



# Central Banker

**SUMMER 2006**
*News and Views for Eighth District Bankers*

## St. Louis Fed's Branching Out Initiative Hits Web

**W**hen the Federal Reserve Bank of St. Louis started expanding its community outreach efforts in the Eighth District, as part of the Branching Out Initiative, the Bank also turned its attention toward cyberspace. Our three branch offices—Little Rock, Louisville and Memphis—now have their own web pages on the Bank's web site.

The pages are designed to be a gateway to the Fed in the branch communities. In addition to information about each branch, content includes:

- messages from the branch executives and links to articles by Fed economists;
- links to the *Fed in Your Community*, which includes summaries of conferences, workshops and speeches you may have missed;
- newly released publications;
- schedules of activities such as economic education workshops and community development events;
- handy links to regional economic data, including a direct link to FRED® (Federal Reserve Economic Data); and
- contact information for branch staff and board members.

"These pages are an excellent resource for



people seeking information about our branches," says Randy Sumner, vice president of Public and Community Affairs at the St. Louis Fed. "We plan to continue adding content in the months ahead."

The three branch pages are found at:  
[www.stlouisfed.org/about/littlerock.html](http://www.stlouisfed.org/about/littlerock.html)  
[www.stlouisfed.org/about/louisville.html](http://www.stlouisfed.org/about/louisville.html)  
[www.stlouisfed.org/about/memphis.html](http://www.stlouisfed.org/about/memphis.html) ■

## Recirculation Policy Seeks To Reduce Overuse of Bank's Vault Services

The Fed's Board of Governors announced March 17 the Currency Recirculation Policy, which will institute a fee in July 2007 to depository institutions (DIs) that "cross-ship" currency over a certain minimal amount. Cross-shipping refers to the deposit and withdrawal of currency considered fit for circulation in the same week with a Federal Reserve bank, which often causes a lot of inefficiencies in the payments system.

The policy is intended to reduce the overuse of Reserve banks' vault services. A combination of DIs working to reduce the currency in their own vaults, and an increase in third-party ATM stocking, has caused an overall increase in the size and frequency of transactions

into and out of deposit and order transactions. The policy also will reduce unneeded costs associated with this activity without affecting the quality of currency in circulation.

The recirculation policy will affect only those DIs that cross-ship large amounts of the \$10 and \$20 denominations. To aid in recirculation of fit currency, those DIs that cross-ship currency may apply to hold a custodial inventory in their vault and record it on the Federal Reserve's books. Those funds will be available to be recirculated to other banks needing fit currency. (The Fed began accepting custodial inventory applications in May.) For more information, see [www.frbsservices.org/Cash/CurrencyRecirculationPolicy.html](http://www.frbsservices.org/Cash/CurrencyRecirculationPolicy.html). ■



## Feditorial

### *Our Strategic Direction: The Big Picture*

By David A. Sapenaro, first vice president of the Federal Reserve Bank of St. Louis

**T**he Federal Reserve Bank of St. Louis' strategic direction is near and dear to my heart; I've been helping to steer it for several years. As a new chief operating officer, one of my most important responsibilities is to ensure that our constituents and employees understand where our organization is headed, and I would like to share that direction with you in this article.

Our strategic direction includes the following:

First: We seek to advance economic knowledge and to influence national macroeconomic policy through our economic research activities. While all of our work at the Bank is important, we believe our research work is our most important responsibility as a Reserve bank and, consequently, our most important goal. Through its research activities, the St. Louis Fed delivers valuable advice to President Bill Poole to use when he contributes to monetary policy decisions at Federal Open Market Committee meetings.

Second: We want to lead the Federal Reserve System's efforts to provide exceptional services to the U.S. Treasury. At its creation in 1913, the Federal Reserve was designated as fiscal agent for the U.S. Treasury—in short, the federal government's banker and service provider. A hallmark of the St. Louis Bank for the last 20-plus years has been our support for the Treasury's payments, collections and cash management activities. In 2001, we added the Treasury Relations and Support Office role to our list of Treasury responsibilities. In this capacity, we serve as the liaison between the Fed and the Treasury.

Third: We want to strengthen the ties with constituents in the District and broaden audiences for our public programs. This goal encompasses the various nonfinancial services programs we offer to our constituents in the region, including economic education, community development-related services and regional economic research. Consistent with our mission, we seek to be an externally focused organization that is providing needed services.

