

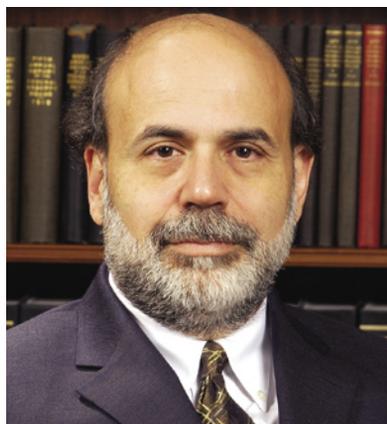


Central Banker

WINTER 2005

News and Views for Eighth District Bankers

Bernanke Receives First Nod as Head Monetary Policy-maker



Those who regularly dissect the highly quoted “Greenspanese” for predictions of the U.S. economy will soon have a new language to learn—that of Ben Bernanke. If confirmed by the Senate, Bernanke will assume his four-year post as chairman of the Federal Reserve Board on Feb. 1, 2006, ending Alan Greenspan’s 18-year reign on the job upon his retirement on Jan. 31, 2006.

Bernanke was first named to the Fed’s Board of Governors by President George Bush in 2002, and since June has headed the White House’s Council of Economic Advisers. Confirmed by the Senate Banking Committee after a one-day hearing Nov. 15, Bernanke easily won the approvals of Capitol Hill and his famous predecessor.

“The president has made a distinguished appointment in Ben Bernanke,” Greenspan states. “Ben comes with superb academic

credentials and important insights into the ways our economy functions. I have no doubt that he will be a credit to the nation as chairman of the Federal Reserve Board.”

Bernanke graduated summa cum laude from Harvard University in 1975 and received his doctorate from the Massachusetts Institute of Technology in 1979. He was professor of economics at Princeton University and then chairman of the economics department there until 2002.

Bernanke must first be confirmed by the full Senate. If approved, he will preside over his first FOMC meeting as Fed chairman on March 28. ■

Sapenaro To Succeed Rives as First Vice President at St. Louis Fed

While upcoming management changes at the top of the Fed System garner national media attention, we in the Eighth Federal Reserve District will usher in the new year with a major leadership change of our own.

David A. Sapenaro will assume the role of first vice president and chief operating officer of the Federal Reserve Bank of St. Louis on Jan. 3, 2006. He will succeed LeGrande Rives, who is retiring after 10 years of service at the Bank, plus almost 30 years in the banking industry.

Currently, Sapenaro is a senior vice president in charge of operations that provide cash management and other services to the U.S. Treasury and that serve as a central point of contact for the Treasury on behalf of the entire Federal Reserve System. Sapenaro previously supported the St. Louis Fed’s president in his role as chair of the Federal Reserve System’s Financial Services Policy Committee, which oversees providing the Fed’s services to financial institutions.

Top priorities for Sapenaro include ensuring that the Eighth

District supports District bankers as they adapt to the vast changes in payment-processing technology, such as Check 21. “I’m absolutely committed to offering services that are of high quality and competitively priced while we shepherd the transition from paper collection processes to electronic processes.”

Sapenaro also intends to build on the District’s Branching Out initiative, which began just over a year ago to strengthen the Fed’s presence around the District, especially in its branch cities of Little Rock, Louisville and Memphis.

For more information on Sapenaro’s agenda for 2006 and beyond, don’t miss his first Editorial in the next issue of *Central Banker*, due out late this winter. ■





Feditorial

My Farewell Feditorial: How Is the Payment Business Likely To Change?

By W. LeGrande Rives, first vice president of the Federal Reserve Bank of St. Louis

I will retire as first vice president and chief operating officer of the Federal Reserve Bank of St. Louis on Jan. 3, 2006. The staff of *Central Banker* suggested that I write a “final Feditorial” concerning the changing landscape of the payment business. Even though it sounded like an invitation to write my own obituary, I agreed to do so.

