Winter 1997

CENTRAL Banker
NEWS AND VIEWS FOR EIGHTH DISTRICT BANKERS
WINTER ISSUE

In This Edition

Small Banks' View of the Fed: Then vs. Now

R. Alton Gilbert
Small banks originally opposed Fed's check collection practices.

Should Community Banks Pursue Electronic Banking?

Certain segments of society may move to electronic banking quicker than others.

St. Louis Fed President Resigns

Defining a Community Bank's Electronic Strategy

Consumer Leasing Act Compliance Delayed

Risk-Focused Consumer Exams to Take Effect

Electronic Payments Fees Plummet Again

Feditorial: Continuing Growth in Technology

W. LeGrande Rives

Regional Roundup

FedFacts

FEDERAL RESERVE BANK of ST. LOUIS
CENTRAL TO AMERICA'S ECONOMY®

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/small-banks-view-of-the-fed-then-vs-now

Small Banks' View of the Fed: Then vs. Now

R. Alton Gilbert

Last year, Federal Reserve Vice Chairman Alice Rivlin headed a committee that nationally solicited payments system participants on how they view the role of the Reserve Banks in providing payment services. Comments received confirmed that relatively small banks located in remote areas are among the strongest supporters of the Fed's payments services. These banks expressed concern about their continued access to check collection and automated clearing house services in the event the Federal Reserve withdrew from these services.

Such banks have not always had a rosy view of Fed payment services. In 1915, when Reserve Banks began their check collection service, the banks that opposed their collection practices most strongly were these same small banks. Many of them considered the Fed a threat to a major source of their revenue: exchange charges.

Banking law in effect prior to the formation of the Fed required banks to pay at par (face amount) for checks presented at their place of business. Banks were permitted to pay less than par, however, for checks presented to them through other means, including the mail.

The rationale for this deduction from the face amount, called an exchange charge, was that paying banks could incur certain expenses in remitting payment to out-of-town collecting banks, including the cost of transporting coins or bank notes to the collecting banks. While these nonpar banks paid collecting banks less than 100 cents on the dollar for checks drawn upon their depositors' accounts, they debited the accounts of their depositors at the full 100 cents on the dollar. This difference was revenue for the nonpar banks.

From the formation of the Fed, the Board of Governors perceived a mandate from Congress to establish a national system for collecting checks at par. Most banks located in large urban areas had been paying collecting banks at par on checks written by their depositors. The nonpar banks were located primarily in remote areas. In 1916, the Board required all banks that were members of the Federal Reserve System to pay at par for checks presented by the Fed, even if the Fed sent the checks to member banks through the mail.

The battle over par check collection involved state-chartered banks that were not Fed members and that refused to pay the Fed at par. To promote use of its collection system, the Fed decided to accept checks drawn upon all banks for collection, including those that refused to pay the Fed at par. The Fed then developed various means of collecting at par from these banks. In some cases, it enlisted the help of member banks with offices located near the nonpar banks; member banks presented the checks at the place of business of the nonpar banks and demanded payment in cash at par.

Nonpar banks strongly opposed these practices and accused the Fed of harassment. They filed several lawsuits against the Fed. In 1923, the U.S. Supreme Court ruled against the Fed, saying that since Congress did not require the Fed to establish a national system for check collection at par, the Fed could not compel banks to pay at par. After this ruling, the Fed ended the practice of accepting for collection checks drawn upon banks that refused to pay at par. The practice of nonpar banking persisted for several decades. The number of nonpar banks fell below 1,000 for the first time in 1968, but nonpar banking did not disappear until the 1980s.

Thus, comments by bankers to the Rivlin Committee illustrate an historic irony: those small, remote banks that once saw Fed services as a threat to their revenue now see these services as crucial in keeping the financial services field competitive.

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/should-community-banks-pursue-electronic-banking

Should Community Banks Pursue Electronic Banking?

With all the news about technological advances available to the financial services industry, community bankers may be wondering if more of their customers will be asking for remote banking services. As electronic banking services become more viable, no one can predict how quickly consumers and businesses will change their habits. There is, however, some high-level demographic information that suggests that at least certain segments of society may move to electronic banking services more quickly than others. The ABA cites several forces that may increase consumers' acceptance of and demand for electronic banking:

- Baby Boomers are getting past the cash-intensive requirement of raising families and into more stable saving patterns; the credit card is not as necessary to "buy now, pay later," and its use may be somewhat replaced by the new "pay as you go" products such as debit cards, stored-value cards or electronic currency over the Internet.
- Busy, dual-income households mean higher income, but also a need for more convenience in shopping, which could eventually make online shopping more mainstream than it is today. Increased demand for online shopping likely will increase the speed of evolution of online payment products.
- Younger generations may be much more comfortable with the advanced technology, having grown up using computers for leisure and schoolwork activities. The proliferation of computer users may spur online shopping and the use of electronic forms of payment.