In support of this goal, over the last couple of years we have made a concerted effort to offer more of these services, particularly in our branch regions of Little Rock, Louisville and Memphis. We're also devoting more resources to producing economic research on topics that are beneficial to local business, community and government leaders in the Eighth District. For example, recently we held a public forum on predatory lending here in St. Louis, and this July, we'll examine just what it is that makes a business not only choose a city in which to locate, but also a specific neighborhood.

Fourth: We want to be a distinctive provider of banking supervision, check collection and cash services. Our goal is to provide you with high-quality products and services in a customer-oriented manner and to do so at the highest levels of efficiency and productivity.

By holding to our planned strategic direction, we hope that the St. Louis Fed will continue to be a strong leader in economic research, community-focused services and financial services. ■

## Fed Economists Ask: What Impacts Community Development?

Economists at the Federal Reserve Bank of St. Louis are taking a deeper look into community development in the Eighth District. In partnership with the Bank's Community Affairs department, economists are learning what factors have an impact on community development and why. The research is available for the asking.

A new study to be released this summer examines what characteristics attract businesses to a particular neighborhood. The Fed will present this study, *Neighborhood Characteristics Matter ... When Businesses Look for a Location*, during a July 19 luncheon in St. Louis. (See calendar on Page 6.)

Previously released reports are:

- *Casino Gambling in America and Its Economic Impacts*

- *Light-Rail Transit in America: Policy Issues and Prospects for Economic Development*

- *Employment Growth in America: Exploring Where Good Jobs Grow*

- *Passive Policies for Entrepreneurs*

- *The Impact of Local Predatory Laws on the Flow of Subprime Credit*

All of the published reports are available under the Research heading at [www.stlouisfed.org/community/other\\_pubs.html](http://www.stlouisfed.org/community/other_pubs.html).

Paper copies can be ordered at no charge by calling Cynthia Davis at 1-800-333-0810, ext. 44-8761, or by e-mailing [communityaffairs@stls.frb.org](mailto:communityaffairs@stls.frb.org). ■

# Missouri Bank among the First To Enjoy Full Check 21 Suite Benefits

Callaway Bank, located in central Missouri, made an aggressive decision in 2005 to adopt the Check 21 product suite through the Federal Reserve Bank of St. Louis, becoming one of the first financial institutions to adopt the full suite of electronic check-clearing services.

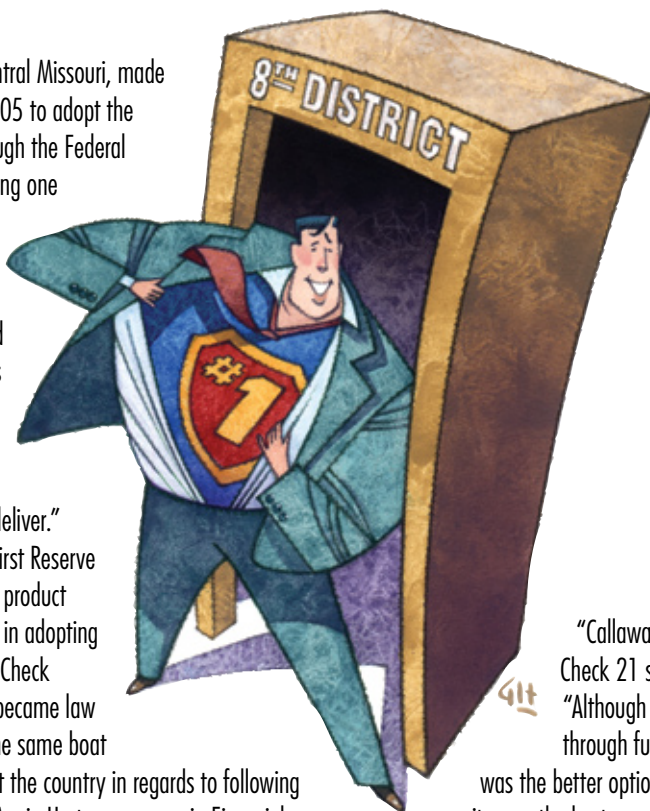
"We had choices and evaluated other clearing opportunities," says Kim Barnes, senior vice president at Callaway. "We chose the Fed because we knew they were in it for the long haul and would deliver."

