

S&R PERSPECTIVES

“We always value the opportunity to share information with the bank leaders in our District and to learn about what is on their minds.”

— Jennifer Burns, Senior Vice President
Supervision, Regulation and Credit

The Latest Fifth District Supervision and Regulation News & Events

Summer Issue 2012

The Effects of the Dodd-Frank Act on Community Banks

By David W. Powers

The stated objectives of the Dodd-Frank Act (DFA) include promoting the financial stability of the United States by improving accountability and transparency in the financial system, ending “too big to fail,” protecting the American taxpayer by ending bailouts and protecting consumers from abusive financial services practices. Much of the attention has focused on the act’s requirements for larger institutions; however, as the implementation of DFA unfolds, discussion related to how its provisions will affect community banks has increased. Many in the industry are concerned about how the requirements will apply to community banks and believe that the focus should remain on larger institutions that pose greater systemic risk.

This article looks at how community banks are affected by some of these provisions, including Debit Interchange, Stress Testing, FDIC Insurance, Capital Requirements, Charter Conversions and Savings and Loan Holding Companies.

Read more at http://www.richmondfed.org/banking/supervision_and_regulation/newsletter/2012/summer/article1.cfm

Disposition of Other Real Estate Owned: Methods, Risks and Rewards

By Michael T. Carson and David C. Schwartz

The 2007-2009 recession led to a sharp increase in the level of other real estate owned (OREO) across banks nationwide. Consequently, this led to an increase in banks’ disposition of OREO. On average, banks in the Fifth District saw a greater increase in OREO levels than banks nationwide. While the increase in dispositions has not yet materialized in our District at levels seen nationally, banks across the nation are exploring methods of disposing of OREO properties.

Read more at http://www.richmondfed.org/banking/supervision_and_regulation/newsletter/2012/summer/article2.cfm

Jennifer’s Notes



Welcome to the summer 2012 edition of S&R Perspectives. Over the last several months, I have had the opportunity to talk with many of you. In March and April, we held two Community Banker Forums — one in Charleston, W. Va. and one in Baltimore, Md. It was terrific to hear what was on your mind and to be able to share some information on key regulatory issues. You can read more about the forums in this issue.

Many of you have asked about improving ratings. Actually, recent guidance (SR 12-4) describes the factors that the Federal Reserve System (FRS) will consider in evaluating whether to upgrade an institution’s supervisory ratings. The guidance instructs examiners to look for demonstrated improvement in a bank’s financial condition and risk

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management processes and have an expectation that this improvement will be sustained as support for upgrade recommendations. In particular, the FRS will evaluate the strength of core financial components, overall risk management and board of directors oversight in assessing whether an upgrade is warranted. We are beginning to implement this guidance in our District.

There is a new FRS newsletter on the horizon, which will be similar to — and serve as the safety and soundness counterpart to — the system's Consumer Compliance Outlook publication. It will be geared toward community bankers and is expected to debut in the third quarter of this year. With the introduction of this new FRS publication, you will see some changes to our Fifth District newsletter in the near future — please stay tuned.

Now, on to the rest of this edition of S&R Perspectives. In this issue, we highlight a variety of financial industry topics, including the effects of the Dodd-Frank Act on community banks, the disposition of other real estate owned and Regulation W. We also cover our Healthy Bank Project, which examines how some banks maintained strong financial conditions over the recent downturn. We hope you find these topics useful and meaningful. Please complete our brief [online survey](#) to ensure that we are covering topics and issues that are important to you.

Jennifer

Weathering the Storm: A Case Study of Healthy Fifth District State Member Banks Over the Recent Downturn

By Ray Brastow, Bob Carpenter, Susan Maxey and Mike Riddle

The financial crisis and subsequent economic downturn resulted in a significant number of bank failures. Analysis of failures by the banking industry, regulators and academics has provided insight to help avert future banking crises. However, in the midst of the crisis and ensuing recession, some institutions did more than endure — they maintained strong financial conditions and above average regulatory ratings throughout. How? In what ways do they differ from weak or failed banks? During 2011, the Policy Analysis Group in Supervision, Regulation and Credit's Risk and Policy unit explored these questions by conducting interviews of bankers at a sample of banks that successfully navigated the crisis.

