SUMMER 2013

CENTRAL Banker

NEWS AND VIEWS FOR EIGHTH DISTRICT BANKERS

FEATURED IN THIS ISSUE | On the "Too Big To Fail" Debate: Implications of the Dodd-Frank Act | Will the Single-Point-of-Entry Concept End "Too Big To Fail"?

Trends in Community Banks' Net Interest Margins

By Gary S. Corner and Andrew P. Meyer

Net interest margins are clearly under pressure at community banks, but this trend is not new. It is a product of a highly competitive banking industry and a direct result of today's lower lending levels and abundant balance sheet liquidity.

The net interest margin (NIM) is the difference between interest income and interest expense. (Both are expressed as a percentage of average earning assets.) As shown in Figures 1 to 4, interest income and interest expense fluctuated considerably through the business cycle, but the long-term trend indicates that asset yields are falling faster than deposit and other funding costs.

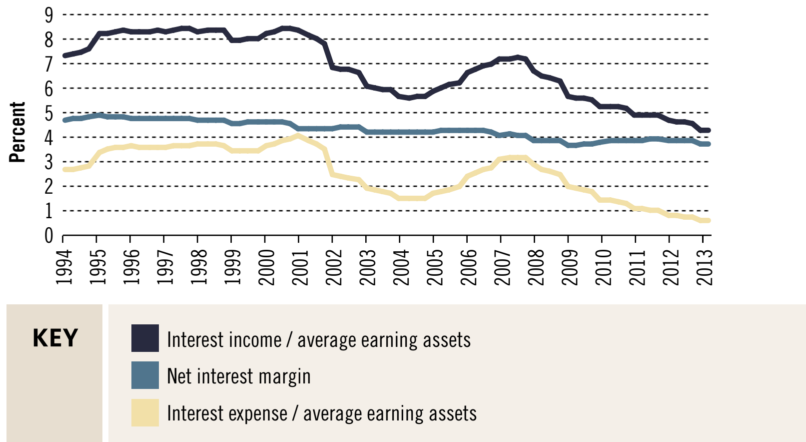
NIM Trends

As shown in Figure 1 to the right, the NIM for U.S. banks under $1 billion in assets fell 117 basis points since 1995 (from 4.89 percent to 3.72 percent). Figure 2 on Page 4 shows that in the Eighth District, the NIM experienced a similar decline, falling 74 basis points (from 4.49 percent to 3.75 percent). District margins were historically weaker than national averages because lending levels were generally lower. Based on the numbers above, small community banks in the District reported an average NIM that was 40 basis points below their national counterparts in 1995. However, by June 2013, District and national measures of small community bank NIM converged to a difference of only 3 basis points, with small District banks slightly edging out other small U.S. banks. In Figure 3 on Page 4, we see that large community banks (between $1 billion and $10 billion in assets) experienced a similar downward trajectory.

It is interesting to note that, generally, smaller banks more effectively reduced funding costs and maintained NIM during the financial crisis than larger banks. As expected, reliance on

FIGURE 1

U.S. Banks Under $1 Billion



SOURCE: Reports of Condition and Income for U.S. Commercial Banks

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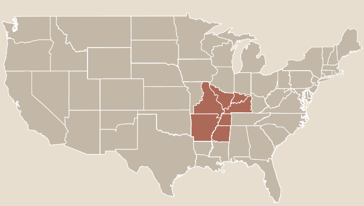
The Eighth Federal Reserve District includes all of Arkansas, eastern Missouri, southern Illinois and Indiana, western Kentucky and Tennessee, and northern Mississippi. The Eighth District offices are in Little Rock, Louisville, Memphis and St. Louis.



Selected St. Louis Fed Sites

Dodd-Frank Regulatory Reform Rules
www.stlouisfed.org/rrr

FRED® (Federal Reserve Economic Data)
www.research.stlouisfed.org/fred2

Center for Household Financial Stability www.stlouisfed.org/HFS

CENTRAL VIEW

On the "Too Big To Fail" Debate: Implications of the Dodd-Frank Act

By Julie Stackhouse

Julie Stackhouse is senior vice president of Banking Supervision, Credit, Community Development and Learning Innovation for the Federal Reserve Bank of St. Louis.

It is common knowledge that the banking industry has become increasingly consolidated over the past 25 years. In 1990, prior to a number of banking law changes, the nation housed around 12,500 charters. Today, there are roughly 6,000 charters, with consolidated assets of the top 10 U.S. banking firms representing approximately 64 percent of U.S. banking assets. The nation's largest banking firm, JPMorgan Chase & Co., alone has more than $2.3 trillion in consolidated assets and more than 3,300 subsidiaries.

Without question, operations of these large firms magnified the financial crisis, emphasizing their systemic importance. The resulting landmark legislation—the Dodd-Frank Act—is intended to reduce systemic risk and, ultimately, end "too big to fail."

