THE FEDERAL RESERVE BANK of ST. LOUIS

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CENTRAL BANKER

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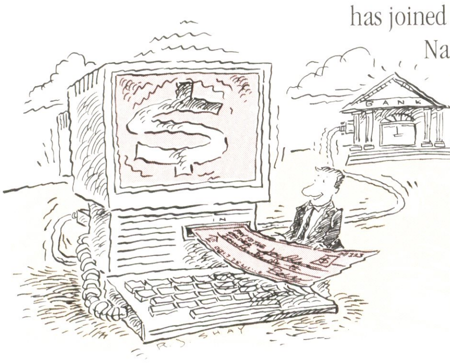
News and Views
for
Eighth District Bankers

Fed Encourages Direct Deposit Use



The Federal Reserve System has joined forces with the National Automated Clearing House and the Social Security Administration to encourage the use of direct deposit among financial institutions, corporations and consumers nationwide. The five-phase campaign kicks off in early March and carries through to the end of 1996.

Although NACHA and SSA have been involved in promoting direct deposit for the past four years, this marks the first time the Fed has taken such an active stance, reflecting its increased commitment to converting paper payments to electronic.

By increasing the use of direct deposit, bankers can generate several tangible benefits for their organizations, through:

- Reduced teller lines in branch lobbies, freeing staff for other tasks;
- Increased customer service by expanding their electronic product offerings; and
- Improved cost efficiency by reducing the number of checks that need to be handled and mailed back to customers. According to a Federal Reserve System study, it costs an average of 74 cents to handle a check deposit over the counter, compared with just 5 cents for an ACH deposit.

Tom Pope, vice president of operations at Owensboro National Bank in Kentucky, says that his bank has been selling direct deposit since 1988 for another reason: It's

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Branches to Offer Imaging Service

The St. Louis Fed's Little Rock and Memphis branches will begin offering check imaging services beginning March 1 and June 1, respectively. The branch introduction of the service comes on the heels of the St. Louis bank's kick-off Jan. 1.

Image technology involves capturing the front and back images of paper checks and then transferring the digitized pictures to CD-ROM or magnetic tape. Benefits include: reduced postage, processing and handling costs, more efficient archiving, enhanced cash management capabilities and speedier check retrievals.

"It's just so fast," says Polly Hoskins, the Memphis Fed's imaging project coordinator, "banks will be able to answer customers' questions in seconds, where it now takes a couple of hours, or even a week."

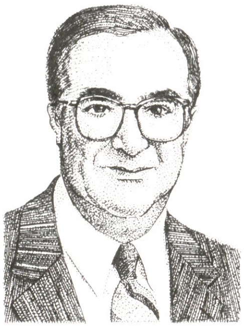
Hoskins says that a small-town bank can gain a competitive advantage over the other bank or banks in town by offering imaging first.

Bill Dean, vice president of People's Bank in Cuba, Mo., plans on just that when his bank starts its imaging service with the St. Louis Fed March 1. "I think all banks are going to get involved in it," Dean says. "The only question is when."

For information on starting imaging service, contact your account executive.

Feditorial

Electronic Banking: Time to Take the Plunge?



LeGrande Rives

In the 20 years I spent in commercial banking before coming to the St. Louis Fed last November, I often had to weigh the benefits of investing in new technologies against the associated expenses and uncertain outcomes. Today, commercial bankers are struggling with perhaps their biggest dilemma yet in this regard: the emergence of electronic banking services like electronic check presentment, personal computer home banking, electronic cash and lots of other forms of electronic payment.

The opportunities to offer electronic banking products and services, which can potentially improve service to customers, seem to be multiplying daily, leaving many bankers pondering how best to proceed. Can a small bank afford to make such an investment? Should the investment be made when only a small percentage of the customer base may be open to using electronic banking services? These are obviously valid concerns.

From my current perspective as a central banker, I've seen banks successfully address product and customer service questions throughout the Eighth District, as highlighted in our Page 1 stories. Some banks are starting small—offering products one market at a time—while others have gained market acceptance by educating their customers about the innovations and services before introducing them.

I believe that financial institutions will have no choice but to familiarize themselves with these new electronic technologies and ultimately to introduce the resulting customer products. For many banks in the Eighth District, this isn't going to mean setting up a virtual bank on the Internet. Rather, it might mean using an existing PC to begin originating ACH items for their customers.

