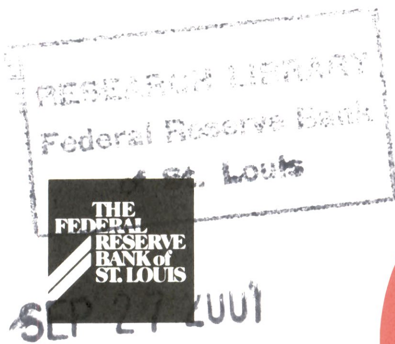


CB
CENTRAL BANKER

Winter 1993

News and Views
for
Eighth District Bankers

Confusing Signals Made Recovery Hard to Recognize

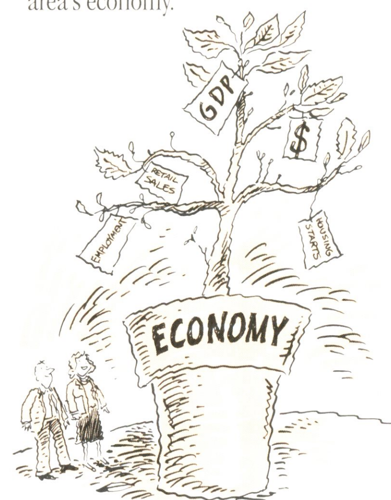
The U.S. recession that began in August 1990 ended almost two years ago—in March 1991—the National Bureau of Economic Research (NBER) reported this past December. So why did it take 21 months to declare the end of the eight-month recession?

"It was difficult to pinpoint the end of the recession because of the unusually slow recovery that followed it," says Fed economist Keith Carlson.

According to the NBER, which has been dating recessions since the 1950s, a recession has ended only after the economy has regained the ground lost during the recession. In this case, various indicators did not all signal recovery at the same time.

"Though we saw growth in some important indicators like real GDP, other indicators like employment growth did not provide strong support," Carlson explains. "In fact, the current expansion is the weakest in job performance of any postwar recovery."

Are there signs of recovery in the Eighth District? Yes. Area retailers report the strongest holiday season in three years. Manufacturers report increases in sales and employment, and single-family home construction continues to buoy the area's economy.



Fed Takes Steps To Improve HMDA Data Collection

When 1991 Home Mortgage Disclosure Act (HMDA) data reflected another year of disparities in approval and rejection rates for minority and white borrowing, one action the Fed took was to ensure the quality of data reporting.

The St. Louis Fed, for example, has taken the lead in developing a PC software package that helps institutions manage their loan applications. Institutions should receive the free package by the end of this month.

The new software has security features to limit the access of users as well as built-in edits to better verify data for correct format, accuracy and completeness. The St. Louis package has been adopted nationwide by five regulatory agencies (Federal Reserve, OCC, FDIC, NCUA and HUD).

The St. Louis Fed has also released the first of its series of Eighth District community profiles to help bankers identify major credit needs and programs that help meet those needs. The results of that study—on the St. Louis city and county area—are found on page two.

In the Feditorial (also on page two), Randall Sumner, vice president of Credit and Community Affairs, describes additional actions taken by regulatory agencies and offers advice to banks on how to improve their HMDA ratings.

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Feditorial

Regulators Share Concerns Raised by HMDA Data: Is There Anything Banks Can Do?

Randall C. Sumner

The 1991 HMDA data has received much publicity lately on two fronts. While reports on the differences in approval and rejection rates for minority and white lending trigger claims of discrimination, some lending institutions contend that data is not precise enough to draw such conclusions.

Though it's true that the data collection process may need more refinement, and that the late release of 1990 data left banks little time to implement improvement programs in 1991, regulatory agencies agree that disparities do exist to some degree. And the Federal Reserve, like other regulatory agencies, is counting on a more encouraging report next year.

What more can banks be doing to increase lending to minorities and ultimately reduce the disparities reported in HMDA?

For one, banks can promote loan products by advertising in publications, radio stations and other media targeted to minority audiences. Some have found it productive to establish lender call programs to reach realtors operating in minority and low- and moderate-income areas and to offer incentives to loan officers for making loans in these communities.

Locating branches or loan offices in minority neighborhoods, especially if it is currently underbanked, is extremely effective in developing new customers.

Finally, some institutions are providing second reviews of turned-down applications to ensure policies and exceptions are applied consistently for all applicants.

While banks continue to improve access for minority borrowing, regulatory agencies are doing their part to improve the quality and consistency of data reporting.

