Federal Reserve Bank
of St. Louis

CB
CENTRAL BANKER

Winter 1991

News and Views
for
Eighth District Bankers

St. Louis Fed Launches Bank Relations Effort

The newsletter you are reading is not just any newsletter. It's *CB*, the *Central Banker*, the St. Louis Fed's new quarterly publication, which kicks off a bank relations effort.

CB is the first of three steps the St. Louis Fed will take in 1991 to improve communications with Eighth District depository institutions.

Other steps include a bank visit program and more frequent Fed-sponsored informational meetings throughout the District.

CB, which will be mailed to CEOs of District institutions, will report on important Fed information–just the facts–that banking leaders in the Eighth District need to know, along with other interesting research and regulatory topics. Regular features will include a regional roundup, a calendar and a "feditorial."

Meanwhile, our officers will begin paying annual informational visits to CEOs of all member and some nonmember banks. (The visits will be friendly, how-can-we-help-you calls.) The result is that banks will have an ombudsman at the Fed, someone to call with a question.

For more information on these efforts, please contact the Office of Public Information, (314) 444-8310.

CRA Ratings: What the Fed Will Disclose

The Federal Reserve has received numerous calls from parties interested in the CRA public evaluation reports. Such callers typically request a list of institutions the Fed has examined since last July 1 and their corresponding ratings.

Since last summer, banks and savings and loans are required to make their CRA reports available to the public 30 business days after receiving them from their supervisory agency.

Until this 30-business-day period has passed, the Fed will release no information about an institution's CRA evaluation. After this time, we will disclose the names of institutions that have been evaluated, but will refer callers to the institutions themselves for more information. In addition, we will release certain District-wide information. For example, as of January 1, 1991, we had completed 15 CRA evaluations in the Eighth District; all 15 received a "satisfactory" rating.

If a caller wishes a copy of your bank's evaluation report, you may charge a reasonable mailing and reproduction fee, since the option to review the documents in person is available at no cost.

For further information, please call Consumer Affairs at (314) 444-8445.

Feditorial

Closer Contact Can Ease Uncertainty

Thomas C. Melzer

The Persian Gulf. The economy. The S&L situation. Clearly, 1990 was a year of uncertainty, filled with new issues but few resolutions. In such complicated times, communications become increasingly important. As I'm sure you will agree, this is true today in the banking community.

Although the Federal Reserve Bank of St. Louis may not be able to eliminate uncertainty, we can help bankers adapt to the changing environment by providing clear, up-to-date information on Fed activities, and we have made that our 1991 New Year's resolution—to improve communications with depository institutions in our District.

How do we propose to do this? By launching a bank relations effort that will include this newsletter, a bank visit program and more regular Fed-sponsored informational meetings throughout the Eighth District. Too often, we believe, bankers view us as another in a long line of confusing, complicated bureaucracies. We hope to make the Fed easier to understand and more responsive to your concerns.

The initiation of *CB* and more regular contact with District bankers, we hope, will lead to improved service on our part and increased understanding of the Fed on yours. In addition, you'll have a few more names to call when you need an answer.

Because the objective of this program is to improve communications, we are interested in hearing from you. We would particularly appreciate any feedback you may have on the content, style or readability of this newsletter and on the bank visit program.

Please let us know what you think. This is one New Year's resolution we intend to keep.

Thomas C. Melzer is the president of the Federal Reserve Bank of St. Louis.

FCA Service Alive and Well

After an outcry from customers and industry groups, the Federal Reserve has revived its Functional Cost Analysis (FCA) service for small and medium-sized financial institutions. The Fed had previously announced that it would discontinue the service.

FCA is a cost accounting program that compares institutions of similar characteristics. Once a year, participants gather data on income, expenses and volume for various functional areas within their organizations and submit this information to the Fed. The Fed edits the data, processes it and produces an annual report for each participant that illustrates how the organization is performing compared to last year, as well as how it compares to its peers.

The annual report is detailed and tailored to the institution. Peer groups are determined by size, specific product activity, and other factors. However, participants can request comparisons based on other criteria if they wish. The Fed will also provide support in interpreting the report.

FCA can be used to price products, control costs, and evaluate key operating functions, as well as to measure overall performance. The charge for the service, which includes a copy of a national average report, is nominal—$150 a year.

The Fed, along with industry trade associations, plans to market the 30-year-old FCA service aggressively in an effort to increase participation. Over the next two years, several enhancements to the program will be offered. The first additions to FCA will be analyses of home equity loans, ATMs and ACH transactions. For more information, call John Lorentz or Flora Armon at 1-800-333-0869, or in St. Louis at 444-8322.