I am often asked whether the Dodd-Frank Act and its hundreds of pages of supporting regulations "will work." I think it is fair to say that it is too early to know. What is clear, however, is that the Dodd-Frank Act, the Basel III capital reforms and other planned regulation will go far to eliminate expected bailouts. This will occur in two ways: by significantly reducing the likelihood of systemic firm failures and by greatly limiting the cost to society of such failures.[1]

The legislative and other requirements to reduce the likelihood of a systemic firm failure are many. They include the Dodd-Frank Act's multiple "enhanced prudential standards" and requirements for central clearing of derivatives. Capital of large banking firms is now stress-tested on a regular basis—twice a year for the largest firms—under adverse economic scenarios. All financial firms regardless of size are subject to the new Basel III capital standards, but larger firms will also be subject to the liquidity requirements contained in Basel III. (For more on Basel III, see the online-only article in this issue of *Central Banker*.)

And the list does not end there. As emphasized by Federal Reserve Gov. Daniel Tarullo in a statement on May 3, four additional rules are planned that will enhance the capital requirements for the eight U.S. financial firms identified as having global systemic importance. These include a regulatory leverage threshold above the Basel III minimum, rules regarding the amount of equity and long-term debt large firms should maintain to facilitate orderly resolution, capital surcharges for banking organizations of global systemic

continued on Page 10

QUARTERLY REPORT

Second-Quarter 2013 Banking Performance[1]

Earnings Performance

	2012: 2Q	2013: 1Q	2013: 2Q
RETURN ON AVERAGE ASSETS[2]			
All U.S. Banks	1.05%	0.94%	0.99%
All Eighth District States	0.91	0.89	0.93
Arkansas Banks	1.07	1.26	1.24
Illinois Banks	0.73	0.72	0.81
Indiana Banks	1.07	1.05	1.09
Kentucky Banks	1.23	0.94	0.90
Mississippi Banks	0.90	0.84	0.88
Missouri Banks	0.90	0.90	0.93
Tennessee Banks	0.83	0.80	0.85
NET INTEREST MARGIN			
All U.S. Banks	3.89%	3.74%	3.79%
All Eighth District States	3.84	3.66	3.66
Arkansas Banks	4.16	4.07	4.07
Illinois Banks	3.64	3.46	3.44
Indiana Banks	3.91	3.73	3.73
Kentucky Banks	4.09	3.79	3.81
Mississippi Banks	4.04	3.82	3.85
Missouri Banks	3.68	3.49	3.48
Tennessee Banks	3.90	3.82	3.85
LOAN LOSS PROVISION RATIO			
All U.S. Banks	0.37%	0.22%	0.20%
All Eighth District States	0.44	0.23	0.21
Arkansas Banks	0.37	0.19	0.19
Illinois Banks	0.57	0.32	0.30
Indiana Banks	0.28	0.14	0.13
Kentucky Banks	0.34	0.23	0.23
Mississippi Banks	0.24	0.15	0.14
Missouri Banks	0.39	0.19	0.15
Tennessee Banks	0.36	0.24	0.22

Asset Quality Measures

	2012: 2Q	2013: 1Q	2013: 2Q
NONPERFORMING ASSETS RATIO[3]			
All U.S. Banks	4.26%	3.53%	3.17%
All Eighth District States	4.65	3.98	3.59
Arkansas Banks	5.09	4.71	4.36
Illinois Banks	5.71	4.69	4.06
Indiana Banks	2.90	2.48	2.33
Kentucky Banks	3.72	3.51	3.33
Mississippi Banks	3.90	3.88	3.55
Missouri Banks	4.41	3.37	3.08
Tennessee Banks	4.89	4.21	3.80
LOAN LOSS COVERAGE RATIO[4]			
All U.S. Banks	66.94%	75.29%	80.77%
All Eighth District States	65.50	73.69	79.24
Arkansas Banks	68.89	70.64	72.71
Illinois Banks	53.56	64.87	71.96
Indiana Banks	83.45	91.72	93.46
Kentucky Banks	71.79	72.45	74.44
Mississippi Banks	78.26	69.05	74.11
Missouri Banks	77.09	95.25	102.33
Tennessee Banks	67.36	76.10	82.26

SOURCE: Reports of Condition and Income for Insured Commercial Banks

NOTES:
1 Because all District banks except 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 earnings assets in the denominator.
3 Nonperforming assets are loans 90 days past due or in nonaccrual status, plus other real estate owned.
4 The loan loss coverage ratio is defined as the loan loss reserve (ALLL) divided by nonperforming loans.

