FALL 2009

CENTRAL Banker

NEWS AND VIEWS FOR EIGHTH DISTRICT BANKERS

FEATURED IN THIS ISSUE: Why Are Banks Failing? | Spotlight on Evansville (Ind.) Banks

Congress Considering 15 Regulatory Reform Proposals

Track Financial Reform with New St. Louis Fed Web Site

By Jim Fuchs

jean-manuel duvivier/munrocampagna.com

If ultimately signed into law, the regulatory reform proposals presented to Congress this summer could significantly alter how financial institutions in the United States are regulated and, in some cases, structured.

Since releasing its regulatory reform white paper June 17, the Treasury Department has submitted more than 15 legislative proposals to Congress. In turn, Congress has held more than 22 hearings, formally introduced two of the bills to a key oversight committee and conducted a full House of Representatives vote on one of them, all in less than six weeks.

The St. Louis Fed created the Reforming the Nation's Financial System Timeline web site (www.stlouisfed.org/regtimeline/) to track the proposals, congressional and regulatory agency hearings and testimony, and committee members' statements.

The most significant proposals as of late August include:

- creation of an eight-member Financial Services Oversight Council to identify and mitigate threats to the financial system;
- elimination of the federal thrift charter and creation of one single national bank supervisor;
- creation of an independent Consumer Financial Protection Agency to oversee and enforce consumer protection laws and regulations at all financial institutions (except for the enforcement of the Community Reinvestment Act);
- mandatory registration of all credit rating agencies with the Securities and Exchange Commission;
- creation of an Office of National Insurance to issue and collect reports on the insurance industry;
- establishment of uniform de novo branching standards, regardless of charter;
- conversion of industrial loan companies, credit card banks and thrift holding companies to bank holding companies;

continued on Page 7

CENTRAL
Banker

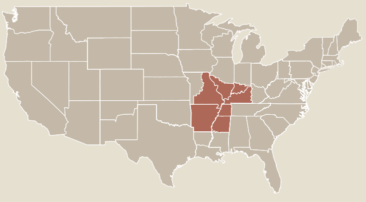
News and Views for Eighth District Bankers
Vol. 19 | No. 3
www.stlouisfed.org/publications/cb

EDITOR
Scott Kelly
314-444-8593
scott.b.kelly@stls.frb.org

Central Banker is published quarterly by the Public Affairs department of the Federal Reserve Bank of St. Louis. Views expressed are not necessarily official opinions of the Federal Reserve System or the Federal Reserve Bank of St. Louis.

To subscribe for free to *Central Banker* or any St. Louis Fed publication, go online to www.stlouisfed.org/publications/subscribe.cfm. To subscribe by mail, send your name, address, city, state and ZIP code to: Central Banker, P.O. Box 442, St. Louis, MO 63166-0442.

The Eighth Federal Reserve District includes all of Arkansas, eastern Missouri, southern Illinois and Indiana, western Kentucky and Tennessee, and northern Mississippi. The Eighth District offices are in Little Rock, Louisville, Memphis and St. Louis.



St. Louis Fed Stationing Examiners in Little Rock

By Julie Stackhouse

Julie Stackhouse is senior vice president of the St. Louis Fed's division of Banking Supervision, Credit and the Center for Online Learning.

During these challenging times, bankers want answers quickly. And sometimes, there is no substitute for a face-to-face meeting.

State member banks in Arkansas will now find this quick in-person access even easier with the opening of the St. Louis Fed satellite supervision office in Little Rock. The office, staffed with 10 examiners, mirrors an initiative undertaken four years ago, when the St. Louis Fed established a satellite office in Memphis. Bankers in Memphis told us that the local presence enhanced overall communication and supported an effective supervisory process.

Among the many benefits we have seen:

- greater accessibility and quicker response time;
- more efficient opportunities to conduct advisory visits on matters of special interest, such as the Bank Secrecy Act and risk management practices; and
- streamlining of collaboration with the state banking authorities, thereby promoting more consistency and higher quality in our examinations and other supervisory processes.

At the same time, we will continue our other communication efforts, including the monthly "Ask the Fed" program and periodic informational forums for bankers. In these challenging times, it is more important than ever that the St. Louis Fed provide you with the information and answers you need.

For further information on the supervisory duties of the St. Louis Fed, please see www.stlouisfed.org/banking/safety_soundness.cfm.

Banks Still Ailing in District and U.S.

By Michelle Neely

Although the U.S. economy has recently shown a few signs of life, the nation's banking industry is still being battered by weak earnings and increasing problems with asset quality.

Aggregate profits at District banks surprisingly rose in the second quarter, albeit by a modest amount. Return on average assets (ROA) increased four basis points to 0.22 percent. For U.S. peer banks (banks with average assets of less than $15 billion), the news was not even remotely good: ROA declined another 21 basis points to -0.30 percent. For both District and U.S. peer banks, the weakest performers were banks in the $1 billion to $15 billion asset range; excluding them, ROA was 0.65 percent at District banks and 0.15 percent at U.S. peers.

