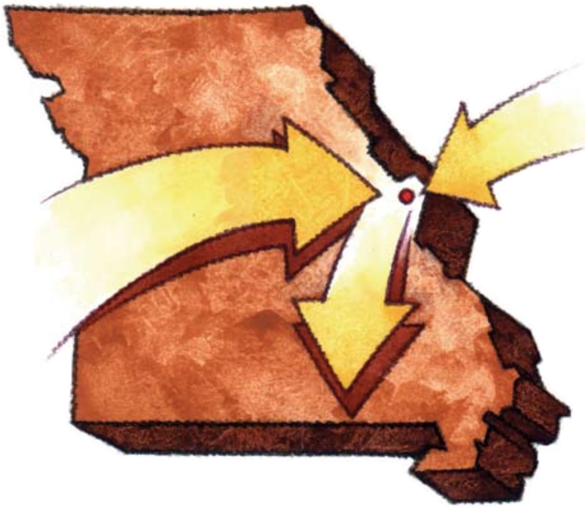
FEDERAL RESERVE BANK OF ST. LOUIS

Central Banker

FALL 2006

News and Views for Eighth District Bankers

Fed Consolidating Adjustments in Mid-2007 and Check Services by 2008



Continuing the Federal Reserve's strategy to serve our customers in the most efficient way possible, the Fed announced changes in the spring to check processing and adjustment operations as consumers and businesses continue the shift from paper checks toward electronic payments. As part of these changes, the Kansas City Fed's check processing operations will be consolidated into St. Louis'.

Although no firm date for the transition has been determined, it is expected to take place in late 2007 or the first half of 2008.

In addition, the Eighth District's check adjustment operation will be absorbed into a regional adjustment site in mid-2007.

Because adjustments are already submitted to a central site—the Richmond Fed's Charlotte office—and researched remotely from various other Reserve offices, the consolidation of Eighth District adjustments to a regional site will be transparent to customers. You will notice no difference in the high quality and speed of service you have come to expect from the Fed.

These changes will help us reduce check service operating costs to bring them in line with the continuing shift in consumer and business preferences for electronic payments. In addition, these changes support our long-term strategy to use Check 21 to collect more checks electronically, reducing the reliance on the physical transportation of checks.

We'll let you know the final details once we know the dates of the consolidations. ■

Fed Develops New Check Adjustments Process for Remotely Created Checks Reported as Unauthorized

Late last year, the Federal Reserve Board of Governors amended its Regulation CC to include a definition of a "remotely created check" and create transfer and presentment warranties for these items.

In place of a signature, a remotely created check generally bears the customer's printed name or a statement that the customer authorized the check. Any bank that transfers a remotely created check guarantees that the person on whose account the check is drawn authorized the check, which ultimately shifts liability for an unauthorized remotely created check to the depository bank.

Now the Fed has implemented a new adjustment process for a remotely created check reported as "unauthorized" by the person or entity on which the item is drawn. A paying bank must request the adjustment within 90 calendar days of presentment. Reserve Bank adjustment staff will credit the requesting bank within five business days of receipt of a complete adjustment request, with the customer's written statement asserting under oath that the item was unauthorized.

The Reserve Bank generally will charge the bank of first deposit for the disputed item within 20 business days of receipt of a complete adjustment request. A depository bank that has reason to believe the item in question was, in fact, authorized, should work directly with its depositor or with the paying bank involved in the dispute. ■

Feditorial

More District Banks Are Choosing the Fed as Their Regulator

By Julie Stackhouse, senior vice president, Banking Supervision and Regulation

In the Eighth District, we are pleased to see a growing number of state-chartered banks choose the Federal Reserve as their federal banking regulator. At the end of 2004, the St. Louis Fed supervised 80 state banks. The number of state banks supervised will approach 100 by the end of this year.

