

FALL 2010 CENTRAL Banker

NEWS AND VIEWS FOR EIGHTH DISTRICT BANKERS

FEATURED IN THIS ISSUE: After Financial Reform | 2Q 2010 State-by-State Call Reports Breakdown

The Changing Landscape of Community Banking

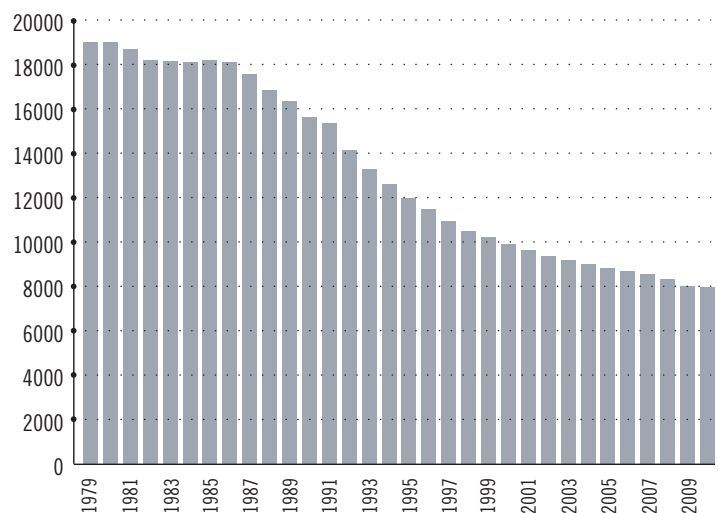
By Gary Corner

The U.S. banking industry is unique among the world's industrialized nations as it consists of thousands of small banks in rural and urban communities. Due to the balance of power that exists between the federal and state governments, the dual banking system has remained in place despite numerous challenges to its existence over the years. Restrictive branching laws and the rural population base of many states fostered the creation of an extensive network of community banks in the more than 155 years of the dual banking system. In some ways, though, the shape of the banking industry today still reflects some legacy effect from an era where vigorous competition was restricted and bank charters swelled, attesting to the strength of the dual banking model.

The three-decade trend of industry consolidation, much involving community banks, has naturally drawn the attention of the industry and policy-makers to the viability of the community bank business model. Today's community banks exist in an environment where competition is intense and financial innovation has stripped away much of a bank's cost advantages in acquiring funds and its revenue advantages on assets. Other contributing factors include the urbanization of population growth and the higher cost of regulation. As illustrated in Chart 1,

CHART 1

Number of Commercial Banks and Thrifts in the U.S.
4Q 1979 – 1Q 2010



SOURCE: Call Reports. Commercial banks include industrial banks and co-op banks. Thrifts include federal savings banks, saving and loan associations and savings banks.

over the past 30 years the number of bank and thrift charters has declined by 58 percent, a loss of more than 11,000 institutions. During this period (as in many others throughout history), the demise of the community bank business model has been prognosticated by many.

Indeed, over the last decade, some 4,000 community bank-sized organizations have merged, failed or outgrown their community bank status. However, during this same period about

continued on Page 8

EDITOR

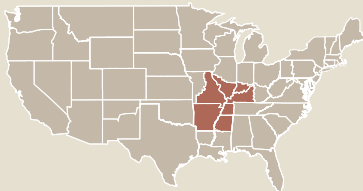
Scott Kelly
314-444-8593
scott.b.kelly@stls.frb.org

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.

Sign up for *Central Banker* e-mail notices at www.stlouisfed.org/publications/cb/. Follow the Fed on Facebook, Twitter and more at stlouisfed.org/followthefed.

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.



After Financial Reform: The Road Beyond

By James Bullard

The Dodd-Frank Wall Street Reform and Consumer Protection Act is the most sweeping change in the regulatory environment for the U.S. financial sector since the Great Depression. Proponents of the reforms envision that the new law will address the root causes of the financial crisis of 2007-8 and will reduce the likelihood of future crises. Yet, with nearly 250 new rules to be written and more than 65 studies to be completed, it is simply too early to know the full impact of the legislation.

Some things are certain. The Act establishes a new Bureau of Consumer Financial Protection and a new Financial Stability Oversight Council; it also extends the supervisory authority of the Board of Governors to systemically significant financial institutions. It creates an additional orderly resolution authority for nonbank financial companies and abolishes the Office of Thrift Supervision.

The Bureau of Consumer Financial Protection is an independent bureau within the Federal Reserve System charged with examining and enforcing consumer compliance laws and regulations at the largest banks and credit unions. In addition, it is to collect, monitor and respond to complaints about consumer financial products or services as well as provide guidance on consumer financial products to traditionally underserved communities and conduct research on marketplace developments for consumer financial products. Financial firms of all sizes, except auto dealers, are subject to new regulations written by this Bureau.