The profitability improvement at District banks was driven by a slight uptick in the net interest margin (NIM), which increased three basis points to 3.66 percent. Net noninterest expense also declined, which more than offset the modest increase in loan loss provisions. The average NIM at U.S. peer banks also rose, but that increase was dwarfed by a large increase in the loan loss provision ratio and a moderate increase in the net noninterest expense ratio.

Loan loss provisions as a percent of average assets increased three basis points to 0.93 percent at District banks in the second quarter. For U.S. peer banks, the hike was more substantial, as the LLP ratio rose 18 basis points to 1.49 percent. Despite the additions to reserves, the coverage ratio fell again at both sets of banks. At the end of the second quarter, District banks had 70 cents reserved for every dollar of nonperforming loans, down 4 cents from the prior quarter and 20 cents from a year ago. At U.S. peer banks, the coverage ratio declined 3 cents from the first quarter and stood 22 cents below its year-ago level.

As indicated by the increasing loan loss provisions and declining cover ratios, asset quality continues to worsen at both sets of banks. Nonperforming loans as a percentage of total loans hit 2.44 percent at District banks in the second quarter, up 25 basis points from the first quarter and 91 basis points from a year ago. For U.S. peer banks, the picture is bleaker, as 3.77 percent of loans were nonperforming at the end of the second quarter, up 46 basis points from the first quarter and 185 basis points from the second quarter of 2008. All major categories of loans (commercial, consumer and real estate) had higher delinquencies in the second quarter at both sets of banks.

Commercial real estate (CRE) lending continues to be the area of greatest concern. CRE loans make up almost half of total loans at District and U.S. peer banks. Therefore, problems in this sector have a major effect on overall results. Within CRE, construction and land development (CLD) loans are the most troubled. In the District, 7.35 percent of CLD loans were

continued on Page 7

When Will Woes Be Gone?

	Q2 2008	Q1 2009	Q2 2009
RETURN ON AVERAGE ASSETS			
District Banks	0.81%	0.18%	0.22%
Peer Banks	0.60	-0.09	-0.30
NET INTEREST MARGIN			
District Banks	3.79	3.63	3.66
Peer Banks	3.83	3.56	3.58
LOAN LOSS PROVISION RATIO			
District Banks	0.52	0.90	0.93
Peer Banks	0.72	1.31	1.49
NONPERFORMING LOAN RATIO			
District Banks	1.53	2.19	2.44
Peer Banks	1.92	3.31	3.77

SOURCE: Reports of Condition and Income for Insured Commercial Banks

Banks with assets of more than $15 billion have been excluded from the analysis. All earnings ratios are annualized and use year-to-date average assets or average earning assets in the denominator. Nonperforming loans are those 90 days or more past due or in nonaccrual status.

Why Are Banks Failing?

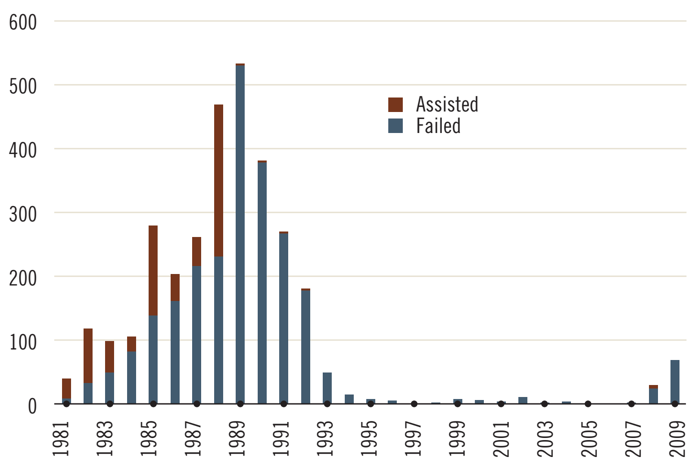
By Jim Fuchs and Tim Bosch

Bank closings are now front-page news in many small communities, with 81 occurring so far this year (as of Aug. 21). Even small towns like Winchester, Ill. (population: 1,650), have experienced the transition of a failed bank to new ownership.

Although today's challenges are great, the four underlying reasons for bank failures have not changed from those of years' past, which are:

- an imbalance of risk versus return,
- failure to diversify,
- offering products and services that management doesn't fully understand, and
- poor management of risks.

Number of Failed and Assisted Banks and Thrifts



Source: FDIC website

One: Imbalance of Risk versus Return

The imbalance of risk versus return can best be illustrated through example. In 2008, ANB Financial N.A., Rogers, Arkansas, failed. (See www.treas.gov/inspector-general/audit-reports/2009/oig09013.pdf.) Public data shows that in less than a two-year period, ANB went from being a mid-sized community bank with $600 million in total assets to a $2.2 billion institution. The bank's balance sheet showed that most of the growth into the risky construction and land development (CLD) loan segment was funded through brokered deposits.

On the surface, ANB's loan pricing of the construction and land development loans appeared favorable. Loans were often priced 300 basis points above typical real estate rates. While 300 basis points seemed opportunistic at the time, the rate charged was insufficient for the risk being assumed. A substantially higher premium, perhaps an unimaginable risk premium, would have been necessary to compensate for the lower quality asset.