From time to time, I am asked why more District banks are choosing the St. Louis Fed as their regulator. While I often note the experience of my staff, including my confidence in their ability to exercise good judgment in drawing fair and reasonable conclusions, I recognize that the views of the banks we supervise can be the most important barometer of our effectiveness.

So how do we seek the input of our banking constituents? Perhaps the most important thing we do is ask our state member banks for feedback. Following each examination, we conduct a survey to gain the banker's view of the quality of the examination process. Whether a safety and soundness or consumer compliance examination, bankers are asked to rate or comment on the examination team's performance in 12 areas, including the knowledge and professionalism of the staff and the consistency of exit meeting comments with the final report. The bankers' responses are submitted to an independent source to foster candor. This feedback is then used to help us continually improve our examination process.

We also hold meetings at each of our offices during the year to hear what is on the minds of bankers. This includes meetings at our satellite supervision office in Memphis. District bankers are generally complimentary of our "firm but fair" approach. To quote Tennessee banker McCall Wilson, "They (the Fed) tell me what I need to correct while offering guidance geared toward making mine a better bank. I don't want an easy exam. I'd rather have an exam that's thorough but reasonable. And they really do understand the business of banking."

We also listen to state bank commissioners in the District, whom we view as business partners. In Arkansas, a state where we've seen a number of banks convert to Fed membership, the bank commissioner tells us that state Fed-member banks like knowing that they can get quick answers to questions. He characterizes our staff as "professional," "stable" and "competent."

The business of banking supervision is not a customer service business in the traditional sense: We must ensure the safety of the federal deposit insurance fund and compliance with consumer protection laws and regulations. That being said, the business of banking supervision can be a business of mutual benefit for both the banker and the deposit insurance fund.

At the St. Louis Fed, we are committed to the results of constituent feedback. And we are also pleased to see a growing number of District banks join the Fed as members! ■

Bird Flu Plans Aren't For the Birds

Do you have a bird flu plan? If your first reaction is, "You have got to be kidding," well, actually, we're not. Because we're the nation's central bank, the Fed has to prepare for any contingency, no matter how remote the possibility.

Think of it this way: Having a plan in place for an event that may never happen can help you prepare for a disaster that actually could happen—just like insurance that you hope you never need, or the Y2K preparations for an event that turned out to be a fizzle.

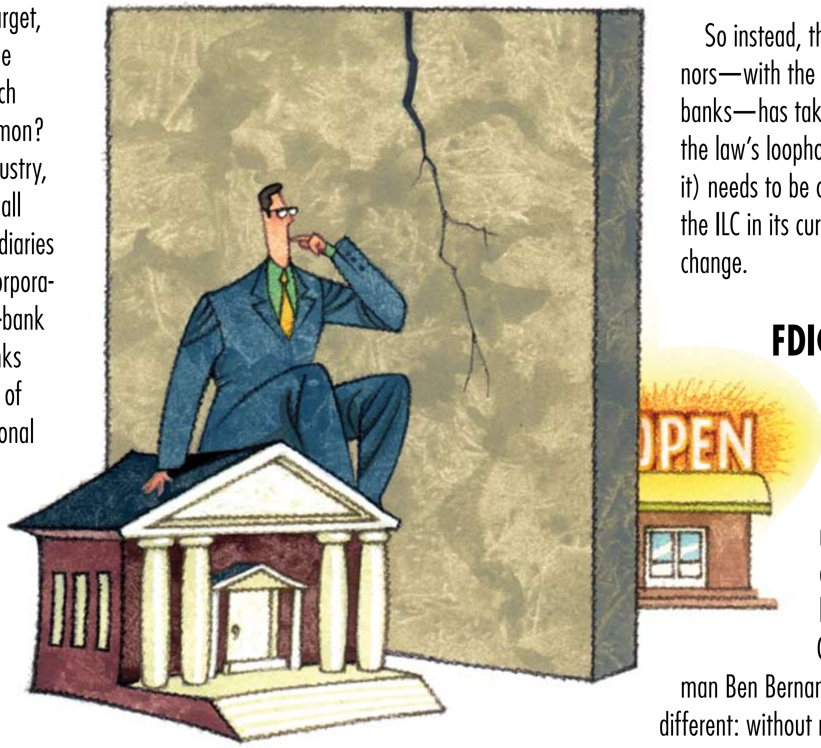
If the avian bird flu becomes transmissible from human to human, a pandemic could encompass the globe in a matter of weeks. While most disasters usually impact a single business or community, a pandemic could affect all of the country simultaneously. Therefore, community leaders must work together to prepare for a pandemic outbreak.