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/st-louis-fed-president-resigns

St. Louis Fed President Resigns

Thomas C. Melzer, the president of the Federal Reserve Bank of St. Louis for nearly 13 years, has announced his retirement, effective Jan. 31, 1998. John F. McDonnell, chairman of the Bank's board of directors, has formed a search committee and hopes to have a successor in place within a few months.

Melzer, 53, joined the St. Louis Fed in 1985 after serving as managing director of Morgan Stanley & Co., Inc. In addition to his responsibilities at the St. Louis Bank, Melzer was chairman of the Financial Services Policy Committee (FSPC), created in 1994 to ensure that the 12 regional Reserve Banks continue to provide reliable, high-quality financial products. Cathy E. Minehan, president of the Boston Fed, will become the new FSPC chair.

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/defining-a-community-banks-electronic-strategy

Defining a Community Bank's Electronic Strategy

If a community banker decides to venture into electronic banking, there are many different strategies for the use of new technology. A bank may position itself as:

Mainstreamer: Banks that delay offering electronic banking and payment products until they become more mainstream. They wait for a critical mass of customers to desire services before making investments.

Marketer: Banks that delay offering electronic banking and payment products but use the new technology to advertise or create goodwill. Examples include home pages on the Internet or selling advertising space on ATM screens.

Improver: Banks that delay implementing the truly advanced technologies but, instead, use "more mature" new technology (i.e., truncation, electronic check presentment, check imaging) to improve internal operations or offer enhanced services to customers.

Partner: Banks that want to implement new technologies and electronic banking products while avoiding the learning curve associated with doing it themselves. They pursue alliances with other organizations that result in giving customers a local option for convenience that big banks offer. These banks may outsource the service to a service-provider or hook up with a developer who is looking for a pilot bank.

Innovator: Banks that are motivated to carve out a niche by offering high-tech electronic banking and payments products. These banks position themselves ahead of the technology learning curve.

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/consumer-leasing-act-compliance-delayed

Consumer Leasing Act Compliance Delayed

The Federal Reserve Board has delayed the compliance date for the final rule regarding the Consumer Leasing Act (Regulation M) until Jan. 1, 1998. This 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.

The new date applies not only to the final rule published in the Federal Register on Oct. 7, 1996, but also to an amendment published April 1, 1997, and the official staff commentary published April 4, 1997.

The Fed is offering a free pamphlet called *Keys to Vehicle Leasing: A Consumer Guide*, which offers a general overview of a closed-end lease, a comparison of leasing and buying, and a sample consumer leasing form. To order this pamphlet, contact the St. Louis Fed's Public Affairs Department at (314) 444-8809.

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/riskfocused-consumer-exams-to-take-effect

Risk-Focused Consumer Exams to Take Effect

The Federal Reserve Board will phase in its new risk-focused consumer compliance supervision program in 1998. As part of the new procedures, the Fed has extended the consumer examination frequency schedule for state member banks and foreign banking organizations.

These procedures are designed to do three things: enhance the effectiveness of the Fed's consumer compliance examination program; reduce the burden of examinations for supervised institutions; and more effectively deploy the Fed's examination resources.

For state-member banks with an exemplary compliance history and assets of less than $250 million, the examination guidelines will extend from 18-24 months to 36 months. Banks with assets greater than $250 million will be examined every 24 months, and banks with performance problems will be examined once every 12 months.

The new consumer examinations will be conducted concurrently with examinations for fair lending laws and the CRA. A critical aspect of the new approach is the correlation of two risk elements, regulation risk and product risk.

Regulation risk involves an evaluation of the potential consequences to the consumer or the bank of noncompliance with consumer protection laws and regulations. Under product risk, examiners will identify the potential risks associated with financial products or services relative to a bank's market position, management expertise and business orientation.

The relationships between these two risk elements will then be correlated to determine the level of review necessary to verify the bank's compliance posture.

The new program also places a greater emphasis on outreach and monitoring activities. The outreach components of the program will be designed to foster compliance through regular contacts with state member banks. These contacts will be conducted apart from examination and supervisory activities, and will include such items as training seminars and advisory visits.

Monitoring efforts will be performed between examinations and will be designed to alert examiners to any potential deterioration in a bank's consumer compliance posture. The conclusions drawn from the monitoring process will be considered when establishing the scope, timing and staffing of future examinations.

For more information, contact Henry Dove at (314) 444-8846.

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/electronic-payments-fees-plummet-again

Electronic Payments Fees Plummet Again

For the fourth straight year, the Federal Reserve is lowering prices for electronic payments services, continuing a trend that it estimates will save the banking industry $15.6 million over the next year.

In announcing its 1998 fee schedules, the Fed lowered prices 11 percent (or 5 cents) for Fedwire funds transfers and by an average of 12.5 percent (or 0.1 cents) for ACH transactions. In general, the Fed is lowering prices for electronic payments and slightly raising prices for processing paper checks. The prices take effect Jan. 2, 1998.

Since 1995, the Fed has progressively lowered prices for electronic transactions, consistent with its long-term strategy to promote this method of payment. The Fed estimates that through its actions, ACH and Fedwire customers will save $41.8 million in fees by year-end 1998.