ANB is an extreme situation. Nonetheless, during strong economic times, the pricing of balance sheet assets is frequently misaligned with the inherent risk acceptance in lending. The result is felt when economic tides turn and losses are experienced.

Two: Failure To Diversify

Failure to diversify can occur on both the asset and liability side of the balance sheet. Any concentration of assets by loan category, industry or geography creates the potential for material losses when stress events occur. Choosing *not* to diversify intensifies the need for higher capital ratios.

Diversification needs to occur on the liability side of the balance sheet as well. More than 85 percent of ANB's funding came from brokered deposits. Brokered deposits, while relatively inexpensive, created huge liquidity consequences when the bank's financial condition deteriorated. Prompt corrective action guidelines restricted the renewal of brokered deposits and limited the rates that could be paid on all deposits. In short, ANB experienced an old problem: Liquidity is unavailable when it is needed most.

Three: Failure To Understand Products and Services

A major contributor to today's financial crisis was the failure to fully understand the products in the financial marketplace and their counterparty risks. Even community banks purchased structured products, such as mortgage-backed securities, presumably designed to lessen balance sheet risk. Banks purchasing the product frequently did not fully understand the composition and risks of the underlying assets, and instead relied on rating agencies or product brokers for the analysis.

Four: Poor (or No) Risk Management

Risk management can be a difficult topic for community bankers who often don't have sophisticated systems in place. In some respects, though, good risk management is simply good management. Good management involves a culture of understanding risks in the institution's operations and how those risks change as product structures evolve, business operations transform, or economic conditions cycle. Good management involves an environment of strong internal controls and high ethical standards on the part of every employee. Good management requires an effort to properly align incentives with performance and to develop appropriate checks and balances through internal audit and board of directors' oversight.

As bank failures are reported over the next few years, each will have its story. Inevitably, the story will reflect one of the themes discussed in this article. Banks that avoid the risk factors will emerge as the survivors in an industry that will end up stronger.

>>ONLY ONLINE

Listen as Tim Bosch discusses how banks can avoid failure at www.stlouisfed.org/publications/cb/

Tim Bosch is a vice president over safety and soundness examinations and Jim Fuchs is a supervisory policy analysis manager in the Banking Supervision and Regulation division at the Federal Reserve Bank of St. Louis.

REGIONAL SPOTLIGHT

Key Your Bank into "Green" Finance Sept. 22

Financial institutions interested in exploring "green" financial products, projects and municipal developments can attend Green Finance: Investing in Sustainable, Energy-Efficient Developments from 10 a.m. to 4 p.m. Sept. 22 at the Hyatt Regency in Louisville.

This event will demonstrate how federal, state and local policies, along with new financial products, are providing opportunities for investment in environmentally friendly and sustainable communities. Bankers can learn how investors are considering the financial returns on investments in green projects and the social and environmental returns. Contact the Fed's Emily Lape at 502-568-9282 or emily.k.lape@stls.frb.org to register.

St. Louis Fed's Web Site Revamped

The St. Louis Fed's web site (www.stlouisfed.org) has been revamped and now offers several new features and tools. These features include customizable economic charts and data, including data from the Fed's Little Rock, Louisville and Memphis zones; multimedia features; RSS feeds; an expanded menu of e-mail alert reports; and a new job search tool.

You can find brief videos of St. Louis Fed President James Bullard exploring such topics as exit strategies for the Fed and origins of the crisis, and audiocasts from Fed economists discussing the latest economic data.

Hey, Whatever Happened to That Bank?

Have you ever wondered what happened to a particular bank in the Eighth District? Did it go out of business, change its name or, more likely, merge with another institution? Find out with a handy St. Louis Fed web page that depicts the merger and name change histories of select institutions. The information is presented state by state.

>>GO ONLINE

www.stlouisfed.org/banking/structure/what_happened_to.cfm

Spotlight on Evansville Metro Bank Performance

Data suggest a link between CRE lending and weak bank performance.

By Gary S. Corner and Rajeev R. Bhaskar

Evansville, tucked away in the southwest tip of Indiana, is the commercial, medical and service hub of the Illinois-Indiana-Kentucky tristate region. The Evansville metropolitan statistical area (MSA) is the 142nd largest in the United States and consists of four Indiana and two Kentucky counties.

A Comparison of Evansville Banks with the Other Eighth District Metropolitan Area Banks, Q1 2009

	Evansville (metro)	Peer Group Average
Number of Banks	12	7.8
Total Assets	$12,804 million	$65,409 million
Return on Assets	-0.33%	0.30%
Nonperforming Loans/ Total Loans	3.54%	2.68%
Loan Loss Reserves/ Non Performing Loans	58.09%	62.02%
Tier 1 Leverage Ratio	7.47%	8.68%
CRE to Total Loans	24.25%	30.11%

SOURCES: Call Reports and CensusBureau. Numbers in red indicate unfavorable differences when compared with the averages of other metropolitan areas' banks.

