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Fed Standardizes Operating Circulars Nationwide

To accommodate interstate branching and the Fed's new account structure, the Federal Reserve will issue new operating circulars for all of its services. The new circulars will be uniform across all Reserve Banks, making it easier for depository institutions who wish to conduct business in multiple Fed districts. The circulars will be distributed later this year and will take effect on Jan. 2, 1998.*

The standardization of operating circulars was prompted by recent changes affecting the banking industry, among them consolidation, technology and interstate banking. The new circulars will complement the account structure being implemented by the Fed in January. Under this structure, each separately chartered depository institution will be able to establish a single master account at a designated Reserve Bank and apply identical operating requirements for any Fed service, regardless of the Fed district in which that service is obtained. For customers with branches in multiple districts, these changes will render traditional geographical boundaries virtually obsolete.

For most institutions without interstate branches, the new circulars will not represent a significant change. Moreover, in most cases, existing agreements between customers and the Fed will remain valid; new agreements must be executed only for the circulars on lending and account relationships.

In the Eighth District, there are currently 22 operating circulars, or operating letters; this number will be reduced to 11 (see below). The circulars will be printed individually in booklet form and packaged in a three-ring binder. Accompanying the binder will be a summary of the changes contained in the new versions and a list of contacts at the St. Louis Fed who can respond to questions.

Customers will notice that the new circulars have been streamlined, with references to operating procedures, time schedules, deadlines, prices, etc. eliminated from the text. The Fed will communicate this type of information in other ways. Customers will also note that Circular No. 11 (Net Settlement) is missing from the binder. The Federal Reserve is planning changes to its net settlement service in 1998, and a new circular, for the revised service, will be issued at that time. In the interim, net settlement customers will receive amendments to existing agreements in a separate mailing. If you have questions about the new circulars, please contact Bernie Berns at (314) 444-8321.

The Federal Reserve Bank of St. Louis Operating Circulars

1. Account Relationships
2. Cash Services
3. Collection Of Cash Items And Returned Checks
4. Automated Clearing House Items
5. Electronic Access
6. Funds Transfer Through Fedwire

7. Book Entry Securities Account Maintenance And Transfer Services
8. Collateral
9. Federal Tax Payments And Treasury Tax And Loan Depositories
10. Lending
11. Net Settlement Arrangements* (* To be issued in 1998)

** The effective date of Circular No. 9 may be later than Jan. 2, depending on the date the Treasury adopts some pending revisions.*



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The Benefits and Hazards of Privatizing Social Security

Patricia S. Pollard

Recently, there has been increasing talk about privatizing the U.S. retirement system—Social Security. Privatization would entail the elimination of Social Security taxes; instead, workers would be required to allocate a fraction of their wages to retirement funds—typically mutual funds. Upon retirement, workers could convert these funds into annuities.

Social Security operates essentially as a pay-as-you-go (PAYG) system. The taxes paid by each generation of workers fund the retirement benefits of the previous generation of workers. While each generation of workers has been confident that its retirement would be financed by the next, this confidence is eroding. Increases in life expectancy and declines in fertility are resulting in a rise in the number of retirees supported by each worker. At the same time, benefits have been rising faster than real wages, further increasing the cost per worker of maintaining the current system. Because of these demographic and economic trends, by 2029 Social Security tax receipts are expected to cover only 75 percent of benefits. And this shortfall will grow.

Privatization would eliminate the PAYG nature of the system. Each worker's contribution would be invested in assets to finance his or her own retirement. Thus, an individual's retirement is fully funded upon retirement rather than depending on contributions from the next generation of workers.

Such a system provides advantages for retirees and the economy. While the current Social Security system has provided a high rate of return on the contributions of previous generations of workers, this rate of return is declining precipitously because of the factors cited above. Allowing individuals to invest their contributions in financial assets raises their potential return. Secondly, Social Security contributions are not savings but simply an intergenerational transfer. A fully funded system should increase savings and thus investment in the economy, resulting in higher economic growth and, therefore, a higher standard of living for all.

If privatization can provide higher rates of return and higher standards of living, why then haven't we eliminated the old system and moved to the new one? Because privatization is not without pitfalls. The most difficult problem is how to handle the transition from a PAYG to a fully funded system. Whereas young workers and future generations should benefit from a fully funded system, many current retirees and those nearing retirement could be left destitute if the current system was abolished.