FIGURE 2

Eighth District Banks Under $1 Billion

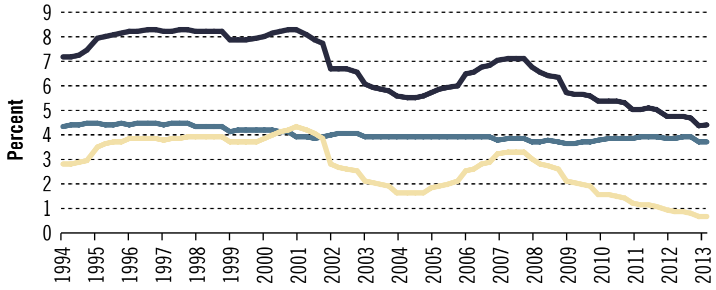


FIGURE 3

U.S. Banks $1 Billion to $10 Billion

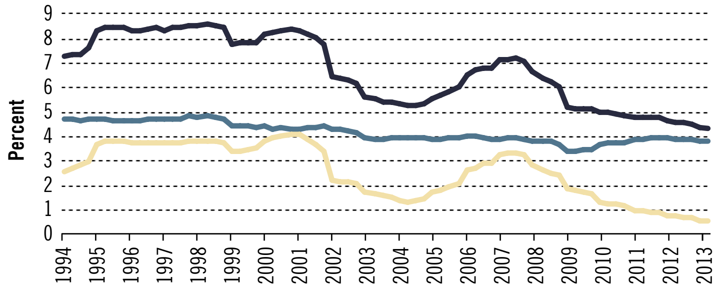
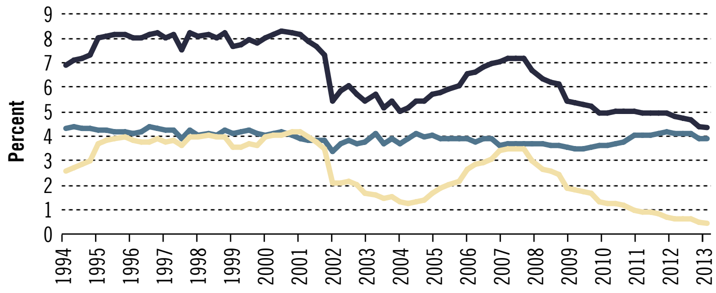


FIGURE 4

Eighth District Banks $1 Billion to $10 Billion



KEY

- Interest income / average earning assets
- Net interest margin
- Interest expense / average earning assets

SOURCE: Reports of Condition and Income for U.S. Commercial Banks

TERMINOLOGY

Average earning assets – Assets, such as loans and securities, that earn interest income

Interest income – Interest earned on the above average earning assets

Interest expense – Interest paid on deposits and other liabilities

Net interest margin (NIM) – The difference between interest income and interest expense, expressed as a percentage of average earning assets

Net Interest Margins

continued from Page 1

institutional or wholesale funding during this period proved less sound than reliance on retail funding.

Until recently, bankers have driven down their deposit costs nearly lockstep with the fall of their asset yields, as depicted in Figures 1 to 4. Banks with higher, more stable loan volume are in a generally better earnings position, along with those that have aggressively reduced funding costs.

Loans to Total Assets

Lending in small community banks (with less than $1 billion in assets) spiked leading up to and into the financial crisis, reaching more than 70 percent of the banks' total assets by 2008. (See Figure 5 on Page 5.) Since then, lending has retrenched and currently stands at around 62 percent of total assets. Contributing factors are weak loan demand, tightened loan standards and a surge in deposits that loan demand could not absorb. As a result, excess liquidity is held in securities and cash balances. Leading up to the financial crisis, large community banks nationwide (between $1 billion and $10 billion in assets) experienced similar gains in lending, but they have been able to retain a slightly greater amount of that lending, as loans currently represent around 64 percent of total assets. (See Figure 6 on Page 5.)

NIM Risk Factors

To maintain margins, banks may need to continue to focus on their deposit costs while waiting for their loan demand to strengthen. Alternatively, chasing asset yields that significantly extend balance sheet duration today may prove painful down the road. As shown in Figures 1 and 3, the average interest expense for banks under $1 billion in assets is 57 basis points; for banks between $1 billion and $10 billion in assets, it is only 48 basis points. Perhaps there is room to further reduce deposit costs, as bank customers today tend to be somewhat indifferent to deposit rates.

When the rate environment turns, will bankers have done enough to protect themselves? In addition to higher funding costs, deposits that surged into the banking system may move back

Interest income and interest expense fluctuated considerably through the business cycle, but the long-term trend indicates that asset yields are falling faster than deposit and other funding costs.

out as depositors find more attractive yields elsewhere. Perhaps, just as loan demand improves, a portion of deposit funding may dissipate. Depending on the nimbleness of their balance sheets, many banks are at risk of experiencing further NIM compression for a period of time. Consequently, decisions relative to today's earnings pressures must be balanced with overall risk-management considerations.

Gary S. Corner is a senior examiner and Andrew P. Meyer is a senior economist, both at the Federal Reserve Bank of St. Louis.

