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Feditorial: Reports of the Death of Banks are Exaggerated

W. LeGrande Rives

A century ago this month, Missourian Mark Twain responded to rumors of his death and impoverishment by quipping, "The report of my death was an exaggeration." Just as Twain was alive and well in 1897 when he made this now-famous remark, banks, too, are alive and well in 1997. Over the past five years, banks have been extremely successful when measured by profitability and return to shareholders. But given the headlines and publicity surrounding the Internet, electronic transactions, changes in the payments system and the delivery of financial services, one might not think this is the case.

According to some reports, technology firms and use of the Internet will soon dominate the payments industry. A famous technology company CEO even went so far as to call banks "dinosaurs" and suggested that their days as viable players in the payments and financial services industry were numbered. I disagree. While I recognize that technological and institutional change is occurring at a rapid pace in the banking industry, I don't believe the fundamentals of banking services, such as deposit taking, lending, personal investment and trust, will change in the near future.

What will change are the access and delivery channels for banking services, through the increased use of electronic networks, personal computers, stored-value cards and other forms of electronic money. Headlines about "exchanging" electronic money on stored-value cards or "downloading" electronic money to computer disks are prevalent in today's financial publications, but the reality is that these are not new forms of money. Rather, they are new ways to exchange ownership of credit money. If you follow these new electronic transactions from beginning to end, it becomes clear that depository institutions are still required to convert electronic "credit money" to "base money," or currency.

My forecast is that, over the next 10 years, payment alternatives will indeed proliferate, but bank customers will also continue to use traditional payment forms like checks. What will emerge is a more diverse payments environment with more high-tech choices for customer payment streams, perhaps creating an increase in total transaction volume. As more individuals demand electronic access to their deposit accounts, depository institutions must be ready and willing to aggressively compete for these customers. The challenge for bankers will be to profitably integrate electronic and paper-based payments streams-not replace one with the other.

To meet this challenge, depository institutions must stay in touch with their customers' needs and be willing to offer new electronic services and delivery channels. If they don't, their customer base—perhaps their most profitable customers—will begin to erode. However, if banks are able to offer the benefits of a more electronic payments system, along with those of the more traditional legacy payments and banking services, then reports of their demise, like Twain's, are indeed exaggerated.

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Accounting for the Growth of Credit Card Debt

Peter S. Yoo

Much has been made recently about the growth and size of the credit card debt of American households. Consumer revolving credit outstanding, which includes credit card debt, totaled more than $480 billion in March of this year, growing at a 13 percent annual rate since the end of the last recession. Unfortunately, such aggregate data combine the behavior and circumstances of many households into a single statistic that is hard to interpret because they do not reveal which households, lower- or upper-income, contributed more to the growth of credit card debt. They also do not indicate which factor—the increasing number of households with credit cards or rising average balances per household—played a larger role in expanding the size of credit card debt. Without such information, inferences about the continued growth of credit card debt and its burden on households are hard to make.

The Surveys of Consumer Finances are a source of data collected from individual households that spans the period between 1983 and 1992—10 years that correspond roughly to the last complete business cycle. During that decade, consumer revolving credit outstanding grew at an average annual rate of 14 percent, which is faster than the current rate. The data from the surveys suggest, however, a more sanguine picture about the growth of credit card debt during the last business cycle, and perhaps for the current period as well.

The individual household data indicate that total credit card debt grew 243 percent between 1983 and 1992. The same data show that the number of households with credit cards increased only 25 percent during that time period, while the number of households grew 14 percent, suggesting a very small increase in the proportion of households with credit cards. In fact, the fraction of households with credit cards increased just 6 percentage points to 72 percent between 1983 and 1992. These figures indicate that only 9 percent to 26 percent of the growth of credit card debt was attributable to the increase in the number of households with credit cards. Because households with credit card experience are presumably more aware of the potential pitfalls of credit card ownership, the growth of credit card debt should therefore have been less troublesome.

Moreover, the household data indicate that the growth of credit card debt between 1983 and 1992 was due in large part to the households in the upper half of the income distribution. According to the data, upper-income households were more likely to have credit cards; in 1992, nearly 90 percent of households in the top half of the income distribution had credit cards, compared with 54 percent in the lower half. The upper-income households also held larger balances; the top half of the income distribution held nearly 74 percent of all credit card balances, with the top 10 percent of households accounting for 17 percent of all credit card debt.