Key points to consider include:

- planning for the impact of a pandemic on your business, employees and customers,
- establishing policies to be implemented during a pandemic,
- allocating resources to protect your employees and customers,
- communicating to and educating your employees, and
- coordinating with external organizations and helping your community.

Guidelines for preparing your business for the impact of a pandemic are available at www.pandemicflu.gov. ■

FDIC Halts All Decisions Related to Charters of Industrial Loan Corporations



What do GE, GM, Target, Volkswagen, Home Depot, Merrill Lynch and Wal-Mart have in common? Besides being giants of industry, commerce or finance, they all have or want to start subsidiaries known as industrial loan corporations (ILCs), a type of non-bank bank that makes small banks nervous and has the Board of Governors urging congressional action.

In late July, the Federal Deposit Insurance Corp. (FDIC) placed a six-month moratorium on all ILC applications and change of control approvals. Some observers expect congress to review its 1987 law that allows any type of business to own an ILC, but we don't know when that would happen. The Federal Reserve and small banks across the country are hoping that Congress will close what the Fed believes is a loophole in the law that lets commercial companies establish these subsidiaries. ILCs have been around for about 100 years, but they were intended originally to be small, local institutions with limited lending and deposit-taking powers.

"The issue lies with the unrestricted ownership of these ILCs, and the fact that the parent companies may escape federal regulatory oversight," says Bill Emmons, senior economist and manager in supervisor policy analysis at the St. Louis Fed. Many ILCs engage in the same activities as other depository institutions insured by the FDIC—primarily performing financing or finance-processing activities. "So what we have are federally insured banks that aren't subject to consolidated banking supervision. Only the ILC itself is supervised by the chartering state and the FDIC.

"In contrast to other insured institutions, neither the state nor the FDIC have the authority to exercise oversight over an ILC's parent company," says Emmons. "The Fed naturally would prefer to see consolidated supervision of the organization to guard against systemic risk. But if you take that to its logical conclusion, it might mean that the Federal Reserve would wind up supervising the parent company, e.g. Wal-Mart or Volkswagen, which is of course not what the Fed intends."

So instead, the Board of Governors—with the support of many small banks—has taken the position that the law's loophole (as the Board sees it) needs to be closed. In other words, the ILC in its current form needs to change.

FDIC Moratorium

Before Alan Greenspan stepped down as Fed chairman, he argued the need for Fed oversight over ILCs and that the law needed to change. Current Fed Chairman Ben Bernanke's position is no different: without regulatory oversight, there is risk to safety and soundness. In addition, the GAO (Government Accountability Office) did a report for Congress and developed conclusions that was close to the Fed's position. "Small banks have been getting nervous because the way the law is written now, there is a potential for intense competition with large non-financial companies getting into banking. This could tilt the playing field against small banks," says Emmons. "Community bankers don't want to see a Wal-Mart bank branch in every Wal-Mart store."

Until recently, the FDIC didn't see a problem, as the commercial applicants such as Home Depot and Wal-Mart insisted they were looking primarily to handle credit and debt card and electronic check payments, and stay out of branch banking. But this year, the FDIC started thinking differently. According to the FDIC's July 28 press release issuing the six-month moratorium, "The growth of the ILC industry, the trend toward commercial company ownership of ILCs and the nature of some ILC business models have raised questions about the risks of ILCs to the deposit insurance fund, and whether their commercial relationships pose any safety and soundness risks."