Its strategic location on the Ohio River and close proximity to a number of large MSAs has helped build a broad economic base in the region known for stability and diversity. Major industries include manufacturing, warehousing and distribution, health care, education and financial services. Evansville is home to two universities, the University of Southern Indiana and Evansville University, which together enroll more than 13,000 students and add stability to the employment base.

Although much attention has been paid to economic issues in other areas of Indiana, such as Elkhart (unemployment rate of 17.5 percent), the downturn has affected Evansville, though to a lesser extent. The unemployment rate in the Evansville MSA is 8.7 percent (May) compared with 10.6 percent in Indiana and 9.4 percent for the nation (as of August). Although Evansville does not appear to be experiencing any unique economic shocks, such as large factory closings or losses of company headquarters, it has not been immune to declining real estate values and elevated home foreclosures either.

Banking Analysis

The banking market of the Evansville MSA is made up of 12 locally headquartered banks, 16 banks headquartered outside of Evansville but with a presence in the MSA, and three thrifts. These institutions offer 146 branches in total. A measure of market competitiveness called the Herfindahl-Hirschman Index (HHI) indicates a moderate level of competition for the Evansville market.

Analysis of the aggregate performance of the 12 Evansville-headquartered banks appears to imply relative weakness for the overall market. The asset-weighted return on average assets (ROA) at Evansville banks averaged -0.33 percent in the first quarter, compared with 0.30 percent for peers. Aggregate numbers for asset quality, nonperforming loans and coverage ratio also indicate a weaker banking market compared with the peer markets in the Eighth District.

A look at individual bank performance within the Evansville market, however, reveals that 10 out of 12 banks are actually profitable, and unweighted average ROA is 0.42 percent. Furthermore, all banks have a positive earnings run rate, which means that their net interest income and fee revenue earned more than what covers their operating expenses.

In addition, significant losses at one institution appear to drag down the average profitability of the entire market. The institution with significant losses has a much higher concentration in commercial real estate (CRE) loans (42 percent of all loans) compared with the other Evansville banks. It also has the highest percent of nonperforming loans (7.8 percent), most of which are in the CRE portfolio. Most other banks in Evansville are performing well and have limited CRE exposure, so there does appear to be an association between CRE exposure and bank performance. CRE portfolios at U.S. banks have witnessed higher loss rates in recent times than most other loan types.

In conclusion, economically the Evansville MSA has fared at par with its peer group in this economic downturn. Aggregate bank performance, at first glance, appears relatively weaker. But most banks in the MSA are actually performing well, with 10 out of 12 being profitable. Significant losses and weak performance at one bank have pushed the market's average performance metrics below peer markets. A closer examination of the individual bank performance seems to suggest an association between high CRE exposure and weak performance.

Gary Corner is a senior examiner and Rajeev Bhaskar is a senior research associate of the Banking Supervision and Regulation division at the Federal Reserve Bank of St. Louis. Intern Connie He provided data support.

Regulatory Reform Proposals

continued from Page 1

- granting new authority for the Fed to supervise all firms, regardless of structure or charter, that pose a threat to financial stability; and
- creation of a new resolution regime for financial institutions deemed systemically important (identified as Tier 1 financial holding companies).

The consumer agency proposal would require nationally chartered banks to comply with state consumer protection laws and regulations if the state requirements would offer a higher level of consumer protection than those of the new agency.

Before Congress' August recess, only two pieces of legislation had been formally introduced into the House Financial Services Committee: the consumer agency proposal and a bill on executive compensation, which would give shareholders of publicly traded companies a greater say on executive pay. The House passed the compensation bill July 31.

Jim Fuchs is supervisory manager in the St. Louis Fed's Banking Supervision and Regulation division.

Quarterly Report

continued from Page 3

nonperforming at the end of the second quarter. For U.S. peer banks, the ratio topped 13 percent. Poor CLD loan performance is spread among banks of all sizes. District banks with assets of less than $1 billion had a 6.46 percent nonperforming ratio.

This tough environment has not had a substantial effect on regulatory capital thus far. At the end of the second quarter, just six banks (out of 689) failed to meet at least one of the regulatory minimums. District banks averaged a Tier 1 leverage ratio of 8.94 percent, well above the 4 percent minimum for that ratio.

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

FEDERAL RESERVE BANK *of* ST. LOUIS
CENTRAL to AMERICA'S ECONOMY™

P.O. Box 442
St. Louis, MO 63166

Central Banker Connected

SEE THE ONLINE VERSION OF *CENTRAL BANKER* FOR MORE IN-DEPTH FEATURES, FED NEWS AND REGULATORY SPOTLIGHTS.

VIEWS

- What are the actual commitments of Federal Reserve lending?
- A look at commercial bank lending during the crisis
- As in the past, reform will follow crisis

TOOLS

- Rapid Response keeps examiners up to date
- Is your bank physically prepared?

REGULATIONS

- Significant changes proposed for Regulation Z (Truth in Lending)
- Interim rules effective for certain types of modified mortgage loans
- Accurate consumer report rules effective in July 2010

>>ONLY ONLINE

Read these features at www.stlouisfed.org/publications/cb/

Sign up for *Central Banker* E-mail Notifications

To improve the usefulness of *Central Banker*, we're now offering e-mail notifications to all subscribers.