Less clear is the outcome of new rule-making authority. The Financial Stability Oversight Council and the expanded supervisory authority of the Board will have the most impact on the largest financial organizations, including banks with \$50 billion or more in assets and nonbank financial institutions deemed systemically significant. Some provisions of the Act, such as a new FDIC assessment that is based on bank assets rather than deposits, consumer compliance examinations by existing federal banking regulators for smaller banks and credit unions, and the grandfathering of current holdings of trust-preferred securities as capital likely will benefit or maintain the status quo for small banks. However, the implementation of other regulatory authority granted to the Bureau of Consumer Financial Protection has the potential to seriously affect the viability of community banks.

The Dodd-Frank Act does not address the resolution of Fannie Mae and Freddie Mac, the two government-spon-



James Bullard
is president and
CEO of the Federal
Reserve Bank of
St. Louis.

continued on Page 11

More Signs of Improvement for District, Peer Banks

By Michelle Neely

Although profitability at District banks dipped slightly in the second quarter, evidence continues to mount that banking conditions here and throughout the country are stabilizing. Return on average assets (ROA) at District banks fell 4 basis points to 0.53 percent in the second quarter (see table), but was substantially above its year-ago level of 0.19 percent. For U.S. peer banks—banks with assets of less than \$15 billion—ROA actually increased 6 basis points to 0.28 percent in the second quarter. One year ago, peer banks as a group lost money and posted an average of ROA of -0.33 percent.

The profit picture was brighter at smaller institutions. ROA rose 3 basis points to 0.79 percent at District banks with assets of less than \$1 billion, and rose 2 basis points to 0.41 percent at U.S. peers of the same size.

At District banks, the net interest margin (NIM) was essentially unchanged in the second quarter at 3.78 percent, making it a nonfactor for the drop in ROA; net income declined because of increases in net noninterest expenses and loan loss provisions. For U.S. peers, net income received a boost from two sources: higher net interest income and lower loan loss provisions. The NIM at these banks rose 7 basis points to 3.84 percent, while the loan loss provision ratio fell 7 basis points.

The most notable result for both sets of banks in the second quarter is the decline in nonperforming loans, the first quarterly dip since mid-2008 for District banks and the first reduction since 2006 for U.S. peer banks. Nonperforming loans as a percent of total loans fell 11 basis points to 2.98 percent at District banks in the second quarter. The drop was twice as large at U.S. peer banks, where the nonperforming loan ratio declined 24 basis points to 4.01 percent. In the District, the declines in nonperforming loans

Progress, Not Perfection¹

	2Q 2009	1Q 2010	2Q 2010
RETURN ON AVERAGE ASSETS²			
District Banks	0.19%	0.57%	0.53%
U.S. Peer Banks	-0.33	0.22	0.28
NET INTEREST MARGIN			
District Banks	3.66	3.77	3.78
U.S. Peer Banks	3.57	3.77	3.84
LOAN LOSS PROVISION RATIO			
District Banks	0.95	0.77	0.83
U.S. Peer Banks	1.52	1.14	1.07
NONPERFORMING LOAN RATIO³			
District Banks	2.44	3.09	2.98
U.S. Peer Banks	3.78	4.25	4.01

SOURCE: Reports of Condition and Income for Insured Commercial Banks

NOTES: ¹ Because all District banks but one have assets of less than \$15 billion, banks larger than \$15 billion have been excluded from the analysis.

² All earnings ratios are annualized and use year-to-date average assets or average earning assets in the denominator.

³ Nonperforming loans are those 90 days or more past due or in nonaccrual status.

all came from the real estate portfolio, as nonperforming loans fell for one-to-four family, multifamily and construction and land development loans. The improvement was more broad-based at U.S. peers: Nonperforming rates dropped in the consumer, commercial and industrial, and real estate categories.

While the rise in loan loss provisions hurt the bottom line somewhat at District banks, it halted the long lasting slide in the average loan loss reserves coverage ratio. The ratio of loan loss reserves to nonperforming loans rose 341 basis points to 65.88 percent in the District, meaning about 66 cents was reserved for every dollar of nonperforming loans. Just two years ago, District banks had almost 90 cents set aside for every dollar of nonperforming loans. The coverage ratio at U.S. peer banks also increased in the second quarter, but remains below the District average at 55.94 percent.

continued on Page 5

Bernanke Discusses Findings of 40 Small-Business Lending Meetings

The summer issue of *Central Banker* discussed a series of nationwide Fed meetings, including several in the Eighth District where community leaders explored small-business lending problems. In mid-July, Federal Reserve Chairman Ben Bernanke related preliminary findings from the 40 meetings that began in February.

Speaking at a July 12 conference in Washington, D.C., to address the financing needs of small businesses, Bernanke noted that credit conditions remain difficult for small businesses. According to Call Report data for 1Q 2010, loans to small businesses have decreased by more than \$40 billion since 2Q 2008 (\$710 billion down to \$670 billion). Difficult to determine is how much the reduction has been driven by weaker demand for loans from small businesses, deterioration in the financial condition of small businesses during the economic downturn and/or restricted credit availability, he said.

