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FEDERAL RESERVE BANK of KANSAS CITY

REGION'S MANUFACTURING SECTOR SHOWS DECEMBER WEAKNESS

Tenth District manufacturing activity weakened further in December, and firms' expectations for future activity remained pessimistic, according to the Federal Reserve Bank of Kansas City's [monthly survey of manufacturers](#). Price indexes in the survey, released on Dec. 30, also fell for the second straight month.

The survey asks plant managers about a variety of manufacturing indicators. The information is compiled into a snapshot of manufacturing activity in the Tenth District.

MAIN STREET ECONOMIST EXAMINES RURAL HOME PRICES

In the [latest issue of *The Main Street Economist*](#), Chad R. Wilkinson, vice president and Oklahoma City Branch executive, explores how rural America's housing prices are faring in the midst of a national home price bust. The article investigates the reasons behind the better recent performance of rural home prices compared to urban areas and whether rural areas will ultimately follow metro areas with falling prices.

SURVEY OF COMMUNITY BANKS PROVIDES INSIGHT INTO FUTURE CHALLENGES

The Federal Reserve Bank of Kansas City periodically surveys Tenth District community banks on their views of the challenges they see ahead and how their business strategies will address these challenges.

The [latest issue of *Financial Industry Perspectives*](#) includes information on what bankers said about their competitive environment and future challenges, regulatory burden, and staffing and governance challenges.

NEW RESEARCH WORKING PAPERS AVAILABLE

The Federal Reserve Bank of Kansas City recently released several research working papers on topics such as payment card fee structures, price-level targeting and risk-management in a low-inflation economy, alternative methods of solving state-dependent pricing models and long-run risks in the term structure of interest rates. Visit the Bank's [research working paper website](#) for the full list of 2008 papers.

PRESENTATION DETAILS
THIRD-QUARTER
BANKING CONDITIONS

A [presentation detailing recent banking conditions](#) in the Tenth Federal Reserve District is now available.

Across the country, the weakening of banking conditions that began in the fourth quarter of 2007 continued into the third quarter of 2008. Earnings continued to decline, driven by increasing loan loss provisions and tighter margins. Coverage ratios have also declined and are reflective of worsening conditions. Deterioration in banking conditions is especially evident in rising levels of noncurrent loans, particularly in construction and land development (CLD) loans. Among District banks, CLD noncurrents have doubled since year-end 2007.

KANSAS CITY FED ANNOUNCES
BOARD ELECTION RESULTS,
RE-APPOINTMENTS

The Federal Reserve Bank of Kansas City has announced the election results of new directors and the re-appointment of the Bank's chairman and deputy chairman. John Ikard, Richard Ratcliffe and Mark Gordon were elected to the Bank's head office board of directors. In addition, Paul DeBruce was re-appointed as deputy chairman, and Lu Cordova was re-designated chairman.

Ikard, president and CEO of FirstBank Holding Co. in Lakewood, Colo., was elected by Group 1 member banks, which have a combined capital and surplus of \$16 million and more. Ratcliffe, chairman of Ratcliffe's Inc. in Weatherford, Okla., was elected by Group 2 member banks, which have a combined capital and surplus of \$3.25 million and more but less than \$16 million. Gordon, owner of Merlin Ranch in Buffalo, Wyo., was elected by Group 3 member banks, which have a combined capital and surplus of less than \$3.25 million.

DeBruce, CEO of DeBruce Grain in Kansas City, Mo., has previously served on the Bank's Economic Advisory Council and was first appointed deputy chairman of the Bank's board of directors in 2008. Cordova is CEO of Corlund Industries and president and general manager of Almacen Storage Group, both in Boulder, Colo. She joined the Bank's board in 2005 and was first named chairman in 2008.

The board of directors includes nine members who meet monthly to confer on economic and banking conditions and to advise the Bank on its operations and policies.

HOLIDAY REMINDER

The Federal Reserve Bank of Kansas City will be closed Jan. 19 for Martin Luther King, Jr. Day. The FRB Financial Services website features a [complete listing](#) of holidays observed by the Federal Reserve.

REGULATORY
DEVELOPMENTS
*Payment System Risk Policy
revisions announced*

The Federal Reserve Board has announced revisions to part II of the Payment System Risk (PSR) policy that govern the provision of intraday credit, or daylight overdrafts, in accounts of depository institutions at the Federal Reserve. Implementation will occur in the fourth quarter 2010 or the first quarter 2011. A specific date will be announced by the Board at least 90 days in advance.

The revised policy reflects a new approach to enhancing intraday liquidity and the flow of payments for the banking system while controlling credit risk to the Reserve Banks from daylight overdrafts. This new approach:

- Explicitly recognizes the Federal Reserve's role in providing intraday balances and credit to foster the smooth operation of the payment system;
- Provides temporary, intraday balances to healthy depository institutions predominantly through collateralized intraday overdrafts; and
- Aims to reduce the reliance of the banking industry on uncollateralized daylight credit if this can be done without significantly disrupting the operation of the payment system or causing other unintended adverse consequences.

To minimize the effect of the policy on institutions that use small amounts of daylight overdrafts, the revised policy increases the biweekly daylight overdraft fee waiver to \$150 from \$25. For healthy institutions with regular access to the discount window that typically require greater capacity, the revised policy allows for voluntarily pledging collateral to secure daylight overdrafts. Collateralized daylight overdrafts will be charged a zero fee. To further encourage the voluntary use of collateral, the revised policy raises the fee for uncollateralized daylight overdrafts to 50 from 36 basis points (annual rate). A fee calculator is available on the Board of Governors' website to assist in estimating fees under the revised policy. Collateral eligibility and margins remain the same for discount window and PSR purposes.

