R&C Bankers Conference

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Overview of Opening Remarks

- Credit quality continues to improve
- Biggest near term risk continues to be compliance risk
- Longer-term risk – Will collateral values continue to appreciate?
Steady Improvement in Banks
Rated 3, 4, or 5

Chart Not Available
Despite the improvement in credit quality less than 20 percent of banks are 1-rated.

Chart not available.
Very Low Delinquency Rates Are Consistent With This Improvement

Delinquency Rates for All Loans
at Commercial and Savings Banks, by Asset Size
Based on Quarterly Call Report Data, 1991:Q1 - 2004:Q4

- Small Banks (Under $1 Bil)
- Mid-Sized Banks ($1 - $20 Bil)
- Large Banks ($20 Bil or More)
The Greatest Improvement Has Been In Large Participation Loans

Delinquency Rates for Commercial and Industrial Loans at Commercial and Savings Banks, by Asset Size
Based on Quarterly Call Report Data, 1991:Q1 - 2004:Q4

- Small Banks (Under $1 Bil)
- Mid-Sized Banks ($1 - $20 Bil)
- Large Banks ($20 Bil or More)
Even With Institutions Experiencing Problems, Credit Quality Has Improved

Delinquency Rates for All Loans at Small Commercial and Savings Banks
Based on Quarterly Call Report Data, 1991:Q1 - 2004:Q4

- All Small Banks
- Small CAMELS 3, 4, 5 Banks
- All US Banks
Enforcement Actions in 2005

- 13 formal enforcement actions this year on state member banks or holding companies
- Only one was solely focused on safety and soundness issues
- 3 focused on AML/BSA
- 4 had major compliance issues - regulatory reports, 23A/23B, internal audit
- 4 CMP on flood insurance
Enforcement Actions

Of the 13, two were large banks
- B of A – mutual fund issues
- Riggs – BSA, safety and soundness

Many of the BSA/AML enforcement actions were on foreign owned banks
Continued Focus on Compliance

BSA continues to be an area of focus
- Continued scrutiny by Congress
- Well publicized lapses highlight potential reputational risk
- Following financial trail will continue to be a major element of the fight on terrorism
Housing Appreciation—Is It sustainable?

“I believe, at worst, prices will level off and not decline” he said of his interest-only loan. - *Boston Globe May 31*

“It has to appreciate (real estate), they’re not making more land.” *Boston Globe May 31*

Will interest only loans and second homes cause housing prices to behave differently than in the past?
“For housing, rent-to price ratios and income-to-price ratios .... have decreased sharply in many countries, and they are currently outside historical ranges in some countries.”
Home Price Appreciation Has Been Greatest on the Coasts

Chart 1: Home Price Appreciation by Census Region
Percent Change, 2002:Q4 - 2004:Q4
Retirement Areas Have Experienced Significant Increases In Home Prices

Home Price Appreciation by State - Top 10 States
Percent Change, 2002:Q4 - 2004:Q4
Prices In Localized Markets Have Exceeded 40 Percent Over The Past Two Years

Home Price Appreciation by MSA
MSAs Reporting Over 40% Percent Change, 2002:Q4 - 2004:Q4
National Association Of Realtors Study

In 2004 second homes comprised approximately 35 percent of existing single-family, condo and new home sales.

Vacation homes were 36 percent of second home sales while investment home sales were 64 percent.
Conclusion

- Credit quality is quite good and improving.
- Low interest rates and collateral appreciation improve credit quality now but could seed problems for the future.
- Housing not an immediate concern – but changes in the housing market could become an issue in a less benign environment.