Flood of '93 Projected Costs Approaching $1 Billion

As waters remain high in portions of the Eighth District, it is difficult to identify fully the economic consequences of the flood of '93. But St. Louis Fed economist Kevin L. Kiesen estimates the damages for the St. Louis region alone to be approaching $1 billion.

Kiesen bases his flood estimate, one he considers conservative, on a comparison with the 1973 flood, which was similar in magnitude. Two distinct differences exist, however.

For one, the 1973 flood generally affected the lower Mississippi region. This year's flood primarily affects the Upper Mississippi River Valley.

Also, as opposed to the flood of 1973 which occurred during the spring, this year's flood occurred during the summer, giving farmers little chance to replant their crops.

The $1 billion estimate includes the cost of flood fighting, evacuations, business losses, damage to buildings, roads and other structures, and loss of crops.

As Fed economists continue to assess the flood's greater impact, the St. Louis Fed will be looking for ways to assist bankers in responding to their customers' unique needs.

FDIC's Audit Requirements Affect Few District Banks

The FDIC’s long-awaited rules on audit requirements encompass only large depository institutions—those with $500 million or more in assets—giving most Eighth District bankers a welcome sigh of regulatory relief.

The rules, which became effective July 2, involve three main requirements. First, covered institutions must prepare and file annual reports containing audited financial statements. Second, they must file a management report, attested by an independent accountant, on internal controls and compliance with designated laws. Third, they must have independent audit committees review these reports with management and the outside accountant.

Covered institutions owned by a holding company may file the audited consolidated financial statements of the holding company rather than their own separately audited statements. In some circumstances, holding companies may also fulfill the reporting and audit committee requirements for their covered subsidiaries.

The final rules differ greatly from those proposed by the FDIC last year in that they limit coverage to large institutions, omit many of the detailed definitions and procedures and, as a result, leave more decisions to the management of financial institutions.

For guidance and interpretation of the audit rules, see the guidelines that accompanied the rules published in the June 2 Federal Register.
Real-World Views Benefit the Policymaking Process

As most of you know, the St. Louis Fed hosts a number of public information programs throughout the District for bankers as well as business and community leaders.

One purpose in hosting these programs is to disseminate information on the economy, banking conditions and regulatory issues. But we have another equally important reason. Through our conversations with you, we learn firsthand about current economic and banking issues.

The information we gather, from individuals dealing with the day-to-day realities of the economy, gives us a unique perspective on the effects of the policies we initiate. Specifically, this type of information serves as a backdrop for policy discussions at Federal Open Market Committee, or FOMC, meetings. Your input can often signal an emerging economic trend not yet apparent in published economic data.

Because the effects of monetary policy on the economy are felt only after considerable lags, the sooner we can identify changing expectations, the better we are able to make timely adjustments. For example, during a recession and into the ensuing recovery, policy actions are typically focused on bolstering sagging monetary growth rates. If we relied solely on previously reported economic statistics, which are backward-looking and are sometimes substantially revised, we might pursue an “easy” policy course too long. The result could be higher inflation in the future, requiring tighter monetary policy which might be destabilizing to the economy. Timely information on current economic activity and prospects can help us avoid such errors.

The next time you receive an invitation to one of our Economic Forums, District Dialogues or other programs, I urge you to recall how we benefit from your attendance and comments. The real-world information you share helps us make better policy decisions. I look forward to seeing you at an upcoming meeting.

Thomas C. Melzer is president of the Federal Reserve Bank of St. Louis.

Banks To Preview Effects Of New Check-Posting Rules

To help account holders prepare for the new check posting rules that become effective this fall, the St. Louis Fed will issue preview daylight overdraft reports using the two check crediting options.

With the revised payment system risk policy, which becomes effective Oct. 14, account holders must choose either a float-weighted or fractional approach to have checks credited to their accounts. The reports will help customers decide which option is best for them.

The first set of reports—using the float-weighted posting time—will be generated for the maintenance period Aug. 5 through 18. The second set—using the fractional approach—will be produced for the maintenance period Aug. 19 through Sept. 1.

Detailed information will be sent to District account holders with the first set of reports. For questions about the check-crediting options, please call Carole Kelly at 314-444-4619 or toll free at 1-800-333-0810, ext. 4619.
Bank Sales Of Mutual Funds: Are The Rewards Worth The Risks?

Every banking industry trade group seems to be organizing conferences and running stories on mutual funds in their trade publications these days. The American Banker was running so many stories on the subject it decided to expand what was once a weekly section on investment products to a daily one.

Why all the interest? A number of bankers and industry analysts view the provision of mutual funds as a way to stem the flow of deposits—and more important, customers—out of banks and into brokerage and investment houses in this low interest rate environment. In addition, banks can earn nominal fees by selling third-party mutual funds or more substantial income by offering their own (proprietary) funds.

