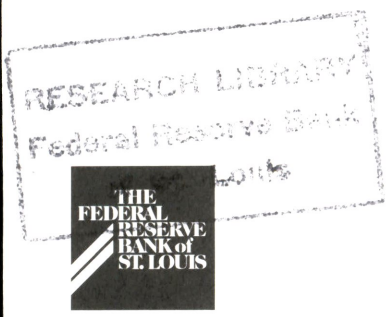


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Spring 1995
News and Views
for
Eighth District Bankers

Fed Approves Final CRA Reform Package

Two years and two comment periods after the effort began, the Federal Reserve joined other federal banking regulatory agencies in approving a final CRA reform package.

The final ruling, passed last month, drops an earlier proposal that would have required the collection of race and gender data for small business and small farm loans. Under the revised CRA regulation, the number and amount of such loans will be reported in census-tract aggregates only, and not loan-by-loan as in home mortgages.

The revamped CRA regulation incorporates three broad standards of performance—lending, investments in the community and service to the neighborhood—rather than the 12 assessment factors that examiners currently review. It also deletes any reference to enforcement actions against institutions with less than satisfactory CRA performance ratings.



Effective Jan. 1, 1996, a streamlined CRA exam will be available for small banks—those with less than \$250 million in assets whose holding companies do not exceed \$1 billion. Also, banks may opt for a strategic plan alternative which allows them to customize their CRA efforts with public comment and Federal Reserve Board approval.

Data collection will begin on Jan. 1, 1996. Banks can then choose to be evaluated under the revised three-pronged test or wait until its formal implementation date of July 1, 1997.

District ROA Declines Despite Increase In 1994 Earnings

The tables have turned. For the first time in recent history, U.S. peer banks outperformed District banks by the return on average assets (ROA) measure of performance.* Though 1994 earnings approached \$2 billion, District banks' ROA slipped to 1.22 percent. Peer bank

ROA, meanwhile, edged upward to 1.29 percent.

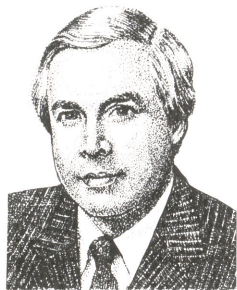
Several factors contributed to the weaker District performance. First, net interest margin (NIM) for District banks, driven by declining yields on investment securities, tumbled to 4.28 percent. NIM for peer banks also declined, though by not

as much, to 4.68 percent. Second, net noninterest margin (NNIM) for District banks worsened slightly to

(continued on next page)

Feditorial

How Many Goals Can the Fed Achieve at One Time?



Thomas C. Melzer

A consensus has been growing at central banks around the world—most recently, in Canada, England, New Zealand, Sweden and Finland—that monetary policy should be directed at a single objective: price stability.

In this country, we, too, pay homage to price stability—but as one objective among many. Other objectives include low unemployment, real output growth and, at times, a stable pattern of international transactions. Can the Federal Reserve hope to achieve these multiple goals?

In the short term, no. With essentially one policy lever—open market operations—the Fed cannot successfully move toward two or more conflicting objectives at any point in time. Nor can it achieve objectives that bear no systematic relationship to its actions.

In the long term, however, the Fed can support all of the objectives assigned to it by Congress by following the lead of the central banks mentioned previously and targeting price stability. As research shows, when prices are stable, the markets for labor, credit and goods all function effectively. Fortunately, price stability is also an achievable goal. There is an empirical link between changes in the price level and changes in the nation's money supply, which the Fed influences directly.

What we hope to achieve, of course, is a rising standard of living for U.S. citizens. Our 1994 annual report, which will arrive at District banks shortly, makes a case for a price stability objective as the best way to achieve such a standard. I urge you to read it.

Thomas C. Melzer is the president and chief executive officer of the Federal Reserve Bank of St. Louis.

District ROA

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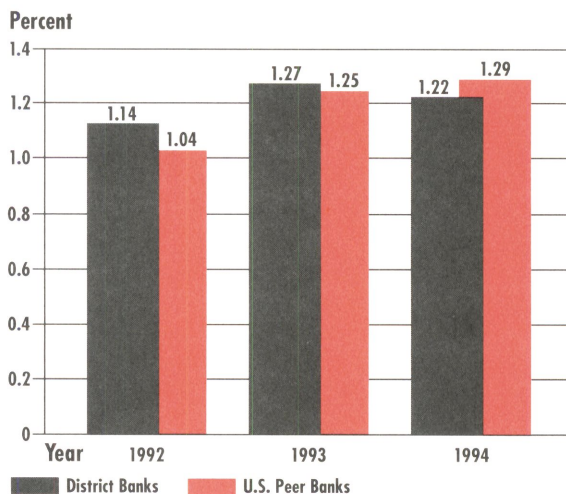
2 percent. Peer bank NNIM, in contrast, improved to 2.12 percent. Third, U.S. peer banks sliced provision expense from 0.41 to 0.28 percent of average assets. District banks, meanwhile, trimmed provision expense by less, from 0.26 to 0.16 percent of average assets.