I’ve been involved with the payments system in various capacities since 1968—first as a consultant to financial institutions, then as a commercial bank operations manager and now in my assignment here at the Fed. Having observed and participated in the forecasting of a future “checkless society” by some of the leading operations pundits in the ’70s and ’80s, it’s unlikely that I’m going to offer any predictions for the payment business of the future. But I will leave you with a couple of observations based on my experience.

Ultimately, the types and forms of payments most widely used will be decided by the consumers—individuals and businesses. While financial institutions and others continue to invent and offer various payment “whiz-bang” alternatives, consumers will not adopt these alternatives to any large extent unless they view them as convenient, secure, low-cost and reliable. Checks have survived because to some degree they’re all these things. And it’s unlikely that consumers will readily abandon any form of payment that meets these criteria—particularly something as longstanding and engrained as the writing of a check.

The number of overall payments will likely continue to grow. While the percentage of checks written as a percent of total payments is declining, there are still large numbers of checks being written.

Other payment options are being adopted rapidly as consumers see advantages in the alternatives. Perhaps some of the greatest recent impact on the number of checks being processed by the Fed and financial institutions has come from technologies that convert checks to electronics after the checks are written and deposited or mailed. Financial institutions and the Fed are going to be challenged to “right-size” their infrastructures to accommodate the legacy payment alternatives, as well as the increasing volume in the electronic alternatives. I don’t believe it’s going to be obvious as to when one abandons the legacy payment infrastructure without a significant risk of losing customers and/or noninterest income supported by legacy products.

But these are not observations of doom and gloom. My final comment is that over the years the financial services industry has proven to be adaptable and resilient. In addition, it includes some very creative people. As a result, some of the other predictions I’ve heard over the years—in terms of banks, credit unions and others becoming irrelevant—have also been inaccurate. Perhaps the

While financial institutions and others continue to invent and offer various payment “whiz-bang” alternatives, consumers will not adopt these alternatives to any large extent unless they view them as convenient, secure, low-cost and reliable.

more things change, the more they stay the same—at least in terms of how we, the financial services industry, adapt to consumer requirements. If you continue to do so, I believe you’ll continue to have a large market share of payments and payment-related income.

Good luck and best wishes to all the financial services industry comrades I’ve met over the years. ■

District Banks Dodge Fall Storms: What Katrina and Rita Taught Us

Although Katrina, Rita and Wilma spared Eighth District banks the brunt of their physical damage, the storms undoubtedly caused many bankers across the country to re-examine their contingency plans. Reserve banks did the same. In fact, many of those not directly affected by the damage played key roles in keeping the banking system up and running. Following are some highlights of the Fed's regional approach to supporting customers throughout the emergency, as well as a brief reflection of some lessons learned.

Let the Juggling Begin

When news of the first hurricane hit, the Sixth Federal Reserve District, headed by the Federal Reserve Bank of Atlanta, put its contingency plan to the test. With floodwaters rising and virtually the entire city of New Orleans evacuated, the Atlanta Fed's branch there was forced to close, and numerous services—including cash and check processing—had to be rerouted.

Fortunately, several Fed branches around the Fed System had already been designated as "buddy sites" to help in the event of a disaster in that region. Several Fed sites across the Sixth District and beyond stepped in immediately to provide cash services to Gulf region customers. The Atlanta office took in rerouted check processing from its closed branch.

The Memphis Branch, located in the Eighth District, was one of the designated buddy sites that provided cash services. As an office that serves as the Federal Reserve System's consolidated food coupon processing site, Memphis had almost every financial institution set up in its accounting operation system. This made it relatively easy and straightforward for financial institutions impacted by the hurricane to obtain cash services from a site that they would otherwise not have had access to.

Memphis Takes the Lead in Destroying Contaminated Currency

The Memphis Branch not only assisted by providing cash services, but also took the lead in destroying currency contaminated during the disaster. Because of exposure to hazardous chemicals and sewage in a flood at a New Orleans armored car facility, the currency had to be burned, rather than simply shredded. Memphis officials coordinated this effort, and with the aid of an off-site technique called hot-burn incineration—at a temperature of 1,600 degrees—the currency was successfully destroyed.

