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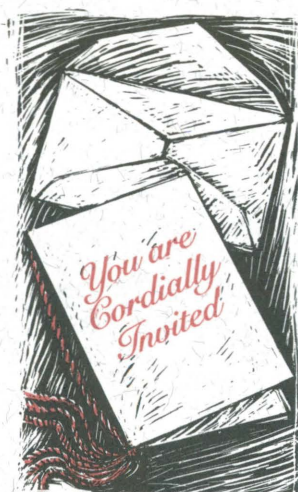


SUPERVISORY ISSUES

November 1992

Supervisory
News and Views
for the Eighth District

St. Louis Fed to Conduct FDICIA Informational Meetings



Beginning in January, the St. Louis Fed will sponsor 12 informational meetings throughout the Eighth District to clarify changes in banking regulations resulting from the Federal Deposit Insurance Corporation Improvement Act (FDICIA).

During each half-day session, Fed examiners and attorneys will present practical guidance on the changes of most concern to bankers. The initial portion of the program will include a discussion of limitations resulting from Prompt Corrective Action, revisions to Regulation

O, the new real estate lending guidelines and the new Regulation F relating to Interbank Liabilities. The remainder of the program will include practical guidance on the provisions of Regulation DD, with which banks must comply no later than mid-June 1993.

District bankers will receive letters of invitation to these meetings in the coming weeks. If you do not receive a letter or want to make sure you are included in a meeting in your area, please call Linda Moser at (314) 444-8320.

Schedule of Meetings

Jan 12	Quincy, IL
Jan 13	Cape Girardeau, MO
Jan 13	St. Louis, MO
Jan 14	Springfield, MO
Jan 19	Mt. Vernon, IL
Jan 20	Louisville, KY
Jan 21	Bowling Green, KY
Jan 26	Memphis, TN
Jan 27	Jonesboro, AR
Jan 28	St. Louis, MO
Feb 2	Little Rock, AR
Feb 3	Greenville, MS

FDICIA Requires Independent Audit Committees

Section 36 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) requires insured depository institutions with assets over \$150 million as of January 1, 1993, to have independent audit committees and to file annual audited financial statements and reports on compliance with safety and soundness laws and regulations. This article discusses

the FDIC's proposed requirement for audit committees composed entirely of outside, independent directors.

The proposed regulation defines "independent" as someone who has not been an employee, associate or affiliate of the covered institution or any of its affiliates within the preceding three years.

Since this requirement will become effective for fiscal

years after December 31, 1992, audit committees should be established early in 1993. Recognizing that the restructuring of existing audit committees may require some time, the FDIC has indicated that it will not object if audit committees are first restructured at annual meetings after which institutions first

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Applications Issues: Fed Introduces Pre-filing Notice

To address the increasing amount of information needed for bank holding company applications, the Federal Reserve Board has introduced a notice of intent to file an application. This notice may be presented to the Reserve Bank by letter or in person and needs to contain little more than a description of the transaction.

The notice permits the Fed to identify any issues that may be unique to the proposed transaction and clarify the information that must be submitted for an adequate evaluation. After a brief review

of the proposal, the Reserve Bank will inform the applicant of information, beyond what is normally requested, that

After a brief review of the proposal, the Reserve Bank will inform the applicant of information needed in the formal application.

is needed in the formal application. This should enable the applicant to address fully the issues relevant to the review of its proposed transaction.

The new procedure, which is

entirely voluntary, does not prevent an applicant from filing a draft application. In some cases, however, a pre-filing notice might more effectively achieve the same goal with less burden.

With this new procedure, the Fed confirmed its current timetable for reviewing Section 3 and Section 4 applications to ensure a complete record on which to base its analyses and decisions. The Reserve Bank provides comments in an exception letter 10 business days after receipt of an application; the applicant then has eight business days to respond by providing supplemental information. Five days after

receiving the supplemental information, the Reserve Bank will accept or return the application.

The Reserve Bank takes action on delegated applications 30 days after acceptance. Applications reviewed by the Board of Governors are normally decided within 60 days unless time is needed to analyze a policy issue or to address issues raised by parties protesting an application.

Audit Committees

(continued from front page)

become subject to Section 36.

A holding company may fulfill the audit committee requirement for all covered subsidiaries (those which are insured and have over \$150 million in assets) as long as it meets certain requirements. To do this, it must perform appropriate functions for the covered subsidiaries, and the depository institutions must either have less than \$5 billion total assets or have CAMEL ratings of either 1 or 2 and assets greater than \$5 billion but less than \$9 billion.