Can banks really afford to take advantage of all that electronic banking has to offer? Perhaps not right away, but they must begin to educate themselves and their customers and begin to chip away at the inefficient paper-based infrastructure that has been in place for most of this century. In time, competition will force the market to change.

LeGrande Rives is first vice president of the Federal Reserve Bank of St. Louis.

Direct Deposit

(continued from front page)

an additional electronic link with a customer, making the relationship tougher to dissolve.

"The more you can move your customer base electronically for a long-term goal, the better off the bank is," Pope says. "Direct deposit is just a piece and not an entity."

Those interested in increasing the number of direct deposit customers at their own bank can make use of any of the following:

- Statement stuffers, available free from SSA, that describe the benefits of direct deposit;
- Tent cards for bank lobbies also available for free from SSA; and
- Expanded use of direct deposit within their organization through interest distribution on CDs and other investment products.

To receive free direct deposit promotional materials from SSA, call Rick Rosen at (410) 965-0390. For more information on direct deposit, contact Kathy Paese of the St. Louis Fed at (314) 444-8453.

Kevin L. Kliesen

The New GDP: "Chainging" with the Times

In January 1996, the U.S. Department of Commerce changed the way it calculates real gross domestic product (GDP)—the broadest yardstick available for gauging the economy's performance. Most economists agree that accurate estimates of any measure of economic well-being are a necessity, but particularly so for GDP estimates, which affect everything from a firm's sales forecast to presidential elections.

To calculate GDP, the number crunchers at Commerce add up the current dollar value of spending on new goods and services produced in the economy each quarter. These data—culled from the tax returns, census surveys and profit statements of households, businesses and other government agencies—are grouped into four main components: spending by consumers, businesses, government and foreigners (less spending on imported goods by U.S. residents). The sum of these components equals the current dollar value of GDP, otherwise known as nominal GDP. These components are first "deflated"—that is, an adjustment is made for inflation—by a series of price indexes and then "summed up" to equal real GDP.

Under the old measure, these price indexes were known as "fixed-weighted" indexes because they measured changes in prices relative to a fixed base year, which Commerce would change about every five years.

This measure was flawed, however, because of the significant changes that occur in the economy over time. Moreover, because these structural changes cause corresponding changes in the relative prices of goods and services produced in the economy, the purchasing patterns of consumers and producers can also change markedly over time. For instance, technological innovations tend to lower the cost of producing a product like computers, thereby increasing the quantity of computers sold and produced. Thus, all other things equal, the value of computer output as a percent of the total value of real GDP should increase.

The old measure of GDP was flawed because of the significant changes that occur in the economy over time.

Fixed-weighted price indexes do not handle these types of changes well because their prices are tied to a specific base year. As a result, the accuracy of GDP calculated using this method erodes over time. To counter this, Commerce has decided with the new method to calculate real GDP using "chain-type" price indexes.

Simply put, instead of measuring prices and quantities relative to a fixed base period (fixed-weighted indexes), a chain-weight measure of GDP uses prices and quantities from the current year and the previous year. In this way, more current prices are used to calculate real GDP, thereby better incorporating changes in the structure of the economy that are reflected in prices and quantities of goods and services.

For example, in 1987, according to the Commerce Department, today's Pentium personal computer would have cost about the same as what a new car cost—a little more than $13,700. Thus, each new computer and new car produced would have added the same dollar amount to real GDP. By 1994, however, because of falling computer prices, the average price of a new PC was about $2,500, while the price of a new car was about $19,700. Using fixed 1987 weights meant that each new PC produced in 1994 was still being counted as if it were equal to one new car ($19,700), rather than its actual amount (about $2,500). Thus, under the old method, because the value of computer output was being overstated, estimates of real GDP were overstated as well.

The new chain-weighted measure should correct for these discrepancies, which, in turn, should produce more reliable estimates of economic growth.

Kevin L. Kliesen is an economist in the Research Division at the Federal Reserve Bank of St. Louis.

Regional Roundup

OUT FOR

COMMENT

The following is a Federal Reserve System proposal currently out for comment:

■ **Request for public comment on whether the rules under Truth in Lending (Regulation Z) provide adequate protection for consumers seeking home-equity lines of credit. Comments due by April 1, 1996. (Docket No. R-0913)**

Direct all comments to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th St. and Constitution Ave., N.W., Washington, D.C. 20551.

