foreign	(60.3)	(98.5)	(158.8)	34.8	87.6	122.4
Total	96.9	(440.8)	(343.9)	446.2	334.3	780.5
Interest expense						
Deposits						
Savings	35.1	(22.7)	12.4	23.1	5.0	28.1
Time	(116.3)	(112.9)	(229.2)	40.6	64.1	104.7
Foreign offices	55.2	(219.2)	(164.0)	239.5	94.7	334.2
Federal funds purchased and s[illegible] under repurchase a[illegible]s	(7.6)	(113.5)	(121.1)	12.9	70.0	82.9
Comm[illegible] paper	(4.7)	(6.0)	(10.7)	(3.9)	6.3	2.4
Other funds borrowed	14.7	(31.9)	(17.2)	5.4	10.7	16.1
Long term debt	34.1	(3.4)	30.7	1.4	2.8	7.2
Total	10.5	(509.6)	(499.1)	322.0	253.6	575.6
rease (decrease) in interest differential	$ 86.4	$ 68.8	$ 155.2	$124.2	$ 80.7	$204.9

FORM 10-K
Securities and Exchange Commission
Washington, D.C. 20549

Form 10-K
Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 1985

Commission file number 1-6052

FIRST CHICAGO CORPORATION
One First National Plaza
Chicago, Illinois 60670
312-732-4000

Incorporated in the State of Delaware
I.R.S. Employer Identification No. 36-2669970

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $5.00 par value	New York Stock Exchange Midwest Stock Exchange Pacific Stock Exchange
Preferred Stock with Cumulative and Adjustable Dividends ($50 stated value), no par value	New York Stock Exchange
Preferred Stock with Cumulative and Adjustable Dividends, Series B ($100 stated value), no par value	New York Stock Exchange
Preferred Stock with Cumulative and Adjustable Dividends, Series C ($100 stated value), no par value	New York Stock Exchange
7½% Notes due 10-15-86	New York Stock Exchange
Floating Rate Subordinated Notes due 1996, Series A	New York Stock Exchange

No securities are registered pursuant to Section 12(g) of the Act.

The Corporation has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and has been subject to such filing requirements for the past 90 days.

The aggregate market value of voting stock held by nonaffiliates of the Corporation as of February 14, 1986 was $1,453,740,403.

At February 14, 1986, the Corporation had 53,347,842 shares of its Common Stock, $5.00 par value, outstanding.

Portions of the Corporation's 1985 Annual Report to Stockholders are incorporated by reference into Parts I, II and IV hereof, and portions of the Corporation's definitive proxy statement dated March 10, 1986 are incorporated by reference into Part III hereof.

FORM 10-K CROSS REFERENCE INDEX

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K

(a) (1) Financial Statements (See Item 8 for a listing of all financial statements).

(2) Financial Statement Schedules.

All schedules normally required by Form 10-K are omitted since they are either not applicable or the required information is shown in the financial statements or the notes thereto.

(3) Exhibits

3(A) Restated Certificate of Incorporation of the Corporation, as amended

3(B) By-Laws of the Corporation, as amended [Exhibit 2 to the Corporation's 1982 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference]

10(A) Strategic Stock Incentive Plan, as amended and restated [Exhibit 10(A) to the Corporation's 1982 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference]

10(B) Executive Incentive Plan [Exhibit 10(B) to the Corporation's 1982 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference]

PART IV (continued)

10(C). 1981 Stock Option Plan [Exhibit 10(D) to the Corporation's 1982 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference].

10(D). 1974 Stock Option Plan, as amended ["Text of the Plan" on pages 2 through 10 of the Corporation's Post-Effective Amendment No. 7 to Form S-8 Registration Statement (File No. 2-50411) incorporated herein by reference]

10(E). First Chicago Corporation Compensation Agreement [Exhibit 9 to the Corporation's 1980 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference]

10(F). FNBC Compensation Agreement [Exhibit 10 to the Corporation's 1980 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference]

10(G). Agreement dated November 19, 1980 among Barry F. Sullivan, First Chicago Corporation and The First National Bank of Chicago [Exhibit 11 to the Corporation's 1980 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference].

10(H). Performance Share Plan of ANC [Exhibit 10(H) to the Corporation's 1984 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference]

10(I). Performance Incentive and Recognition Plan of ANB [Exhibit 10(I) to the Corporation's 1984 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference]

10(J) Management Award Program for Employees of ANC and Subsidiaries. [Exhibit 10(J) to the Corporation's 1984 Annual Report on Form 10-K (File No. 1-6052) incorporated herein by reference]

12. Statements re computation of ratios

13. The Corporation's 1985 Annual Report to Stockholders.

22. Subsidiaries of the Corporation.

24. Consents of experts and counsel ["Consent of Independent Public Accountants" on page 61 of the Corporation's 1985 Annual Report to Stockholders incorporated herein by reference]

(b) The Corporation filed a report on Form 8-K during the quarter ended December 31, 1985. The report, dated October 3, 1985, regarded the approval by the Federal Reserve Board of the Corporation's investment in a foreign subsidiary, and a related agreement with the Board

*Unless otherwise stated, the indicated pages refer to pages in the Corporation's 1985 Annual Report to Stockholders that are incorporated by reference into the Form 10-K.

**This item is omitted because it is either inapplicable or the answer thereto is in the negative

***Incorporated by reference from the indicated pages of the Corporation's definitive proxy statement dated March 10, 1986

This report on Form 10-K has not been approved or disapproved by the Securities and Exchange Commission, nor has the Commission passed upon the accuracy or adequacy of this report. Portions of the Corporation's 1985 Annual Report to Stockholders are not required by the Form 10-K and are not filed as part hereof. Only those sections of the 1985 Annual Report to Stockholders referenced in the foregoing index are incorporated in the Form 10-K

DESCRIPTION OF BUSINESS

GENERAL

First Chicago Corporation (the "Corporation") is a bank holding company incorporated in Delaware in 1969, the principal asset of which is the capital stock of The First National Bank of Chicago ("FNBC"). In addition, the Corporation owns all the outstanding capital stock of American National Corporation ("ANC"), the holding company for American National Bank and Trust Company of Chicago ("ANB") and three suburban Chicago banks—American National Bank of Arlington Heights, American National Bank of Bensenville and American National Bank of Libertyville. The Corporation also owns the stock of various other subsidiaries engaged in businesses related to banking and finance.

In addition to its equity investment in subsidiaries, the Corporation, directly or indirectly, raises funds principally to finance the operations of its nonbank subsidiaries. A substantial portion of the Corporation's annual income is typically derived from dividends directly from FNBC and indirectly from ANB (collectively, the "Banks") and interest on loans to its subsidiaries.

The Corporation's business strategy focuses on three major lines of business: global financial business, consumer financial business and middle market financial business. These three lines of business are supported through the organizational structures of FNBC, ANB and the Corporation's nonbank subsidiaries, as described below.

THE FIRST NATIONAL BANK OF CHICAGO

FNBC provides a broad range of banking, fiduciary, financial and other services on a worldwide basis to individuals, businesses and governmental units. The following describes the organizational structure of FNBC.

Corporate Banking Department

The Corporate Banking Department has global responsibility for delivery of FNBC's wholesale banking products and services. The principal focus of the Department is the extension of credit and the delivery of corporate financial services to commercial, industrial, financial, governmental and real estate customers. The Department also provides noncredit services to its customers.

The Corporate Banking Department is composed of six groups representing geographic and industrial banking specializations. The Midwest Banking Group focuses FNBC's wholesale activities on the Chicago market and 11 Midwest states. The North American Banking Group includes geographically organized units that serve the wholesale marketplace outside the Midwest through offices in New York and other locations across the United States and Canada. The group also includes industry specialized units which serve government, health and service organizations and U.S. financial institutions, as well as a unit involved in asset based finance. The specialized units serve their industries nationally. The Energy and Minerals Group serves the petroleum, electric, gas and mining industries, while the Real Estate Group primarily provides commercial construction lending. The Specialized Industries Group contains units that serve the communications, retailing, transportation, commodities, finance, insurance and securities industries. The International Banking Group is responsible for conducting FNBC's wholesale banking activities outside the United States and Canada, and operates through 11 installations and 10 affiliates in 28 countries.

For information concerning the location of the Corporation's international installations, please refer to page 78, and for information with respect to the Corporation's foreign operations, please refer to pages 50 through 51.

Personal Banking Department

The Personal Banking Department has the primary responsibility for the development and marketing of FNBC's services to individuals. These services include traditional deposit and lending activities, personal trust management, a discount brokerage service, and card issuance and merchant services for both VISA and MasterCard. The Department also operates and participates in a local shared automatic teller machine (ATM) network called "Cash Station," which is a member of CIRRUS, a nationwide ATM system.

The Department operates several banking centers in FNBC's main office building, including the Two First National Plaza building. FNBC also has two off premise banking centers, which are located at Monroe and Wabash Streets in downtown Chicago, and at Michigan and Chicago Avenues on Chicago's near north side. In addition, the Department operates credit card centers out of Elgin, Illinois and Long Island, New York, and maintains a trust office in Boca Raton, Florida.

In 1985, the Department closed its personal banking services office in Miami, Florida. In early 1986, the Department transferred its discount brokerage and precious metal operations to the newly formed First Chicago Investment Services, Inc., a wholly-owned subsidiary of FNBC.

Financial Products Department

The Financial Products Department has responsibility for positioning FNBC's resources in financial activities outside of traditional commercial banking markets. The Department's products include leasing, trade finance, private placements, merger and acquisition advisory services, interest rate swaps, leveraged buyout financing advisory services, international investment banking and venture capital investments. These products are provided through FNBC, through nonbank subsidiaries of the Corporation including First Chicago Leasing Corporation, First Chicago Investment Corporation and First Capital Corporation of Chicago, and through international merchant banking subsidiaries of FNBC. See "Description of Business-Nonbank Subsidiaries."

Service Products Department

The Service Products Department develops, markets and delivers noncredit products to corporate and institutional customers, both domestically and abroad. These products include money transfer, collection, disbursing, freight payment, cash management consulting, corporate trust and shareholder services. The Department also provides centralized data processing services and other utility functions for FNBC and the Corporation.

The Department is responsible for two operating subsidiaries: ComTrac, Inc., which provides freight payment services to domestic corporations; and First Chicago National Processing Corporation, which provides noncredit services, including lock box processing, on a nationwide basis.

Asset & Liability Management Committee

The Asset & Liability Management Committee is responsible for establishing financial policies which maximize net interest income and ensure the maintenance of the Corporation's liquidity. In addition, the Corporation's Chief Financial Officer, as chairman of the Committee, has direct responsibility for the activities of the Financial Markets, Government Bond, Foreign Exchange, Municipal Finance and Corporate Treasury Divisions, the Economic Council and the Control Department.

The Financial Markets Division has global responsibility for the Corporation's money market funding and secondary trading operations, short-term investment management, and the coordination of asset and liability management to ensure the optimization of net interest income.

The Government Bond Division is responsible for FNBC's activities in United States government and Federal agency securities, including trading and sales to customers. As one of 36 primary government bond dealers, this Division reports its position daily to the Federal Reserve Open Market Committee Trading Desk.

The Foreign Exchange Division has worldwide responsibility for FNBC's activities in foreign exchange markets, including trading, hedging overseas investments, and providing foreign exchange products and services to customers.

The Municipal Finance Division is responsible for FNBC's activities in the markets for securities of states, municipalities and [illegible] governmental entities, including trading, sales, underwriting, [illegible]earch, and maintenance of an active secondary market [illegible]tional sales distribution.

The Corporate Treasury Division handles a diverse array of corporate finance functions, including public financing, capital planning and investor relations.

The Economic Council studies major economic trends, as well as shorter-term economic developments, and provides basic guidance to the Corporation for strategic and operating decisions.

Credit Strategy Committee

The Credit Strategy Committee ("CRESCO") has the responsibility to provide general direction and supervision of FNBC's loan and lease portfolio. CRESCO develops loan portfolio strategy, delegates commitment approval authority and maintains policies and procedures related to the portfolio's creation, on going management and accounting. In conjunction with a supportive body, the Country Risk Management Council, CRESCO provides initiation and maintenance of country limits designed to manage the diversification of the foreign asset portfolio. Similarly, in concert with the Industry Risk Management Council, CRESCO develops and maintains diversification practices, credit marketing planning and industry concentration analysis to manage the domestic asset portfolio.

Credit activities reporting to the Chairman of CRESCO include the Credit Policy Group and the Asset Management Group. The Credit Policy Group provides ongoing portfolio surveillance and evaluation, [illegible] it develops into management information. Through its [illegible]ry Risk Management Division, it monitors socioeconomic [illegible] political developments in foreign countries to guide portfolio evaluation and management of foreign assets. Through the Industry Analysis Division, it provides insight and guidance in the construction, selection and management of worldwide positions in selected industries. The Asset Management Group manages selected corporate and real estate loans and certain real estate owned by FNBC and the Corporation. In addition, the Credit Process Review Section of the Audit Department reports indirectly to the Chairman of CRESCO through the head of the Audit Department. This section reviews the activities of individual business units to examine their credit processes, adherence to established policies and procedures, achievement of portfolio objectives, and credit ratings of individual loans and leases.

New York Market

The Corporation has designated a senior officer to be responsible for coordinating and leading the efforts of the various FNBC departments conducting business in the New York market. The senior officer and his staff have four primary responsibilities: 1) develop a comprehensive strategy for all of the Corporation's New York activities, 2) coordinate the implementation of this strategy, 3) act as the senior representative of the Corporation in the market, and 4) coordinate the administrative support for all New York business units.

Staff Departments

Staff support for FNBC, the Corporation and certain of their subsidiaries is supplied by Corporate Resource Management, which consists of the Human Resources and Corporate Planning Departments; Corporate Services, which consists of the Systems and MIS and Administration Departments; and the Community and Governmental Affairs, Law, Control, Audit and Communications Departments.

As of December 31, 1985, the Corporation and its subsidiaries had approximately 14,300 employees.

AMERICAN NATIONAL BANK AND TRUST COMPANY OF CHICAGO

ANB offers a wide range of banking and financial products and services, with primary emphasis on the middle market corporate customer in the Chicago metropolitan area. In addition to its main office in Chicago, ANB has three other facilities in Chicago, as well as foreign branches in London and Grand Cayman.

ANB is organized into three major lines of business: Banking, Trust, and Investment Management. There are also four support divisions within ANB: Financial and Management Services, Auditing, Marketing and Personnel.

Banking Department

The Banking Department is comprised of Commercial Banking, Correspondent and Institutional Banking, Treasury Division, International Banking, Personal Banking, and Banking Operations. The Banking Department provides services for commercial and correspondent bank customers, including commercial loans, demand deposit and time deposit accounts, commercial finance and real estate mortgage loans, cash management services, and investment services. The Department also provides personal banking services, including personal consumer loans, credit card services, deposit services, discount brokerage, and safe deposit facilities.

Trust Department

The Trust Department provides complete agency, trust, and investment services to individuals, partnerships, corporations, institutions, municipalities, and governments. The Department is functionally divided into service groups as follows: Corporate Trust Services, Individual Services, Investor Services, Business Development, and an operations group to support the service groups.

The Corporate Trust Services group acts as trustee and performs other services related to various financings such as stock and bond transfer. The Individual Services group provides personal trust and estate administration services for various types of trusts. The Investor Services group administers pension, profit sharing, and employee benefit plans. The Business Development group is the marketing arm of the Department.

Investment Management

The Investment Management Group provides active and passive management of bond and equity securities for individuals, corporations, and employee benefit plans. The Group provides management services to the national institutional market, the local institutional market and to individuals as clients of the Trust Department.

NONBANK SUBSIDIARIES

The Corporation's [illegible]bank subsidiaries are engaged in businesses related to [illegible]ing and finance, including leasing personal property and providing specialized financing that supplements FNBC's commercial lending activities.

First Chicago Financial Corporation raises funds to finance the operations of its subsidiaries: First Chicago Leasing Corporation and First Chicago Investment Corporation. First Chicago Leasing Corporation is engaged in leasing real and personal property on a full payout basis, whereby the cost of the property will be returned over the life of the lease. Property leased by this company includes manufacturing and transportation equipment, industrial production and electrical power generation facilities, and various other items of commercial and industrial real estate and equipment. First Chicago Investment Corporation provides various forms of specialized financing to business ventures, including subordinated debentures, convertible preferred stock, and other types of debt and equity arrangements.

First Capital Corporation of Chicago, a small business investment company licensed under the Small Business Investment Act of 1958, offers equity financing for small business ventures.

First Chicago Investment Advisors, N.A., is an institutional investment advisor that manages in excess of $7 billion in assets of corporate, union and public retirement funds.

First Chicago Trust Company of Florida, N.A., located in Boca Raton, and First Chicago Trust Company of New York, located in New York City, provide trust and fiduciary services in Florida and New York, respectively.

COMPETITION

All phases of the Corporation's activities, including banking, are highly competitive. The Banks compete actively with money market mutual funds, national and state banks, mutual savings banks, savings and loan associations, finance companies, credit unions, and other financial institutions located throughout the United States. For international business, the Banks compete with other United States banks that have foreign installations, and with other major banks and financial institutions throughout the world. In addition, the Corporation's subsidiaries are subject to competition from a variety of financial and other institutions that provide a wide array of products and services.

MONETARY POLICY AND ECONOMIC CONTROLS

The earnings of the Banks, and therefore the earnings of the Corporation, are affected by the policies of regulatory authorities, including the Board of Governors of the Federal Reserve System (the "Board"). An important function of the Board is to promote orderly economic growth by influencing interest rates and the supply of money and credit. Among the methods that have been used to achieve this objective are open market operations in United States government securities, changes in the discount rate on member bank borrowings, changes in reserve requirements against bank deposits, and limitations on interest rates that member banks may pay on time and savings deposits. These methods are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, interest rates on loans and securities, and rates paid for deposits.

Because its actions strongly influence short-run movements in interest rates, the monetary policies of the Board can have a significant effect on the operating results of commercial banks. In the first quarter of 1985, market participants began to perceive that economic activity was gaining momentum. These perceptions were reinforced by the surprisingly rapid growth of the monetary aggregates during the last part of 1984 and early 1985. Against the backdrop of these perceptions and fear that the Board would be forced to tighten credit conditions to head off inflationary imbalances, most market interest rates rose during the first quarter. But, in fact, the economy failed to live up to these expectations—as both real output and inflation posted smaller than expected advances throughout most of 1985. In reaction to the apparently disappointing performance of the economy, the Board began to ease credit conditions early in the second quarter, capping its actions by lowering the discount rate to 7.5 percent in mid May. As a result, short term market rates had fallen by almost 1 percent from their first quarter levels. For most of the remainder of the year short term interest rates drifted slightly higher until late in the year when speculation

intensified that continued economic weakness might prompt the Board into a more accommodative posture. During most of the fourth quarter, however, long term interest rates fell sharply—to their lowest levels since 1979. This sharp decline was triggered, in part, by new signs of progress toward reducing Federal budget deficits and by the continuation of only modest inflation pressures. However, as most of the volatility in market interest rates was confined to the longer term markets, net interest margin of banks reflected the greater stability of the shorter term money markets.

The effect of the various measures utilized by the Board on the future business and earnings of the Banks and the Corporation cannot be predicted.

Other economic controls also have affected operations of the Corporation in the past. The Corporation cannot predict the nature or extent of any effects that possible future governmental controls or legislation may have on its business and earnings.

SUPERVISION AND REGULATION

Bank Holding Company Regulation

The Corporation is a bank holding company within the meaning of the Bank Holding Company Act of 1956, as amended (the "Act"), and is registered as such with the Board. Under the Act, bank holding companies are prohibited, with certain exceptions, from engaging in or from acquiring more than 5 percent of the voting stock of any company engaging in activities other than banking, or managing or controlling banks, or furnishing services to or performing services for their subsidiaries.

The Act authorizes the Board to permit bank holding companies to engage in, and to acquire or retain shares of companies that engage in, activities which the Board has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Activities which the Board has determined meet this standard include, with certain limitations: making and servicing loans; performing certain fiduciary functions; providing investment and financial advice; leasing real and personal property; investing in community welfare corporations or projects; providing data processing and data transmission services and facilities; acting as insurance agent for, or underwriter of, certain kinds of credit related insurance; providing courier services; providing management consulting advice to banks not affiliated with the holding company and to nonbank depository institutions; the issuance and sale at retail of money orders, the issuance and sale of travelers checks, and the sale of U.S. savings bonds; performing appraisals of real estate; arranging commercial real estate equity financing; providing securities brokerage services solely as agent for customers; underwriting and dealing in government and certain money market obligations; providing foreign exchange advisory and transactional services; and acting as a futures commission merchant. The Board may from time to time revise this list of permitted activities.

The Act also prohibits bank holding companies from acquiring more than 5 percent of the voting shares of any bank that is not already majority owned without the prior approval of the Board. No application to acquire shares of a bank located outside the state in which the operations of the applicant's banking subsidiaries are principally conducted may be approved by the Board unless such acquisition is specifically authorized by a statute of the state in which the bank whose shares are to be acquired is located. At present, in excess of 20 states have adopted legislation permitting the acquisition by an out of state bank holding company of the shares of an in state bank. In some of these states only banks with limited powers may be established, and in other jurisdictions the laws permit only specific out-of-state bank holding companies to acquire in-state banks. Some states permit emergency bank acquisitions by out of state bank holding companies. In addition, the laws of some other states permit an out of state bank holding company to own a bank within their state only if a bank holding company within such state would be permitted to own a bank in the state of the out-of state bank holding company. Certain reciprocal statutes are limited to specific regions of the country. In 1985, the United States Supreme Court sustained the constitutionality of a regional interstate banking statute. Additional developments by state and federal authorities, with respect to interstate banking, may occur in the future. The impact of any such developments on the Corporation and the Banks cannot be predicted at this time.

During 1985 the Illinois Bank Holding Company Act was amended to provide for reciprocal interstate banking in a region consisting of seven Midwestern states: Illinois, Indiana, Iowa, Kentucky, Michigan, Missouri and Wisconsin. This statute, which takes effect July 1, 1986, will permit a bank holding company whose principal place of business is in one of the six Midwestern states other than Illinois to acquire control of an Illinois bank or bank holding company, provided that the laws of the other jurisdiction permit an Illinois bank holding company to acquire control of a bank or bank holding company in that jurisdiction. The approval of the Illinois Commissioner of Banks and Trust Companies is required to complete such an interstate acquisition in Illinois. Indiana, Kentucky and Michigan have existing reciprocal interstate statutes which include Illinois. Similar legislation is at an advanced stage in the Wisconsin legislature and is expected to be reintroduced in the Missouri legislature during 1986. The new Illinois act also abolishes the five Illinois banking regions established under the prior statute. This earlier provision had limited intrastate bank acquisitions in Illinois to one banking region and a contiguous region. Beginning July 1, 1986, Illinois will permit state wide bank holding companies. All interstate and intrastate bank acquisitions by the Corporation are subject to the approval of the Board. The ultimate impact of these Illinois statutory changes on the Corporation and the Banks, while clearly significant, cannot be predicted at this time.

Subject to approval of the Board and the appropriate federal or state bank regulatory authority, a bank holding company under present law has been permitted to acquire the voting shares of a "nonbank bank" located outside the state in which the operations of the applicant's banking subsidiaries are principally conducted. A nonbank bank is a banking organization that either accepts demand deposits or makes commercial loans, but does not do both. Various restrictions on the powers of nonbank banks and their transactions with affiliates have been imposed on the nonbank banks approved by the regulatory authorities to date. During 1985 a number of judicial developments occurred concerning nonbank banks. In January 1986, the United States Supreme Court held that the Federal Reserve Board did not act within its statutory authority in redefining "banks" to include nonbank banks that are "functionally equivalent" to banks. While it is anticipated that additional nonbank charters may now be issued, significant legal and legislative problems remain. Because of the legal and business uncertainties that continue to surround nonbank banks and, in light of a reassessment of its own strategic priorities, the Corporation has withdrawn the preliminary applications previously filed with the Office of the Comptroller of the Currency for authority to charter and acquire five nonbank banks. Additional developments by state and federal author-

ities, as well as the judiciary, with respect to nonbank banks can be expected to occur in the future. The impact of such developments on the Corporation and the Banks cannot be predicted at this time.

The Corporation is required to file with the Board annual reports and such additional information as the Board may require pursuant to the Act. The Board periodically examines the Corporation and its nonbank subsidiaries, and is authorized to impose reserve requirements and interest rate limitations on certain debt obligations issued by bank holding companies.

In October 1985, First Chicago International Finance Corporation ("FCIFC"), a wholly-owned subsidiary of FNBC, entered into an agreement with the Federal Reserve Bank of Chicago. Under this agreement, FCIFC will maintain a management structure, policies and procedures concerning the acquisition and management of overseas investments that will ensure appropriate controls, informed decision making, and adherence to the Board's regulations. FCIFC is in full compliance with the agreement and intends to continue to carry out its responsibilities under the agreement. FCIFC anticipates that its continued compliance will not have an adverse effect on its operations or financial results.

As a bank holding company, the Corporation and its subsidiaries are prohibited from engaging in certain tie-in arrangements in connection with extensions of credit or the provision of property or services.

Bank Regulation

The Corporation and its nonbank subsidiaries are affiliates of the Banks within the meaning of the Federal Reserve Act. As such, they are subject to certain restrictions on loans made by the Banks to the Corporation or such other subsidiaries, on investments made by the Banks in their stock or securities, and on the Banks taking such stock and securities as collateral for loans. The Corporation and its subsidiaries, including the Banks, are also subject to certain restrictions with respect to engaging in the issuance, flotation, underwriting, public sale, or distribution of securities.

There are various additional requirements and restrictions in the laws of the United States and the State of Illinois affecting the Banks and their operations, including the requirement to maintain reserves against deposits, restrictions on the nature and amount of loans that may be made by the Banks, restrictions relating to investments and other activities of the Banks, and restrictions against branch banking. The Banks, as national banks, are subject to regulation by the Office of the Comptroller of the Currency (the "Comptroller"), the Board and the Federal Deposit Insurance Corporation. The Banks are examined by the Comptroller, and in their operations in other countries the Banks are subject to various restrictions imposed by the laws of such countries.

In November 1984, FNBC entered into an agreement with the Comptroller that primarily addresses FNBC's capital, funding and asset quality. FNBC is in full compliance with the agreement and intends to continue to carry out its responsibilities under the agreement. FNBC anticipates that its continued compliance with the agreement will not have an adverse effect on its operations or financial results.

The approval of the Comptroller is required if the total of all dividends declared by the board of directors of a national bank in any calendar year will exceed the total of such bank's net profits (as defined) for that year, combined with its retained net profits for the preceding two years. As of December 31, 1985, the Banks could have declared additional dividends of approximately $221 million without such approval. The Comptroller also has authority under the Financial Institutions Supervisory Act to prohibit a national bank from paying dividends if, in the Comptroller's opinion, the payment of dividends would, in light of the financial condition of such bank, constitute an unsafe or unsound practice.

In recent years a number of legislative developments affecting national banks have occurred. Among these developments have been ones that repealed statutory limitations on the power of national banks to borrow, simplified limitations and restrictions on transactions of national banks with affiliates, removed interest rate limitations on deposits and authorized money market deposit accounts, increased the limit on the aggregate amount of outstanding loans and extensions of credit by a national bank to any person, and increased the permissible amount of bankers' acceptances a national bank may issue.

Certain organizational units within each of the Banks are registered with the Securities and Exchange Commission (the "Commission") as municipal securities dealers. As such, they are subject to the rules and regulations of the Commission and the Municipal Securities Rulemaking Board with respect to transactions in municipal securities performed in a municipal securities dealer capacity.

The Banks are registered with the Comptroller as transfer agents and, as such, are subject to the rules and regulations of the Commission and the Comptroller with respect to their activities as transfer agents.

First Chicago Futures, Inc. ("FCFI"), a subsidiary of FNBC, is registered with the Commodity Futures Trading Commission (the "CFTC") as a futures commission merchant, and is a member of certain domestic and foreign commodity exchanges and the National Futures Association. As such, FCFI is subject to the rules and regulations of the CFTC and such exchanges and Association with respect to its activities as a futures commission merchant.

PROPERTIES

The Corporation and FNBC occupy a sixty-story combined bank and office building at One First National Plaza, Chicago, Illinois, which is owned by FNBC's wholly owned subsidiary, First Chicago Building Corporation. It has 1,850,000 rentable square feet of space, of which the Corporation occupies approximately 59 percent, and the balance is leased to others. The building is located on the north half of a block in the heart of the Chicago "Loop," the entire block being owned by FNBC. The south half of the block includes a plaza, the First Investment Center (a Personal Banking Department facility), parking and restaurant facilities, and a general purpose auditorium.

The Corporation rents additional office space as necessary under various terms from various lessors.

EXECUTIVE OFFICERS OF THE REGISTRANT

Name and Age	Present Position Held with the Corporation and Effective Date First Elected to Office Indicated	Other Positions Held During Past Five Years
Barry F. Sullivan (55)	Director and Chairman of the Board (7-28-80)	
Richard L. Thomas (55)	Director and President (5-01-74)	
*Curtis G. Anderson (44)	Executive Vice President (12-14-84)	Executive Vice President of FNBC; Senior Vice President of the Corporation and FNBC; Senior Vice President, Citibank, N.A. (banking)
George L. Davis (51)	Executive Vice President (6-08-81)	Executive Vice President of FNBC; Senior Vice President, Citibank, N.A. (banking)
A. D. Frazier (44)	Executive Vice President (1-10-86)	Executive Vice President of FNBC; Senior Vice President of the Corporation and FNBC; Executive Vice President, Citizens and Southern National Bank of Georgia (banking)
Donald R. Hollis (50)	Executive Vice President (1-10-86)	Executive Vice President of FNBC; Senior Vice President of the Corporation and FNBC; Vice President, Chase Manhattan Bank, N.A. (banking)
William J. McDonough (51)	Executive Vice President (1-12-79) and Chief Financial Officer (9-10-82)	
Leo F. Mullin (43)	Executive Vice President (12-14-84)	
Lawrence C. Russell (47)	Executive Vice President (12-14-84)	
D. John Stavropoulos (53)	Executive Vice President (1-12-79)	
Michael E. Tobin (60)	Chairman of the Board of ANC (10-8-82)	Chairman of the Board of ANB
Ch[illegible] Montgomery (55)	Executive Vice President (12-31-75) and Comptroller (10-12-73)	
Ke[illegible]. Arnesen (57)	Senior Vice President and General Counsel (9-12-80) and Secretary (9-10-82)	
Gary P. Brinson (42)	Senior Vice President (2-8-85)	
A. Ray Einsel (46)	Senior Vice President (1-09-81)	
George T. Guernsey IV (37)	Senior Vice President (2-8-85)	Senior Vice President of FNBC; Senior Vice President, Republic National Bank (banking); Principal, Cresap, McCormick and Paget, Inc. (consulting)
Barbara B. McNear (46)	Senior Vice President (9-09-83)	Senior Vice President of FNBC; Vice President, Fireman's Fund Insurance Companies (insurance)
Norman Ross (64)	Senior Vice President (4-11-80)	
Jeffrey P. Tassani (43)	Senior Vice President (8-14-81)	
Douglas E. Van Scoy (44)	Senior Vice President and General Auditor (1-02-81)	

*Has served as an officer of the Corporation or one of its subsidiaries for at least the past five years.