Large institutions, with assets of at least \$500 million, must have two audit committee members with banking or financial management

expertise. This expertise can be obtained as follows:

- through five years of service as a director of an insured institution or a financial services company;
- as an audit committee member of any corporation; or
- through three years of finance, accounting or banking related employment at an executive or professional level in education, business, or a federal or state financial regulatory agency.

Audit committee members of large institutions may not be large customers or representatives of large customers. Such customers are defined as those whose transactions with the institution, including loans, deposits or other transactions, exceed the lesser of

15 percent of risk-based capital or \$50 million.

Audit committees of large institutions must have access to outside counsel. This means that the committee must have the authority to hire and compensate its own counsel without approval of the company's management or directors. Counsel must not concurrently represent the company, its management or its board of directors.

The only duty of the audit committee specified in the proposal is to review the required reports of management and independent accountants. The proposed regulation, however, suggests a number of other optional duties for the audit committee. These include approving the selection of the accountant, approving the scope of the

audit, reviewing proposed adjustments and disagreements, meeting with the accountants before required audited financial statements are filed, reviewing the adequacy of internal controls and management's handling of deficiencies in compliance with safety and soundness laws, reviewing call reports for accuracy and timeliness, and supervising the internal audit function.

The FDIC's summary of the proposal indicates that the list of optional duties are meant to be examples and not requirements. These duties may vary with the nature of the institution.

Applications Issues: What to Do Before Proposing an Expansion

In general, a bank holding company pursuing an expansionary proposal should exhibit the following characteristics:

- it should be in satisfactory financial condition as reflected in a BOPEC composite

rating of 1 or 2 at its most recent inspection;

- a majority of its banking assets should have been rated CAMEL composite 1 or 2 based on the subsidiary banks' most recent examinations; and
- each subsidiary bank should have received a satisfactory CRA composite rating at its last compliance examination.

If a prospective applicant does not meet these criteria, the Fed recommends that the proposal be deferred until appropriate ratings are achieved.

If an applicant chooses to file such a proposal without

level. Copies of significant correspondence between the bank and its regulators that relate to compliance or improvement efforts would be helpful.

- For any current or proposed subsidiary bank operating under some form of supervisory action with its primary regulator, the proposal should include a discussion of the corrective measures taken to address each provision of the action. This discussion should be supplemented by a copy of the supervisory action and copies of any correspondence between the bank and its regulator detailing compliance efforts taken or planned.

A bank holding company pursuing an expansionary proposal should be in satisfactory financial condition.

meeting the above criteria, however, it must be prepared to address in writing the following issues supported by appropriate documentation:

- For any current or proposed subsidiary bank assigned a less-than-satisfactory CAMEL, CRA or compliance rating at its most recent examination, the discussion should include the nature of the violations and exceptions disclosed and the corrective measures taken that will produce an improvement in the rating to a satisfactory

If a company and its subsidiary banks are in satisfactory condition but either the company or a subsidiary bank has exhibited an adverse trend since the last examination in the areas of earnings, capital or asset quality, the applicant should provide a discussion of the reasons for the trends and the actions taken to improve performance.

In addition, any application that would result in a change in control should be supplemented by background information on each proposed officer, director and principal shareholder of the acquiring holding company.



New Program Monitors Timeliness of Regulatory Reports

St. Louis Fed Accepts Several Reports Electronically

To assist institutions in submitting timely and accurate regulatory reports, the St. Louis Fed accepts reports electronically. Currently, electronic data for the following bank holding company reports are accepted: FR Y-9C, FR Y-9LP, FR Y-9SP and FR Y-11Q. Electronic submission of regulatory reports does not relieve an institution of the requirement to maintain a hard copy of the signed and attested cover page in its files as mandated by Operating Letter No. 22.

Bank regulators rely on accurate and timely reports of financial condition to carry out their supervisory responsibilities. The Fed recently formalized its monitoring responsibilities by implementing a Regulatory Reports Monitoring Program.

Effective with the September 30, 1992, reporting period, the program will identify banking institutions supervised by the Federal Reserve that file late reports. The program will later be expanded to include monitoring of inaccurately prepared or false regulatory reports.

Which reports are covered by the program?

Reports covered by the program include all periodic financial reports submitted by commercial banks, bank holding companies and non-banking subsidiaries of bank

Reports must be the complete and signed originals to be considered timely.