Clearly, eliminating the benefits to current retirees is not an option. However, requiring the current workers to continue financing these benefits while saving for their own retirement is also not a desirable option. One possibility is to gradually increase the portion of a worker's salary that must be invested in a retirement plan while gradually reducing the Social Security taxes workers pay. This would increase the time before a fully funded system would become operational, but would also reduce the transition costs which any one generation would bear.

Another obstacle to replacing the current system with a private system is that the investment risk individuals must bear is higher under the latter. Because of a poor investment strategy or a prolonged downturn in financial markets, an individual may approach retirement age with less savings than expected. A way to overcome this problem is to maintain a portion of Social Security taxes to provide a minimum income guarantee of some insurance against market risk in addition to providing a boost to the retirement income for low-wage workers.

Developing a retirement system that combines aspects of public (PAYG) and private (fully funded) systems should promote economic growth while maintaining a safety net for retirees.

This article is based upon the Federal Reserve Bank of St. Louis' 1996 Annual Report titled: *Will Social Security Be Here for Future Generations?* The report is available on the Internet at www.stlouisfed.org. You may request a hard copy by calling Debbie Dawe at (314) 444-8809.



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<https://www.stlouisfed.org/publications/central-banker/fall-1997/fed-provides-help-in-developing-cdc-plans>

Fed Provides Help in Developing CDC Plans

The Fed recently produced a video and a century date change (CDC) bulletin to help financial institutions address the CDC problem. The video highlights the importance of the CDC initiative to financial institutions, and the bulletin provides more specific information regarding Federal Reserve applications that your institution may use. The video or printed materials may be obtained by contacting Jeff Dale at (314) 444-8400 or your account executive.



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EBT Moves Along in Eighth District

Conforming somewhat early with the federal welfare reform mandate that requires all states to implement Electronic Benefit Transfer (EBT) services by 2002, the Eighth District's seven states are making strides toward that goal. Two states, Illinois and Missouri, are well into their pilot stages, while the other five are planning to launch their EBT pilots soon (see map).

EBT represents another step toward a complete electronic payments system. By 2002, recipients of state and federal benefit payments no longer will receive checks or food stamps. Instead, those with bank accounts can request direct deposit for their cash benefits. For those without bank accounts, as well as everyone enrolled in food stamp programs, states will issue EBT magnetic-stripe or chip-based smart cards, which will be used at automated teller machines (ATMs) or retail point-of-sale (POS) terminals. Users will be able to access cash benefits through any ATM that displays the Quest® mark. To activate the cards, recipients will use a four-digit PIN number.

In some states, financial institutions participating in EBT systems can gain additional fees through increased ATM transactions. Financial institutions should also see reduced food coupon processing costs under EBT. Institutions that elect to impose a surcharge for transactions must post this information on the ATM. Each state will decide whether to charge clients monthly maintenance fees for EBT accounts.

Besides using ATMs, individuals can perform EBT transactions at participating neighborhood merchants featuring the Quest logo. Some states, like Missouri, offer incentives to merchants who accept EBT cards. Also, Missouri merchants are able to accept EBT cards for debit payments, thus mitigating the need for the recipient to carry cash.

For more information about EBT, contact Cheryl McCarthy at (314) 444-8459.

EBT in the Eighth District

Missouri—Pilot started in June 1997; Thirteen counties in Southeast Missouri were added Sept. 1; Statewide implementation to be completed by May 1998.

Illinois—Pilot began in October 1996; Program expanded over the summer to include the northern 23 counties of the state, plus half of the Chicago area; Statewide implementation to be completed by November 1997.