The St. Louis Fed became the first Reserve Bank to offer the entire Check 21 product suite, taking a leadership position in adopting the Check 21 provisions after the Check Clearing for the 21st Century Act became law in 2003. "We were actually in the same boat as financial institutions throughout the country in regards to following and interpreting Check 21," says Angie Harter, manager in Financial Services Check Processing.

"However, the Fed has a responsibility to the payments system in that our mission is to provide and promote efficient, reliable and accessible payments services. So the Eighth District decided to take a leadership position in the implementation of Check 21 in the Fed System, being the first district to provide the new products and services while partnering with banks to show them how to most effectively use these innovations," says Harter.

Check 21 allows banks that process checks—including the Fed—to convert paper checks into electronic images, which can then be cleared electronically and presented as images or as a "substitute check"—a paper print-out of the image that has the same legal standing as the original check. During 2005, the St. Louis Fed purposely pursued testing and implementation of Check 21 products—first offering FedForward<sup>SM</sup>, followed by FedReceipt<sup>SM</sup>/FedReceipt Plus and then FedReturn<sup>SM</sup>.

- FedForward is a mixed image cash letter deposited electronically to Fed banks to clear the items and it presents either substitute checks or an electronic file to the paying banks. This product offers later-than-paper deadlines that let depositors significantly improve availability on the dollars presented.
- FedReceipt is an electronic file containing the items drawn on your financial institutions that have been deposited in image cash letters with Fed banks or converted to images by the Reserve banks. This



product is available to banks at no fee and qualifies institutions for a discount on forward collection items deposited with the Reserve banks.

- FedReturn is a mixed image cash letter deposited electronically to the Fed to return either substitute checks or an electronic file to the bank of first deposit. This product enhances inbound and outbound returns processing operations to reduce risk, while streamlining backroom operations to reduce operating cost and improve quality.

"Callaway had multiple choices when pursuing Check 21 service providers," Barnes says.

"Although competitors looked good on paper, through further comparison the Federal Reserve

was the better option. We decided that the Check 21 suite was the best way to go, and it has proven to be a good business decision." In addition to using the full Check 21 suite,

Callaway Bank has also deployed enhanced internal processes such as Branch and Merchant Capture made possible by Check 21.

Vendor selection and coordination with Fed resources is vital to the success of this type of operational shift, explains Barnes, who gives credit to the Fed, particularly Andy Lueckenhoff, the primary Check 21 service coordinator for the Eighth District. "He worked with Callaway, vendors and operations to hammer out any issue until resolution was accomplished," she says.

For more information regarding the Check 21 products offered by the Federal Reserve, visit [www.frbstlouisfed.org](http://www.frbstlouisfed.org). ■

## Number of Eighth District Financial Institutions in Check 21 Production

### December 2005

FedForward	38
FedReceipt	4
FedReturn	3

### January 2006

FedForward	42
FedReceipt	5
FedReturn	3

### February 2006

FedForward	55
FedReceipt	6
FedReturn	4

### March 2006

FedForward	67
FedReceipt	11
FedReturn	7

# Regional Roundup

## Fed Reports Highlight Economic Education and Branching Out

Making the right economic decisions can be tough—and could be even more of a challenge for the next generation of adults. That's why economic education, the topic of the St. Louis Fed's 2005 annual report, is a critical part of the Federal Reserve's mission.

The report, titled *Feducation: How the Federal Reserve Bank of St. Louis' economic education programs are shaping today's minds and tomorrow's economy*, discusses why economic education is important and how the St. Louis Fed plays a key role through its programs, seminars and materials. Education experts, teachers, students and Fed employees share their perspectives on the topic.

The report is available at [www.stlouisfed.org](http://www.stlouisfed.org) under the Publications link. To order additional print copies, call 1-800-333-0810, ext. 44-8809.

The St. Louis Fed will also be releasing a report to the community summarizing our Branching Out efforts to date. At our Little Rock, Louisville and Memphis branches, as well as at our St. Louis headquarters, we're devoted to economic research, community development and economic education. The report will provide an overview of programs that are redefining how the St. Louis Fed sees its communities and how our communities view us. Release details will be given in the next issue of *Central Banker* and on [www.stlouisfed.org](http://www.stlouisfed.org).

## Fed To Discontinue PATAX Voice Response, DOS-Based FedLine

As of September, PATAX Voice Response and DOS-based FedLine will no longer be available for TT&L services. Customers that previously used them for reporting their institution's

tax deposits and managing their TT&L assets will need to convert to Treasury Tax and Loan (TT&L) Plus before that time.