Viewed another way, robust asset growth at Eighth District banks depressed District ROA. In 1994, District assets jumped 6.3 percent; peer bank assets grew by only 2.2 percent. Loans, by growing at almost twice the national rate, fueled the rise in District assets.

Indeed, for District banks, loans as a percentage of total assets closed 1994 at a four-year high of 60 percent.

**National peers are U.S. banks with less than \$15 billion in average assets. As of December 31, 1994, all District banks met this criterion.*

Return on Assets: Eighth District Banks vs. U.S. Peer Banks





Christopher J. Neely

The Move Toward Inflation Targeting in Other Countries

As Tom Melzer pointed out in his Feditorial on page 2, monetary policy in the United States currently has multiple objectives. The Federal Reserve is directed by law to “promote effectively the goals of maximum employment, stable prices and moderate, long-term interest rates.” Unfortunately, in the short run, these objectives sometimes seem to conflict with one another. Many economists think that the best way to achieve them all is to maintain stable prices, which ultimately fosters high employment and strong growth.

With this in mind, a number of countries, including New Zealand, the United Kingdom, Canada, Sweden and Finland, have recently directed their central banks to make inflation control, or price stability, their main objective. Other countries, like France, Italy and Switzerland, have moved toward less formal “quantified inflation objectives.” Although the details differ from country to country, the common structure among these policy initiatives is telling.

An integral part of each plan is that the central bank firmly commits itself to price stability and reduced uncertainty about the objectives of monetary policy by announcing a downward target path for inflation, as well as a long-term low target range—typically zero to 2 percent. The plans may also include contingencies for permitting a suspension of the inflation targets—a temporary increase in inflation—in the face of extreme events, like an oil price shock. The thought

here is that long-term inflation credibility will actually be enhanced by explicitly allowing flexibility in the case of unusual circumstances.

Another measure, adopted in New Zealand, the United Kingdom and other countries to increase the credibility of these plans, is increased central bank independence. Independent central banks are typically able to look beyond the next six to 12 months in making decisions about controlling inflation, but remain accountable to the public and

Each of these countries has announced a downward target path for inflation, as well as a long-term low target range—typically zero to 2 percent.

the legislature to achieve the democratically decided goals of monetary policy—stable prices. In New Zealand, for example, the governor of the central bank may be dismissed if he fails to meet the inflation objective. As research indicates, countries that have achieved the best records in controlling inflation are typically those with independent central banks, like Germany, Switzerland and the United States. Where day-to-day monetary decisions are decided by political institutions, inflation rates are usually higher.

To accompany inflation targeting, countries often adopt budgetary reforms because irresponsible fiscal policy can ultimately trump even the best

monetary policy. If the government’s expenditures are out of control, it may force the central bank to print money to pay these bills. Hence, fiscal reforms can help lend credibility to a policy of inflation control.

So far, inflation targeting has been quite successful in bringing down inflation in these countries. Although the reduction in inflation has typically been accompanied by some slowdown in output, the fall in inflation has led to a fall in interest rates and, later, a recovery of output and employment. Recently, New Zealand, Canada and the United Kingdom have enjoyed lower rates of underlying inflation and higher output growth than the average OECD country. New Zealand, which has taken the boldest steps toward inflation targeting and financial reform of any country in the world, is currently enjoying the best of both worlds, with underlying inflation below 2 percent and very strong output growth.

Christopher J. Neely is an economist at the Federal Reserve Bank of St. Louis.

Regional Roundup

OUT FOR

COMMENT

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

■ **Proposal to amend Regulation B to permit, but not require, banks to request information on the race, color, sex, religion and national origin of credit applicants. Comments due by June 27, 1995. (Docket No. R-0876)**

Direct all comments to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th St. and Constitution Ave., N.W., Washington, D.C. 20551.

Fed to Offer Seminars On Sales of Investment Products

The Federal Reserve will begin a nationwide educational campaign about the sale of uninsured investment products—like mutual funds and annuities—from banks.