Officers of the Corporation serve until the annual meeting of the Board of Directors (April 11, 1986).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, this 11th day of February, 1986.

FIRST CHICAGO CORPORATION
(Registrant)

By ______________________
Barry F. Sullivan, Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Corporation and in the capacities indicated, this 11th day of February, 1986.

Signature	Title	Signature	Title
Thomas G. Ayers	Director	Jerry K. Pearlman	Director
John H. Bryan, Jr.	Director	William Wood Prince	Director
Frank W. Considine	Director	Ernestine M. Raclin	Director
Marshall Field	Director	Patrick G. Ryan	Director
William B. Graham	Director	George A. Schaefer	Director
Ben W. Heineman	Director	Roger W. Stone	Director
Donald P. Jacobs	Director	Barry F. Sullivan	Director and Principal Executive Officer
Frederick J. Jacks	Director	Richard L. Thomas	Director
Charles S. Locke	Director	Fred L. Turner	Director
Walter E. Massey	Director	Arthur W. Woelfle	Director
Richard M. Morrow	Director	William J. McDonough	Principal Financial Officer
John J. Nevin	Director	Charles H. Montgomery	Principal Accounting Officer

Worldwide Facilities and United States Offices

American National Corporation

Chicago
Grand Cayman
London

Community Banks in Illinois:
Arlington Heights
Bensenville
Libertyville

Bankcard Services

Elgin
Uniondale

Data Services

Chicago
Columbus

Edge Act Offices

Boston
Houston
Los Angeles
New York
San Francisco

Energy Offices

Chicago
Houston
Los Angeles
New York

Institutional Investment Management

Atlanta
Chicago
Dallas
London
Phoenix

International Banking Locations

Abu Dhabi
Athens
Barcelona
Beijing
Buenos Aires
Cairo
Caracas
Cardiff
Cayman Islands
Chicago
Dubai
Dublin
Düsseldorf
Frankfurt
Geneva
Guernsey
Hong Kong
Jakarta
Lagos
London
Madrid
Manila
Mexico City
Milan
Nairobi
Panama City
Paris
Rome
Sao Paulo
Seoul
Singapore
Stockholm
Sydney
Tokyo
Toronto
Zurich

Leasing Office

Chicago

Merchant Banking Offices

Geneva
Hong Kong
London
Mexico City
Singapore
Sydney
Tokyo

National Processing Centers

Atlanta
Chicago
Dallas
Pasadena
Secaucus

Real Estate Offices

Atlanta
Chicago
Dallas
Los Angeles
Miami
New York
San Francisco
Washington, D.C.

Regional Offices

Atlanta
Boston
Cleveland
Dallas
Los Angeles
New York
San Francisco
Washington, D.C.

Personal Banking and Personal Trust Installations

Abu Dhabi
Boca Raton
Chicago
Geneva
Guernsey
Hong Kong

Corporate Trust Offices

Chicago
Guernsey
London
New York

Venture Capital Offices

Boston
Chicago

Corporate Reports

This Annual Report and the SEC Report on Form 10-K and quarterly interim reports are available upon request without charge. For copies, please call (312) 732-6204 or write Public Relations at the address shown on the back cover. An enlarged version will be available for the visually impaired. Also, a list of organizations receiving substantial charitable, educational, cultural or other grants by the Corporation or subsidiaries is available to any stockholder on request. Your comments, questions, or suggestions on any aspect of our business are welcome.

Annual Meeting

The Annual Meeting of Stockholders of First Chicago Corporation will be held at 9:30 a.m. (CST) Friday, April 11, 1986 in the First Chicago Center located in One First National Plaza.

Stock Transfer Agent and Registrar

The First National Bank of Chicago
One First National Plaza
Chicago, Illinois 60670

Independent Accountants

Arthur Andersen & Co.

Stock Listings

Midwest Stock Exchange*
New York Stock Exchange, Inc.*
Pacific Stock Exchange Incorporated*
The Stock Exchange (London)
Tokyo Stock Exchange
*Stock Symbol—FNB

F417600

FIRST CHICAGO
CORPORATION

Financial Supplement
and Form 10-Q
For the Period Ending
March 31, 1986

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First Quarter

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First Chicago Corporation and Subsidiaries
Financial Supplement and Form 10-Q

Contents

Earnings Analysis
Summary

First Chicago Corporation reported record earnings in the first quarter of 1986 with net income of $63.0 million, an increase of 58 percent from $39.9 million a year ago. Net income per common share was $1.06 compared with $0.68 in the first quarter of 1985.

(Dollars in Millions, except per share data)	Three Months Ended March 31 1986	1985
Net interest income - tax-equivalent basis	$283.5	$288.5
Provision for loan losses	100.0	80.0
Noninterest income	187.1	122.8
Noninterest expense	255.9	246.3
Net income	63.0	39.9
Net income per common share	1.06	0.68
Return on assets	0.66%	0.40%
Return on common equity	12.65%	8.09%

As indicated in the Corporation's 1985 Annual Report, the Corporation adopted the provisions of Statement of Financial Accounting Standards No. 87-Employers' Accounting for Pensions. In accordance with this Statement, the Corporation's results for the first three quarters of 1985 have been restated, increasing the net income in the first quarter of 1985 by $1.6 million or $0.03 per common share.

The Corporation's improved performance in the first quarter of 1986 was marked by continued strong net interest income, record levels of noninterest income highlighted by significantly increased profits in bond and foreign exchange trading activities, and higher levels of gains on the sale of investment securities. These positive contributions were partially offset by a higher provision for loan losses and increased noninterest expense, primarily reflecting higher salary and employee benefit costs.

Overall profitability ratios increased significantly from a year ago. Return on assets in the first quarter of 1986 was 0.66 percent compared with 0.40 percent a year ago. Return on common equity increased to 12.65 percent from 8.09 percent in the first quarter of 1985.

In addition, during the first quarter of 1986, the Corporation's balance sheet reflected continued strength as the ratio of allowance for loan losses to loans outstanding increased to 1.87 percent and the Corporation's primary capital ratio increased to 7.67 percent.

As a result of the improvements in capital strength, credit processes, and funding capacity over the past five quarters, The First National Bank of Chicago's agreement with the Comptroller of the Currency was terminated by mutual consent in March of 1986.

Net Interest Income

Net interest income on a tax-equivalent basis was $283.5 million for the first quarter of 1986, down slightly from the $288.5 million reported a year-ago.

Net Interest Income - Tax-Equivalent Basis

(In Millions)	Three Months Ended March 31 1986	1985
Net interest income	$259.7	$265.1
Tax-equivalent adjustment	23.8	23.4
Total	$283.5	$288.5

The goal of management is to maintain strong and consistent net interest income by focusing on asset composition and funding costs. Earning asset volumes have declined steadily since the first quarter of 1985, reflecting management's strategy of reducing the total of lower-yielding earning assets, while maintaining balance sheet liquidity. Earning asset volume for the first quarter of 1986 was $34.2 billion, down 3 percent from the $35.4 billion level in the first quarter of 1985. At the same time, net interest margin increased to 3.36 percent, up from 3.30 percent in the first quarter of 1985, reflecting a higher-yielding asset mix in the portfolio.

(Dollars in Billions)	Three Months Ended March 31 1986	1985
Average earning assets	$34.2	$35.4
Interest margin	3.36%	3.30%

Domestic Net Interest Income

Domestic net interest income in the first quarter of 1986 increased 5 percent compared with a year ago because of higher levels of fundamental net interest income, partially offset by decreases in other components of domestic net interest income including such items as loan fees, cash interest collections on problem loans net of interest reversals, and dividend income.

	Three Months Ended March 31 1986	1985
Fundamental Percentage Spreads on Domestic Earning Assets	3.98%	3.56%

Fundamental domestic net interest income increased primarily because of higher fundamental percentage spreads, increasing to 3.98 percent in the first quarter of 1986 from 3.56 percent in the comparable year-earlier period. Key factors contributing to this improved performance were:

- The percentage spreads on credit card loans showed improvement compared with a year ago primarily because of declines in relative funding costs.
- The mix of domestic earning assets continued its shift toward assets having higher yields, specifically credit card loans and American National middle-market loans.
- Average available demand deposits were significantly higher than a year ago.

Partially offsetting the positive impact of percentage spreads on fundamental domestic net interest income was a slight decline in domestic average earning asset volume versus a year ago.

Domestic interest income for the first quarter of 1986 also reflected a lower level of loan fees and dividend income as well as an increased amount of interest reversals on loans.

Overseas Net Interest Income

Overseas net interest income in the first quarter of 1986 declined by 37 percent as a result of both a lower level of profits earned on deposit placement and funding operations and decreased loan spread income.

The decline in profits earned on overseas deposit placement and funding operations resulted from a slightly lower level of average deposit placement balances and an interest rate environment that did not provide for profitable arbitrage opportunities.

Overseas loan spread income was down principally due to significantly lower loan volume, reflecting management's strategy to reduce the level of lower-yielding assets. In addition, fundamental loan spreads were down slightly from a year ago because of an increased volume of nonperforming assets.

Provision for Loan Losses

The changes in the allowance for loan losses are presented in the following table:

(Dollars in Millions)	Three Months Ended March 31 1986	1985
Provision for loan losses	$100.0	$ 80.0
Net charge-offs		
Commercial	(41.1)	(45.2)
Consumer	(30.6)	(20.1)
Net additions to allowance for loan losses	28.3	14.7
Allowance for loan losses		
—at end of period	$459.9	$306.4
—as a percentage of loans outstanding	1.87%	1.20%

The Corporation's provision for loan losses in the first quarter of 1986 was $100 million, compared with $80 million a year ago and $90 million in the fourth quarter of 1985. Net charge-offs totaled $71.7 million in the first quarter of 1986, compared with $65.3 million a year ago and $69.7 million in the fourth quarter of 1985.

The Corporation's allowance for loan losses at March 31, 1986 was $459.9 million, or 1.87 percent of loans outstanding, compared with $306.4 million, or 1.20 percent of loans outstanding, a year ago. At December 31, 1985, the allowance for loan losses was $431.6 million or 1.78 percent of loans outstanding.

Noninterest Income

Noninterest income increased to $187.1 million in the first quarter of 1986, up 52 percent from the $122.8 million in the first quarter of 1985.

	Three Months Ended March 31	
(Dollars in Millions)	1986	1985
Trading account profits	$ 12.0	$ 3.7
Foreign exchange trading profits	24.2	(4.6)
Fiduciary and investment management fees	26.3	22.2
Credit card fees	29.5	28.5
International fees	18.3	17.4
Other service revenue and fees	25.5	25.0
Gains on sales of equity securities	19.9	23.4
Investment securities gains (losses)	19.4	0.2
Other	12.0	7.0
Total	$187.1	$122.8

The following factors contributed to this strong performance:

- Gains on the sale of investment securities aggregated $19.4 million compared with $0.2 million a year ago.
- Trading account profits increased to $12.0 million, up from $3.7 million a year earlier.
- Foreign exchange trading profits reached a record level of $24.2 million compared with last year's first quarter loss of $4.6 million. First quarter 1985 results included an $11.9 million loss related to a customer default on long-term foreign exchange forward contracts.
- Equity securities gains continued to be a sizable contributor, totaling $19.9 million, although slightly under the $23.4 million in gains reported a year ago.

Fiduciary and investment management fees, credit card fees, international fees, and other service revenue and fees also contributed to this improved performance in noninterest income in the first quarter of 1986, compared to a year ago.

Noninterest Expense

Noninterest expense was $255.9 million in the first quarter of 1986 compared with $246.3 million a year ago. Excluding the first quarter 1985 charge of $15.8 million relating to Banco Denasa, noninterest expense increased 11 percent.

	Three Months Ended March 31	
(Dollars in Millions)	1986	1985
Salaries and benefits	$136.7	$118.6
Occupancy, net	26.7	25.6
Equipment rentals, depreciation and maintenance	18.0	16.0
Other	74.5	70.3
Subtotal	255.9	230.5
Loss from an affiliate investment	-	15.8
Total	$255.9	$246.3

The majority of the increase in noninterest expense was reflected in higher levels of salaries and employee benefits of $136.7 million, up from $118.6 million a year ago. Salary expense increased because of planned growth and salary rate increases as well as a higher level of incentive compensation accruals, based on the Corporation's improved performance. Employee benefits increased over a year ago because of higher profit-sharing expense accruals and increased costs for payroll taxes.

Occupancy and equipment expense increased $3.1 million or 7.5 percent from a year ago. This reflects an increased cost for rented facilities and equipment and their ongoing maintenance.

Applicable Income Taxes

The following table shows the Corporation's effective tax rate for the first quarter of both 1986 and 1985.

	Effective Tax Rate	
	Three Months Ended March 31	
(Dollars in Millions)	1986	1985
Income before income taxes	$90.8	$61.6
Applicable income taxes	$27.8	$21.7
Effective tax rate	30.6%	35.2%

The effective tax rate for the first quarter of 1986 was 30.6 percent, down from the 35.2 percent effective tax rate for the comparable year-ago period. The principal reason for the higher effective tax rate in the first quarter of 1985 was the Corporation's writedown of its investment in a Brazilian affiliate, Banco Denasa de Investimento S.A., which was not tax benefitted. Partially offsetting the effect of this item in comparison to the first quarter of 1986 was a lower level of tax-free income relative to income before income taxes as compared with the first quarter of 1985.

Balance Sheet Analysis

Assets

Total assets of the Corporation were $38.1 billion on March 31, 1986, $2.5 billion, or 6 percent, lower than last year. This asset reduction reflects management's strategy to optimize return on capital by shifting asset mix toward higher yielding assets. Total loan volume was down $1.0 billion, reflecting a decrease at The First National Bank of Chicago. American National Corporation's loan volume increased 11 percent from a year ago. The composition of the consolidated loan portfolio has changed significantly from March 31, 1985; domestic commercial loans and foreign loans have declined $187 million and $1.2 billion, respectively, while consumer loans have increased $335 million.

Trading account assets increased by $1.2 billion from last year's first quarter, but were offset by lower levels of Federal funds sold, securities purchased under resale agreements and deposit placements. The investment securities portfolio of $1.6 billion at March 31 was down slightly from a year ago. Customers' acceptance liability declined by $693 million from a year ago.

Total assets at quarter-end were down $777 million, or 2 percent, when compared with the balance sheet at December 31, 1985. Much of the reduction was due to the sale of government securities in the first quarter of this year to take advantage of favorable market conditions. Trading account assets were also lower compared with the year-end level, offset by an increase in loans of approximately 2 percent.

Average assets during the first quarter were $38.6 billion, a decrease of $1.4 billion from the first quarter of 1985, almost entirely due to a $1.1 billion decline in the average volume of foreign loans.

Liabilities

First Chicago's consolidated deposits on March 31, 1986, were $27.2 billion, compared with $29.7 billion a year ago. Total demand deposits increased $1.0 billion, or 24 percent, to $5.1 billion.

Domestic time deposits dropped to $6.2 billion from $7.5 billion on March 31, 1985. Deposits held in foreign offices declined almost 16 percent, consistent with the lower overseas loan volume and deposit placement activity.

Long-term debt increased $217 million over the year-ago level, to a total of $850 million at quarter-end, resulting from the issuance of $200 million subordinated floating rate notes in the second quarter of 1985. All other purchased funds remained relatively unchanged from a year ago.

Compared with December 31, 1985, the level of total deposits was relatively unchanged. The sum of Federal funds purchased and securities under repurchase agreements, and commercial paper decreased $718 million from year-end 1985.

Capital

At March 31, 1986, the Corporation's stockholders' equity totaled $2.173 billion, an increase of $225 million from a year ago. Common equity was $1.848 billion and preferred equity was $325 million.

The primary capital ratio for the Corporation, which includes stockholders' equity, the allowance for loan losses and equity commitment notes, was 7.67 percent at March 31, 1986. The ratio has increased significantly from 7.24 percent at December 31, 1985, and 6.06 percent a year ago. For The First National Bank of Chicago, the primary capital ratio was 6.85 percent at March 31, 1986 compared with 6.61 percent at December 31 and 5.89 percent a year ago.

Primary and Total Capital Ratios

(Dollars in Millions)	March 31 1986	Dec. 31 1985	March 31 1985
Total stockholders' equity	$ 2,173	$ 2,090	$ 1,949
Allowance for loan losses	460	432	306
Equity contract notes	199	199	-
Equity commitment notes, net*	124	124	224
Minority interest	1	1	1
Total primary capital	2,957	2,846	2,480
Long-term debt that qualifies as secondary capital*	527	502	368
Total capital	$ 3,484	$ 3,348	$ 2,848
Primary capital ratio	7.67%	7.24%	6.06%
Total capital ratio	9.03%	8.51%	6.96%

* In December of 1985, the Corporation dedicated $100 million proceeds from the issuance of common stock since 1982 to partially fulfill the note fund requirements of its outstanding equity commitment notes. This reduction in long-term debt qualifying as primary capital is reclassified as secondary capital for regulatory reporting purposes.

Common shares outstanding at March 31, 1986 were 53.4 million, an increase of 6.1 million shares from a year ago, primarily due to the issuance of common stock as part of the Dividend Reinvestment and Stock Purchase Plan.

Nonperforming Assets

As shown in the table on the following page, the Corporation's nonperforming assets at March 31, 1986 totaled $945 million, up from $768 million a year ago and $657 million at year-end 1985.

Nonperforming Assets (Dollars in Millions)	March 31 1986	Dec. 31 1985	March 31 1985
Nonaccrual loans	$924	$636	$701
Renegotiated loans	4	4	8
Nonperforming loans	928	640	709
Other real estate	17	17	59
Nonperforming assets	$945	$657	$768
Nonperforming assets as a percentage of loans and other real estate	3.8%	2.7%	3.2%

As projected in the Corporation's 1985 annual report, nonperforming assets increased over year-end 1985 levels to $945 million at March 31, 1986. This increase was primarily caused by a small number of customers in the energy and domestic real estate industries. In its review of the energy portfolio, management assumed that the weakness in oil prices would continue over a sufficiently long period that a relatively small number of energy customers may not be able to service their debt on a timely basis. These energy loans, as a result, were classified as nonaccrual loans.

In addition, weakness in certain sectors of the domestic real estate industry has affected the debt service capability of a group of investors who had financed the purchase of a package of real estate assets through First Chicago in the early 1980's. While expecting little, if any, loss of principal, management believes that the investors' ability to maintain interest payments on a current basis is sufficiently questionable to warrant placing this credit of approximately $138 million, on a nonaccrual status. Management believes that nonperforming assets are now at or near their peak for 1986.

The foreign and domestic components of nonperforming assets as of March 31, 1986 were as follows:

Nonperforming Assets (In Millions)	Total	Domestic	Foreign
Nonaccrual loans	$924	$600	$324
Renegotiated loans	4	4	-
Nonperforming loans	928	604	324
Other real estate	17	16	1
Nonperforming assets	$945	$620	$325

As of March 31, 1986, loans past due 90 days or more and still accruing interest amounted to $46.2 million, of which $5.9 million were to foreign obligors, compared with $52.7 million and $10.4 million, respectively, at December 31, 1985.

Foreign Outstandings

The Corporation's cross-border outstandings, consisting of loans (including accrued interest), acceptances, interest-bearing deposits with other banks, other interest-bearing investments and other non-local currency monetary assets, to countries where such outstandings exceeded 1.0 percent of the Corporation's total assets ($381 million as of March 31, 1986) are shown in the following table.

Foreign Outstandings

(In Millions) Country	Total	Government and Official Institutions	Banks and Other Financial Institutions	Commercial and Industrial	Other
March 31, 1986					
Japan	$2,427	$ -	$2,295	$ 115	$ 17
Mexico	918	265	223	426	4
Brazil	800	81	387	332	-
United Kingdom	604	47	277	124	156
Italy	487	3	454	14	16
South Korea	413	101	111	194	7
France	412	10	352	39	11

Several countries are experiencing foreign exchange liquidity problems that have disrupted the timely payment by private and public sector borrowers in those countries of principal and interest on loans from the Corporation and its subsidiaries. The aggregate amount of outstandings extended by the Corporation and its subsidiaries to public and private sector obligors in each country that is experiencing liquidity problems is less than 1.0 percent of the Corporation's total assets at March 31, 1986, with the exception of Mexico and Brazil.

Total outstandings in Mexico at March 31, 1986 represented approximately 2.4 percent of the Corporation's total assets. Approximately $12.3 million was classified as nonperforming as of this date, and no loans were past due 90 days or more and still accruing interest.

Public sector outstandings in Mexico at March 31, 1986 were approximately $664 million, or approximately 72 percent of total outstandings. These outstandings included term loans of approximately $426 million and approximately $232 million of short-term advances, bankers' acceptances, time deposits, and other investments, compared with approximately $426 million and $218 million, respectively, at December 31, 1985.

Revenue generated from Mexican public sector outstandings approximated $15 million for the first quarter of 1986. Interest payments of approximately $18 million were made in respect to public sector outstandings in Mexico during the first quarter. The Corporation collected no principal payments in respect to term loans to Mexican public sector borrowers during the first quarter of 1986.

The Corporation is not committed to lend any new funds to Mexico; however, due to continued deterioration in the Mexican economy caused in large part by the 1985 earthquake and the sharp fall in oil prices, Mexico is expected to request its creditor banks to make significant new loans and to renegotiate the terms of its current loans to the Mexican government. The ability of Mexico to continue to service existing loans is largely dependent upon additional loans being made available by international banks, including the Corporation.

Total outstandings in Brazil at March 31, 1986, represented approximately 2.1 percent of the Corporation's total assets. As of this date, loans totaling $7.9 million were nonperforming, and no loans were past due 90 days or more and still accruing interest. Outstandings included approximately $445 million of term loans and approximately $341 million of short-term advances, bankers' acceptances, time deposits, and other investments, compared with approximately $449 million and $341 million, respectively, at December 31, 1985. Public sector borrowers accounted for approximately 71 percent of outstandings at March 31, 1986.

Term loans to Brazilian obligors decreased by $3.6 million during the first quarter of 1986. Of this decrease, $2.9 million represents the planned conversion of an existing term loan to the Central Bank of Brazil as an investment in Banco Denasa, while the remaining $0.7 million represents a collection of principal.

During the first quarter of 1986, interest accrued and cash payments representing interest collected on the Corporation's term loans to borrowers in Brazil totaled approximately $14 million and $16 million, respectively. Accrued interest receivable on these loans was approximately $11 million at March 31, 1986, compared with approximately $13 million at December 31, 1985.

During the first quarter of 1986, a proposed agreement has been reached as the result of negotiations with the Brazilian government. Under this agreement, 1985 and 1986 term loan maturities to Brazilian obligors will be extended through March, 1987. In addition, the proposed agreement calls for the Corporation to maintain a combined level of trade finance and deposit placement facilities with Brazilian banks of $355 million, which represents no incremental Brazilian cross-border commitments for these types of financing activities.

The restructure arrangements described above are intended to assist Mexico and Brazil in alleviating their liquidity problems. However, continuing uncertainties in Mexico, Brazil and other foreign countries that have experienced liquidity problems make it possible that further deterioration could occur, and that additional loans could be classified as nonperforming, with a resulting adverse impact on the Corporation's earnings.

First Chicago Corporation and Subsidiaries
Consolidated Balance Sheet

(In Thousands)	March 31 1986	March 31 1985	December 31 1985
Assets			
Cash and due from banks—noninterest bearing	$ 2,494,446	$ 2,400,021	$ 2,408,621
Due from banks—interest bearing	4,668,835	5,391,617	4,743,061
Federal funds sold and securities under resale agreements	1,267,676	2,244,486	1,294,404
Trading account assets	1,934,083	713,369	2,187,246
Investment securities (market values—$1,720,136, $1,607,075 and $2,003,393, respectively)	1,615,357	1,687,779	2,011,694
Loans	24,582,598	25,624,236	24,190,368
Less Allowance for loan losses	459,864	306,374	431,643
Loans, net	24,122,734	25,317,862	23,758,725
Premises and equipment	462,208	454,370	462,375
Accrued income receivable	387,050	465,414	409,504
Customers' acceptance liability	623,307	1,316,537	850,306
Other assets	539,421	649,748	766,670
Total assets	$38,115,117	$40,641,403	$38,892,506
Liabilities			
Deposits			
Demand	$ 5,111,500	$ 4,234,543	$ 5,420,424
Savings	2,626,036	2,335,133	2,541,630
Time	6,165,586	7,457,553	6,477,086
Foreign offices	13,302,590	15,749,206	12,708,395
Total deposits	27,205,712	29,676,435	27,147,535
Federal funds purchased and securities under repurchase agreements	4,240,607	4,199,372	5,167,931
Commercial paper	571,376	444,112	362,399
Other funds borrowed	1,461,038	1,546,781	1,447,307
Long-term debt	850,163	433,334	841,690
Acceptances outstanding	623,369	1,316,537	850,306
Other liabilities	989,377	876,306	985,294
Total liabilities	35,941,642	38,692,837	36,802,462
Stockholders' Equity			
Preferred stock—without par value, authorized 10,000,000 shares			
Issued and Outstanding:			
Series A ($50 stated value)— 2,500,000 shares	125,000	125,000	125,000
Series B ($100 stated value)— 1,250,000 shares	125,000	125,000	125,000
Series C ($100 stated value)— 750,000 shares	75,000	75,000	75,000
Common stock—$5 par value	267,994	237,375	259,792
Number of shares authorized—80,000,000, 54,000,000 and 80,000,000 respectively			
Number of shares issued—53,598,842, 47,475,012 and 51,958,347, respectively			
Number of shares outstanding—53,387,334, 47,321,355 and 51,764,586, respectively			
Surplus	918,334	811,993	881,309
Retained earnings	681,823	584,870	642,718
Translation adjustments	(15,841)	(8,068)	(15,328)
Total	2,177,312	1,951,150	2,093,491
Less Treasury stock at cost, 211,528, 153,657, and 193,761 shares, respectively	3,837	2,584	3,447
Stockholders' equity	2,173,475	1,948,566	2,090,044
Total liabilities and stockholders' equity	$38,115,117	$40,641,403	$38,892,506

NOTE: The results for 1985 have been restated to reflect the adoption of Statement of Financial Accounting Standards No. 87 relating to accounting for pension costs.

First Chicago Corporation and Subsidiaries
Consolidated Income Statement

Three Months Ended (In Thousands)	March 31 1986	March 31 1985	December 31 1985
Interest Income			
Interest and fees on loans	$657,969	$742,097	$680,513
Interest on bank balances	99,606	121,006	95,697
Interest on Federal funds sold and securities under resale agreements	25,394	47,392	35,918
Interest on trading account assets	44,402	29,451	34,206
Interest on investment securities			
United States Government and Federal Agency	11,981	13,822	15,090
States and political subdivisions	8,726	8,914	8,361
Other (including dividends)	8,829	10,427	9,715
Total	856,907	973,069	879,520
Interest Expense			
Interest on deposits	444,082	527,205	463,905
Interest on Federal funds purchased and securities under repurchase agreements	96,379	117,936	102,534
Interest on commercial paper	8,094	7,721	8,013
Interest on other funds borrowed	31,067	42,725	28,524
Interest on long-term debt	17,554	12,416	17,944
Total	597,176	708,003	620,920
Net Interest Income	259,731	265,066	258,600
Provision for loan losses	100,000	80,000	90,000
Net Interest Income After Provision for Loan Losses	159,731	185,066	168,600
Noninterest Income			
Trading account profits	12,048	3,677	12,362
Foreign exchange trading profits	24,237	(4,617)	14,474
Fiduciary and investment management fees	26,287	22,247	23,499
Credit card fees	29,479	28,314	33,051
Service charges and commissions	43,741	42,376	44,751
Equity securities gains (losses)	19,859	23,375	34,682
Investment securities gains(losses)	19,413	210	625
Other income	11,968	7,048	14,831
Total	187,092	122,834	178,275
Noninterest Expense			
Salaries	112,354	100,433	119,271
Employee benefits	24,394	18,206	13,876
Occupancy expense of premises, net	26,732	25,639	25,947
Equipment rentals, depreciation and maintenance	17,976	16,017	18,342
Other expense	74,484	70,248	89,831
Loss from an affiliate investment	-0-	15,752	-0-
Total	255,940	246,295	267,267
Income Before Income Taxes	90,843	61,605	79,706
Applicable income taxes	27,600	21,700	20,300
Net Income	$63,243	$39,905	$59,406
Net Income Attributable to Common Stockholders' Equity	$56,722	$32,277	$52,522
Earnings per Common and Common Equivalent Share	$1.26	$0.68	$1.24
Average Number of Common and Common Equivalent Shares Outstanding	53,345,906	47,335,941	49,220,036

NOTE: The results for the three months ended March 31, 1985, have been restated to reflect the adoption of Statement of Financial Accounting Standards No. 87 relating to accounting for pension costs. As a result, net income for the three months ended March 31, 1985, increased by $1,600,000 or 3 cents per common share.

