THE FEDERAL RESERVE BANK of ST. LOUIS

Central Banker

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News and Views for Eighth District Bankers

Fed Launches Personal Financial Education Campaign

The Federal Reserve System believes educated consumers can play a key role in promoting a healthy economy. But with a constant flow of new products and changes hitting the financial markets, consumers are hard-pressed to keep up. Statistics show that financial stress is continuing to take a toll, as evidenced by the growth in household debt (relative to income), delinquent payments on bills and even bankruptcies.

Starting this spring, the Fed is stepping up efforts to lend a helping hand with the launch of "There's a Lot to Learn about Money," a nationwide personal financial education campaign.

"No matter who you are, making informed decisions about what to do with your money will help build a more stable financial future for you and your family," says Fed Chairman Alan Greenspan. He is playing a key role by starring in public service announcements airing on English and Spanish television.

The St. Louis Fed is doing its part to promote financial literacy through:

- a personal financial education web site for consumers, which you can find via our national economic education site, federalreserveeducation.org (click on "By Region");
- collaboration with John Bryant, founder of Operation Hope, to bring his personal financial education classes to St. Louis area children, and participation by Bank President Bill Poole in the June 18 kick-off event at the Herbert Hoover Boys & Girls Club;
- publications and meetings that encourage bankers to participate in personal financial education projects, such as the state "Bank at School" programs; and
- volunteer efforts by Fed employees in various programs, including Gateway to Financial Fitness in the St. Louis area, designed for low-income adults; local Jump$tart Coalition events, which focus on youth education; and the International Institute of St. Louis' banking and credit series for immigrants. ■

Fed Expands ACH Network to Europe and Mexico

Two years after introducing ACH services between the United States and Canada, the Fed will begin piloting cross-border payment systems with Europe and Mexico as well, the Federal Reserve Board announced recently. FedACH International℠ will offer ACH to Mexico and five European countries—Austria, Germany, the Netherlands, Switzerland and the United Kingdom. Pilot tests will begin near the end of the third quarter, with the system expected to be in full operation by the fall of 2004. About 10 banks will be involved in each pilot test.

While the European service will be two-way, the Mexican service will initially include transfers only from the United States to Mexico. Transactions in the opposite direction will be added before the pilot is complete. Eventually, the Fed hopes to expand its ACH network to other continents, including Asia and South America.

The Minneapolis Fed, which currently serves as the outgoing gateway for ACH transactions going to Canada, will fill that same role for Mexico and Europe, as well as for future network participants.

In the new markets, ACH transfers will be converted to the local currency at their destination. Currently, Canadian funds can be received in U.S. currency because Canada is a dual-currency nation that accepts U.S. dollars. This feature will not be an option for ACH transactions with Europe or Mexico. ■

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Feditorial

Community Banks Are Here to Stay

By Julie L. Stackhouse, Senior Vice President, Banking, Supervision and Regulation

On a local St. Louis street corner sits a family grocery store called Freddie's Market, where older residents recall shopping as children.

Nothing is particularly unusual about this small store except, perhaps, that it is still in business. Just down the road is a regional chain store that dominates the local grocery market. The chain's better selection and cheaper prices have driven nearly every other independent grocery store in town out of business.

A few years ago, some claimed that community banks would follow a similar fate, suggesting there would be only a few thousand community banks left at the turn of the 21st century. Yet, here we are in the spring of 2003 with more than 7,000 U.S. community banks in operation.

Despite a wave of consolidation, we have seen community banks thrive using a business model built on personal relationships and trust. Typically, large banks can deliver lower prices and better selection, but they lack the personal relationships that set community banks apart. Indeed, some Internet-only banks are struggling because they are unable to develop this trust relationship.

The personal relationship with borrowers gives community banks an edge in small-business lending. Intangible information, such as an entrepreneur's reputation in the community, is obtained more easily by a local, community banker. Additionally, community banks often are more flexible in tailoring their loan policies to small-business customers. Because small-bank loan officers are closer in the chain of command to senior managers, they generally deal with less bureaucracy and, therefore, have more discretion in lending with "exceptions."

Despite these advantages, community banks still must overcome significant hurdles. Larger banks will continue to lure customers who value wider product selection and lower prices. Moreover, by tailoring loan and deposit terms to individual customer needs, community banks may find themselves with higher levels of liquidity and interest-rate risk than they experienced previously. The challenge for community banks will be to provide excellent customer service while incorporating more advanced risk-management strategies.