The local effort kicks off this June when the St. Louis Fed will offer free informational seminars for bankers. Fed examiners will discuss regulatory issues, compliance issues and the risks involved in selling such products.

In a related effort, the Fed will join the American Association of Retired Persons (AARP) to offer informational seminars on uninsured investment products.

A 10-minute video providing basic information about mutual funds is also being developed for use by the Federal Reserve System, bankers and consumer groups. The video is due out this fall.

Note Fee Increase for Daylight Overdrafts

Effective April 13, 1995, the daylight overdraft fee increased from a daily rate of 10 basis points to 15 basis points. The increase is lower than once planned; the Board of Governors had originally planned an increase to 20 points. The change results from the sizeable reductions in daylight overdrafts achieved with a 10 basis point fee, as well as concerns about future fee increases.

For more information, please call Daneé Appel at (314) 444-4289 or Hillary Debenport at (314) 444-8488.

Savings Bond Information Number Changes

Last fall, the St. Louis Fed's savings bond operations were transferred to the Federal Reserve Bank of Kansas City.

To make savings bond information more accessible

to their customers, the Kansas City Fed has combined the Regional Delivery System (RDS) and Savings Bonds toll-free numbers. Please direct all savings bond-related calls to 1-800-333-2919. Customer service representatives are available from 8 a.m. CT to 6 p.m. CT. General information messages can be accessed 24 hours a day.

Help Is On The Way For Future Electronic Taxpayers

Sooner or later, the majority of corporate taxpayers will be required to pay their payroll taxes electronically through a financial institution or a Treasury financial agent.

To help bankers prepare for the upcoming requirements, the IRS will conduct informational workshops about the electronic tax payment system later this summer. Watch your mailbox for more information.

Bankers Attend Economic Development Conference

More than 220 lenders, community group leaders and government representatives attended the "Renaissance of Rural America" megaconference in Memphis March 7 and 8. The meeting focused on the needs of economic development in rural areas.

At the conference, the St. Louis Fed's Community Affairs Office released its composite profile of the credit needs of eight rural areas in the Eighth District. According to their findings, job creation was the No. 1

economic need. The profile also identified programs that exist to help meet these needs.

The conference also featured a video of successful partnerships among lenders, community groups and local governments. Success stories ranged from a business incubator and affordable housing project to industrial development and the Main Street USA program.

The conference was co-hosted by the Community Affairs Offices of the Federal Reserve Banks of Atlanta, Dallas, Richmond and St. Louis.

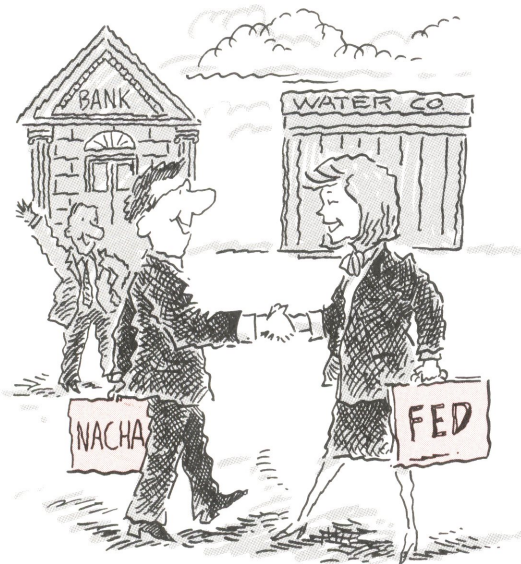
Community Affairs staff assist bankers with meeting their CRA requirements by acting as information brokers of economic development information.

For a copy of the community profile presented at the conference, or the successful partnerships video, please call Glenda Wilson of the St. Louis Fed at (314) 444-8317 or toll-free at 1-800-333-0810, ext. 8317.

Fed Teams Up With NACHA to Promote Electronic Payments

The Federal Reserve and the National Automated Clearinghouse Association

(NACHA) joined forces recently to promote the use of electronic bill payments. The three-phased educational campaign



aims to increase awareness of the benefits of direct payments among financial institutions, corporate billers and, ultimately, consumers.

After working with financial institutions to promote the advantages of direct payment, the Fed and NACHA will target their campaign toward corporations in 12 different industries with significant consumer payment volume, including utilities, cable television, mortgage and loan companies. The effort will conclude early next year when NACHA and the Fed, along with local ACH associations and financial institutions, will work to increase awareness at the consumer level.