Recent ACH price reductions are particularly significant, said Paul M. Connolly, product director for the Federal Reserve's retail payments office and first vice president of the Federal Reserve Bank of Boston.

"We have cut the price for some ACH items by as much as 73 percent in the last two years," Connolly said. "We lag behind most industrialized nations in moving toward electronic retail payments. But, by reducing prices while still improving the quality of service to our customers, the Reserve Banks hope to encourage greater use of ACH for such payments."

In November, the St. Louis Fed sent out its 1998 price books. To request additional copies, please contact your Federal Reserve account executive. In addition, the St. Louis Fed's prices are listed on the Bank's home page (www.stlouisfed.org).

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/continuing-growth-in-technology

Feditorial: Continuing Growth in Technology

W. LeGrande Rives

In the coming months, the Federal Reserve Bank of St. Louis will usher in a new era when we welcome a new president. As Tom Melzer prepares to move on, the District staff is deeply grateful to him for nearly 13 years of inspirational leadership, and we wish him equal success with future endeavors. Tom's tenure was a time of rapid technological growth here, during a critical period for the banking industry. Tom was a major contributor to that growth in his role as District president and more recently as chairman of the System's Financial Services Policy Committee (FSPC).

I thought now might be an appropriate time to reflect on some of these advancements. The most obvious technological progress at the Fed has come in financial services. Here, our primary goal has been to promote the move from paper-based to electronic payments. Just a decade ago, most institutions transferred ACH information manually from paper listings or hired couriers to deliver magnetic tape. By 1993, the service was all electronic, enabling us to lower ACH prices and aggressively market options like direct deposit and direct payment. Today, we operate on a national centralized system.

Meanwhile, we've also made major improvements to our check collection services to reduce processing costs and paper handling, while speeding up check collection times. In addition, we've developed, through our Fedline system, an electronic check presentment (ECP) service, moving check collection one stride in the direction of electronic payment. We have also introduced check truncation and imaging services.

In the supervisory arena, we developed information systems which allow us to perform many tasks directly from the Fed, reducing the disruptive hours examiners must spend on-site at financial institutions. Here, technology has improved our ability to identify risk, while reducing the burden of Fed examinations.

Finally, our presence on the Internet permits us to share information with constituents. Today, at www.stlouisfed.org, you will find the latest economic statistics, copies of our publications, educational resources for teachers, and a host of information for bankers.

Clearly, the technological boom of the past decade has enabled us to more effectively carry out our mission. Tom has been a champion of this technological growth, and I anticipate that this trend will continue as we prepare for a change in our District leadership.

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/regional-roundup

Regional Roundup

Reminder: Return Account Relationship Circular Agreement

It is important that each chartered institution that plans to have a Fed account on Jan. 1, 1998, sign and return a new Master Account Agreement to the Fed as soon as possible. The Fed's Payment Risk Management Section has also asked institutions to provide an updated list of contacts.

For more information, call Tammie Hittmeier at (314) 444-8565 or Hillary Debenport at (314) 444-8488.

Texarkana Resource Guide Available

Texarkana Community Partnership Opportunities, a resource guide developed by the Reserve Banks of St. Louis and Dallas, now is available. The guide contains information on organizations and programs working to meet the community and economic development needs of the Texarkana metropolitan area. To request a copy, call Kim Bowlin at (501) 324-8251.

New Look for Monetary Trends

The St. Louis Fed's research publication Monetary Trends, which offers monthly data on commercial bank loans and investments, interest rates and monetary policy, will feature a new format beginning in January 1998. Changes include additional charts replacing growth triangles, as well as a broader selection of data. For a complimentary subscription, call Debbie Dawe at (314) 444-8809.

CENTRAL BANKER | WINTER 1997
https://www.stlouisfed.org/publications/central-banker/winter-1997/fedfacts

FedFacts

Fed Hires Firm for ACH Study

To learn more about corporate and consumer attitudes toward direct payment and direct deposit, the Federal Reserve System recently hired a market research firm to perform an in-depth study on ACH payments. The goal is to define the characteristics of users and nonusers, find out what people like and don't like about electronic payments, and learn how the Fed can position electronic transactions in the payments arena.

In addition, the research will reveal any potential improvements the Fed can make to its ACH service. The study results will be published by mid-1998.

Fed Enhances Account Management Reports

To support its new account structure, which is effective Jan. 1, 1998, the Fed will offer enhanced versions of the ABMS reports (formerly known as the Monitor Balance Inquiry) and the Daylight Overdraft and IAS Account Inquiry reports. ABMS reports delivered automatically to Fedline users will reflect an enhanced format as of Monday, Dec. 15. IAS Account Inquiry report changes became effective Dec. 8.

For more information, contact Danee Appel at (314) 444-4289.

Electronic Call Reports Required

Effective with the Dec. 31, 1997, report date, banks with assets less than $50 million will be required to file their Call Reports electronically or on computer diskette with EDS (the federal bank supervisors' collection agent). Banks may opt to contract with EDS or any other party to convert their paper-based Call Report to an automated format for electronic filing.