If you sign up, we'll send you an e-mail when the latest issue is published (four times a year) and when critical information is made available between issues. For example, we may send you a message when an important regulatory or policy message is coming from our Bank president or our Banking Supervision and Regulation division. The frequency of the between-issue messages will not be extravagant, but tempered by respecting your time at work.

If you're interested, please go to http://research.stlouisfed.org/useraccount/login/secure/ and follow the instructions. For information on Federal Reserve user accounts, see http://research.stlouisfed.org/useraccount/learnmore.

Please note that we respect your time and privacy and will use your e-mail address for this purpose only.

FEDERAL RESERVE BANK of ST. LOUIS
CENTRAL TO AMERICA'S ECONOMY®

CENTRAL BANKER | FALL 2009
https://www.stlouisfed.org/publications/central-banker/fall-2009/clarifying-the-roles-and-the-spending-the-separate-functions-of-the-fed-treasury-and-fdic

Views: Clarifying the Roles and the Spending: The Separate Functions of the Fed, Treasury and FDIC

Yadav K. Gopalan , Julie L. Stackhouse

As banks and consumers struggle with the current effects of the recession, events of last fall remain blurred in the eyes of many. The public has struggled to distinguish between the actions of the Federal Reserve as a central bank, the U.S. Treasury as a fiscal authority and the Federal Deposit Insurance Corp. (FDIC) as an insurer of certain bank deposits.

Indeed, the extraordinary risk in financial markets required extensive coordination among the Federal Reserve, the U.S. Treasury and the FDIC, while each continued to operate in a manner that was consistent with its congressional mandate.

One way to differentiate the Fed's role is to recall the mission of the Federal Reserve. Congress formed the Federal Reserve in 1913 to provide the nation with a safer, more flexible and stable monetary and financial system. Maintaining the stability of the financial system and containing systemic risk were a key responsibility for the Federal Reserve during last fall's crisis.

The Fed's actions

The Federal Reserve carried out its responsibilities in a number of ways last fall. First, it implemented numerous lending programs under the "unusual and exigent circumstances" provision of Section 13(3) of the Federal Reserve Act. These lending programs resulted in many new acronyms, including AMLF, CPFF, TSLF, PDCF, MMIFF and TALF. (See the table for full names and details of Federal Reserve programs.) In addition, the Fed initiated a number of currency swap lines with foreign central banks to provide U.S. dollar liquidity. Finally, following the March 18, 2009, meeting of the Federal Open Market Committee, the Federal Reserve announced that it would purchase up to $1.25 trillion in government agency mortgage-backed securities, $200 billion in agency debt and up to $300 billion in longer-term Treasury securities.

The Treasury's actions

The U.S. Treasury, on the other hand, used its fiscal authority to intervene in the economy. Two programs are notable from the Treasury and the federal government: The Troubled Asset Relief Program (TARP), which made roughly $700 billion available to certain financial institutions, and the federal government's economic stimulus package, which totaled $787 billion. The Treasury was also instrumental in taking the beleaguered government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac into conservatorship. In addition, the Treasury extended temporary insurance coverage to money market mutual funds.

The FDIC's actions

About the same time, the FDIC expanded general deposit insurance coverage to $250,000 per depositor. It also implemented two special term liquidity programs: The Temporary Liquidity Guarantee Program (TLGP) and the Legacy Loans Program (LLP).

Not all announced funding has been spent

Many people have been confused as to how much money the agencies actually extended under both the old and new programs. Some of the public assumed that *all* of the funds made available for certain programs would be deployed; these people concluded that the Federal Reserve and Treasury had provided support in the range of $15 trillion to $17 trillion dollars. Others asked where the off-balance sheet liabilities were recorded.

However, there is a significant difference between the announced funding limits for the programs and the amount that was *actually used*.

For example, by adding the upper spending limits of the Fed's programs as announced in press releases, the total amount comes to approximately $4.4 trillion. Yet, the amount actually extended under these programs has been dramatically lower in several cases. (See table.) Moreover, programs such as the Commercial Paper Funding Facility, the Term Auction Facility and the central bank liquidity swaps have decreased in amount outstanding as financial markets have recovered from their very distressed levels of last fall.

Although many have been confused, the roles of the Federal Reserve, the U.S. Treasury and the FDIC, while very different, have complemented one another during the financial crisis. The Federal Reserve has acted strongly to provide stability to avoid a collapse of shaken financial markets. The Treasury has provided funding to begin the recovery. And the FDIC has stabilized the key funding sources for banks.
For more information on the Fed's balance sheet, see the Board of Governors' Credit and Liquidity Programs and the Balance Sheet web page.