First Chicago Corporation and Subsidiaries
Consolidated Statement of Changes in Stockholders' Equity

Three Months Ended March 31 (In Thousands)	1986	1985
Stockholders' Equity		
Balance, beginning of period	$2,090,544	$1,924,159
Net income	63,043	39,905
Issuance of common stock	45,227	8,985
Translation adjustments	(523)	(1,022)
Other	(390)	(187)
	2,197,411	1,971,840
Cash dividends declared on preferred stock	(6,322)	(7,668)
Cash dividends declared on common stock	(17,615)	(15,616)

	1986	1985
Rate per common share for period	$0.33	$0.33

Balance, end of period	[illegible]	[illegible]

First Chicago Corporation and Subsidiaries
Consolidated Statement of Changes in Financial Position

Three Months Ended March 31 (In Thousands)	1986	1985
Financial Resources were provided by (applied to)		
Operations		
Net income	$ 63,043	$ 39,905
Noncash charges (credits)		
Provision for loan losses, depreciation, amortization, deferred income taxes	104,932	98,581
Financial resources provided by operations	167,975	138,486
Cash dividends declared	(23,936)	(23,284)
Net financial resources provided by operations	144,039	[illegible]
Deposits and other financing activities		
Deposits	55,177	1,084,518
Federal funds purchased and securities sold under repurchase agreements	(927,124)	(597,737)
Commercial paper	208,977	74,930
Other funds borrowed	(6,269)	(166,783)
Long-term debt	8,473	202,003
Common stock issued	45,227	8,985
Total financial resources provided by (applied to) deposits and other financing activities	(612,539)	605,756
Nonearning assets and liabilities		
Cash and due from banks	(85,825)	(125,459)
Premises and equipment, net	(23,330)	(19,477)
Other, net	201,310	(106,029)
Total financial resources provided by (applied to) nonearning assets	[illegible]	(250,964)
Increase (decrease) in financial resources invested in earning assets	[illegible]	[illegible]
Increase (decrease) in earning assets:		
Due from banks—interest bearing	$ (74,226)	$ 589,961
Federal funds sold and securities purchased under agreement to resell	(26,728)	116,857
Trading account assets	(253,063)	(287,794)
Investment securities	(336,337)	(62,699)
Loans, net	[illegible]	[illegible]
Increase (decrease) in earning assets	[illegible]	[illegible]

Footnotes to Consolidated Financial Statements

Note 1

Earnings per share amounts for the first three months of 1986 and 1985 were computed based on 53,345,904 and 47,155,981 common and common equivalent shares outstanding. Common equivalent shares consist of shares issuable under the employee stock purchase plan, outstanding stock options, performance share grants and restricted shares. The potential aggregate dilutive effect of common share equivalents on earnings per share was less than three percent during both periods.

Note 2

While the interim amounts are unaudited, they do reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the results of operations for the interim periods. Because the results from commercial banking operations are so closely related and responsive to changes in economic conditions, fiscal policy and monetary policy, the results for any interim period are not necessarily indicative of the results that can be expected for the entire year.

Note 3

Standby letters of credit amounting to approximately $5.0 billion were outstanding at March 31, 1986 and March 31, 1985, and approximately $4.8 billion at December 31, 1985. In the normal course of business there are outstanding various other commitments and contingent liabilities, such as commitments to extend credit, foreign exchange forward contracts, guarantees, etc., which are not reflected in the accompanying financial statements. Management does not anticipate any material loss as a result of these transactions.

Note 4

The ratio of income to fixed charges for the three months ended March 31, 1986 excluding interest on deposits was 1.5, and including interest on deposits was 1.1. The ratio has been computed on the basis of the total enterprise (as defined by the Securities and Exchange Commission) by dividing income before fixed charges and income taxes by fixed charges. Fixed charges consist of interest expense on all long- and short-term borrowings, excluding or including interest on deposits as indicated.

Note 5

On November 13, 1984 an agreement was entered into between the Corporation's subsidiary, The First National Bank of Chicago, ("Bank") and the Comptroller of the Currency that primarily addressed the Bank's capital, funding and asset quality. This agreement has been terminated by mutual consent in March of 1986.

First Chicago Corporation and Subsidiaries
Selected Statistical Information

Average Balances/Interest Differential/Rates — Three Months Ended March 31

(Income and rates on tax-equivalent basis) (Dollars in Millions)	1986 Average Balance	1986 Interest	1986 Average Rate	1985 Average Balance	1985 Interest	1985 Average Rate
Assets						
Due from banks—interest bearing (A)	$ 4,963	$ 99.6	8.14%	$ 5,137	$121.0	9.55%
Federal funds sold and securities under resale agreements	1,363	25.4	7.56	2,165	47.4	8.88
Trading account assets*	2,136	46.6	8.85	1,192	30.4	10.34
Investment securities						
United States Government and Federal Agency	540	12.0	9.01	563	13.8	9.94
States and political subdivisions*	534	15.7	11.92	558	15.9	11.56
Other*	534	12.2	9.27	630	14.6	9.40
Loans (B)(C)						
Domestic*	17,481	503.1	11.32	17,447	532.6	11.98
Foreign	6,632	166.1	10.09	7,726	220.8	11.54
Loans	24,113			25,173		
Total earning assets	34,183			35,418		
Cash and due from banks—noninterest bearing	2,215			2,087		
Allowance for loan losses	(438)			(304)		
Other assets	2,672			2,784		
Total assets/Total interest income (D)	$38,582	$880.7		$39,985	$996.5	
Liabilities and Stockholders' Equity						
Deposits						
Demand	$ 4,237			$ 4,035		
Savings	2,586	$ 39.7	6.23	2,321	$ 39.7	6.94
Time	6,265	139.0	9.00	6,910	165.8	9.73
Foreign offices (E)	13,816	265.4	7.79	14,420	321.7	9.05
Total deposits	26,904			27,686		
Federal funds purchased and securities under repurchase agreements	5,022	96.4	7.78	5,533	118.0	8.65
Commercial paper	418	8.1	7.84	324	7.7	7.64
Other funds borrowed	1,484	31.0	8.47	1,807	42.7	9.58
Long-term debt	846	17.6	8.44	545	12.4	9.23
Other liabilities	1,764			2,149		
Preferred stock	325			325		
Common stockholders' equity	1,819			1,616		
Total liabilities and stockholders' equity/Total interest expense	$38,582	$597.2		$39,985	$708.0	
Interest Income/Earning Assets		$880.7	10.45		$996.5	11.41
Interest Expense/Earning Assets		597.2	7.09		708.0	8.11
Interest Differential		$283.5	3.36%		$288.5	3.30%

*Includes tax-equivalent adjustment based on 46% Federal income tax rate.

(A) Principally balances in overseas offices.

(B) Includes fees on loans of $22,561,000 and $24,366,000 for the three months ended March 31, 1986 and 1985. Rates are calculated exclusive of fee income.

(C) Includes amortization of investment tax credits on a tax-equivalent basis of $2,779,000 and $3,306,000 for the three months ended March 31, 1986 and 1985. Rates are calculated on balances reduced by deferred liability for taxes and deferred investment tax credits.

(D) Includes tax-equivalent adjustments based on 46% Federal income tax rate of $23,746,000 and $23,483,000 for the three months ended March 31, 1986 and 1985.

(E) Includes International Banking Facilities deposit balances in domestic offices and balances of Edge Act and overseas offices.

First Chicago Corporation and Subsidiaries
Selected Statistical Information (Continued)

March 31 (In Millions)	1986	1985
Loans and Deposits		
Loans		
Domestic		
Commercial	$ 7,188	$ 7,599
Secured by real estate		
Construction	1,581	1,658
Mortgage	1,930	1,808
Financial institutions	1,396	1,446
Consumer	3,690	3,355
Lease financing	427	389
Other	1,936	1,745
Total domestic	18,148	18,000
Foreign	6,433	7,624
Total loans	$24,581	$25,624
Deposits—Domestic		
Demand		
Individuals, partnerships and corporations	$ 4,097	$ 3,057
Foreign governments and official institutions	9	7
United States Government	13	14
States and political subdivisions	171	162
Banks	738	781
Certified and official checks	83	113
Total demand deposits	5,111	4,134
Savings	2,626	2,335
Time		
Individuals, partnerships and corporations	5,299	6,536
Foreign governments and official institutions	9	84
States and political subdivisions	324	312
Other	534	526
Total time	6,166	7,458
Foreign offices	13,300	15,749
Total deposits	$27,203	$29,676

First Chicago Corporation and Subsidiaries
Selected Statistical Information (Continued)

	1986	1985			
(Dollars in Millions)	March 31	December 31	September 30	June 30	March 31
Loan Statistics					
Beginning of the quarter allowance for loan losses...	$ 431.6	$ 411.3	$ 330.8	$ 306.4	$ 291.7
Provision for loan losses for the quarter....................................	100.0	90.0	150.4	90.8	80.0
Net charge-offs for the quarter........................	71.7	69.7	69.9	66.4	65.3
End of the quarter allowance for loan losses.........	459.9	431.6	411.3	330.8	306.4
Loans outstanding at quarter-end......................	24,583	24,190	25,430	25,504	25,624
Average loans for the quarter...........................	24,113	24,573	24,837	25,329	25,173
Allowance for loan losses/loans outstanding..........	1.87%	1.78%	1.62%	1.30%	1.20%
Analysis of Net Charge-Offs (During the Quarter)					
Charge-Offs					
Domestic					
Commercial....................................	$14.1	$16.1	$26.4	$31.5	$28.4
Secured by real estate..........................	3.6	3.1	0.3	0.1	0.4
Consumer......................................	34.7	30.2	26.7	24.6	22.8
Other..	2.4	2.3	0.4	2.3	0.4
Foreign..	26.4	32.3	22.8	17.7	20.2
Total charge-offs....................	81.2	84.0	76.6	76.2	72.2
Recoveries					
Domestic					
Commercial....................................	4.7	6.8	0.8	3.9	2.0
Secured by real estate..........................	0.1	0.5	0.3	0.4	0.6
Consumer......................................	4.1	3.6	3.4	3.2	2.7
Other..	0.2	-	0.1	0.4	0.2
Foreign..	0.4	3.4	2.1	1.9	1.4
Total recoveries....................	9.5	14.3	6.7	9.8	6.9
Net charge-offs....................	$71.7	$69.7	$69.9	$66.4	$65.3

First Chicago Corporation and Subsidiaries
Selected Statistical Information (Continued)

(Dollars in Millions, except per share data)	1986 March 31	1985 December 31	1985 September 30	1985 June 30	1985 March 31
Selected Financial Data					
For the Quarter Ended					
Net interest income	$259.7	$258.6	$259.2	$270.1	$265.1
Tax-equivalent adjustment	23.8	23.6	22.2	22.9	23.4
Net interest income— tax-equivalent basis	283.5	282.2	281.4	293.0	288.5
Provision for loan losses	100.0	90.0	130.4	90.8	80.0
Net income	63.0	55.4	58.0	11.7	39.9
Per common share	1.06	1.04	1.04	0.08	0.68
Dividends declared					
Per common share	0.33	0.33	0.33	0.33	0.33
At Quarter-End					
Total assets	$38,115	$38,893	$40,157	$39,922	$40,641
Total deposits	27,206	27,148	28,587	28,225	29,676
Loans	24,585	24,190	25,430	25,504	25,624
Long-term debt	850	842	843	838	633
Stockholders' equity	2,173	2,090	2,021	1,964	1,949
Financial Ratios					
For the Quarter Ended					
Net income as a percentage of:					
Average stockholders' equity	11.93%	11.40%	11.35%	2.38%	8.34%
Average common stockholders' equity	12.63	11.96	11.87	0.99	8.09
Average total assets	0.66	0.61	0.60	0.11	0.40
Average earning assets	0.75	0.69	0.68	0.13	0.46
Stockholders' equity at quarter-end as a percentage of:					
Total assets at quarter-end	5.7	5.4	5.0	4.9	4.8
Total loans at quarter-end	8.8	8.6	8.0	7.7	7.6
Total deposits at quarter-end	8.0	7.7	7.1	7.0	6.6
Average stockholders' equity as a percentage of:					
Average assets	5.6	5.3	5.3	4.8	4.9
Average loans	8.9	8.4	8.2	7.8	7.7
Average deposits	8.0	7.6	7.5	6.9	7.0
Common Stock and Stockholder Data					
For the Quarter Ended					
Market price					
High	$32 7/8	$30 1/8	$25 5/8	$26 5/8	$26 1/4
Low	26 3/4	20 1/4	21 1/8	21	20 1/8
At quarter-end	32 3/4	29 1/2	21 1/2	22 1/4	21 1/4
Price earnings ratio (quarter-end market)	10.2	10.4	7.6	*	23.6
Common stockholders' equity per share (at quarter-end)	$34.62	$34.10	$33.91	$33.66	$34.31

*Not meaningful

NOTE: The Corporation has adopted Statement of Accounting Standards No. 87 - Employers' Accounting for Pensions. As a result, the above statistical information, where applicable, has been restated for the first three quarters of 1985 to reflect the necessary changes. As a result of adopting this change, net income increased by $1.6 million or approximately $0.03 per common share for each of the first three quarters of 1985.

First Chicago Corporation and Subsidiaries
Selected Statistical Information (Continued)

Investment Securities

The book value and market value of investment securities included in the consolidated financial statements as of March 31, 1986 were:

(In Millions)	Book Value	Market Value
United States Government and Federal Agency	$ 446	$ 442
States and political subdivisions	527	513
Other (including Federal Reserve Bank stock)	652	765*
	$1,625	$1,720

The maturities of certain securities as of March 31, 1986 are set forth below:

(In Millions)	United States Government and Federal Agency	States and Political Subdivisions
Maturities		
One year and under	$254	$ 6
One through five years	95	141
Five through ten years	-	138
Over ten years	97	242
	$446	$527
Average Maturities	4 yrs. 9 mos.	11 yrs. 4 mos.

*Estimated for certain securities for which market quotations were not available.

FORM - 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Quarterly Report Under Section 13 or 15(d)
of the Securities Exchange Act of 1934

For Quarter Ended March 31, 1986 Commission file number 1-6052

FIRST CHICAGO CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	36-2669970
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

ONE FIRST NATIONAL PLAZA CHICAGO, ILLINOIS	60670
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code........ 312 - 732-4000

NO CHANGE

Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No____

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of April 30, 1986.

Class	Number of Shares Outstanding
Common Stock $5 par value	53,836,525

Form 10-Q Cross Reference Index

PART I - FINANCIAL INFORMATION

PART II - OTHER INFORMATION

PART II - OTHER INFORMATION

ITEM 6. Exhibits and Reports on Form 8-K.

(a) Exhibit 12 Statements re computation of ratios.

(b) Reports on Form 8-K.

The Registrant did not file a Report on Form 8-K during the quarter ended March 31, 1986.

EXHIBIT INDEX

Exhibit Number	Description of Exhibit	Page
12 -	Statements re computation of ratios.	26

COMPUTATION OF RATIOS OF INCOME TO FIXED CHARGES

The computation of the ratios of income to fixed charges is set forth in Note 4 of Notes to Consolidated Financial Statements on page 16 of the Form 10-Q.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FIRST CHICAGO CORPORATION
(Registrant)

Date May 13, 1986

Barry F. Sullivan
Chairman of the Board

Date May 13, 1986

Charles H. Montgomery
Principal Accounting Officer

END

DREXEL BURNHAM LAMBERT

ANNUAL REVIEW 1985

THE YEAR IN QUOTES

"The nature of our business encourages creativity. We finance the world's entrepreneurs. Some of the brightest and most imaginative people in the world pass through our doors. We are inspired by our clients, and challenged by their ideas."

"Our creativity stems from our ability to analyze problems, devise solutions and make these solutions feasible. We can get people excited, infuse them with the Drexel Burnham spirit of innovation and let them go."

"People have seen us come up with unusual solutions that work, so now when they've got a particularly knotty problem they'll bring it right to us. They know we'll approach it in a new way, and they know we won't quit until it's solved. The end result is that everyone in the transaction is better off than before."

"A 'can-do' attitude lets us aim for ever higher levels of performance."

"I think the words that best describe us are creativity, innovation, flexibility and teamwork. They can be clichés – but they've been real at Drexel Burnham. We couldn't have achieved the position we have today without all of these forces working together."

Contents

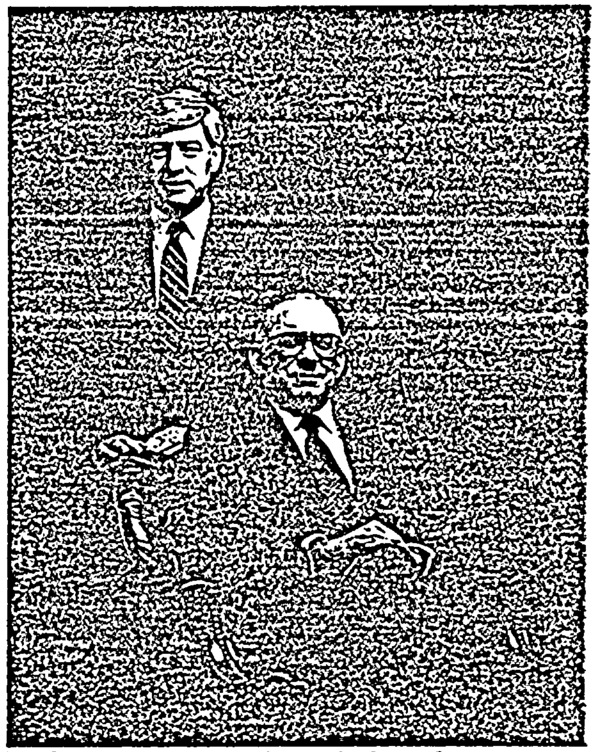
MANAGEMENT LETTER
TO OUR CLIENTS AND FRIENDS

In 1985 Drexel Burnham Lambert achieved by far its most profitable year to date. Revenues set a new record, approximately doubling and surpassing the $2 billion mark. Our capital base expanded from $560 million to nearly $950 million at year-end, of which 76 percent was equity. The book value of our stock appreciated 73 percent and the number of employees continued to expand, approaching 8,000 worldwide.

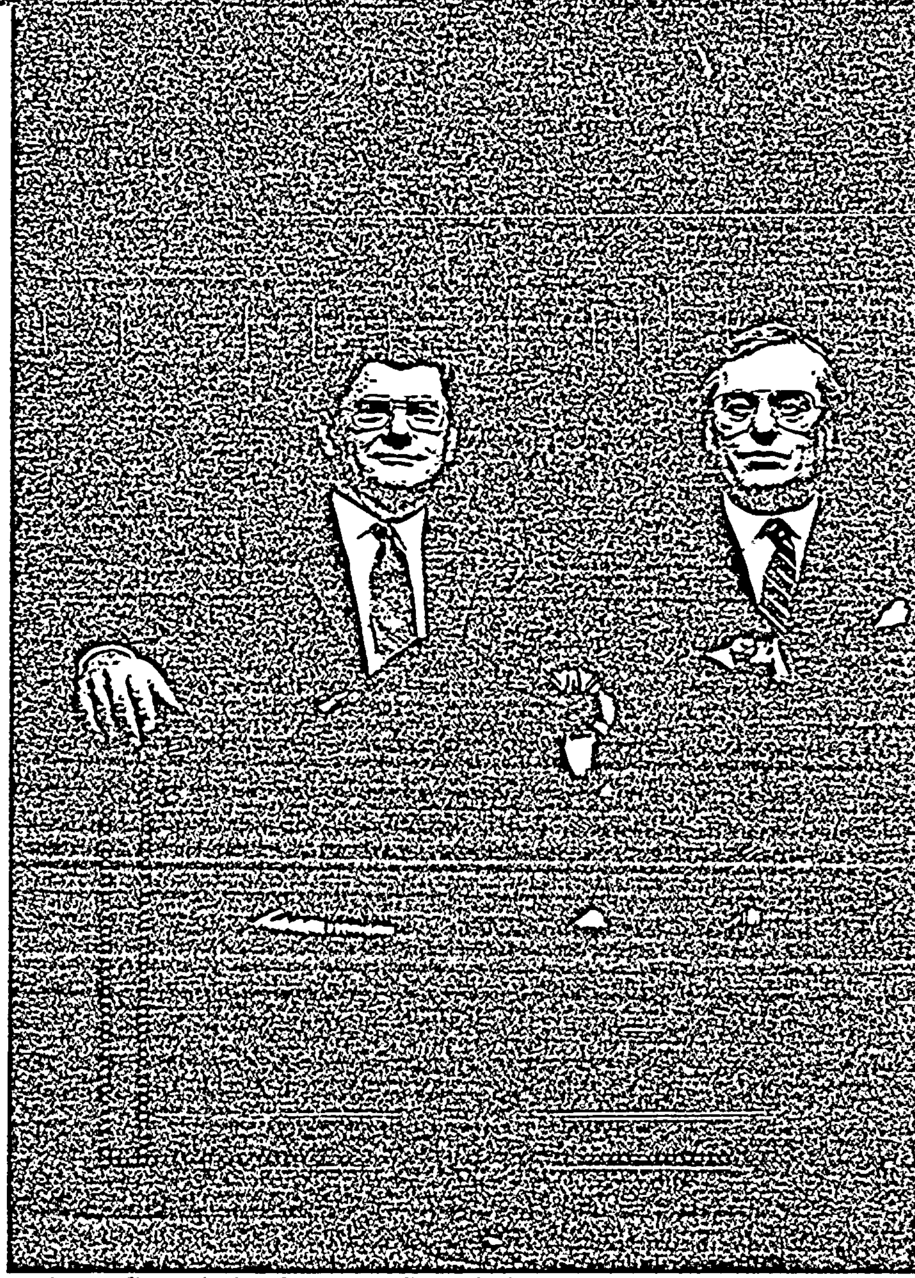
We believe this success is a direct result of our value-added approach to financial problem-solving. Through innovation, individual tailoring, and a deep sense of commitment, we are helping our clients more effectively adapt to economic changes and volatile financial markets.

This year's Annual Review explores five fundamental themes in our value-added approach, as expressed by a representative group of our professionals from a wide spectrum of business areas. On the following pages they present their own views on how and why Drexel Burnham is well-positioned to provide consistently superior service.

Several senior management appointments were announced in 1985. In May, coincident with Robert E. Linton's sixtieth birthday, the post of Chief Executive Officer was passed to Frederick H. Joseph, previously head of Corporate Finance. Mr. Joseph was also elevated to Vice Chairman of the Board. Mr. Linton remains Chairman of the Board and of the Executive Committee. James Balog was appointed Vice Chairman with responsibilities for Individual Investor Services and Edwin Kantor was named Vice Chairman in charge of Professional Investor Services. In addition, Herbert J. Bachelor was appointed Executive Vice President and a member of the Executive Committee with responsibilities for the firm's Investment Banking Division.


Robert E. Linton, Chairman of the Board, Chairman of the Executive Committee
Standing: Frederick H. Joseph, Chief Executive Officer, Vice Chairman of the Board

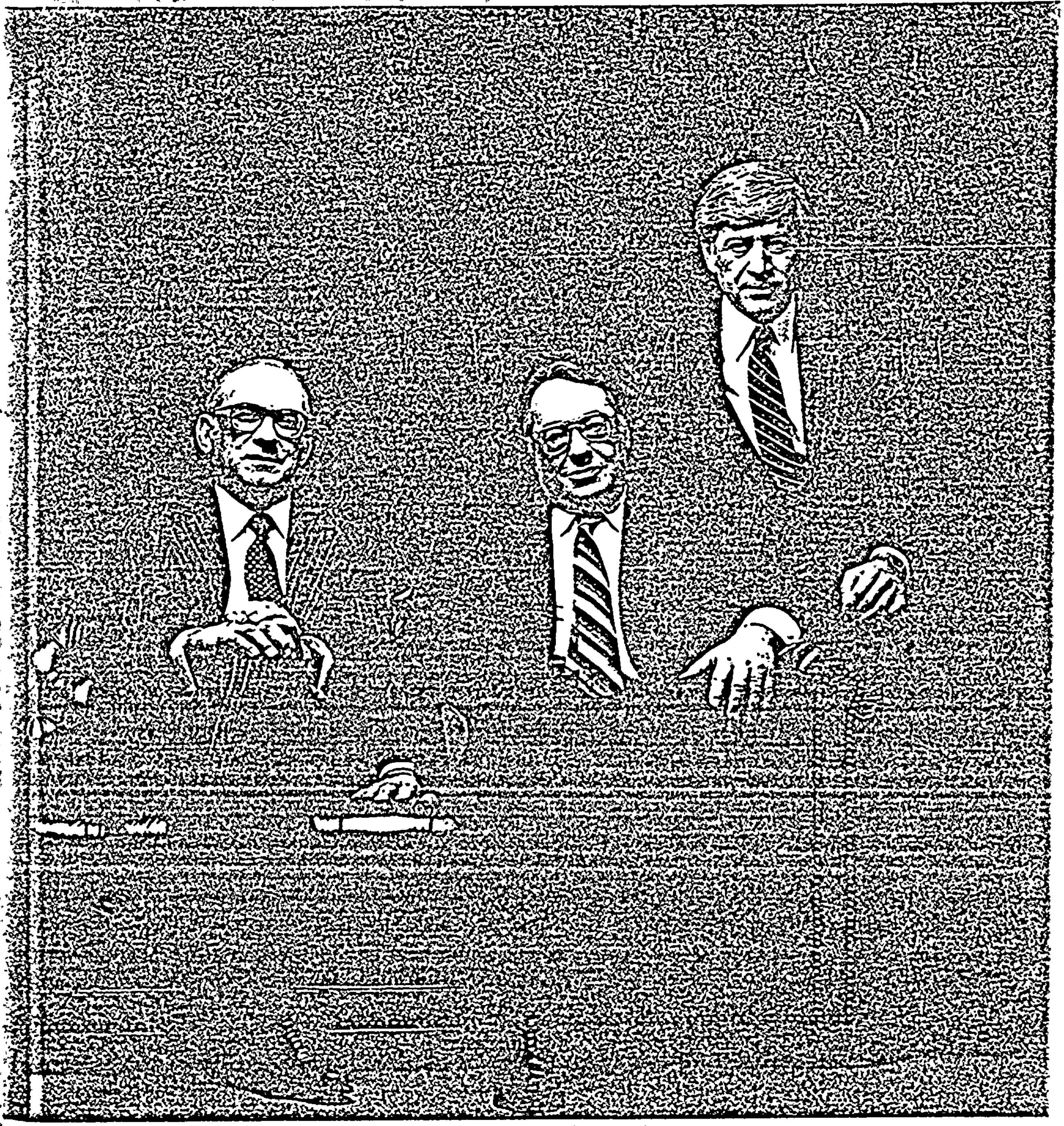
These appointments were made concurrently with the realignment of various line operations into three major business segments to accommodate the firm's rapid and dramatic growth: Investment Banking, Individual Investor Services and Professional Investor Services. Investment Banking includes corporate finance



James Balog, Vice Chairman of the Board; Edwin Kantor, Vice Chairman of the Board

and municipal finance activities. The Individual Investor Group includes retail securities brokerage, marketing and the asset management businesses of the firm. The Professional Investor Group encompasses the firm's trading departments and institutional sales and research activities.

All areas of the firm contributed to our successful year. The Corporate Finance and High Yield Bond Departments scored impressive gains. In corporate finance the firm ranked fifth in managed public offerings, lead managing over $13.3 billion in public underwritings for an increase of 27 percent over 1984. For corporate issues managed or co-managed, we raised $16 billion. Drexel Burnham emerged as a leading source of funds to finance leveraged buyouts, acquisitions and corporate financings, both in the public and private sectors. In private placement financings, the firm rose from sixth to second place in the rankings, raising over $7.3 billion, an increase of 170 percent over 1984. In the area of mergers and acquisitions, the combination of Drexel Burnham's financing strengths and merger expertise led to participation in many of the year's most noteworthy transactions. The number of completed transactions was more than double that of the preceding year, and the dollar volume of those transactions completed or pending at year-end exceeded $24 billion.



Robert E. Linton, Chairman of the Board; Joseph A. Vitanza, President; Frederick H. Joseph, Chief Executive Officer

To enhance services for individual investors, our branch system was restructured in 1985. Satellite offices in several markets were consolidated into major regional centers, and we continued to expand in a number of areas of the country, including Detroit, Michigan; Newport Beach, California; and Orlando, Florida.

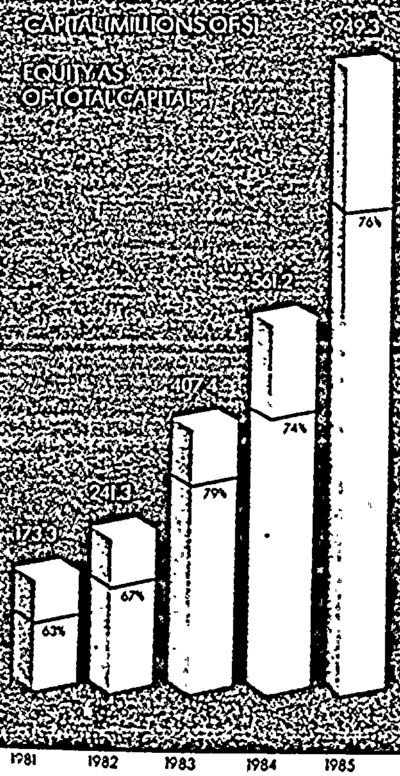
Rising values in both the equity and fixed income markets contributed to record trading profits. Continuing as major growth areas were the Mortgage-Backed Securities, Municipal Finance and Government Securities Departments. Formed in early 1984, the Mortgage-Backed Securities Department has grown to over 250 employees and ranked fifth in dollar volume as lead manager of underwritten collateralized mortgage obligations issued in 1985, raising $870 million.

The uncertainty created in the municipal marketplace by proposed tax legislation brought many municipal borrowers to the capital markets in 1985. Our Municipal Finance Department managed or co-managed over $23 billion of municipal securitie and catapulted in the rankings to place among the top firms in this area.

Our Government Securities Department posted a record yea largely due to increased Treasury and zero coupon trading and a 23 percent increase in our matched book portfolio. Mark-

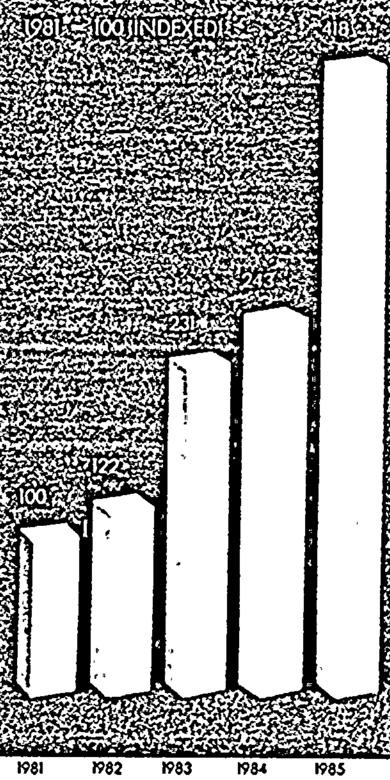
TOTAL YEAR-END CAPITAL

Drexel Burnham's capital base at year-end 1985 exceeded 500 percent of the 1981 figure. Today, the firm ranks, by capital, as the second largest privately held investment banking firm.

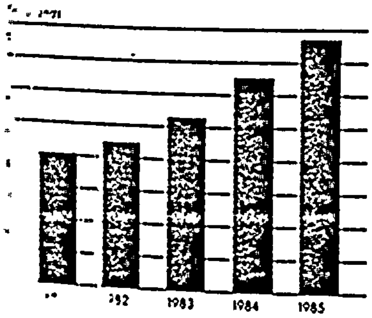


GROSS REVENUE

Drexel Burnham's revenues reached a new level in 1985, surpassing the $2 billion mark for the first time. The year's record performance represented the continuation of an unbroken history of profitability since our founding in 1935.