Read more at http://www.richmondfed.org/banking/supervision_and_regulation/newsletter/2012/summer/article3.cfm

Community Banker Forums Hosted in West Virginia and Maryland

By Steve Malerba

The Federal Reserve Bank of Richmond recently hosted two Community Banker Forums — one on March 22 in Charleston, W. Va., and one on April 12 in Baltimore, Md. Representatives of state member banks, bank holding companies, and savings and loan holding companies took part in the forums.

Read more at http://www.richmondfed.org/banking/supervision_and_regulation/newsletter/2012/summer/article5.cfm

Upcoming Conferences and Events

June 20, 2012 — BSA Coalition Anti-Money Laundering Conference, Richmond, Va.

September 20, 2012 — Community Banker Forum, Richmond, Va.



The Federal Reserve System (FRS) recognizes the important role that community banks play in the larger economy. To provide them with stronger support and guidance, the FRS is launching a new publication and website focusing specifically on community bank matters. The new publication, Community Banking Connections, will include articles on current, common issues that community banks are facing; resources that provide further details on key supervisory guidance; highlights of new regulations; perspectives from bank examiners and other Federal Reserve staff; and much more. Look for the first issue of Community Banking Connections, to be released in the third quarter of 2012.

Examiner's Corner

This section highlights new technological developments utilized for examinations of community banks within the Fifth District.

To improve examination efficiency and reduce hardcopy records, the Supervision, Regulation and Credit Department (SRC) has adopted the use of electronic work papers. For your institutions, this use of electronic documents should reduce some of the burden involved with the preparation and delivery of information for our reviews. Examiners generally send an email with instructions on how to set up secure stationery prior to the initial meeting with management. Once secure communication is established, there are three approved options for delivering electronic information.

Electronic documents can be submitted using one or a combination of the methods for handling and delivering confidential electronic information. The three approved methods include: encrypted secure email, an encrypted website for bulk data transfer, or an encrypted flash drive sent by the Reserve Bank. Our secure email system is easy to set up and allows users to establish a reusable password; however, this method may require multiple emails due to file size limitations. The encrypted website allows users to share large amounts of information easily, although the set up takes longer and there is a learning curve to posting documents and notifications. The final method is the use of an encrypted USB flash drive, which will hold up to 2 GB of information and will be sent to your institution directly through overnight delivery with a postage paid return envelope. The password for the flash drive will be provided to you separately through our secure email process. During the onsite portion, examiners may also share a USB flash drive or use a scanner to electronically capture hard-copy reports.

In preparation for the next examination, we will ask that you communicate your preferred method for delivering information by sending an email to RICHSRC.BusinessSupport@rich.frb.org. Many bankers have proactively indicated a preference based on the recent email notification. If you have questions or concerns regarding the use of one of these approved methods, please contact Business Support at the email address provided.

If you have any questions about any of these or other topics, please contact your Fifth District relationship manager or email BKSRCcommunications.RICH@rich.frb.org.

A Closer Look Into Regulation W

By Paul Frey and Donna Thompson

This article touches upon some common oversights and violations cited in recent reports related to financial institutions' transactions with affiliates.