From all that we have seen, our community banks are up to the challenge! ■

Oct. 1 Is Deadline for USA Patriot Act Compliance

Financial institutions have until Oct. 1 to come into full compliance with the final regulations that implement Section 326 of the USA Patriot Act. These regulations require certain institutions to establish procedures that:

• verify the identity of a person opening a new account,

• maintain records of the information used to verify the person's identity and

• determine whether the person appears on any list of known or suspected terrorists or terrorist organizations.

The regulations apply to banks and trust companies, savings associations, credit unions, securities brokers and dealers, mutual funds, futures-commission merchants and futures-introducing brokers. Institutions affected by the rules are required to establish a program for obtaining standard identifying information—such as name, address, date of birth and Social Security number—from new customers.

Financial institutions affected by the new rules must also develop procedures to verify the identity of existing customers within a reasonable period of time. Many financial institutions may ask for standard identification such as a driver's license or passport, but the final rule gives institutions the flexibility to choose other methods based on their individual circumstances.

The USA Patriot Act regulations are part of a continuing national effort to fight crimes such as money laundering, terrorist financing, identity theft and other forms of fraud while also giving financial institutions flexibility in how they implement the new rules. The rules were developed jointly by the Treasury Department, Treasury's Financial Crimes Enforcement Network and seven federal regulators, including the Federal Reserve Board. ■

THE NEW COLOR OF MONEY: Safer, Smarter, More Secure

In their ongoing efforts to stay a step ahead of counterfeiters, the Federal Reserve System and the U.S. Treasury Department are once again launching a redesign of U.S. currency. But this latest revamp is no small change. For the first time since 1905, paper money will feature colors besides black and green.

The Series-2004 currency redesign effort, unveiled in May by the Bureau of Engraving and Printing, gets under way in late 2003 when the new $20 note will be issued. The new $50 and $100 will follow, in 2004 and 2005, respectively. (A future redesign of the $10 and $5 notes is still being considered, but no changes are planned for the $2 and $1 bills.)

The most noticeable difference in the redesigned bills is the addition of subtle background colors on each side of the new notes—with different colors planned for each denomination. The colors will help visually impaired consumers, in particular, tell one denomination from another.

But the Fed and Treasury's primary goal in spicing up the color palette of our currency is to throw yet another roadblock in the path of counterfeiters, with the hope that the burden of copying extra colors will be enough to discourage many would-be criminals.

In doing so, the Fed and Treasury hope to duplicate or exceed the success of the last currency redesign, in 1996, which has resulted in lower counterfeiting rates despite advances in computer and printing technology that have made counterfeiting easier and cheaper. (See sidebar.)

The new $20 design does retain three important security features that were major components of the 1996 series: a faint watermark image, a security thread and color-shifting ink so that the numeral in the lower-right corner of a note changes color when the note is tilted. The new notes include a more dramatic color shift, making it even easier for consumers to check their money.

In addition, each denomination of the new currency will feature different symbols of freedom on the face of the notes. The currency will still keep its traditional look, with notes remaining the same size and bearing the same—but enhanced—portraits and historical images.

With the introduction of Series-2004, the Fed and Treasury are launching a broad public-education program, targeting cash-handlers (such as cashiers and bank tellers), merchants and associations that represent key industries and audiences. The campaign will include training materials, public service announcements and even mentions of the new money in the story lines of popular television shows.

For more information on training materials, as well as updates on when the redesigned currency will be available, visit the St. Louis Fed's web site, www.stlouisfed.org.

FED, TREASURY MAKE GAINS AGAINST COUNTERFEITERS

Counterfeiting has declined markedly since the 1996 U.S. currency redesign, and efforts to stop it continue to be effective, according to a recent joint report issued by the Federal Reserve System and the U.S. Treasury Department.

Currently, approximately one or two counterfeit notes are detected within every 10,000 genuine notes worldwide, according to the report—leaving counterfeit notes at just .01 percent or .02 percent of the approximately $650 billion in circulation. And from 1995 to 2002, while the value of U.S. notes in circulation worldwide grew by about 7 percent a year, the value of counterfeit notes detected by the Fed declined from $54 million to $42 million.

The Fed and the Treasury credit the 1996-Series currency changes as well as increased education, awareness and law enforcement efforts for their success. But they note that those efforts will have to continue at the same pace as counterfeiters increasingly discover easier and cheaper digital methods.

In the past, counterfeiting was the exclusive practice of organized criminal groups with traditional printing methods and equipment. Today's counterfeiter is just as likely to be working on his or her home computer system. Last year, 40 percent of all counterfeit notes detected in the United States were digitally produced, and the U.S. Secret Service made 555 seizures of digital equipment, such as personal computers. ■

Regional Roundup

St. Louis Fed's Annual Report Now Available

The United States endured its third straight year of financial turbulence in 2002. Through it all, the roots of the U.S. financial system—the banking sector—remained deeply entrenched. The St. Louis Fed's 2002 annual report, "Financial Stability: Well-Rooted in U.S.," examines why the U.S. economy historically has been able to stand firm in the face of shocks and challenges that tend to destabilize other nations. The report also looks at the possibility of new threats to our economy that could require even more vigilance.