Employee Growth
In 1985 the total number of employees reached 7,680, nearly double the number of 1981.

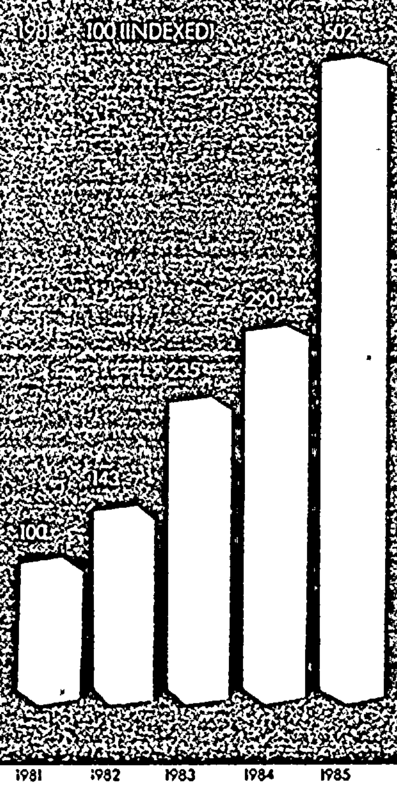


penetration increased from an average 2.8 percent share of market in Treasury securities in 1984 to a peak of 6.8 percent in the fourth quarter of 1985 for a total annual volume of $1.5 trillion.

During 1985 our firm's operations continued to be influenced by the activity–and often inactivity–of government. Congress again failed to act on comprehensive legislation that would clarify the powers of banks and reaffirm their specialized role in the economy. Drexel Burnham's financing activity is having a widening impact on national economic policy issues. As a consequence, we have devoted a significant effort to dealing with federal and state legislators and regulatory bodies to ensure that policy

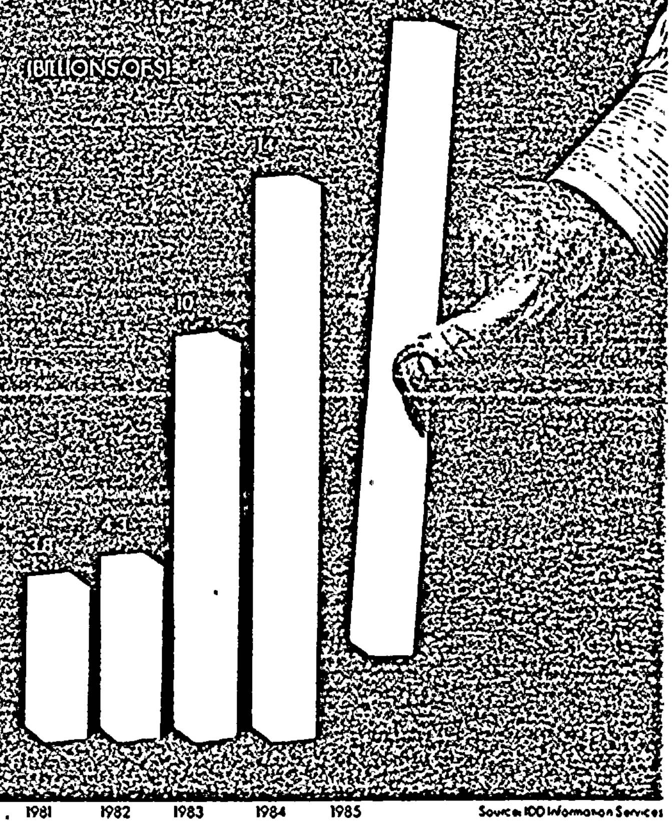
BOOK VALUE PER SHARE

The book value per share of our stock appreciated 73 percent in 1985. Over the past five years, the book value has increased at an average annual compound growth rate of 50 percent.



UNDERWRITINGS MANAGED OR CO-MANAGED

In 1985 Drexel Burnham managed or co-managed 213 public offerings, raising $16 billion. This represents an annual average compound growth rate of 44 percent over the past five years. In the category of lead manager, we raised over $13 billion, ranking us among the top five investment banking firms.



Source: IDD Information Services

changes will be constructive without inhibiting the efficient functioning of the capital markets.

Given the high level of uncertainty in almost every sphere, predicting the course of governmental actions, the economy or the markets in 1986 is unusually challenging. Actions over which our firm has little or no control—changes in tax laws, political unrest overseas, or violent market swings—can affect our performance. But there are many reasons for optimism.

Our innovative culture and management strengths position us to adapt swiftly to change. The firm is more diverse than at any time in its history and is developing several profitable new lines of business. Our commitment to hiring the best, hardest working people remains constant. And our philosophy of providing value-added services to our clients has been demonstrated by over 50 years of performance. We are ready for the future.

Robert E. Linton

Robert E. Linton
Chairman of the Board, Chairman of the Executive Committee

Fred Joseph

Frederick H. Joseph
Chief Executive Officer, Vice Chairman of the Board

THE YEAR IN QUOTES

"At Drexel Burnham we're surrounded by unusually bright, talented people in every department. To work here and not take advantage of them would be like living in a library and never reading a book."

"This is a no-holds place. We jump through hoops for our clients, always remembering that without them we'd be just a bunch of warm bodies."

"We are uniquely oriented toward the value-added transactions. Transactions that we have structured enhance the market val the client company in a very substantial way."

"THERE'S A WONDERFUL OPENNESS HERE AND A WILLINGNESS TO BE HELPFUL THAT EXISTS AT ALL LEVELS. IT MAKES MY JOB EASIER AND LETS ME GET THINGS DONE FOR MY CLIENTS."

PROLOGUE

It is 4:15 am Eastern time. Except for an occasional passing cab, the streets of New York's Upper East Side are silent and deserted.

In an apartment high above street level, a man in shirtsleeves sits at a computer terminal with a phone in his hand. After trading through the night on the Tokyo and Hong Kong exchanges, he's bringing London up-to-date on trading patterns in Treasuries.

By 7:30 am, the trader is downtown, preparing for his final meeting of the day with the heads of trading for equities, fixed-income, mortgage-backed, corporate, municipal, and money market securities.

On the West Coast, it is 4:30 am. Traders and salesmen are seating themselves at desks lined with monitors and keyboards. Their telephone panels are aglow with flashing lights, and the room is humming with conversations among traders, salesmen, clients, and contacts around the world.

In Zurich, it's early afternoon. Although the gold market has been calm all morning, impending political news could cause a radical shift in the market. Drexel Burnham's open wire system keeps traders continually informed of trading activity and news events throughout our worldwide network.

In London, an analyst presents information about the U.S. automotive industry to a group of European investors. He distributes a research report that has just been published in New York and translated into several languages.

At 8:30 am in New York, five members of the Corporate Finance Department are holding a breakfast meeting. A managing director explains a client's dilemma and two proposed solutions. In the ensuing discussion a third approach emerges, and associates are assigned to determine the relative merits of each.

By mid-morning, a vice president in the mergers and acquisitions area is on the phone, discussing the legal implications of a tende defense. Next door, three people are planning strategies for the sale of a private company. Further down the hall, an associate confirms a prospectus shipment for a five-tiered financing, and a leveraged buyout specialist prepares a pro forma analysis for a company considering a management buyout.

In the early afternoon, municipal finance and leasing speciali are working together to lower the cost of financing an alternative energy project. A team of real estate professionals reviews the marketing materials for their upcoming public offering. And members of the Mortgage-Backed Securities Department meet with the manager of the Interest Rate Products Group to improve an institutional client's risk profile.

Throughout the day, Drexel Burnham research analysts will hold meetings and review their opinions about specific companies and industries. Private placement specialists will complete a transaction and initiate another. Corporate finance specialists will plan an initial public offering for a growing business and restructure the debt of a company in decline.

In over 40 offices across the U.S., Drexel Burnham account executives will guide thousands of investors toward their individual objectives. They'll design strategies, make recommendations, distribute research reports and place orders to help client take advantage of opportunities in global securities markets.

In a typical day, Drexel Burnham serves the full spectrum of financial needs of corporations, institutions and individual investors worldwide. Coordinating the efforts of dozens of departments in 11 countries takes more than memos and telephones. It takes a spirit of teamwork and an extraordinary sense of commitment. That commitment is evident not only in the analysis that goes into our work, but also in the tailored and creative solutions that come out of it. But most of all, it's evident i our people. Drexel Burnham isn't an impersonal corporation. It's 8,000 dedicated individuals, each making valuable contributio to the financial community.

Our people have a lot to say about how they do it. And on th following pages, a representative group of them does just that. No one can say more about performance at Drexel Burnham thc the people who are doing the job.

Constant innovation is recognized as a basic requirement for coping with the forces of change in today's capital markets. It's precisely this innovative perspective that both sets us apart and keeps us a step ahead of our competition.

Drexel Burnham is widely recognized as the leader in innovative financial problem-solving. Whether that leadership is expressed as a new type of security, a new investment strategy, or new ways for corporations to raise capital, our approach is the same. Instead of looking at standard solutions or conventional wisdom, we focus on the desired results and how to achieve them.

INNOVATION

Institutional Financial Futures

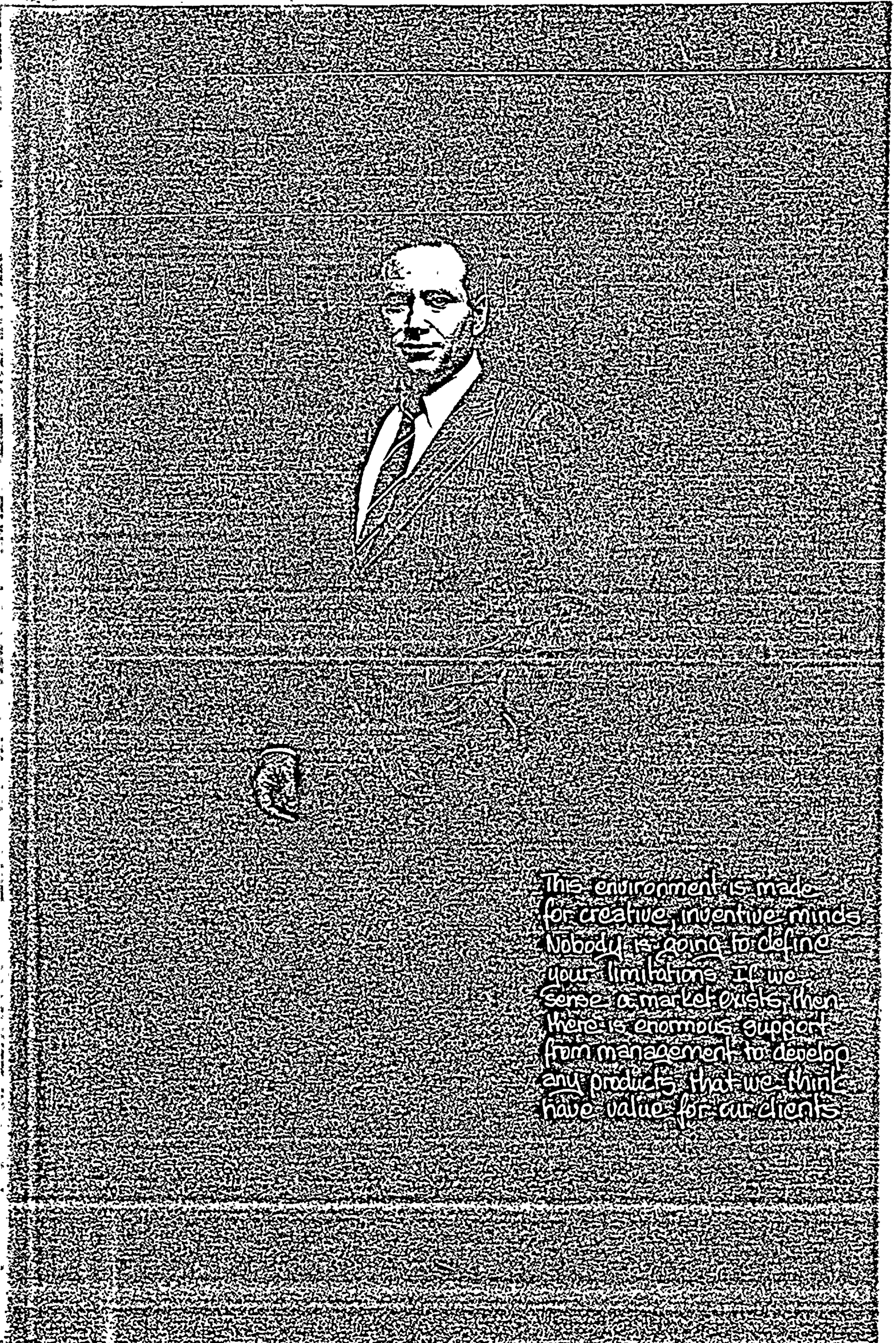
"I think the secret of Drexel Burnham's innovative approach lies in the firm's willingness to decentralize the corporate structure. This environment is made for creative, inventive minds. Nobody is going to define your limitations. If we sense a market exists, then there is enormous support from management to develop any products that have value for our clients. There are no rigorous committee proposals. If you can prove it makes sense, you're given all the freedom in the world to make it go.

"For example, here in Chicago we've developed and are selling a computer software package for accounting and regulatory reporting for financial futures. Nobody else is offering anything like it—even if they were creative enough to come up with it, it would be going through layers of approval from now until doomsday. Here, we thought of it; we showed management how it worked; and we got the go-ahead. Easy as that.

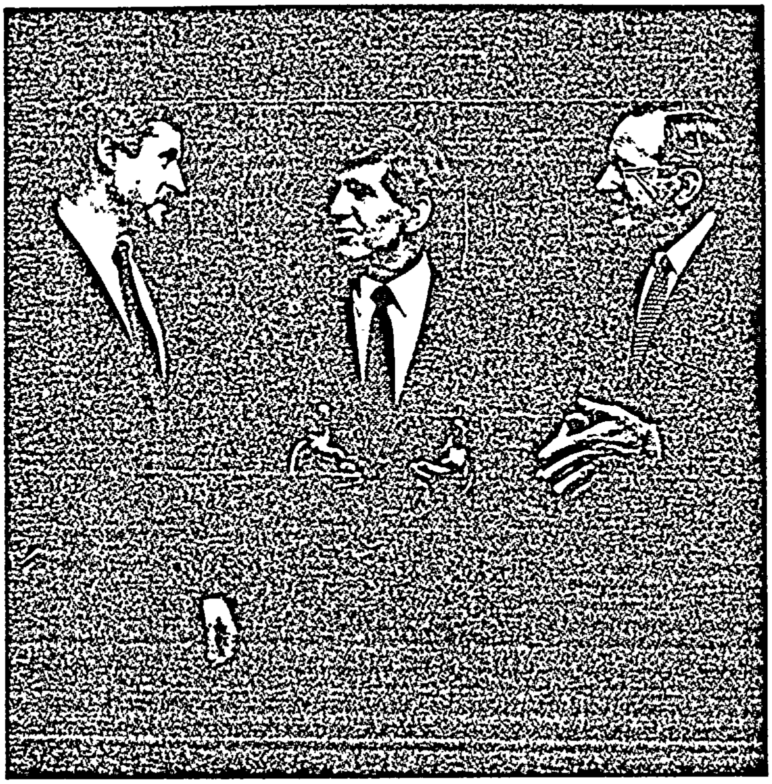
"We're pioneers in the financial futures area. We've been in the business since the day it started over ten years ago, and, according to industry figures, we've been consistently at or very near the top in terms of dollar volume done in most of the contracts since day one. Because we've been involved in writing contracts and serving on the boards of the exchanges, we have an insider's perspective not only of what works, but of why things fail when they do miss.

"You've got to be continually developing new ideas to sustain a record of consistent performance. Assuming you've got the talent—creativity grows out of necessity."

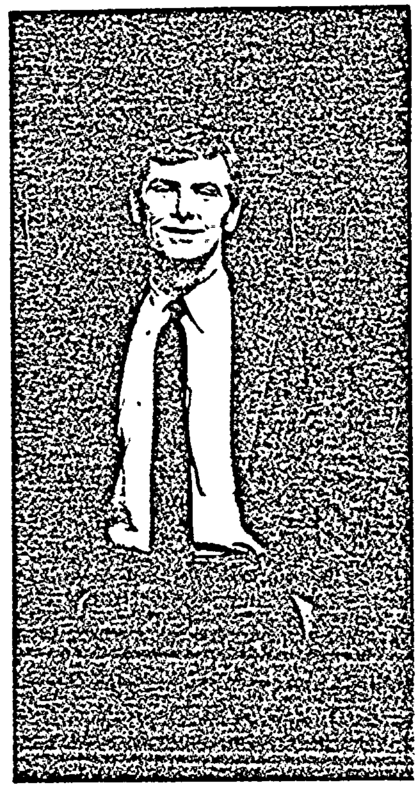
Richard L. Sandor, Senior Vice President, Chicago



This environment is made for creative, inventive minds. Nobody is going to define your limitations. If we sense a market exists, then there is enormous support from management to develop any products that we think have value for our clients.



George M. Douglas, G. Chris Andersen, Howard M. Brenner



Kenneth H. Sullivan

Quantitative Research

"To me, the word innovation means change for the better. Whether or not you believe that a mathematical approach to investment decision-making is the right one, you have to agree that quantitative methodologies are changing, if not totally transforming, the money management business.

"The DAIS (Decision Analysis Investment Systems) Group provides clients with access to the largest and most sophisticated set of common stock valuation models and data bases available on Wall Street. Armed with personal computers, they can screen through thousands of stocks, run endless 'what if' scenarios, back-test investment strategies and even optimize portfolios. This gives them a competitive edge when it comes to applying human judgment to the complex process of investment decision-making.

"To be the best in computer-based investment systems and quantitative disciplines is to be at the forefront of creative solutions in the financial marketplace as a whole, which is exactly where we plan to stay."

George M. Douglas, First Vice President

Corporate Finance

"In our firm's culture we have a fondness for ideas and a lack of fear in expressing ourselves. That creates an openness which is unique in large corporations. The nature of our business encourages creativity. Some of the brightest and most imaginative people in the world wander through our doors. We are inspired by our clients and challenged by their ideas.

"Drexel Burnham finances change, responding to changes in the world at large. Years ago we were taught that a balance sheet was a snapshot or photograph of the financial condition of a company on a single day in the year. And for a long time it was sufficient to look at the balance sheet just one day in the year because companies tended to change little over time. In recent years the economy and corporate structures have evolved at an extraordinarily rapid pace. The time frames are becoming shorte[r.] The demands on companies have increased and to keep up, the[y] must finance new opportunities, and restructure themselves to remain globally competitive. We help companies deal with thes[e] changes. That is our strength."

G. Chris Andersen, Managing Director

Stephen D. Weinroth

Equity Trading

"I think the words that best describe us are creativity, innovation, flexibility and teamwork. They can be clichés–but they've been real at Drexel Burnham. We couldn't have achieved the position we have today without all of these forces working together. You can't be innovative without the ability to deliver. And you have to have the flexibility to change that bell or add this whistle to make it all go. All these elements make it work–plus a lot of good, smart people.

"We try to figure out how to get a transaction done, rather than focusing on the difficulty of getting it done. We try to anticipate the marketplace rather than reacting to it. We want to be in the forefront of the new products rather than to adopt them after our competition. An example of this is in the options market where we are the leading factor in a brand new area–index trading. Sophisticated computer tools we developed enable us to measure volatility and thereby minimize risk. Being first is the hardest, and there are an awful lot of firsts at Drexel Burnham."

Howard M. Brenner, Executive Vice President

Mortgage-Backed Securities

"The toughest problem that investors face is not how to accumulate securities but how to minimize the effects of changing market conditions and volatility on their portfolios.

"Our central premise is that investing in securities need not be a zero-sum game for investors. Some people can and should assume risk. Others should not. Our mission is to recommend appropriate kinds of securities. It's a matter of knowing your client, his objectives and limitations and of knowing the market.

"At Drexel Burnham we use advanced mathematical techniques to combine securities in new ways in order to maximize performance. This could involve taking on the toughest liability immunization problems and devising carefully structured portfolios that will perform as required in volatile interest rate environments. Our creativity stems from our ability to analyze problems, devise solutions and make those solutions feasible.

"People here tend to come from analytical backgrounds–they're mathematicians or engineers–so they've got the know-how to make new ideas work. We get them excited, infuse them with the Drexel Burnham spirit of innovation, and let them go."

Kenneth H. Sullivan, Managing Director

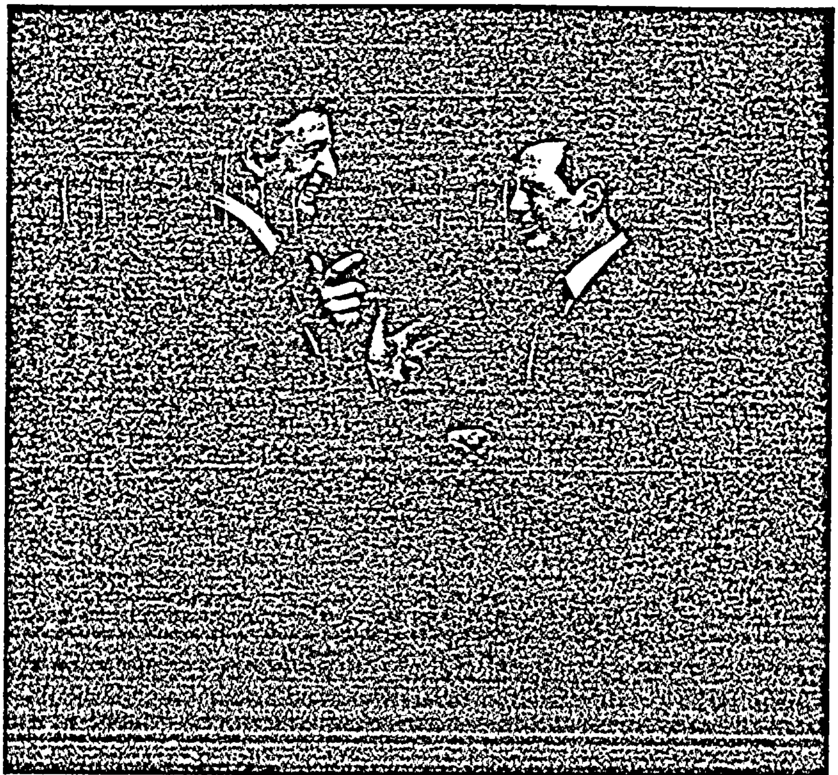
Corporate Finance

"The idea of issuing unrated commercial paper for middle market companies evolved from a brainstorming session in the early 1980s. We were looking for ways to expand our product base while capitalizing on our strength in the high yield bond market. We saw an opportunity to provide these companies with a range of financing alternatives that had been available only to America's largest corporations.

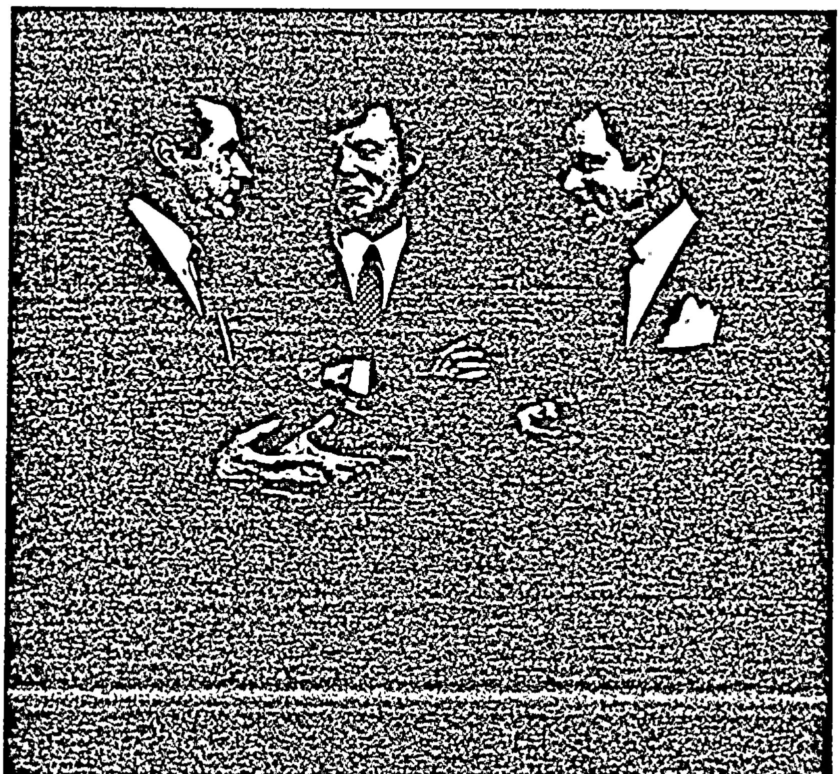
"Drexel Burnham comes up with creative solutions for a number of reasons. Nobody values being hidebound here. People value imagination, even if it doesn't lead to an immediate transaction, because we realize that false starts are a necessary part of the creative process.

"Our clients are not hidebound either. They are entrepreneurial, generally growing companies which are attracted to new techniques. They've used them to forge ahead in their own businesses and they respect and admire them in others."

Stephen D. Weinroth, Managing Director



Richard J. Capalbo, Donald R. Kendall Jr.



Thomas Connors, James A. Schneider, Gerard B. Finneran

Marketing

"Creativity is as necessary to marketing as it is to art or any other endeavor. The market's changing so fast that, like it or not, the old tried-and-true solutions just don't work anymore. That may mean trouble for firms that built their business on the old solutions, but it's good news for us.

"People have seen us come up with unusual solutions that work, so now when they've got a particularly knotty problem they'll bring it right to us. They know we'll approach it in a new way, and they know we won't quit until it's solved. The end result is that everyone involved in the transaction is better off than before."
Richard J. Capalbo, Senior Vice President

Corporate Finance

"We've done a number of innovative leasing transactions to finance equipment and facilities for difficult credits by isolating assets with exciting cash flow potential and utilizing them as capital.

"More attempted transactions are completed here than anywhere else, for two reasons. First, we have an aggressive, innovative environment without a lot of bureaucracy, the kind of environment that encourages unusual deals. And second, we have a better understanding of the markets. If you have a situation that is more complex and riskier than usual, we can do a better job of analyzing the risk, structuring a transaction that makes sense, and convincing investors of future returns."
Donald R. Kendall Jr., Managing Director

Preferred Stocks

"We don't offer standard or prepackaged solutions. We believe there are possibly hundreds of ways to finance a company. By coming to Drexel Burnham, a company doesn't simply receive the solution which an investment banking firm is best capable of selling but rather one that provides the best financing alternative for the company. Generally, conventional investment wisdom will lead you nowhere. When we do an underwriting, we don't focus on yesterday's investments. If you are going to make a loan, you have to determine which company will be the stronger credit in the future."
Thomas Connors, Senior Vice President—Preferred Stocks, Beverly Hills

Corporate Finance

"Drexel Burnham encourages innovations and more importantly, nurtures their implementation. For example, the market for restructuring public debt did not exist before 1981. Traditional investment bankers believed that public debt could not be restructured outside of a bankruptcy.

"We pioneered the restructuring of public debt for troubled companies through exchange offers. The new securities offered in exchange minimize the cash obligations of these companies and often pay interest in cash or common stock. The company is relieved from making cash payments while the debt holder receives common stock that can be sold into the market immediately.

"Since exchange offers allow companies to quickly adjust their capital structure, healthy companies have also recognized the advantages of exchange offers in volatile financial markets to restructure their balance sheets."
James A. Schneider, Managing Director, San Francisco

International Trading and Capital Development

"Our group intermediates the approximately $650 billion of debt issued by developing and newly industrialized countries, most of which sells at a discount. We look for value in these countries the same way one analyzes companies: first and foremost the quality of management, followed by export industries, debt-to-equity levels and so on. We're pioneering this market in the same way we developed the market for high yield corporate debt ten years ago.

"Drexel Burnham offers a unique combination of qualities to deal successfully in this market. Our Corporate Finance Department has the capacity to originate and provide innovative solutions to complex trade and investment problems. Our high yield and convertible bond areas provide the trading skills and knowledge of financial instruments and investor preferences to distribute the securities. Finally, our capital base, geographic distribution and commodity expertise provide the necessary support."
Gerard B. Finneran, Senior Vice President—International Trading and Capital Development, Beverly Hills

Transactions on the leading edge of market change demand critical analysis – not just superficial tracking – if they're to be successful over time. Through analysis we define risk and thereby minimize it. At Drexel Burnham, we're uniquely able to analyze changing markets, isolate risk and reach nontraditional solutions to help clients manage change.

To make these solutions viable, we begin with analysis that's accurate and complete. We examine markets, trends, companies, securities, risks, and opportunities from every possible perspective.

Analysis

Money Market Research

"In a market environment with great volatility it is very difficult to provide a daily market letter as I do and continually put yourself on the line, but when you do it for several years and build up a track record, you become more confident in your judgments.

"It is very satisfying to see profitable results from your forecasts, but it is even more rewarding to know that someone in New Zealand or Tokyo depends upon your information and it is the firs source they turn to. To know that there are investors throughout the world who read your market comments religiously is worth all the effort you put into it on the nights you least want to do it. The most important tools in forecasting near-term trends are knowing the flows of information and whether they pertain to investment decisions, economic data or changes in expectations. The marke absorb news extremely quickly and prices move immediately on perceptions of what may happen six months or one year ahead. Being well-informed on domestic and international issues that affect investments in the United States or abroad adds value to fundamental analysis upon which we still have to rely.

"The fact that I spend at least half of my time working closely with our trading areas makes me more sensitive to the needs of those individuals whose job it is to try to position themselves for the next 30 seconds, not the next year. Immediately analyzing all news with bottom line trading decisions in mind and making all the analysis – verbally or on the screens – easily available to our clients is a strength we have that our competitors do not."

