THE FEDERAL RESERVE BANK of ST. LOUIS

CB
CENTRAL BANKER

Spring 1991

News and Views
for
Eighth District Bankers

St. Louis Fed Introduces FRED®, the Electronic Bulletin Board

The St. Louis Fed recently went on-line with a new electronic database, which allows PC users with modems to obtain up-to-the-minute national and regional economic data. Federal Reserve Economic Data, or FRED,® is available 24 hours a day, seven days a week.

Accessible through FRED is all the data published in *U.S. Financial Data*, the St. Louis Fed's weekly monetary publication, as well as a brief analysis of current conditions, historic monetary and interest rate information, other selected economic indicators, and regional business and banking data. Current USFD subscribers will continue to receive their issues in the mail as usual.

Weekly data will be updated on FRED Thursdays by 5:30 p.m. CDT and can be downloaded onto diskette or printed from the screen view. The service is free—you pay only for the call.

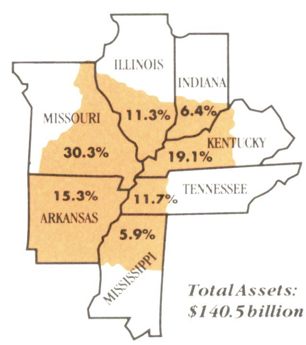
FRED can be accessed through a modem by dialing (314) 621-1824. (Parameters for communication software should be set to no parity, word length=8 bits, 1 stop bit and the fastest baud rate your modem supports, up to 9600 bps.) For more information, call the Federal Reserve Bank of St. Louis at (314) 444-8562.

District Banks Outperform Peers in 1990

Despite many concerns confronting the banking industry, Eighth District banks continued to outperform their national peers in 1990, particularly in measures of asset quality and profitability.[1]

While banks in certain parts of the country experienced severe asset quality problems, District institutions as a whole showed only slight deterioration and continued to report lower levels of nonperforming loans, net loan losses and other real estate (ORE) than their national counterparts. District nonperforming loans averaged 1.81 percent of total loans in 1990, up from 1.60 percent in 1989, while net loan losses remained unchanged from 1989, averaging .71 percent of total loans. Both nonperforming loans and net loan losses were highest in the commercial loan account. Although some bankers are concerned over weakening conditions in local real estate markets, real estate nonperforming loans and loan loss levels in the District con-

Distribution of District Assets



tinue to fall well below the average national level. Likewise, the level of ORE carried by District banks is only slightly more than half the level carried by the national peers.

District bankers, recognizing some weakening in asset quality, slightly boosted their loan

(continued on next page)

Feditorial

Banks In Our Region Show Resiliency

Joan P. Cronin

As Eighth District bankers consider their prospects for 1991, they have reason for optimism. As the companion article describes, 1990 aggregate bank earnings remained stable with District banks continuing to outperform their national peers.

Asset quality, as measured by increases in nonperforming loans, declined slightly, but remained notably better than that reported by banks in other regions. District loan mix continues to be well-diversified, with loans secured by one- to four-family dwellings making up almost half of the District's portfolio of loans secured by real estate. Of the remaining real estate credits, 33 percent are commercial real estate or construction and land development loans. It is not clear, however, whether this portfolio will suffer the fast erosion in value experienced in similar portfolios held by banks in other regions.

District bank dividend policies generally remained prudent as reflected in an average payout ratio of 57 percent of earnings. In comparison, the average payout ratio for their national peers jumped from 65 percent to 86 percent of earnings. Returns on equity remained high. District banks averaged an 11.21 percent return on equity in 1990—virtually unchanged from 1989—while their national peers saw a decline from an average of over 10.50 percent to 8.14 percent. Finally, most banks have tangible leverage ratios that are consistent with the consolidated capital guidelines.

Thus, District banks are generally profitable, sound and adequately capitalized. Despite uncertainty in several sectors of the economy, we expect that the District's banks in 1991 will demonstrate a resiliency not enjoyed by their counterparts in other regions.

Joan P. Cronin is a senior vice president in charge of the Banking Supervision and Regulation Division of the Federal Reserve Bank of St. Louis.

District Banks Outperform

(continued from page 1)

loss reserves in 1990 to 1.58 percent of total loans, up from 1.51 percent in 1989; this level trailed the national reserves, which were maintained at 2.08 percent of total loans. Nonetheless, District reserves provided higher coverage of nonperforming loans, 87 percent, than the 74 percent coverage provided by national reserves.

District provision and overhead expenses were lower than the national average by as much as 23 percent in 1990, allowing District banks, regardless of size, to continue to outperform national banks in earnings performance. District banks generated an average return on average assets (ROAA) of .89 percent in 1990, a much stronger showing than the .60 percent average ROAA reported by U.S. banks. District overhead actually declined in 1990, while increasing at U.S. banks. District provision expenses increased slightly, but, at .50 percent of average assets, were significantly lower than the high .96 percent at U.S. banks.

