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Federal Reserve Bank of St. Louis

Central Banker

SPRING 2007

News and Views for Eighth District Bankers

Fed Connects Bank Directors to Management Oversight Resources

Corporate governance and director duties, training, data resources, publications, banking agencies—keeping track of these can be a chore. How would you like to access these in one place? The Federal Reserve has created the Resources for Bank Directors web site, a portal designed to assist you with numerous management oversight responsibilities. The Fed also has updated a helpful training course.

The site, www.kansascityfed.org/bankdirect, includes:

- financial data for banks and bank holding companies;
- examination manuals, regulation and supervisory letters issued by the Federal Reserve System, director training materials, speeches by members of the Board of Governors;
- a calendar of Federal Reserve events; and
- links to the web sites of other federal and state banking agencies.

The online bank director training course, Insights, has been updated. It introduces bank directors to corporate governance and director duties and responsibilities; covers basic bank financial analysis; and discusses the sources, control and monitoring of portfolio risks, including credit, liquidity and market risks.

Questions and comments regarding Resources for Bank Directors or Insights should be directed to Timothy Todd at the Kansas City Fed at 816-881-2308. ■

Bankers Can Take Community Lead in a Crisis

For months, talk of a possible bird flu pandemic was a fixture in the news. But these days, there's hardly a peep. However, the possibility of a pandemic remains—and all levels of government and many corporations can be found making precautionary plans.

The Federal Reserve suggests that bankers get involved with their local government and local companies that are already making plans. For example, in early 2006 the Missouri Department of Health and Senior Services brought together planners from business, government, utilities and associations to create pandemic plan templates for small and medium business. (For example, see www.pandemicflu.gov/plan/tab4.html.)

Says Ed Pearce of Business Continuity at the Federal Reserve Bank of St. Louis: "As leaders within their communities, bankers could play a pivotal role in pandemic preparedness. Banker examples would encourage business customers to join with them in establishing partnerships with city and county public health departments. Each community pandemic partnership can determine a collective approach to preparing for a pandemic using planning templates and establishing lines of communication."

For more information, see www.federalreserve.gov/boarddocs/press/bcreg/2006/20060315/attachment.pdf. ■

Feditorial

Expanded Mission Means a Sturdier Stool

By Bill Poole, president of the Federal Reserve Bank of St. Louis

Any introductory lesson about the Federal Reserve usually includes a mention of the Fed's three main functions, commonly referred to as the three-legged stool: 1. formulating sound monetary policy; 2. fostering safe and responsible banking practices; and 3. providing efficient, reliable and accessible payments services. Like other Reserve banks, the St. Louis Fed's mission statement has always contained wording reflecting these roles. But in our 2007 strategic plan, we expanded our mission to incorporate two functions that we believe distinguish us as a Reserve bank:

- performing effectively as the fiscal agent of the U.S. Treasury; and
- providing regional economic research, community development programs and economic education.

Partnering with the U.S. Treasury is our Bank's primary national assignment. By adding Treasury work to our mission, we are making more explicit our commitment to helping the agency find cost-efficient solutions that benefit taxpayers. One example is our management of the U.S. Treasury's Go Direct campaign, through which the Treasury is aggressively working to convert paper check payments to electronic payments to save the government more money. The campaign aims to persuade people receiving paper Social Security checks to convert their payment to direct deposit. The campaign's first year led to a savings of $18 million.

Over the last several years, the St. Louis Fed has worked with the other Reserve banks to identify cost-saving opportunities. This effort has resulted in new systems, such as a web site for making government payments that will reduce costs by automating payments and business processes for hundreds of government agencies.

The decision to include public programs in our mission is another step to broaden our outreach efforts through the areas of community economic development, economic education and regional economic research. While we've always performed these functions, we expanded them in earnest when we lost our check processing operations in Little Rock and Louisville and decided we could no longer efficiently support cash operations in these locations. What we've found is a pent-up demand in our communities for Fed programs. Look for us to sponsor or host an increasing number of events and programs throughout the District as we strive to reach wider audiences, including bankers.

It is not often that you'll see a Reserve bank tinker with its mission statement. We felt, however, that adding a couple of new legs to the Federal Reserve stool would make that stool sturdier. ■

Check Up on Customer Feedback Opportunities

Several years ago, the Federal Reserve Bank of St. Louis implemented mechanisms to help us understand your experiences with Federal Reserve check services. We use this feedback to improve our ability to deliver quality products and services to meet your business needs.

There are currently two feedback mechanisms available for institutions to provide valued information. The Check Customer Service Feedback card is designed to help understand how we are serving you and your institution's needs over the telephone. The feedback cards are sent out randomly every month.