Maria Fiorini Ramirez, First Vice President, Money Market Economist

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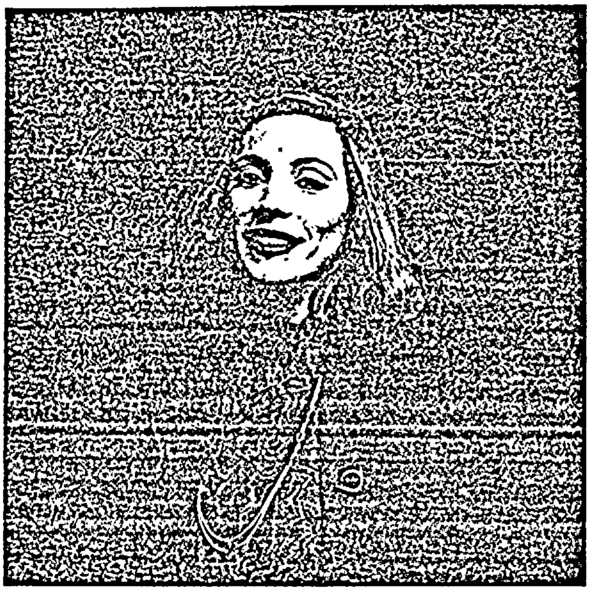
Investment Research

"Our staff is responsible for analyzing congressional and executive branch policy that could affect investors. Our function is to provide clients with a more in-depth understanding of Washington policy developments than you'll see in the newspaper, or anywhere else, for that matter. The experience and knowledge of the staff help us anticipate new trends well in



Jeanne Thornton

advance of their impact on the market. We offer continuous coverage of over a dozen public policy areas, ranging from health care to banking regulations. Our information enables clients to assess the effect of political developments on business and market psychology and profit by it."

Jeanne Thornton, Vice President–The Washington Forum

"Investment policy decisions at Drexel Burnham are arrived at through an interactive process. It's both top-down and bottom-up. Our Investment Policy Committee arrives at a meeting of the minds on economic issues and what we think will be the implications for the financial markets. We then discuss these conclusions with our research analysts, who use them in evaluating the recommendations they are formulating on individual companies and investment ideas. This is the 'top-down' part of the process.

"The second part of the policy process is the 'bottom-up.' For example, if our analysts are making recommendations on certain companies or industries that seem counter to the economic picture we see, we may reexamine our stance. In 1985 the more typical pattern was for the conclusions of our macro analysis to be independently confirmed by bottom-up company analysis.

"Our investment policy is a distillation of all information available, not just a good story. Some other firms have a resident guru, who sends down the 'revealed truth.' We pay keen attention to the facts but we don't merely compile and edit information. We spend most of our efforts trying to add value to this information through thoughtful analysis and the insights made available by a multidisciplined approach."

Abby Joseph Cohen, Vice President–Research
(not photographed)

"When interviewing analyst candidates I'll ask, 'What do you think is the most important role of an analyst?' They usually tell me it's to know your industry better than your competition, to write definitive reports on the companies and to know those companies better than anybody else. And it's to travel and visit with the clients. When I hear this response, I say, 'Yes, all of that. But the real role, the only reason we're around, is to make money for clients. Security analysis is more than an abstract pursuit of facts–it's more than a nonprofit profession.

"Clients know our position on a particular issue; there is no hemming and hawing. Clients don't want to read through a half pound of paper to find out where you stand. I like to think that our strength is finding more winners than losers. If one of my ideas is not working out, I don't sleep at night."

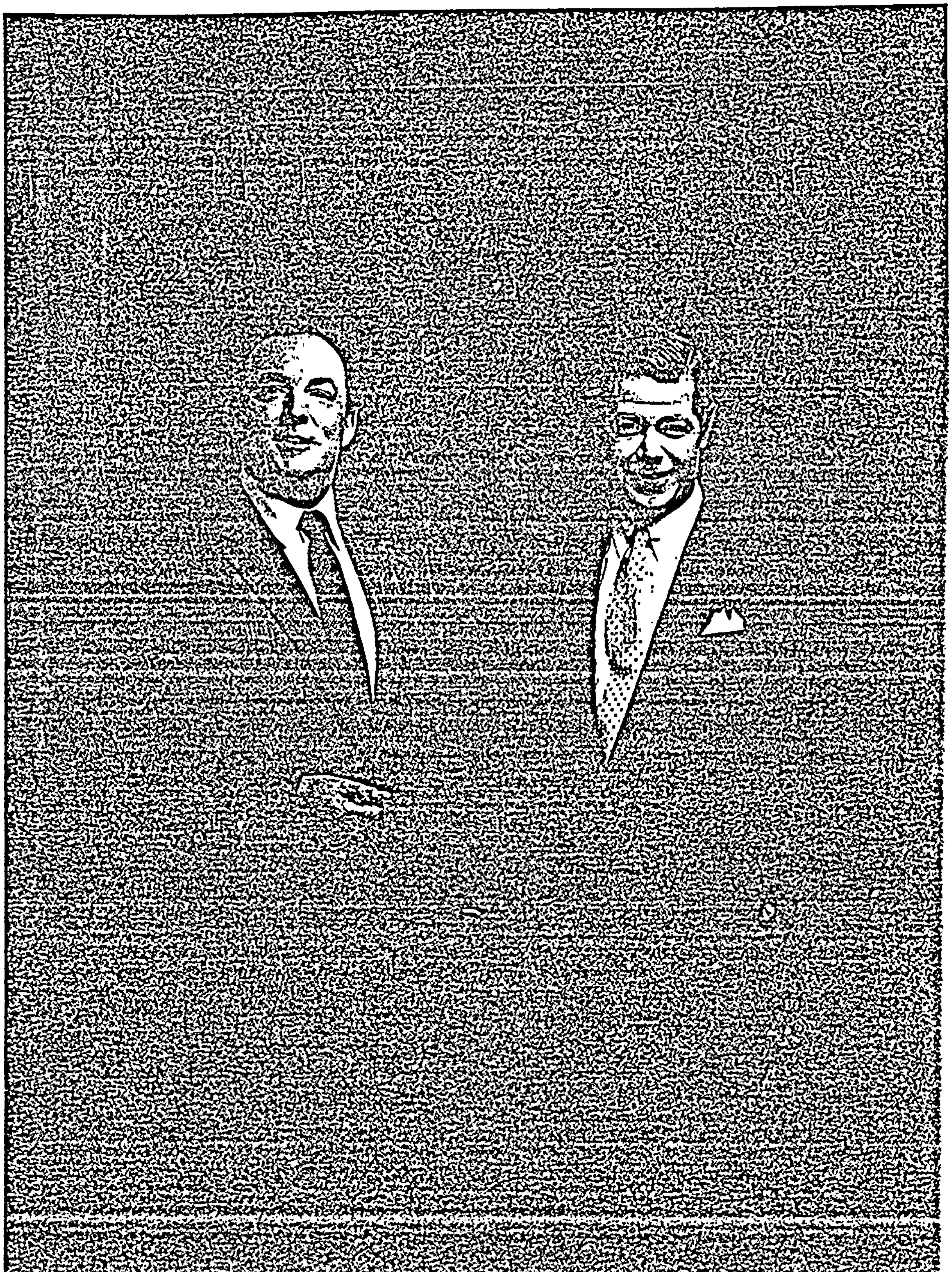
Terence M. York, Managing Director

International Investment Research

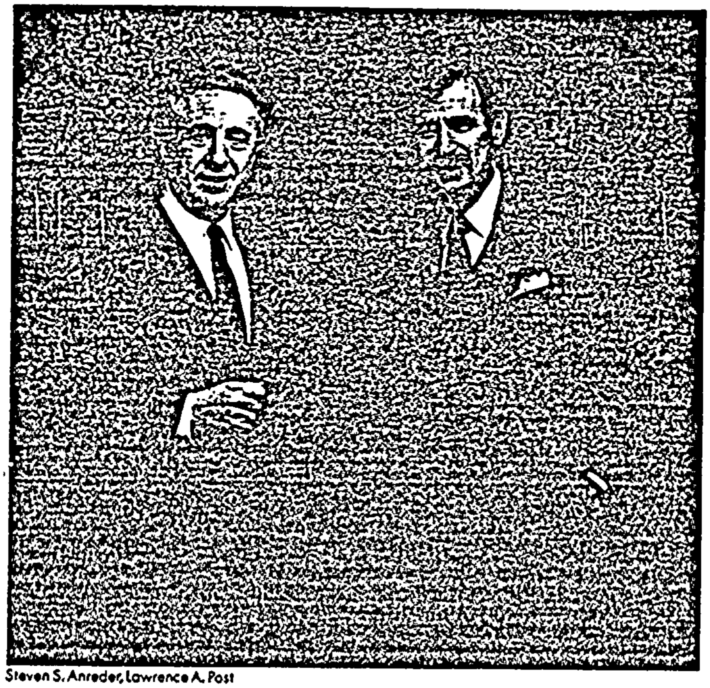
"We make global markets accessible to our U.S. clients by providing useful economic, financial and stock market data. As a potential investor in foreign markets, local industry statistics aren going to do you any good without an international comparison. We function as interpreters of the international markets, giving clients a broader perspective–and ideas that can make it pay of

"There is an exchange of information with our domestic industr analysts and our quantitative research group. In addition, we ca provide clients with dividend discount models and relative histor ical multiple comparisons, which evaluate each individual foreig market relative to others. The result is a comprehensive picture of each industry on a global basis."

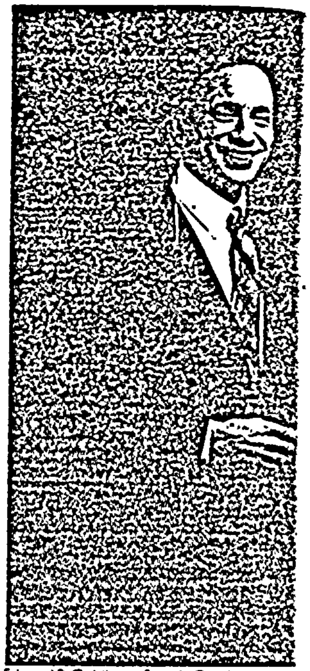
Rein van der Does, Vice President



Rein van der Does, Terence M. York



Steven S. Anreder, Lawrence A. Post



Edward R. Goldberg, Ezra A. Goldberg

Investment Research

"Our research should be viewed from a market perspective. This means we have to move quickly and make decisions rapidly. It means gaining an understanding of an industry and a company's place in it, a knowledge of the finances and the management running it, and combining all that with our market expertise. And, of course, we are involved in doing this for hundreds of companies.

"If we are going to create value for both ourselves and our clients, then we must anticipate change. It's not enough just to be able to react. We invest countless hours visiting people, getting to know and understand their companies and their securities. We don't have time for long, flowery reports. More often, it's communicated via a quick huddle on the trading floor or a phone conversation with a client."

Steven S. Anreder, Senior Vice President–High Yield Bonds, Beverly Hills

"Our job starts as the underwriting is being done. We monitor companies as long as the debt is outstanding–five, ten, or even 20 years. We're constantly talking to these companies–we're not fair weather friends. We are just as interested when times are tough. In fact, the need for research is greater when things get difficult.

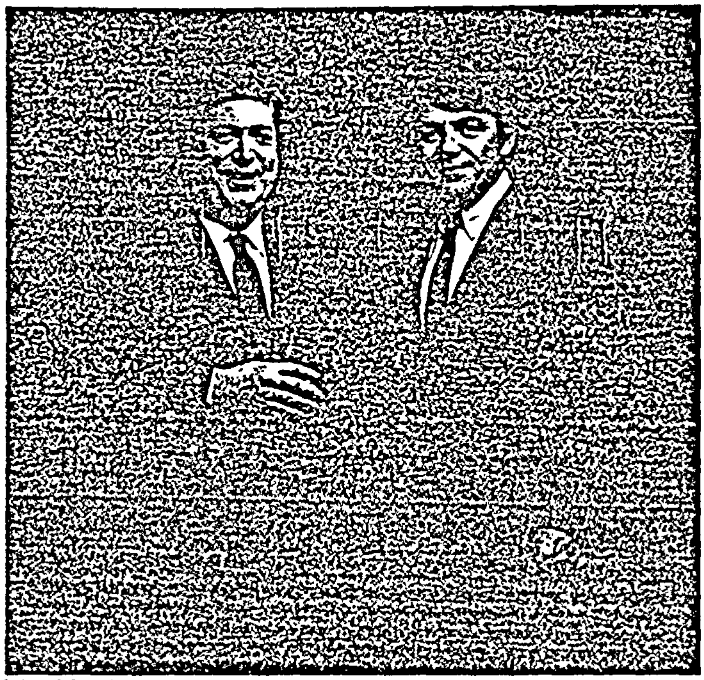
"We're right there on the trading floor in touch with the market. Often our capital is on the line and we're forced to make judgments on what the market is saying–is the market right or wrong. We're always looking for relative value–what's attractive in the market versus something else.

"We pride ourselves on making stronger, more orderly markets in high yield securities than other firms. Part of the way you can do that is to have superior research. An effective market is good for the issuer if he's coming back to do another deal and is good for the buyer if he wants to trade."

Lawrence A. Post, Senior Vice President–High Yield Bonds, Beverly Hills

Investment Services

"We help trustees of pension and profit-sharing funds choose and evaluate managers for their companies' plans by analyzing the methods, costs and performance of fund managers. Too frequently, corporate treasurers neither have the time nor experience to evaluate the performance of their funds. As a result, the whole area of supervising a company's pension assets is often overlooked and underworked. When you consider that an employee's largest asset outside of a home may be an interest in a company's retirement plan, it is essential that management take a more active role in achieving the best results for their valued



Richard S. Frary, David V. Hedley

employees. One of the most gratifying aspects of our work is being able to work with management in achieving this goal.

"We think of ourselves as consultants who bring in-depth experience to our client relationships. With the use of uncomplicated software and subtler elements such as the evaluation of investment styles, we are able to match a client with the right manager in order that long-term goals can be achieved."
Edward R. Goldberg, Senior Vice President—Investments, Boston
Ezra A. Goldberg, Senior Vice President—Investments, Boston

Corporate Finance

"In 1985 Drexel Burnham raised approximately $3.5 billion in the capital markets for both public and private real estate companies which previously had access to capital only through private sources. Very often Drexel Burnham has been able to raise long-term capital when only short-term floating rate debt was available, or where no market existed for a particular transaction.

"Our skills in analyzing and understanding undervalued companies come from our willingness and ability to emphasize the strength of corporate managements as much as balance sheets in assessing a company's credit quality. Drexel Burnham's added value in raising capital in the public markets has been our ability to combine real estate expertise and unique deal structures with institutional investors and a secondary market for the securities issued. This allows us to bring innovative financing solutions and competitive pricing to a variety of real estate issuers."
Richard S. Frary, Managing Director

"At Drexel Burnham, we are oriented toward value-added transactions. Transactions that we have structured enhance the market value of the client company in a very substantial way.

"There is a consistent practice here of hiring people who are imaginative and adaptive, even if they don't always have traditional backgrounds. This means that among us we have unique abilities in analyzing the market. We analyze and isolate risk to come up with new, nontraditional solutions that meet the market's immediate needs.

"Our competitors tend to be very conservative and unable to adjust to changes in the market. For example, the majority of our competitors in the utility finance area see the end of the financing business in sight, so they're contracting their utility finance groups. We're doing the opposite. Our utility group has doubled in the last year. We see the restructuring of the utility industry as an opportunity to enhance our business.
David V. Hedley, Managing Director

There's no book of answers at Drexel Burnham. We work to adapt the specific needs of a client to the demands of the market. We form a thinking partnership with our clients. The closer we get to understanding their objectives, the better our solutions become.

Our efforts have led to new products and new standards in client service. They've made us more responsive, more adaptable, and more realistic in meeting our clients' demands within the complexities of today's financial markets.

Flexibility

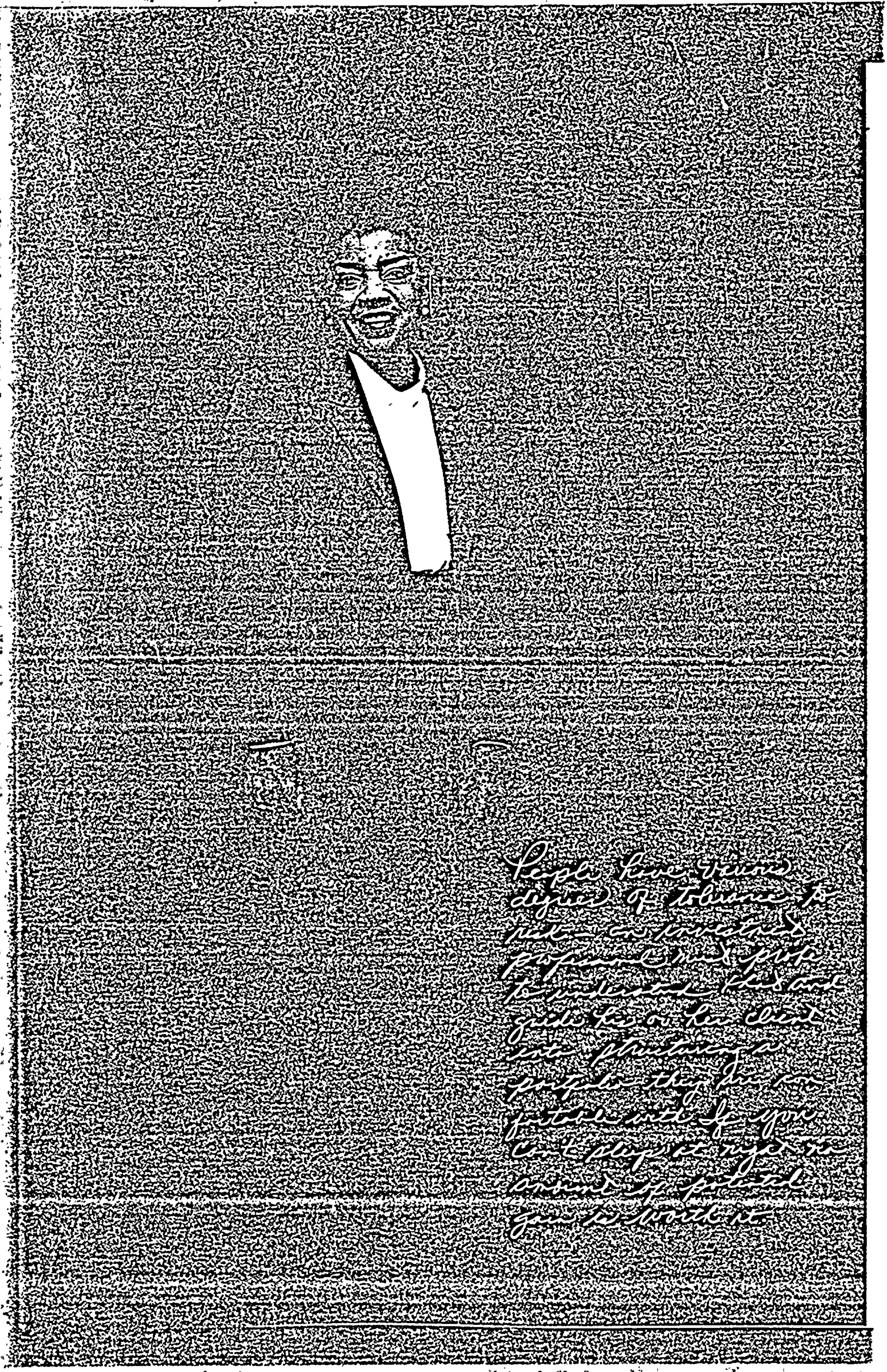
Individual Investing

"Since my clients differ in their knowledge of the various markets, an important value-added service that I can offer is the time to explain the potential risks and rewards of particular investments. I always try to keep in mind that, complex as the market appears to us, it's probably ten times as overwhelming to many of our clients. Therefore, I see part of my function as that of an interpreter and one of the most important things I give clients is a concise, understandable explanation of various investments. With the help of other Drexel Burnham professionals, I digest an enormous amount of information to give clients precisely what they need.

"People have various degrees of tolerance to risk–an investment professional must probe to understand that and guide his or her client into structuring a portfolio they are comfortable with. If you can't sleep at night, no amount of potential gain is worth it. I made a vow when I came into this business that I would try to help people make the proper investment decisions–even if it means they should not invest at all.

"Once I know my client, I can draw on all the resources Drexel Burnham offers to build a portfolio that meets specific objectives. Since we can provide a level of excellence in a broad range of financial services, we don't ever have to settle for second best. The ability to make the perfect fit is what brought me to Drexel Burnham."

Brenda D. Neal, Senior Vice President–Investments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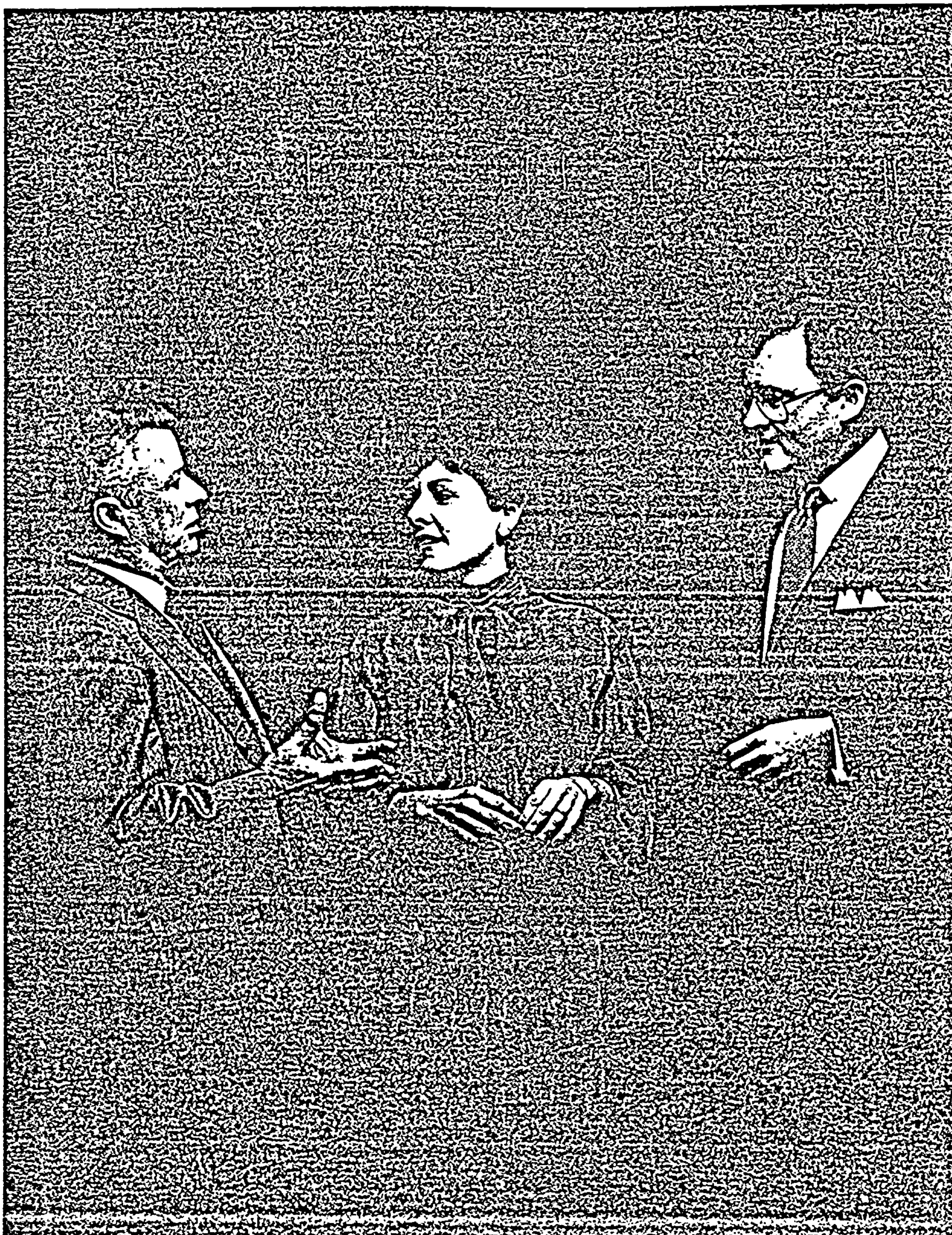
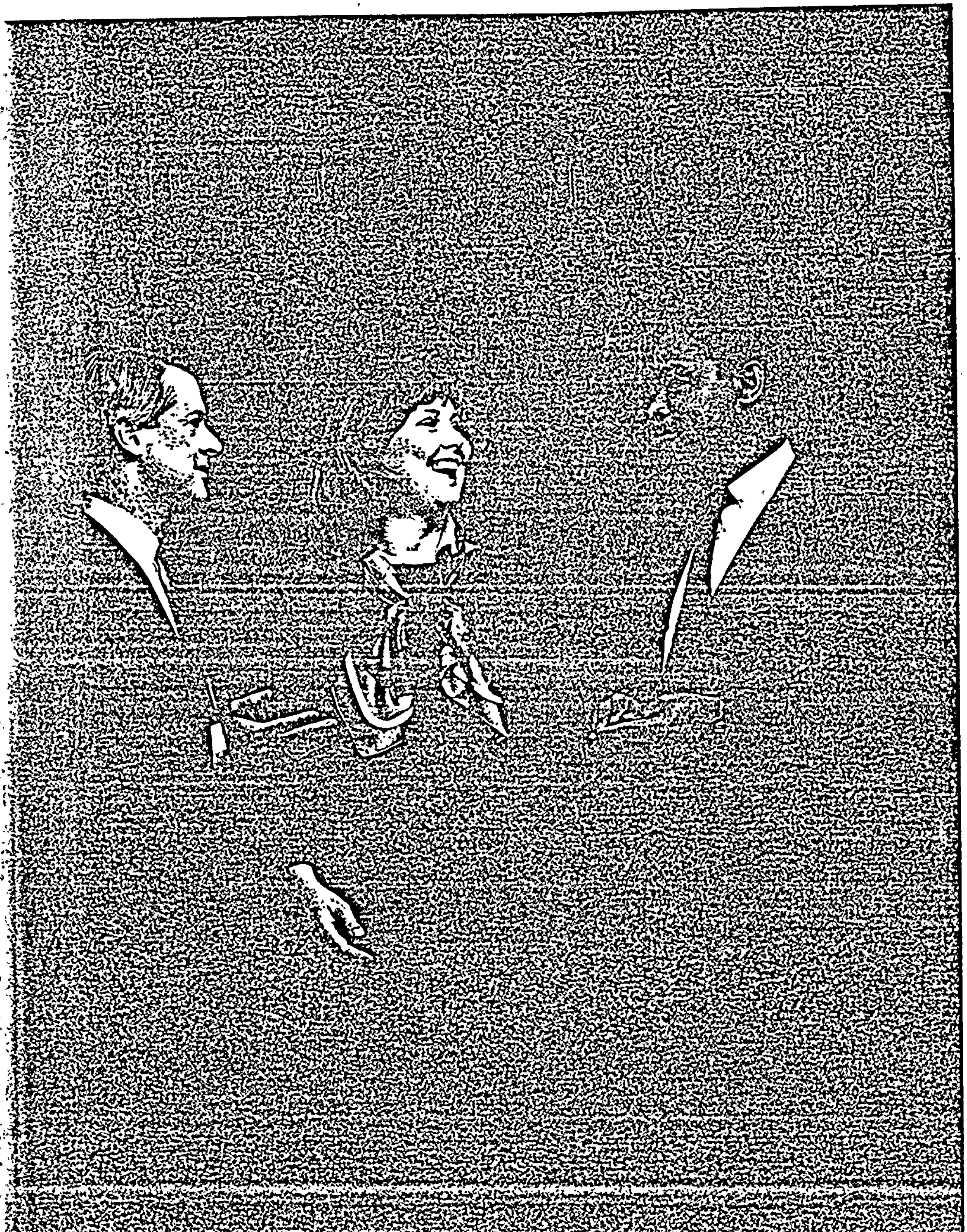


William E. Tuite, Jo Anne Laird, Brian T. McGirl



John F. Sorte, Robin Bauer, Kenneth E. Glover

Information Systems

"The efficient use of technology pays off in better client support. Access to computers and office automation enables the account executive, research analyst and trader to serve clients more productively. Proper use of automation enables these professionals to manage risk and tailor a portfolio to the client's goals.

"What we really have developed is the successful integration of technology and professional management. We've created the tools to do a better job in helping clients reach investment decisions. Making all of this work together pays off."
William E. Tuite, Senior Vice President

Investment Research

"We stacked up all the equity research published by the firm in one year and it was taller than I am. Account executives couldn't digest all that and still have time to give clients effective service.

"The Liaison Group markets the research product of the firm's investment analysts to our 1,200 account executives. Our job is to point each account executive toward the part of our overall data that's important to his or her accounts–both maintenance information and new recommendations. We highlight the information they need, so they can serve clients quickly and efficiently without getting bogged down in a paper chase."
Jo Anne Laird, Vice President–Research

Harbor Trust Company

"We could try to be all things to all people, but we don't feel that's the best way to serve our clients. We conduct ongoing explorations of various markets to gain a clearer understanding of investors' needs. We want to provide a 'hassle-free' environment by developing products that make it easier to cope with the constant changes in tax laws and government regulations.

"The morale of our people is reflected in the way they handle their jobs and the quality of service they provide for clients. I'm continually asking my staff, 'Are you satisfied?' I want them to find satisfaction in their jobs, of course. But I also want them to be constantly thinking about whether they're satisfied with the way we serve clients–or whether there are ways to do things better."
Brian T. McGirl, Chief Executive Officer–Harbor Trust Company

Corporate Finance

"We respond to our clients' needs in several ways. A client may have a specific problem–he might want to build a new plant or repay bank debt, for instance–but what he usually wants is a financing that has the lowest cost consistent with being the most flexible instrument possible. Generally these are two competing desires. We present a number of alternatives and try to get a feel from the client for which one would work best for him.

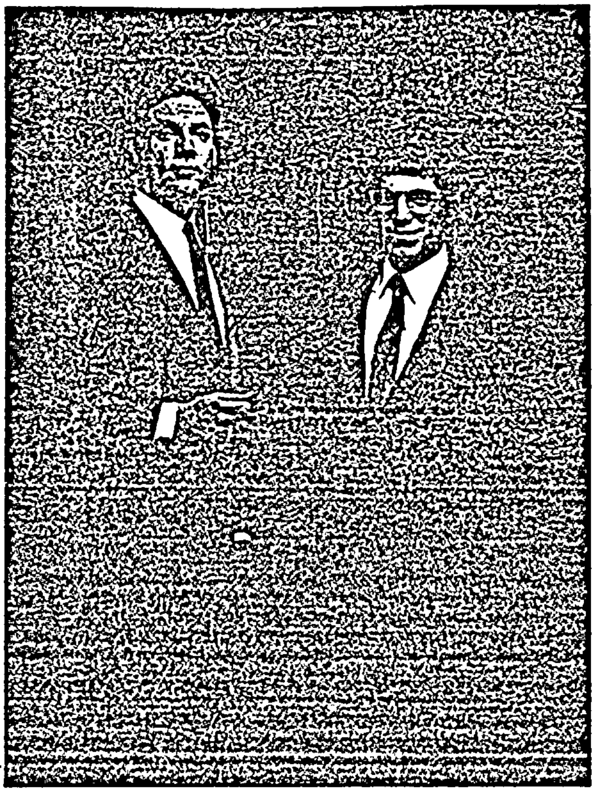
"We do our homework and suggest appropriate new financial instruments for which there seems to be a demand on the buy side. Because of our innovative approach to financings, we can offer a variety of unique financial products to middle market companies and present them with more options than they would find at another investment bank.