The increase in the number of upper-income households holding credit cards, coupled with the increase in the average balances of upper-income households, accounted for 72 percent of the rise in credit card debt between 1983 and 1992. Again, presuming that upper-income households have the wherewithal to finance their credit card debt, the household data would appear to present a less pessimistic view of the growth of credit card debt.

Although it is clear that credit card debt has grown considerably during the current expansion, aggregate statistics do not provide enough information about why it has grown. Without such knowledge, it is difficult to assess if the debt will excessively burden individual households or if these households may actually know what they are doing.

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Feds Form Electronic Partnership

The St. Louis, Kansas City and Chicago Federal Reserve Banks have formed an alliance with the Mid-America Payment Exchange to increase the awareness and use of electronic payments among financial institutions, corporations, nonprofit organizations and consumers.

Known as the Automated Payments Partnership, the alliance is a multiyear effort that will make use of various communication channels to promote electronic payments across Arkansas, southern Illinois, Indiana, southwestern Iowa, Kansas, Kentucky, Missouri, Nebraska and Oklahoma.

The partnership has three main goals:

- to convince at least 100 companies and 50 nonprofit organizations to begin offering electronic payments;
- to persuade 200 companies that already offer direct deposit to market it to their employees and customers; and
- to encourage 40 utility companies to establish joint marketing campaigns for automatic consumer bill payments.

For information on becoming a partner in the campaign, contact Cheryl McCarthy of the St. Louis Fed at (314) 444-8459.

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Electronic Directions: EDI

A CB series covering electronic payment forms and the Fed's efforts to promote them over paper-based methods.

Thanks to two major government initiatives that are currently under way, the term EDI—which stands for electronic data interchange—is no longer an acronym that bankers can afford to ignore.

Because of the timing, the most pressing of the two initiatives is the Social Security Administration's move to include remittance information in its electronic payments to organizations and individuals who receive the payments on behalf of beneficiaries. Implemented this June, the change in payment method applies to all recipients who are newly eligible for Social Security benefits—those who receive payments on the second, third or fourth Wednesday of each month.

This means that, for example, a nursing home that has been used to handling Social Security payments for its patients will now have to divide up a lump sum electronic payment according to the addenda information attached to it. If the nursing home's financial institution is unable to translate this information into readable characters, the home will have no idea how much to credit each resident's account.

Although the amounts received by beneficiaries are generally stable and well known, they will vary when the government's cost-of-living adjustments go through at the first of each year, making it essential for a nursing home, hospital or similar facility to have a financial institution that's EDI-capable.

The second major government initiative that is bringing EDI to the forefront is EFT 99—the government's plan for converting nearly all of the 40 million paper payments it issues annually to electronic form by Jan. 1, 1999.

The plan also calls for payment and remittance information to accompany vendor payments. This information, which is included in addenda records, will be indispensable to vendors since they'll need to determine which invoice the payment is for or if the payment is intended to cover more than one invoice.

The upshot of both of these initiatives for bankers is simple: A financial institution that is not EDI (FEDI)-capable stands a good chance of losing business to one that is. With that in mind, the Federal Reserve Bank of St. Louis this fall will continue a campaign explaining to Eighth District bankers the business opportunities brought by EFT 99—one of the biggest of which is EDI.

To become EDI-capable, contact your software vendor.

Key EDI Terms

EDI: Stands for electronic data interchange, which refers to the electronic exchange of business information between or within firms using standard, machine-processable structured data formats.

FEDI: Stands for financial electronic data interchange, which is a subset of EDI that combines the actual payment for goods or services with the conveyance of remittance data, such as invoice numbers, payment terms, etc.

EFT: Stands for electronic funds transfer, which occurs among companies, consumers and governments.

VAN: Stands for value-added network, which facilitates the exchange of payment information between firms that use different communication protocols, transmission speeds and hardware.

VAB: Stands for value-added bank, which provides EDI and FEDI services including payment posting and translation of addenda records.

ANSI X12 Standard: A technology standard for electronic data interchange. Named after the committee that developed it, the ANSI standard has since been adopted by several industry groups.

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New $50 Bill to Roll Out Soon

In an effort to further reduce counterfeiting and make U.S. currency easier to recognize, the Treasury Department will issue a redesigned $50 note this fall. The new $50 is the second in the U.S. currency series to include enhanced security features; the redesigned $100 note was issued last year. As with the $100 note, $50 notes from the old series will continue to be honored at full face value while the new notes are being phased in Reserve Banks will retire the old notes as they are returned through the banking system.