The Fed decided to move away from DOS and the voice response system a few years ago because the technology is outdated and because web-based applications are much more flexible and convenient to use.

The conversion process for TT&L only takes a few weeks. There is no fee or additional equipment for the service.

TT&L Plus users can enter Advices of Credit (AOCs), review an account status and request reports on the web.

For more information about TT&L or to start your conversion process, visit [www.frb services.org](http://www.frb services.org) and click on Access Treasury Services at the top of the page. For more information, contact the TT&L Treasury Support Center (TSC) at 1-888-568-7343. ■

## Fed Tackles Payroll Card Accounts And More During Spring

The Fed's Board of Governors released the following guidance and advisories in recent months. For more information, see Supervisory and Regulatory Guidance at [www.stlouisfed.org/banking](http://www.stlouisfed.org/banking) or call your contact in Banking Supervision.

### Payroll Card Accounts Covered Under Reg E

A rule effective July 1 provides that payroll card accounts are covered by the Board's Regulation E, electronic fund transfers. Payroll card accounts are established by an employer for an employee to which transfers of wages or other compensation are made on a recurring basis. Banks may provide regular periodic paper statements or make available information, including fees for electronic funds transfers, through alternatives granted in Regulation E.

### Borrower Loan Deferred Repayment Proposed

The federal financial regulatory agencies have proposed guidance on nontraditional mortgage products. The guidance focuses on effective risk management of loans that lets borrowers defer repayment of

principal and, sometimes, interest. These products include "interest-only" mortgages and "payment option" adjustable-rate mortgages.

The guidance relates to appropriate borrower repayment analysis, the potential for collateral-dependent loans, below-market introductory interest rates and lending to subprime borrowers. Finally, the guidance concerns consumer protection issues raised because borrowers may not fully understand the terms of these products.

The guidance should be finalized by this summer.

### Limit Placed on External Auditor Liability

The federal financial regulatory agencies have issued a final advisory addressing concerns caused when financial institutions agree to limit their external auditors' liability. Generally, banks should not indemnify external auditors against third-party claims. Nor should an institution release the auditors from potential claims the institution might assert.

Finally, institutions should not limit remedies available against external auditors. ■





*Richard G. Anderson is a vice president and economist at the Federal Reserve Bank of St. Louis*

The Federal Open Market Committee (FOMC) tends to tighten monetary policy by increasing real short-term interest rates during economic expansions before incoming data confirm an increase in the rate of inflation. In May, the FOMC increased for the 16th consecutive meeting its target level for the federal funds rate. Today, it seems worthwhile to review the benefits that policymakers believe flow from sustained low inflation.

A common theme among monetary policymakers is that price stability—typically defined as an inflation rate that is sufficiently low, stable and predictable so as not to be a factor in decision-making—is a prerequisite for attaining maximum sustainable economic growth. At the August 2005 Federal Reserve Bank of Kansas City policy conference, then-Fed Chairman Alan Greenspan said, “I presume maximum sustainable economic growth will continue to be our goal, with price stability pursued as a necessary condition to promote that goal.” At an October 2004 Federal Reserve Bank of St. Louis conference, Fed Gov. (and soon-to-be Chairman) Ben Bernanke said, “The low-inflation era of the past two decades has seen not only significant improvements in economic growth and productivity but also a marked reduction in economic volatility, both in the United States and abroad. As I have argued elsewhere, there is evi-

## The Long-run Benefits of Sustained Low Inflation

By Richard G. Anderson

dence for the view that improved control of inflation has contributed in important measure to this welcome change in the economy.”

Often, policymakers equate low inflation to annual increases of 1 to 2 percent in a broad index of consumer prices, a rate that Chairman Bernanke has dubbed the “Optimal Long-Run Inflation Rate.” Such a rate, in part, reflects small measurement biases due to imperfect adjustment for quality changes and the introduction of new goods. The rate also reflects, in part, a cushion against the risk that an adverse economic shock might corner policymakers against the zero lower bound on nominal interest rates.