FIGURE 5

Loan-to-Asset Ratio, Banks Under $1 Billion

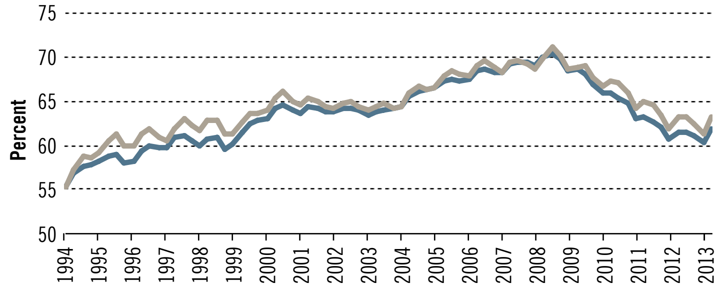
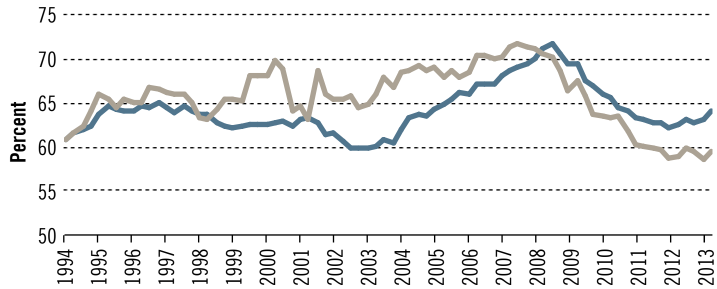


FIGURE 6

Loan-to-Asset Ratio, Banks $1 Billion to $10 Billion



KEY
U.S.
Eighth District

SOURCE: Reports of Condition and Income for U.S. Commercial Banks

IN-DEPTH

From Bailouts to Bail-ins:

Will the Single-Point-of-Entry Concept End "Too Big To Fail"?

By Jim Fuchs

In the wake of the financial crisis, many troubled financial firms were rescued by their sovereign governments. The undesirability of "bailouts" has led global policymakers to shift their focus to new "bail-in" approaches as a means of minimizing the impact of the failure of a large financial institution.

Last year, the Federal Deposit Insurance Corp. (FDIC) and the Bank of England (BOE) issued a joint paper outlining the merits of a single-point-of-entry (SPOE) strategy for resolving a large, internationally active financial firm.[1] A May 2013 report by the Bipartisan Policy Center concluded that the SPOE approach should generally allow a systemically important financial institution to fail "without resorting to taxpayer-funded bailouts or a collapse of the financial system."[2]

The SPOE strategy is, in essence, a bail-in strategy because it implements a resolution process that imposes losses on shareholders and unsecured creditors. Resolution powers would be applied at the top-tier level of holding companies by a single-resolution authority, which, in the U.S., would be the FDIC.

continued on Page 6

From Bailouts to Bail-ins
continued from Page 5

Bailouts vs. Bail-ins

One way to think about the difference between a bailout and a bail-in is to consider the source of funding. In a bailout, the funds essentially come from outside the institution, usually in the form of taxpayer assistance via a direct intervention by the sovereign government. Conversely, in a bail-in, rescue funds come from within the institution as shareholders and unsecured creditors bear the losses.

> The SPOE strategy is, in essence, a bail-in strategy because it implements a resolution process that imposes losses on shareholders and unsecured creditors.

The SPOE Approach

Under the FDIC/BOE proposal, a U.S. financial institution for which a determination has been made that it go through resolution under the SPOE approach, instead of bankruptcy, would be subject to the following:

1. The FDIC would be appointed as the receiver of the institution's top-tier holding company.
2. Assets of that holding company would then be transferred to a bridge holding company, enabling domestic and foreign subsidiaries to remain open and operating.
3. Work would then begin to transfer ownership of the bridge holding company to the private sector.
4. The subordinated debt, or even the senior unsecured debt, of the troubled firm would be used as the immediate source of capital for the new private-sector entity.
5. Remaining debt claims would be converted into equity claims that would also serve to capitalize the new private-sector entity.
6. The FDIC would provide assurances, as appropriate, that the ongoing operations of the firm and its attendant liabilities would be supported.

So, Will It Work?

Critics of SPOE question two underlying assumptions of the approach: that market confidence will be quickly restored, minimizing contagion; and that the underlying business model of the institution is sound. If even one of these conditions is not met, critics believe the overall process could be much more chaotic than the SPOE approach suggests.

Ultimately, the credibility of the SPOE approach won't be known until it is actually tested. The FDIC has made it clear that the first consideration, in any potential resolution, is to assess whether the bankruptcy code provides an appropriate tool for resolving a troubled firm. In fact, the Bipartisan Policy Center, in its May report, makes several recommendations for amending the bankruptcy code to avoid resorting to extraordinary, and untested, measures for resolving global systemically important institutions. Regardless, the approaches discussed under SPOE and under the bankruptcy code suggest that future remedies for handling troubled financial firms will focus on bailing-in the firm by imposing losses on shareholders and unsecured creditors, instead of bailing out firms and putting taxpayers at risk.