"Is the 1987 law as written what congress intended?" asks Emmons. "Or is it a badly written law? Ideally, congress should determine whether the ILC loophole created then was an oversight or whether allowing a non-financial company to own an insured bank via an ILC was the original intent. What the Board of Governors would like to see happen is that the loophole be closed, and perhaps a time-limited grandfather clause be placed on existing commercial ILCs." ■

Regional Roundup

Louisville Board Chairman Perishes in Cycle Accident

Cornelius Martin, chairman of the St. Louis Fed's Louisville Branch Board of Directors, died in a motorcycle accident June 2 in south-central Kentucky. A Bowling Green businessman, Martin was president and CEO of Martin Management Group, the fourth-largest black-owned auto group in the nation, which owns and operates dealerships in six states along with other business entities.

He chaired Western Kentucky University's Board of Regents, served on numerous community and nonprofit organization boards and participated in automotive industry associations.

He had served on the Fed's Louisville board since January 2002.

Are Communities Friendly to Entrepreneurs?

What makes a community friendly enough for an entrepreneur to want to set up shop? The Community Affairs Office of the Federal Reserve Bank of St. Louis wanted to find out.

Recently, staffers surveyed several communities in the Eighth District to help determine their level of support for local small businesses. The Fed has published the findings and recommendations for the cities of Arkadelphia, Ark.; Madisonville, Ky.; Tupelo, Miss.; and the Illinois counties of Alexander, Johnson and Pulaski.

The survey asked small business owners and entrepreneurs to rate their own communities. The results are being shared with local leaders who have expressed an interest in using the findings to plan future community and economic development efforts.

The survey template was developed in 2003 by the Community Policy Analysis Center at the University of Missouri-Columbia. The center also produced a guide book, *Growing Entrepreneurs from the Ground Up: A Community-based Approach to Growing Your Own Business* available at www.mrdp.net.

For copies of the surveys, call Fed employees Pam Haynie at 501-324-8205 for the Arkadelphia, Ark., report; Kendra Keller at 502-568-9202 for the Madisonville, Ky., report; Gloria Irving at 901-579-4101 for the Tupelo, Miss., report; and Cynthia Davis at 314-444-8761 for the Illinois counties reports.

Navigate Through Check and Adjustment Changes

Keep current on changes in check processing and adjustments services by attending one of the 2006 FedExchange seminars and check adjustments training sessions hosted by the Federal Reserve banks of Cleveland and St. Louis:

- Nov. 7, St. Louis
- Nov. 9, Elizabethtown, Ky.
- Nov. 14, Tunica, Miss.
- Nov. 15, Little Rock, Ark.

At FedExchange, you will hear from industry experts on topics such as strategy for superior customer service, check image exchange, fraud, pandemic influenza and ACH industry updates. Concurrent sessions on check adjustment training will also be provided. Invitations and program details were to be mailed in August.

Watch for more information on our web sites at www.clevelandfed.org or www.stlouisfed.org. If you have any questions, contact Sandy Runyon at 216-579-2158. ■

FinCEN Finds Suspicious Check-Cashing Activity

Check cashing and money transmission are two of the suspicious activities most reported by the Financial Crimes Enforcement Network's (FinCEN) examination of money service businesses (MSBs). MSBs include certain non-bank financial institutions that offer financial services.

The May 2006 issue of *The Suspicious Activity Review* published by the FinCEN focuses on MSBs, which need banking services to operate. A study of suspicious activity reports filed between 2002 and 2005 revealed approximately 13 different types of MSB-related suspicious activities. Check cashing was the activity most often reported, followed by money transmission.

