September 1993

Supervisory News and Views for the Eighth District

SUPERVISORY ISSUES

Community Banks Demonstrate Resilience

In late July, the St. Louis Fed conducted an informal telephone survey of community banks to determine the effects of the Midwest flood. Fed employees reached 205 banks in 38 counties that border the flooded Missouri, Mississippi and Illinois Rivers.

Despite the many obstacles to overcome, including sandbags and spectators, respondents confirmed that all banks located in flooded counties continued to operate. Institutions that were forced to evacuate found alternate locations from which to conduct daily business. Many banks moved their operations from their head office to a branch or facility, whereas others relocated to contingency sites.

Of the 19 banks that had to evacuate, one served customers from a gymnasium, another from a firehouse, and still another from a local college library. In one area, a competing bank cooperated by permitting a displaced bank to continue operations in its building. In another area, the bank was the only business remaining on its main street and was surrounded by a tall sandbag wall. To get employees and customers to the bank, the managers brought them in with a boat-and-pulley system. In addition, for those who were

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Flood Prompts Regulatory Response

As part of an interagency effort, the Fed is working to assist banks and their customers affected by flooding in the Midwest. Among other measures, the Fed has waived federal appraisal requirements for extensions of credit related to flood recovery, permitted the use of preprinted forms to waive the right of recision, and allowed more flexibility in certain consumer compliance matters. Specific information about these initiatives follows.

Waiver of Appraisal Regulation

As permitted by provisions of the Depository Institutions Disaster Relief Act of 1992, each banking agency has exempted transactions involving real estate located in areas directly affected by the Midwest flood from real estate appraisal requirements. For the next three years, state member banks and bank holding companies are exempt from the provisions of Regulation H relating to real

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Flood Survey

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not comfortable banking by boat, an office was opened in city hall.

Thirty-one additional banks responded that their operations were significantly affected by flooded roads and bridges, which hindered employee and courier traffic. To circumvent potential problems, one bank planned to fly key employees to work had conditions warranted. Also, the Fed made arrangements with several banks to deliver cash letters to alternate sites.

Despite the efforts of these bankers, however, the flood did deliver some costly blows to institutions. Ten banks reported that either the main office or a branch had sustained physical damage from lengthy flooding. In at least one instance, the facility is estimated to be a total loss.

As part of the survey, the Fed requested information about the flood's effect on loan portfolios. Although respondents believe that it is premature to provide estimates concerning credit quality, two-thirds reported that they expect an adverse effect. As of mid-August, however, most lenders estimated that less than ten percent of their portfolios would be affected.

The Fed will continue to monitor the effect of the flood on Eighth District institutions.

Regulatory Response

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estate appraisals providing that the following conditions are met:

- The property is in a major Midwest flood disaster area, as declared by President Clinton, and designated as eligible for federal assistance by the Federal Emergency Management Agency (FEMA);
- The property is either directly affected by the flood or, if it is not directly affected, the institution's records explain how a transaction involving the property would enable disaster recovery;
- A binding commitment exists to fund transactions no later than July 9, 1996; and
- The lender retains documentation supporting the property's valuation for examiner review.

Consumer Compliance Relief

Regulation Z

The Board is providing a temporary exemption to Regulation Z for consumers who need to obtain credit quickly to begin repairs in flood damaged areas. Bankers may use a preprinted form to secure a consumer's waiver of the right to rescind certain home-secured loans when the loan proceeds are necessary to meet a consumer's bona fide personal financial emergency. While using the form is permissible, the consumer must sign and date the waiver. This exemption is available immediately in counties declared disaster areas by President Clinton and will expire on July 9, 1994.

The Fed is working to assist banks and their customers affected by the flooding.

Consumer Compliance Examinations

The St. Louis Fed has postponed several Eighth District consumer compliance examinations to minimize disruptions to banking operations that are directly affected by the flood or serve communities affected by the flood. While Fed examiners will take into account any extenuating circumstances on a case-by-case basis before citing violations, the Fed is not legally able to relieve state member banks from responsibility for compliance with these laws and the civil liability provided in many of the consumer protection statutes.

Community Reinvestment Act

In assessing CRA performance in communities affected by the flood, the Fed will give positive consideration to financial institutions' participation in programs where most or all of the financing provided may ultimately benefit low- and moderate-income borrowers, even if such neighborhoods are located outside an institution's delineated community.