Fed Surveys Bankers on Account Prototype

Eighth District bankers were among those surveyed nationwide in late 1995 for their input on a proposed interstate branching account model. Industry feedback will help the Fed structure the new account model, which is expected to be announced by mid-1996, so that it meets customer needs.

The new model will address how banks with offices across several Fed Districts can most effectively manage their accounts when interstate branching is fully under way in 1997. While the model will provide for a consolidated view of account balances, banks should be able "to slice and dice the detail any way they want, depending on their informational needs or organizational structure," explains Hillary Debenport, assistant vice president at the St. Louis Fed.

Enhanced EDITH®

Users of EDITH, the Eighth District Interactive Telephone Helpline, will be converted to an upgraded version of the voice response system by March 18. The new system incorporates improved security features to better safeguard customer account information. The new system also calls for all customers to use a new telephone number: 1-800-333-0864. The local number will no longer be effective.

If you have questions about the new EDITH or would like to receive a quick reference guide that will help you use it, call Customer Access Support at (314) 444-8999 or 1-800-333-0871.

New Fed ACH

Fed ACH customers will soon be receiving a Fedline patch enabling them to expand their use of the new Fed ACH software that was implemented late last year. Once it's loaded, the patch will enable users, via a Fedline terminal, to receive current-day ACH files and balance reports on-demand, as well as inquire on ACH files awaiting delivery, at anytime during the day.

In addition, after all Districts have converted, which is expected to be sometime this fall, Fed ACH users will be able to request their own remakes of advices or files, and initiate online item traces and file inquiries.

Surprise: Branch Numbers Continue to Rise

The number of banks in the Eighth District may be declining, but the number of branches is continuing to rise.

St. Louis Fed data show that, in the Eighth District, the number of branches rose an average of 6 percent from 1991 to 1995. About a quarter of the increase is due to the acquisition of thrifts by banks.

Overall, though, the figures counter the notion that branches are being made obsolete by factors like electronic banking and industry consolidation.

St. Louis Fed economist Neil Stevens says that electronic banking has not developed to the point yet where it would greatly influence branch closures. In addition, Stevens says, the Eighth District has seen little in the way of same-market mergers, which shrink the number of branches. "We haven't had any huge in-market combinations in recent years," he says.

On the flip side, Stevens says, the population continues to spread in metropolitan areas like St. Louis, necessitating branches in areas farther out. The upshot: "Old offices don't get closed as fast as the new ones get opened."

Number of Eighth District Banks and Branches

Year	Number of Banks	Number of Branches
1991	1239	2986
1992	1196	3150
1993	1168	3316
1994	1124	3543
1995	1079	3791

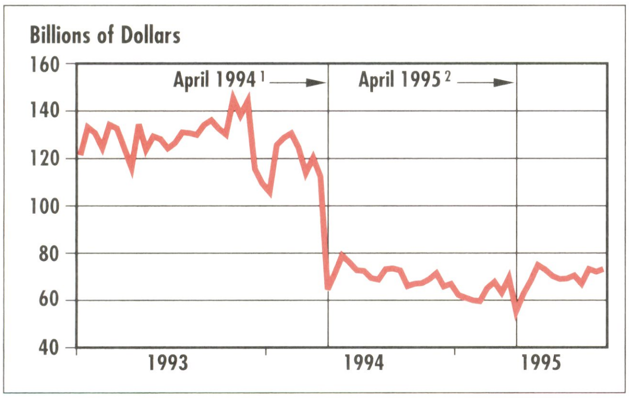
SOURCE: Federal Reserve Bank of St. Louis (Customer Information System)

Daylight Overdraft Fees Found Effective

The fees that the Federal Reserve began charging two years ago for daylight overdrafts incurred in Reserve Bank accounts have produced dramatic results, bringing peak daylight overdrafts down below the level of the mid-1980s, in constant-dollar terms. This conclusion is the result of a two-year study of the policy by the Federal Reserve Board.

In the first 12 months of the daylight overdraft fee program, the Fed collected a total of $18.5 million in fees from 280 depository institutions nationwide. In the Eighth District, the Fed collected roughly $87,000 in fees from 12 institutions.

