THE FEDERAL RESERVE BANK of ST. LOUIS

Central Banker

SPRING 2003

News and Views for Eighth District Bankers

Cleveland and St. Louis Feds Form Regional Partnership

The Cleveland and St. Louis Federal Reserve banks recently entered into a partnership combining local customer support. Account executives now travel across district lines and potentially service financial institutions located outside their Reserve bank. In addition, some functions, such as product development and communications, have been combined. While these activities are mostly transparent to customers, the partnership allows both districts to better align internal resources and become more efficient.

The Cleveland and St. Louis Feds also will jointly sponsor special events and educational seminars. Pooling these resources will enhance the quality of events offered and give customers more options to choose from when they select event locations.

The first opportunity to attend a regional event will come this spring when we introduce Fed Exchange, a new educational forum that will be held throughout April and May. All Fourth and Eighth District institutions will receive an invitation soon.

This partnership will not affect any other business you conduct with the Fed, such as check processing, cash orders or regulatory activities. The St. Louis Fed will continue providing these services for your institution. In addition, national and local support centers will continue to answer questions on various Fed services, such as FedACH®.

For more information about this partnership, see the special edition of *Payments Quarterly*, or contact your local account executive. ■

Fed Announces Check Re-engineering Initiative

The Federal Reserve System has announced it will reduce its check-processing sites from 45 to 32 and its check-adjustment sites from 43 to 12. Among the sites that will no longer process checks are the Little Rock and Louisville branches.

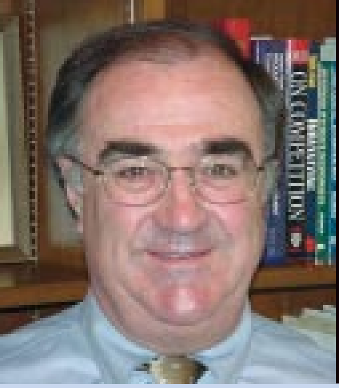
While some Fed offices will transition beginning this year, Little Rock and Louisville will continue processing checks until sometime in late 2004. At that point, Little Rock's check-processing function will be shifted to the Memphis Branch and Louisville's to the Cincinnati Branch of the Cleveland Fed.

The plan was approved by the Fed's Conference of Presidents in January after a team of Federal Reserve check operations experts worked with consultants from Accenture—a leading management consulting and technology services company—to analyze the Fed System's existing check infrastructure.

In making its recommendations, the team considered several criteria, including an office's:

• ability to handle additional volume;
• proximity to other Fed check processing sites;
• current and historical check volumes; and
• physical presence in markets with relatively large check volumes.

In the Feditorial on page two, St. Louis Fed First Vice President LeGrande Rives offers Fed customers his reassurance that check service levels will remain high. ■



Feditorial

The Check Re-engineering Initiative: It Really Is Business as Usual

By LeGrande Rives, First Vice President of the Federal Reserve Bank of St. Louis

We have a lot to be proud of in the Eighth District. Our check-processing sites in Little Rock, Louisville, Memphis and St. Louis are among the most efficient in the Federal Reserve System. But every prudent business, including the Federal Reserve, must adapt to significant changes in the marketplace.

Nationwide, we know consumers are choosing the efficiency of electronic payments, such as ACH and debit cards, over checks. One of the Fed's objectives is to promote an efficient payment system, so we endorse these trends.

As consumers adopt electronic payment alternatives, recent definitive research indicates check usage is declining, and we must re-engineer our check operations. So last fall, the Fed's Conference of Presidents met to develop a plan for boosting revenues and cutting costs. After much debate, a final decision was announced in February. Between now and the end of 2004, Reserve bank check-processing sites will be reduced from 45 to 32, and check-adjustment sites will be reduced from 43 to 12.

Closing our District's Little Rock and Louisville check-processing sites will allow our District to save $4.9 million a year. That's a number we couldn't walk away from, but we have not forgotten our mission to provide high-quality service.

Throughout the transition, all Reserve banks will work to maintain deposit times and availability as close as possible to current service levels, and our new check-imaging and check-adjustments technology will allow us to offer additional services.

Likewise, because we care about our affected employees and we want them to remain with us throughout the transition, we've offered them generous severance and retention benefits. This will ensure that our sites continue operating fully and efficiently.

