



CB CENTRAL BANKER

Spring 1993
News and Views
for
Eighth District Bankers

Fed Sponsors Payments System Risk Meetings

To better acquaint customers with changes to the Federal Reserve's Payments System Risk (PSR) policy, the St. Louis Fed is holding informational meetings this spring in 22 cities throughout the Eighth District.

In each two-hour meeting, Fed staff members cover the new policy and the revised formula for measuring and

pricing daylight overdrafts. Cash managers and check operational officers may benefit most from attending. (For a list of upcoming meetings, see the calendar on the back page.)

The changes to the PSR policy, which will be phased in beginning October 1993, are part of a major initiative to reduce the Fed's risk from excessive

daylight overdrafts at large institutions. Though pricing is not expected to affect most Eighth District account holders, the new posting rules could affect bank operations.

If you have questions about the new PSR policy but are unable to attend a meeting, please call Hillary Debenport at (314) 444-8488 or your local Fed accounting officer.

District Banks Have Record Year In '92

In the Eighth Federal Reserve District and across the nation, 1992 was a winning year for the banking industry. District banks racked up record profits with a Return on Average Assets (ROA) of 1.14 percent—a significant stride ahead of the industry benchmark of 1 percent.

Net income at District banks was spurred by strong core earnings resulting from favorable net interest revenue.

The District's net interest margin increased each quarter during the year as a result of low short-term interest rates. Lower loan loss provision expenses and gains on the sale of securities also bolstered earnings.



Asset quality measures indicated steady improvement, with both nonperforming loans and net loan losses declining. When compared with their national peers, District banks

reported even lower levels in both of these areas.*

By year-end, for example, the District's nonperforming loans declined 19.6 percent to their

(Continued on next page)

Feditorial

How The Fed Is Helping Institutions Address Payments Systems Risk



James R. Bowen

For several years now, the Federal Reserve has been concerned about payments system risk (PSR). In an effort to reduce PSR, the Fed will soon implement a new method of measuring daylight overdrafts, which occur when an institution has a negative Fed account balance during the day. More important, starting in April 1994, the Fed will begin charging institutions that have excessive daylight overdrafts.

When the Federal Reserve Board of Governors began addressing PSR, its objective was to minimize the possibility of settlement failure by reducing the amount of intraday credit exposure and by encouraging institutions to control overexposure better. Currently, Reserve Banks' aggregate peak in daylight overdrafts amounts to \$170 billion per day.

Establishing the new PSR program is a big step that likely will affect all Fed account holders to some degree. Although we expect the impact on Eighth District financial institutions to be

minimal, we want to make sure that you understand what these PSR changes are.

To help institutions prepare, the Federal Reserve Bank of St. Louis is hosting PSR informational meetings throughout the District. (See the related story on page 1.)

In addition, to assist institutions with the management of their Federal Reserve accounts, the Fed will provide new reports with detailed information on overdrafts incurred and any associated charges. On-line customers will be able to monitor their balances and retrieve information on transactions posted throughout the day, and the Fed will offer morning and midday account balance updates on EDITH, our telephone voice response system.

Although the changes you'll be experiencing may impose some initial adjustments for you, it's important to remember the benefit they'll bring—a more stable payments system.

James R. Bowen is the first vice president at the Federal Reserve Bank of St. Louis.

Record Year

(Continued from page 1)

lowest level in years—to 1.31 percent of total loans. Additionally, net loan losses averaged 0.64 percent of total loans in 1992, down from 0.74 percent in 1991. This compares with the U.S. peer ratios of 2.27 percent for nonperforming loans and 1.08 percent for net loan losses.

At the end of 1992, District banks had a comfortable reserve level of 138 percent of nonperforming loans.

With such a strong showing in earnings in 1992, District

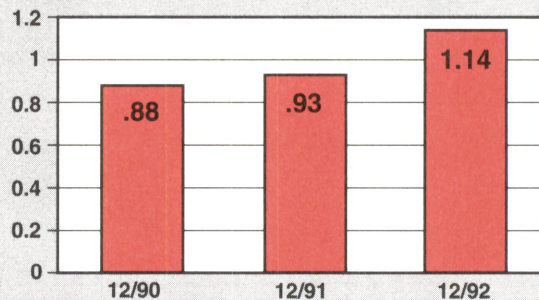
banks' equity capital grew by 9.9 percent. This compares with asset growth of 4.7 percent. A good portion of the growth in assets is due to the acquisition of failed thrifts.

As all trends continue to move in favorable directions, District bankers seem positioned to make 1993 another successful year.

** National peers are U.S. banks with less than \$15 billion in average assets. As of Dec. 31, 1992, all District banks met this criterion.*

Return On Average Assets

Percent





R. Alton Gilbert

Are Annual Bank Examinations A Good Thing?

By any yardstick, the FDIC Improvement Act of 1991 (FDICIA) has dramatically changed the lives of both bankers and bank supervisors alike. Many bankers, arguing that the act imposes an excessive regulatory burden, would probably say it's changed their lives for the worse. And some have called for the repeal of several of FDICIA's provisions.