The costs to the economy of more rapid inflation, measured in foregone real economic output, are primarily of two types. First, “monetary costs” arise as inflation reduces the real return on money, needlessly inducing firms and households to incur additional financial management costs. Inflation also muddies price signals by increasing the difficulty of distinguishing temporary versus permanent changes in the price of goods. Higher inflation also tends to attract real resources, including new college graduates, into professions such as law and financial services that disproportionately benefit by creating anti-inflation hedges and shelters.

Contrary to the protests of policymakers, however, most empirical studies have concluded that the costs of a steady inflation more rapid than the optimal inflation rate are small, often less than three-hundredths of one percentage point of annual GDP growth. But, this opinion is not universally held. Recently, some researchers have challenged this conclusion by arguing that the models omit both the many important difficult-to-measure functions of money and the distortions caused by the nominal nature of the U.S. tax system. These studies suggest that the economy’s level of real output may be lower by up to 1 percent for each percentage point that the inflation rate is above that associated with price stability.

In short: Measures of the cost to the economy of sustained inflation above a minimal rate are extremely uncertain. Yet, almost uniformly, central bankers argue that sustained low inflation is a prerequisite to realizing an economy’s maximum long-run economic growth. Evidence aside, surveys of inflation expectations suggest that the public is confident the Federal Reserve will sustain an environment of low, stable inflation. ■

## Identify Fraudulent Postal Money Orders

The growing number of fraudulent money orders caused the U.S. Postal Service (USPS) to create an interactive voice response system. Financial institutions can verify money orders issued at least two days earlier but not more than 90 days before by calling 1-866-459-7822.

You will need to provide the following information to verify the authenticity of USPS money orders:

- Money order serial number (11 digits)
- Money order dollar amount (one to six digits)
- Money order post office ID (six digits)

The system will either verify that the money order was issued by the USPS in the dollar amount entered or respond that the money order does not match the USPS database.

For more information, call 1-800-ASK-USPS or visit [www.usps.com/missingmoneyorders/security.htm](http://www.usps.com/missingmoneyorders/security.htm) for more details on money order security features.

## Small Bank Holding Companies Defined

The Federal Reserve announced Feb. 28 the approval of a final rule that expands the definition of a small-bank holding company (BHC). The changes include:

- raising the small-asset size threshold

from \$150 million to \$500 million in consolidated assets, and

- amending the related qualitative criteria for determining eligibility as a small BHC for the purposes of the Policy Statement and capital guidelines.

The amendments, under the Board's Small Bank Holding Company Policy Statement and the Board's risk-based and leverage capital guidelines for BHCs, are designed to address the effects of inflation, industry consolidation and normal asset growth since the Policy Statement was introduced in 1980. The final rule was effective March 31. For additional information, please contact Rebecca Roberts at 1-800-333-0810, ext. 44-8744.

## New Members Take Seats at Board of Governors

Two vacancies were filled on the Federal Reserve Board of Governors during late winter.

Kevin M. Warsh of New York was sworn in Feb. 24. He is completing the term ending Jan. 31, 2018 of Ben Bernanke, now Fed Chairman. Warsh most recently served as special assistant to the president for economic policy, managing domestic finance, capital markets and banking issues. He also served as executive secretary for the National Economic Council and worked in investment banking at Morgan Stanley.

## When Businesses Look for a Location

ST. LOUIS—JULY 19

What attracts businesses and jobs to a neighborhood? Christopher Wheeler, economist at the St. Louis Fed, examined 15,000 neighborhoods in 361 metropolitan areas to find out why certain neighborhoods are more conducive to economic development. He will present the results of his research during a lunch meeting sponsored by the Community Affairs department of the Federal Reserve Bank of St. Louis.

Information: [www.stlouisfed.org/community](http://www.stlouisfed.org/community), or call Cindy Davis at 1-800-333-0810, ext. 44-8761.

Randall S. Kroszner, a professor of economics from the Graduate School of Business at the University of Chicago, was sworn in March 1. He is completing the 14-year term ending Jan. 31, 2008, of Edward M. Gramlich, who retired last August. Kroszner has been involved with the Fed and Board of Governors in several capacities, including serving as a visiting scholar and research consultant. ■

*"FedForward," "FedReceipt" and "FedReturn" are either registered or unregistered trademarks or service marks of the Federal Reserve Banks. A complete list of marks owned by the Federal Reserve Banks is available at [www.frb-services.org](http://www.frb-services.org).*



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

Editor  
Scott Kelly  
(314) 444-8593  
[scott.b.kelly@stls.frb.org](mailto: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