Read more at http://www.richmondfed.org/banking/supervision_and_regulation/newsletter/2012/summer/article4.cfm

Fifth District Indicators*

4Q 2011

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| ↑ | <p>Earnings</p> <p>Earnings performance improved at community banks during the fourth quarter, but remained suppressed compared with the national peer group. The number of Fifth District community banks citing quarterly net losses declined from 104 to 74, or 28.8%, during the quarter. The mean ROAA improved slightly quarter-over-quarter from negative territory to 0.15%, but remained well below the National mean of 0.61%. Loan-loss provisions continued to suppress earnings at community banks as credit quality issues prevented the reserve releases experienced at community banks outside the Fifth District.</p> |
| ↑ | <p>Liquidity and Non-Core Funding</p> <p>Community bank liquidity continued to improve, as core deposit increases again outpaced modest loan growth. Additionally, reliance on non-core funding continued to trend downward. Despite these improvements, Fifth District community bank liquidity indicators still lagged improvements to the national peer group. The ratio of loans to core deposits fell to 87% for the District compared with 76% for the nation. Core deposits as a percentage of total assets climbed to 75% for the District and 78% for the nation. Non-core funding sources declined but remained significantly higher than the national peer.</p> |
| ↑ | <p>Balance Sheet</p> <p>The gradual expansion of community bank balance sheets that began in the second quarter of 2011 continued in the fourth quarter. Total assets for Fifth District community banks increased 5.6% during 2011, while total loans rose a more modest 2.3%. The residential real estate category primarily drove loan growth, while declines were noted in Commercial Real Estate, Construction and Land Development (CLD) and consumer loans.</p> |
| ↔ | <p>Credit Quality</p> <p>Community banks continued to display gradual improvement in credit quality trends despite relatively high levels of nonperforming loans and loan losses compared with the national peer group. Nonperforming loans declined to 3.9% of loans compared with 3.1% for the nation, and loan losses declined modestly to 1.25% of total loans compared with 0.89% for the nation. The sectors experiencing the most improvement included 1-4 family residential, CLD and commercial loans.</p> |
| ↔ | <p>Capital</p> <p>Fourth-quarter capital levels remained stable, as the mean Fifth District community bank maintained its well-capitalized status according to Prompt Corrective Action guidelines. The mean leverage ratio remained around 10%, Tier 1 risk-based capital was approximately 15.5% and total risk-based capital stayed at approximately 16%.</p> |

Source: Consolidated Reports of Condition and Income. *Fifth District Community Banks defined as those with Total Assets under \$1 Billion
http://www.richmond.org/banking/supervision_and_regulation/newsletter/2012/summer/pdf/5th-dist-ind.pdf

Recent Guidance

Supervision and Regulation (SR) Letters:

<http://www.federalreserve.gov/bankinforeg/srletters/srletters.htm>

SR 12-7

Supervisory Guidance on Stress Testing for Banking Organizations with More Than \$10 Billion in Total Consolidated Assets

<http://www.federalreserve.gov/bankinforeg/srletters/sr1207.htm>

SR 12-6

Inactive Supervisory Guidance

<http://www.federalreserve.gov/bankinforeg/srletters/sr1206.htm>

SR 12-5/CA 12-3

Policy Statement on Rental of Residential Other Real Estate Owned (OREO) Properties

<http://www.federalreserve.gov/bankinforeg/srletters/sr1205.htm>

SR 12-4

Upgrades of Supervisory Ratings for Banking Organizations with \$10 Billion or Less in Total Consolidated Assets

<http://www.federalreserve.gov/bankinforeg/srletters/sr1204.htm>

Consumer Affairs (CA) Letters:

<http://www.federalreserve.gov/boarddocs/caletters/>

CA 12-5

Revised Interagency Examination Procedures for the Fair Credit Reporting Act

<http://www.federalreserve.gov/bankinforeg/caletters/caltr1205.htm>

CA 12-4

Guidance on the Usage of 2010 Census Data in Community Reinvestment Act Examinations

<http://www.federalreserve.gov/bankinforeg/caletters/caltr1204.htm>

CA 12-2

Consumer Financial Protection Bureau Clarifies the Rules on Compensation to Loan Originators Based on Mortgage Transaction Terms or Conditions under Regulation Z

<http://www.federalreserve.gov/bankinforeg/caletters/caltr1202.htm>

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