In addition, the Federal Reserve was among five regulatory agencies that recently hired Arthur Andersen & Co. to review compliance exams and recommend policies that both deter and detect discrimination. The company was chosen as an outside consultant to ensure an independent review of current procedures.

Randall C. Sumner is vice president of Credit and Community Affairs at the Federal Reserve Bank of St. Louis.

St. Louis Community Profile Released

The most significant credit needs identified in the St. Louis area, according to the Fed's community profile released in December, are loans that encourage small business development and those that create affordable housing rehabilitation and development.

For small businesses, the report identifies specific needs for working capital, venture capital and start-up loans, often at small dollar amounts.

Rating at the top of the list of housing-related credit needs were financing the construction and providing mortgages for affordable housing, as well as contributing to the revitalization of neighborhoods.

Specifically, the report suggested banks reduce or eliminate minimum loan amounts on mortgage loans, offer more flexible lending criteria and loan structures, maintain more mortgage loans in the lender's own portfolio and underwrite these loans themselves.

In addition to identifying major credit needs, the study lists numerous governmental agency and community group programs that help meet these needs.

Over the next few years, similar studies will be conducted in other Eighth District cities. Memphis, Tenn., and Evansville, Ind., are next on the list.

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Daniel L. Thornton

Should the Fed Be Boosting M2 Growth?

The Fed has come under fire recently for allowing the broad monetary aggregate, M2, to fall below the bottom of its target range. (The target range for 1992 was 2.5 percent to 6.5 percent.) Some Fed critics have attributed the slow M2 growth to the bailout of failing depository institutions over the past few years and the Fed's slavish attention to its federal funds rate target. According to this argument, the Fed drained excess reserves resulting from the bailout through open market sales of government securities to prevent the funds rate from falling below its target.

The Fed would have had to let M1 grow at a brisk19 percent annual rate during the past 18 months to put M2 at the midpoint of its target range for 1992.

Has the Fed been derelict in its responsibility to keep M2 growing within its target range? M2 growth has been slow, increasing at less than a 2 percent annual rate from June 1991 to December 1992. If the critics' account is accurate and the Fed was draining reserves in response to the bailout, however, we should have seen heavy Resolution Thrift Corporation (RTC) activity and slow reserve growth during this period of slow M2 growth. Instead, total reserves increased at a rapid 18 percent rate during this period, and RTC activity slowed.

Could the Fed have prevented M2 growth from slowing? Perhaps not. Through open market operations, the Fed can directly affect the narrow monetary aggregate M1 (currency in the hands of the public and checkable deposits). But M1 accounts for less than 30 percent of M2. Moreover, it is the rest of M2 (money market mutual funds, small CDs and other savings-type deposits) that has accounted for its slow growth during the past 18 months.

The Fed, of course, could have boosted M2 growth somewhat by causing M1 to grow even faster than it did (a 13 percent rate since June 1991). But M1 would have had to grow at a brisk 19 percent annual rate during the past 18 months to put M2 at the midpoint of its target range. Back-of-the-envelope calculations suggest that reserves would have had to increase at a 29 percent rate during the period—more than 50 percent faster than they actually grew during the period.

What is causing M2's sluggish growth? Many factors have contributed. Higher deposit insurance premiums have increased the cost of deposit funds, while weak loan demand, rising capital requirements and the increased availability of nonbank sources of funds have given depository institutions little incentive to bid aggressively for deposit funds. Consequently rates on savings-type deposits in M2 have become unattractive.

In addition, some investors have invested in bond funds and other non-M2 assets that offer a higher interest rate than do M2 assets. The effect of these developments on M2 growth has been exacerbated by financial market innovations that have significantly eroded the role of traditional depository institutions as the principal purveyors of credit.

Will the slow growth of these deposits persist? It is difficult to say. It is likely that the growth of savings-type deposits will increase if the yield curve flattens during the current expansion. Their growth might also rise with the anticipated cyclical rise in loan demand.

Depository institutions, however, might meet increases in loan demand by selling some of their unusually large holdings of government securities instead of competing more aggressively for deposits. Moreover, the trend away from depository intermediaries is likely to continue.

On the whole, it seems possible—even likely—that the growth of the non-M1 components of M2 will remain disappointingly slow.

Many market participants are already concerned that reserve and M1 growth have been too rapid. Are the Fed's critics willing to risk the potential effects of even faster reserve and M1 growth on future inflation?

Daniel L. Thornton is an assistant vice president and economist at the Federal Reserve Bank of St. Louis.