You have my promise that for the next 18 months it really will be business as usual at the St. Louis Fed. We have not yet worked through all the details of the re-engineering initiative, but we will communicate any changes as soon as we know them. For upcoming announcements, visit our web site, www.stlouisfed.org. ■

Fed Announces Enhancements to FedLine® for the Web

The Federal Reserve System will introduce two new web-based informational tools during the second and third quarters of 2003. Eventually, these enhancements will replace DOS-based FedLine®.

ReserveCalc allows financial institutions to check reserve requirements, access position reports and drill-down on various report items, such as as-of adjustments data and close-of-business account balances.

An additional feature is the Balance Calculator, which institutions can use to determine the balances they should hold each day in order to achieve a zero net position. The calculator automatically updates every day after the Federal Reserve records an institution's close-of-business account balance and processes as-of adjustments.

The calculator also will function as an interactive decision-making tool. Institutions will be able to:

• enter estimated future account balances to determine net positions under different scenarios or

• calculate the effect of an anticipated as-of adjustment on required balances.

Daylight Overdraft Reporting and Pricing System (DORPS) is a new web-based service that will be rolled into the Account Management Information system. Five reports will be available:

1) Two Week Daylight Overdraft Summary,

2) Advice of Daylight Overdraft Charges,

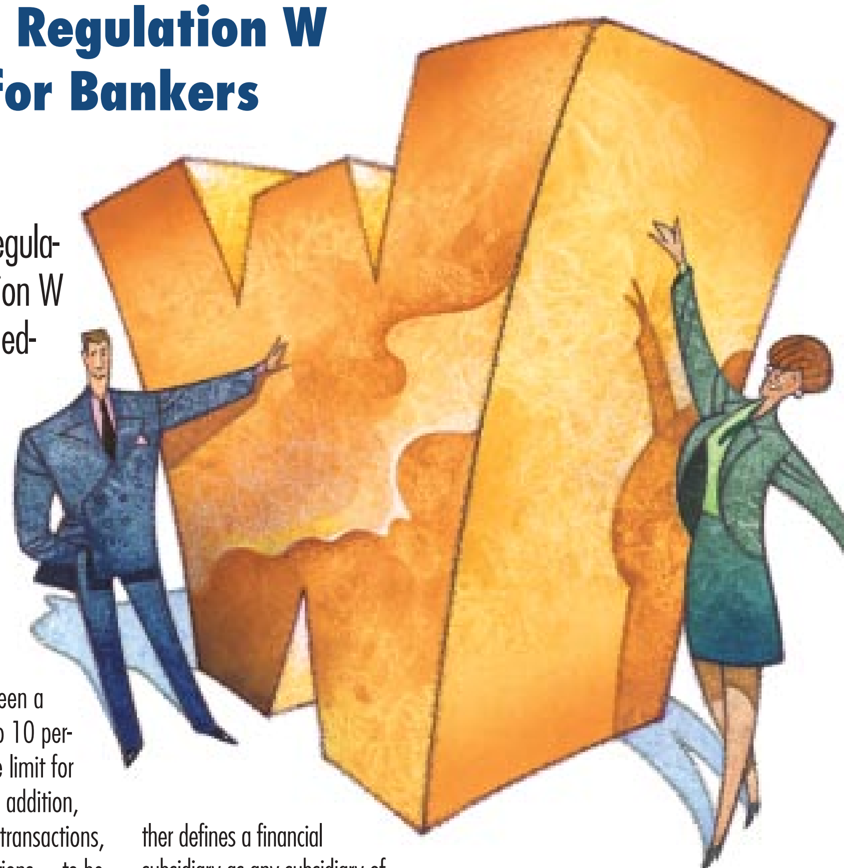
3) Statement of Daylight Overdraft Charges,

4) revised advices and

5) revised statements.

If you have any questions about these two new services, contact your account executive. ■

Upcoming Changes to Regulation W Simplify Compliance for Bankers



The Board of Governors of the Federal Reserve System has published a final Regulation W, which takes effect April 1. Regulation W implements sections 23A and 23B of the Federal Reserve Act, imposing limits on transactions between a bank and its affiliates. For the first time, all of the Board's interpretations, staff opinions and comments on those sections have been consolidated into one public document.

Section 23A restricts certain "covered transactions" between a bank and any of its defined affiliates to an amount equal to 10 percent of the bank's capital stock and surplus. The aggregate limit for a bank's transactions with all its affiliates is 20 percent. In addition, Section 23A imposes requirements for collateral on certain transactions, requiring covered transactions—and other exempted transactions—to be on terms "consistent with safe and sound banking practices."