Consistent with its long-standing practice to promote supervisory actions that encourage institutions to work constructively with borrowers who experience difficulties from conditions beyond their control, the Fed encourages institutions to work with borrowers in a manner that is consistent with sound business practices. Noting that one of the principal objectives of the examination and supervision process is to achieve an accurate assessment of a financial institution's loan portfolio and financial condition, the Fed recognizes that efforts to work with borrowers in communities under stress, if conducted in a reasonable manner, are consistent with safe and sound practices and in the public interest.

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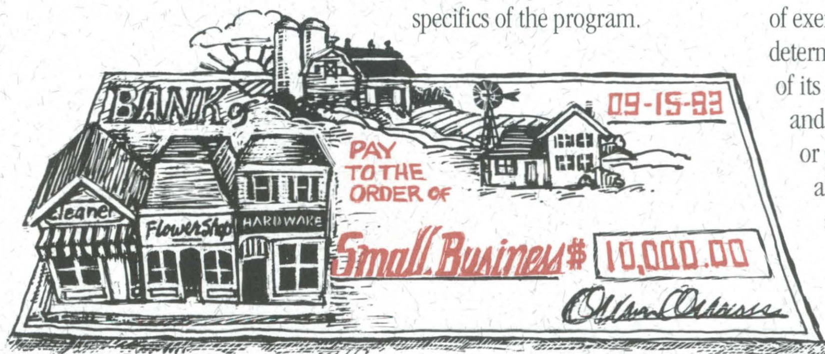
Small Loans Evaluated on Performance

The four federal banking agencies are encouraging bankers to foster the growth of lending to creditworthy borrowers, particularly small- and medium-sized businesses and farmers. In March 1993 an interagency statement on credit availability outlined a program that encouraged adequately capitalized institutions to identify a portion of their loan portfolios for examiners to evaluate solely on performance. Recognizing that as of mid-August few banks in the Eighth District have taken advantage of this program, the following reiterates the specifics of the program.



- **Exempt loans:** Bankers must document in writing assignments of loans to this exempt portion of their portfolios and they must maintain aggregate lists or accounting segregations of the assigned loans, including the performance status of each loan.
- **Limit on value of individual loans:** A loan, or group of loans, to one borrower, assigned to the exempt loans category may not exceed $900,000 or 3 percent of the institution's total capital (as defined in the capital adequacy standards), whichever is smaller.
- **Ineligible loans**: Loans to any executive officer, director, or principal shareholder of the institution, or any related interest of that person, may not be included with the exempt loans.
- **Aggregate limit on loans:** The aggregate value of all exempt loans may not exceed 20 percent of the institution's total capital (as defined in the capital adequacy standards).
- **Restrictions on loans in the exempted portion of the portfolio:** The institution must fully evaluate the collectibility of exempt loans when determining the adequacy of its allowance for loan and lease losses (ALLL) or general valuation allowance (GVA) attributable to such loans and must include this evaluation in internal records of assessment of the adequacy of its ALLL or GVA. Once a loan in the exempt portion of the portfolio becomes more than 60 days past due, the loan may be reviewed and classified by an examiner; however, any decision to classify would be based on credit quality and not on the level of documentation.

Institutions that choose to designate a portion of their portfolio for these exempt loans may benefit by stimulating lending growth in their communities.

Official Reassignments

Effective August 1, 1993, the Banking Supervision and Regulation Division realigned many responsibilities. Please call the following Division officers and field directors with questions concerning regulatory and supervisory matters.

Bank and Bank Holding Company Applications

John W. Block, Jr.
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(314) 444-8486
Dennis W. Blase
Supervisory Officer
(314) 444-8435

Safety & Soundness, Western Region (AR, MS & MO)

Timothy A. Bosch
Assistant Vice President
(314) 444-8440
Carl K. Anderson
Field Director
(314) 444-8481

Safety & Soundness, Eastern Region (IL, IN, KY & TN)

Kim D. Nelson
Assistant Vice President
(314) 444-8735
Barkley E. Bailey
Field Director
(314) 444-8768

CRA & Consumer Compliance, Trust & EDP Supervision

Harold H. Rieker
Assistant Vice President
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John W. Block, Jr.
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(314) 444-8486
Michael W. DeClue
Supervisory Officer
(314) 444-8759