"On Wall Street, there's a definite perception of Drexel Burnham as a company that moves fast to respond to client needs. The energy area, for instance, was tough to finance in 1985, but we raised several billion dollars in merger- and acquisition-related financings for companies in a difficult market environment–in some cases in just a few days. We did it by tailoring our transactions to the needs of both the issuers and purchasers."
John F. Sorte, Managing Director

Foreign Exchange

"In the foreign exchange markets, where hundreds of millions of dollars change hands within seconds, one of Drexel Burnham's strengths is our flexibility. We're more nimble than larger institutions which may be impeded by organizational hurdles or internal red tape. Drawing on Drexel Burnham's expertise in the commodities, financial futures, international equities and U.S. bond markets to glean insights and trading ideas for our foreign exchange clients, we tailor our services to meet clients' objectives

"Unlike many other institutions, we can execute transactions in all of the markets where foreign exchange-related instruments trade. Each of these markets presents different opportunities and risks which we examine in helping our clients to identify and execute the most cost-effective currency risk management strategies."
Robin Bauer, Vice President–Foreign Exchange


Norman E. Mains, Howard Sosin

Municipal Finance

"This is a people-oriented business, and Drexel Burnham's approach is to develop ongoing relationships in which we fully satisfy our clients by devising tailored solutions for their needs. Our investment banking teams are fluid. We try to match the particular financing situation and client with the right team of investment bankers.

"We don't try to sell them on a prepackaged product. We examine the financing situation, offer our understanding of it, then ask the client to discuss his or her understanding of the demands and challenges of the project. We work together with our client, as a thinking partnership, to devise solutions to meet their particular needs. It's a process of give-and-take."
Kenneth E. Glover, Managing Director

Institutional Financial Futures

"To effectively tailor investment strategies to institutional investors, you must do a more complete analysis than if you were offering standard solutions. Our Financial Futures Division excels in this area with the most intense and carefully focused research on the Street.

"To my knowledge, we are one of the few firms that has a department that focuses specifically on the analysis of the futures markets relative to the cash markets. Because our research is more focused, we're able to give our clients better, more specific counseling in their futures activities. Financial futures markets are affected by many factors, and it's amazing that other firms try to get by with only the most general market research and statistics."
Norman E. Mains, First Vice President—Financial Futures, Chicago

Interest Rate Products

"We are here to provide clients with innovative, cost-effective strategies that reduce their interest rate and currency exposure while allowing them to exploit market opportunities. We have an extensive product menu including swaps, options and reinvestment programs. We are widely known as market-makers in all of these products, but are best known for transactions that combine these products in unique ways. We also customize products, or even invent new ones, to meet specific needs.

"Our approach is to develop an in-depth understanding of a client's business. This enables us to pinpoint risks a client might not recognize and help him manage these risks. We find problems and commit ourselves to creating solutions."
Howard Sosin, Senior Vice President

Individual Investing

"As a general rule at most firms, account executives are essentially order-takers. They're working with a limited amount of information, and they take it 'off the shelf' for every customer who walks through the door. At Drexel Burnham, we give each account executive complete access to the firm's resources and help provide him or her with the support necessary to sort through a huge amount of information and come up with the best recommendations for each individual investor.

"In effect, the Drexel Burnham account executive functions as a financial advisor rather than just a clerk. He doesn't sell you a prepackaged product; he designs it to your specifications and investment objectives."
Kurt Karmin, Senior Vice President, Chicago
(not photographed)

Everyone who comes to work at Drexel Burnham is driven. Driven by the need to give their clients the kind of superior performance that a changing global market demands. Doing the best job means covering world markets 24 hours a day, providing the most thorough analysis, delivering the best services, or structuring the best transaction. It's the spirit of the firm that gets it accomplished.

Commitment isn't just an attribute of our firm. It's an aspect of our people. It's their motivation, their dedication and their concern for the individual needs of our clients.

Commitment

Government Securities

"Drexel Burnham is one of only a handful of primary government securities dealers who enjoy significant market penetration. The research and trading commitment required to maintain this level of client service is quite a challenge. In the next year we expect the number of primary dealers to increase by 50 percent. No doubt this means we will have to work that much harder to stay at the top, but we thrive on such challenges.

"Government securities isn't the kind of business you can walk away from at five o'clock. It's a 24 hour job and it's my hobby. If I'm not at my desk here, I'm usually speaking to Tokyo or London from my home. In fact, our traders regularly participate in transactions that occur when the New York markets are closed.

"You have to be very innovative to attract customers in this market. The 20 or so professionals who work with me combine innovation, experience and the commitment it takes to help client make sound decisions about their portfolios.

"Because each of our traders is a highly skilled professional in his own right, we're uniquely qualified to make split-second decisions that can benefit our clients. Every one of them can stand alone if they have to–but they also know we're stronger when we stand together. I'm proud of the way our people work toward common goals–both within the department and within the firm a a whole. This helps to give us the edge over everyone else out there."

Michael (Jack) Kugler, Vice Chairman, Chief Executive Officer–
Drexel Burnham Lambert Government Securities Inc.

Government securities isn't
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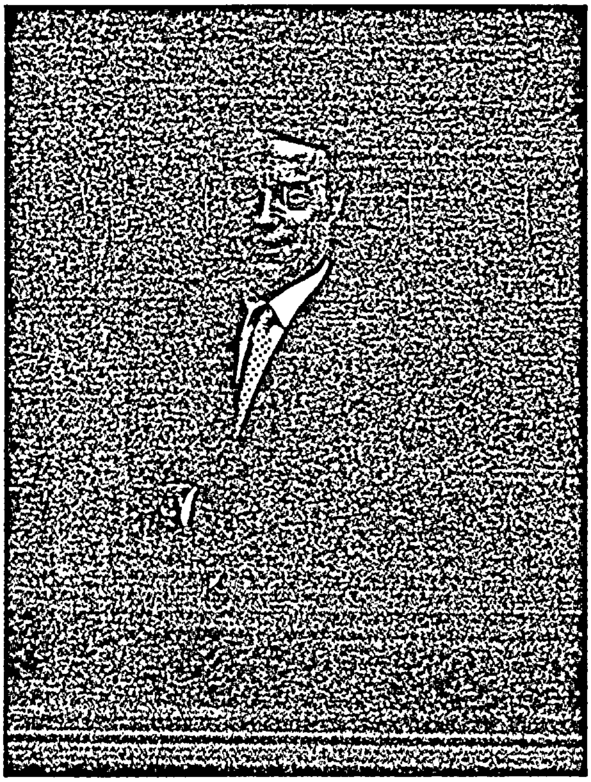

John H. Kissick

Corporate Finance

"Drexel Burnham has always attempted to structure and sell securities by stressing that static numbers and traditional approaches to looking at companies are not the best way to achieve the highest rewards. We believe the more critical ingredients in security analysis are management strengths and what these strengths can do for a company.

"When we worked with Wickes Companies, for instance, the company had just come out of bankruptcy with a new management team that had performed a hat trick in doing a major reorganization and realignment of their capitalization. Good management had made the company viable.

"Wickes wanted to make a major acquisition, not just a series of small acquisitions. I think most investment bankers would not have had the gumption or the guts or the vision, or the ability, to merge Gulf + Western's industrial group with Wickes. It was daring and it was big and most people would have feared the failure of not being able to close the transaction successfully. But we said, 'Let's go for something that really makes sense.' In this instance the bigger transaction actually had lower risk and higher rewards. For people to invest, they had to believe in the management team and their ability to successfully reposition the company in the future. Drexel Burnham's commitment to work with a client to develop unusual solutions to difficult problems paid off for both the client and the investors. Everybody had a good experience. Sometimes doing something in a major fashion is the right answer."

John H. Kissick, Managing Director, Beverly Hills

Investment Advisory

"Clients give us an investment objective–for instance, they want their pension funds to outperform the bond market as a whole–and we try to outperform both the bond market and the clients' objective. It's quite a challenge, but we usually do it.

"Our performance has consistently added value to our clients' portfolios in the most literal sense of the word. But what makes Drexel Burnham really exceptional is our ability to add value without risk. In many cases we actually reduce risk.

"Why are we so successful? We have one of the best credit analysis capabilities, better than average timing and a superior understanding of the intrinsic value of bonds with various features. We also have a long history of successful strategies–and are willing to try new things. We're on the cutting edge of investment strategy and that's a good place to be."

Robert J. Vitale, First Vice President, Philadelphia

Institutional Sales

"It's easy to say that we're more entrepreneurial and that we work harder than our competitors, and we do. But what sets us apart on the equity side is that our main focus has been to try to make money for our clients, and we've done that. The Priority Selection List, which contains the 30 top-rated stocks from the firm's Research Department, was up 44 percent in 1985 versus the S&P 500, which was up about 26 percent. Our investment strategy has been right on target and the stock selection based on that strategy has been outstanding.

"If you don't add incremental value, then there's no reason for you to be in business. We try to add value every day through our investment comments, matching our products and services to meet our clients' needs, and working harder with an extra telephone call, meeting or special note. The bottom line is very

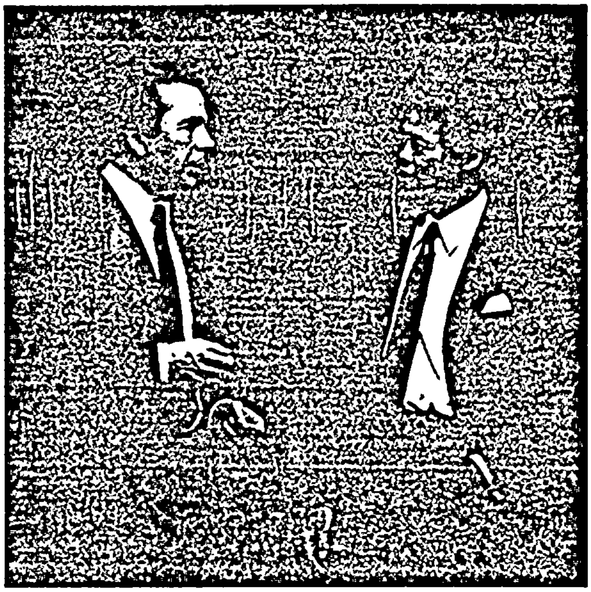
Robert J. Vitale, Bruce H. Brandaleone, Robert R. Cooper

simple–you've got to make more money for your client than your competitor and provide more effective service."
Bruce H. Brandaleone, Senior Vice President

Municipal Finance

"In order to provide a high caliber of service to municipal finance clients, it is essential to first understand the marketplace. Due to a variety of local and federal legal requirements, as well as the inherently risk averse nature of most elected officials, the municipal market is more constrained than the corporate markets. We strive to meet our clients' needs better than our competitors by stressing our commitment to top level performance.

"Once an issue has been properly structured, the firm then commits its substantial capital resources to the underwriting and distribution of the bonds and subsequently to the full support of each issue in the secondary market. Our goal has been to achieve all of this in as smooth, professional and cost-effective a manner as is possible."
Robert R. Cooper, Managing Director



John H. Gibson, Eugene Wong

Betty Perper, Nelson R. Schiff

Municipal Finance

"Drexel Burnham has a very broad perspective in approaching a financing. Issuers are becoming more and more sophisticated, and they want their interests represented as well as the interests of the user, whether a developer, hospital or institution of higher learning. They want something more than just to get the financing done. They want program concerns taken into consideration. They want their goals and objectives to be fully considered. My 20 years in government in Orange County gives me the ability to appreciate the perspective of the issuer. It gives me a knowledge and understanding of both the political and staff perspectives, which are not always the same. All of these subtleties have to be understood to make the various interests in a financing work together."

John H. Gibson, Vice President, Los Angeles

High Yield Bonds

"Our business is to serve the needs of our clients, whether it is investing their money or raising capital for them to build a business. We interact closely with managements, serving as a sounding board for a client's ideas and business strategies.

"There are major forces at work in the U.S. economy today. The combination of ownership and management is coming together again. The owner is once more asserting that he is looking for certain measures of performance at a certain rate of return.

"Many of our issuers have their own money tied up in a transaction, which makes a difference. Many are owners running their own companies. Capital isn't the scarce resource. What is scarce is innovative, bright management. We attempt to direct capital to those people who are best capable of managing the business and managing the capital."

Eugene Wong, Senior Vice President–High Yield Bonds, Beverly Hills

Trading Information Systems

"We're completely committed to providing the best possible trading system. We've always focused on the need to improve trading and sales capabilities and pride ourselves on the ability to respond quickly.

"I love it when traders call me up and ask, 'Can we do this?' At most firms, new systems can take years to develop and implement. Here, we'll get something installed on an interim basi tomorrow and follow up with a permanent system. It's our busine: to make sure no one is slowed down by methods that are less than optimal. We provide the tools that make our track record a: good as it is. And we're dedicated to making it even better. This firm is entrepreneurial–people give you the ball and expect you to run with it."

Betty Perper, First Vice President

Individual Investing

"The talents and leadership abilities of Drexel Burnham's managers are crucial to the firm's success in providing clients with effective service. Our branch office managers spend less time as administrators and more time as leaders. Greater efforts are continually being made to train and motivate account executives which results in greater benefits to our clients.

"We constantly strive to provide our account executives with information needed to provide top level service. For example, managers conduct a daily 'impact meeting' to discuss the latest research findings and investment opportunities. And, to maintain up-to-the-minute contact with market activities, account executives hear a continual flow of topical comments on DrexeLine, an internal communications system.

"Invigorated leadership and informed and motivated account executives are all part of the firm's effort to deliver more effective service to our clients. A can-do attitude lets us aim for ever higher levels of performance."

Nelson R. Schiff, Senior Vice President

International Capital Markets

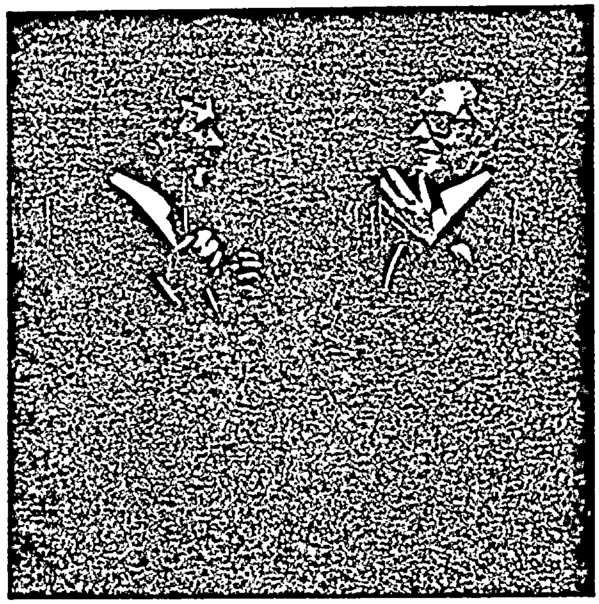
"We don't just publish research and execute trades. We provide financial management and advice. The bottom line is to improve the client's performance. Each of our professionals is fully committed to responding to our client's needs, all the way through a trade. Traders, salesmen, research analysts and economists all sit together in the trading room, plugged into the minute-to-minute activity. When a salesman is talking to a client who wants to talk to the head trader, there will be a three-way conversation. If the client wants information from a research professional, he'll join the conversation and work with the others to answer the client's questions and assist in making investment decisions."

Jean-Pierre Buri, Senior Vice President, London

Investment Management

"When looking at money funds or other types of mutual funds, we add value through our ability to perform within the context of negligible risk. We manage all of our portfolios actively but very conservatively.

"Overall yield in any portfolio is the bottom line. We've outperformed benchmark averages for the industry by 40 to 50 basis points for the year.



Jean-Pierre Buri, Bruce J. Trottier

"We are often in a position to offer assistance in the form of product flexibility and customer service to complement our expertise in portfolio management. All this translates into better overall service and performance for clients."

Bruce J. Trottier, Senior Vice President—Drexel Management Corporation

Commodities

"The strength of the Drexel Burnham Lambert Trading Corporation is that it's managed by traders. Senior traders are on the desk all day running the major positions, so our clients are interacting directly with our top people. Other firms make management trainees work on the trading desk for a few months as part of their training. We don't believe in that. Everyone here sees trading as their career.

"We don't make any distinction between trading and sales. You can't sell something unless you understand how it trades, and you can't trade worth a damn unless you can interact with customers. So you better be good at both.

"This is a no-frills place—you've got to be in order to be price competitive. We jump through hoops to do the trades our clients want to do, and we always remember that without them, we'd be just overhead and warm bodies."

Robert M. Rubin, President—Drexel Burnham Lambert Trading Corporation
(not photographed)

Working together is the foundation of our success. At Drexel Burnham, teamwork reaches beyond the boundaries of any single department or discipline. It is a firmwide exchange of information and ideas that is essential to the efficient handling of transactions. By pooling our resources, we're able to deliver both innovative solutions and superior performance to all our clients.

TEAMWORK

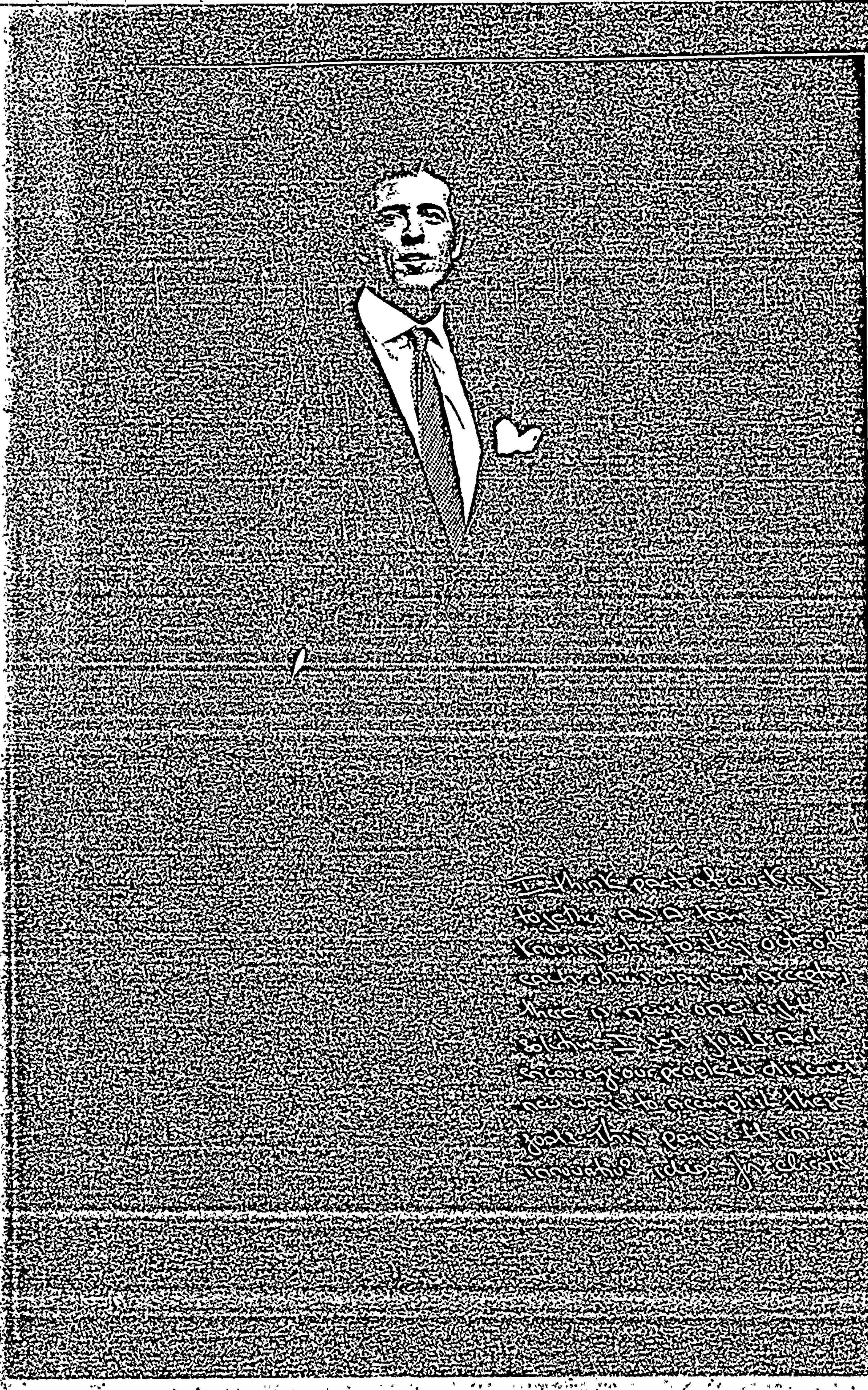
Mortgage-Backed Securities

"The trading desk interacts closely with a number of areas to assure customers get the best execution. Our people have varying backgrounds with a wide range of experiences. They are ready to apply new solutions to difficult problems. We meet daily with the mortgage research unit to anticipate client needs and expectations. We not only want to come up with the best ideas but also to accommodate customers' trading requirements. Typically, we attempt to position clients in certain sectors of the mortgage market in an effort to obtain maximum appreciation in an u market and the greatest capital preservation in a down market. Close coordination internally assures that Drexel Burnham can keep pace with the growth in breadth and complexity of the market. The synergism that exists between the trading desk, the research department and the mortgage finance area ensures that if a problem is solvable, we will do it.

"I think the firm as a whole reflects this philosophy. We do an enormous volume at our desk. Trades of $100 million are not unusual. Frequently, we work with the government or corporate desk in executing such trades. Drexel Burnham allows me to handle these transactions without a lot of structured direction from management. But if I need anything all I have to do is ask.

"I think part of working together as a team is knowing when tc stay out of each other's way and accepting there is never one 'right' solution. I never dictate what our traders should do. I set goals and encourage them to discover new ways to accomplist these goals. This pays off in innovative ideas for clients."

Thomas K. Guba, Senior Vice President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Mortgage-Backed Securities

"No one person is responsible for any of the successes we've achieved. I work closely with our trading departments, our syndicate people, our institutional and retail sales forces, our analysts covering the thrift industry, and the management of our firm. A successfully managed offering is an all-team effort.

"The Mortgage-Backed Securities Department has integrated investment banking, research, sales and trading in order to provide our clients with all the services they require. The continuous interaction of these groups leads to greater creativity in problem solving and in achieving our clients' goals.

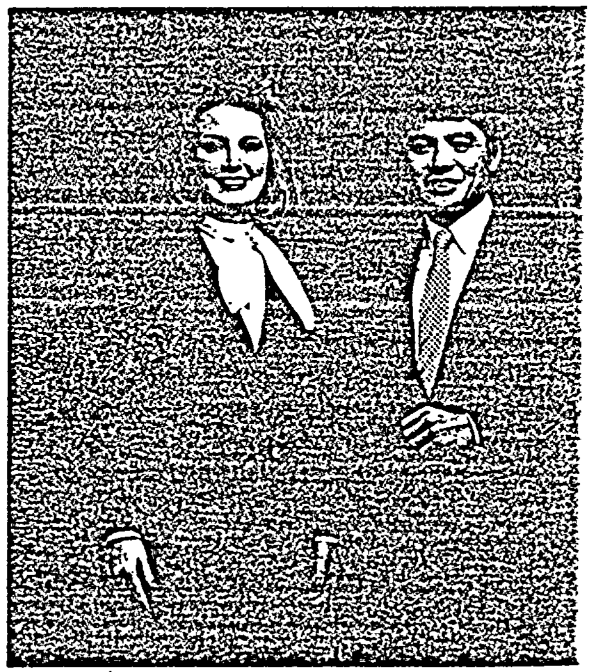
"There's an incredible 'can-do' attitude here. People find ways to get a deal done. For example, when we want to do an exchange offer for one of our clients, people throughout the firm will assist in the structuring and execution of the transaction. There's a wonderful openness here and a willingness to be helpful that exists at all levels of the organization. It makes my job easier—it lets me get things done for my client."
Leslie M. Hannafey, Managing Director

Municipal Finance

"Each Wall Street firm has its own personality. Drexel Burnham has an eclectic image, and, at the same time, a special attitude of service. We're not there just for the one-shot deal; we want to be there for the long haul. The only way you can serve a client's best interests is to use a dedicated team concept. Not just from within the municipal finance area, but within the investment banking division and the firm as a whole.

"We look at the underwriter as the captain of the financing team. We try to educate the client and other financing team participants—lawyers, lenders, and states and municipalities—on what is available out there.

"When you are choosing an investment banking firm, you are not buying hard assets. You are buying 'thinking' assets. And those assets are the people. Our people understand the sensitivities of establishing and managing a long-term relationship which benefits the client by allowing us to know him and his needs in depth."
Victor N. Lee, Managing Director, Los Angeles



Leslie M. Hannafey, Victor N. Lee

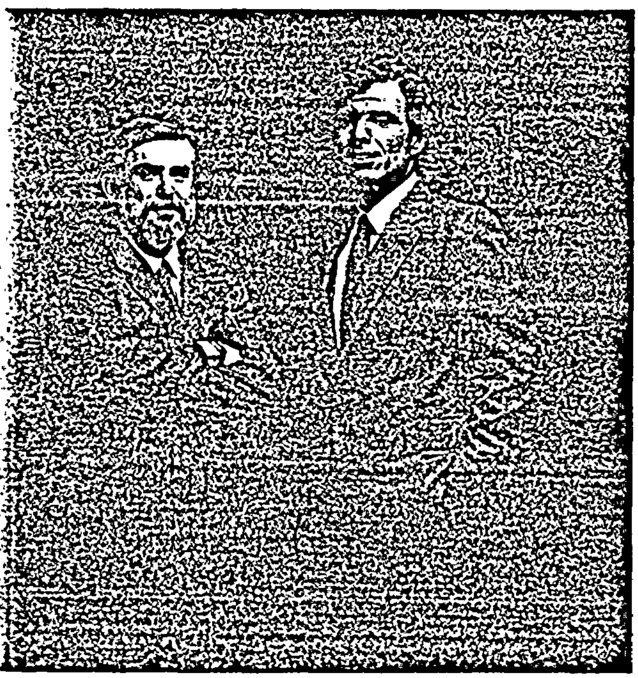
Investment Research

"There are about six to eight major firms at the core of the market-making function on Wall Street. Drexel Burnham is one of these firms. I find I spend a great deal of time speaking to the people who are actually making markets at our firm. Tapping into that nexus of information, I'm able to find out what's happening and make a forecast about the future.

"Working at Drexel Burnham, I'm able to access the vast information sources available here, and that gives me a clear competitive advantage in interpreting trends in the economy and the markets.

"From a people perspective, one of the firm's most valuable assets is the willingness to share information. If I ask a question, I know the people here will do everything in their power to answer it. And they know I'll do the same for them, whenever they need help. People here trust each other. There's a real spirit of working together that makes this firm tick."

Richard B. Hoey, First Vice President, Chief Economist



Richard B. Hoey, Alan S. Greditor

"A group of senior people in our department comprise the stock selection committee. The committee puts people with different backgrounds together to give us the edge in market judgment and experience. No one, including the most senior analyst here, can recommend a stock without the backing of the stock selection committee. That's not a standard practice. At most firms, the analyst alone makes the decision.

"Many times we're able to find a trend in one industry or something that's going on in the economy that will present opportunities in other areas which an analyst, working alone, could easily miss. For instance, corporate restructuring in the food industry has had ramifications for a variety of other industries. We were able to find them and take advantage of them.

"There are two kinds of teamwork happening here. The investment policy committee works together in a formal way, but what makes us tick is the tremendous amount of informal interaction between specialists in the different areas.

"At Drexel Burnham, we're surrounded by unusually bright, talented people in every department. To work here and not take advantage of them would be like living in a library and never reading a book."

Alan S. Greditor, Managing Director

Mergers and Acquisitions

Martin A. Siegel

"To maximize shareholder value, corporations are seeking to optimize the deployment of assets and to assure that they are at their competitive best in this era of internationalization of business. Corporate restructuring and strategic redirection are two major programs that can be undertaken to achieve substantial shareholder and corporate benefits.

"Drexel Burnham is uniquely positioned to serve its clients through experienced merger and acquisition advice and creativity combined with its great financial strength. That is the combination for which we seem to be best known.

"To me, though, our most important characteristic is that we are ever mindful of our serious responsibility to each client. That is, to understand their strategic aspirations and be as objectively and professionally responsive as possible. In this way, I believe, we contribute to the strengthening of American businesses."

Martin A. Siegel, Managing Director

Municipal Bonds

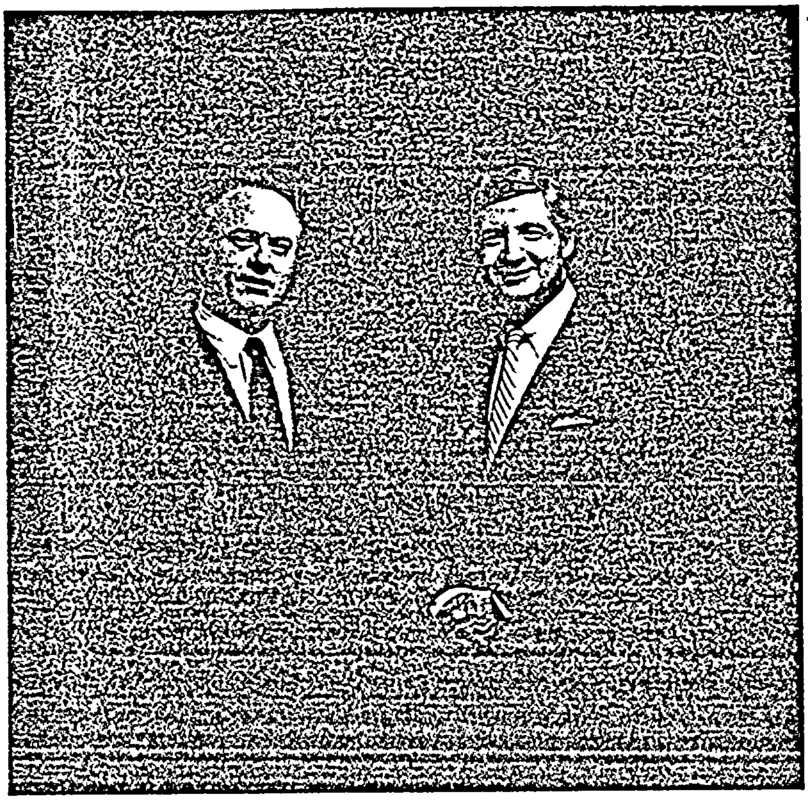
Doreen E. Brownfield

"When I started at Drexel Burnham three years ago our goal was to build the best Municipal Bond Sales Department servicing individual clients on the Street. I believe we've done that, but it took the combined efforts of the best team anywhere.