Today, of the 20 billion consumer payments processed annually, only about 800 million—or 2.5 percent—are made by direct payment. Consequently, the estimated

cost of printing, mailing and delivery of the remaining checks for these types of payments each year costs the country about 0.5 percent of the U.S. gross domestic product.

As the nation's central bank charged with promoting the efficiency and minimizing the risk of the payments system, the Fed has been a longtime advocate of electronic payment methods. For financial institutions, the change from paper-based to electronic payments systems can mean improved customer convenience and cost reductions from the elimination of paper handling and transport.

Several St. Louis Fed staff will be actively involved in the joint marketing effort with NACHA. Currently, St. Louis Fed staff are working with a local ACH association, the Mid-America Payments Exchange (MPX), to foster the use of direct payment among utility companies in the Eighth District.

Funds Transfer Applications To Become Centralized

On August 19, the Eighth District's Funds Transfer application will be converted to the Federal Reserve's new centralized application—Funds 5.0—at our East Rutherford, NJ, operations center. Each of the 12 Fed districts have been running separate applications since consolidating at our Richmond site more than a year ago.

The Fed's centralized Funds 5.0 software will offer customers

several enhancements over the current system. For one, it will provide customers with the ability to retrieve transfer items on-line for two prior days, compared with the current one-day period. Second, the message retrieval feature will provide the Output Message Accountability Data (OMAD) information on retrievals upon request. Third, the new software will allow customers to receive individual acknowledgements

after 6 p.m. EST, rather than the batch acknowledgements currently sent.

In addition, as districts convert to the new software, interdistrict rejects between centralized districts will cease to exist. All rejects will then be treated the way intradistrict rejects are handled today: Customers will receive immediate notification of incorrect wire transfers.

A detailed description of these and other Funds 5.0 changes was communicated with customers late last month.

As the St. Louis Fed prepares for the transition to the

centralized application, we'll be contacting customers to verify information and update data. We may also ask some to assist us in testing the new software to ensure a smooth conversion.

By September, the last Fed district will have converted to the centralized funds transfer software, marking another milestone toward our goal of consolidating our data centers and centralizing our critical payment systems.

FedFacts

Fedline Upgrade Delivers Several Enhancements

Fedline customers should have recently received a new Fedline software release—the Combination Patch—which contains versions 2.40.40 and 2.40.50. This release changes the communication sessions to a standard, Federal Reserve configuration, with an additional session to provide direct communication to centralized applications as they become available.

The Combination Patch will introduce the ability to sign on to more than one IMS session while using only a single user ID and password, as well as a new data compression method, ANSI X9.32, which reduces the transmission of files.

In addition, with the Combination Patch, we will be able to use a bulk data download to send future software releases, replacing our current practice of mailing diskettes to each customer.

New Services Directory Released

When you're in need of a Fed contact, let your fingers do the walking through the St. Louis Fed's revised services directory sent to Eighth District financial institutions last month.

The directory reflects several reorganizations within the St. Louis and branch offices since its last publication in March 1993.

For additional copies of the services directory, call Anne Guthrie at (314) 444-8810 or toll-free at 1-800-333-0810 ext. 8810.

Federal Reserve Publications Booklet Available

The New York Fed has just issued *Public Information Materials*, a comprehensive listing of informational publications available through Federal Reserve Banks nationwide.

Among topics covered in the listing: The Federal Reserve System, the banking system,

payments systems, money, financial markets and instruments, consumer finance, economics, international economics, periodicals, teaching materials and audiovisual materials. Most of the materials are free; ordering information is also contained in the booklet.

For a copy of the *Public Information Materials* listing, please call Cindy Davis at the St. Louis Fed at (314) 444-8808 or Debbie Dawe at (314) 444-8809.

Fed ACH Bulletins To Foretell Changes

This fall's transition to the Fed's new centralized ACH software system, Fed ACH, is right around the corner.

Throughout the upcoming transition period, ACH customers will receive customized bulletins detailing impending changes, as well as any specific action required by your institution.

Watch for these announcements soon and share them with the staff at your institution.

Calendar

Upcoming Fed-sponsored Events for Eighth District Depository Institutions

Mutual Funds Seminars

June 19 - St. Louis, Mo.
June 20 - St. Louis, Mo.
June 21 - Little Rock, Ark.
June 22 - Memphis, Tenn.
June 23 - Louisville, Ky.

For more information on Mutual Funds Seminars, call Bernie Berns at (314) 444-8321 or toll-free at 1-800-333-0810, ext. 8321.



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