Thomas B. Mandelbaum

Regional Economic Multipliers: The Ripple Effect

A boulder drops into a pond. While its initial impact makes the biggest splash, the ripples surrounding its entry are more widespread and long-lasting. Similarly, a dramatic change in a region's economy–the opening of a major manufacturing plant or the construction of a convention center–will have both a direct and a "ripple" effect on the region's economy.

How a new construction project will affect the local economy is hard to predict. Multipliers provide logical, but sometimes inaccurate, estimates.

Recognizing the importance of these indirect, ripple effects, economists and city planners often find themselves discussing something called "regional economic multipliers." Such multipliers are one way to predict how a change in the economy will affect a region's employment or income. A multiplierof three, for example, indicates that, for every new job created, two additional jobs will be generated in the region.

This additional activity is the result of firms in a region buying goods and services from one another. Suppose, for example, a new manufacturing plant opens, directly adding 500 new jobs to the local economy. As it buys industrial inputs and business services from other firms in the region, and as its new workers spend a portion of their earnings on locally produced goods and services, additional jobs and incomes are generated throughout the region. Often, these ripple effects can end up exerting a stronger influence on the regional economy than the plant's initial effects did.

Such multipliers are used in a variety of situations. Local governments might use them to justify their investment in a public project, like an airport expansion. Regional planners might use them to help estimate the total number of additional classrooms or public utility capacity needed to accommodate a major manufacturing facility. Multipliers might also be used to anticipate the reduction in economic activity that will result from some cutback, like a plant closing. Given their widespread use, it is important that these figures be accurate; few realize, however, where multipliers come from or how meaningful they are.

In many cases, a regional multiplier is derived from an input-output model, which is simply a mathematical way to describe the relationship among all the sectors of a regional economy. Unfortunately, multipliers are imperfect estimates because of the way in which the model is put together.

It is prohibitively expensive, for example, to survey all of a region's firms in constructing the model, so estimating procedures are used. These procedures often rely on limited or outdated information.

Moreover, if the structure of the economy changes substantially after the model is developed, its multipliers will likely be inaccurate. Many widely used regional models are derived from U.S. input-output relationships as they existed in 1977.

The model also relies on assumptions that are sometimes suspect. For example, the relationship between an industry's production and its pattern of purchases from other regional businesses is assumed to be fixed. In practice, this is often not true. As a business expands or contracts, it may radically change its pattern of purchases. A manufacturer in the midst of an expansion, for example, will likely purchase proportionately less labor per unit of output or buy more inputs from suppliers in other regions.

Another big problem is that people simply misinterpret what multipliers mean. Part of the problem is that the economic effects that multipliers identify are often transitory. A large drop in government purchases of aircraft produced in St. Louis, for example, would reduce employment throughout the metropolitan area; however, a portion of this reduction will be only temporary, as some workers who lost their jobs find new jobs in the area.

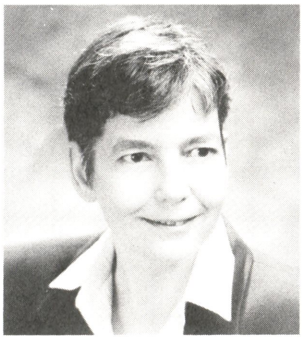
Despite these drawbacks, regional economic multipliers often provide the best available guess about the effects of a big change in the economy. Because of their limitations, however, keep in mind that such effects are merely estimates, subject to considerable error.

Thomas B. Mandelbaum is an economist at the Federal Reserve Bank of St. Louis.

Regional Roundup

Karr Joins St. Louis Bank

Mary H. Karr joined the St. Louis Fed as vice president, general counsel and secretary on January 1, 1991. Karr succeeded Joan P. Cronin, who was named senior vice president over the Banking Supervision and Regulation division last year.



Karr previously was a partner with Peper, Martin, Jensen, Maichel and Hetlage, where she represented banks and bank holding companies in regulatory and compliance matters. She was also involved in mergers, acquisitions and general corporate work.

Karr received her bachelor's and law degrees from Washington University in St. Louis and is a member of the American Bar Association, the Missouri Bar, the Florida Bar Association and the Bar Association of Metropolitan St. Louis.

Real Estate Loan Shakeout Limited at District Banks

Despite increasing real estate loan problems across the nation, Eighth District commercial banks remain relatively unscathed. The proportion of District real estate loans in nonperforming status remained at its September 1989 level of 1.83 percent in September 1990, while the ratio at U.S. banks of comparable size rose from 2.73 percent to 3.07 percent. Real estate loans made up slightly more than half of all nonperforming loans at both District and U.S. banks during the third quarter.