"At most firms the retail trading desks function in a passive manner. But at Drexel Burnham they're part of a team providing individual clients with support, strategies and ideas that ensure that their municipal bond investments suit their needs. When a market is as complex as the municipal market, everyone has to give his very best. We pride ourselves on the way we work together to give clients more information and better recommendations.

"Since the municipal market can't be readily tracked on individual screens, a member of our team coordinates with the account executives, giving up-to-the-minute trading information that an individual client wouldn't ordinarily receive. Essentially serves the function of being their representative directly on the trading desk—that was the missing link."

Doreen E. Brownfield, Vice President



David N. Waite, E. Alan Brumberger

Commodities

"In an active market opportunities come and go virtually every minute. You have to move fast to catch them and that takes teamwork.

"Because our desk functions as a unit, we can put new ideas to work a lot faster than our competitors. If I think of a new way to help a client I'll run it by the desk, discuss it with senior management, and have it in the client's hands inside of 24 hours. We're all working together–I don't get tripped up by time-consuming layers of approval.

"We also encourage a kind of cross-fertilization among ourselves. Clients talk to several traders, each specializing in a different metal, and come up with their own balanced view. It's helpful for clients to test the prejudices of one trader against another, and it's also helpful for us. It encourages us to work closely with each other.

"When you work with people as a team, you get to know and trust their ability. And when you trust the people behind you, you can trade with more assurance."

David N. Waite, Vice President

Corporate Finance

"Our industry is perceived as being full of large egos but the fact is, most of what we do succeeds through the joint efforts of a lot of people. In corporate finance, we staff our transactions with a team of at least three people–a managing director, a vice president and an associate. Corporate finance work doesn't stop with the analysis of a company and the creation of a prospectus. To conclude a transaction successfully usually requires the efforts of our East and West Coast Corporate Finance Departments and the Trading, Syndicate and Sales Departments.

"This is an exhilarating place for young people to work–that's why we get the best graduates in the country. I know that the young people on my team are tested sooner, more often, and in a much more challenging way than at other firms.

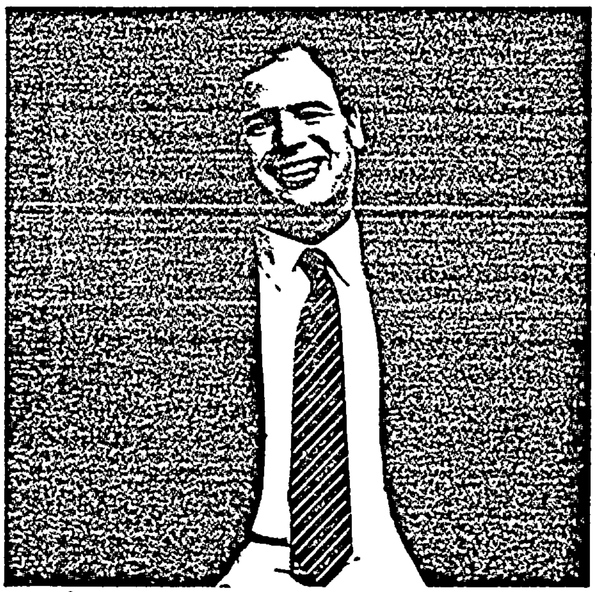
"What gives us the edge over other firms is the fact that we're all building something together. We're not simply resting on our laurels. Much of what we do is new, and there really is a spirit of building something. There's incredible growth, and the excitement that comes from that growth."

E. Alan Brumberger, Managing Director

Capital Markets

"When you're working in the international marketplace, you're always on the line representing the firm, and you're always regarded as a member of the Drexel Burnham team.

"Teamwork starts very early in the morning when I place a phone call from my home to New York to be briefed on how the market did that day. When I arrive at the office and see what's happening in the Japanese markets, I call our head traders in New York at their homes. During the day, we exchange information with our offices in Hong Kong and Singapore and in the afternoon, we check in with convertible securities, Eurobond and foreign currency traders in London. Our traders are exchanging information literally 24 hours a day.


Lawrence Pomerantz

"Doing business in Japan gives one a different orientation toward teamwork than most people are accustomed to in the United States. The Japanese have a proverb that goes, 'The nail that sticks up gets hammered down.' The Japanese, who are hard-working and dedicated people, direct their effort solely towards the firm's success. To them, individual performance is only important in the context of the optimal performance of the firm as a whole. Drexel Burnham's orientation is very similar to that."
Lawrence Pomerantz, Vice President, Tokyo

Government Securities

"Instead of a lot of independent traders, we have an entire group working towards one goal. We have a freer exchange of information, and our positions are better coordinated.

"We work together for two reasons, one, because we like each other, but, more important, because we recognize the necessity of it. The complexity of the market is so great that information obtained from the peripheral markets is now absolutely necessary. If you cut yourself off, you not only have an ego problem, I think you have an intelligence problem.

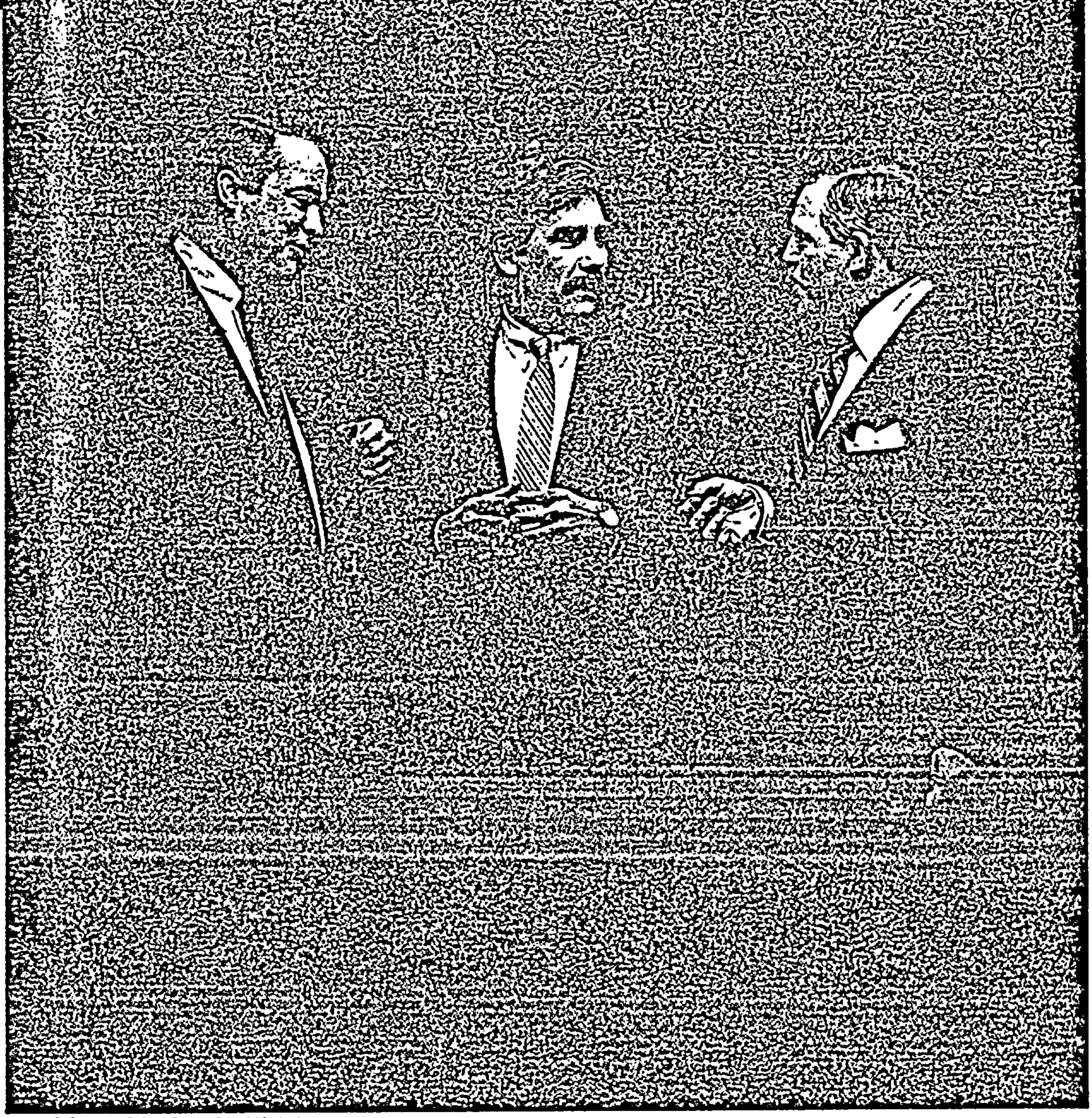
"The truly unique thing about Drexel Burnham is that when someone sees something that is going to affect another segment of the market they make it their business to get that information to the appropriate person. When you know there's a team like that behind you, you trade with a higher level of confidence."
William S. Coleman, President—Drexel Burnham Lambert Government Securities

Equity Trading

"The trading team works a lot like a basketball team. We're constantly passing the ball back and forth, taking shots and changing our strategy. For example, we're in the process of expanding our group to better coordinate sales, research and trading efforts. All players get constant intelligence from the fixed income, the futures and options markets—everything they need to perform for clients.

"The concept of teamwork on the trading desk extends to our branch network. We're improving communications and have installed a direct, open line to all the branches. Everyone on this line can hear everyone else, so we all have a working knowledge of what's happening in every location. When you're off in the branches, sometimes you feel like you're in the hinterlands. We want all our traders to feel that they're part of the team. Everyone has the same product knowledge simultaneously.

"That's important because we are in the front line, acting as the clients' eyes and ears to provide them with better service. In short, we have an immediate and responsive feedback system that produces the team effort necessary for all of us to stay on top of the market. To improve our senses is to improve our service."
G. Peter Furniss, Senior Vice President



William S. Coleman, G. Peter Furniss, Donald R. Kaplan

International Fixed Income Sales

"We are a transaction department. The uniqueness of the transaction is not what stands out. What stands out is the service that we provide as a unit.

"Most clients don't do business with you just because they like your smile. You could do some business that way but to be successful you must offer them an added value. You must provide them with the service, a price, or a product in which you are competitive. Maybe you don't have to be the best on every occasion, but you have to have a pretty good track record in terms of information, execution, and service to have the customer keep coming back.

"We like to think of ourselves as a full-service department within a full-service firm. That's why we have the various specialties within the fixed income area. We don't do equities, options or futures. But in terms of the bond business we want to be a one-stop shop for international financial institutions that can execute their asset business, their short-term business, their long-term business, their high yield business and their high grade business.

"In addition to a unique mix of products, we have another quality that differentiates us—a spirit that is unequaled on the Street."
Donald R. Kaplan, Vice President

INVESTMENT BANKING

Drexel Burnham Lambert's position as one of Wall Street's top five underwriters was confirmed in 1985. We extended the breadth of our capital-raising capabilities with an expanded list of products and services. During the past year, Drexel Burnham:

☐ Surpassed all its previous capital-raising records. The firm lead managed more than $20.6 billion in the public and private corporate markets, an increase of more than 50 percent over 1984.

☐ Raised $9 billion in 110 issues for industrial companies, a greater number of issues than any other Wall Street firm.

☐ Underwrote the largest debt offering of the year, a $1.2 billion issue of notes and debentures for a major communications company. Overall, we had a 10 percent share of the straight debt market.

☐ Raised more than $1.3 billion in 38 common stock issues, including a unit offering. Drexel Burnham lead managed the third largest equity deal of 1985, a $416 million offering for a major oil company. Our share of the equity market increased significantly, from 3.8 percent to 5.3 percent.

☐ Ranked second in number of initial public offerings.

☐ Registered a 260 percent increase in volume in the area of convertible debt, to $1.2 billion.

☐ Continued to rank first as manager in the area of unit offerings with debt and equity components, raising over $750 million.

☐ More than tripled its preferred stock volume to over $800 million.

☐ Acted as lead agent for over $7.3 billion in private placements of various types of securities, ranking the firm second in this market, up from sixth place in 1984.

Our Corporate Finance Department has established a reputation for responding to changing economic and financial circumstances with innovative financing strategies. For example, Drexel Burnham pioneered the use of private placements with registration rights as a means of facilitating merger and acquisition transactions and leveraged buyouts. We continue to expand the horizons of customized financings, offering our clients new instruments such as zero coupon extendible notes and increasing rate notes. Drexel Burnham has also developed a reputation for executing exchange offers to meet a variety of financial objectives including corporate restructurings.

INDUSTRIAL OFFERINGS, 1985

	($ BILLIONS)	NUMBER OF ISSUES
1 SALOMON BROTHERS	10.9	79
2 DREXEL BURNHAM LAMBERT	9.0	110
3 GOLDMAN, SACHS	7.4	65
4 MERRILL LYNCH	4.7	68
5 FIRST BOSTON	4.4	50
6 MORGAN STANLEY	4.1	52
7 SHEARSON LEHMAN BROTHERS	2.6	43
8 KIDDER, PEABODY	2.1	36
9 SMITH BARNEY, HARRIS UPHAM	1.2	24
10 PAINE WEBBER	.9	22

Full credit to lead manager — Source: IDD Information Services

COMPOUND GROWTH RATE OF UNDERWRITINGS, 1980-1985

	PERCENT
1 DREXEL BURNHAM LAMBERT	66
2 SALOMON BROTHERS	34
3 FIRST BOSTON	30
4 GOLDMAN, SACHS	26
5 MERRILL LYNCH	19

Full credit to lead manager — Source: IDD Information Services

PRODUCT BREADTH CORPORATE FINANCE

	TOTAL NUMBER	PERCENT
STRAIGHT DEBT	96	33
CONVERTIBLE DEBT	21	7
UNITS	11	4
PREFERRED STOCK	6	2
COMMON STOCK	37	13
PRIVATE PLACEMENTS	57	19
MERGERS AND ACQUISITIONS	65	22
	293	100

Source: Drexel Burnham Lambert
Represents number of transactions lead managed

SYNDICATE

The Syndicate Department offers an extensive capacity for domestic and international distribution of securities, enabling us to complete offerings in difficult markets for a diverse group of companies. In 1985, our Syndicate Department experienced continued growth and distributed 171 public offerings which Drexel Burnham lead managed with a market value in excess of $13.3 billion.

COMMERCIAL PAPER

Drexel Burnham pioneered a program to issue unrated commercial paper for mid-sized growth companies that had previously been excluded from the commercial paper market. An increasing number of corporations are finding that this kind of unsecured debt offers significant advantages over bank borrowing. A total of more than $2 billion has been issued under the commercial paper program.

MERGERS AND ACQUISITIONS

Merger and acquisition activity figured prominently in the headlines throughout 1985, and Drexel Burnham played a major role in this sector. The combination of Drexel Burnham's financing strengths and merger expertise led to participation in many of the year's most noteworthy transactions. The number of completed transactions was more than double that of the preceding year, and the dollar value of those transactions completed or pending at year-end exceeded $24 billion.

INTERNATIONAL ACTIVITIES

In 1985, Drexel Burnham increased its presence overseas and is serving an expanding middle market of fast growing companies in Europe. Our London-based professionals provide a full range of corporate finance services including raising capital using debt and equity instruments in both the U.S. and European markets, and international merger and acquisition services.

REAL ESTATE

In 1985, for the third consecutive year, Drexel Burnham raised more money publicly for real estate companies than any other Wall Street firm. We raised approximately $3.5 billion for a broad spectrum of issuers including home builders, real estate developers, syndicators, Real Estate Investment Trusts (REITs) and real estate service companies.

The Real Estate Group is a leader in securitizing commercial mortgages, raising about $661 million in 1985. In December, we raised $146 million for one of the nation's largest real estate developers in one of the first publicly offered issues of participating first mortgage bonds.

In addition, during the year, Drexel Burnham Lambert Realty syndicated more than $500 million worth of real estate, providing investment opportunities for clients including tax-advantaged and income-producing public and private property syndications. In addition, Drexel Burnham Lambert Realty completed four major sale-leaseback transactions valued at a total of $237 million.

MUNICIPAL FINANCE

Our penetration of the municipal finance marketplace continued to expand in 1985 with financing activities increasing by nearly 150 percent. Last year's acquisition of Kirchner Moore & Company, a Denver-based investment banking company, and the opening of regional offices in Philadelphia, Chicago, Los Angeles and Puerto Rico were followed by the establishment of offices in Atlanta and Salt Lake City. The hiring of additional experienced professionals raises the number of municipal finance professionals to over 90.

We continue to structure and market issues for institutions in the areas of higher education, single and multifamily housing, health care, industrial development, pollution control, transportation, public power and water and waste control.

MUNICIPAL UNDERWRITINGS

	($ BILLIONS)
1985	23.2
1984	9.4
1983	5.5

Full credit to managers and co-managers
Source: Securities Data Company, Inc.

INVESTMENT RESEARCH

Drexel Burnham Lambert consistently ranks among the leading research efforts on Wall Street, maintaining a top-ten position in both the *Institutional Investor* All America Research Team and the Greenwich Research polls. In recent years, as dramatic changes have swept the financial markets, our investment research has evolved and grown in response to client needs.

☐ To support its research efforts, Drexel Burnham spent more than $20 million in 1985. Forty-five senior security analysts follow 550 companies, issuing comprehensive reports.

☐ Our stock recommendations originate with the firm's Investment Policy Committee, which approves and monitors all recommendations. Economic, monetary, political, quantitative and fundamental data are processed in order to generate an equity investment position for the firm.

☐ The Quantitative Research Group, organized in 1984 into a division of Drexel Burnham called the DAIS (Decision Analysis Investment Systems) Group, has expanded the computer-based research capabilities of the firm. The group's extensive equity data bases and valuation models provide institutional clients with insight into company fundamentals, market expectations and stock valuation for identifying investment opportunities in the competitive equity markets.

☐ The International Research Group, which tracks securities in all major markets abroad, expanded its coverage to meet the growing interest in international fund management and investment banking. Our research report, "The International Investment Monthly," contains analyses of foreign markets and specific stock recommendations within each market. Our reports on relative international market performance provide clients with comprehensive information for their foreign investments. Drexel Burnham continues to be a leading source of information on gold and gold mining companies and monitors the impact of foreign currency fluctuations on international corporations.

☐ The Fixed Income Research Group issues a variety of reports on monetary and fiscal policy to assist in forecasting trends in the money and capital markets. Extensive analysis of tax-exempt securities is provided through our municipal bond research effort.

☐ Drexel Burnham's Washington, D.C.-based research group, the Washington Forum, is a valuable resource for monitoring the government's administrative, legislative and regulatory activities and their impact on investments.

INDIVIDUAL INVESTING

Drexel Burnham Lambert serves the individual investor through its 1,200 account executives throughout the United States. In 1985 new branch offices in Detroit, Michigan; Newport Beach, California; and Orlando, Florida, were opened. Several other offices were substantially expanded. In addition, to provide increasingly efficient service to our clients, we realigned the branch office system into three regions, covering the Eastern, Central and Western sections of the United States.

☐ Training programs continue to be an integral part of our plans to provide premium service to investors. The Branch Manager Leadership Program focuses on sales management strategies, while extensive follow-up programs for account executives provide updated information on new financial services.

☐ Broad Street Productions, the firm's award-winning video division, provides our account executives as well as clients with videotapes on new investment vehicles.

☐ DrexeLine, a new internal communications/sales support system, provides market updates and information direct from the trading floor via speakers on our account executives' desks.

□ In 1985 we introduced Active Municipal Portfolio Management (AMPM), a nondiscretionary management service that allows investors to tailor their municipal bond investments to their own objectives. AMPM maximizes portfolio performance by utilizing specialized techniques and products such as bond swapping, zero coupon bonds and put bonds to take advantage of changing market conditions.

□ Drexel Management Corporation's short-term assets increased from $1.5 billion in 1984 to over $2 billion in 1985. The Money Market and Government Securities portfolios of the DBL Cash Fund were among the highest yielding money market funds in the industry. Drexel Management Corporation introduced Drexel Series Trust, a mutual fund consisting of seven individually managed portfolios. Each Series is designed to achieve a different investment objective.

□ Harbor Trust Company, formerly Drexel Trust Company, introduced a Trust Liaison Center to provide additional support to the growing retirement products market. The Trust Company currently serves over 47,000 accounts and holds over $700 million in assets. Drexel Financial Systems Corporation, the financial planning arm of the firm, became a part of the Trust Company to better serve the personal trust, tax, estate and long-range financial planning needs of our clients.

□ In 1985 the Unit Investment Trust Department continued to sponsor investment vehicles in conjunction with our Tax Exempt Securities Trust (TEST) program. We offer short, intermediate and long-term maturity TEST products, as well as long-term portfolios fully insured as to principal and interest payments by the Municipal Bond Insurance Association.

We continue to sponsor our own unit investment trust, High Income Trust Securities (HITS), a fixed portfolio of high yield corporate bonds, and offer Fixed Income Trust (FIT) Zero Coupon Series, which is designed for IRAs, Keoghs and pension plans to provide a high yield from high quality corporate zero coupon bonds.

□ In 1985 Drexel Burnham Real Estate Associates made its most successful offer to date, with a third public limited partnership fund, available exclusively to clients.

□ In early 1986 the firm introduced The Fenimore International Fund, an open-end mutual fund that seeks a total return of its assets from growth of capital and from income, principally through a portfolio of international securities. The fund is diversified by company, industry and country to provide stability and growth.

INDIVIDUAL ACCOUNT GROWTH

	NUMBER
1985	249,889
1984	198,752
1983	162,028
1982	134,457
1981	107,250

Source: Drexel Burnham Lambert

INSTITUTIONAL INVESTING

Drexel Burnham Lambert continues to increase its capital commitment to institutional investors worldwide. An account team, assigned to each client, works closely with our Research and Trading Departments, relaying timely information and investment ideas. These activities are supported by the most advanced communications systems, enabling our Fixed Income and Equity Departments to provide tailored information to each account.

MARKET-MAKING: EQUITY SECURITIES

Drexel Burnham Lambert makes markets in more than 1,000 equity and equity-linked securities. In 1985 we continued to penetrate the market, providing consistently high levels of service to both institutions and individuals. Coordination between an account team assigned specifically to each client and the Research and Trading Departments occurs not only from our headquarters in New York but also from our 12 regional centers throughout the country.

□ Options continue to be an important investment product for Drexel Burnham. With more than 70 professionals in trading and research functions, the firm is a major force in the market for both institutional and individual investors. Options industry growth in 1985 was primarily in the broad-based indices, reaching 50 percent of the total industry at year-end. In 1985 we were awarded the specialist post for the Value Line Index on the Philadelphia Stock Exchange. The firm also expanded its execution capability on the Chicago, Philadelphia and Pacific Options Exchanges.

Through a subsidiary, Drexel Burnham Lambert Options, Inc., we have become the dominant specialist in currency options, trading the British pound, Swiss franc and French franc on the Philadelphia Exchange.

□ Our OTC Department continues to rank among the top market-makers in the industry in both execution and block handling. The Institutional Block Trading area broadened its service to the professional community. An expanded staff of traders in New York, Atlanta, Boston, Chicago, Dallas, Los Angeles and San Francisco, has succeeded in enhancing the firm's market share in the primary capital centers around the U.S.

□ In the area of International Arbitrage, the firm has expanded its participation in the trading and selling of foreign securities domestically and internationally.

MARKET-MAKING: FIXED INCOME SECURITIES

Drexel Burnham Lambert is a major underwriter and market-maker in all sectors of the fixed income market. The Taxable Fixed Income Sales Group, organized on a regional basis, has offices in Atlanta, Boston, Chicago, Dallas, Los Angeles, New York and San Francisco. The sales professionals are expert in all fixed income instruments, including government securities, corporate bonds and mortgage-backed securities.

□ The Corporate Bond Department has established a wider and more comprehensive distribution system. Improved account coverage, coupled with an expanded trading operation, provides increased competitive participation in all areas of the corporate bond market.

□ Our subsidiary, Drexel Burnham Lambert Government Securities Inc. (DBL/GSI), makes markets in U.S. Treasury and Federal Agency securities. The firm also maintains strong presence in the money markets through its activities in bank liability instruments, interest rate swaps and matched book trading. Responding to the increasingly global orientation of the marketplace, we have expanded our operations in London and Tokyo to ensure full-service capabilities on a 24-hour-a-day basis.

□ The High Yield and Convertible Bond Department remains the dominant factor in its market. To foster further growth, it continues to expand significantly its research, sales and trading staff, and to widen its range of securities products.

☐ The Interest Rate Products Group provides clients with innovative and cost effective strategies that reduce interest rate risk exposure while exploiting interest rate opportunities. The group manages various types of ceiling and floor programs and interest rate swaps for corporate, municipal and institutional clients.

☐ The Mortgage-Backed Securities Department numbers over 250 professionals in the areas of finance, trading, research and distribution, and provides a complete range of services to all mortgage market participants.

The Trading Group is a market-maker in nearly 100 securities including mortgage securities, options on mortgage securities, repurchase and reverse repurchase transactions in mortgage securities and whole loan and participation transactions. Since January 1985, the trading desk has increased its monthly trading volume by 300 percent.

The Research and Product Development Group, the largest of its kind in the industry, is widely regarded as the leader in its field. In addition to mortgage-related securities, the group covers investment grade corporates and government bonds and options on bonds. Dedicated fixed income portfolios, from the simplest cash matching to sophisticated tailored portfolios, are structured by the group.

The Financial Institutions Group ranks as one of the largest finance units in the industry. Since the department's inception in 1984, Drexel Burnham has raised more regulatory capital for the thrift industry than any other firm.

The Commercial Mortgage Group packages, securitizes and trades commercial loans and securities backed by commercial loans for thrifts and other portfolio investors. The group also advises financial institutions in portfolio restructuring, which can result in the outright sale of commercial loans or the creation of collateralized securities backed by loans.

☐ The Municipal Bond Department remains a major underwriter of public securities in the primary market. We managed 369 issues and, according to the Public Securities Association, ranked in the top ten in the industry in 1985 in competitive underwritings. The department continues to expand its distribution capabilities, with sales to individuals and institutions up 35 percent.

☐ Drexel Burnham Lambert Puerto Rico Inc., the firm's full service Puerto Rico-based subsidiary, provides clients with institutional trading and corporate and municipal finance capabilities throughout the Caribbean region.

☐ In the Eurobond market, our London-based subsidiary, Drexel Burnham Lambert Securities Limited, is an active and major market-maker in over 700 Eurobond issues.

REGULATORY CAPITAL RAISED FOR THRIFTS, 1985

	($ MILLIONS)
1 DREXEL BURNHAM LAMBERT	559.0
2 SALOMON BROTHERS	429 2
3 FIRST BOSTON	303.4
4 MERRILL LYNCH	289 3
5 SHEARSON LEHMAN BROTHERS	165.5

Full credit to lead manager   Source: Securities Data Company, Inc.

PROFESSIONAL INVESTMENT MANAGEMENT SERVICES

The increasing complexity of the marketplace and investment alternatives demands ever-greater sophistication while market volatility requires ever-faster decision making. To provide investors with the benefits of specialized expertise, the firm offers a number of investment programs.

DREXEL MANAGEMENT CORPORATION

Drexel Management Corporation has over $2.5 billion under management in mutual funds and other accounts. Professional Cash Asset Management (ProCAM) offers custom-tailored short-term investment management expertise to institutions, with the advantages of higher than average yields and sophisticated operational support. The Credit Evaluator, a premier financial service designed to instantly access extensive financial information from SEC filings via a remote terminal at a client's desk, provides sophisticated screening and portfolio monitoring capabilities. Our new consulting service, the Asset Consulting Evaluator, can help clients select an investment manager and monitor his performance.

FUND MANAGEMENT

Drexel Burnham Lambert is the investment advisor and administrator for an expanding number of mutual funds. The combined assets of these funds total more than $2.8 billion.

☐ We offer individual investors four money market funds which provide liquidity and high yields by investing in short-term money market instruments.

GROWTH OF FUNDS

	NUMBER OF PORTFOLIOS	($ BILLIONS)
1985	27	2.8
1984	13	1.9
1983	9	1.4
1982	8	1.4
1981	7	1.2

Source: Drexel Burnham Lambert
Represents total net assets for commodity, international and domestic funds administered or managed by Drexel Burnham Lambert.

☐ The Drexel Burnham Fund is an open-end equity mutual fund appropriate for those investors seeking capital appreciation and income. The Fund has produced consistent long-term performance since its inception in 1975.

☐ Our closed-end bond fund, the Drexel Bond-Debenture Trading Fund, has compiled the best performance record of all closed-end bond funds over the past five and ten year periods in up and down markets, according to industry analysis services.

☐ The firm expanded the DBL Tax-Free Fund by adding a second portfolio, the Limited Term portfolio. With an average portfolio maturity of three to six years, the Limited Term portfolio seeks the highest level of income exempt from federal income taxes to the extent consistent with the preservation of capital.

☐ The firm advises or sponsors ten international investment companies, including two commodity futures funds.

☐ In 1985 Drexel Burnham Lambert introduced the Drexel Series Trust which currently has over $265 million under management. Designed for long-term investors, the Series is especially attractive for IRAs and other retirement plans since there are no sales fees or commissions if the investment is held for more than five years. By investing in the Drexel Series Trust, clients are able to take advantage of market trends and investment opportunities through professional management, institutional quality investment research and diversified portfolios.

DREXEL BURNHAM LAMBERT INVESTMENT ADVISORS

With over $1.9 billion in assets under management, Drexel Burnham Lambert Investment Advisors, headquartered in Philadelphia, serves a broad spectrum of accounts. These include corporate, public and Taft-Hartley employee retirement funds; financial, charitable, educational and religious institutions; and high net worth individuals. Each account is overseen by a team of portfolio managers

who select investments to meet client objectives. Portfolio managers handle a maximum of 20 accounts to ensure the highest degree of attention to client objectives.

The group offers a full range of investment management services on a discretionary or advisory basis including:

☐ Equity Asset Management, a proprietary model used to structure a portfolio of stocks that represent the best relative values with attention to reducing risk and attaining client objectives.

☐ Fixed Income Asset Management, which serves portfolios that consist exclusively of quality corporate, government and agency issues.

☐ Cash Portfolio Management, which structures a portfolio of investment securities with a maximum one year maturity, utilizing the full research capabilities of the firm.

☐ Balanced Portfolio Management, which utilizes a strategic asset allocation model to best position a portfolio to achieve the desired investment objective.

COMMODITY SERVICES

Widely recognized as a leading multinational futures broker to commercial and institutional interests, Drexel Burnham is also a significant factor in the dealer market for precious metals and the interbank market for foreign exchange.