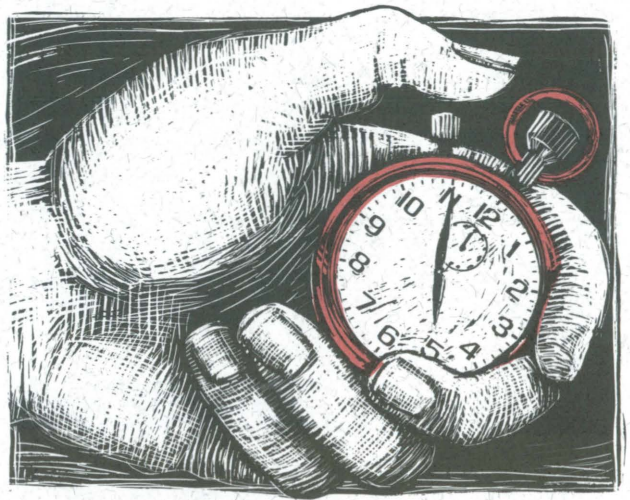
holding companies (Call, FR Y-6, FR Y-9 Series, and FR Y-11 Series reports). Reports submitted by Edge Corporations and foreign banking organizations are also covered. Reports not subject to the program include those dealing with supervisory actions, merger and acquisi-

tion applications and Federal Reserve monetary aggregate reports.

What is a timely report?

A timely report is defined as an official copy of a report that is received by the Reserve Bank

- The report is received electronically by the end of the reporting day on the submission deadline (5 p.m. at each of the Reserve Banks), or for the Call Report, it is received by the electronic collections agent by the submission deadline.



or its designated electronic collections agent in a "timely" manner. Filing of original reports will be considered timely in the following cases:

- The report is received by the end of the reporting day on the submission deadline (5 p.m. at each of the Reserve Banks).
- The report is mailed first class and postmarked no later than the third calendar day before the submission deadline, regardless of when the report arrives at the Reserve Bank.
- The report is put into an overnight delivery system on the day before the submission deadline.

In any of the first three cases, the reports must be the complete and signed originals to be considered timely. Facsimile copies will no longer be accepted.

Are extensions available?

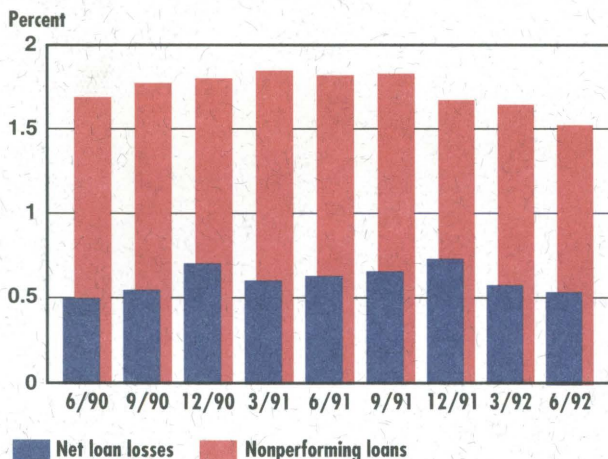
Reserve Banks will no longer be able to grant grace periods or extensions beyond the due date unless exigent circumstances exist and staff at the Federal Reserve Board concurs.

More information about the program will be mailed to banking organizations in the coming weeks.

BANK PERFORMANCE

District Bank Earnings and Asset Quality Improve

Loan Losses and Nonperforming Loans as a Percentage of Total Loans



Key profitability and asset quality measures for the first half of 1992 indicate that District banks are poised for a very good year. Annualized ROAA for the first six months of 1992 demonstrates a substantial

increase from both year-end 1991 and the first six months of 1991. At 1.16 percent, ROAA is up almost 21 percent when compared to the same period last year. Additionally, District ROAA exceeded the national peer (U.S. commercial banks with total assets less than \$15 billion), which equaled 1.03 percent based on June 30, 1992, data.

The leading factor supporting the improved earnings is the net interest margin, which increased significantly by 22 basis points during the first half of this year. The wider margin is the consequence of

lower interest expense resulting from the continuing decline in short-term interest rates. Level overhead expense and modestly lower provisions were also contributing factors.

Nonperforming loans and loan losses have decreased to their lowest levels in several years (see chart at left). Both measures declined for the first two quarters of 1992. Accompanying the decline in nonperforming loans is an increase in the coverage of those loans. Coverage is defined as the level of loan loss reserves to nonperforming loans. This ratio has increased steadily over the last five quarters and as of June 30, 1992, it stood at 117.6 percent.