Bernanke addressed an often-expressed concern that bank examiners have prevented banks from making good loans. “We take this issue very seriously. The Federal Reserve has worked assiduously with the other banking regulators to develop inter-agency policy statements on this issue, aimed at both banks and examiners. Our message is clear: Consistent with maintaining appropriately prudent standards, lenders should do all they can to meet the needs of creditworthy borrowers,” he said.

“Doing so is good for the borrower, good for the lender, and good for our economy. To ensure that this message is being heard and acted upon, we have conducted extensive training programs for our bank examiners as well as outreach with bankers, and we will continue to seek feedback from bankers and borrowers,” he said.

Bernanke acknowledged that more can be done, and that the insights gained from meeting with small business owners, lenders, community

leaders and others has given the Fed a “more nuanced understanding of the problem.” Said Bernanke, “Not surprisingly, these meetings confirmed that facilitating small business financing is not a simple or straightforward matter. Notably, the term ‘small business’ encompasses a heterogeneous mix of enterprises, ranging from pizzerias to start-up technology firms, and each small business faces a unique combination of local economic conditions and complex relationships with customers, suppliers and creditors. Hence, we should be wary of one-size-fits-all solutions.”

Among the common themes raised during the meetings were:

- Declining value of real estate and other collateral securing their loans poses a particularly severe challenge.
- Business owners cited credit lines and working capital as their most critical financial needs, followed by refinancing products that would permit them to take advantage of low interest rates.
- Many owners resort to borrowing through their personal credit cards or from their retirement accounts. Several mentioned the need for small-value loans in amounts less than \$200,000 as well as the need for “patient capital” from investors willing to commit funds for 5 to 10 years without an expectation of immediate returns.
- Some lenders said that current lending conditions don’t represent credit tightening as much as a return to more traditional underwriting standards following a period of too-lax standards.

Though some lenders said they were emphasizing cash flow and relying less on collateral values in evaluating creditworthiness, some creditworthy businesses—including some whose collateral has lost value but whose cash flows remain strong—have had difficulty obtaining the credit that they

need to expand, and in some cases, even to continue operating.

"The challenge ahead for lenders will be to determine how to assess the credit quality of businesses in an uncertain and difficult economic environment," Bernanke said. "It is in lenders' interest, after all, to lend to creditworthy borrowers; ultimately, that's how they earn their profits. Regulators, for their part, need to continue to work with lenders to help them do all that they prudently can to meet the needs of creditworthy small businesses."

>> MORE ONLINE

Bernanke's speech

www.federalreserve.gov/newsevents/speech/bernanke20100712a.htm

Eighth District small-business lending meetings

www.stlouisfed.org/publications/cb/articles/?id=1969

Demographics of small-business lending

www.stlouisfed.org/publications/cb/articles/?id=1933

More Signs of Improvement for District, Peer Banks

continued from Page 3

Capital ratios also rose at both sets of banks in the second quarter. The average tier 1 leverage ratio increased 13 basis points to 8.96 percent at District banks, and 16 basis points to 9.28 percent at U.S. peer banks. As with the earnings ratios, coverage ratios and capital ratios remain higher at banks with average assets of less than \$1 billion.

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

Eighth District Bank Data 2Q 2010¹

COMPILED BY DAIGO GUBO

	2Q 2009	1Q 2010	2Q 2010
RETURN ON AVERAGE ASSETS²			
All Eighth District States	-0.36%	0.33%	0.41%
Arkansas Banks	0.66	0.89	0.79
Illinois Banks	-0.95	-0.08	0.21
Indiana Banks	-0.62	0.22	0.40
Kentucky Banks	0.76	1.07	0.96
Mississippi Banks	0.35	0.48	0.52
Missouri Banks	-0.33	0.37	0.28
Tennessee Banks	-0.66	0.35	0.31
NET INTEREST MARGIN			
All Eighth District States	3.45	3.66	3.72
Arkansas Banks	3.97	3.96	4.07
Illinois Banks	3.09	3.48	3.61
Indiana Banks	3.55	3.74	3.75
Kentucky Banks	3.93	4.23	4.09
Mississippi Banks	3.81	3.88	3.87
Missouri Banks	3.30	3.35	3.41
Tennessee Banks	3.64	3.72	3.77
LOAN LOSS PROVISION RATIO			
All Eighth District States	1.39	0.92	0.93
Arkansas Banks	0.75	0.64	0.75
Illinois Banks	1.92	1.30	1.22
Indiana Banks	1.47	1.01	0.94
Kentucky Banks	0.52	0.52	0.53
Mississippi Banks	0.80	0.79	0.79
Missouri Banks	1.31	0.74	0.87
Tennessee Banks	1.52	0.73	0.81
NONPERFORMING LOAN RATIO³			
All Eighth District States	3.96	3.92	3.79
Arkansas Banks	2.40	3.03	2.92
Illinois Banks	6.46	5.35	5.20
Indiana Banks	2.95	3.14	3.21
Kentucky Banks	1.97	2.44	2.42
Mississippi Banks	1.87	2.58	2.77
Missouri Banks	3.15	4.16	3.76
Tennessee Banks	2.99	3.16	3.10

SOURCE: Reports of Condition and Income for Insured Commercial Banks

NOTES: ¹ Because all District banks but one have assets of less than \$15 billion, banks larger than \$15 billion have been excluded from the analysis.