Federal Reserve Programs	Announced Program Limit (if any)	Outstanding as of 07/09/2009
Primary, secondary and seasonal credit	NA	$35 billion
Term Auction Facility (TAF) TAF program limit depends upon the maximum that would be outstanding if all non-matured auctions were fully subscribed (originally $900 billion)	$725 billion	$273.7 billion
Collateralized funding provided to Bear Stearns under Section 13(3) of the Federal Reserve Act	$30 billion	$25.9 billion
Collateralized funding provided to AIG (aggregate) under Section 13(3) of the Federal Reserve Act (Includes initial $85 billion loan + Maiden Lane II + Maiden Lane III)	$125 billion	$78 billion
Asset-Backed Commercial Paper Money Market Mutual Fund Lending Facility (AMLF) under Section 13(3) of the Federal Reserve Act	NA	$12.6 billion
Money Market Investor Funding Facility (MMIF) under Section 13(3) of the Federal Reserve Act	$540 billion	$0
Term Asset-Backed Securities Loan Facility (TALF) under Section 13(3) of the Federal Reserve Act	$1,000 billion	$24.9 billion
Term Securities Loan Facility (TSLF) under Section 13(3) of the Federal Reserve Act	$75 billion	$4.3 billion
Primary Dealer Credit Facility (PDCF) under Section 13(3) of the Federal Reserve Act	NA	0
Central bank swap arrangements under Section 14 of the Federal Reserve Act	Swap line limits vary, depending on specific agreements between the Federal Reserve and the particular central bank	$109.4 billion
Repurchase agreements (and reverse repurchase agreements)	NA	$0 ($70.2 billion)
Purchase of government agency mortgage backed securities and debt	$1,450 billion	$560.2 billion
Purchase of longer term U.S. Treasuries	$300 billion	Approximately $200 billion

SOURCE: Federal Reserve H.4.1 Statistical Release, Factors Affecting Reserve Balances, at www.federalreserve.gov/releases/h41/Current/.

CENTRAL BANKER | FALL 2009
https://www.stlouisfed.org/publications/central-banker/fall-2009/emask-the-fedemsupsup-news-supplements-now-available-for-senior-bank-officers

Views: *Ask the Fed*® News Supplements Now Available for Senior Bank Officers

If you're a participant in the monthly *Ask the Fed* conference call program, you now have access to additional information between each call. The new "Ask the Fed(itorial)" news supplements will feature post-conference call updates provided by Julie Stackhouse, senior vice president of Banking Supervision. The update topics, posted on the *Ask the Fed* web page, will address events in the news of interest to bankers and provide a regulatory perspective.

For those not familiar with the monthly program, *Ask the Fed* is a call-in session for senior officers of state member banks and bank holding companies. St. Louis Fed economists and examiners—and an occasional outside guest—give critical insights to senior officers on regulatory matters, the financial markets and financial crisis.

Both *Ask the Fed* and the "Ask the Fed(itorial)" service are accessible only to Ask the Fed participants, who will receive alerts via their e-mail whenever the updates occur, usually after a monthly call.

For more information on Ask the Fed, contact Erik Soell, director of Ask the Fed, at 314-444-7358, or go to https://www.stlouisfed.org/askthefed/.

CENTRAL BANKER | FALL 2009
https://www.stlouisfed.org/publications/central-banker/fall-2009/commercial-bank-lending-data-during-the-crisis-handle-with-care

Views: Commercial Bank Lending Data during the Crisis: Handle with Care

Silvio Contessi , Hoda El-Ghazaly

Since the financial crisis began in mid-2007, media sources and academics alike have scrutinized data from the banking sector to understand how lending to consumers and firms has changed. The graph shows total loans and leases by commercial banks and their components: real estate loans, individual loans, commercial and industrial loans, and other loans. This measure is part of the H.8 data, which provide weekly aggregate balance sheet data for commercial banks with a charter in the United States.

If considered over the past three decades, the series appears approximately on trend but slightly erratic during the current recession; total loans and leases remains fairly constant until the end of Q3 2008, when it increases sharply and then declines.
If our goal is to understand changes in lending dynamics, particularly over the past few quarters, do the graph series imply that commercial bank lending increased in the last few months of 2008 and then bank lending to the public contracted? Not quite. Several reasons suggest reading such data with extreme care.

First, existing loans and leases at each point in time are equilibrium quantities that depend on the interaction between the supply and demand of credit. Whether the observed decrease in the series is caused by banks restricting their lending or by borrowers demanding less credit during a major recession remains unclear.

Second, commercial banks are responsible for only a fraction (about 35 percent) of financial intermediation in the U.S. economy. The H.8 release does not include the loans of other intermediaries (thrifts and non-depository institutions); therefore, just because we do not observe a large contraction in this volume of total loans and leases does not mean that a contraction in the overall economy has not occurred. In fact, evidence suggests that other credit markets have been severely strained.

Third, since the onset of the crisis, several financial services companies and thrifts that made loans to consumers and firms (but whose loans were not included in the H.8 release) have either become commercial banks or have been acquired by commercial banks. When a commercial bank acquires a thrift, an insurance company or another financial firm, the loans of the target (acquired) company suddenly appear as additional commercial bank loans even though no real change in credit took place in the economy.