Although District banks experienced lower funding costs, U.S. banks continued to report a stronger net interest margin (NIM)—4.54 percent as of December 31, compared with 4.21 percent for District banks—primarily because of a higher-yielding asset mix. While both U.S. and District banks invested approximately 83 percent of their assets in loans and securities, U.S. banks invested 61 percent in loans, generally the higher-yielding asset of the two, compared with District banks, which invested 56 percent in this category.

Return On Average Assets By Eighth District Region

Region	All	Less than $100 MM	$100 MM-300 MM	$300 MM-1B	$1B-10B
Arkansas	1.06%	1.13%	.97%	1.06%	NA
llinois	.99	.98	.99	1.02	NA
Indiana	.90	.61	.92	1.07	NA
Kentucky	.82	1.02	1.20	1.09	.53
Mississippi	.95	1.06	.86	1.08	.87
Missouri	.84	.89	.87	.79	.85
Tennessee	.74	.77	.73	.92	.73

[1]National peers are U.S. banks with average assets less than $10 billion. As of December 31, 1990, all District banks fell into this category.

Anatol B. Balbach

When Recession Looms: How the Fed Affects the Economy

Late last year, when it became clear that the U.S. economy might enter a recession, the Federal Reserve undertook several steps to "ease" monetary policy. The Fed can ease policy in several ways: by reducing reserve requirements, reducing the discount rate or enacting open market operations. All of these actions are intended to increase banks' excess reserves, inducing them to do more lending and investing, create more money, and, in the short run, contribute to a lower federal funds rate. While we all know what easing is supposed to mean, there is some confusion about how it's actually done.

Each financial institution is required to hold reserves, in the form of vault cash or deposits at a Federal Reserve Bank, against a portion of its checkable deposits. A 10 percent reserve requirement, for example, would require banks to have 10 cents in cash or 10 cents deposited with a Federal Reserve Bank for every dollar of reservable deposits on its balance sheet. When a bank makes a loan or an investment, the borrower usually spends its loan receipts quickly and this money usually ends up at another bank. As the check is cleared, the lending bank transfers reserves to the receiving bank dollar-for-dollar of the spent loan. Because of this potential loss of reserves, a bank can make loans or investments only if it has excess reserves. An injection of reserves by the Fed creates this excess and allows banks to expand their loans and investments.

How do these injections come about? A change in reserve requirements is one way. If reserve requirements are reduced from 10 percent to 5 percent, a bank will have excess reserves of 5 cents for every dollar of deposits and thus will be able to expand its loans or investments by that amount. The Fed's elimination of reserve requirements on certain time deposits on December 27, 1990, created $13 billion of excess reserves for the depository system.

While we all know what "easing" is supposed to mean, there is some confusion about how it's actually done.

A change in the discount rate is another method of injecting reserves into the system. Lowering the discount rate lowers the interest rate that banks must pay on their loans from the Fed. This makes borrowing from the Fed more attractive. When a bank borrows, it receives a credit to its Fed account and, since bank deposits at the Fed are reserves, its reserves increase. Thus, it can increase its loans and investments again. The lowering of the discount rate on December 19, 1990, and again on February 1, 1991, however, produced only small and very temporary increases in borrowings (on December 19, 1990, borrowings were $155 million and on March 13, 1991—$148 million) and thus no significant increases in excess reserves, loans or investments.

The third and most frequently used way of injecting reserves into the depository system is through open market operations, that is, the Federal Reserve buying government securities in the open market. Irrespective of whom these securities are bought from, they are paid for, and this payment is ultimately deposited in a bank. When the payment is deposited, the bank's account at the Federal Reserve Bank increases and therefore the bank acquires excess reserves. Again, this allows that bank to expand.

In early 1991, as mentioned, the reduction of reserve requirements created $13 billion of excess reserves. If all $13 billion had remained in the system, there would have been a veritable explosion of credit and money. To prevent this, the Fed sold government securities and thus "mopped up" some of the $13 billion of excess reserves. The net effect was an increase in excess reserves of $2.8 billion by March 6, which has produced substantial (but not excessive) growth in money and credit.

Anatol B. Balbach is a senior vice president and director of research at the Federal Reserve Bank of St. Louis.

Regional Roundup

FFIEC Extends Real Estate Appraiser Deadline

Good news for depository institutions—the Federal Financial Institutions Examination Council (FFIEC) has extended until December 31, 1991, the date on which all insured depository institutions must use state-certified or licensed appraisers on most of their real-estate-related financial transactions. The previously announced July 1 deadline is being extended to give states further time to implement the appraiser certification and licensing systems envisioned in FIRREA.