² All earnings ratios are annualized and use year-to-date average assets or average earning assets in the denominator.

³ Nonperforming loans are those 90 days or more past due or in nonaccrual status.

Arkansas Community Banker Leaders Discuss the State of Their Industry

Recently, Robert Hopkins, senior branch executive of the St. Louis Fed's Little Rock Branch, talked with Richard Trammell and Cole Martin regarding the state of community banking in Arkansas today following the July 21 passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Trammell is the executive director of Arkansas Community Bankers (ACB), which represents 134 state-chartered banks in Arkansas. Martin is chairman and CEO of First Security Bank of Clarksville, Ark., a \$105 million asset bank, which is part of a \$4 billion holding company. Martin currently serves as president of ACB.

Robert Hopkins: How do you define a community bank in 2010?

Richard Trammell: From ACB's standpoint it is any bank chartered in Arkansas that gathers deposits locally, makes loans locally and makes decisions locally, which in essence defines most banks in Arkansas today.

Hopkins: How does the U.S. benefit from having a dual banking system in 2010 and beyond?

Cole Martin: From my perspective, it provides banks, and ultimately their customers, balanced and improved choices. During the financial reform debates, I was concerned that we would move away from that and end up with one super regulator. I'm pleased we did not end up there. I think that would not have served the country well.

Trammell: The state banking regulators are locally situated and are in a better position to assess what is going on in local markets, pick up on issues or problems earlier and help banks address them before they become serious problems.

Hopkins: What are your overall impressions of the final Dodd-Frank

Act in meeting the administration's goal of ensuring we never have a recurrence of the recent financial crisis?

Martin: Our primary position all along has been that community banks do not need any new regulations; we did not create the problems that led to the crisis and therefore do not need more regulatory burden. Having said that, and knowing that reforms were going to take place, we fought successfully for a number of things.

Trammell: I don't think we can answer that question yet. The first phase was putting a new regulatory framework in place; Congress and the president did that with the passage of the Dodd-Frank Act. The next phase will be the federal regulators interpreting the intent of the Act's provisions and crafting regulations for financial institutions and others to follow. So, it is too soon to judge if this piece of legislation ensures their overarching goal is met. I will say, because they did not address Fannie Mae and Freddie Mac, it is doubtful that this legislation alone will prohibit a recurrence of a similar crisis.

Hopkins: Some believe that community banks fared well and were in fact winners as a result of the Dodd-Frank Act. Do you share that view?

Martin: We went in to the reform debate determined to mitigate the impact on community banks, which did not cause the recent crisis. From ACB's perspective, I think we were largely successful. From a single community-bank perspective, that's less clear to me. Smaller community banks cannot afford any more regulatory burden, and we are bound to get more regulation as result of the Dodd-Frank Act.

Trammell: We focused on the amendment process, knowing that new

legislation would likely pass. So, we worked toward getting reforms that would be beneficial to community banks. In this context, I think you can say we had some wins. One of the positives is an asset-based deposit insurance process; no longer are the assessments based on just deposits. So, community banks will be paying a proportionally smaller share than in the past. This is fair. We also now have a resolution framework to unwind so-called too-big-to-fail institutions. And they are now going to regulate non-bank entities (e.g., payday lenders), which has never occurred before and will level the competitive playing field for community banks.

Hopkins: How do you see the Act impacting community bank profitability and customers?

Trammel: It's certainly going to make it more difficult when you layer additional cost on for regulatory compliance. Depending on the magnitude, we may see an acceleration of community banks merging to get the economies of scale to handle the added regulatory burden and compete with larger financial competitors.

Martin: I agree that there will be more regulatory burden and associated costs. From a customer perspective, they likely will see more inconvenience and more paperwork and, perhaps, higher debit/credit interchange fees and generally higher prices. The question will be how much the community banks can pass along the added cost from new regulations to the consumer. That is, can they remain competitive while passing on additional cost? That remains to be seen.

Hopkins: How do you see existing community bank business models changing as a result of the Dodd-Frank Act?

Trammel: I recently asked a number of the ACB board members what they see as the "new normal." Four things emerged: tighter loan underwriting, less aggressive deposit gathering, balance sheet and margins shrinking, and increased regulatory burden. I'm not sure that translates into a new business model for community bankers, but these are the changes they see for the foreseeable future.

Hopkins: What changes to community banks' products and services do you

see following the passage of the Dodd-Frank Act?

Martin: Until we see the specific new regulations, I don't think we know what new products and services will result. We will see a continued conservative mindset for the near future.

Hopkins: How do the community banks you represent see the economic recovery unfolding?

Trammel: Arkansas just recently begun to feel the effects of the recession. So, I see slow growth ahead for awhile longer. This downturn, while severe, will end and we will see solid growth. We just need to have more clarity from the changes recently enacted, which will build confidence in business and their customers.