Leaving aside the broader issue of whether the burden of FDICIA is excessive, let's take a brief look at one of the act's controversial provisions—the requirement that banks be examined annually.

To assess this provision's merit, one must answer the question, Do annual examinations make supervisors more effective in limiting the Bank Insurance Fund's (BIF) losses? One can reasonably call for a repeal of the annual examination requirement if one can show that the additional expense that banks and their supervisors must incur to comply with the requirement are not offset by some measurable savings to BIF. Are there reasons to believe that there will be such a savings?

In a recent study, published in the January/February 1993 issue of our Bank's Review, I investigated several of these issues, using information on more than 800 banks that failed between 1985 and 1990. The first issue was whether examination reports had been successful in identifying problems at banks before they failed. As it turns out, more than 90 percent of the banks that later

failed had been classified as problem banks in examinations before their failure. While this record is not perfect, it does demonstrate that examiners are typically able to distinguish between a sound and a troubled bank.

A second issue is whether examiners discovered problems at banks that were not revealed in previous call reports. If annual examination reports reflect merely the information in the call reports, they are of little use to supervisors in identifying problems. Focusing on a large group of banks that were downgraded to problem status after they were examined, we found relatively large declines in equity at the time of the examinations and relatively large increases in nonperforming loans on call reports just after the examinations. Thus it appears that examiners did discover problems not revealed in the call reports.

A third issue is, Do supervisors use the information obtained in annual examinations to constrain the behavior of problem banks? If one looks at asset growth rates and dividends at banks that were downgraded to problem status, one finds sharp declines in both. Thus problem banks stopped accumulating assets and stopped paying out dividends following their examinations, a change in behavior that would tend to lessen BIF's exposure to losses.

A fourth question gets to the heart of the relationship between examination frequency

and BIF's losses: Are such losses smaller at banks that were examined during their last 12 months of operation? The answer is yes; in the group studied, the ratios of BIF losses to total assets were smaller for

To repeal FDICIA's annual examination requirement, one must show that the extra expense banks and their supervisors incur for compliance are not offset by savings to the Bank Insurance Fund.

those banks that were examined in their final 12 months.

One can conclude then that annual examinations do make bank supervisors more effective in identifying troubled banks and in limiting BIF's exposure to losses. Any argument to repeal this provision of FDICIA, therefore, must be made on the grounds that the cost of conducting and complying with annual examinations is greater than their value to bank supervisors.

R. Alton Gilbert is an assistant vice president and economist at the Federal Reserve Bank of St. Louis. For more information on this topic, see the January/February 1993 issue of Review, the St. Louis Fed's bimonthly research publication which you can receive by calling (314) 444-8809.

Regional Roundup

OUT FOR

COMMENT

The following are Federal Reserve System proposals currently out for comment:

■ **Proposal to revise Regulation E, which implements the Electronic Fund Transfer Act, to cover electronic benefit transfer programs. Comments due by May 21, 1993. (Docket No. R-0796)**

Direct all comments to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th St. and Constitution Ave., N.W., Washington, DC 20551. For copies of proposals out for public comment, contact Anne Guthrie at (314) 444-8810.

Treasury Changes Multiples For Buying Securities

Last month, the Treasury changed the multiple *above the minimum standard amounts* for purchasing Treasury bills, notes and bonds. Previously, securities were sold in varying multiples above the minimum amounts; as of April 5, securities can be sold in multiples of \$1,000 above the minimums.

This change applies to outstanding securities as well as new issues. The remaining par amount of a security in an account after a transfer will continue to be subject to the minimum standard amounts.

If you have any questions about this change, please contact the Securities Department at your local Reserve Bank office.

Rules for Refunding Unearned Interest Amended

Unearned interest from consumer loans will soon be calculated by a method "at least as favorable to the consumer" as the actuarial method, according to the Housing and Community Development Act of 1992.

The ruling affects consumer loans issued for longer than 61 months and consummated after Sept. 30, 1993.

In addition, refunds must be promptly issued if loans are prepaid in full and, upon request, creditors must provide consumers with a prepayment statement for any precomputed consumer credit account. If requested, one prepayment statement must be provided to a consumer at no cost each year.

Reg DD Compliance Date Nears

Beginning June 21, Fed examiners will start reviewing banks for compliance with Regulation DD, Truth in Savings.

Specifically, examiners will request information about the type of accounts offered and will review the disclosures accordingly. Additionally, examiners will want to see copies of printed advertisements and text for television and radio advertisements.

For questions about Reg DD compliance, call the Federal Reserve Board "hotline" at (202) 736-5500.

Fed's Consolidation Countdown Begins

The sites have been chosen. The timetable's set. Testing is right around the corner. The countdown to the Fed's consolidation of critical computer operations has begun.

As we announced last year, Federal Reserve facilities at Richmond, Dallas and East Rutherford, New Jersey, were chosen as the three automation consolidation sites for the Federal Reserve System's primary mainframe data processing.

The East Rutherford Operations Center (EROC) will be the ultimate home to the Fed's centralized applications such as ACH, Funds Transfer, Securities Transfer and Accounting. Eighth District Funds and Securities Transfer operations will be temporarily transferred to Richmond in November 1993 but will be centralized at EROC by 1995.