Real estate loans continue to grow faster than total loans at both District and U.S. peer banks. Real estate loans on the books of District banks rose 10 percent from September 1989 to September 1990, while total loans increased 6.4 percent. At U.S. banks of comparable size, real estate loans increased 6.2 percent over the period, compared with 3 percent total loan growth. Residential lending accounts for much of this growth.

District Service Industry A Boon

Led by spectacular growth in health and business services, the service sector of the Eighth District economy grew more rapidly than any other sector in the past three decades, according to Fed economist Tom Mandelbaum. At the same time, manufacturing's share of jobs fell sharply. This pattern also emerges in the national picture.

The employment shift from manufacturing to services does not mean, however, that the U.S. is losing its industrial base, Mandelbaum says. Instead, it reflects manufacturing's success in increasing productivity.

In fact, such gains in manufacturing productivity are responsible for consumers' mounting affluence. This affluence allows consumers to buy more services, boosting their growth.

For more on this, see the December issue of the St. Louis Fed's regional research quarterly, *Pieces of Eight*. Also stay tuned for the March issue, when the author asks the question, Are service jobs good jobs?

Fed Enhances EDITH With TT&L

Beginning in the first quarter of 1991, a new TT&L application will become available for EDITH customers. EDITH (which stands for Eighth District Interactive Telephone Helpline) is an automated voice response system that allows financial institutions to tap into the Fed's computer using a touch-tone telephone.

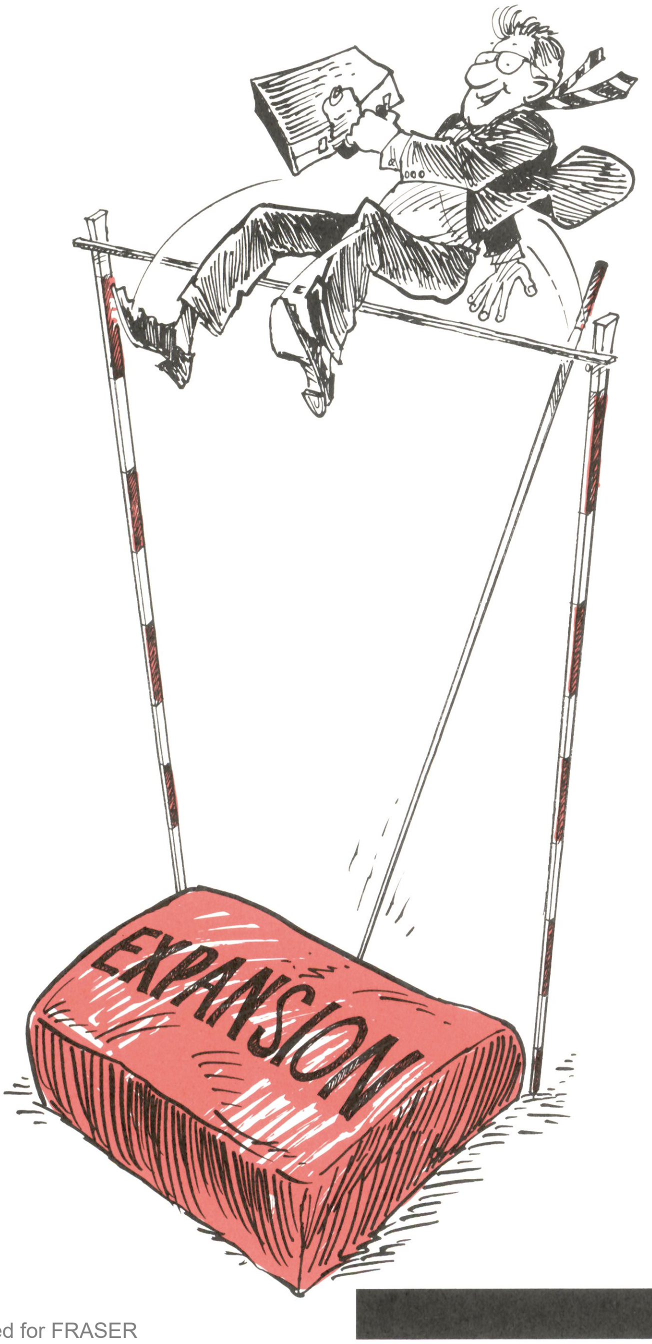
The new TT&L application will allow institutions to:

- enter advice of credit deposits. This will help institutions who depend heavily on mail or courier services to avoid incurring late fees.
- obtain TT&L account balance information, including pending withdrawals and investments.
- obtain cycle accounting information.