Martin: I think we are in a period of stagnant growth for awhile. There is a lot of waiting and watching for signs of improvement. There is so much uncertainty related to the Dodd-Frank Act and the recently passed healthcare legislation that, for example, banks and their commercial customers are on hold until they gain a clearer picture of the business environment and the impact from these sweeping but as yet undefined legislative changes.

Hopkins: Looking out 10 years, what does the environment look like for community bankers?

Trammel: My crystal ball is not that clear. I still think there will always be a need and opportunity for community banks and bankers because the small communities across this country depend on them. I think we will see more community banks merging going forward in order to gain scale and remain competitive. Community bankers have been creative, innovative and resilient. They will figure out a way to deal with change and do so profitably.

>> MORE ONLINE

Current state of the banking industry

www.stlouisfed.org/publications/cb/articles/?id=1963

The Changing Landscape of Community Banking

continued from Page 1

one-third have been replaced by a new (de novo) bank charter. Further, since the onset of the financial crisis in 2007, we've seen more than 276 banks fail; 220 of them (or 80 percent) were community banks. By most estimates, this episode of bank failures is not over, and it is expected that we will see an even further decline in the number of community banks in the U.S. in the next few years.

So, what do these numbers imply for the future of community banking? To begin answering this question, it's important to first define what is meant by the term "community bank." Typically a community bank conducts its business within a limited geographic area, is primarily retail-funded and has its decision makers locally based. A high level of personal service is another trait of a community bank. Commonly, banks under \$1 billion in assets possess most of these characteristics; thus, for simplification, \$1 billion or less in assets is considered our proxy of a community bank for the purpose of this analysis.

Down but Not Out

As a percentage of industry charters, community banks still represent 92 percent of all charters, but this is down from 96 percent a decade ago. And within our definition of a community bank, those with assets of \$500 million or less outnumber banks with between \$500 million and \$1 billion in assets by a ratio of 10 to 1. As a portion of industry assets, the declining trend is more pronounced: Over the last ten years, community bank assets have grown rather modestly and lagged overall economic growth. By comparison, the nominal compound annual growth rate of aggregate community bank assets is 1.75 percent, compared with the nominal compound annual growth rate of the overall economy of 3.9 percent. While community banks hold a seemingly impressive \$1.5 trillion of assets, this is only 10 percent of industry assets today, as highlighted in Chart 2. A decade ago, community banks represented 18 percent of industry assets.

Community banks have traditionally been an important provider of credit to small businesses. During the financial crisis, banks with less than \$1 billion in total assets generally maintained their small-business loan volumes (as a percentage of total loans) compared with larger banks. For example, from June 30, 2009, to June 30, 2010, small banks on average saw virtually no change in their ratio of small-business loans to total loans (24.85 percent to 24.86 percent) while larger banks experienced a decline (7.02 percent to 6.63 percent). Small businesses arguably foster economic growth, and thus, their ability to find credit today and in the future is of consequence. Community banks have a comparative advantage in providing credit to small businesses, particularly in their ability to properly assess "informationally opaque" borrowers due to their knowledge of local conditions. Their focus on relationship-based lending prevents borrowers without histories suitable for credit-scored lending models from being completely cut out of the credit markets. This advantage is mutually beneficial.

An examination of Call Report data shows that the loss experience and yields on commercial and industrial (C&I) loans at community banks outperform those experienced at larger banks. For example, C&I yields for banks with less than \$1 billion in total assets was 6.25 percent as of June 30, 2010, while yields at banks with more than \$1 billion in total assets was 4.36 percent. While this is in line with what one would expect since community banks are dealing with more "opaque" borrowers (and should be able to achieve higher yields as a result), it is interesting that C&I loss rates for smaller banks were 1.32 percent as of June 30, 2010, while loss rates at the larger institutions were 1.96 percent. During the most recent recession, we've again seen how important relationship lending continues to be for many small businesses. For well-run and efficient small banks throughout the U.S., there will arguably always be a demand for their products and services as the need for credit cannot solely be allocated based on "hard credit data."

Current Challenges Facing Community Banks

Despite continued demand for the products and services offered by community banks, technology and regulatory costs and standardized loan products have hurt their market share and profitability. Because community banks lack scale, technology and regulatory costs are spread across a smaller customer base. Also, standardized consumer, small-business and mortgage loans programs offered by larger market participants are less profitable in the low-scale community bank environment. Over the past decade, these factors have contributed to community banks seeking revenue in other more risky asset classes, such as commercial real estate loans. A look at the material loss reviews of failed banks (issued by their respective agency inspector general offices during this current episode of bank failures) suggests that CRE (commercial real estate) concentrations developed and proved disastrous for many community banks during the economic downturn.