Avoiding Recession? Employment Data Show District Economy Growing

Both the nation's and the District's economies weakened somewhat since last summer. Nationally, nonfarm employment fell at a 1.8 percent annual rate between June 1990 and February 1991. In the District, however, employment continued to grow, rising at a 0.9 percent rate in this period. This represents almost 41,000 new District jobs. District employment in manufacturing has fallen, but in most other sectors—even construction—it has expanded.

Looking at some individual states, job declines in Missouri and Tennessee were more than offset by strong gains in Arkansas and Kentucky.

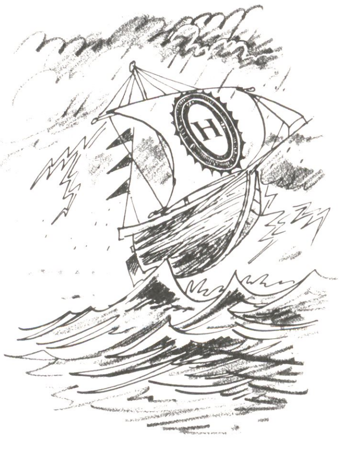
Paper Stubs Out, Electronic Reporting In, For Savings Bond Payroll Plans in '93

The St. Louis Fed announced in April another move toward all-electronic services. Beginning April 1, 1993, payroll savings bonds agents must begin reporting, in electronically processable form, the savings bonds they sell through payroll deduction plans. This is another step in a long-term plan to improve efficiency in processing savings bonds that included the EZ CLEAR system for redemptions in February 1991 and the Regional Delivery System (RDS) for over-the-counter sales last year.

Currently, of the two million bonds sold through payroll deduction in our District, nearly 80 percent are reported to the Fed electronically. Agents for the other 20 percent have several options in the next two years to consider in replacing the current paper stubs: reporting sales information on magnetic tape themselves, processing bonds at an institution that already reports on magnetic tape, or using the Fed to issue and deliver their bonds. Currently, the Fed will accept orders on magnetic tape and PC diskette; in the near future, we'll accept them through Fedline transmissions. Our service is free of charge.

In any case, we can advise payroll agents about their options and assist them in establishing the type of reporting arrangements they need. Please call us at 314- 444-8705 for more information.

Fed Ready For Disaster



As the anxiety surrounding last December 3 fades into memory, so too has all talk of earthquakes . . . except at the Fed's Disaster Recovery Center.

Here, Fed staff continue to discuss, develop and refine contingency plans to ensure a rapid recovery from any disaster affecting Fed services. Such discussions cover a broad range of topics, from floods, tornados and fires to software errors, equipment failures and telecommunications problems.

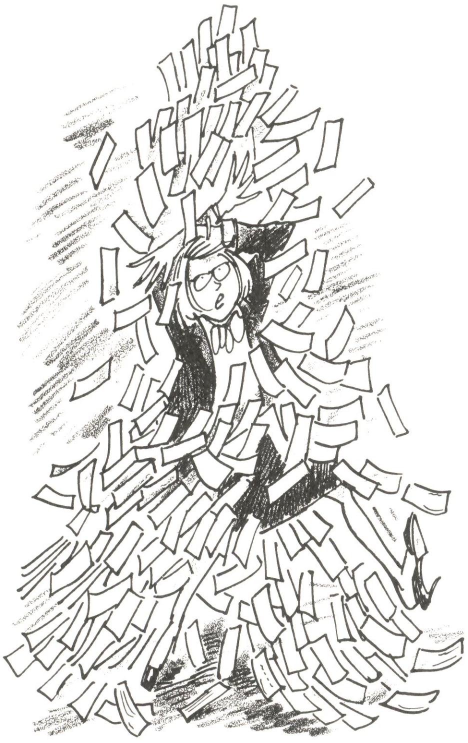
In each case, the Fed has developed detailed contingency plans to bring these services back up quickly. For some disruptions, our operations are shifted to back-up equipment within the Bank. In a worst-case scenario, our critical functions would be moved to the Little Rock Branch and our computer operations to a hotsite in Culpeper, Virginia.

Regardless of the disaster, the Fed will contact banks by phone or by fax as quickly as possible. If a disaster occurs on a weekend or holiday, a Western Union Mailgram describing the status of Fed services will arrive the following business day.

Detailed instructions that explain how to access Fed services in the event of a disaster were recently mailed to banks. If you have any questions about our disaster recovery plan, please call Jim Gagen at (314) 444-8754.

Truncation: Is Now the Time?

As you know, truncation is not a new idea. You've heard all about it before, and you know the conventional wisdom: the customer won't go for it.



But many credit unions started taking a chance on truncation years ago. And some believe that given the current banking environment, the time for others to follow suit is now better than ever.