The revisions also contain changes to other elements of the PSR policy dealing with daylight overdrafts, such as adjusting net debit caps to retain only the single-day cap, eliminating the current deductible for daylight overdraft fees, adopting additional flexibility in ex-post counseling, and increasing the penalty daylight overdraft fee for ineligible institutions from 136 to 150 basis points (annual rate).

Also, effective March 26, 2009, an interim policy will be adopted which streamlines the procedures for obtaining additional capacity through the max cap process, and changes the calculation of the deductible for eligible foreign banking organizations (FBOs).

Finally, the Board has announced that it will not pursue at this time its proposal to change the posting rules for FedACH and related Treasury Tax and Loan (TT&L) investments associated with Electronic Federal Tax Payments.

Questions on the Board's announcements can be directed to the Credit and Risk Management Department at (800) 333-2987.

Deduction of goodwill from tier 1 capital approved

On Dec. 16, the federal banking and thrift regulatory agencies approved a **final rule** that would permit a banking organization to reduce the amount of goodwill it must deduct from tier 1 capital by any associated deferred tax liability. The final rule is in substance the same as the proposal issued in September. The rule will be effective 30 days after publication in the *Federal Register*; however, banking organizations may adopt its provisions for purposes of regulatory capital reporting for the period ending Dec. 31, 2008.

For more information, read the **draft Federal Register notice**.

Amendments to Regulation Z proposed

On Dec. 5, the Federal Reserve Board proposed for public comment **changes to Regulation Z** that would revise the disclosure requirements for mortgage loans. The revisions would implement the Mortgage Disclosure Improvement Act, which was enacted in July 2008 as an amendment to the Truth in Lending Act. The rule will require estimates of mortgage loan costs to be provided within three days of application on all loans secured by dwellings. It also will require creditors to wait seven business days after providing early application disclosures before closing the loan. The proposed rule would become effective on July 30, 2009. Comments may be submitted until Feb. 9, 2009.

Annual asset-size threshold adjustments released

On Dec. 17, the federal bank regulatory agencies announced the **annual adjustment to the asset-size thresholds** used to define “small bank” and “intermediate small bank” under the Community Reinvestment Act (CRA) regulation. The definitions of small and intermediate small institutions for CRA examinations will change, and the new asset-size threshold adjustments are effective Jan. 1, 2009.

“Small bank” means an institution that, as of Dec. 31 of either of the prior two calendar years, had assets of less than \$1.109 billion. “Intermediate small bank” means a small institution with assets of at least \$277 million as of Dec. 31 of both of the prior two calendar years, and less than \$1.109 billion as of Dec. 31 of either of the prior two calendar years.

Asset-size exemption threshold issued

On Dec. 18, the Board published its **annual notice of the asset-size exemption threshold** for depository institutions under Regulation C, which implements the Home Mortgage Disclosure Act. The asset-size exemption for depository institutions with offices located in metropolitan areas will increase from \$37 million to \$39 million. As a result, depository institutions with assets of \$39 million or less as of Dec. 31, 2008, are exempt from collecting data in 2009. An institution’s exemption from collecting data in 2009 does not affect its responsibility to report the data it was required to collect in 2008. The adjustment is effective Jan. 1, 2009.

Rules that better protect credit card users approved

On Dec. 18, the Board approved [final rules to better protect credit card users](#) by prohibiting certain unfair acts or practices and improving the disclosures consumers receive in connection with credit card accounts and other revolving credit plans. The rules amend Regulations AA, Z, and DD.

The Regulation AA provisions will allow increases in interest rates only under certain conditions, prohibit the “two-cycle” billing method, require that consumers receive billing notices at least 21 days in advance of the due date, prohibit the use of payment allocation methods that maximize interest charges, and limit fees on subprime credit cards.

The Regulation Z provisions revise the disclosures that consumers receive in connection with credit card accounts and other revolving plans, including application and solicitation disclosures as well as ongoing disclosures during the life of credit card accounts.

The Regulation DD provisions address depository institutions’ disclosure practices related to overdraft services. The amendments related to credit cards are effective July 1, 2010, and the amendments under Regulation DD take effect on Jan. 1, 2010.

Amendments to Regulation E proposed

In conjunction with the rules to better protect credit card users, the Board issued proposed [amendments to Regulation E](#) to protect consumers that use overdraft services offered by financial institutions.

The proposal would limit the ability of a financial institution to assess an overdraft fee for paying automated teller machine (ATM) withdrawals and one-time debit card transactions that overdraw a consumer’s account. In addition, the proposal would prohibit financial institutions from assessing an overdraft fee if the overdraft would not have occurred but for a debit hold placed on funds in the consumer’s account that exceeds the actual amount of the transaction. The comment period will close 60 days after the proposed rule is published in the Federal Register, which is expected soon.

Interagency questions and answers on Community Reinvestment issued

Revised [questions and answers](#) that interpret the Community Reinvestment Act regulations were released by the federal financial institution regulatory agencies. These revised Q&As address banks’ participation in foreclosure prevention programs, community development investments, and activities undertaken in coordination with minority- or women-owned institutions. In addition, the agencies have also proposed three new or revised Q&As for comment. Comments must be submitted by Mar. 9, 2009.

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