The second feedback mechanism is the Check Inclearing Feedback card, which is designed to help understand the quality in which we send and you receive cash letters from the Federal Reserve. The feedback cards are distributed quarterly to all Federal Reserve cash letter recipients.

Enclosed with each feedback card is a self-addressed, postage-paid envelope for your convenience. We look forward to your feedback so that we can research and resolve outstanding issues or concerns. We encourage you to provide your contact information in the event we need to contact your institution for more information.

If you would like to be sent either feedback card at any time, call the Check front office at 1-866-433-3227. ■

Federal Agencies Issue Guidance on Commercial Real Estate Concentrations

Commercial real estate can be a profitable component of a financial institution. Federal regulatory institutions want to help make sure that institutions that pursue a significant commercial real estate lending strategy remain healthy and profitable while continuing to serve the credit needs of their communities.

With such concerns in mind, federal banking agencies in December issued guidance on risk management expectations for banks with significant concentrations in commercial real estate (CRE) loans. Some bankers have expressed concerns that any benchmarks contained in the guidance would become hard limits, while others indicated a concern that the risk management requirements were unnecessarily burdensome.

The guidance was considered necessary because many banks, particularly community banks, have become increasingly dependent on CRE lending. The agencies are concerned that without strong underwriting and risk management practices, banks with high CRE concentrations may be exposed to earnings and capital volatility in the event there are adverse changes in CRE markets.

The final guidelines also make it clear that the bank regulatory agencies will make every effort to apply the guidelines reasonably and consistently. To help achieve those goals, examiner training will be provided on an interagency basis.

"As part of our regular contact with our state member banks, we will make sure they are familiar with the guidance," says Tim Bosch, division vice president in Banking Supervision & Regulation at the St. Louis Fed. "We will provide our banks a reasonable transition period to enhance their risk management practices and management information systems where necessary."

The guidance does not limit banks' commercial real estate lending, but rather guides institutions in developing risk management practices that are consistent with the level and nature of their CRE portfolio. The loans covered are those dependent upon the cash flow derived from the real estate held as collateral and are sensitive to conditions in local or regional commercial real estate markets. Loans secured by owner-occupied properties or when CRE collateral is taken as an abundance of caution are generally excluded.

The numerical concentration screening, which now includes a loan growth measure, will be used as a supervisory monitoring tool, not a limit. For monitoring purposes, a CRE concentration is defined as:

- Total loans for construction, land development, and other land loans equal to 100 percent or more of total capital; or
- Total CRE loans equal to 300 percent of total capital (excluding owner-occupied CRE) and CRE loans increased by 50 percent or more within the past 36 months.

Over time, banks with high CRE concentrations will be expected to set policy limits consistent with the strength of their operating practices, credit underwriting and capital. Bankers should understand the risks in the CRE portfolio, not just the quality of the individual credits. They should know the bank's lending markets and understand the impact should a real estate shock occur. Banks will be expected to have management information systems (commensurate with the size and complexity of the bank) that enable them to measure, monitor and prudently control the risks inherent in the CRE portfolio.

"Superficially, about 40 percent of Eighth District state member banks have CRE concentrations that exceed one or both of the monitoring screen ratios," Bosch says.

For more information, see www.federalreserve.gov/boarddocs/press/bcreg/2006/20061206. ■

Regional Roundup

Check 2007 Price and Product Changes

The financial services industry continues to experience growth and expansion of electronic payment alternatives. This evolution has set the stage for the Federal Reserve banks to further enhance product offerings while simplifying the way customers do business with the Reserve banks. This year, fee increases generally affected nonelectronic payment processing services.

Fee reductions are realized on select services in the FedForward℠ check product to reflect the efficiencies associated with end-to-end electronics. Prices on check items drawn on electronic endpoints are reduced on average 12.5 percent. The Federal Reserve banks also modified the FedForward deposit deadlines. The 11 a.m. deadline has been eliminated, and additional deadlines have been added for 3 p.m. and 6 p.m. Eastern time.

To encourage the migration from paper to electronic check clearing, the Federal Reserve Plus price for services has been reduced by $0.001. The $0.002 per item FedReceipt℠ billing credit has been replaced with a $0.003 deposit discount for forward collection. The FedReceipt returns deposit discount increased from $0.02 to $0.03.

