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News and Views for Eighth District Bankers

Little Rock Stands Out in Growth of Good Jobs

Job growth has a direct impact on a city's economy and its social structure. Urban areas that experience rapid growth in the number of high-paying jobs tend to see incomes rise throughout the entire labor market. Such growth also is associated with lower rates of crime, higher property values and rising educational levels. Unfortunately, the growth of low-paying jobs does not have the same outcomes.

Those are the results of a new St. Louis Fed study, "Employment Growth in America: Exploring Where Good Jobs Grow." The study captures data on 206 cities across the country, with special emphasis on the four major metropolitan areas in the Federal Reserve's Eighth District: Little Rock, Louisville, Memphis and St. Louis.

The study found that between 1980 and 2000, Little Rock led the way in the growth of high-paying jobs in the District. Following close behind was Louisville, then Memphis and St. Louis, which experienced the slowest growth.

The study suggests that the growth of good jobs tends to be associated with:

- the education level of the work force;
- a larger number of finance, insurance or real estate jobs;
- lower rates of union membership and low wage levels; and
- the presence of certain amenities, such as movie theaters, restaurants and a warm climate.

For a copy of the study, visit www.stlouisfed.org/community or call Cindy Davis at (314) 444-8761. ■

Regulators Issue Guidance on Home-Equity Loans

Home-equity loan products are increasingly popular for both consumers and financial institutions. But in many cases, these aren't your parent's home-equity loans, and they carry substantial risk. New versions may feature interest-only options, limited or no documentation, higher loan-to-value or debt-to-income ratios, and other characteristics that could increase credit risk.

Historically, delinquency and loss rates for home-equity products have been low; however, regulators are now concerned about the combination of rapid growth, new products with higher embedded risk and the easing of underwriting standards. In many cases, regulators have found that an institution's credit risk-management practices for home-equity lending aren't keeping pace with these changes. So, on May 16, the Federal Reserve joined in issuing interagency guidance (SR 05-11) to promote sound risk-management practices for home-equity lending programs.

This guidance describes sound credit-risk management systems for areas including product development and marketing; origination and underwriting; third-party originations; collateral valuation; account management; portfolio management; operations, servicing and collections; secondary market activities; portfolio classifications; the allowance for loan and lease losses, and capital.

The complete SR letter can be found on the Board of Governors web site at www.federalreserve.gov/boarddocs/srletters/2005/sr0511.htm. For more information about the guidance, contact Scott Smith at (314) 444-8836 or toll-free at 1-800-333-0810, ext. 44-8836. ■

Feditorial

A Regulator's Notebook: Keeping Track of Real Estate and Mortgage Lending Practices

By Julie Stackhouse, senior vice president, Banking Supervision and Regulation

Regulators frequently discuss emerging issues and ways to monitor trends. In the Eighth District, our current list of "radar risk" issues is short; however, a few continue from month-to-month, especially when we examine mortgage and commercial real estate lending practices.

During the last year or so, we've seen noteworthy changes in the home mortgage market. Currently, about one-third of all mortgage originations nationwide are adjustable rate mortgages, representing almost one-half of the dollar value of new mortgages. Some market analysts also report that interest-only mortgages now make up roughly 10 percent to 20 percent of the mortgage portfolios of some of the nation's largest banks.

Although adjustable-rate and interest-only mortgages are suitable for many borrowers, some borrowers have little cash flow flexibility—creating risk should interest rates change sharply. In other cases, the borrower's ability to repay the principal balance is dependent not on the borrower systematically paying down the principal, but rather the eventual sale of the home. So we become especially watchful when these types of loans appear to finance speculative purchases.

We also carefully monitor commercial real estate loans (CREs), which are growing in many community banks' loan portfolios. Community banks usually do a good job of underwriting CRE loans. Most banks compete effectively in this market because they know their market well and have the ability to tailor loan terms and closely monitor projects. Nonetheless, more CRE loans can mean concentration risk—putting too many eggs in one type of lending basket—thereby increasing the need for banks to maintain high underwriting standards and sound risk-management practices.

As a bank's CRE concentrations grow, our examiners will expect to see:

- strong management information systems that can distinguish CREs by geographic location, property type, loan-to-value and phase of construction; and
- effective procedures for monitoring primary real estate markets and assessing the quality of appraisals.

For more significant concentrations in larger organizations, we also may look for the bank's ability to stress-test individual loans and loan portfolios by type and location.