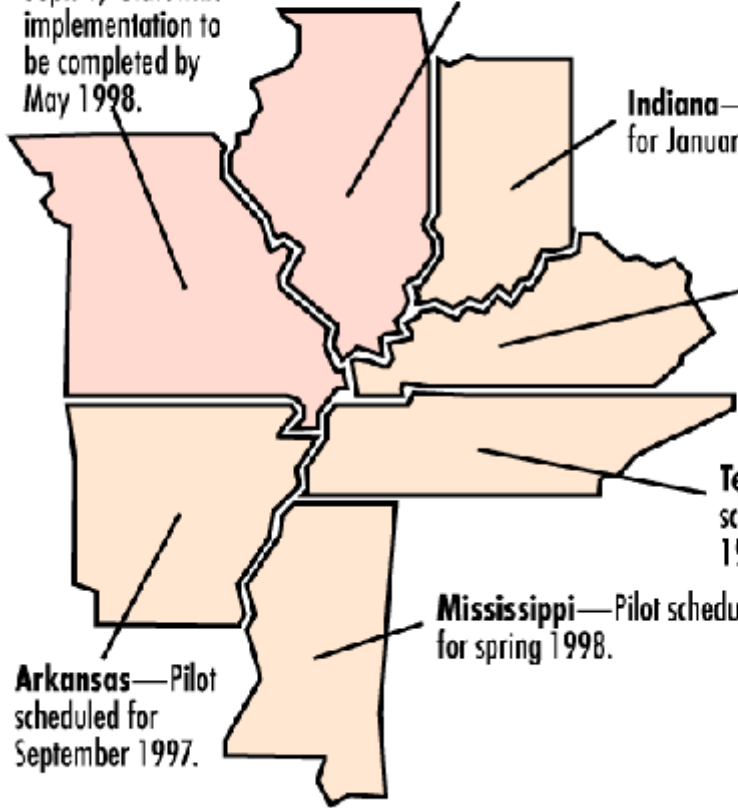
Indiana—Pilot scheduled for January 1998.

Kentucky—Pilot scheduled for April 1998.

Tennessee—Pilot scheduled for April 1998.

Mississippi—Pilot scheduled for spring 1998.

Arkansas—Pilot scheduled for September 1997.





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<https://www.stlouisfed.org/publications/central-banker/fall-1997/new-community-profile-of-st-louis-msa-to-be-released>

New Community Profile of St. Louis MSA to Be Released

The St. Louis Fed's new profile, Community Investment Opportunities for St. Louis, will be released in October. The profile is divided into sections on community development, economic development, affordable housing, small business, rural development and community investments. It includes tables that provide demographic data for each county in the St. Louis MSA.

By combining information obtained from on-site interviews in the community with analysis of census and lending data, the profile helps financial institutions identify lending, service and investment opportunities. It also identifies many of the local, state and national organizations active in community development, as well as existing programs available to enhance affordable housing and small business development. The profile emphasizes opportunities for creating partnerships and working relationships between financial institutions and these organizations and programs.

In addition to the new St. Louis profile, others are available for the following areas: Little Rock (recently updated) and Fayetteville-Springdale-Rogers, Ark.; Evansville, Ind.; Louisville and Owensboro, Ken.; Columbia and Springfield, Mo.; Jackson and Memphis, Tenn.; and eight rural areas in the Lower Mississippi Delta Region covering parts of Arkansas, Illinois, Kentucky, Mississippi, Missouri and Tennessee. In addition, a community profile of the Texarkana MSA in Texas and Arkansas is being prepared jointly with the Federal Reserve Bank of Dallas. All Eighth District profiles are available by calling Diana Judge at (314) 444-8761.



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<https://www.stlouisfed.org/publications/central-banker/fall-1997/century-date-conversion-no-time-to-waste>

Feditorial: Century Date Conversion: No Time to Waste

Joan P. Cronin

If the banking industry plans to provide financial services competitively and profitably in the near term, its conversion to Year 2000 compliant technology must be almost transparent to its customers. According to a recent FFIEC survey, some institutions have yet to complete their Year 2000 plans. Because an awareness of Year 2000 issues appears mixed among senior management and directors of smaller institutions, I encourage all institutions to complete plans that are fully consistent with key dates in FFIEC supervisory guidance.

By Sept. 30, 1997, all critical applications should be identified, and plans that include priorities for work during 1998 should be in place. By Dec. 31, 1998, programming changes and hardware updates for these applications should be complete, and testing should be well under way.

In addition to making an assessment and completing renovation or replacement plans for their own software and hardware, institutions should check the progress of the plans of their suppliers. For example, those institutions relying on data processing support from third-party service providers or software vendors must evaluate and monitor the progress of these companies in renovating their software. In particular, these providers should have an all-inclusive testing plan that covers their own internal testing and describes the methodology and extent of testing at client banks. Testing of interfaces and exchange of data between different vendors' software products should also have high priority. Vendors should provide periodic Year 2000 progress reports to their client institutions.

In addition, institutions should evaluate any borrowers with significant credit exposure to determine the effectiveness of their Year 2000 planning. Plans of other corporate customers must also be evaluated to ensure that they will be able to exchange and settle payments timely.

