No Bank Failures, Fewer Net Losses
In Eighth District Last Year

The banking industry's record profits over the last two years have resulted in good news for the Eighth Federal Reserve District: No bank failures in 1993. While that may not be surprising, third-quarter results indicate that the percentage of District banks with negative earnings has dropped to about 1 percent, half of the third-quarter figure in 1992.

While the long-term economic impact of the Great Flood of '93 continues to be assessed, early indications are that the disaster will have little effect on aggregate bank performance.

According to a Fed follow-up survey of banks in flood-affected areas, three-quarters estimated that only 5 percent of their loan portfolios would be affected by flood damage. This is better news than bankers expected: In a survey conducted during the peak of the disaster, two-thirds of the 200 bankers contacted speculated that up to 10 percent of their loan portfolios would be affected.

The number of banks anticipating a severe impact—more than 25 percent of their loan portfolios affected—was cut in half from the first poll—from 10 banks to five.

Flood Won't Hurt District Bank Performance

Nationwide there were 42 bank failures, which was the lowest number since 1982. More important, those banks held just a fraction of the assets of the banks that failed in 1992—$3.82 billion in 1993 compared with $46.2 billion one year earlier.

California had the most bank failures in 1993 with 20, followed by Texas with 10 and Kansas with two.
Editorial

Why The Fed’s Role In Banking Supervision Is Good Public Policy

Making the bank supervisory structure more effective is good public policy. But any proposed changes to the current regulatory structure (see next page) should serve to strengthen—and not diminish—the benefits that result from the Fed’s role in bank supervision. Specifically, there are three reasons why the public benefits from the Fed’s participation in banking supervision.

Reason no. 1: Because the Fed implements monetary policy through the banking system, firsthand knowledge about banks gained through supervision helps the Fed make better monetary policy decisions. Because of our perspective as the central bank, we are more aware than other supervisory agencies of the effects of supervisory policies on regional and national economic prospects. Our dual charge of policymaker and supervisor allows us to balance concern for bank safety and soundness with policies that promote sustainable economic growth.

Reason no. 2: To administer the discount window, the Fed must assess a bank’s financial condition before extending credit. As president of a Reserve Bank, I would be uncomfortable managing that responsibility without Reserve Bank examiners whose duties yield a broad, hands-on knowledge of District banks—both large and small—and the markets in which they operate.

Reason no. 3: The Fed guarantees final settlement on its own books and has regulatory responsibility for payments systems. When these systems are under stress, the Fed relies on its knowledge and responsibility as a bank supervisor to promote settlement of securities trades and other transactions critical to the economy’s well-being.

The current supervisory structure can benefit from a better allocation of responsibilities among federal regulators. But let’s make sure that any changes maintain the public benefits derived from the Fed’s current role.

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

CRA In The News: An Update

Thirteen percent of all lenders earned an outstanding CRA rating in 1993; another 80 percent earned a satisfactory rating, according to aggregate ratings of the 6,049 lenders released in January. In 1992, 90 percent of lenders earned one of the top two ratings.

In related news, the OCC will publish national bank CRA ratings that have become public within the last month in a new publication called The CRA Report. The publication is available to lenders for $25 a year and is free to community groups and the media.

Meanwhile, bankers and community groups now have until March 24 to comment on proposed CRA changes that would put additional emphasis on CRA performance rather than process. The proposed ruling would incorporate tests to measure lending performance to low- to moderate-income residents, the degree to which banks make their services accessible to underserved areas and the extent to which investments are made in small and minority-owned businesses. For a copy of the CRA proposal, call Anne Guthrie at (314) 444-8810.
Surges In Mortgage Refinancing Complicate Monetary Policymaking

A
n April 1993 survey by the Federal National Mortgage Association found that one in four homeowners had refinanced their mortgages since 1990. Even more startling, perhaps, was that one in 10 had done so in the preceding six months. Today, those numbers are no doubt even higher. Mortgage rates dropped about 1 percentage point last year, following decreases of nearly 2 points during 1991 and 1992.

What are the implications of this remarkable increase in mortgage refinancing for monetary policymakers? First, policymakers should perhaps pause and take a bow for fostering the decreases in market rates that have prompted these refinancings. Unlike short-term interest rates, which can be significantly affected for a short time by day-to-day Federal Reserve policy actions, long-term rates like the mortgage rate largely reflect changes in the market’s perception about future inflation. Thus, the conduct of monetary policy in the 1980s, and to an even greater extent since 1989, appears to have significantly increased the credibility of the Fed’s commitment to its long-run goal of price stability.

As the applause ends, however, policymakers must confront the distortions to money growth that the ebbs and flows of refinancing activity have caused during the last three years. Today, most fixed-rate mortgages are securitized by mortgage-backed securities (MBS) guaranteed by one of three federal government-sponsored enterprises—Fannie Mae, Ginnie Mae or Freddie Mac. The refinancing of mortgages securitized in this manner causes the principal of the old mortgage to be returned pro rata to investors in the associated MBS. In turn, new MBSs are issued based on the newly originated mortgages.