Jim Fuchs is an assistant vice president at the Federal Reserve Bank of St. Louis.

ENDNOTES

1 "Resolving Globally Active, Systemically Important Financial Institutions," a joint paper by the Federal Deposit Insurance Corp. and the Bank of England, Dec. 10, 2012, www.fdic.gov/about/srac/2012/gsifi.pdf.

2 "Too Big To Fail: The Path to a Solution," a report of the Failure Resolution Task Force of the Financial Regulatory Reform Initiative of the Bipartisan Policy Center, May 2013, http://bipartisanpolicy.org/sites/default/files/TooBigToFail.pdf.

Can the U.S. Achieve Long-Run Fiscal Sustainability?

The continual growth of federal nondefense spending in conjunction with the government's almost flat revenue-to-GDP ratio, which has fluctuated roughly between 15 and 20 percent since 1945, was the topic of the April 8 *Dialogue with the Fed*. If current trends continue, federal nondefense spending and tax revenues could prompt a fiscal crisis—which the U.S. has so far averted.

In his presentation, William Emmons, an assistant vice president and economist at the St. Louis Fed, discussed whether the United States can achieve long-run fiscal sustainability. Emmons explained that the cost drivers of Social Security, Medicare and other federal programs are very difficult to affect and present a challenge when trying to reduce or control spending.

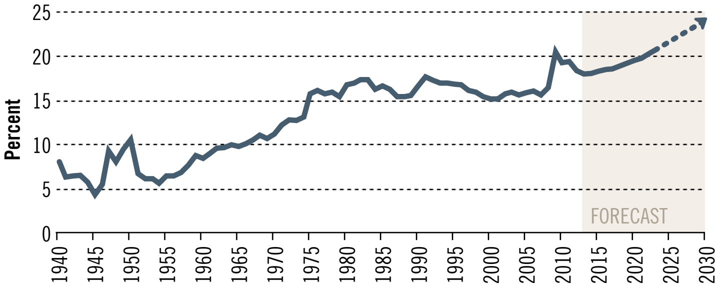
Following the presentation, Kevin Kliesen, a research officer and business economist, offered his views on the topic. Kliesen and Emmons then answered questions from the audience in a session moderated by Julie Stackhouse, the senior vice president of Banking Supervision, Credit, Community Development and Learning Innovation. To see Emmons' presentation slides and videos of the dialogue, visit www.stlouisfed.org/dialogue.

What Happens When an Irresistible Force Meets an Immovable Object?

To visually explain the future fiscal situation of the United States, Emmons used a physics paradox—an irresistible force meeting an immovable object. He characterized nondefense spending growth as the irresistible fiscal force, and tax revenues as a share of GDP as the immovable fiscal object. This collision depicts a looming fiscal disaster, which could include: high inflation, default on government debt, and drastic benefit cuts and tax increases. To best understand the implications, Emmons analyzed trends in federal spending and taxes relative to GDP and posed two questions: First, how have we avoided a fiscal crisis so far? And, can we achieve long-run fiscal sustainability?

FIGURE 1

Ratio of Federal Nondefense Spending to GDP



SOURCES: Congressional Budget Office/Haver Analytics
NOTE: Annual data through fiscal year 2012; CBO projections for 2013-2023 as of Feb. 2013

Can We Slow Spending Growth?

Since 1945, federal nondefense spending relative to GDP has quadrupled. Currently, this spending—on Social Security, Medicare and other programs—is approximately 20 percent of GDP and shows no signs of slowing. (See Figure 1 above.) "This is our irresistible force: Through all sorts of historic periods for all sorts of different reasons, federal nondefense spending has relentlessly grown faster than the overall economy," Emmons said.

Emmons examined the popularity of federal spending programs like Social Security, Medicare and defense, and explained that the major cost drivers are health-care expenditures. He pointed out that health-care costs have risen faster than GDP and are projected to continue to do so. And, while Social Security is presently the largest budget item, it's projected to remain relatively flat over the next several decades. All other federal spending—including for defense—is declining. Emmons went on to explain that although interest rates on the debt are currently very low, they will return to more historically normal levels. Thus,

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Long-Run Fiscal Sustainability

continued from Page 7

given unchanged circumstances, the interest payments will eventually become the largest budget item.

Elaborating on why it won't be easy to slow spending growth, Emmons explained that the first obstacle is the popularity of major federal programs. He cited a March 24 *CBS News* poll that indicated strong majorities opposed spending cuts to Medicare, Social Security and, to a lesser extent, defense to reduce the deficit.[1] The immense popularity of the health-care programs, plus the program cost drivers that are very difficult to influence—including the aging population and the fact that health-care costs are rising faster than GDP—make it difficult to find a way to control or slow spending.