Fed's Response Credited to Creative Partnerships and Cooperation

Communication is a critical part of any contingency plan, but what happens when traditional communication vehicles are completely unusable? In this case, the Fed capitalized on strategic channels that already existed.

"We worked directly with our armored carrier services and considered them as primary conduits for communication," Matthew Torbett, assistant vice president at the Memphis Branch, states. "Since most armored carriers had facilities in the affected areas, they had first-hand relationships with

many of the banks impacted and were considered a primary channel for information between bankers and the Fed."

In a cooperative effort among its employees, Memphis extended its hours of operation to meet customer needs, filling orders that were called in past deadlines, even receiving and processing orders on Saturday, Sunday and Labor Day. The Memphis cash operation processed orders for 20 consecutive days following Hurricane Katrina. Other buddy sites had similar responses.

Lessons Learned

Using tools from its contingency plan and a commitment to customer service, the New Orleans Branch resumed some cash operations by late September, just four weeks after the first hurricane hit and months before it was expected to open.

Now, after the critical phase of the emergency ended, is when the real evaluations of the Fed's contingency efforts begin, of course. The Fed reaped the value of partnerships across many services and will, as an organization, continue to discuss best practices in order to respond effectively to any future emergencies.

Torbett considers his experience on this issue to be valuable to the Fed and worthy of sharing with bankers, as well. "We must engage all available parties in emergency planning and seek additional partnerships for times when normal communication channels may not be available," he says.

The Federal Reserve Board established and continues to update a web page featuring operational and regulatory guidance on issues raised by the recent disasters. (See shaded box.) These documents and other helpful links might help your institution learn more about the Fed's response and how to best prepare for future situations. ■

Federal Reserve Board Resources and Updates

For more information on the Fed's official responses to hurricanes Katrina and Rita, go to the Federal Reserve Board's hurricane web page at www.federalreserve.gov/hurricanekatrina.htm. There, you will find official Fed documents issued by the Board, as well as links to additional resources from the Atlanta Fed, Dallas Fed, FDIC, FFIEC, FTC, SEC and the U.S. Treasury.

Regional Roundup

New Research Publication Highlights Regional Development

The St. Louis Fed this fall launched a new online research publication called *Regional Economic Development*. The new journal features local and regional economic development, with particular focus on the Eighth Federal Reserve District.

In its debut issue, the publication releases papers from the Bank's first conference of the Business and Economics Research Group (BERG) and includes discussions of income inequality around the region, the effects of the 2001 economic recession on the Eighth District and economic growth in middle Tennessee.

To read this issue or to receive notice of subsequent issues, go to <http://research.stlouisfed.org/publications/red/notify/>. ■

Courtney Named Senior VP at the St. Louis Bank

Judith A. Courtney has been named senior vice president by the St. Louis Bank's board of directors. Upon the Jan. 3 effective date, Courtney will lead the Bank's Treasury Relations Division and serve as the product manager for the Treasury Relations

and Support Office (TRSO). She succeeds David Sapenaro, who will become first vice president and COO of the Bank upon LeGrande Rives' retirement in January. Throughout her 39 years at the Fed, Courtney has held a number of management positions, including her most recent as vice president and deputy product manager of the TRSO. ■

Study Shows Businesses Grow When Government Takes a Back Seat

A new study by the St. Louis Fed finds that less is more when it comes to government intervention into small business.

The study, *Passive Policies for Entrepreneurs*, asserts that the absence of government intervention creates a better climate for entrepreneurship. In reality, policy-makers and community development leaders often pursue active policies when recruiting businesses, such as targeted tax breaks, subsidies or other incentives. The authors of the report present evidence that passive policies—for example, policies that involve overall reductions in regulations and taxes—lower the general cost of running or starting a business and increase rates of entrepreneurship.

The study is available online at www.stlouisfed.org/community. The printed version is available for free by calling Cindy Davis at (314) 444-8761 or toll-free at 1-800-333-0810, ext. 44-8761. ■

St. Louis Bank Has New Address

Eagle eyes may have noticed a change in the St. Louis Bank's official address recently. That's because the Bank's main lobby expansion project is now complete, making the Bank's old street address of 411 Locust St. literally obsolete.