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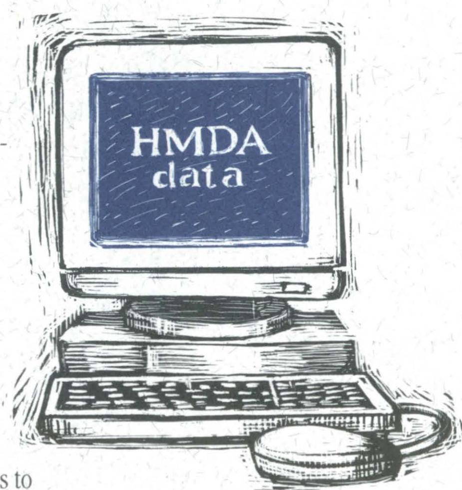
Fed Strengthens Fair Lending Examination Activities

Home Mortgage Disclosure Act (HMDA) data released August 5 will soon be subject to more extensive analysis by federal regulators. The Fed, along with the OCC, FDIC and OTS, issued a statement on credit availability expressing concern that some small business owners and minority consumers may be experiencing discriminatory treatment and urged banking institutions to increase fair lending activities.

In addition, the Fed is developing and testing a new compliance examination tool that will supplement its analysis of HMDA data and permit examiners to conduct more detailed reviews and comparisons of loan application files to detect possible discrimination. The new examination tool relies on a statistical model loaded on a personal computer to make detailed analyses of Loan Application Register (LAR) data supplemented by additional facts from application files. Using a technique based on regression analysis, the model will identify discrepancies in credit decisions on loan applications that contain similar financial data, but are submitted by applicants of different races.

Once identified, examiners will review the questionable loan applications more carefully by gathering and analyzing applicant information, such as credit history and debt, to test whether the additional factors can explain the institution's decision to deny credit. This information will serve as a basis to discuss with bank management any disparities in lending.

This approach concentrates on identifying discrimination in specific mortgage applications in specific institutions. While this new tool flags disparities for further analysis, the examination technique ultimately relies on the examiners' judgment when determining whether possible lending discrimination exists.



Regulation O Lending Limit Clarified

In response to numerous questions received at this Reserve Bank, the following clarifies exceptions to the aggregate lending limit as established by Regulation O.

Specifically, the aggregate lending limit for each institution does not apply to extensions of credit to insiders (including executive officers) which are secured by:

- a segregated deposit account in the lending bank;
- Treasury bills, federally guaranteed bonds, or other obligations fully guaranteed by the United States; or
- unconditional takeout commitments or guarantees of any department, agency, bureau, board, commission, U.S. establishment, or any wholly owned U.S. corporation.

In addition, the Bank has been asked whether loans secured by such means are included in the $100,000 limit that applies to executive officers. The regulation does not provide for collateral exceptions to this limit. Therefore all loans made to an executive officer must be included in the individual limit for that officer (i.e., $100,000 or 2.5 percent, whichever is less).

Please direct additional questions regarding Regulation O to Timothy A. Bosch at (314) 444-8440 or Kim D. Nelson at (314) 444-8735.

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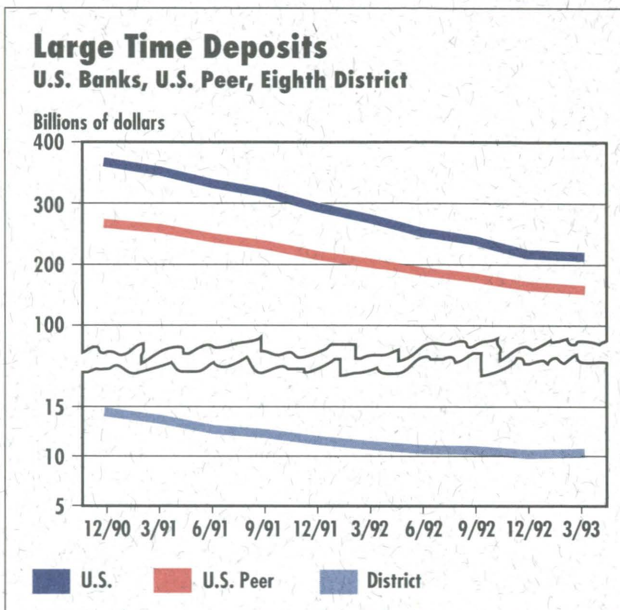
Bank Performance