Testing is critical to Year 2000 implementation. Both incremental changes to hardware, software and upgrades, as well as connections with the systems of all counter parties, must be tested. Finally, realistic contingency plans should be in place for instances where it appears that full and timely compliance with year 2000 may not be attained.

Our discussions with Year 2000 experts, bankers and field examiners indicate that some financial institutions have not yet considered all the implications of the Year 2000 problem. Now is the time for managers to begin preparing their institutions for this conversion.



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<https://www.stlouisfed.org/publications/central-banker/fall-1997/regional-roundup>

Regional Roundup

New ACH Deadline Eliminates Surcharge

Beginning Oct. 1, the Federal Reserve will extend its deadline for ACH items by five hours. The regular billing deposit deadline, previously known as the premium surcharge deadline, will be 1 a.m. rather than 8 p.m. Eastern time. This extension eliminates the premium surcharge fee of 0.5 cent for items deposited between 8 p.m. and 1 a.m. Eastern time and may yield annual savings of \$2.1 million to the Fed's ACH customers.

For more information, call Andy Lueckenhoff at (314) 444-8647.

National Consumers Week Coming in October

The U.S. Office of Consumer Affairs has proclaimed Oct. 25-31 as National Consumers Week (NCW). This year's theme, "A Fair Shake Marketplace," emphasizes the themes of honesty, courtesy and fairness in the marketplace.

The Federal Reserve has chosen to focus some of its NCW activities on the Consumer Leasing Act (Regulation M) since new regulations go into effect Oct. 1, 1997. The Consumer Leasing Act covers leases for cars, furniture, cell phones and other items consumers might lease. But most of the recent attention on leasing has focused on vehicles. The Act requires lessors to provide consumers with uniform cost and other disclosures about consumer lease transactions. To help consumers understand their rights and responsibilities under the new leasing regulations, the Federal Reserve Board will release a consumer education brochure Oct. 1. If your bank would like a supply, please fax your request Diana Judge at (314) 444-8753.

Partners Software Still Available

The Fed has distributed more than 35,000 copies of its Partners software to financial institutions, government agencies, community organizations and consumers. The software, created by the Atlanta Fed and introduced in early 1996, helps determine whether a potential home buyer qualifies for a mortgage loan using the buyer's financial situation and various underwriting criteria. For applicants who may not qualify for conventional home purchase loans, Partners offers suggestions to overcome these barriers.

To obtain copies, call Diana Judge at (314) 444-8761 or download the software from the Atlanta Fed's homepage (www.frbatlanta.org).

Fed Measures Quality

The Federal Reserve Bank of St. Louis has published its 1996 quality measures for its financial services in a publication called *Targeting Perfection*. The Fed tracked these measures to ensure it is meeting its customers expectations and operating requirements.

Later this year, the Fed will publish a quality measures report for the first three quarters of 1997. If you have any questions or would like extra copies, please call Cheryl McCarthy at (314) 444-8459.



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FedFacts

Two Versions of FCA Now Available

The Federal Reserve has reintroduced two improved versions of Functional Cost and Profit Analysis (FCA), the unique accounting service that assists financial institutions in identifying costs, comparing performance and managing for profitability.

Under FCA Basic and FCA Plus, the Fed creates profitability reports for financial institutions, then compares their results with those of other institutions. New features of FCA include direct and indirect cost analyses, as well as updated transaction costing that recognizes both electronic and non-electronic transactions.

For more information, call Marilyn Corona at (314) 444-8883.

Feds Switch to Common Image Format

By Jan. 1, 1998, all Federal Reserve Banks are planning to export Image data using a new standard called the Common Output Format (COF). By converting to COF, the Fed will standardize the format of exported data regardless of type of media or type of Image system used to capture, store and export it.

Financial institutions that receive images on CD-ROM or magnetic tape from the Fed will need to work with their software vendors to ensure that their software can understand COF. For more information, call David Grace at (314) 444-4259 or your Fed account executive.

Fedwire to Expand Hours

On Dec. 8, the Federal Reserve's Wire Transfer System will open for business at 12:30 a.m. Eastern time, eight hours earlier than the current opening. Participation is voluntary, and those who use the expanded hours can start at any time within the period. The Fed will provide a list of participants to financial institutions in the near future.