During 1988-89, a period during which there was little refinancing activity, about $5 billion to $6 billion of principal was returned to MBS investors each month. During December 1993, the most recent month for which we have reasonably complete data, such payments likely exceeded $53 billion. Put in perspective, December’s pace, if maintained for a year-would result in the rollover of more than half the outstanding stock of MBSs, an unprecedented pace.

The demand for transaction deposits, and hence for bank reserves, increases rapidly with surges in mortgage refinancing-related MBS activity. Thus, the growth of the monetary aggregates may be distorted by such surges. A jump in refinancing activity in late 1992, for example, boosted the fourth-quarter to fourth-quarter growth of M2 by perhaps one-half to three-quarters of a percentage point, significantly reducing M2’s shortfall from the growth range targeted for it by the Federal Open Market Committee. Refinancing activity accelerated further in 1993, as shown in the chart. During the second quarter, for example, refinancing-related activity likely accounted for about one-half of the extraordinary increases in liquid deposits.

Monetary policy in the 1980s appears to have increased the credibility of the Fed’s commitment to price stability.

These distortions have made interpreting the growth of the narrow monetary aggregates during the last three years perhaps as much an art as a science. To forestall any short-run swings in market rates due to movements in deposits and bank reserve demand, the Fed has accommodated the growth of mortgage refinancing with generous amounts of new bank reserves. As mortgage rates stabilize and refinancing slackens, policymakers may feel the need to withdraw these reserves during 1994.

Richard G. Anderson is an economist at the Federal Reserve Bank of St. Louis. For more information on this topic, see the July/August issue of Review, the St. Louis Fed’s bimonthly publication which you can receive by calling (314) 444-8889.

Richard G. Anderson

Mortgage Interest Rate and Refinancing Activity 1984 - 1993

- Rate on 30-year, fixed-rate mortgages
- Total prepayments of MBSs
- Billions of Dollars

- 0 10 20 30 40 50 60
- 0 10 20 30 40 50 60
- 6 8 10 12 14 16

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Federal Reserve Bank of St. Louis
Regional Roundup

OUT FOR COMMENT

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

- Proposal to revise Regulation BB, which implements the Community Reinvestment Act. Comments due by March 24, 1994. (Docket No. R-0822)
- Proposal to expand the Fedwire funds transfer format to incorporate more data elements. Comments due by March 4, 1994. (Docket No. R-0817)

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

St. Louis Fed Returns Money To U.S. Treasury

In 1993, Reserve Banks paid almost $16 billion to the Treasury, according to preliminary figures. How much of that was from the Eighth District? $472 million.

Income from the Fed is derived primarily from interest earned on U.S. government securities that the Fed acquires through open market operations.

Savings Bond Consolidation Continues

More Eighth District institutions will transfer their savings bond operations to the Kansas City Fed this spring as consolidation of the Fed’s savings bond processing sites continues.

Savings bond transactions for Kentucky and Indiana institutions have been handled by the Kansas City Fed since last July. Arkansas banks come next in April followed by Mississippi and Tennessee in May. Institutions in Illinois will transfer their operations in July, and Missouri institutions will change in August.

Fed Offers New Same-Day Settlement Services

Early this year, the St. Louis Fed began offering new services to facilitate the Jan. 3 implementation of the same-day settlement (SDS) rules. The services will help some payor banks make their check processing operations more efficient by designating the Fed as a check presentment site.

The Primary Presentment Point Service, for example, allows a payor institution to designate a Fed office as its exclusive presentment site. This service guarantees that your SDS deposits arrive at a secure and fully staffed location and may be especially beneficial for banks that use the Fed’s payor services such as MICRLine and truncation. The Fed will time-stamp deposit tickets and hold the checks for pickup by the payor bank. We provide no settlement or adjustment services for the items presented under SDS.

The Alternate Presentment Point Service allows a paying bank to designate our Fed office or one in another territory as its presentment point for certain collecting banks, while agreeing to accept checks from others at another location.

With either service, a payor bank may take advantage of the Fed’s Enhanced Information option, which gives them information about all SDS deposits received each day, including dollar amount, number of items and the name of the bank making the SDS deposit.

For more information on any of these SDS services, call your account executive or Customer Support at (800) 333-0869.

St. Louis Fed Redefines Quality

What do Fed customers expect from our priced services? To help us find out, the St. Louis Fed recently polled customers to help us set new quality standards.

Error-free work topped customers’ list of expectations, followed closely by timeliness. With this in mind, the Fed has established new monthly quality targets. We plan to communicate our progress with customers throughout the year.