For more detailed information, refer to the 2007 local Check Service fee schedule at www.frbservices.org/Local-Information/StLouis/feeschedules.html. ■

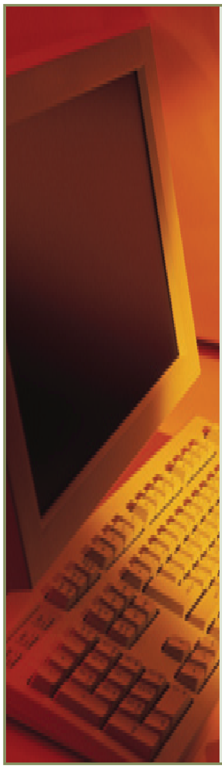
Seasonal Credit Is Available for Community Banks

The Federal Reserve offers seasonal credit to qualifying community banks to help them meet the seasonal needs of their local customers. Frequent qualifiers are community banks that experience yearly fluctuations in their deposits and loans, caused by construction, farming, college or resort activities, municipal financing and seasonal businesses.

All Federal Reserve loans must be secured to our satisfaction. We apply a flexible, market-based rate to all outstanding loans.

For an application and a brochure, please visit our web site at www.stlouisfed.org/banking/credit/credit.html. If you would like to learn more about the program or obtain answers to questions you may have about collateral or the borrowing relationship, please contact Gloria Dampier or anyone in our Credit office at 1-866-666-8316 or via e-mail at creditoffice@stls.frb.org. ■

"FedForward" and "FedReceipt" are service marks of the Federal Reserve banks. A complete list of marks owned by the Federal Reserve banks is available at www.frbservices.org.



Treasury Introduces OTCDirect for Bank Lobbies

The U.S. Department of the Treasury is introducing OTCDirect, a web-based bank lobby service for your customers to order paper savings bonds. With a link to the TreasuryDirect® web site, your customers can order bonds directly from Treasury and pay with an ACH (automated clearing house) debit.

OTCDirect will help to introduce your customers to TreasuryDirect and lower your processing costs for selling paper bonds over the counter. Here's how it works:

- The bank provides a self-service kiosk with Internet access and a link to OTCDirect. The OTCDirect home page informs the customer about TreasuryDirect, giving the customer an opportunity to purchase securities electronically.
- If the customer chooses to buy paper savings bonds, OTCDirect will ask for information to identify the customer using a government-operated verification service. The customer selects the series and denomination of the desired bond and provides registration information.
- The customer provides ACH payment information (routing and account numbers). Treasury collects the funds, sends a confirmation e-mail message to the customer, processes the order and mails the bond within two to three weeks.

For more information on OTCDirect or to get a free demo, visit www.treasurydirect.gov/instit/savbond/otc/otc_otcdirect.htm, send an e-mail to OTCDirect@bpd.treas.gov or call the OTCDirect team at 304-480-6588. ■

How U.S. Currency Stacks Up—at Home and Abroad

By Richard G. Anderson and Marcela M. Williams

Richard G. Anderson is vice president of Research and Marcela M. Williams is a senior research associate at the Federal Reserve Bank of St. Louis.

Despite the increasing use of electronic payments and credit cards, currency remains the most familiar medium for face-to-face transactions in the U.S. economy. In addition, U.S. currency—unique among the world's currencies—is widely held as a store of value and used as a medium of exchange outside its home country. Although some U.S. currency has flowed out of the United States since before the Second World War, outflows accelerated during the 1970s. Today, the Treasury and Board of Governors staffs estimate that nearly 60 percent of all U.S. banknotes in circulation, or close to $500 billion, is held outside the United States.

U.S. banknotes are an attractive asset to residents of nations with political or economic uncertainty. Much of the recent growth in demand for U.S. banknotes has been in countries of the former Soviet Union and Latin America. Indeed, anecdotal press reports tell of Moscow taxi drivers insisting to be paid in U.S. dollars rather than rubles. Other stories tell of merchants in the most remote areas of China accepting—and giving change—in U.S. banknotes. The extensive, widespread use of U.S. banknotes benefits American taxpayers because, unlike Treasury bonds, the banknotes are a liability of the Treasury on which no interest is paid. The use of the banknotes also is a social and economic benefit to the residents of foreign countries who might otherwise lack a currency that is stable in value and widely accepted in transactions.

This same popularity also is a curse, encouraging counterfeiting of U.S. banknotes. Counterfeiters range from the casual, who produce a few notes with desktop scanners and ink jet printers or with color copiers, to professionals using sophisticated lithographic printing systems, to foreign governments such as North Korea that are reported to print counterfeit "supernotes" on government-owned intaglio presses.