Peak Daylight Overdrafts



NOTE: Biweekly averages of daily data, Jan. 6, 1993 to Oct. 11, 1995

[1] 10 basis point daylight overdraft fee implemented

[2] 15 basis point daylight overdraft fee implemented

The bulk of the effect appears to be due to the initial institution of fees—10 basis points of chargeable daily daylight overdrafts—in April 1994. The additional increase of 5 basis points instituted in April 1995 has had little additional effect, prompting the Fed to put off the increase it had scheduled to start this April until it can evaluate the results of the 1995 raise.

The fees have produced several other effects in the two years since their passage. They've caused:

- a shift in the overall intraday peak of overdrafts to earlier in the day. This shift is caused by U.S. government securities dealers now arranging their financing transactions earlier in the morning and delivering securities used as collateral for repurchase agreements more quickly to cover overdrafts caused by early-morning repayment of maturing repurchase agreements.
- a reduction in daylight overdrafts that parallels the concentration of overdrafts that existed before the implementation of fees. Specifically, more than 90 percent of the System-wide reduction in average overdrafts has come from the six institutions that generally incur average per-minute overdrafts of more than $1 billion. Overdrafts among these banks have fallen 45 percent.
- an overall reduction in positive intraday balances in Reserve Bank accounts. In the six months after the start-up of overdraft fees, positive intraday balances averaged about $70 billion, compared with $90 billion in the six months before April 1994.

The fees supplement the quantitative limits on daylight overdrafts, known as net debit caps, set by the Fed in 1985. The caps, which are based on a variety of factors and average about 20 percent of an institution's capital, have proven to be the most effective method of managing overdrafts in all but the largest institutions.

The Federal Reserve Board is continuing to look for additional ways to reduce the volume of daylight overdrafts. Possibilities include: the development of an intraday funds market, greater use of private payments systems and increased netting of securities transactions.

District Banks Can Hold Their Heads High

In the Eighth District, only about 40 percent of account-holding institutions have any daylight overdrafts, and less than 30 of them breach their net debit caps. Of those that incur daylight overdrafts, only about six are charged fees.

"A lot of banks in our District never go overdrawn," says Hillary Debenport, assistant vice president at the St. Louis Fed.

Even though they have no history of daylight overdrafts, many Eighth District banks have implemented additional account controls to ensure compliance with the overdraft policy.

"The majority of them have made a lot of changes just to be cooperative," Debenport says. "We really appreciate their effort since it has helped the Fed reduce overall risk in the payments system."

FedFacts

Help for Nondeposit Investment Compliance

The Federal Reserve System has developed a checklist to assist state member banks in their compliance with the Interagency Statement on Retail Sales of Nondeposit Investment Products. The checklist highlights key features of the statement, which was issued in 1994, and focuses on provisions that examiners have identified as important for banks to monitor.

While not intended to be a substitute for a thorough understanding of the Interagency Statement, the checklist can serve as a guide for periodically reviewing your bank's compliance performance. It also can be used to identify additional staff training needs and areas requiring improved procedures and controls.

To receive a checklist, contact Bernie Berns of our Public Affairs Department at (314) 444-8321.

Mutual Funds Education Material Available

The Federal Reserve System has developed an educational program, *Mutual Funds: Understand the Risks*, to help consumers understand the difference between insured bank deposits and uninsured investment products. Program materials include an eight-minute video and a resource kit, complete with a script, overhead masters, consumer handouts and sample publications. The kit also contains information on how to plan and implement a consumer seminar. To order copies of the video or the kit, contact Bernie Berns of our Public Affairs Department at (314) 444-8321.

Risk Management in '96

The Federal Financial Institutions Examination Council (FFIEC) will hold two risk management planning seminars this year: April 18-19 in San Diego, Calif.; and Sept. 26-27 in Kansas City, Mo. The seminars will cover a variety of risk-related topics, such as the implications of interstate banking, the risks of emerging technologies and a summary of pending legislation and its potential impact on risk management. For more information on the seminars or to register, contact the FFIEC at (703) 516-5588.

Calendar

Upcoming Fed-sponsored Events for Eighth District Depository Institutions

"Examining for the CRA" Seminars

Small Institution Seminars

March 12—Columbia, Mo.
March 14—St. Louis, Mo.

Large Institution Seminars

March 13—St. Louis, Mo.

For more information on Examining for the CRA seminars, call Diana Judge at (314) 444-8751.

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