Unregistered check cashers appeared to be most concentrated in the central United States, especially Tennessee and Illinois. The issue is available on FinCEN's web site www.fincen.gov under BSA Guidance, SAR Information. ■

Gas Prices: Don't Panic … Yet

By Riccardo DiCecio

Riccardo DiCecio is an economist at the Federal Reserve Bank of St. Louis.

Do you find yourself watching the corner gas station to see if the price of a gallon of gas rose or dropped 10 cents overnight? While the $1 gallon seem to be long gone, real gas prices aren't the highest they could be.

During April 2006, the U.S. average retail price of gasoline increased from $2.73 to $2.97 per gallon and remained above $2.90 in May and the first half of June.[1] This increase was evenly distributed across U.S. regions, leaving the historical differences in prices across regions unaffected. For example, gas is 10.4 percent more expensive on the West coast than the national average—but 2.5 percent cheaper here in the Midwest than the national average.

Analysts sometimes play down consumers' concerns about the high prices of gas by noting that in real terms (that is, relative to other goods and services) gas is still relatively cheap compared with prices in the late 1970s and early 1980s. However, the recent increases in the prices of oil and gas undermine this argument.

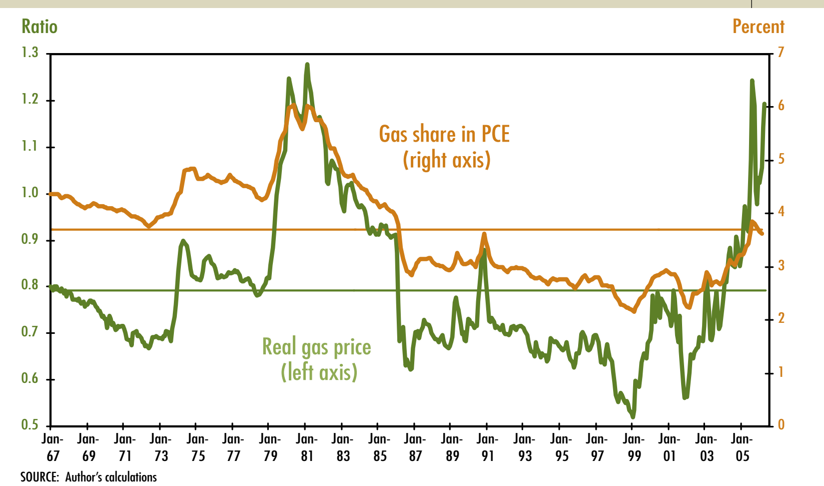
Take a look at the adjoining chart. The consumer price index (CPI) for all items provides a measure of prices of all goods and services. The Bureau of Labor Statistics also publishes consumer price indices for expenditure categories, including one for gasoline. The chart tracks the real price of gasoline since 1967, i.e., the ratio of the CPI for gasoline to the CPI for all items. Even disregarding the September 2005 spike due to Hurricane Katrina, it is clear that gas has become more expensive in relation to other goods since 2003.

The real gas price has not yet reached record high levels, but it is above the long-run average and comparable to mid-1980s levels.

Gasoline price inflation tracks closely with the growth rate of the price of oil. The price of oil in the week of April 21 crossed the $70 per barrel threshold, and has remained around $70 per barrel ever since.[2] The high oil price is the result of sustained world demand at a time when several factors have restrained the supply of oil. The world demand is fueled by sustained growth in oil-hungry China and India, continual demand from the United States and Japan's recovery. On the supply side, the oil industry does not have much spare capacity. Any disruption would be reflected immediately in higher spot oil prices. For example: the war in Iraq, rising tensions in United States-Iran relations, civil unrest in Nigeria and so on. Futures prices suggest that the prices of oil and gasoline are likely to remain high in the medium term.