Can the U.S. Stabilize the Debt?

Emmons pointed out that the federal revenue-to-GDP ratio has been essentially flat since 1945. (See Figure 2 below.) Even with the current fiscal tightening, it is projected to return to its historic level (around 18 to 20 percent of GDP). So, when the federal spending-to-GDP ratio is combined with the federal revenue-to-GDP ratio, a fiscal crisis seems probable, Emmons suggested. (See Figure 3 at the bottom.) According to Congressional Budget Office (CBO) projections, the budget deficit will be at approximately 20 percentage points (or $3 trillion) by the end of the projection period.

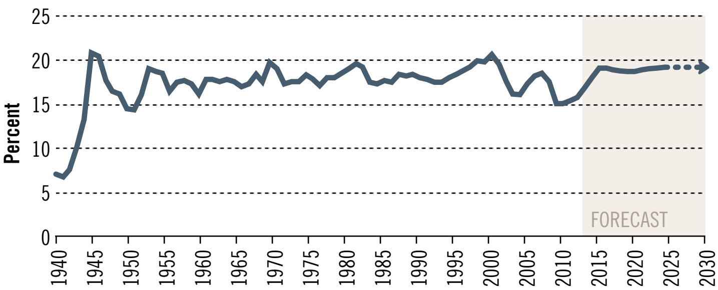
"The result of these exploding budget deficits is that accumulated debt would also explode," said Emmons. Figure 4 (opposite page) depicts the CBO's baseline scenario and its alternative fiscal scenario. The latter is the CBO's more plausible projection; however, both of these scenarios are unsustainable, as the ratio of debt-to-GDP goes up indefinitely. "That is the simplest and most pertinent measure of fiscal sustainability. Can we get the debt stabilized relative to the size of GDP? It's not the case that we have to pay off the debt, and it's not the case that the debt can't grow; it's just that it can't grow faster than the economy forever. That's the situation of fiscal unsustainability," Emmons explained. So, can the U.S. stabilize the debt? Historical evidence suggests that when other countries have hit these levels of debt-to-GDP, the ratios have been difficult to stabilize—but is the United States different?

Why Haven't We Had a Fiscal Crisis Already?

Given that nondefense spending has continued to rise, while revenues have stayed flat, how has the United States gone so long without a crisis? Emmons proposed a few explanations. First, we have had an extended peace dividend, which refers to declining military spending. However, he pointed out that due to the defense cuts previously enacted, there isn't much left to cut; certainly not enough to absorb the soaring health-care costs expected over the next few decades. The second reason we've been able to avoid a fiscal crisis is the demographic dividend. "We've had the Baby Boomers—often defined as people born between 1946 and 1964—moving through their most productive years, swelling the labor force, increasing GDP growth, paying taxes—and at the same time, not collecting as many benefits as, say, a very young population or a very old population," said Emmons. As we are

FIGURE 2

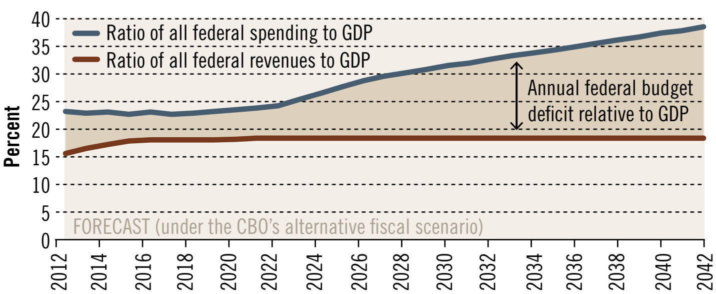
Ratio of Federal Revenue to GDP



SOURCES: Congressional Budget Office/Haver Analytics
NOTE: Annual data through fiscal year 2012; CBO projections for 2013-2023 as of Feb. 2013

FIGURE 3

Budget Deficits



SOURCES: Congressional Budget Office/Haver Analytics
NOTE: Projections as of June 2012

now moving to a permanently older population though, one consequence is that economic growth is likely to be slower (see Figure 5 at the bottom), and another is that government spending on health and retirement programs will be higher. Finally, some good luck and good policy in the 1980s and 1990s helped prevent a fiscal crisis. For instance, economic growth and the stock market were strong, reducing deficits.

In Light of These Obstacles, Can We Achieve Long-Run Fiscal Sustainability?

The issue, Emmons said, is that in general neither political faction nor the public seems to be willing to address the reality of what lies ahead in terms of the U.S. fiscal situation. Overall, it seems that one faction will not admit to the popularity of the major federal programs, such as Social Security and Medicare, whereas the other faction will not admit that the tax revenues needed to pay for these programs are not politically or economically feasible. Given these circumstances, will the United States have a fiscal crisis?