In summary, today's "regulator's notebook" for community banks is focused on the mortgage and CRE markets. We realize that rapid growth in these areas reflects opportunities for financial institutions, but we still encourage bankers to engage in prudent risk management. ■

Regulators Issue Final Community Reinvestment Act Guidance

Banking regulators have approved the final Community Reinvestment Act (CRA) rules, which took effect Sept. 1. The goal is to make CRA evaluations more effective in encouraging community banks to meet their community development needs while also reducing regulatory burden.

The asset size threshold for small banks has been raised from $250 million to include assets of less than $1 billion, without regard to holding company affiliation. Intermediate small banks—banks with assets between $250 million and less than $1 billion—will no longer need to collect and report CRA loan data; however, examiners will continue to evaluate bank lending activity during CRA examinations and disclose the results. Intermediate small banks also will be evaluated and required to receive satisfactory ratings under two separately rated tests: the small bank lending test and a new, flexible community development test that evaluates community development loans, investments and services in light of community needs and the bank's capacity.

For all banks, the definition of community development has been expanded to include activities that revitalize or stabilize designated disaster areas, distressed or under-served rural areas. The new regulations also clarify when discrimination or other illegal credit practices by a bank or its affiliate will adversely affect the bank's CRA performance evaluation.

For more information, contact Allen North at (314) 444-8826 or toll-free at 1-800-333-0810, ext. 44-8826. Bankers also may register for upcoming outreach seminars to learn more about the new guidance. (See the Calendar section on Page 6.) ■

Federal Reserve Increases Number of Cash Depots

A good idea catches on fast. In order to reduce costs, while also keeping customers happy, the St. Louis Fed recently discontinued cash services at the Little Rock and Louisville branches and established cash depots. Now the boards of directors for all Reserve banks, the Board of Governors and the Fed's Conference of Presidents have approved and announced locations for three additional depots which will open within the next six to 12 months.

Under the cash depot system, the Federal Reserve signs a contract with a third party, usually an armored carrier, which then accepts cash deposits and delivers orders for financial institutions. The Federal Reserve pays all transportation costs between the Reserve bank office and the depot operator, and the operator must follow strict procedural guidelines.

A Federal Reserve office in a different city maintains the responsibility for counting deposits and preparing orders. Currently, Memphis services the Little Rock depot, while Cincinnati is servicing the Louisville depot. For the new cash depots, Atlanta will serve Birmingham, Dallas will serve Oklahoma City, and Seattle will serve Portland, Ore.

So far, the transition to cash depots has gone smoothly with little to no impact on commercial bank customers. John Baumgartner, vice president of Cash Operations at the St. Louis Fed, credits good planning, which began about 18 months before the depots were created. No specific dollar figures are in yet, but the Fed has already seen dramatic cost savings.

"The Eighth District basically became the proving ground to show that cash depots could work for the System," says Baumgartner. "We started the ball rolling, and I'm proud to say that our staff will be assisting other districts as they begin their transition to cash depots."

The move to cash depots began with the Strategic Direction Project, undertaken by the Fed's Council of Presidents, which studied cash service across the country. During the project, the committee examined the population and the volume of currency usage in the markets the Fed serves.

"We asked ourselves, 'Are we located where we need to be, compared to where we were when we began our operations?'" says Baumgartner.

Since the founding of the Federal Reserve System in 1913, the population has shifted and business climates have changed. Yet, despite the increased usage in electronic payments over the past few years, the committee found that cash remains not only a vital part of the payment system but also is increasing. By the end of 2004, about $720 billion of U.S. currency was in circulation, 88 percent more than 1994.

The committee examined several possibilities before deciding on four possible options:

- establish cash depots;
- identify new locations to offer currency services;
- make no changes and continue regular service; or
- shut down cash services at some locations, which would require some commercial banks to receive services from another Fed location farther from their bank.

The decision became apparent after the Fed's Retail Payments Office decided to discontinue check operations in Little Rock and Louisville. Without check processing, the Cash department would have to pick up all support and overhead costs for those two facilities. The Fed's Cash Product Office had also instructed the Eighth District to maintain customer service without dramatically increasing costs.

Baumgartner explains, "Our senior management felt that cash depots were the best solution for maintaining a service presence in our markets, with a minimal impact on costs to the financial institutions we serve. If we had gone to a full shutdown, for instance, customer service as well as cost would have been affected. But with cash depots, we're proving to financial institutions that our focus is not just to reduce costs—we also value our customer service relationships." ■

Regional Roundup

St. Louis Fed Publishes Resource Guides

The St. Louis Fed has published two new resource guides, which are designed to help small and micro businesses located in and near Little Rock and Memphis. Both the Little Rock and Memphis editions of *The Resource Guide for Small Businesses* list many resources for startup businesses and existing businesses wishing to expand. Readers also will find information about nontraditional lending sources and where to obtain technical expertise.