This year's report, which was recently mailed to District financial institutions, includes two new features: a message from management reviewing the St. Louis Fed's performance in 2002 and a "By the Numbers" section listing everything from the amount of hits on our web site to the number of cans of food our employees donated to charity.

To order additional copies, contact Debbie Dawe at (314) 444-8809, or toll-free at 1-800-333-0810, ext.44-8809. The report is also available on the St. Louis Fed's web site at www.stlouisfed.org/publications. ■

One New Web Site, Another New Look

The Federal Reserve System has debuted one new web site and redesigned another existing site. The Fed's new personal financial education web site gives visitors quick and easy access to information and resources on a number of important financial topics, from understanding credit to building wealth. The site is part of the System's overall campaign to promote personal financial education. (See page 1 article.) You can find the new site at http://www.federalreserveeducation.org/fined/index.cfm.

The System also recently redesigned its national Financial Services site, giving it a new look and new features. The site now features more intuitive navigation, a helpful and accessible "Contact Us" link, and an updated, attractive design. Visit our redesigned site at http://www.frbservices.org. ■

The Customers Speak: Survey Helps Fed Set Priorities

Late last year, the Federal Reserve System conducted a second National Customer Satisfaction Survey, asking for your feedback on our products and services. With the help of an outside market research firm, we conducted telephone interviews with CEOs at more than 2,500 financial institutions—including 272 CEOs in the Eighth District. We asked participants to rate the quality of our service in our business functions, and the results were encouraging. (See chart at right.)

BUSINESS FUNCTION	2002 SURVEY SCORE*	1999 SURVEY SCORE*	CHANGE
Accounting	63	64	–1
Billing	46	41	+5
Cash	70	72	–2
Check – Processing	70	61	+9
Check – Adjustments	40	26	+14
Check – Payor Bank Services	63	67	–4
Check – Return Items	48	38	+10
Overall Customer Service	61	60	+1

**Scores represent the percent of responses rating the service as "Excellent" and "Very Good."*

Overall, the survey findings told us the following:

- You see the Fed as a trustworthy, customer-focused national provider of payment services.
- You perceive FedACH℠ origination and receipt, Fedwire® Funds and Securities Services, and account manager knowledge of Fed products and services as strengths.
- You believe our FedACH and Fedwire consolidation efforts were successful—a success we will try to mirror in future consolidations.
- You cited noticeable improvements in Fed service areas, such as check processing and adjustments, despite tremendous industry challenges we have faced in recent years.
- You are still not completely satisfied with DOS-based FedLine® (an opinion expressed in previous surveys). We will continue to develop and enhance FedLine® for the Web applications to ensure we offer flexible, yet secure replacements for all DOS-based FedLine services.

After the 1999 survey, we took action to improve service, and it's clear that those improvements have had an impact in some of our service areas. Over the coming months, we'll identify more improvement opportunities and key priorities for the future—and we'll keep you informed of our efforts along the way. Thanks for letting us know how we're doing! ■

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Will an End to the War with Iraq Unleash Economic Prosperity?

By Kevin L. Kliesen, Economist, Research

Prior to the start of military hostilities with Iraq on March 19, numerous Fed officials, including Chairman Alan Greenspan and St. Louis Fed President Bill Poole, said that the economic expansion was being tempered by rising oil prices and "geopolitical uncertainties." In other words, businesses were unwilling to expand their payrolls and were postponing new capital investment projects until the dust settled in the Middle East and elsewhere. This uncertainty was also being reflected in financial markets (falling stock prices and increasing interest rate risk premiums). How did the conflict affect the U.S. economy? Moreover, will the war's end be the spark that starts another economic boom?

Doctors worry when a virus attacks a patient who has been weakened by another unrelated illness. In similar fashion, the conflict with Iraq was occurring against the backdrop of one of the weakest economic recoveries in the post-World War II period. Once again, the nation found itself experiencing a "jobless recovery"—much like that seen in 1991-92 after the first Gulf War.

In economics, it is sometimes difficult to link cause and effect—particularly for large, complex economies like the United States. Nevertheless, one can reasonably identify four major economic effects arising from the conflict with Iraq. First, given that Iraq is a major oil-producing country and that it is situated in an oil-rich region, the most immediate effect was a sharp rise in crude oil prices. Because modern industrial economies use large amounts of energy, users were particularly keen to guarantee an uninterrupted source should Iraq's oil fields have become damaged and taken off-line for longer than expected; to do so, users were willing to bid up the prices.