Emmons referenced *This Time Is Different: Eight Centuries of Financial Folly*, by Carmen M. Reinhart and Kenneth S. Rogoff.[2] Reinhart and Rogoff found that default on sovereign debt is more common than one might think. History is full of countries that lost control of their fiscal situations, ending in crisis. For example, Spain has defaulted 15 times during the last 450 years.

Implicit defaults through inflation or currency devaluation, though less obvious, are just as common, Emmons noted. For example, the United States implicitly defaulted on its debt by effectively reducing the value of its financial promises when it devalued the dollar against gold in 1933 and when it broke the link between the dollar and other currencies in 1971.

To Worry or Not To Worry about a Fiscal Crisis?

"The U.S. government will not default on its debt in the foreseeable future," Emmons said, suggesting no pressing need to worry. "Also, the Federal Reserve will not allow inflation to surge in the foreseeable future. With these two options off the table, the only way to achieve fiscal sustainability is through political action." Unfortunately, our political system seems gridlocked, and most members of the public seem hesitant to make sacrifices, as illustrated by the aforementioned poll. However, Emmons urged that "our political leaders must help the public understand spending and taxing realities." The public perception needs to change; the public must agree to make sacrifices—not all equally—but everyone should be involved.

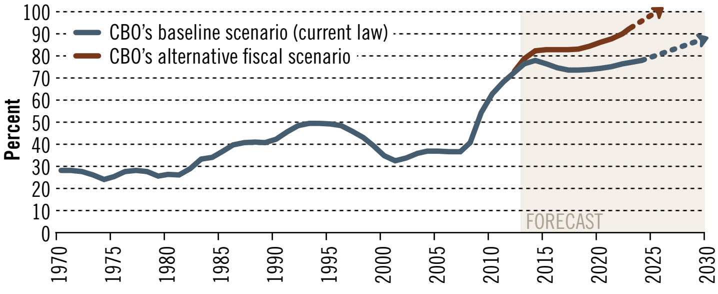
A step in this direction, Emmons suggested, would be to separate the insurance function of government

continued on Page 11

Since 1945, federal nondefense spending relative to GDP has quadrupled. Currently, this spending—on Social Security, Medicare and other programs—is approximately 20 percent of GDP and shows no signs of slowing.

FIGURE 4

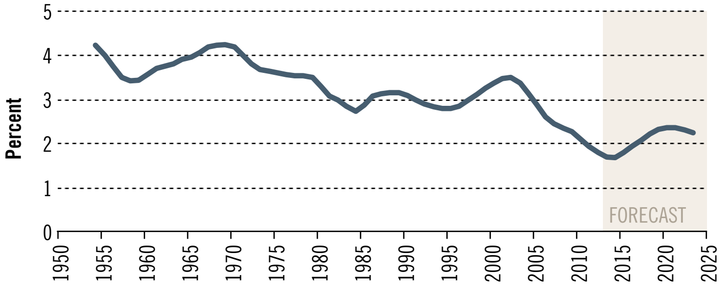
Ratio of Federal Debt Held by the Public to GDP



SOURCES: Congressional Budget Office/Haver Analytics
NOTE: Annual data through fiscal year 2012; CBO projections for 2013-2023 as of Feb. 2013

FIGURE 5

CBO Estimate of Real Potential GDP Growth (5-year trailing average)



SOURCES: Congressional Budget Office/Haver Analytics
NOTE: Annual data through 2012; CBO projections for 2013-2024 as of Feb. 2013

Final Basel III Capital Rule—Less Impact on Community Banks

>> ONLINE EXTRA

The U.S. federal banking agencies approved the final Basel III risk-based capital rule this summer. Our online-only *Central Banker* article examines three key provisions that provide some relief to community banks under the final rule relative to the proposed rule and discusses how many banks will be affected by the new capital requirements.

To read the article, visit www.stlouisfed.org/cb.

Why Do Family Balance Sheets Matter?

The financial crisis and Great Recession had profound effects not only on the U.S. economy as a whole, but on individual households.

In our new annual report, find out more about the link between households' balance sheets (their savings, assets, debts and net worth, as distinct from wages and income) and the overall performance of the U.S. economy. In addition, learn why it's important not just for individual families but the economy as a whole for those balance sheets to get back on track.

This essay, "After the Fall: Rebuilding Family Balance Sheets, Rebuilding the Economy," is also the subject of a short video.

To read the report, visit www.stlouisfed.org/ar.

Central View

continued from Page 2

importance, and additional measures that will directly address risks related to short-term wholesale funding.

Beyond efforts to reduce the likelihood of failure, the Dodd-Frank Act also contains provisions to address the cost to society should a failure occur. In this regard, large banking firms are required to submit resolution plans, or "living wills," for their orderly resolution under the Bankruptcy Code.