Although hard numbers on the extent of banks' involvement in the mutual fund business are lacking, a number of estimates exist. A recent study by the Investment Company Institute (ICI), the mutual fund industry's trade group, found that banks accounted for about one-third of new sales of money market mutual funds and about 14 percent of new sales of bond and equity funds in the first half of 1992. That was enough to push the banking industry's share of the mutual fund business to $175.5 billion, or 12 percent of the $1.5 trillion in mutual fund shares outstanding in mid-1992. Since then, banks' share of a growing market has probably risen even further.

While mutual fund sales look like a win-win situation from the banking industry's perspective, some observers aren't so sure. Their major concern is that customers may mistakenly believe their investments are FDIC-insured, like deposits. To ensure that customers aren't confused, the regulatory agencies have begun advising banks to produce clear disclosures and to be sure that deposit and investment activities are physically separate.

It's not just the banking regulators who are concerned. Congressional leaders have asked the General Accounting Office to conduct a study on the adequacy of banks' mutual fund disclosures and regulatory supervision, and have urged the Securities and Exchange Commission and the National Association of Securities Dealers to take a closer look at banks' sales practices.

First-time investors may not fully understand the risks associated with mutual funds.

First-time investors are of special interest. The ICI has estimated that 10 percent of households that own mutual funds made their first purchase in January 1991 or later. No one knows how much of those funds were purchased through a bank, but some observers believe it is a substantial proportion.

These first-time investors in mutual funds may not fully understand the risks associated with investments in equity and bond funds. If the stock market turns down, equity funds will go down in value and if interest rates go up, bond funds will—and equity funds could—decline in value.

Investors in stock and bond mutual funds would quickly become aware of declines in the value of their investments, since the values of the shares in these funds are marked to market and appear daily in newspapers.

Credit risk is also a factor for investors purchasing bond funds. The market value of bond funds would decline if the credit ratings of bonds in mutual fund portfolios were downgraded.

Bank customers accustomed to fixed CD yields could be in for a rude shock if the value of their mutual fund investments—their principal—goes down. And the more closely associated banks are to mutual funds, especially through a private-label or proprietary relationship, the more likely they are to suffer customer backlash if market prices take a big plunge. Because the value of a bank's franchise is largely related to its reputation for safety and soundness, it's in banks' best interests to exercise considerable care in selling mutual funds to novice investors.

The bottom line is banks' entry into the mutual fund business—like any new business—presents risks as well as rewards.
Reforming: Growing Pains For the Economy

Hear that “restructuring” is going on in your community and you’re likely to consider it bad news for the local economy. Not so, says Fed economist Kevin L. Kliesen.

“Despite the transition costs of increased unemployment and declining wages, the process of restructuring is both necessary and desirable,” Kliesen says. “In fact, restructuring, though painful at the time, more often than not leaves the economy better off than it was before.”

When taking the long-term view, restructuring is actually a sign of a healthy dynamic economy responding to changes in technology and competition, he adds.

For more information, see the July issue of The St. Louis Federal River Economist.

St. Louis Fed To Co-Sponsor Lending Conference

Rural America in the ’90s will be the theme for a lending conference to be held late this fall. The conference will be co-sponsored by the St. Louis, Richmond, Atlanta and Dallas Feds. The program will feature workshops on community development projects, CRA initiatives and related issues affecting rural America.

The St. Louis Fed’s participation in the conference coincides with the Community Affairs Office’s focus on the portion of the Lower Mississippi Delta region located within the Eighth District. As one of the poorest regions in the country, community development initiatives there are particularly critical to revitalization.

Watch for more conference information coming soon.

Fed Examiners Look Closer At Mutual Funds

With the noticeable spur in the number of banks offering investment services, the Fed, along with the other supervisory agencies, is taking a closer look into banks’ mutual fund activities.

Fed examiners will review banks’ disclosure practices to determine whether they effectively communicate to bank customers that mutual funds are uninsured and can fluctuate in value. In addition, examiner guidelines suggest that funds should be sold in a location separate from the area involving insured bank deposits.

The Fed plans to issue a more extensive policy statement with the other regulatory agencies at a later date.

Treasury Follows Fed In All-Electronic ACH Initiative

As it been three years already?

In 1990, the Federal Reserve adopted an objective to convert all commercial ACH receivers to electronic connections by July 1, 1993. In the Eighth District, the Fed’s goal was met, and 578 District banks have established electronic access to the Fed directly via Fedline® or Flash-Light® connections.

In a similar effort, the U.S. Treasury has directed the Fed to convert government-only ACH receivers to electronic connections by July 1, 1994. Affected institutions were recently contacted about available alternatives. As of last month, 44 District banks will be establishing an electronic connection with the Fed or will be receiving government items through others who are electronically connected.

Regardless of the type of electronic connection banks have chosen, the conversion to electronic ACH processing takes time to implement. So the Fed is urging early action to meet next year’s deadline.

For more information, contact your account executive or Customer Support at 1-800-333-0869.
Check Imaging: The Technology Of The Future Is Here Today

T
day, if your customer needs information from a check written three years ago, searching for a microfilmed copy could take several days. With check imaging, retrieving this information will one day be as fast and easy as punching a keyboard.