The new TT&L application joins EDITH's other applications, ACH return items, account balance information, check auto charges and mixed cash letter availability. Customers using the latter two check applications will soon begin receiving these same services for return items.

Capital Adequacy for Expansion-Minded Banks

As of the first of the year, the Fed began evaluating capital adequacy by looking at two capital/risk ratios and a leverage ratio. Increasingly higher minimums for these ratios will be phased in over the next two years.



These minimums are not the whole story, however. The Fed expects only the healthiest banks to be operating near the low end of these allowable ratios. Others should have capital ratios 100 to 200 basis points above the minimum— even higher if the risk profile of the organization warrants.

This is particularly true of organizations experiencing growth—whether internally or by acquisition. In assessing the capital adequacy of an expanding firm, the Fed will review its leverage ratio, *after deducting all intangible assets*. Large bank holding companies ($150mm or more in assets) will be assessed on a consolidated basis.

Generally, financially sound companies proposing to expand or take on additional risk are expected to show stronger capital adequacy figures than their non-expanding peers. This translates into a pro forma tangible leverage ratio of at least 5 percent and a total capital to risk-weighted assets ratio of between 9 and 10 percent, using the formula established for the fully phased-in 1992 standards. Any decline in these ratios that results from the proposed transaction will be taken into consideration.

In general, the Fed believes that holding companies in less-than-satisfactory condition should focus on methods of improving their financial condition, rather than opportunities to take on additional risk.

Capital Adequacy: The Basics

The new risk-based capital ratios took effect on January 1 for all state member banks and for BHCs with assets of at least $150 million. National and state nonmember banks are subject to the same standards from their primary regulator.

To qualify as having adequate capital, a firm should have:

- well-diversified risk (including no undue interest rate risk exposure)
- excellent asset quality
- high liquidity
- good earnings
- leverage ratio of at least 3 percent
- risk-based total capital ratio of at least 8 percent.

Those that do not meet the first four standards must have a higher level of capital to be considered adequate. The Fed expects most banks to maintain a leverage ratio of at least 4 percent to provide for unanticipated adverse operations or economic conditions.

Until the end of 1992, when these guidelines become fully effective, transitional guidelines will permit a total risk-based capital ratio of 7.25 percent. This will allow time for certain multinational and money center banks to meet the 8 percent minimum.

FedFacts

New Services Directories Shipped

The 1991 services directories for the St. Louis Fed and its branches in Little Rock, Louisville and Memphis will be shipped shortly. The directories are handy guides to the important telephone numbers and contact persons for various Fed services and information. Customers may order additional copies by calling (314) 444-8444, ext. 501.

New Check Deadlines in St. Louis Zone

The St. Louis office announced some new check deadlines starting March 4. The early mixed and other Fed deposit deadlines, for both forward and qualified return items, will move from 8 to 8:30 p.m.; the regular mixed and other Fed deadline will go from 10:30 to 11:15 p.m. Country deadlines, previously set at 10:30 p.m., will move to 12:01 a.m. Country group sorts will move from 11:30 p.m. to 1 a.m., while country fine sort moves from 12:01 to 1:30 a.m.

At the same time, two new products will debut: a late, other Fed, pre-processed deposit option at 10:30 p.m. (the early deadline moves from 7 to 7:30 p.m.) and a country premium fine sort option with a 2 a.m. deadline. These improvements will make it easier for depositors to reach the Fed and allow current customers time to include more items in their deposit. For further information, contact Customer Support at 1-800-333-0869, or in St. Louis at (314) 444-8680.

Say Good-Bye to FEDNET

At the stroke of midnight December 31, 1990, the St. Louis Fed's PC-based communications system called FEDNET ceased to exist. All 500 of our customers have been converted to Fedline, a new system that was developed for the entire Federal Reserve System.

When FEDNET was introduced in 1983, the only service available was wire transfer. Today, Fedline offers customers access to wire transfer, ACH, TT&L, accounting, savings bonds, check and U.S. government security transfer services.

FR2900 To Go Over Fedline in 1991

Weekly reporters to the Fed's FR2900, "Report of Transaction Accounts, Other Deposits and Vault Cash," will be able to transmit their reports electronically over Fedline sometime in 1991. Currently, about 700 institutions file their FR2900 reports weekly. The new service will be free of charge. Additional information will be distributed in the coming months.

Calendar

Legal Holiday Schedule for the Remainder of 1991

Day	*Date*
Monday	*February 18*
Monday	*May 27*
Thursday	*July 4*
Monday	*September 2*
Monday	*October 14*
Monday	*November 11*
Thursday	*November 28*
Wednesday	*December 25*

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