Features of the new bill include:

- a larger, off-center portrait of Ulysses S. Grant; a watermark to the right of the portrait;
- color-shifting ink on the number that appears in the lower right-hand corner on the front of the bill;
- fine concentric lines printed behind both the portrait and the building; and
- an oversized "50" printed on the lower right-hand corner on the back of the note to accommodate people with low vision.

Features that have not changed include:

- size of the bill;
- ink colors; and
- paper

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Regional Roundup

Automated Adjustments System Implemented

Since April, the St. Louis Fed has been using an automated system to research and monitor all customer adjustments requests. The new system offers a variety of features to improve efficiency and enhance customer service.

In addition, the automated system includes an interface to Fedline, enabling all Fedline requests to be handled same-day. The Fedline connection also provides other check reporting options, including mixed cash letter availability and autocharge reports.

Fedline Advices Altered

On May 23, all Eighth District customers began receiving telephone and paper advices of Fedwire funds transfers credited to their accounts in a slightly different format. The new, more comprehensive, format offers increased opportunities for automation of funds transfers; eliminates the potential for truncation when payment orders are received from other large-dollar payment networks; and permits the inclusion of more complete information. The origination of funds transfer messages in the expanded format is scheduled for implementation in the second half of 1997.

New Contingency Service Available

The St. Louis Fed is now offering a service that enables area financial institutions to provide their customers with uninterrupted payments processing in the event of a disaster. Through this new contingency service, institutions are able to receive MICR transmissions of their customers' check data and image files of the actual checks at a predetermined back-up site.

To activate the service, institutions must pay a one-time set-up fee of $500 and a monthly maintenance fee of $25. In return, they receive an initial test of the connection and systems to ensure workability, as well as biannual check-up tests. If a disaster were to occur, institutions could receive MICR line transmissions, check images or both. If these processing services are ever provided, the normal fees will be charged.

Accounting Contact Changes

Accounting contacts have changed for Federal Reserve account holders in the Little Rock, Louisville and Memphis zones. To ensure that we continue to maintain a high level of customer support in an interstate branching/automation consolidation environment, all Eighth District institutions will now be assisted by St. Louis staff.

Questions on payments system risk policies, overnight overdrafts, reserve and clearing requirements, account management and balance monitoring should be directed to the Payments Risk Management staff in St. Louis.

Questions on accounting and billing statements, mergers, account reconciliation, signature cards and Fedline should be directed to the Customer Accounts and Access Support staff in St. Louis. All Little Rock, Louisville and Memphis account holders should have received a detailed list of accounting contacts and their telephone numbers earlier this year. If you did not receive the list, or if you have questions, call Hillary Debenport at (314) 444-8488 or your current Fed Accounting Department.

Little Rock Branch Names New Officer

The St. Louis Fed has announced the appointment of Andrea Eddy to officer in its Little Rock Branch. In her new position, Eddy is responsible for the Branch's Check/Data Processing Department, as well as Accounting/Personnel and Community Affairs. Eddy will also accompany account executive Danny Wilson on visits to Little Rock-area bankers. Eddy has been with the Federal Reserve System since 1990.

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FedFacts

Community Affairs Revamps, Renames Newsletter

The St. Louis Fed's Community Affairs Department has expanded and redesigned its quarterly newsletter. *Bridges* is now twice the size of its predecessor, which was called *Community Affairs*, and features color photographs. Bridges is intended to encourage greater participation and cooperation in public/private partnerships that support community development lending. The publication contains news of interest, regulatory changes that affect community development activities, and a calendar detailing upcoming community affairs conferences and events. To receive *Bridges*, call Diana Judge at (314) 444-8761.

New Publication Lists Applications, Notices

The Federal Reserve Board of Governors has launched a publication, called H.2A, that provides a weekly listing of applications and notices that have been filed under the Bank Holding Company Act or the Change in Bank Control Act. The publication is available in three forms:

- by fax-on-demand by calling (202) 452-3655;
- on the Board's web site, which is at www.federalreserve.gov;
- by mail, which can be set up by either calling (202) 452-3245 or writing to: Publications Services, MS-127, Federal Reserve Board, Washington, D.C., 20551.

New Annual Report Online

The St. Louis Fed's 1996 Annual Report is now available on the Internet. The report discusses social security systems throughout the world, as well as the adjustments needed to keep these systems solvent into the next century. Pension systems in the following countries are also compared and contrasted: Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. The report can be found at www.stlouisfed.org.