Essentially, check imaging allows a financial institution to take a picture of a check electronically and store that image on a computer. The image can then be transmitted through a modem to another location. Although it’s not a new technology—early Fed experiments with imaging date back to the mid-’80s—the newest prototype being piloted this summer at the Boston and St. Louis Feds has come a long way from those tested just a few years ago (see sidebar).

Today, three advanced features are available. One is a quality review, which flags poorly imaged items. Second is a computerized archival system, which allows the images to be stored longer and more compactly than microfilm, which is currently used. Perhaps most important is the third feature, remote retrieval, which allows anyone to view selected images on a computer screen—from virtually anywhere—using telephone lines and a modem.

Eventually, check imaging is expected to move from a storage service into a processing service. When imaging becomes the standard, only the bank of first deposit may have to handle the physical checks.

In addition to boosting the efficiency of check processing, imaging will likely mean lower costs for bankers. Not only will postage and courier services drop, but fewer processing staff will be needed to handle the physical checks.

Ultimately, the use of check imaging could streamline the check-collection process and virtually eliminate lost or misplaced checks.

When compared with microfilming, the digital images obtained through high-speed imaging are sharper. In addition, the user can rotate, reverse and view the images in greater detail.

Currently, only government checks are being imaged by the Federal Reserve. What’s next? Most likely Postal Money Orders and, eventually, commercial checks.

Fed’s Check Imaging Pilot Takes Off in St. Louis

As reported last year, the St. Louis Fed was chosen as one of two sites for imaging pilots conducted with the U.S. Treasury this summer. The program’s goal was to determine whether the process would produce images as clear as those on microfilm.

During the June-through-August program, the St. Louis Fed is using prototype IBM high-speed image technology reader/sorters to process and store about 2.5 million U.S. Treasury checks each month. Later this summer, the Boston Fed will test similar equipment made by Unisys.

Here’s how the program works. Each day, the Treasury office in Hyattsville, Md., selects 75 U.S. Treasury checks at random that it wishes to view. The Fed loads these images on magnetic tape substations in St. Louis and sends them via modem to the Treasury’s computer. The Treasury compares the image on its screen to the same image on microfilm.

How is the pilot going? “The images we’ve looked at so far have been very clear,” says Edith Wells, program manager of the Treasury’s check digital imaging project. “But the technology is not there yet.

“We have a few bugs to work out before we can do away with microfilming completely,” says Johann Johnson, the St. Louis Fed’s imaging program manager. “But we’ll continue to image even after the official pilot concludes. We’re eager to work the bugs out so we can stop microfilming government checks.”

The Treasury is eager as well. “We’re most anxious for the check imaging technology to get up to speed,” says Wells. “For us, it can’t happen soon enough.”

No timetable has yet been set, says Johnson. “Imaging is still in its infancy, but anybody who has anything to do with the check-collecting business views imaging as the next big step to streamlining everything.”
Fed Offers Enhancements to MICR Plus

In June, the St. Louis Fed’s four offices began offering MICR Plus customers improved service—a new one-day retention option. With the new service, customers can choose to have checks delivered one or three days after the transmission of MICR line data, depending on their specific needs. Under the new one-day option, customers also have the choice of handling return items themselves rather than using the Fed’s return service. With either option, MICR Plus customers can use the Fed’s microfilming and account post sort service before receiving the items.

Another plus for St. Louis zone customers: The St. Louis office has cut in half the per item fee for MICR Plus microfilming service, to $0.003, and beginning Sept. 13, will reduce the fine sort inclusion fee from $0.007 to $0.005.

For more information on the MICR Plus service, please contact Customer Support at 1-800-333-0869.

Get The FACTS In Little Rock

One-day Fedline® Advanced Continuation Training Session (FACTS) seminars will be offered in Little Rock on Sept. 15 and 16.

The popular seminars offer Fedline users training in some of Fedline’s lesser-known features and services. Fedline users should receive more information later this month.

Evansville Community Profile Due Out Soon

The St. Louis Fed’s community profile on Evansville, Indiana, is expected to be out later this month.

In addition to providing an analysis of census and HMDA data for the Evansville MSA, the study will focus on the community’s credit needs as identified through interviews with community organizations, government officials and Evansville residents. Also included are listings on state and local programs that help address those credit needs.

Copies of the profile will be mailed to Evansville CRA officers in mid-August. To obtain an extra copy or a copy of our St. Louis profile, call Judy Armstrong at (314) 444-8646.

Calendar

Upcoming Fed-sponsored Events for Eighth District Depository Institutions

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<th>Event</th>
<th>Date</th>
<th>Location</th>
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<tr>
<td>District Dialogue</td>
<td>Sept. 28</td>
<td>Jackson, Tenn.</td>
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<td>Regional Economic Forums</td>
<td>Oct. 5</td>
<td>Evansville, Ind.</td>
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<td>Oct. 6</td>
<td>Mt. Vernon, Ill.</td>
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For more information on these meetings, please call Jackie Himmelberg (314) 444-8511.