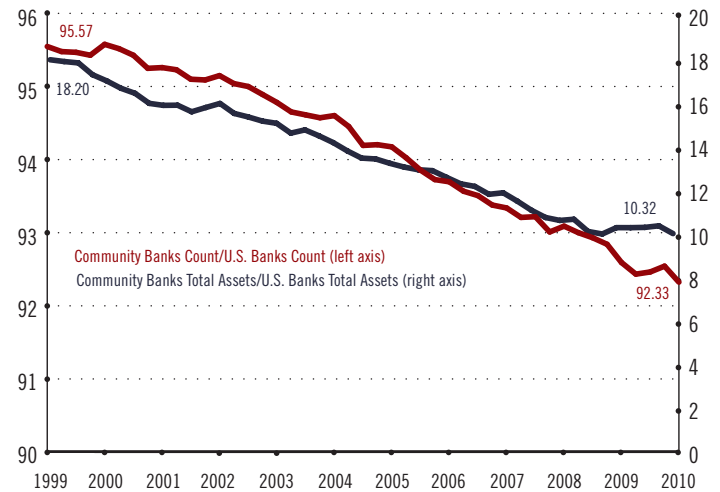
So, how does the community bank model thrive? The most direct approach is to drive more efficiency into core business lines. This strategy has the advantage of staying within a community bank's proven areas of expertise. According to a 2007 study by St. Louis Fed, the most important driver of high earnings in small banks is control of operating expenses, followed by a high ratio of good quality and attractively yielding loans-to-assets. Of less importance is the percentage of core deposits.

A less proven strategy is to seek out new strategic businesses and sources of revenue. As with any new risk-taking endeavor, however, a risk management process should be in place to provide proper oversight. And finally, economic conditions matter. Stagnant local economic conditions and low population growth test the viability of the community bank business model. Under such conditions, community banks may experience returns, which are less than their cost of capital. In some instances, finding a merger partner may be the best alternative.

Financial innovation over the last 30 years has changed the complexion of banking. Made possible by advances

CHART 2

Community Banks/U.S. Banks Ratio



SOURCE: Call Reports

in technology, innovations such as money market mutual funds, junk bonds, commercial paper, securitizations and the development of a shadow banking system, have provided a greater array of nonbank alternatives to consumers and the direct access to the capital markets for many commercial firms. Over time, this has changed the revenue and funding structure of all banks. However, for some community banks, the costs and risks to adapt to these changes were too high. Many found strategic partners.

Community banks that exist today have evolved in many ways—some by reducing operating costs, others by finding new sources of revenues. While opportunities will always exist for well-run and efficient community banks, many still need to evolve. As the banking industry continues to adjust from the fallout of the financial crisis, it seems likely that some of the consolidation currently taking place will continue for at least the next few years.

Gary Corner is a senior examiner at the Federal Reserve Bank of St. Louis. The author thanks Daigo Gubo, research associate in the Supervisory Policy and Risk Analysis Unit, for contributing to this article.

Dodd-Frank Act Changes Begin

At this point, federal regulatory agencies are anticipating nearly 250 new regulatory rules called for in the Dodd-Frank Wall Street Reform and Consumer Protection Act. Some of the changes already underway include the following.

Discount Window Lending Rules Permit Disclosure of Depository Institution Information

According to provisions in the Act, the Federal Reserve has altered disclosure of discount window lending information. The Fed will now publicly disclose the following information, generally about two years after a discount window loan is extended to a depository institution:

- the name and identifying details of the depository institution;
- the amount borrowed by the depository institution;
- the interest rate paid by the depository institution; and
- information identifying the types and amounts of collateral pledged in connection with any discount window loan.

See more at www.frbdiscountwindow.org under General Information > FAQs.

Rulemaking Starts with Proposals on Alternatives to Credit Ratings in Risk-Based Capital Guidelines

Federal agencies gave advanced notice Aug. 10 for proposed rulemaking regarding alternatives to the use of credit ratings in the risk-based capital guidelines of the federal banking agencies.

The Act requires each agency to review 1) any regulation issued by such an agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and 2) any references to or requirements in such regulations regarding credit ratings. In developing substitute standards of credit-worthiness, agencies are supposed to establish, as feasible, uniform standards of credit-worthiness for use by the agency, taking into account the entities it regulates that would be subject to such standards.

See the advance notice and comments instructions at <http://federalreserve.gov/newsevents/press/bcreg/bcreg20100810a1.pdf>.

You Can Still Participate in Final CRA Public Hearings in September

The final of a series of Federal Reserve public hearings on proposals to changing parts of Regulation C, which implements the Community Reinvestment Act, will be held Sept. 15 at the Federal Reserve Bank of Chicago and Sept. 24 at the Federal Reserve Board in Washington, D.C. Even though these hearings are being held far from the Eighth District, you or your officer overseeing CRA can participate by submitting comments and watching the hearings.

The four hearings (the previous two were held July 15 at the Atlanta Fed and Aug. 5 at the San Francisco Fed) have three objectives:

- Help the Board evaluate whether the 2002 Regulation C revisions that required lenders to report mortgage pricing data have in fact provided useful and accurate information about the mortgage market.
- Provide information to help the Board assess the need for additional data and other improvements.
- Identify emerging issues in the mortgage mar-

ket that may warrant additional research.