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Regional Roundup

OUT FOR COMMENT

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

■ **Extension of a proposal to move the opening time for the Fedwire funds transfer service to an earlier hour. Comment period has been extended to Feb. 8, 1993. (Docket No. R-0778)**

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 Announces End to Stub Reporting of Savings Bonds

In its latest effort to handle savings bond transactions more efficiently, the U.S. Treasury will eliminate stub reporting for savings bonds.

Currently, agents issuing savings bonds via payroll deduction send bond stubs to the Fed, which passes them on to the Treasury. Effective April 1, 1993, all savings bonds purchased through payroll deduction will be issued directly by Reserve Banks and will be reported to the Treasury in a standard automated format.

By eliminating stub reporting and requiring an automated format, the Treasury can better streamline its operations.

For more information about the new procedures or available options, please contact Maria Cova at (314) 444-8707.

A Reminder About Exceptions to the Interlocks Act

Last November, the four federal agencies clarified that institutions seeking regulatory exceptions from the Depository Institution Management Interlocks Act (Regulation L) need only obtain approval of the primary federal regulator of the institution needing management expertise.

Institutions that receive approval should keep copies of the approval letter for their files.

Changes to be Made to Call Report

With the March 31, 1993, report date, additional information will be collected on the Reports of Condition and Income (Call Report), as mandated by FDICIA.

Among the new data to be collected is information on preferred deposits, deferred tax assets, all other off-balance sheet assets, extensions of credit to a bank's directors and their related interests, deposits in lifeline accounts, estimated uninsured deposits and loans that are past due 30 days or more in a nonaccurual status but are wholly or partially guaranteed by the U.S. government or agency.

For the June 30, 1993, report date, a new section to an existing schedule will be added to collect annual information on lending to small businesses and small farms.

Success of *CB* Leads to Fourth *CB* Spinoff

Since the original *Central Banker (CB)* newsletter was introduced two years ago, its success has spawned several supplementary newsletters, namely, *Community Affairs, The Cash Manager, Supervisory Issues* and, most recently, *The Check Exchange*.

While *CB* features general news on banking and economic issues and is targeted to senior management at Eighth District financial institutions, the "spinoffs" include more detailed news about certain bank functions and are targeted to a narrower audience.

Community Affairs is a semiannual publication written for District community affairs compliance officers and community organizations. It contains articles on community development strategies and helpful hints for meeting CRA compliance.

The Cash Manager, also published semiannually, is written for managers of currency and coin operations, and bank tellers at District institutions. It features news on cash services, procedural updates and interesting facts about money.

Supervisory Issues, published bimonthly, provides bankers with information on supervisory and regulatory matters, including proposed and final regulations, and policy guidelines.

Introduced just last month is our fourth spinoff, *The Check Exchange*, which is published quarterly for check operations staff in the St. Louis zone. It contains technical tips and hands-on information on the Fed's payments services and highlights electronic technology in the check industry.

The series of *CB* publications was introduced early in 1991 as part of a bank relations effort to improve communications between the Fed and District institutions.

If you have story ideas for *CB* or its spinoffs, or if you'd like to receive any of these publications, please call our Public Information Office at (314) 444-8809.

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Fed Narrows Scope of Definitive Safekeeping Business

This past December, the Fed announced it would no longer store definitive securities for safekeeping in its vaults. The securities removal will begin July 1, 1993, and should be completed by the end of the year.

The decision followed a 90-day public comment period and an 18-month evaluation of alternative options.

Only definitive securities pledged as collateral to secure joint accounts between state and local government agencies and financial institutions, and those the Fed stores to provide institutions greater security and more room in their own vaults are affected by this change.

Securities that have been pledged as collateral for Treasury Tax & Loan deposits or Credit Discount loans are not included in the change. Book-entry securities, which are a computer-stored form of security, are also unaffected.

Reserve Banks decided to withdraw from the definitive safekeeping business for two main reasons.