Section 23B requires market terms not only for covered transactions with defined affiliates but also for certain other transactions. *(The 23B definition of "affiliates" varies from the 23A definition.)*

The original laws were designed to prevent banks from being abused as a funding source for their affiliates. The laws' broad scope, however, often made application somewhat complicated.

The new regulations clarify how the Board will treat a number of transactions of concern and provide exemptions that ease the compliance burden. Four treatments identified as among the most significant are summarized below.

Derivative Transactions: The revised Regulation W:

- stipulates that derivative transactions between banks and their affiliates be subject to the 23B market terms requirement and
- requires banks to adopt policies and procedures to manage credit risk resulting from those transactions.

Most derivative transactions, however, will not be subject to the 23A quantitative and collateral limitations.

Intraday Credit: Similarly, under new rules required by Graham-Leach-Bliley, intraday credit extensions from a bank to an affiliate will be subject to 23B market terms requirements; however, these extensions will be exempt from the percentage limits and collateral requirements under 23A, if the bank:

- adopts policies and procedures to manage the credit exposure that may arise and
- has no reason to believe that the affiliate would have difficulty repaying the credit according to its terms.

Financial Subsidiaries: Consistent with 23A, the new rule defines a bank's financial subsidiaries as affiliates; therefore, transactions between a bank and its financial subsidiary are subject to 23A and 23B. The rule further defines a financial subsidiary as any subsidiary of a national or state bank that engages (directly or indirectly) in an activity not permissible for a national bank to conduct directly.

Insurance agency subsidiaries of both national and state banks, however, are exempt, so they are not considered affiliates. Subsidiaries of a state bank are exempt if they only engage in activities that either:

- are permissible for a state bank to conduct directly or
- were conducted lawfully by a subsidiary before the final rule was implemented.

General Purpose Credit Card Transactions: Under 23A, transactions—including extensions of credit—with nonaffiliates of a bank are deemed covered transactions if the proceeds were transferred to or used for the benefit of the bank's affiliate. The new rule includes an exemption where any nonaffiliated entity can use a general-purpose credit card issued by a bank to purchase products or services from the issuing bank's affiliate.

Although those extensions of credit meet the 23A standard for covered transactions, they are considered exempt if:

- the credit card used is widely accepted by merchants not affiliated with the bank and
- less than 25 percent of purchases (by all cardholders) are with bank affiliates.

To ease the compliance burden, a bank is deemed to meet the 25 percent test if it has no commercial affiliates and has no reason to believe it wouldn't meet the test. A bank with commercial affiliates beyond those authorized by Bank Holding Company Act subsection 4 must either present information to the Federal Reserve Board showing that its card is expected to always comply with the 25 percent test or establish systems to calculate and validate compliance.

For more information, visit the Board of Governors web site, http://www.federalreserve.gov/regulations/regref.htm#w. ■

RegionalRoundup

Eighth District Announces Changes to Boards of Directors

The Federal Reserve Bank of St. Louis has announced the following changes to its boards of directors:

- **Charles W. Mueller**, chairman and CEO of Ameren Corp., St. Louis, re-appointed as chairman of the St. Louis Board.
- **Walter L. Metcalfe Jr.**, chairman of Bryan Cave LLP, St. Louis, re-appointed as deputy chairman of the St. Louis Board.
- **Gayle P.W. Jackson**, managing director of FondElec Clean Energy Group Inc., St. Louis, re-appointed to a three-year term on the St. Louis Board.
- **J. Stephen Barger**, executive secretary-treasurer of the Kentucky State District Council of Carpenters, Frankfort, Ky, elected to a three-year term on the St. Louis Board.
- **Lunsford W. Bridges**, president and CEO of Metropolitan National Bank, Little Rock, re-elected to a three-year term on the St. Louis Board.
- **Rogers Yarnell II**, president of Yarnell Ice Cream Co. Inc., Searcy, Ark., re-appointed to three-year term on the Little Rock Board.
- **David R. Estes**, president and CEO of First State Bank, Lonoke, Ark., re-appointed to a three-year term on the Little Rock Board.
- **Everett Tucker III**, chairman of Moses Tucker Real Estate Inc., Little Rock, re-appointed to a three-year term on the Little Rock Board.
- **Scott T. Ford**, president and CEO of ALLTEL Corp., Little Rock, appointed to fill the unexpired portion of a three-year term on the Little Rock Board.
- **Thomas W. Smith**, president of Thomas W. Smith & Associates, Inc., Danville, Ky., re-appointed to a three-year term on the Louisville Board.
- **Marjorie Z. Soyugenc**, executive director and CEO of Welborn Foundation, Evansville, Ind., re-appointed to a three-year term on the Louisville Board.
- **(Mr.) Meredith Baird Allen**, vice president of Staple Cotton Cooperative Association, Greenwood, Miss., appointed to a three-year term on the Memphis Board.
- **James A. England**, chairman, president & CEO of Decatur County Bank, Decaturville, Tenn., re-appointed to a three-year term on the Memphis Board.
- **Tom A. Wright**, Chairman, President & CEO of Enterprise National Bank, Memphis, Tenn., re-appointed to a three-year term on the Memphis Board. ■