See www.federalreserve.gov/communitydev/hmda_hearings.htm for a list of specific topics.

All hearings include panel discussions by invited speakers. Interested parties able to travel to the hearings may deliver oral statements as time permits. Written statements of any length may be submitted for the record. Submit written comments to:

- e-mail regs.comments@federalreserve.gov,
- call 202-452-3819 or 202-452-3102,
- follow the instructions at <http://www.regulations.gov/search/Regs/home.html#home> or
- mail them to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551.

Please identify your comments by Docket No.OP-1388. If e-mailing, include the docket number in message's subject line.

After Financial Reform: The Road Beyond

continued from Page 2

sored enterprises that were placed into government conservatorship nearly two years ago and still hold or guarantee the majority of residential mortgage debt in the U.S. The Act does not provide any limit on taxpayer support for these institutions. How these institutions are ultimately resolved will have a significant impact on the future of mortgage finance in the U.S. Under the Act, the Treasury is required to submit by January 31, 2011, a report to Congress on options to end the conservatorships.

While the aftermath of the regulatory reform debate has unleashed a flurry of opinions and commentary on the “winners” and “losers” from this year-long process, I believe it is more important to focus on how the new environment affects incentives. Will the new environment generate more transparent financial contracts? Will it successfully constrain the ability of the managers of financial institutions to engage in inappropriately risky behavior? Will it end taxpayer bailouts of large institutions whose “bets” turn out badly? Alternatively, will it generate imaginative and successful efforts at regulatory avoidance? The answers to these questions will become apparent only with time. Only then will we know if the Act reduces the probability of a future financial crisis.

>> MORE ONLINE

Systemic risk and the financial crisis: a primer

<http://research.stlouisfed.org/publications/review/09/09/part1/Bullard.pdf>

Bullard's speeches, interviews and papers

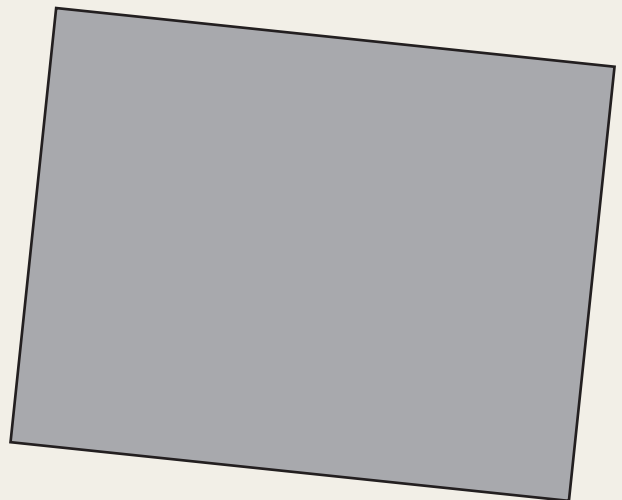
<http://research.stlouisfed.org/econ/bullard/index.html>

Get the Latest on the New Financial Reform Law

President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act on July 21. Keep track of the latest developments, and see what steps were taken toward reform since March 2009, with the St. Louis Fed's Reforming the Nation's Financial System web site at <http://regtimeline.stlouisfed.org/>. You can also use the site to understand how the Act came to be, using primary documents from Congressional hearings and various speeches.

Other useful St. Louis Fed sites:

- Tracking the Global Recession (<http://research.stlouisfed.org/recession/>) tracks the current economic environment through easy-to-understand charts of monthly indicators, such as employment, industrial production, retail sales and real income; current GDP data breakdowns; data from other countries; and more.
- The Financial Crisis (<http://timeline.stlouisfed.org/>) is designed to help the public better understand the major financial events and policy actions that the Fed has taken since the crisis began in 2007.





FEDERAL RESERVE BANK *of* ST. LOUIS

CENTRAL to AMERICA'S ECONOMY®

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

STLOUISFED.ORG

FIRST-CLASS
US POSTAGE
PAID
PERMIT NO 444
ST LOUIS, MO

Central Banker Online

SEE THE ONLINE VERSION OF THE FALL 2010 CENTRAL BANKER FOR MORE INSIGHTS, REGULATORY SPOTLIGHTS AND FED NEWS.

BANKING RESEARCH FOR YOUR STAFF

- Jump in Consumer Loans Due to New Accounting Standards
- The Alt-A: The Forgotten Segment of the Mortgage Market
- Fed, International Banks Cooperate on Remittance Service to Latin America
- Help Your Customers and Community Avoid Loan Modification Scams
- Test Access to the Discount Window for Contingency/Liquidity Purposes
- Fed Now Authorized to Offer Interest-Bearing Term Deposits

>> ONLY ONLINE

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

Reader Poll

What is the main concern for community banks as the nation emerges from the financial crisis and Great Recession?

- Unusually high numbers of residential and commercial real estate loan delinquencies
- Negative public perception toward large banks, which unfairly stigmatizes small banks
- High unemployment and low consumer spending
- Effects of the recently passed financial reforms

Take the poll at www.stlouisfed.org/publications/cb/. Results are not scientific and are for informational purposes only.