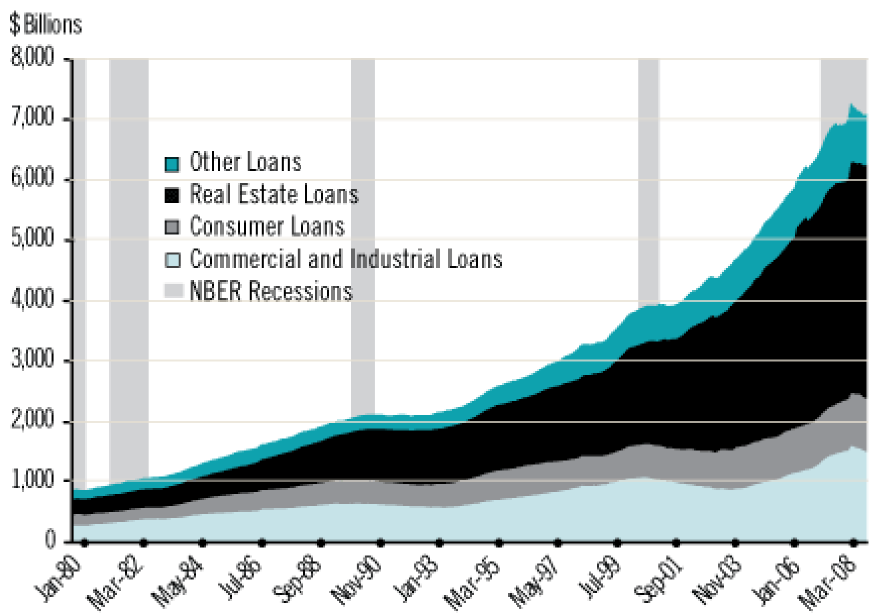
Many such transactions have occurred since the crisis began, creating an upward shift to the series that cannot be interpreted as an increase in lending. (Take, for example, the acquisition of the banking operations of Washington Mutual by JPMorgan Chase on Sept. 25, 2008.)

Fourth, evidence indicates that firms and individuals are taking advantage of their previously unused (but committed) bank credit lines, just as they did in previous periods of credit contraction. If banks grant only a handful of new loans but borrowers continue to draw from existing lines of credit available at commercial banks, the end result would appear to be an increase in lending. At the same time, commercial banks may be withdrawing part of their commitments, which would not be recorded in balance sheet and H.8 data.

Finally, this series may be affected by the programs implemented by the Treasury and the Federal Reserve (for example, the Troubled Asset Relief Program or the Term Auction Facility), and may have been very different without these interventions.

These caveats indicate that caution is necessary when making inferences based solely on aggregate loans data.

Total Loans and Leases of Commercial Banks



This article is adapted from an Economic Synopsis published Aug. 6. Economic Synopses provide brief encapsulations of current economic issues. See more at http://research.stlouisfed.org/publications/es/.

CENTRAL BANKER | FALL 2009
https://www.stlouisfed.org/publications/central-banker/fall-2009/as-in-the-past-reform-will-follow-crisis

Views: As In the Past, Reform Will Follow Crisis

James Bullard, president of the Federal Reserve Bank of St. Louis and a non-voting member of the Federal Open Market Committee, writes in the current issue of Regional Economist that:

Historically, crises have led to significant legislation. For example, the panic of 1907 led to the Federal Reserve Act of 1913, which established the Federal Reserve as the central bank. Out of the Great Depression came the Glass-Steagall Act, which established the Federal Deposit Insurance Corp. and separated commercial from investment banking. The thrift crisis in the late 1980s led to the enactment of the Federal Deposit Insurance Corp. Improvement Act (FDICIA) of 1991, which mandated prompt resolution of failing banks and new standards for bank supervision, regulation and capital requirements.

Read the entire column.

CENTRAL BANKER | FALL 2009
https://www.stlouisfed.org/publications/central-banker/fall-2009/rapid-response-keeps-examiners--up-to-date

Tools: Rapid Response Keeps Examiners up to Date

When examiners come to your bank, you expect them to have the latest understanding of regulations, guidelines and issues affecting the banking system. When the financial crisis erupted last year, and changes started coming rapidly, the Federal Reserve immediately saw the need to provide examiners detailed and pertinent information on emerging issues. And the St. Louis Fed took on the responsibility for getting it done by designing and implementing a program called Rapid Response.

"We knew that discussions were going on informally about supervisory issues. So, we elevated those discussions to a learning experience for anyone who saw the topic as relevant," says the Fed's Erik Soell, who manages the program on a daily basis.
"Examiners already understood the regulations. What they needed was the wider context on the practical implications in the current environment," he says. "Until now, there hadn't been an outlet on this scale that could provide such information."
Rapid Response examiner conference calls are held once or twice a week. Examiners receive an e-mail invitation to register for the session.

One recent session was held on the registered warrants issued by the state of California. Regulatory guidance was issued on July 8, and a System-wide training conference was held the following day. As with most sessions, state bank examiners were also invited to participate. Because of the call, Fed and state examiners nationwide understood the risk and issues facing the banks that were asked to accept the warrants.

Phil Herwig, a senior examiner for safety and soundness at the St. Louis Fed, reports that Rapid Response helps fulfill his duties. "A Rapid Response session can provide a good overview of a particular topic, which helps me develop a better action plan when examining for that topic," Herwig says. "It's also helpful to have current information about a particular issue, and a more global perspective on the issue's implications, when having discussions with bank management during an examination."