Fed Implements Two New Lending Programs

The Federal Reserve has replaced adjustment credit and extended credit with two new programs: primary credit and secondary credit. The same types of depository institutions that previously qualified for adjustment or extended credit—such as commercial banks, savings and loans and credit unions—will now qualify for primary or secondary credit.

The restructuring of the Federal Reserve's credit programs is designed to improve the functioning of the discount window. It does not represent a change in either the stance of monetary policy or the process by which the discount rate is set.

Primary credit will be available to financial institutions that Reserve Banks deem to be in generally sound financial condition. Normally, primary credit will be granted on a "no questions asked" basis at an initial rate of 100 basis points above the Federal Open Market Committee's target for the federal funds rate.

Generally, primary credit will be extended on a very short-term basis—typically overnight—but small institutions that cannot obtain temporary funds in the market at reasonable terms may extend their credit for up to a few weeks, as long as they are in sound financial condition.

Secondary credit is for institutions that do not qualify for primary credit, and it will entail increased administration. The rate is 50 basis points above the primary credit rate.

For more information about both programs, please see the Credit office's web site, www.stlouisfed.org/banking/Credit/credit.html, or contact an analyst in the Credit office, 1-866-666-8316, then press 1. ■

The Condition of Banks: *What Are Examiners Finding?*

By R. Alton Gilbert, vice president and economist, Research

Federal law requires supervisory agencies to examine each bank at least once every 18 months. Most examinations assess six aspects of a bank's operations (spelling the word "CAMELS"):

- **C** capital protection,
- **A** asset quality,
- **M** management competence,
- **E** earnings strength,
- **L** liquidity risk and
- **S** sensitivity to market risk.

All banks receive a rating of 1 (best) through 5 (worst) on each of these six aspects along with a composite rating. A composite CAMELS rating of 1 or 2 indicates that the supervisors consider a bank to be in satisfactory condition. Supervisors use a 3 rating for banks that exhibit some degree of concern in one or more areas; a rating of 4 or 5 indicates more serious problems.

While the CAMELS ratings assigned to individual banks are confidential, a comparison of CAMELS ratings across all banks over time may provide useful information about the condition of U.S. banks as a whole.

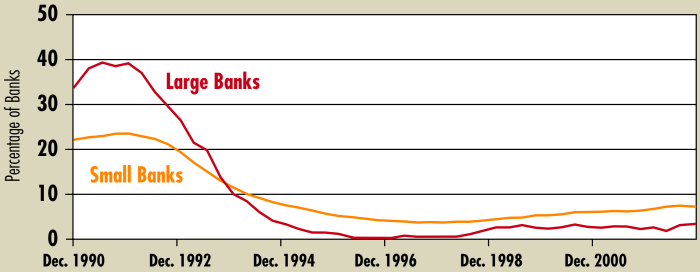
Figure 1 illustrates one method of measuring banking industry condition: the percentage of banks rated as being in unsatisfactory condition. According to this measure, banking industry condition has worsened slightly since the mid-1990s for both large and small banks. This measure, however, remains much stronger in recent quarters than during the recession period of 1990-91.

Figure 1 has limitations as a method for measuring current condition. Given the timing of examinations, the percentages reflect the results of examinations conducted at various points in time during the prior 18 months. Additionally, the percentage of banks rated as being in unsatisfactory condition could change over time if the downgraded banks (CAMELS 3-5) recover to ratings of 1 or 2 either faster or more slowly than in the past.

Figure 2 illustrates another method of measuring banking industry condition: the percentage of banks rated 1 or 2 at the beginning of a quarter that were downgraded to 3-5 during examinations begun that same quarter. The denominator of the ratio equals the number of banks that entered the quarter rated 1 or 2 and were subject to examinations that began during the quarter. The numerator is the number of these banks that received ratings of 3, 4 or 5 on the examinations that began during the quarter. The percentages reflect the results of examinations conducted during each quarter.