As competition for customers increases, as profitability declines and as banks continue to seek ways to cut non-interest expenses, truncation has become one sure way banks can effectively reduce costs.

Many banks that have adopted truncation have significantly reduced postage, storage, labor and, in some cases, capital costs. At the same time, they have succeeded in satisfying customer needs.

Many banks have introduced truncation slowly by offering it as a service to new customers like college students or young families. Some banks have offered lower-cost truncated checking accounts to their customers.

According to Diane McCluskey, an assistant vice president and cashier with the Independent Bankers' Bank of Illinois, the time to start educating customers on the value of truncation is now.

"With all the benefits of truncation, we can no longer afford not to use it," says McCluskey. "If we don't begin truncating checks at some point, 50 years from now bankers will still be saying the same thing."

Throughout the country, many banks have truncation success stories to tell.
One truncation leader is Penn Security Bank in Scranton, Pennsylvania. Penn Security currently boasts 97 percent truncation, which has resulted in cost savings of approximately $80, 000 each year for the past five years.

"As expected, we saved on both postage and labor, cutting our bookkeeping department in half," said D. William Hume, senior vice president. "There are a lot of advantages to truncation and very few disadvantages."

How Penn Security introduced truncation is described in the ABA pamphlet "How to Evaluate and Implement Check Safekeeping," which can be obtained by contacting the National Automated Clearing House Association.

According to Hume, the transition to truncation is just a matter of time. Sooner or later everyone will be truncating. And, because Penn Security introduced it early, they are now ready to take on other innovations, like imaging.

Perhaps today, the question is not "why truncation," but "why not?"

St. Louis FED Offers Truncation

In April, the St. Louis Fed began offering Check Truncation, making the service available throughout the Eighth Federal Reserve District. Last summer, the service was introduced in Little Rock, Louisville and Memphis.

Check truncation is the separation of MICR information from paper. After capturing the MICR line data and microfilming your checks, the Fed delivers the data and related totals to you electronically or on magnetic tape. The checks meanwhile are placed in safekeeping. The information collected includes ABA routing transit numbers, customer account numbers, check numbers, dollar amounts and trace numbers.

With the new truncation service, the Fed will also balance your cash letter, correct misreads and include reject and fine-sort items. Truncated checks will be saved for 90 days before being destroyed; the microfilm is stored for seven years. Upon request from the payor institution, the Fed will provide customers with photocopies of any check within 24 hours and will return any truncated item to the bank of first deposit.

The new truncation service can also be tailored so that only specific accounts or range of accounts are truncated.

For more information on truncation, please contact Customer Support toll-free at 1-800-333-0869 or contact the Check Department at your local Fed office.

FedFacts

Fed Cash Services Rated Highly

A recent survey of Eighth District cash customers paints a flattering portrait of the Fed's cash services: more than 90 percent of survey respondents rated us above average.

The survey response rate—a whopping 50 percent— was significantly higher than we expected. As with any survey, areas of improvement were also identified, and these areas are currently being investigated. In the meantime, we appreciate the vote of confidence.

HMDA Software Released

A PC software program developed to improve the efficiency of collecting Home Mortgage Disclosure Act data was recently released to various Eighth District financial institutions.

The HMDA Data Entry System will help institutions manage the ongoing status of their loan applications and ultimately expedite the processing of disclosure and aggregation reports.

We have found that lenders who submit their data in an automated format are able to significantly reduce errors; built-in edits will further verify data accuracy and completeness.

For more information about the HMDA Data Entry System, call (314) 444-8555.

St. Louis Clears Canadian Checks; Memphis Extends Check Deadlines

Earlier this month, the Fed offered one new check service and improved another.

In the St. Louis zone, a new Canadian check-clearing service is now being offered in conjunction with the Helena Branch of the Federal Reserve Bank of Minneapolis. The service is available to current depositors, for direct-send and consolidated shipments only. For more information, please call Gary Auer or Frank Blacharczyk at the St. Louis Fed at 1-800-333-0810, ext. 8463.

In the Memphis zone, check deadlines for mixed local and mixed other Fed deposits have been extended from 10 a.m. to 10:30 a.m. for both forward and qualified return item collections. For more information, call David Garavelli or Travis Smith at the Memphis Branch at (901) 523-7171, ext. 365 or 203, respectively.

Calendar

Upcoming Fed-sponsored Events for Eighth District Depository Institutions

May 21
Regional Economic Forum
Columbia, MO

June 5
Functional Cost Analysis (FCA) Workshop
Little Rock

June 25
FCA Workshop
St. Louis

June 27
FCA Workshop
Springfield,MO

July 10
FCA Workshop
Memphis

July 17
FCA Workshop
Louisville

For more information on these meetings, please call 314-444-8320.

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