Banking in the ninth

June 2011

Ninth District Highlights

In my inaugural article for this newsletter, I focus on supply and demand, a choice befitting the centrality of the economy to the Fed's responsibilities. Specifically, why is the Supervision, Regulation and Credit (SRC) division of the Minneapolis Fed supplying this newsletter, and why should you read (demand) it?

Let's start with demand and begin by specifying our audience and our goal. We've aimed the newsletter at depository institutions that have or may have contact with SRC through our examination of state member banks and holding companies, our provision of credit and related management of our credit risk and/or our processing of statistical and regulatory reports. We write the material in the newsletter in an effort to inform and improve the operations and decisions of these financial institutions. In particular, we want the newsletter to reduce the cost of and uncertainty associated with complying with our regulations and our operational and supervisory expectations. We want these benefits to come at a low cost, so we are keeping articles short and focused.

Financial institutions, and other readers with an interest in financial institutions, will have an incentive to read the newsletter if we meet these goals.

We certainly need your feedback to ensure that we achieve these goals. Please send comments and suggestions for improvements to our outreach email address: **Mpls.src.outreach@mpls.frb.org**.

I have already explained some of our supply rationale, but it goes beyond improved compliance. SRC needs to be more transparent and more present in the district. We are a public institution supported by taxpayers. We have a duty of clarity to the public.[1] The newsletter provides one tool for greater communication. We have also increased our outreach efforts throughout the district and have made the information on banking conditions available on our website.

Ron Feldman

A column in a newsletter offers a unique chance to communicate. I will use my column to explain key features of SRC operations. In that vein, I view an emphasis on risk management by depositories as a defining feature across our activities. We expect

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SAFETY and SOUNDNESS UPDATE

Appraisal Guidelines

The regulatory agencies issued the Interagency Appraisal and Evaluation Guidelines[1] ("Guidelines") effective Dec. 10, 2010. The agencies issued the Guidelines to clarify the existing real estate appraisal regulations and to provide institutions and examiners with supervisory guidance for a prudent appraisal and evaluation program. The Guidelines are based on the core principles of the 1994 Guidelines and incorporate other appraisal-related guidance documents.

We have received a number of questions from bankers asking for clarification on the Guidelines. Some of the questions we have received include:

- May a bank's appraisal review staff contact an appraiser to ask for clarification of information contained in an appraisal? ***Yes, to clarify or to request additional information to support the opinion of value. There should be adequate internal controls to prevent the review staff from trying to influence or coerce the appraiser.***

- If the loan for the purchase of agricultural land is between $250 thousand and $1 million, can a bank prepare an evaluation if the primary source of repayment is not based

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on the sale of or rental income from the real estate purchased? ***Yes, this meets the exemption criteria for a business loan.***

- May loan administration staff prepare appraisal engagement letters and select appraisers from a bank's approved list? ***Yes, if qualified and knowledgeable about the property type and market.***

- How do small community banks handle independence? ***If absolute lines of independence cannot be achieved, a bank should be able to demonstrate clearly that it has prudent safeguards to isolate its collateral valuation program from influence or interference from the loan production process.***

- What constitutes loan production staff? ***All personnel responsible for generating loan volume or approving loans.***

In addition to the above questions, the Federal Reserve System hosted an Ask the Fed session on Feb. 23, 2011, for institutions on the Guidelines. You can find the presentation at: https://www.stlouisfed.org/bsr/askthefed/index.cfm by registering for an Ask the Fed account and clicking on the 2/23/2011 call materials.

[1]The Guidelines can be found in SR 10-6 or www.federalreserve.gov/boarddocs/srletters/2010/sr1016a1.pdf

depository institutions to manage the risk associated with their Federal Reserve accounts, for example, and we make an evaluation of risk management a key component of our supervision of financial institutions.

The Federal Reserve has long emphasized risk management in its assessments of banks. We provide a distinct risk management rating for our safety and soundness exams, for example. I expect the focus on risk management to continue to grow even more.

Weak risk management poses a risk to financial institutions even when overall conditions and the conditions of a specific firm seem robust. Deficiencies in risk management can manifest themselves in future loss. The financial crisis and related weak recovery only reinforced this message. I think Federal Reserve Governor Sarah Bloom Raskin put it well:[2]

One thing I would note here is that if done properly, effective examination requires looking behind the numbers. The crisis made clear that a bank that appears to be in sound financial condition may actually have a ticking time bomb on its books. As I said before, it can be difficult for an examiner to tell a profitable bank with strong financial indicators that there are management weaknesses. But that is exactly what we should empower our examiners to do because we know that the seeds of financial crisis are planted during the good times. When conducting an examination, an examiner should be attuned to weaknesses in governance, risk management, and internal controls that may not pose a current problem but that may expose the bank to losses in the future. And ultimately, as you know, it is easier to fix a problem during the good times.

Finally, I want to reiterate my request for feedback and your thoughts. In particular, what type of information should SRC communicate via public means, and how should we communicate it? Please give us the benefit of your thoughts.

Ron Feldman
Senior Vice President, SRC

[1] Narayana Kocherlakota, president of the Federal Reserve Bank of Minneapolis, elaborated on these points in the June 2010 *Regio*n. See "Failure to Communicate?" at http://minneapolisfed.org/publications_papers/pub_display.cfm?id=4449.