In addition to housing the above centralized applications temporarily, the Richmond site will act as a contingency back-up site for the critical payments systems being run at EROC. It also will provide the support for "District-unique"

nonpayments applications such as Billing and TT&L for East Coast financial institutions.

For Midwest and West Coast financial institutions, the consolidation site for these nonpayment applications will be Dallas. The St. Louis Fed will be transferring these applications beginning May 1994. Dallas also will act as a secondary contingency back-up facility for the critical centralized payment applications running at EROC.

We'll continue to keep you informed of our progress and of any changes that may affect you.

ACH Enhancements Provide More Services Around The Clock

Choices. That's what ACH customers can expect beginning Oct. 1, 1993, when the Fed offers several new enhancements to its current ACH service.

The new system, called Fed ACH '93, offers more flexibility and processing options than

the current ACH system allows.

For one, Fed ACH '93 gives customers a more continuous flow processing environment by adding two new deposit cycles, bringing the total number of deposit times each day to four. In addition, deposit times have been extended up to two-and-a-half hours.

With Fed ACH's increased flexibility, originators can choose to deposit more often, deposit later or receive ACH information earlier. Receivers can choose more frequent deliveries of ACH items—as frequently as four times each day—and, by receiving data earlier, have more time to post items to customer accounts.

“With double the number of cycles available, our customers can move outgoing items to endpoints faster and can receive items sooner,” Jerry McGunnigle, assistant vice president in the Fed's Electronic Services Department, says. “This offers our financial institutions several additional

hours to prepare their items; or they can pass this processing time on to their customers and maybe even attract new ACH business.”

Correspondent banks and ACH data processors will also be able to better control their daily processing with a feature that will allow files to be sorted by depository institution. Other new features include enhanced cross-district processing, later return item deadlines and improved file tracking information.

Fed ACH '93 is the latest step in the Fed's plan to improve ACH processing. Several additional enhancements will be made to the ACH environment in 1995 that will offer near-continuous, round-the-clock ACH processing.



St. Louis' Savings Bond Operations Will Move To Kansas City

Over the next few years, the U.S. Treasury will reduce the number of Federal Reserve offices that process savings bond transactions from 18 to five. When consolidation is complete, Eighth District financial institutions will interact directly with the Federal Reserve Bank of Kansas City for savings bond information.

The transfer of savings bond operations to the Kansas City Fed will begin with Kentucky and Indiana institutions this July. Arkansas institutions

come next in April 1994, followed in May by Mississippi and Tennessee institutions. Institutions in Illinois will transfer their operations next July, and the final phase—involving Missouri institutions—will occur in August 1994.

The consolidation is one phase of the Treasury's plan to modernize the U.S. savings bond program while reducing administrative costs and maintaining good customer service.

Institutions will be contacted by Fed representatives at least

60 days before their transition date to discuss how the changes will affect them, as well as what specific actions may need to be taken.

If you have questions about the Fed's savings bond program, please call Judie Courtney at (314) 444-8630.

FedFacts

Calendar

Upcoming Fed-sponsored Events for Eighth District Depository Institutions

St. Louis Office Announces New Group Sorts

As of March 15, the St. Louis office began offering one new RCPC and two new Other Fed group sorts. For a little more work on the depositor's part, these group sorts offer an hour later deadline at significantly lower prices.

The RCPC Group Sort offers a 3:30 a.m. deadline for \$0.014 per item and a \$1.25 cash letter fee.

Other Fed Group Sort No. 1 has a 10 p.m. deadline, and No. 2 has a 12:15 a.m. deadline. Each has a \$0.043 per item and a \$1.50 cash letter fee.

For a listing of the endpoints in the group sorts or for more information, contact Customer Support at 1-800-333-0869.

Pricing of Account Post Sort Service Simplified

This past April, the St. Louis Fed changed the way it charges for the Account Post Sort service to simplify the billing process and help potential customers more accurately predict their costs.

Customers using this service will now be charged a flat \$0.012 per item rather than \$0.002 per item, per pass.

With Account Post Sort, available exclusively to MICR Plus customers, the Fed sorts checks drawn on MICR Plus customers before forwarding them to the payor bank.

For more information on our Account Post Sort or MICR Plus services, call Customer Support at 1-800-333-0869.

Cash Ordering Services Available Soon

Beginning this July, the St. Louis Fed will be offering its cash-ordering services over Fedline® and EDITH®.

To access the new cash services, all customers—even those who currently use Fedline and EDITH for other services—will need a unique personal identification number (PIN) specifically for ordering cash.

The Fed recently requested user information to assign the PINs. If you haven't already done so, please send this information to Customer Support at the St. Louis office.

District Dialogues

Greenville, Ms. — May 4
El Dorado, Ark. — May 5

PSR Meetings

Springfield, Mo. — May 5
Memphis, Tenn. — May 6
Mountain Home, Ark. —
May 11
Columbia, Mo. — May 13

CRA Training

Little Rock, Ark. — May 26
Memphis, Tenn. — May 27
St. Louis, Mo. — June 15
Louisville, Ky. — June 16



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