The guides can be downloaded at www.stlouisfed.org/community. Then click on "Other Publications." For more information, contact Amy Simpkins at (501) 324-8268 in Little Rock or Dena Owens at (901) 579-4103 in Memphis.

2005 Economic Policy Conference Appeals to Bankers

The St. Louis Fed's 2005 Economic Policy Conference, "Federal Credit and Insurance Programs," will be held Oct. 20 and 21 in St. Louis. Leading scholars will discuss the evolving role of the federal government in the private credit and insurance markets. Sessions will address an array of existing federal programs, including:

- Social Security, Medicare and Medicaid;
- Small Business Administration and other loan-guarantee programs;
- federal housing programs, including housing-related government-sponsored enterprises;
- deposit insurance and defined-benefit pension guarantees;
- terrorism-risk insurance and insurance against natural disasters; and
- other security-related risks.

The final conference session will be a panel discussion that evaluates the current state of federal credit and insurance programs and that looks toward the future of these programs.

The conference agenda is available at http://research.stlouisfed.org. For more details, contact Denise Cain at denise.a.cain@stls.frb.org or (314) 444-8567, or toll-free at 1-800-333-0810, ext. 44-8567. ■

Federal Reserve Announces Sunset Date for DOS-based FedLine

More than 7,500 financial institutions are expected to migrate to the new FedLine Advantage access solution by Sept. 30, 2006, when DOS-based FedLine® is retired. It normally takes four to six months for a bank to install and test the new systems, but, those banks that complete their conversion by March 2006 will avoid price increases for DOS-based FedLine access. Specific 2006 increases will be announced later this year in the Federal Reserve's annual pricing letter to customers.

FedLine Advantage uses web technology to provide financial institutions with more-efficient access to critical payments services—e.g., Fedwire® Funds Service, Fedwire Securities Service and FedACH® Services—and was developed with user feedback in mind. It offers flexible connection options and provides customer-driven features, such as:

- a user-friendly interface,
- quick access,
- online help and
- enhanced communication methods.

As with all Federal Reserve FedLine access solutions, security is a top priority. FedLine Advantage incorporates the latest security controls such as authentication, encryption, firewalls, intrusion detection and security reviews of internal Federal Reserve Bank systems, among others.

All customers who have not yet converted to FedLine Advantage will be contacted by their local account executives during September. Additional information about FedLine Advantage also can be found on the Federal Reserve's Financial Services web site, www.frbservices.org. ■

Are We Saving Enough?

By Kevin L. Kliesen

Kevin L. Kliesen is an economist at the Federal Reserve Bank of St. Louis. This article is adapted from "Do We Have a Saving Crisis?" published in the July 2005 issue of The Regional Economist.

Just as the proverbial piggy banks of our youth offered the promise of future riches—or a more enjoyable trip to the toy store!—a country that saves a relatively high percentage of its income will usually find that its living standards improve over time. Why? Because saving finances business investment, which is a key building block of long-term economic growth.

But with the nation's households currently saving only about 1 percent of their after-tax personal income (personal saving rate), many policymakers are increasingly concerned about our future economic prospects. Indeed, if this low rate persists, it could lead to much lower growth rates of labor productivity and real incomes, which would mean slower growth of living standards over time.

Many people view the nation's total saving rate in terms of the personal saving rate. In reality, though, gross national saving is the sum of saving done by the three major economic sectors: households, businesses and the government.

Throughout most of the postwar period (1947-1999), gross private saving—the sum of household and business saving—remained at about 17.25 percent of GDP because increased business saving roughly offset the declining saving rates of households. Business saving averaged about 69 percent of gross private saving from 1947-1999, but rose to about 93 percent between 2003 and 2004.

The third component, government saving, usually was positive during the postwar period. That's only because state and local governments tend to run budget surpluses, while the federal government usually runs deficits. Although government saving at all levels is less today than, say, 30 or 40 years ago, government saving also tends to be a relatively small percentage of the gross national saving rate—even during periods of budget surpluses.

By adding these three components, we find that gross national saving (GNS) averaged a little more than 15 percent of GDP between 2000 and 2004. Although 15 percent is a modest fall from the nearly 17 percent average rate seen between 1983 and 1999, it is more than five percentage points lower than the 20.3 percent average GNS rate that prevailed between 1947 and 1982.