Post-session surveys confirm that the program is helping Fed examiners do their job more effectively with bank holding companies and state member banks, explains Julie Stackhouse, senior vice president of Banking Supervision, Credit and the Center for Online Learning. "In addition to our post-session surveys, we receive feedback through anecdotal e-mails and phone calls. The feedback tells us that the sessions are bringing to light the experts in the Fed System, making it easier to know whom to call when questions arise during an examination," Stackhouse says. "A participant from one Fed even told us that he had seen better alignment in views with state banking regulators because of the shared training."

While established because of the financial crisis, Rapid Response will likely outlast the current financial and economic difficulties. "I don't think there will be a time that we won't need Rapid Response, because it's a concept that goes beyond the current crisis," Soell says. "In the future, we could scale it back to once a week, then once a month after the recession and crisis are over, because Rapid Response fills a need regardless of the current economic landscape."

Banking Supervision and Regulation's Erik Soell explains how Rapid Response helps examiners and bankers.

CENTRAL BANKER | FALL 2009
https://www.stlouisfed.org/publications/central-banker/fall-2009/is-your-bank-physically-prepared-for-the-unexpected

Tools: Is Your Bank Physically Prepared for the Unexpected?

Bankers across America are re-examining their financial safety and soundness during the current financial crisis. At the same time, bankers may also want to consider their physical contingency plans.

You would rather not be caught flat-footed by natural disasters such as floods, tornadoes, ice storms and severe thunderstorms, or even swine flu and bird flu pandemics and terrorist attacks. While the last three may seem unlikely, it's better to be prepared. Here are some considerations you may want to revisit:

- Do contingency plans go beyond technology functions?
- Is there more than one alternative site for conducting business, including back-end operations?
- Is there a central location from which to deploy plans of action?
- Are plans tested regularly?
- Are newer staff members and the board of directors familiar with the plans?
- Are contingency plans in writing and easy to find?
- Are data storage and backup efforts up to date with today's technology and operating environment?
- Is there a network of vendors with whom to coordinate alternative plans?
- Is there a clear plan for communicating with your constituents?

>>Read more:
Lessons from Katrina

FEDERAL RESERVE BANK of ST. LOUIS
CENTRAL TO AMERICA'S ECONOMY®

CENTRAL BANKER | FALL 2009
https://www.stlouisfed.org/publications/central-banker/fall-2009/regulations-spotlight

Regulations Spotlight

Significant Changes Proposed for Truth in Lending

The Federal Reserve Board in July proposed significant changes to two components of Regulation Z (Truth in Lending) designed to improve disclosures consumers receive for closed-end mortgages and home-equity lines of credit (HELOCs).

To shop for and understand the cost of credit, consumers must be able to identify and understand the key terms of the mortgage. The Board used consumer testing to ensure that providers give the most essential information at a suitable time, using content and formats that are clear and conspicuous. Therefore, under the proposed changes, disclosures would need to highlight potentially risky features, such as adjustable rates, prepayment penalties and negative amortization.

The public comment period for both proposals **ends Nov. 27, 2009.** For details, see the Board's press release. To comment on either component, go to the Board's Proposals for Comment page and scroll down to use the comment links under the titles Regulation Z — Truth in Lending — Home-Equity Lines of Credit (HELOC) [R-1367] and Regulation Z — Truth in Lending — Closed-end Mortgages [R-1366].

Accurate Consumer Report Rules Effective in July 2010

This final rule affects all financial institutions and other entities that report information to credit bureaus and other consumer reporting agencies, which is widely used to determine consumers' eligibility for credit, employment, insurance and rental housing.

The rules and guidelines take effect July 1, 2010. Under the rules, entities that furnish information about consumers to consumer reporting agencies generally must include a consumer's credit limit in the information provided. The federal agencies also published an Advance Notice of Proposed Rulemaking (ANPR) to identify possible additions to the information that furnishers must provide to consumer reporting agencies, such as the account opening date.

Also, under the rules, if a consumer believes his or her credit report includes inaccurate information, the consumer may submit a dispute directly to the entity that provided the information to the consumer reporting agency, and that entity must investigate the dispute. The rules do not change a consumer's ability to submit a dispute to a consumer reporting agency or a furnisher's duty to investigate a dispute referred by a reporting agency. Read the final rules.

Interim Final Rule Effective for Certain Modified Mortgage Loans

The federal bank and thrift regulatory agencies issued an interim final rule that provides that mortgage loans modified under the U.S. Department of the Treasury's Making Home Affordable Program (MHAP) will retain the risk weight applicable before modification.

Earlier this year, the Treasury announced guidelines under the MHAP to promote sustainable loan modifications for homeowners at risk of losing their homes to foreclosure. The interim final rule would provide a common interagency capital treatment for mortgage loans modified under MHAP. For example, mortgage loans risk weighted at 50 percent prior to modification would continue to be risk weighted at 50 percent after modification provided they continue to meet other applicable criteria. Interim Rule took effect July 30.

Read more.