Deposit Base Changes in U.S. and District Banks

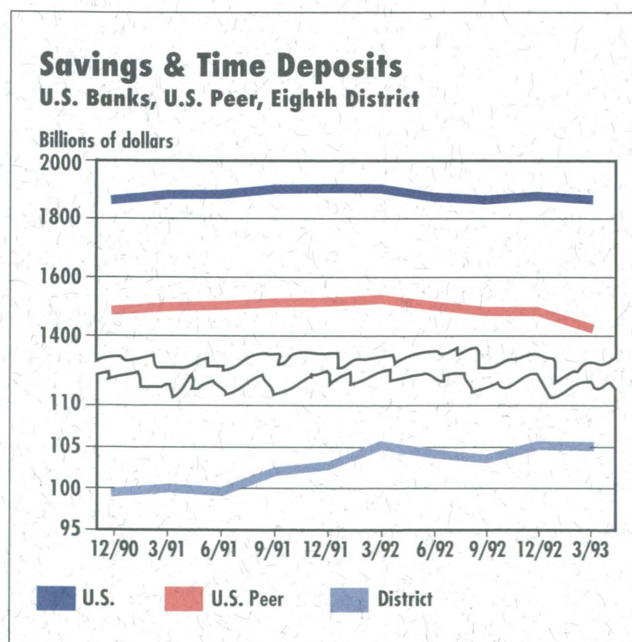
The relatively slow growth (1.8 percent) of total deposits in U.S. banks between March 1991 and March 1993 has been accompanied by a significant shift among deposit accounts. Comparing changes in the deposit base of District banks, which increased by 5.5 percent, with that of their national counterparts highlights a difference in the behavior of several deposit accounts.

As the chart below illustrates, total time and savings deposits in U.S. banks showed a slight increase over this two-year period. Moreover, time and savings deposits in U.S. banks of comparable size (less than $15 billion in assets) actually declined 3.9 percent over the period. In the District, however, time and savings deposits grew 5.6 percent.



The primary reason for the national decline was a drop in large time deposits (over $100,000). Of total deposits, District large time deposits followed the national trend in the first four quarters as illustrated above. Beginning in March 1992, however, U.S. and U.S. peer deposits fell from 10.4 percent to 8.2 percent as of the end of first quarter 1993 — a decline of almost 25 percent. This decline was somewhat offset by an increase in money market deposits accounts (MMDAs). In contrast the District's $731 million (6.6 percent) decline in large time deposits was offset by increases in more interest rate-sensitive MMDAs.

Large time deposits now constitute a smaller portion of total deposits both in the District and across the country. Non-District banks, however, continue to rely more heavily on such deposits than do District banks. Overall, District banks are experiencing less volatility in their deposit base than are their national counterparts.



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CRA Hearings Held Throughout the Country

The federal financial supervisory agencies have been holding a series of hearings on the Community Reinvestment Act (CRA) nationwide since mid-August. The hearings are intended to help the agencies develop new regulations and standards for assessing a financial institution's performance under the CRA.

Specifically, the agencies are meeting with the public, community groups and banking and thrift industries to make CRA implementation more effective. The goal is to reform CRA regulations and supervision in order to improve performance, clarify the regulations, and make CRA performance assessments more objective.

For information on dates and locations of future meetings, please contact Harold H. Rieker at (314) 444-8445.

Third Party ATM Fees Do Not Affect Advertising

This Reserve Bank has received inquiries about whether accounts that are charged third party ATM fees can be advertised as "free." The Board of Governors has clarified that fees imposed by third parties for the use of their ATMs worldwide cannot reasonably be expected to be known or disclosed by an institution advertising a free account. A fee imposed by a third party for use of its ATM is not considered either a maintenance or activity fee under Regulation DD when it is merely passed on by the consumer's institution. Therefore in accordance with the regulation, accounts that might be assessed third party ATM fees may be advertised as "free."

Survey Results

Thank you for your participation in the recent *Supervisory Issues* survey. Your responses suggest that we generally meet your need for supervisory information. To continue that trend, we plan to incorporate your suggestions for more specific guidance, information and details.

Your continued involvement is appreciated. Please direct your comments and suggestions to Amy A. Helean, editor, at (314) 444-4634.

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