[2] See "Community Bankers and Supervisors: Seeking Balance," a speech at the Federal Reserve Bank of New York Community Bankers Conference, April 7, 2011. Online at http://federalreserve.gov/newsevents/speech/raskin20110407a.htm.

CONSUMER AFFAIRS UPDATE

Several years ago, the Federal Reserve System adopted a risk-focused consumer compliance supervision program. In addition to outlining a process for conducting consumer compliance examinations and reviews, the program highlights the need for the System to provide state member banks with timely information regarding consumer compliance regulatory and supervisory matters. This newsletter contributes to the outreach goal, a particularly important objective now given the recent increase in the volume and complexity of consumer compliance-related regulatory changes. Here we are providing a few key resources that banks can rely on in the future to help fashion and maintain a strong compliance program.

In particular, the System developed the *Consumer Compliance Outlook* newsletter and the *Outlook Live* webinar as channels for distributing compliance-related information to state member banks. The *Consumer Compliance Outlook* is a quarterly publication with articles on regulatory changes, compliance management best practices, federal court opinions and other compliance issues. During the System's periodic *Outlook Live* webinars, Federal Reserve staff discuss regulatory changes and other compliance topics of interest. You can access current and previous *Consumer Compliance Outlook* issues or archived versions of the *Outlook Live* webinars online at http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/. You can also register at this website to receive future *Outlook* issues in electronic or paper format and notice of upcoming *Outlook Live* webinars.

DISCLOSURE OF DISCOUNT WINDOW BORROWING INFORMATION

Historically, Reserve Banks have not disclosed information on individual depository institution (DI) borrowings from the discount window. But two recent events have changed that.

First, Fox News Network LLC and Bloomberg LP were successful in winning cases under the Freedom of Information Act to obtain public release of certain information on individual DI borrowings from the discount window from Aug. 8, 2007, through March 1, 2010. Information released consisted of the names of borrowers, loan amounts, dates and some limited collateral information. That information was released to the public on March 31, 2011. Each affected DI was contacted by its Reserve Bank prior to release of the data.

The announcement regarding the release of this data is available on the FOIA Service Center section of the Board's public website at http://www.federalreserve.gov/generalinfo/foia/servicecenter.cfm . The documents released are available to the public upon request.

Second, the Dodd-Frank Act required the disclosure, by Dec. 1, 2010, of information regarding certain loans and financial assistance provided to institutions between Dec. 1, 2007, and July 21, 2010. This disclosure requirement included information on Term Auction Facility (TAF) borrowings from the discount window. Dodd-Frank also requires the disclosure of discount window lending information for loans outstanding on or after July 21, 2010, on a roughly two-year lag basis. Information to be disclosed on a two-year lag basis includes:

1. The name of the borrow DI.
2. The amount borrowed.
3. The interest rate paid.
4. Information identifying the types and amounts of collateral securing the loan.

The discount window is designed primarily to be a backup source of funding for banks in sound financial condition. Institutions usually borrow, on an overnight basis, in response to tight money markets or undue market volatility, to prevent an overnight overdraft in their Federal Reserve account or to meet a need for backup funding. *The Interagency Advisory on the Use of the Federal Reserve's*

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Primary Credit Program in Effective Liquidity Management (July 23, 2003) encourages depository institutions to consider the discount window as part of their backup liquidity arrangements.

If you have any questions pertaining to disclosure of discount window borrowing information, please contact Jim Deusterhoff (612-204-5868) or Jean Garrick (612-204-5862).

APPLICATIONS FILING TIPS

In this column, we focus on current events in applications. One of our goals is to provide information to facilitate the processing of applications filed with the Federal Reserve. The tips discussed here relate to requests for confidential treatment of information submitted in applications and a method to file applications electronically and avoid paper filings.

Confidentiality Requests

Under the provisions of the Freedom of Information Act (FOIA), an application filed with the Federal Reserve is a public document. However, an applicant may request confidential treatment for information it believes is exempt from disclosure under FOIA. For example, if an applicant is of the opinion that disclosure of commercial or financial information would likely result in substantial harm to its competitive position or that disclosure of information of a personal nature would result in a clearly unwarranted invasion of personal privacy, confidential treatment of such information may be requested. The request must be submitted in writing concurrently with the filing of the application and must discuss in detail the justification for each portion of the application for which confidential treatment is sought. The request must specifically describe the harm that would result from public release of the information. Also, information for which confidential treatment is requested should be: (1) specifically identified in the public portion of the application (by reference to the confidential section); (2) separately bound; and (3) labeled CONFIDENTIAL. Filers of applications are encouraged to contact staff of the Applications section with questions. Contact information is available at http://www.minneapolisfed.org/banking/apps/info/contacts.cfm.

Electronic Applications (E-Apps)

If a banking organization wants to avoid filing a number of paper copies with the Federal Reserve in connection with the filing of an application, E-Apps is an alternative. E-apps is a web-based application that allows banking organizations supervised by the Federal Reserve to submit applications online, either directly or through their authorized representatives. E-Apps is intended for applications and notices related to bank holding company mergers, acquisitions and nonbanking activities; state member bank mergers and branch expansion; and international banking applications. The process for submitting applications online has been carefully designed to ensure the confidentiality of the data (as appropriate) and to verify the identity of the filer. Digital certificates are issued to ensure that only authorized users can access the system. Questions pertaining to E-Apps can be directed to Julie Randall of our Applications area at (612) 204-5202. More detailed information on E-apps can be accessed at www.federalreserve.gov/bankinforeg/eapps.htm.