☐ In 1985 we continued to extend our network of financial futures operations by establishing an institutional unit in New York to complement existing operations in London, Paris and Singapore and the primary unit in Chicago.

☐ We provide comprehensive brokerage and trading facilities in base metals from New York and London, serving producers, fabricators and dealers around the world. In New York we enhanced our metals brokerage facilities through the organization of a specific unit of professionals with expertise in the precious metals markets.

☐ Through its subsidiaries, Drexel Burnham is the only U.S. firm with complete market facilities in both the London and New York markets for sugar, coffee and cocoa, augmented by an important physical cocoa brokerage activity in London.

☐ The firm's international trading activities in grain and livestock continue to be expertly handled in Chicago, the primary market center for these commodities, and in strategic locations around the world including Europe, Brazil and Southeast Asia.

☐ A team of energy futures specialists in New York and London provides professional hedging and arbitrage services to the international petroleum trade.

☐ In foreign exchange, we provide full brokerage and dealing services to the international trading and financial community. Core units located in New York, London and Singapore provide institutional clients with 24-hour trading facilities in the interbank market.

☐ Our subsidiary, Drexel Burnham Lambert Trading Corporation and its London affiliate, Drexel Burnham Lambert Trading Limited, serve as primary market-makers in gold and silver bullion and the platinum group metals. The firm actively trades in concentrates, precious metal-bearing scrap and dore bullion, financing and shipping precious metals in all forms.

☐ In response to the major structural changes taking place in world oil markets, Drexel Burnham Lambert Trading Corporation now trades internationally in crude oil and petroleum products. This activity merges the expertise of several veteran professionals from the petroleum industry with the Trading Corporation's established commodity dealing capabilities and resources.

☐ A team of research analysts and economists monitors the commodities markets, providing support and guidance to our trading groups worldwide. From Chicago, analysts cover the agricultural and financial markets. In New York and London, specialists cover the precious and base metals markets. In 1985 we initiated the development of highly technical computer models for complex commodity options trading strategies.

☐ In the area of professional asset management, Drexel Burnham has developed a strong reputation for servicing institutional and substantial individual accounts by recognized commodity trading advisors. We continue to offer non-U.S. investors two funds which utilize a multiple trading advisor approach, including one which specializes in the financial futures markets and another which provides diversification of trading across all major futures market groups. In 1985 we developed a guided technical trading program, Futures Trading Service, to assist our account executives in providing professional guidance in specific trading situations to Drexel Burnham's clients.

INTERNATIONAL ACTIVITIES

Drexel Burnham Lambert, one of the first investment banking firms to penetrate the international markets, continues to expand its activities and maintain its leading position overseas. In response to the globalization of world markets, Drexel Burnham is meeting the challenge of the new era from a position of exceptional strength.

Our international activities are expanding rapidly while we maintain a prominent position in traditional areas of business. The Securities Industry Association consistently ranks Drexel Burnham among the top five U.S. securities firms executing U.S. equity business in Europe and the Far East. Drexel Burnham is regarded as one of the leading U.S. market-makers in a full range of foreign securities. In 1985 Drexel Burnham:

☐ Was granted a license by the Japanese Ministry of Finance to open a branch office in Tokyo, enabling us to expand our activities throughout the Far East.

☐ Restructured its futures activities, strengthening our position as one of the most significant factors in overall commodities trading in London. Drexel Burnham is a member of all futures exchanges, including the LIFFE, and is a leader in financial futures.

☐ Expanded its international fixed income capabilities through the addition of a streamlined trading room in our London offices.

☐ Continued to expand its corporate finance business thoughout Europe and the Pacific with a major commitment of resources.

☐ Continued to provide non-U.S. investors with a broad range of investment vehicles to meet their specific needs. Total assets in our offshore funds now approach $500 million. The Finsbury Group Limited and Finsbury Fund Limited, our offshore high yield bond funds, continue to perform well and have drawn over $200 million in assets since their inception in 1984.

☐ Sponsored its annual two-week International Training program in New York for international clients, designed to familiarize client representatives from overseas with the framework of the U.S. securities industry. Drexel Burnham also hosted its Fifth International Seminar, held in Washington, D.C. The seminar was attended by senior investment managers from all over the world.

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

THE DREXEL BURNHAM LAMBERT GROUP INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF FINANCIAL CONDITION
DECEMBER 31, 1985

ASSETS	*(Thousands)*
Cash and temporary cash investments (including $91,685 segregated in compliance with Federal and other regulations)	$ 467,839
Receivable from brokers and dealers	3,642,128
Receivable from customers	1,571,522
Securities purchased under agreements to resell, at contract value	14,226,868
Securities and spot commodities, at market value:	
U.S. Government and Government agency obligations	6,693,233
State and municipal obligations	572,054
Corporate debt	3,421,067
Corporate equities and options	1,224,966
Commercial paper, certificates of deposit and bankers' acceptances	192,102
Spot commodities	418,840
Other assets	620,671
TOTAL	$33,051,290

LIABILITIES AND NET WORTH	
Short-term borrowings from banks	$ 3,861,354
Commercial paper	599,155
Drafts payable	559,530
Payable to brokers and dealers	3,083,478
Payable to customers	1,230,548
Securities sold under agreements to repurchase, at contract value	15,720,023
Securities and spot commodities sold but not yet purchased, at market value:	
U.S. Government and Government agency obligations	4,533,774
State and municipal obligations	26,795
Corporate debt	133,407
Corporate equities and options	474,862
Spot commodities	301,357
Accounts payable and accrued liabilities	1,577,744
	32,102,027
Subordinated liabilities	229,784
Stockholders' equity	719,479
Total subordinated liabilities and stockholders' equity	949,263
TOTAL	$33,051,290

The accompanying notes are an integral part of this consolidated statement of financial condition.

THE DREXEL BURNHAM LAMBERT GROUP INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

The consolidated statement of financial condition includes the accounts of The Drexel Burnham Lambert Group Inc. (the "Group"), Drexel Burnham Lambert Incorporated ("DBL"), Drexel Burnham Lambert Government Securities Inc., Drexel Burnham Lambert International Bank N.V., Drexel Burnham Lambert Trading Corporation, K.M. Financial Corp., and all other subsidiaries.

Principal transactions in securities and commodities are recorded on a trade date basis. Agency transactions and contractual commitments, including forward and futures contracts, are recorded on a settlement date basis with commission income, related expenses and unrealized gains or losses on open commitments accrued on a trade date basis.

The Group obtains letters of credit in the normal course of business which are not reflected in the consolidated statement of financial condition. At December 31, 1985, letters of credit of $610,446,000 were outstanding and were collateralized by securities owned with a market value of approximately $441,841,000 and customer margin securities with a market value of approximately $29,624,000.

NOTE 2. SHORT-TERM BORROWINGS FROM BANKS AND COMMERCIAL PAPER

Borrowings from banks are generally payable on demand with interest rates related to the broker call loan interest rate. Commercial paper is payable within 60 days bearing interest generally based on similarly rated short-term money market instruments. At December 31, 1985, borrowings from banks were collateralized by securities and spot commodities owned by the Group and securities purchased under agreements to resell with a combined market value of approximately $3,841,902,000 and customer margin securities and spot commodities with a combined market value of approximately $37,095,000.

NOTE 3. SUBORDINATED LIABILITIES

Borrowings subordinated to the claims of general creditors at December 31, 1985 are as follows:

	Expiration Term	*(Thousanc*
Senior borrowings	March 31, 1986-April 1, 1994	$187,00
Cash subordinated loans	January 27, 1986-February 10, 1992	11,65
Variable rate convertible debentures	December 31, 1988-December 31, 1991	10,0C
Variable rate debentures	December 31, 1986-December 31, 1989	9,95
Borrowings pursuant to secured demand note collateral agreements	Six months from date of notice	5,72
Other	Various	5,45
TOTAL		$229,78

Under the terms of the senior borrowing agreements, as of December 31, 1985 the Group must maintain subordinated liabilities and stockholders' equity of $498,000,000 and stockholders' equity of $380,000,000. In addition, DBL must maintain subordinated liabi ities and stockholder's equity of $650,076,000, stockholder's equity of $486,502,000, regulatory net capital, computed pursuant to the Securities and Exchange Commission's "Uniform Net Capital Rule," of $187,000,000 and a ratio of regulatory net capital to aggregate debits in excess of 7% (see Note 4).

During 1985, Series C and D convertible subordinated notes in the amount of $6,667,000 were converted into 660,792 shares of the Group's common stock.

Borrowings pursuant to secured demand note collateral agreements are redeemable six months after notice is given by either DBL or the subordinated lender. The aggregate maturities of the other subordinated liabilities for the years ending December 31, 1986, 1987, 1988, 1989 and 1990 are $14,348,000, $18,442,000, $17,076,000, $17,562,000, and $97,846,000, respectively, and for the years thereafter, $58,785,000.

NOTE 4. NET CAPITAL REQUIREMENTS

DBL is subject to the Securities and Exchange Commission's "Uniform Net Capital Rule" and has elected to compute its regulatory net capital in accordance with the "Alternative Net Capital Requirement" of this rule. At December 31, 1985, DBL had regulatory net capital of $222,072,000 which was 12.8% of aggregate debits and $187,423,000 in excess of the required regulatory net capital of $34,649,000.

NOTE 5. COMMITMENTS

Minimum rental commitments were $418,290,000 as of December 31, 1985, for all noncancelable leases (principally office rentals) and range from approximately $64,159,000 to $51,137,000 for the years 1986 to 1990 and aggregate $131,017,000 thereafter. Various leases contain provisions for escalation based on certain increases in costs incurred by the landlord.

NOTE 6. CONTINGENT LIABILITIES

There are various legal actions pending against the Group and its subsidiaries relating to its business. In the opinion of management and General Counsel, such actions should be resolved with no material adverse effect on the consolidated financial position.

NOTE 7. EMPLOYEE BENEFIT PLANS

DBL has a noncontributory defined benefit pension plan and a defined contribution tax deferred savings plan covering substantially all full-time employees of the Group. The net assets available for plan benefits are greater than the actuarial present value of accumulated vested and nonvested benefits. DBL also has a funded profit sharing plan and an employee stock bonus trust which cover substantially all employees whose annual compensation (as defined by the plans) is within a specified range. DBL also provides certain life insurance and health care benefits for active and retired employees.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND STOCKHOLDERS OF
THE DREXEL BURNHAM LAMBERT GROUP INC.:

We have examined the consolidated statement of financial condition of The Drexel Burnham Lambert Group Inc. and Subsidiaries as of December 31, 1985. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statement of financial condition referred to above presents fairly the consolidated financial position of The Drexel Burnham Lambert Group Inc. and Subsidiaries at December 31, 1985 in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Coopers & Lybrand
New York, New York
March 12, 1986

CUSTOMER INSURANCE

Securities held by the broker-dealer for the accounts of customers are insured up to $2,500,000; the first $500,000 by the Securities Investor Protection Corporation and the remaining $2,000,000 of coverage provided by the broker-dealer through a major U.S. insurance company.

An additional $7.5 million is available to all customers executing an account coordination agreement in connection with investment in one of Drexel Burnham Lambert's funds.

DREXEL BURNHAM LAMBERT SELECTED FINANCINGS 1985

PUBLIC OFFERINGS
MANAGED OR CO-MANAGED

CORPORATE DEBT

Aeroflex Laboratories Incorporated
AFG Industries, Inc.
AMC Entertainment Inc.
American Capital Bond Fund, Inc.
American Capital Corporation
American Continental Corporation
American Fructose Corporation
A.R.A. Manufacturing Company of Delaware, Inc.
Astrex, Inc.
Bally Manufacturing Corporation
Bally's Health & Tennis Corporation
BASIX Corporation
Benjamin Franklin Savings Association
Bergen Brunswig Corporation
Burroughs Corporation
Calton, Inc.
Care Enterprises
Centex Acceptance Corporation
Central Soya Company, Inc.
Centronics Data Computer Corp.
CenTrust Savings Bank
Charter Medical Corporation
Citibank, N.A.
Coast Savings and Loan Association
C.O.M.B. CO.
Commonwealth Savings & Loan Association of Florida
Cook Inlet Communications Corp.
CooperVision, Inc.
Corroon & Black Corporation
Crane Co.
Days Inns of America, Inc.
Fairfield Communities, Inc.
Financial Trustco Capital Ltd.
First Capital Holdings Corp.
Freedom Capital Inc.
GAF Corporation
General Defense Corporation
General Homes Finance Corporation
General Host Corporation
Golden Nugget Finance Corp.
Green Tree Acceptance, Inc.
Guarantee Savings and Loan Association
Gulf States Utilities Company
Harte-Hanks Communications, Inc.
Hasbro, Inc.
Household Finance Corporation
Houston Natural Gas Corporation
Integrated Resources, Inc.
Jamesway Corporation
K mart Corporation
Las Colinas Corporation
Lehigh Valley Industries, Inc.
Leucadia National Corporation
Lincoln Property Associates Limited
Lyons Funding Corporation
Malrite Communications Group, Inc.
Mattel, Inc.
MAXXAM Group Inc.
MCO Holdings, Inc.
M.D.C. Corporation
MDU Resources Group, Inc.
Minstar, Inc.
Mitel Corporation
Mobil Corporation
National Healthcare, Inc.
NBS Capital Corp.
New Plan Realty Trust
Nortek, Inc.
Northern Pacific Corporation
Orion Capital Corporation
Pantry Pride, Inc.
Paracelsus Healthcare Corporation
Pennsylvania Power & Light Company
Petroleum Heat and Power Co., Inc.
Philadelphia Electric Company
Polycast Technology Corporation
Porta Systems Corp.
Reliance Financial Services Corporation
Republic Airlines, Inc.
RLC CORP.
Rykoff-Sexton, Inc.
R.N. Koch, Inc.
SCI Holdings, Inc.
Scovill Inc.
Seaboard System Railroad, Inc.
Southern California Edison Company
Standard Brands Paint Company
Stone Container Corporation
Summit Health Ltd.
Sunshine Mining Company
Texas Air Corporation
The Atchison, Topeka and Santa Fe Railway Company
The Circle K Corporation
Town & Country Jewelry Mfg. Corporation
Transcontinental Gas Pipe Line Corporation
Transohio Savings Bank, F.S.B.
Triton Group Ltd.
Union Texas Petroleum Holdings, Inc.
United Cable Television Corporation
United Stockyards Corporation
U.S. Health, Inc.
U. S. Home Corporation
Waxman Industries, Inc.
Western Air Lines, Inc.
Western Financial Auto Loans, Inc.
Westworld Community Healthcare, Inc.
West Texas Utilities Company
Wickes Companies, Inc.
Zayre Corp.

CORPORATE EQUITY

Alco Health Services Corporation
American Medical Services, Inc.
Apache Petroleum Company
Audio/Video Affiliates, Inc.

BRIntec Corporation
Capital Federal Savings and Loan Association
Carver Corporation
CenTrust Finance Corporation
CenTrust Savings Bank
Charter Medical Corporation
Cincinnati Microwave, Inc.
Circus Circus Enterprises, Inc.
Coast Savings and Loan Association
Com Fed Funding Corporation
Component Technology Corp.
Days Inns Corp.
First Capital Holdings Corp.
First Executive Corporation
Gearhart Industries, Inc.
Georgia Power Company
Green Tree Acceptance, Inc.
Grist Mill Co.
Gulf States Utilities Company
Hasbro, Inc.
Intermet Corporation
John Adams Life Corporation
Laser Industries Limited
LSI Lighting Systems Inc.
MacGregor Sporting Goods, Inc.
M.D.C. Holdings, Inc.
National Healthcare, Inc.
Newmark & Lewis Inc.
Nortek, Inc.
Occidental Petroleum Corporation
Orion Capital Corporation
Pantry Pride, Inc.
Patten Corporation
Philadelphia Electric Company
Philips N.V.
Ply-Gem Industries, Inc.
Pogo Producing Company
Radice Corporation
Rogers CableSystems of America, Inc.
Salick Health Care, Inc.
SCI Equity Associates, L.P.
SCIPSCO, Inc.
Storage Equities, Inc.
Student Loan Marketing Association
Superior Industries International, Inc.
Sylvan Learning Corporation
Tele-Communications, Inc.
Texas Air Corporation
The All American Gourmet Company
The Coastal Corporation
Thermo Analytical Inc.
Tiger International, Inc.
Town & Country Jewelry Mfg. Corporation
UtiliCorp United Inc.
VMS Mortgage Investors L.P.
Waxman Industries, Inc.
Western Federal Savings Bank
Westworld Community Healthcare, Inc.
Wickes Companies, Inc.

PRIVATE FINANCINGS

American Satellite Company
AmeriWest Financial Corporation
Calvin Klein Industries
CH Financial Corporation
Citizens Financial Corporation
Comdisco Financial Corporation
Conner Financial Corporation
Continental Telephone Co. of Barbados
Continental Telephone Co. of California
Continental Telephone Co. of Vermont
Continental Telephone Co. of Virginia
Diamond Lands Corporation
Estrella Communications, Inc.
Farley/Northwest Industries, Inc.
First Capital Holdings Corp.
Forum Health Partners, L.P.
Freedom Capital Inc.
Grant Broadcasting System, Inc.
Great American Industries, Inc.
Hunters Square Commercial Properties
Ingersoll Newspapers, Inc.
Jamaica Hotel Properties, Inc.
Lafer Amster & Co.
Levitz Furniture Corp.
MAXXAM Group Inc.
Mobex
Motel 6 Holding Company, Inc.
National Can Corporation
New Plan Realty Trust
PACE Industries Inc.
P&C Food Markets Holding Corporation
Paid Prescriptions, Inc.
Pantry Pride, Inc.
Papercraft Corporation
Paragon Tampa Properties Associates
Pennsylvania Engineering Corp.
Regency Apartment Associates L.P.
SCOA Industries Inc.
SFN Companies, Inc.
Southmark Corporation
Sterling Software, Inc.
Sun Valley Lake Associates
Talley Industries, Inc.
The Amalgamated Sugar Company
The CBS/Fox Company
The Circle K Corporation
The Coastal Corporation
The Kroger Co.
The Travelers Corporation
Triangle Industries, Inc.
Triton Container Partners
Union Texas Petroleum Holdings, Inc.
Uniroyal, Inc.
Wickes Companies, Inc.
Winn-Dixie Stores, Inc.
Wundies, Inc.
Zenith National Insurance Corp.

MERGERS AND ACQUISITIONS

Acquiring Company
Acquired Company
•indicates Drexel Burnham Lambert client

American Healthcare Management, Inc.
HealthCare USA Inc.•
Acquisition

Beecham Group PLC
Norcliff Thayer/Reheis•
Acquisition

Berkey Photo Inc.
B&E Sales Co., Inc.•
Acquisition

Borg-Warner Corp.
Chilton Corp.•
Tender Offer and Merger

Carl C. Icahn
Trans World Airlines, Inc.
Sale of strategic block and common stock options of Trans World by Texas Air Corp.•

Carlisle Capital Corporation
Bercon Packaging, Inc.•
Acquisition

Carlisle Capital Corporation
Rex Plastics, Incorporated•
Acquisition

Cement Roadstone Holdings, PLC
Callanan Industries Inc.•
Acquisition

Central Jersey Industries Inc.
Rowe International Inc.•
Acquisition

Citizens & Builders Federal Savings Bank
Freedom Savings and Loan Association•
Acquisition

Clayton & Dubilier Inc.•
Uniroyal, Inc.
Leveraged Buyout

Compagnie Oris Industrie
CIS-US, Inc.•
Acquisition

Conair Acquisition Corporation
Conair Corporation•
Leveraged Buyout

Crane Co.
*Aloyco, Inc.**
Acquisition

Crane Co.
Unidynamics Corp.
Sale of 6.2% strategic block of Unidynamics by Nortek Inc.*

Farley Metals, Inc.*
Northwest Industries Inc.
Tender Offer and Merger

GB-Inno-BM S.A.
*Handy Andy Home Improvement Centers, Inc.**
Acquisition of Control

Gearhart Industries Inc.*
Smith International Inc.
Repurchase of 20.4% block of Gearhart common stock

General Defense Corp.
*Hamilton Technology, Inc.**
Acquisition

General Oriental Securities Ltd.*
Crown Zellerbach Corporation
Acquisition of Control

Giant Portland Masonry Cement Co.*
Keystone Portland Cement Co.
Merger

GrandMet USA, Inc.
*Quality Care, Inc.**
Merger

Group of Investors
*Deerfield Groves Company**
Merger

Group of Investors*
Levitz Furniture Corp.
Leveraged Buyout

Group of Investors
*Panavision Inc.**
Acquisition

Group of Investors*
SCOA Industries Inc.
Leveraged Buyout

Group of Investors
Universal Ford, Inc. (subsidiary of Sandgate Corporation)*
Acquisition

Hanover Companies Incorporated
*Titan Group, Inc.**
Acquisition

Hawley Group PLC
*Olsen Industries, Inc.**
Acquisition

HealthCare USA Inc.*
Independence Health Plan, Inc.
Merger

Home Furnishing Enterprises, Inc.
*Perfect Fit Inc.**
Leveraged Buyout

International Controls Corp.
Transway International Corp.
Sale of 11% strategic block by Nortek, Inc.*

Lehigh Valley Industries, Inc.
*Nico, Inc.**
Merger

Limited Inc.
*Lerner Stores Unit**
Acquisition

MacAndrews & Forbes Holdings Inc.
*Pantry Pride, Inc.**
Acquisition

MAXXAM Group Inc.*
Pacific Lumber Co.
Tender Offer and Merger

MCA Inc.
LJN Toys Ltd.
Sale of 59% strategic block of LJN Toys Ltd. by Uni-Investors*

Multimedia, Inc.
*Jack Kent Cooke Inc.**
Sale of 9.7% strategic block of Multimedia common stock

National Beverage Corp.
*Shasta Beverages Inc.**
Acquisition

National Business Systems Inc.*
Dek Identification Systems
Acquisition

Nuclear Pharmacy Inc.
*Syncor International Inc.**
Merger

Pantry Pride, Inc.*
Revlon, Inc.
Tender Offer and Merger

Phillips Petroleum Corp.
*Icahn Group Inc.**
Sale of 48% strategic block of Phillips Petroleum common stock

Planning Research Corp.
*Kentron International, Inc.**
Tender Offer and Merger

Ply-Gem Industries Inc.*
Barris Industries, Inc.
Sale of 27.7% strategic block of Ply-Gem common stock

Powder Hill Group Ltd.
*Globe Distribution**
Acquisition

Primark Corp.
*Aviation Group, Inc.**
Tender Offer and Merger

Revco D.S., Inc.
*Group of Investors**
Sale of 13.5% strategic block of Revco common stock

Sengra Corporation*
Graham Company
Merger

Stauffer Chemical Co.
*Applied Solar Energy Corp.**
Tender Offer

Sterling Software, Inc.*
Informatics General Corp.
Tender Offer and Merger

Sunshine Mining Co.*
Woods Petroleum Corp.
Merger

Talcon, Inc.
*Calton, Inc.**
Leveraged Buyout

The Coastal Corporation*
American Natural Resources Co.
Tender Offer and Merger

The William Lyon Co. and JDH Realty Co.
*Senior Corp.**
Acquisition

Titan Systems International, Inc.
*Electronic Memories & Magnetics Corporation**
Merger

Triangle Industries, Inc.*
National Can Corp.
Tender Offer and Merger

Trump Group*
Pay'N Save Corp.
Tender Offer and Leveraged Buyout

Unocal Corp.
*Mesa Petroleum Co.**
Sale of 7.9% strategic block of Unocal common stock

Utilicorp. United Inc.*
Peoples Natural Gas Co.
Acquisition

Valley Forge Corporation*
Food Emulsifiers, Inc.
Acquisition

Wechco, Inc.
*West Chemical Products, Inc.**
Leveraged Buyout

Whittaker Corporation
*Yardney Corporation**
Acquisition

Wickes Cos.*
Consumer and Industrial Products Division of Gulf & Western Industries Inc.
Acquisition

MUNICIPAL FINANCINGS
MANAGED ISSUES,
PRIVATE PLACEMENTS AND
FINANCIAL ADVISORY

ALABAMA
Alabama Housing Finance Authority
Fairfield Special Care Facilities Finance Authority (Lloyd Noland Hospital)

ALASKA
Alaska Housing Finance Corporation
Alaska Municipal Bond Bank Authority
City of Fairbanks

ARKANSAS
Arkansas Development Authority

CALIFORNIA
County of Orange
County of Santa Clara
Industrial Development Authority of Simi Valley
City of Colton
City of Los Angeles
City of Oakland
County of Santa Barbara
County of Ventura
California Department of Veterans Affairs
County of Los Angeles
City of Oxnard
California Pollution Control Financing Authority
Redevelopment Agency of the City of Burbank

COLORADO
Arvada Urban Renewal Authority
City of Aspen
City of Boulder
Town of Breckenridge
Colorado Housing Finance Authority
City of Colorado Springs
Colorado Student Obligation Bond Authority
State of Colorado
City and County of Denver
Town of Dillon
County of Douglas
City of Grand Junction
Adams County
Jefferson County
Northglenn Water Project
Pueblo County
City of Steamboat Springs
Town of Vail

CONNECTICUT
Connecticut Development Authority
Connecticut Resource Recovery Authority

DELAWARE
City of Wilmington
New Castle County

FLORIDA
City of Clearwater
Housing Finance Authority of Broward County
Florida Housing Finance Agency

GEORGIA
Urban Residential Finance Authority of Atlanta
Fulton County Building Authority
City of Atlanta

HAWAII
Hawaii Housing Authority

IDAHO
Ada County
Bear Lake County
Idaho State Building Authority
Regents of the University of Idaho
Twin Falls County

ILLINOIS
City of Rockford
Illinois Health Care Facilities Authority
Board of Trustees of Southern Illinois University
Illinois Educational Facilities Authority
City of Springfield
Chicago Transit Authority
Illinois Educational Development Authority
Eastern Illinois University
City of Chicago
Greater Chicago Metropolitan Sewer District
Western Illinois University
Metropolitan Fair and Exposition Authority of Illinois

INDIANA
State of Indiana
Whiteland Community High School Building Corporation

IOWA
City of Des Moines

KANSAS
Crawford County
City of Hutchinson
City of Kansas City
City of Olathe
County of Sedgwick
Johnson County
City of Wichita

KENTUCKY
City of Jeffersontown
County of Jefferson

LOUISIANA
Parish of Jefferson

MAINE
City of Biddeford

MARYLAND
Maryland Health and Higher Educational Facilities Authority

MASSACHUSETTS
Massachusetts Industrial Finance Agency
Massachusetts Convention Center Authority
Massachusetts Housing Authority

MICHIGAN
Economic Development Corporation of Ann Arbor
Economic Development Corporation of the County of Wayne
City of Detroit

MINNESOTA
City of Burnsville
City of Egan

MISSOURI
Industrial Development Authority of Kansas City
Industrial Development Authority of the City of Macon
City of St. Louis
Metropolitan Sewer District of St. Louis

MONTANA
Billings High School District

NEBRASKA
Nebraska Higher Educational Loan Program

NEVADA
Churchill County School District

NEW HAMPSHIRE
New Hampshire Municipal Bond Bank

NEW JERSEY
Township of Parsippany-Troy Hills
New Jersey Transportation Trust Fund Authority
New Jersey Educational Facilities Authority
(Princeton University)
(Drew University)
(Glassboro State College)
(Kean College)
(Richard Stockton State College)
(William Paterson College)
(Seton Hall University)
(Fairleigh Dickenson University)
(Princeton Theological Seminary)
Mount Laurel Township Municipal Utility Authority
New Jersey Sports and Exposition Authority
New Jersey Housing and Mortgage Finance Agency
County of Camden
Essex County Improvement Authority

NEW MEXICO
Chaves County
Counties of San Miguel and Mora
City of Roswell
City of Albuquerque
Regents of the University of New Mexico
State of New Mexico

NEW YORK
Power Authority of the State of New York
New York State Medical Care Facilities Finance Authority
(Columbia-Presbyterian Hospital)
(Mount Sinai Hospital)
State of New York Mortgage Agency
New York State Dormitory Authority
(Jewish Board of Family and Children's Services)
Triborough Bridge and Tunnel Authority
New York State Urban Development Corporation
Metropolitan Transportation Authority
New York State Housing Finance Agency
New York City Municipal Water Finance Authority
New York State Job Development Authority
Suffolk County Industrial Development Agency

NORTH DAKOTA
City of Fargo

OHIO
County of Clark
Ohio Housing Finance Agency
State of Ohio Building Authority

OKLAHOMA
Central Oklahoma Transportation and Parking Authority
Miami Baptist Hospital Authority
Stillwater Medical Center Authority

PENNSYLVANIA
Redevelopment Authority of Philadelphia
Central Dauphin School District
School District of Philadelphia
Palmyra Area School District
Delaware River Port Authority
Pennsylvania Higher Educational Facilities Authority
(Drexel University)
Union County Higher Educational Facilities Financing Authority
(Bucknell University)
County of Montgomery
Lehigh County Industrial Development Authority
Quakertown Hospital Authority
Pennsylvania Housing Finance Agency
Delaware County Authority
(Villanova University)
City of Philadelphia
Erie County Industrial Development Authority

PUERTO RICO
Puerto Rico Industrial, Medical, Higher Educational, Environmental and Pollution Control Facilities Financing Authority
Puerto Rico Aqueduct and Sewer Authority
Puerto Rico Housing Bank and Finance Agency
Commonwealth of Puerto Rico

RHODE ISLAND
State of Rhode Island
Rhode Island Health and Educational Building Corporation
(Roger Williams College)
(Roger Williams General Hospital)
(Memorial Hospital)
Rhode Island Public Building Authority

SOUTH CAROLINA
Charleston County
(Roper Hospital)

SOUTH DAKOTA
South Dakota Housing Development Authority

TENNESSEE
Metro Government of Nashville and Davidson County

TEXAS
Harris County Industrial Development Corporation
Galveston County Water Authority
Grand Prairie Independent School District
Harris County Housing Finance Corporation
City of Irving
Travis County Housing Finance Corporation

UTAH
Board of Education of Salt Lake City School District
Daggett Water and Sewer District
Housing Authority of Salt Lake City
Logan City
Salt Lake County Water Conservancy District
City of South Weber
Weber County
Davis County Housing Authority
University of Utah State Board of Regents

VERMONT
State of Vermont

VIRGINIA
Portsmouth Redevelopment and Housing Authority

WASHINGTON
City of Bremerton
City of Everett
City of Vancouver

WISCONSIN
City of Milwaukee
City of Oshkosh

WYOMING
City of Cheyenne
Laramie County School District
Wyoming Community Development Authority

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