The remodel project not only creates a redesigned entrance for the public and employees, but enhances security around the Bank's perimeter through its expansion into previous city streets and the addition of a guarded vestibule to the already guarded main lobby. The space outside the entrance, once open to vehicles, is now a pedestrian walkway formally known as Federal Reserve Bank Plaza.

Mail to the St. Louis Bank should now be sent to: Post Office Box 442; St. Louis, MO; 63166. ■

Reg CC Amendments Address Remotely Created Checks

On Nov. 21, the Federal Reserve Board approved amendments to Regulation CC that define remotely created checks and shift liability for unauthorized remotely created checks to the institution holding the account for the person who created and deposited the item. The amendments are effective July 1, 2006.

Currently, the law in most states specifies that a paying bank must bear the loss when it pays a check that was not authorized by the accountholder. A remotely created check typically is created when a checking accountholder authorizes a payee to draw a check on the account but does not actually sign the check; thus,

remotely created checks do not bear handwritten signatures of the accountholder that can be verified by the paying bank before the midnight deadline.

In recognition of the particular vulnerabilities of remotely created checks, the amendments to Regulation CC create warranties that would apply only to banks and would ultimately shift liability for the loss created by an unauthorized remotely created check to the depository bank. The amendments do not affect the rights of checking account customers, because they are not liable for unauthorized checks drawn on their accounts. ■



Does the Oil Futures Market Accurately Predict Energy Prices?

By Michael R. Pakko

Michael R. Pakko is a senior economist at the Federal Reserve Bank of St. Louis. This article is adapted from the July 2005 issue of National Economic Trends.

Although the official 2005 hurricane season is behind us, the ripple effects of this year's storms will be felt for some time. One of the more widely felt economic impacts is on energy prices, resulting in gasoline costing more than \$3 per gallon at times. The good news is, as refineries are brought back online, temporary supply constraints have been alleviated, and prices are beginning to recede to pre-hurricane levels.

In the longer term, however, the outlook for energy prices is not so easy to forecast because it is dependent on conditions in world oil markets, rather than on current events. Even before the hurricanes impaired domestic production, world oil prices were at historic highs. At its peak, oil was trading at well over \$60 per barrel, up from about \$25 per barrel in early 2002. This rapid run-up in prices has generated uncertainty about the long-term outlook: Will recent high prices persist, or will world oil prices moderate as supply and demand continue to adjust?

Some analysts look to the market for oil futures as a source of information on prospective prices. Futures markets provide a direct reading on the price of a contract to deliver oil at a specified future date. Although we might expect that prices on these contracts would provide information about future spot prices, futures prices have not historically provided very accurate predictions. That's because the spot price of oil, which is the price of oil available for immediate delivery, reflects information about both

current and expected future supply and demand conditions. Futures prices reflect the same information; so, the spot and futures prices tend to move closely together.

To examine this further, let's look at the recent history of the futures market. As oil prices rose during 2004, prices of oil futures contracts were persistently lower than spot prices. Were futures markets erroneously predicting a reversal before news of the hurricanes hit? More recently, as prices approached their current highs, this pattern reversed: Futures prices now lie above spot prices. Are the markets now predicting even higher oil prices in the future?

Not necessarily. These apparent misprojections are actually indicative of some particular details of the spot and future markets for oil; interpreting the patterns as predictions of future spot prices can be misleading.

In general, there is a marked tendency for futures prices to lie below spot. In the jargon of commodity futures markets, this is known as "backwardation." Backwardation in the oil futures market is related to a consideration known as "convenience yield," the marginal benefit of holding a commodity in reserve. For oil, the convenience yield lies in the option-value of allowing oil to remain in the ground. By not pumping oil in the first place, the owner of an oil field retains the option of increasing production at a later date. An unanticipated need for oil in the future is often more conveniently and less expensively met by pumping additional oil, rather than buying it on spot markets. The presence of a convenience yield acts to push futures prices below spot prices.