Despite the temptation and potential profit from counterfeiting, the Treasury and Federal Reserve estimate that the frequency of counterfeiting is low, approximately one note in 10,000 both in the United States and abroad. At Federal Reserve cash offices during 2005, the most frequently counterfeited notes were $100 denominations at 44.1 notes per million processed, followed by the $10 notes at 7.8 notes per million. Overall, 6.4 counterfeit notes were detected per million notes processed.[1]

Internationally, the major challenger to U.S. banknotes is the euro; the euro is the only paper currency other than U.S. banknotes held extensively outside its own currency area. Published reports suggest that counterfeit activity in Europe decreased sharply following the introduction of euro notes in 1999, but increased somewhat thereafter. For 2003-2006, the European Central Bank reports detecting and confiscating annually approximately 600,000 counterfeit notes, vs. the 10 billion euro notes in circulation, a rate not noticeably different than the detection rate for U.S. banknotes at Federal Reserve cash offices.

Technological innovations in color copying, scanning and printing have intensified the race between increasingly sophisticated banknote counterfeiters and government banknote designers. Perhaps the most difficult-to-duplicate counterfeit deterrence feature of U.S. banknotes is its unique yellow-green paper, manufactured under close security by a single U.S. firm from a mixture of 75 percent cotton and 25 percent flax. When combined with intaglio-printed images and numerals, this gives the notes a unique "feel," which surveys have reported is the most common method of counterfeit detection by the public and bank employees. Magnetic ink also is an important feature, difficult to duplicate; high-speed scanners most frequently detect counterfeit notes due to incorrect or missing magnetic signatures.[2]

Color-shifting ink, larger portraits, watermarks and security threads are among the features that the public can use to detect counterfeiting without sophisticated equipment. ■

ENDNOTES

1 U.S. Treasury Department, *The Use and Counterfeiting of United States Currency Abroad*, Part 3. September 2006.

2 National Research Council, *Is That Real? Identification and Assessment of the Counterfeiting Threat for U.S. Banknotes*. The National Academies Press, Washington, D.C., 2006.

FedFacts

Fed Eliminates Certain Regulation O Requirements

The Federal Reserve Board has eliminated certain reporting and disclosure requirements under Regulation O. While the rule does not alter the substantive restrictions on loans made to executive officers and principal shareholders, it does eliminate the following disclosure requirements:

- Reports by executive officers filed with a member bank's board of directors whenever the executive officer obtains certain extensions of credit from another bank.
- Member bank's inclusion of a separate report with its Call Report on any extensions of credit the bank has made to its executive officers since its last Call Report.
- Reports and public disclosure of extensions of credit to executive officers and principal shareholders by correspondent banks.

Read the rule at www.federalreserve.gov/boarddocs/press/bcreg/2006/200612062. ■

Pre-Order Presidential One Dollar Coins

The U.S. Mint, working with the Federal Reserve, has provided an early ordering window for financial institutions for the new presidential dollar coins. The ordering window is designed to ensure that each new coin is available to the public on its official release date (and prevent an unauthorized, premature release of a coin). For coin release and program information, go to www.usmint.gov/$1coin; select Mailer for ordering information. ■

Fed Starts New Studies on Electronic Payments and Check Usage

How many checks are written in the United States each year? What is their collective worth, and how are they used? What is the total value of all the electronic payments made in the United States?

The Fed wants to know. The Federal Reserve System, in conjunction with two outside vendors, is conducting a new round of studies similar to ones performed in 2001 and 2004 to determine the composition of the retail payments market, which includes checks, credit and debit cards, as well as automated clearing house (ACH) transactions.

The information will be collected during the first half of 2007, with results released later in the year. The Fed hopes the data will help financial institutions make better-informed decisions about future investments in their payments technology. For more information, see www.frbservices.org/Retail/pdf/2007PRPaymentStudy.pdf. ■

CalendarEvents

UPCOMING FED-SPONSORED EVENTS FOR EIGHTH DISTRICT DEPOSITORY INSTITUTIONS

Neighborhoods in Bloom

LOUISVILLE, KY.—MARCH 20

Dan Tatar, Community Affairs officer at the Federal Reserve Bank of Richmond, will speak at the Kentucky International Convention Center on neighborhood revitalization. Lenders, private-sector investors, government officials, economic development officials, community development professionals and representatives of nonprofit organizations are welcome. Register by March 16 by calling Kendra Keller of the Louisville Branch of the St. Louis Fed at 502-568-9202.

Evansville Economic Forum

EVANSVILLE, IND.—MARCH 28

The Louisville Branch of the St. Louis Fed will host an economic forum at the Evansville Country Club. St. Louis Fed President Bill Poole will discuss Fed policy and the national economy. Participants are invited to share their observations about local economic conditions, business trends and factors affecting the national economy. Call Jill Dorries at the St. Louis Fed at 314-444-8818 to register.

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