Even if the real price of gasoline is high by historical standards, and trending toward record levels, the trend will have to be sustained for quite some time before most U.S. consumers trade in their cars, trucks and SUVs for smaller and more fuel-efficient cars. The fraction of personal consumption expenditures (PCE) spent on gasoline (as shown by the orange line in the chart) is on the rise, but close to its historical average (3.7 percent) and much lower than the 6 percent peak in the early 1980s.[3]

So don't panic about gas prices … yet. ■



SOURCE: Author's calculations

ENDNOTES:

1 Weekly data for gasoline prices (all grades) from the Energy Information Administration: http://tonto.eia.doe.gov/dnav/pet/pet_pri_gnd_dcus_nus_w.htm.

2 Domestic spot market price: light sweet crude oil, WTI, Cushing. SOURCE: *Wall Street Journal*/Haver Analytics

3 See also Cashin, David and McGranahan, Leslie. "Household Energy Expenditures, 1982-2005." Chicago Fed Letter, June 2006, (227).

FedFacts

Fed Offers New FedACH Risk Origination Monitoring Services

The Federal Reserve banks have a first-of-its-kind service to help institutions mitigate ACH risk. The new FedACH Risk Origination Monitoring Service provides the ability to customize monitoring criteria at the company ID level or a specific routing number. You can also monitor accumulated totals over the origination processing day or multiple exposure days.

The service provides e-mail notification of batches pended due to breached caps. Institutions can also set end-of-day defaults to reject or release pended batches in extraordinary situations where batches remain pended at end of day. For more information, go to www.frbservices.org.

Lincoln Getting a Facelift

Honest Abe is getting a makeover. The U.S. Treasury has announced that the $5 note, which features President Abraham Lincoln on the front, will be redesigned. The U.S. Secret Service has detected a pattern of counterfeiters bleaching the ink off $5 notes and then printing $100 notes on the paper. The security features on the $5 and $100 notes are in similar places. The new $5 note is expected to be issued in early 2008, with a new $100 note to follow.

CalendarEvents

UPCOMING FED-SPONSORED EVENTS FOR EIGHTH DISTRICT DEPOSITORY INSTITUTIONS

Affordable-Housing Bus Tour and Forum

MEMPHIS—SEPT. 19

Tour three affordable, single-family housing developments in Memphis. The forum will address challenges in developing home-buyer counseling programs. Lenders; affordable, single-family housing developers; and other housing professionals will find this event useful. For information, visit www.stlouisfed.org/community or call Cindy Davis at 314-444-8761.

Exploring Social Return on Investment

ST. LOUIS—OCT. 11

The Federal Reserve Bank of St. Louis and the St. Louis Metropolitan Association for Philanthropy are teaming up for the third event in the Improving Access to Community Development Capital Series. For information, visit www.stlouisfed.org/community or call Matthew Ashby at 314-444-8891.

The Rise of Personal Bankruptcy

ST. LOUIS—OCT. 24

Thomas A. Garrett, research officer at the Federal Reserve Bank of St. Louis, will present his study on the reasons more Americans are filing for bankruptcy. While job loss, medical bills and divorce are among the most common causes, the study looks at other factors—such as availability of credit and bankruptcy laws—and what role they play in making Americans even more susceptible to bankruptcy. The study includes filing statistics in counties in the Fed's Eighth District. For information, visit www.stlouisfed.org/community or call Cindy Davis at 314-444-8761.

Kohn Named Board of Governors Vice Chair

Donald L. Kohn became vice chairman of the Federal Reserve's Board of Governors June 19. Kohn, a member of the Board since August 2002, replaced Roger Ferguson, who retired in April.

Before becoming a Fed governor, Kohn served as the advisor to the Board for Monetary Policy. He has also served as secretary of the Federal Open Market Committee. Earlier in his career, Kohn served as a financial economist at the Fed. ■

FEDERAL RESERVE BANK OF ST. LOUIS

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

Editor
Scott Kelly
314-444-8593
scott.b.kelly@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.*

FIRST-CLASS
US POSTAGE
PAID
PERMIT NO 444
ST LOUIS, MO