Foreign saving recently has become an important source of investment funds for our economy, helping to keep gross national investment rates nearly constant (as a share of GDP) throughout most of the post-war period. From 2000 to 2004, net foreign capital inflows—for example, foreign purchases of U.S. stocks or bonds—averaged 4 percent of GDP.

Some commentators are alarmed by this development; they believe U.S. residents must save more and rely less on foreign sources of investment funds. To others, the upsurge in foreign-capital flows to the United States is a measure of a fundamentally sound economy that offers high (risk-adjusted) rates of return. Regardless, foreign purchases of U.S. dollar-denominated assets have helped to lower long-term interest rates, which have been a boon to the U.S. housing industry and other producers of interest-sensitive products, e.g., cars and trucks.

Low interest rates are only one reason why American households have been saving less. Another reason is that household wealth has increased during recent years—arising largely from the rising values of stocks, bonds and house prices. Evidently, many households also have viewed this increased wealth as permanent and have decided to spend part of it by saving less out of their current wage income.

Ultimately, it's hard to escape the conclusion that current U.S. saving rates are low by historical standards and may need to be raised significantly. Why? Because the United States and most of the world's developed countries will soon be in a situation where the percentage of retirees—those who are drawing down their accumulated saving—will begin to rise relative to workers. Without sharp increases in taxes and/or reductions in benefits, it is likely that government budget deficits also will rise sharply, further lowering the national saving rate. ■

Calendar Events

UPCOMING FED-SPONSORED EVENTS
FOR EIGHTH DISTRICT
DEPOSITORY INSTITUTIONS

Into the Mainstream: As the Number of Hispanics in the Region Grows, How Can Banks and Communities Join Forces to Provide the Right Financial Services?

LOUISVILLE—SEPT. 23

Across the nation, community-based organizations and banks are developing innovative partnerships to increase the number of Hispanics who use banking services and products. A recurrent theme throughout this meeting will be the importance of building and maintaining trust when reaching new Hispanic immigrant customers. The event is designed for representatives of financial institutions, community-based organizations and government agencies, as well as immigrant and housing advocates.

For more event information, visit www.stlouisfed.org/community or call (502) 568-9216.

"Entrepreneurship: What's Government Got To Do with It?"

ST. LOUIS—OCT. 18

St. Louis Fed economist Tom Garrett will share his research into the effects of state and local government policies on those who want to start a business. He'll discuss government programs that work well and those that don't work nearly as well—despite being tried over and over. Other experts will participate in a panel discussion afterward. For more information and to register, visit www.stlouisfed.org/community or call (314) 444-8761.

The Pulse of Compliance: Monitoring Changes in CRA and Trends in Home Lending

LITTLE ROCK—OCT. 4
MEMPHIS—OCT. 5
ST. LOUIS—OCT. 26

The Banking Supervision and Regulation Division of the St. Louis Fed will be holding its annual compliance seminars during October in St. Louis, Memphis and Little Rock. This year's seminar will be of interest to compliance officers, CRA officers and senior bank officers who oversee lending for residential real estate. The seminars are free, but registration is required. For more information and to register, visit www.stlouisfed.org/banking, or call Kathy Griffin at (314) 444-8437 or 1-800-333-0810, ext. 44-8437. ■

Fed Facts

Treasury Begins Nationwide Direct Deposit Campaign

The U.S. Department of the Treasury and the Federal Reserve Bank recently completed a six-month pilot campaign, *Go Direct*, and have announced plans to expand the campaign nationally. *Go Direct* encourages federal benefit recipients, particularly Social Security and Supplemental Security Income (SSI) recipients, to use direct deposit.

Go Direct focuses on partnerships with organizations people know and trust, such as financial institutions and community and faith-based organizations. The Treasury issues nearly 13.3 million benefit checks each month. If these checks were converted to direct deposit, it would save the American taxpayers about $120 million annually. Customers benefit from the safety and convenience of direct deposit, and financial institutions' costs are reduced.

Kathy Paese, vice president of the St. Louis Fed's Treasury Relations and Support Office, says tens of thousands of Social Security and SSI recipients converted to direct deposit during the pilot program. The Treasury is now looking for more banks to help promote the direct-deposit option. For more information on becoming a *Go Direct* Partner, visit the *Go Direct* web site, www.GoDirect.org, or call (952) 346-6688. ■

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