# Steve's Corner

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## A Very Challenging Year

Greetings and Happy New Year to you all during these very challenging times. When we look back on 2008, I think we can all agree that the year's events both nationally and regionally were breathtaking in their scope, speed, and severity. The loss of value in our housing and equity markets, the surge in foreclosure rates, the freezing of credit markets, the failure of large financial institutions, the demise of the investment banking industry—coupled with the slowdown in global economic growth—are unprecedented.

In meeting with many of you last year, it was clear how far-reaching the current financial turmoil has become. Hearing your accounts and witnessing some of our District's problems first hand has reinforced that we are encountering the most tumultuous and consequential financial stress that I have seen in my 37 year career.

Fortunately, the concerted efforts of the Fed, Treasury, and FDIC—as well as those of the banking industry—are enabling the financial services industry to regain its footing. This in turn will allow the economy to recover by ensuring that creditworthy borrowers continue to have access to loans, that depositors and creditors regain confidence in their financial institutions, and that financial markets return to normal. But much more work needs to be done if we are to ensure that this progress continues to a point where we are back to more stable and fruitful times.

As I have traveled throughout the District, it has struck me that there are certain distinct qualities shared by the more successful and resilient institutions in the region. They include being well informed and being prepared, and these are the qualities we will all need if we are to meet the challenges of 2009 head on.

### Be Well Informed

I have spent much of the past several months talking to bankers about the innovative programs put in place by the Fed, the Treasury, and the FDIC, to promote financial stability and to mitigate the procyclical effects of current market conditions. I encourage you to keep abreast of the ongoing refinements and regulatory revisions related to these programs through the Web resources listed at the end of this letter.

As issues have emerged, we have tried to get information out to you as quickly as possible with the opportunity for questions and a dialog. With that in mind, I hope you and your staff will continue to take advantage of the "Call the Fed" audio conference presentations. In the box on the next page are links to the most recent presentations on consumer compliance and liquidity management.

For those of you with a state member bank or bank holding company, please also remember that your Examining Manager or Officer here at the Reserve Bank is available for consultation on any number of issues, including the newly implemented programs and risk management topics mentioned above, as well as concerns or questions you may have. Also listed in the resources box are the names and contact information for several members of our management team. Please don't hesitate to use the Federal Reserve Bank resources available to you.

### Be Prepared

In these uncertain times, stronger firms have not only taken a pro-active stance toward understanding the magnitude and severity of their current problems, but have also challenged themselves to look around the corner and expect the unexpected. Of course, there is a delicate balance between being well prepared and being overly cautious.

Those institutions that have done their homework in understanding their current condition, as well as stress testing the more vulnerable aspects of their credit and liquidity risk on an ongoing basis, are much better prepared to continue to meet the credit needs of their communities and take advantage of new opportunities on the horizon. Moreover, by performing a more thorough analysis of current and potentially adverse conditions, institutions are better positioned to address ALLL provisioning needs and perform strong capital planning, including an evaluation of the appropriateness of dividend levels. These steps in turn make institutions more resilient through these challenging times. I probably need not add that well prepared institutions fare much better during examinations by demonstrating to supervisors a more thorough understanding of their risks and capital adequacy.

One of the key elements of capital planning is the continuous evaluation of common stock dividends. In this environment, it's especially important to remember that dividends are usually appropriate only if they're fully covered by an institution's current earnings and supported by management's projections for capital and profitability. I urge you to review the Federal Reserve's long-standing Policy Statement on the Payment of Cash Dividends by State Member Banks and Bank Holding Companies, dated November 14, 1985 (Federal Reserve Regulatory Service, 4-877 at page 4-323).

Right now, institutions have a unique opportunity to improve their preparedness. As part of our outreach to the banking community, we've noted that many of the tools now available to combat the current crisis, such as the FDIC's debt guarantee program, are temporary and have important deadlines or expiration dates. Bankers who are taking steps now to prepare for the point in the relatively near future when many of these programs come to an end will be best positioned for the expiration of the programs.

In addition to the challenges of the immediate financial crisis, there is also some longer term work preparing for new rules designed to address past excesses. In particular, new and proposed regulations concerning consumer disclosures and unfair or deceptive practices have been finalized or are out for comment. While there is a transition period for many of these changes, part of being prepared is reviewing how your current practices measure up against the new rules and ensuring that adequate time and resources are available for cost-effective implementation. Other aspects regarding consumer protection are still open for comment, and I urge you to take advantage of this opportunity to make your views known and to be part of this process.

**The Year Ahead**

It's difficult to predict what the next 12 months will bring, but there will surely be challenges for us all. As supervisors, our priorities for 2009 are to continue to ensure that banking organizations are objectively evaluating their condition and risks, and are taking proper steps to improve their resiliency. We are dedicated to conducting balanced evaluations so that viable organizations are able to address their issues and meet the banking needs of their communities. After emerging from a year that was more challenging than any we've seen in decades, I'm confident that the groundwork laid by the government and by bankers in recent months leaves the industry better prepared to recover over time and, once again, thrive.

In that spirit, I wish you all the best in the New Year.

Sincerely,

*Steve*

## Resources and FRBSF Contacts for Current Industry Issues

Recent Federal Reserve Actions. Check here to keep updated on recent policy statement and actions of the Federal Reserve Board. Of special interest are the recent policy statement on minority equity investments in banks and bank holding companies and the Interagency Statement on Meeting the Needs of Creditworthy Borrowers.

TARP and the Emergency Economic Stabilization Act. The latest information on the US Treasury's implementation of the EESA.

*FRBSF contact for TARP*: Kenneth Binning, Vice President, Applications and Enforcement

Temporary Liquidity Guarantee Program. Information and FAQs on the FDIC's TLGP.

*FRBSF contact for TLGP*: David Wright, Group Vice President, Risk Monitoring and Analysis

Compliance Challenges in a Declining Economic Environment. ( December 10, 2008) ***Call the Fed*** program on consumer compliance issues relating to HELOCS, CRA, and new and proposed Reg Z rules. Click here to review the proposed rules in the Federal Register, and provide comment.

*FRBSF contact on consumer compliance issues*: Tracy Basinger, Vice President, Examinations Group

Be Prepared: Sound Liquidity Risk Management in a Challenging Environment — Round II. (October 30, 2008) ***Call the Fed*** program on liquidity management and stress testing scenarios, the TLGP, and the Discount Window.

*FRBSF contact on liquidity management and stress testing*: David Erigero, Senior Examiner

*On the Discount Window:* Rick Miller, Discount Officer and Director of Credit and Risk Management

### FRBSF Economic Analysis and Discussion

12th District Banking Profile (January 2009)—Key indicators of banking conditions, through 3Q 2008.

12L Economic Trends (December 2008)—Most recent performance indicators for the 12th Federal Reserve District economy.

Real Estate Lending Risks Monitor - Special Edition (October 2008) Prepared by the Banking Supervision & Regulation Division to help understand the conditions and credit quality outlook related to the office, industrial, multi-housing, and retail sectors.

U.S. Monetary Policy Objectives in the Short and Long Run (January 4, 2009) Speech by Janet Yellen, President & CEO, FRBSF