Storage costs and interest costs provide an opposing effect on the relationship between spot and futures prices. Unless one has direct access to an oil production facility, a promise to deliver oil in the future requires the purchase of oil on the spot market, the interest cost of borrowing to finance that purchase, plus storage costs. The interest costs and storage costs comprise the total carrying cost of oil. When carrying costs exceed convenience yields, futures prices should exceed spot prices—and vice versa.

Backwardation characterizes the oil futures market more than two-thirds of the time, implying significant convenience yields in the oil market. Recently, however, futures prices have risen above spot prices—a situation known as a "contango" market. One possible explanation for the emergence of this pattern is that futures prices are signaling an expectation of rising spot prices. On the other hand, the current high price of oil for immediate delivery might be suppressing convenience yields—a development that would be consistent with lower oil prices over time as producers increase their output.

When considering the convenience yield factor, we are left with the conclusion that prices of futures contracts convey little exploitable information about future spot prices. ■

FedFacts

New \$10 Note Coming Soon

The new, more secure design for the \$10 note, unveiled in late September, will hit circulation early in 2006. Most noticeably, the new note incorporates subtle background colors in shades of orange, yellow and red. It also features several new torch symbols, which are a unique characteristic of the redesigned \$10 denomination. For more information about how to recognize these and other changes, go to the Bureau of Engraving and Printing's web site at www.bep.treas.gov. ■

Brochures Guide Home Buyers to Home Counseling Services

The St. Louis Fed recently updated its series of brochures highlighting resources for potential home buyers. The brochures are now available for order and display as lobby promotions.

The brochure series, entitled *Learn Before You Leap*, focuses on organizations that provide housing counseling in the major cities of the Fed's Eighth District: Little Rock, Louisville, Memphis and St. Louis. The organizations listed provide advice on every step of the home-buying process, from budgeting income to negotiating a contract to closing on a loan.

Learn Before You Leap is available at www.stlouisfed.org/community; click on "Other Publications." Multiple copies can be ordered from Julie Kerr in Little Rock,

(501) 324-8296; Kendra Keller in Louisville, (502) 568-9202; Cathy Martin in Memphis, (901) 579-4102; or Cindy Davis in St. Louis, (314) 444-8761. ■

New Fees for Priced Services Reflect Fed's Cost-Cutting Initiatives

Fee schedules for 2006 Federal Reserve Financial Services are now available online at www.frbservices.org/FeeSchedules. The new fees become effective Jan. 3, 2006.

Prices in most of the priced-service areas will remain stable or decline next year, thanks in part to recent Fed initiatives to improve operational efficiencies and reduce costs. Responding to the national trend away from the use of checks and toward more efficient electronic payment alternatives, the Fed

continued to introduce and enhance the more efficient electronic products. Price increases affect mainly manual, paper-based payment processing services. ■

FOMC Releases 2006 Meeting Dates

The Federal Open Market Committee has announced its tentative meeting schedule for 2006:

| | |
|------------|----------|
| Jan. 31 | Aug. 8 |
| March 28 | Sept. 20 |
| May 10 | Oct. 24 |
| June 28/29 | Dec. 12 |

Each meeting date is tentative until confirmed at the meeting immediately preceding it.

2006 Holiday Schedule:

Federal Reserve System

| | |
|----------------------------|----------|
| New Year's Day | Jan. 2 |
| Martin Luther King Jr. Day | Jan. 16 |
| Presidents Day | Feb. 20 |
| Memorial Day | May 29 |
| Independence Day | July 4 |
| Labor Day | Sept. 4 |
| Columbus Day | Oct. 9 |
| Veterans Day | Nov. 11* |
| Thanksgiving Day | Nov. 23 |
| Christmas Day | Dec. 25 |

**For holidays falling on Saturday, Federal Reserve banks and branches will be open the preceding Friday.*



P.O. Box 442
St. Louis, Mo. 63166-0442

Managing Editor
Stephen Greene
(314) 444-8636
stephen.p.greene@stls.frb.org

Central Banker is published quarterly by the Public Affairs department of the Federal Reserve Bank of St. Louis. Views expressed are not necessarily official opinions of the Federal Reserve System or the Federal Reserve Bank of St. Louis.