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The Dodd-Frank Act also contains an Orderly Liquidation Authority, giving the Federal Deposit Insurance Corp. backup resolution authority. The associated single-point-of-entry concept is discussed separately in this issue of *Central Banker* (see Page 5). Finally, the Dodd-Frank Act forbids acquisitions by any financial firm that controls more than 10 percent of the total liabilities of financial firms in the U.S., and requires banking regulators to consider "risk to the stability of the U.S. banking or financial system" in evaluating any proposed merger or acquisition.

It would be unrealistic to conclude that the Dodd-Frank Act will end "too big to fail." Many of the supporting rules are not yet implemented, and importantly, the provisions of the Dodd-Frank Act have not been tested during a period of financial stress. Although, having said that, the safeguards in the Dodd-Frank Act have already influenced a safer banking system.

ENDNOTE

1 See also the speech by Federal Reserve Gov. Jerome Powell on March 4.

The St. Louis Fed Financial Stress Index

The St. Louis Fed Financial Stress Index (STLFSI) measures the degree of financial stress in U.S. markets. The index is constructed from 18 weekly data series: seven interest rate series, six yield spreads and five other indicators. Each series captures some facet of financial stress. As the level of financial stress in the economy changes, the data series are likely to move together.

The average value of the index, which begins in late 1993, is designed to be zero. Thus, zero is viewed as representing normal financial market conditions. Values below zero suggest below-average financial market stress, while values above zero suggest above-average financial market stress.

The St. Louis Fed is now issuing a weekly news release of the STLFSI. To view past news releases, visit www.stlouisfed.org/newsroom/financial-stress-index/. For an explanation of the data series used to construct the STLFSI, refer to www.stlouisfed.org/newsroom/financial-stress-index/key.

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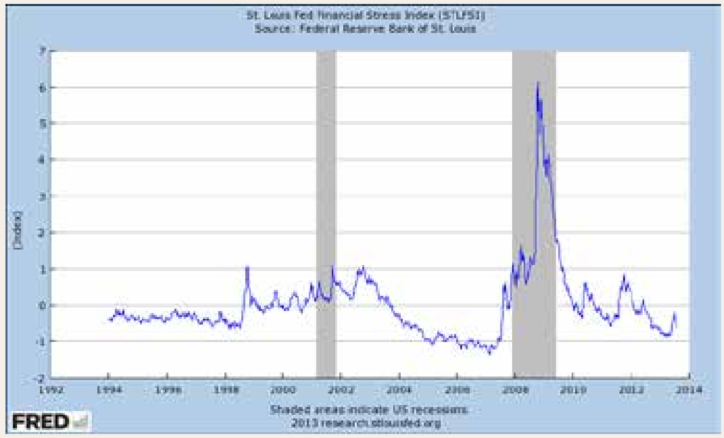
www.research.stlouisfed.org/fred2/series/STLFSI



Long-Run Fiscal Sustainability

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from redistribution. "Make the actual cost of government insurance programs transparent, so that everyone knows how much it costs to provide services—especially health care and retirement annuities," said Emmons.

Changing the Discussion: Be Transparent about the Cost of Benefits

Under current circumstances, federal nondefense spending and tax revenues are, respectively, an irresistible force meeting an immovable object, according to Emmons. "A series of temporary fixes has prevented a fiscal crisis so far, but those fixes are gone. The only plausible route to long-run fiscal sustainability is through political courage and leadership. Since we are not going to default on our debt or inflate away our debt, the only solution is political. We have to get the taxes and the spending to add up, and that's going to require shared sacrifice." However, to accept this sacrifice, the public must be informed—Emmons reinforced that transparency is the key. We must convince our political leaders to help the public better understand these realities and to emphasize that we are all in this together. Going forward, he suggested, we must initiate a more straightforward discussion about health-care costs, the role of the aging population and taxes.

ENDNOTES

1 "Americans' Views on Washington, the President & the Budget Deficit," *CBS News* poll, March 20-24, 2013, www.cbsnews.com/8301-250_162-57576433/poll-80-of-americans-unhappy-with-washington/?pageNum=2.

2 See chapters 4-9 and chapter 12 in *This Time Is Different: Eight Centuries of Financial Folly*, by Carmen M. Reinhart and Kenneth S. Rogoff. Princeton University Press, 2009.

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Community Banking Research Conference To Be Webcast

Community bankers, academics, policymakers and bank supervisors from across the country will meet at the Federal Reserve Bank of St. Louis for "Community Banking in the 21st Century," an inaugural community banking research and policy conference Oct. 2-3. A live webcast of the conference, which will be hosted by the Federal Reserve System and the Conference of State Bank Supervisors (CSBS), can be viewed when the conference begins Oct. 2 at 2 p.m. CT at **www.stlouisfed.org/live**.

Scheduled speakers include Fed Chairman Ben Bernanke, St. Louis Fed President James Bullard and CSBS President and CEO John Ryan. View the full schedule at **www.stlouisfed.org/CBRC2013/agenda**.