Figures 1 and 2 illustrate different pictures of banking industry condition during recent quarters. Figure 1 indicates deterioration—a rising percentage of both large and small banks being rated less than satisfactory by supervisors during recent years. In contrast, figure 2 indicates that the examinations conducted since around the end of 2000 have resulted in relatively small percentages of banks being downgraded to unsatisfactory condition. Regardless, both Figures 1 and 2 suggest that the condition of the banking industry during recent quarters has been much stronger than during the 1990-91 recession. ■

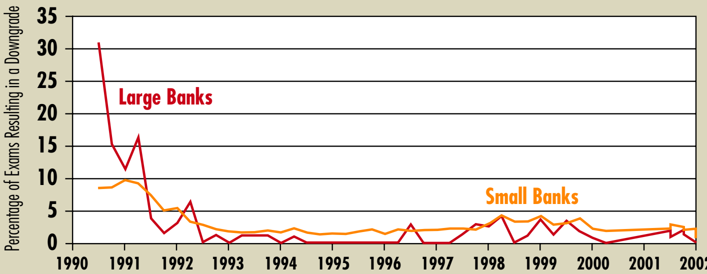
FIGURE 1: Percentage of Banks Rated CAMELS 3-5



Quarterly data Dec. 31, 1990, through Sept. 30, 2002

Note: Small banks are banks with less than $1 billion in total assets, and large banks are banks with assets greater than or equal to $1 billion.

FIGURE 2: CAMELS Downgrade from 1 or 2 to 3, 4 or 5



Quarterly data ending in September of each year

Note: Small banks are banks with less than $1 billion in total assets, and large banks are banks with assets greater than or equal to $1 billion.

Calendar Events

UPCOMING FED-SPONSORED EVENTS FOR EIGHTH DISTRICT DEPOSITORY INSTITUTIONS

2003 Evansville Small Business Meeting

MARCH 20—EVANSVILLE, IND.

What can urban areas do with vacant, deteriorating buildings in their downtown areas, and how can they entice residents to move there? This will be the topic of a quarterly meeting sponsored by the St. Louis Fed. Developers and interested parties from both the public and private sectors are invited to attend.

For information, call Faith Weekly at (502) 568-9216.

Economic Development in the Minority Community

MARCH 25—LOUISVILLE

This community affairs forum is co-sponsored by the St. Louis Fed and the University of Louisville's School of Urban and Public Affairs.

For information, call Faith Weekly at (502) 568-9216.

2003 Community Affairs Research Conference: Sustainable Community Development

MARCH 27-28—WASHINGTON, DC

The Community Affairs officers of the Federal Reserve System are sponsoring their third biennial research conference, "Sustainable Community Development: What Works, What Doesn't and Why." This conference will bring together a diverse audience from academia, financial institutions, community organizations, foundations and government to learn about research being done in the community development arena.

Information is available at www.federalreserve.gov/communityaffairs/national.

There's a Lot to Learn about Money

APRIL 1—COLLINSVILLE, ILL.

The Community Affairs office of the St. Louis Fed is sponsoring this financial education program. Its purpose is to make bankers, community organizations and other interested parties aware of the financial education programs that are offered in Illinois.

How to Work with the Latino Community

MAY 14—ST. LOUIS

This Community Affairs program is for bankers, government agencies and community organizations that serve Latino immigrants, and is sponsored by the St. Louis Fed and the FDIC.

For information on the above programs, contact Diana Zahner at (314) 444-8761.

FED EXCHANGE

An information-sharing event for regional Fed customers

2003 SPRING SEMINAR SERIES

FOURTH DISTRICT:

APRIL 8, 2003
PITTSBURGH, OHIO

MAY 8, 2003
COLUMBUS, OHIO

MAY 13, 2003
CLEVELAND, OHIO

MAY 22, 2003
LEXINGTON, KY.

EIGHTH DISTRICT:

APRIL 8, 2003
ST. LOUIS, MO.

MAY 6, 2003
MEMPHIS, TENN.

MAY 15, 2003
LITTLE ROCK, ARK.

MAY 21, 2003
LOUISVILLE, KY.

Fed Exchange is a new educational forum for financial institutions and is co-sponsored by the St. Louis and Cleveland Feds.

For information, call Debbie Boren at (314) 444-8946, or 1-800-333-0810, ext. 44-8946.