Second, with higher oil prices cutting their purchasing power, households became more reluctant to spend. Likewise, higher oil prices, increased uncertainty and a more cautious consumer led firms to trim expenses and reduce production. Both of these effects caused economic growth to slow. In turn, investors became concerned about the future growth of corporate profits and earnings. This caused stock prices to fall, which reduced household wealth—perhaps exacerbating the cutback in spending—and increased the cost of capital for businesses.

> Conflict with Iraq was occurring against the backdrop of one of the weakest economic recoveries in the post-World War II period.

The third drag on the economy was the hit to consumer and business confidence. Economists have found that changes in consumer confidence tend to produce fairly small changes in consumer expenditures on big-ticket items like automobiles and household appliances. Surveys of firms, though, found that many were postponing, or in some cases canceling, plans for new capital investments and new hires until a clearer picture of the economic outlook emerged.

Finally, with a greater perceived threat of future terrorist attacks, leisure and business travel fell noticeably, which adversely affected the nation's travel and tourism industry. Firms also found themselves devoting more of their scarce resources to enhancing workplace security.

After their March 18 FOMC meeting, Fed policy-makers said that they expected "an improving economic climate over time" once the conflict ended. This was also the view of the majority of private forecasters in early April, as reported in the Blue Chip Economic Indicators. With the conflict over, will the economy bloom like spring flowers? This is the most likely outcome given that inflation and interest rates remain low, fiscal policy is stimulative (tax cuts and increased government spending) and oil prices have fallen significantly.

At another level, the economy is still struggling with the remnants of the investment boom of the late 1990s. With manufacturing capacity at historically high levels relative to GDP, growth of business investment spending has been weak. Further, persistent declines in stock prices (down three consecutive years) have cut household wealth significantly. Initial indications suggest that the end of the Iraqi conflict, though helpful, has not produced enough euphoria to offset the drag from these impediments. ■

FedFacts

FEDLINE® OFFERS NEW ONLINE SERVICE ENHANCEMENTS

Spring brings with it good news for FedLine® for the Web customers: new enhancements to three of our key applications, and more online service options as a result.

FedACH℠ Services

To make processing exception items easier, ACH receivers can now use FedLine for the Web to return ACH entries and to create notifications of change (NOCs) electronically.

Easy-to-navigate screens and drop-down lists automate these exception-item tasks and help you avoid having to manually enter most transaction details. If you use DOS-based FedLine® or FedPhone℠ to derive returns and NOCs, try it on FedLine for the Web and see how easy it is.

Cash Services

If you receive cash shipments more than once a week, you can now schedule your cash orders up to one week in advance. After you submit your cash order, you automatically receive an acknowledgement showing when your armored carrier can pick up your order from the Fed—a function not available on DOS-based FedLine.

This acknowledgement gives your institution a written record of your order and acts as a physical reminder of when your shipment will be available for your courier.

Accounting Services

FedLine for the Web customers will enjoy several enhancements to the accounting services suite. You'll find one of the biggest changes right on the service's home page—a link to view your daylight overdraft reports. Previously, this information was available only through DOS-based FedLine.

You'll also notice additional search options available with the "Find Specific Entry(s)" feature in Account Management Information. You now have the choice to view either deferred or future items processed today.

Getting Started Is Easy

If you are an existing FedLine for the Web customer but haven't signed up for one or more of the services, simply update your subscriber certificate request form. New web customers must complete a new form. For more information, or if you need assistance signing up, contact your account executive or visit www.frbservices.org.

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CalendarEvents

UPCOMING FED-SPONSORED EVENTS FOR EIGHTH DISTRICT DEPOSITORY INSTITUTIONS

Community Land Trust: A Tool for Neighborhood Revitalization

JUNE 4—LOUISVILLE

A seminar sponsored by the Federal Reserve Bank of St.Louis, Community Affairs Office and the Metropolitan Housing Coalition

11:30 a.m. to 1 p.m.
Louisville Urban League,
1535 West Broadway

Downtown Redevelopment

JUNE 12—EVANSVILLE,IND.

A seminar sponsored by the Federal Reserve Bank of St.Louis, Community Affairs Office

11:30 a.m. to 1:30 p.m.
YWCA, 118 Vine Street

Casinos and Local Development

AUG. 5—ST. LOUIS

A symposium sponsored by the Federal Reserve Bank of St.Louis, Community Affairs Office

Time and location to be determined.

For more information, call Cindy Davis at (314) 444-8761.