In the summer issue's poll, we asked whether the new rules governing debit cards and overdrafts will make you more or less likely to use overdraft programs. Based on 127 responses:

- 13 percent said they were more likely, because they liked being able to opt in to overdraft services for debit card and ATM transactions.
- 15 percent said they were less likely, because opting in could lead them to overspend.
- 72 percent said that the new rules won't change their spending habits.



CENTRAL BANKER | FALL 2010

<https://www.stlouisfed.org/publications/central-banker/fall-2010/fed-banking-research>

Fed Banking Research

Jump in Consumer Loans Due to New Accounting Standards

At first glance, the upward spike in consumer loans during March and April 2010 seems to suggest a dramatic expansion in credit. The spike itself could be seen as a strong signal that banks have loosened credit standards or originated more consumer loans in the wake of an improving economy.

While there have been improvements in consumer loans recently, the dramatic increases over the past few months have been caused by a new reporting requirement issued by the Financial Accounting Standards Board. Financial Accounting Statements 166 and 167 have implications for how banks treat off-balance-sheet special purpose vehicles. Moreover, these statements have more impact in certain loan categories and on certain bank types in particular. Read the whole article.

The Alt-A: The Forgotten Segment of the Mortgage Market

This St. Louis Fed study presents a brief overview of the Alt-A mortgage market with the goal of outlining broad trends in the different borrower and mortgage characteristics of Alt-A market originations between 2000 and 2006. The paper also documents the default patterns of Alt-A mortgages in terms of the various borrower and mortgage characteristics over this period.

Data from 2007-2010 Reveal Characteristics of Bank Failures

Economists investigate the characteristics of banks that failed and regional patterns in bank failure rates during 2007-2010 in the September/October 2010 *Review*, the St. Louis Fed's economic research publication.

The article compares the recent experience with that of 1987-1992, when the U.S. last experienced a high number of bank failures. As during 1987-1992 and prior episodes, bank failures during 2007-2010 were concentrated in regions of the country that experienced the most serious distress in real estate markets and the largest declines in economic activity. The authors found that although most legal restrictions on branch banking were eliminated in the 1990s, many banks continue to operate in a small number of markets and are vulnerable to localized economic shocks.



CENTRAL BANKER | FALL 2010

<https://www.stlouisfed.org/publications/central-banker/fall-2010/for-your-staff>

For Your Staff

Help Your Customers and Community Avoid Loan Modification Scams

The St. Louis Fed and the attorneys general of Missouri and Illinois are among those supporting a nationwide effort by NeighborWorks America to help homeowners avoid loan modification scams. This initiative is designed to help homeowners in danger of or facing foreclosure protect themselves against loan modification scams, find trusted sources of help, and identify and report scam activity.

In addition to the advice you already give your customers, you can direct them and community organizations to www.loanscamalert.org, which contains various contact resources and the six red flags to look for in a scam.

Test Access to the Discount Window for Contingency/Liquidity Purposes

The Federal Reserve Bank's primary credit program, available through the discount window, may be a part of your institution's liquidity management or contingency plan. Institutions are encouraged to periodically test their ability to borrow at the discount window to ensure that there are no unexpected impediments or complications. If your institution already has the discount window in your plans, you can easily complete a test by calling the Credit and Payment Risk Management Division at 1-866-666-8316 to request a small, one-day loan.

If the discount window is not a part of your institution's liquidity management or contingency plans and you are interested in learning more about establishing a discount window relationship, including necessary documentation and collateral requirements, call the number above. Additional information can also be found on the discount window's web site.

Fed Now Authorized to Offer Interest-Bearing Term Deposits

Reserve banks can now offer term deposits to eligible depository institutions, under a recent change to Regulation D, Reserve Requirements of Depository Institutions.

The Federal Reserve Board has authorized up to five small-value offerings of term deposits under the Term Deposit Facility to be conducted in coming months. Term deposits will be made available through an auction-based TDF that will offer fixed quantities of term deposits for a specified maturity date to eligible institutions. Term deposit auctions will generally include both a competitive auction and a noncompetitive tender option.

Fed, International Banks Cooperate on Remittance Service to Latin America

Your bank's account-holders can now transfer funds easily to an unbanked receiver in 11 Latin American countries. The Federal Reserve is collaborating with Banco de México (The Central Bank of Mexico), Banco Rendimento and the Microfinance International Corporation (MFIC) to offer this remittance service.

Funds can be transferred to a bank location or a trusted third-party provider. This "account-to-receiver" service is an expansion of the Fed's FedGlobalSM ACH Payments suite, which enables automated clearing house transactions between the United States and Canada, Mexico, Europe and Latin America. This feature dramatically improves the ability of U.S. depository financial institutions to enroll new customers who want to send funds back home to family members without bank accounts. The Reserve Banks work directly with Banco de México to provide the service to receivers in Mexico and with Banco Rendimento and MFIC to reach receivers in 10 other countries.