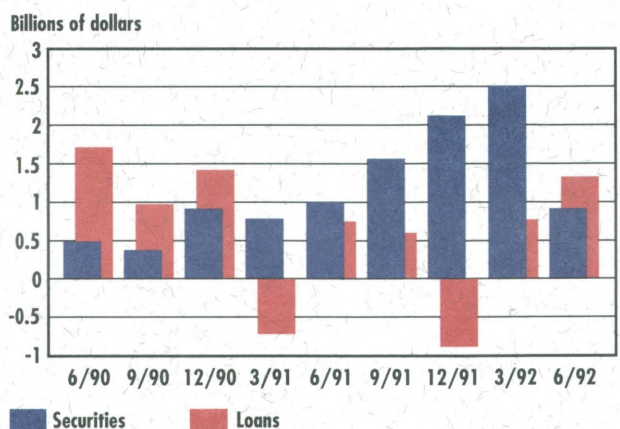
The balance sheet restructuring that began in 1991 and continued into the first quarter of 1992 stalled in the second

quarter. During the second quarter, loan growth exceeded securities growth for the first time in six quarters (see chart below). This growth, combined with a small decrease in deposits, resulted in an increase in the loan-to-deposit ratio. In addition, the inverse relationship between large time deposits and MMDAs tapered off, which is characteristic of the last five quarters.

Finally, District banks experienced appreciable growth in assets and equity. The District banking assets base grew by 1.7 percent compared with a growth rate for U.S. peers of only .30 percent. Cumulative equity growth of 5.5 percent during the first half of 1992 provides additional strength for future asset growth.

Growth of Investment Securities and Loans

(Quarterly dollar change)



RESPA Enforcement Program Now in Effect

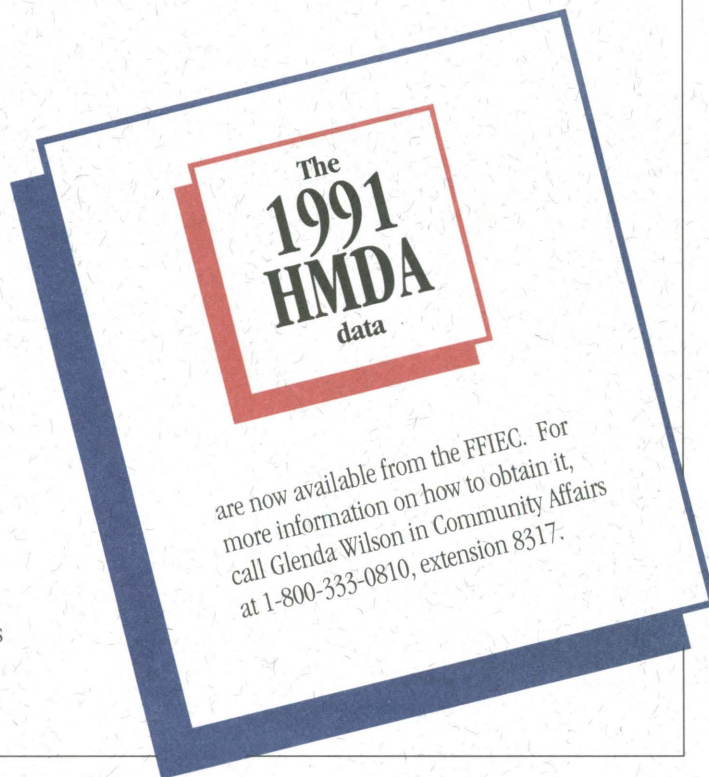
District bankers should be aware that the Department of Housing and Urban Development (HUD) has established an enforcement program for violations of the Real Estate Settlement Procedures Act (RESPA). As part of its compliance examinations, the Federal Reserve notes violations of RESPA and has recently established procedures for referring certain violations to HUD.

Of particular concern to HUD is a recent increase in compensated referrals of real estate settlement business. Although the payment of reasonable fees for services actually performed is not prohibited, HUD has determined that a party must perform some processing service, beyond simply taking a mortgage loan application and referring the business to a lender, in order to receive a fee for services rendered.

Correction:

In the previous issue, the section reference for Regulation D was incorrectly printed. The

correct reference for limitations on savings accounts is Paragraph 204.2 of Regulation D.



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