Danee Appel at (314) 444-4289 or toll-free at (800) 333-0810.

Fed To Begin Charging For Daylight Overdrafts

Beginning April 14, the Fed will begin charging banks for excessive daylight overdrafts. Since new check-posting rules went into effect last October, institutions incurring daylight overdrafts as a result of the new posting rules were notified of the occurrence.

The charges are part of the Fed’s Payment System Risk (PSR) policy which attempts to reduce the Fed’s risk from exposure to overdrafts at large institutions.

For more about the policy, call Danee Appel at (314) 444-4289 or toll-free at (800) 333-0810.
Fed Proposes Plan For A More Effective Regulatory Structure

Federal Reserve Governor John P. LaWare stated recently that something ought to be done about the bank regulatory structure, citing that the current structure has "too many regulators, each of which has overlapping and different regulations and interpretations."

To improve the structure, LaWare offered a proposal that would streamline regulation by allowing for a single federal examiner for each banking organization while avoiding the establishment of a costly new regulatory agency. Following is a brief explanation of the proposal and how it would work.

Each banking organization would have only one federal examiner. To do this, the OTS would be merged into the OCC. This organization would examine all national banks and thrifts and would establish rules for these institutions. The Fed would examine all state-chartered banks and, along with the states, make rules for these depository institutions.

Responsibility for examining bank holding companies and all non-bank subsidiaries would be determined by the charter of the largest bank in the holding company. For example, for each bank holding company in which the largest bank is state-chartered, the Fed would retain supervisory responsibility. For bank holding companies in which a nationally chartered bank or thrift is the largest depository institution, the sole federal examiner would be the OCC/OTS. The Fed would retain rulemaking responsibilities for all BHCs.

The FDIC would retain its supervisory role for "problem institutions" and maintain its rulemaking responsibilities as the federal deposit insurer. The Fed would continue to supervise all foreign banking organizations operating in the United States as well as the bank holding companies of domestic organizations that are particularly important to the stability of the payments system.

There would continue to be more than one regulator. The regulatory structure benefits from having a variety of viewpoints on supervisory issues. By dividing regulatory responsibility according to bank charter, the proposed structure guarantees the existence of more than one regulator while streamlining the regulatory process. Having more than one federal examiner provides needed checks and balances so a single regulator doesn't become inflexible or develop too narrow of a focus. What's more, it allows for the preservation of the dual banking system, wherein the current value of state charters is maintained.

The Fed would maintain hands-on supervisory responsibilities. The central bank would continue to provide needed links between banking supervision, monetary policymaking and managing the payments system, as discussed in the Editorial.

Essentially, LaWare's proposal attempts to simplify banking supervision without giving up the benefits that result from the Fed's current role as both the nation's central banker and a banking examiner. In addition, the proposal allows for the introduction of a new structure with minimal disruption and risk to the banking system and without the cost of a new federal agency.

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<tr>
<th>The Fed Proposal: Who Regulates What</th>
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<td>- Thrifts</td>
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<td>- BHCs in which the lead bank is nationally chartered</td>
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<td><strong>FDIC</strong></td>
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<tr>
<td>- State banks</td>
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<td>- BHCs in which the lead bank is state-chartered</td>
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<td>- Foreign banking organizations and BHCs critical to the payments system</td>
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**Book-Entry Securities Procedures To Change**

To help make operating procedures consistent across Fed offices, the St. Louis Fed recently made some minor changes effective March 1 in the conditions for use, operating procedures and levels of service provided for book-entry securities.

The changes are spelled out in the new Operating Letter No. 23, which was mailed to District institutions in January. For an extra copy, call Anne Guthrie at (314) 444-8810.

**HMDA Reporting Deadline Approaching**

Just a reminder that mortgage lenders’ 1993 HMDA data are due to their federal regulator by March 1, 1994. All institutions are expected to submit the HMDA report in machine-readable form.

To ease automated reporting, the St. Louis Fed has helped create a PC-based data-entry program. If you have not already received the software, or if you are interested in obtaining an extra copy, contact Frank Buie at the St. Louis Fed at (314) 444-8750.

**Fedline Now Offers Electronic Submission Of More Reports**

Beginning next month, Fedline customers will be able to submit their quarterly FR 2900 (report of transaction accounts) to the Fed electronically through a new Fedline patch, 2.40.30. Also next month, customers can submit their fed funds data (weekly report of selected assets, liabilities and federal funds transactions) over Fedline. Electronic submission will allow you to submit more accurate data faster, while eliminating the paper forms you usually fax or mail.

For more information, please contact Joan Boelter at (314) 444-8627.

**Fed Offers Educational Video**

To teach students about the Federal Reserve System and the role it plays in the economy, the Fed has produced an educational video package with accompanying classroom materials.

For more information about the free package, call Debra Bangert at (314) 444-8421.