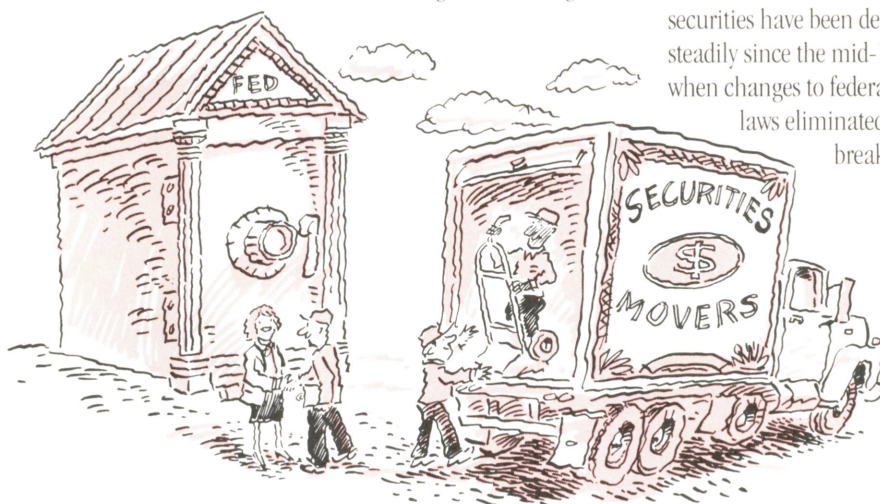
One, sales of definitive securities have been declining steadily since the mid-1980s when changes to federal tax laws eliminated tax breaks for purchasers of bearer municipal securities. This resulted in a shift to book-entry securities at the depositaries.

In addition, Reserve Banks bear high fixed costs maintaining a definitive securities vault. With the steady decline in volume, cost recovery has been difficult to achieve.

Now that the decision has been made, the Fed is working to make the transition a smooth one for customers. Several options (for example, using the services of a securities depository company, relocating the documents to a correspondent vault or their own vault) are available for those institutions that need to transfer their securities.

This spring, the Fed will contact customers to find out which options they have chosen and what arrangements must be made for the securities transfer.

For more information about this effort, please call Theresa Carroll at (501) 324-8287.



Changes To Reg F Attributed To Your Comments

Last July, the Federal Reserve Board issued for public comment a proposed Regulation F to satisfy the Federal Deposit Insurance Corporation Improvement Act (FDICIA) mandate to set standards for limiting interbank risk.

An overwhelming number of your comments opposed this proposal, generally because compliance would be costly and burdensome. Such comments were considered in the revision to Regulation F that was adopted last November.

The final version of the regulation gives banks the responsibility for limiting their own exposure to correspondents.

Specifically, the regulation requires banks to set policies for selecting and terminating correspondent relationships and establish written guidelines to prevent excessive exposure to any individual correspondent according to the correspondent's financial condition.

Banks must also regularly review such relationships to see if any correspondent's financial situation has worsened. When necessary, a bank must use internal limits to control risk.

Under the revised regulation, a bank is allowed to rely on another party, such as its bank holding company or a bank rating service, to assess the financial condition of correspondents or select and monitor correspondents.

The final regulation sets no limits on a bank's exposure to a correspondent as long as that correspondent is "at least adequately capitalized." It does limit exposure to correspondents not adequately capitalized to 25 percent of the exposed bank's capital.

Regulation F will be fully phased in over a two-year period beginning June 19, 1993.

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FedFacts

Fed Billing Statements Now Available Through Fedline

The Fed's Statement of Service Charges is now available through a Fedline connection, allowing District institutions to receive their monthly statements earlier.

If you currently use the dial-up service, your summary statement will be transmitted by the opening of business on the sixth business day of the following month. If you do not use the dial-up feature, your statement will print after you establish your Fedline session.

For more information about receiving the Statement of Service Charges electronically, contact Tony Montgomery at (314) 444-8650, Rita Dunn at (314) 444-8313 or Customer Support at 1-800-333-0869.

PC-XTs To be Phased Out For Fedline Customers

Fedline customers using XT-type personal computers (8086 or 8088 processors) will need to upgrade their hardware by the end of the year to use the newest version of Fedline. Fedline version 2.4, to be released this spring, will not support XT-type hardware.

Support for Fedline 2.3, the last version that uses XT-type computers, will continue through June 30, 1993. All Fedline customers must then convert to the newer version by Dec. 31, 1993.

Customers needing to upgrade their hardware will be contacted further by the Fed. If you have questions about this conversion, contact your account executive or Customer Support at 1-800-333-0869.

St. Louis Check Reference Manual Distributed

Recently, all St. Louis zone check depositors were sent a new Check Reference Manual, which contains concise, easy-to-understand check processing information for both forward and return item depositors.

Topics covered in the manual include cash letter preparation, collection of Canadian checks, large-dollar return item notification, check adjustments and instructions on how to read various advices.

If you did not receive your copy, or if you have any questions about the manual, please contact Customer Support at 1-800-333-0869.

Calendar

Upcoming Fed-sponsored Events for Eighth District Depository Institutions

March 9
Regional Economic Forum
Paducah, Ky.

March 10
Regional Economic Forum
Cape Girardeau, Mo.

For more information, please call Linda Moser at (314) 444-8320.

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