



## Summer 1998



### In This Edition



#### [Feditorial: Ducking Those Questions](#)

[William Poole](#)

Every member of the FOMC shares a deep commitment to long-term low inflation.



#### [Do Banks Hold More Vault Cash Than They Need?](#)

[Donald S. Allen](#)

The percentage of reserves covered by vault cash has steadily increased.



#### [What Financial Institutions Should Know about FEDEDI](#)



#### [Direct Payment Campaign Surges Forward in St. Louis](#)



#### [Treasury Direct Investment Participants Received Highest Return](#)



Fed to Unveil Financial EDI Software This Fall

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Regional Roundup

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FedFacts



CENTRAL BANKER | SUMMER 1998

<https://www.stlouisfed.org/publications/central-banker/summer-1998/ducking-those-questions>

## Feditorial: Ducking Those Questions

William Poole

How does the Fed see the economy developing over the rest of the year?"

"What is the Fed likely to do?"

The Fed has a long-standing rule of not forecasting interest rates, but that doesn't stop people from asking Fed employees to do so. Implementing this rule is not always easy, especially when talking with knowledgeable and insistent reporters. I recently talked with one reporter who argued that it is my obligation as a member of a governmental policy board—the Federal Open Market Committee (FOMC)—to fully explain my thinking on current policy. Instead of refusing outright to accommodate such requests, I have so far tried to take a more positive approach by emphasizing the following argument.

The Fed's monetary policy is formed by blending together an amalgamation of views to form one view. At each meeting, we in the FOMC debate the current state of the economy, as well as our forecasts of the future, before voting on policy. Our collective judgment, conveyed to the markets, results in the clearest and most consistent policy possible, which contributes to the stability of the economy. Thus, a member of the FOMC who publicly conveys personal opinions about the future of monetary policy risks splintering this united analysis. While it is important for individual members to not confuse the markets by speaking freely about the Fed's possible actions, one thing that *can* be publicly stated is that every member of the FOMC shares a deep commitment to long-term low inflation.

As the new president of the St. Louis Fed, I am pleased to say that not all of my responsibilities require me to keep a shrewd poker face. This job provides me with ample opportunity to discuss openly a wide range of issues that affect bankers. If I haven't met you already, I look forward to doing so soon at one of the many District Dialogues and banking forums I will be attending in the next several months. I also will continue the Fed tradition of hosting breakfast meetings with business and community leaders throughout the Eighth District. As someone who is new not only to this job, but to this part of the country, I look forward to learning from bankers all that I can about our region. And, of course, I will be happy to answer your questions about the Fed's multifaceted role in determining the future of the economy. Well, perhaps not all of your questions...



CENTRAL BANKER | SUMMER 1998

<https://www.stlouisfed.org/publications/central-banker/summer-1998/do-banks-hold-more-vault-cash-than-they-need>

## Do Banks Hold More Vault Cash Than They Need?

Donald S. Allen

Depository institutions are allowed to use vault cash, in addition to funds held on deposit with the Federal Reserve, to satisfy statutory reserve requirements. In 1992, statutory reserve requirements were reduced. Then, in 1995, banks expanded sweeps, or reclassifications, of customers' cash reserves into savings accounts not subject to reserve requirements. Because of these reductions in required reserves, the percentage of reserves covered by vault cash has increased steadily.

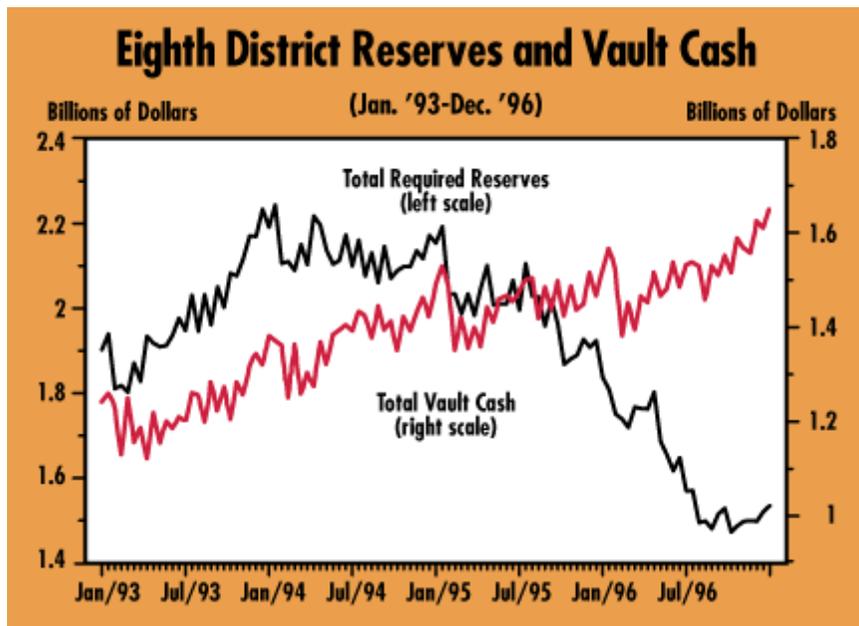
In the Eighth Federal Reserve District, this percentage increased from 54 percent in 1993 to 75 percent in 1996. The number of small banks whose required reserves are completely satisfied by vault cash increased from 73 percent in 1993 to 80 percent in 1996; for medium banks the number rose from 26 percent in 1993 to 49 percent in 1996; and for large banks, from none in 1993 to 28 percent in 1996. The chart shows the downward trend in total required reserves for the Eighth District and the upward trend in total vault cash held by banks through the end of 1996.

Vault cash that is used to satisfy required reserves is not available for lending. So even if vault cash is more than necessary to meet daily demand, the foregone earnings may be small.<sup>[1]</sup> The quantity of "surplus" vault cash (i.e., above that used to meet reserve requirements) also has increased steadily, however. This currency is an idle asset. If banks determine that the potential value of this surplus vault currency exceeds the cost of tighter cash management, they may take steps to reduce the surplus. Indeed, recent developments in 1997 suggest that some banks are becoming more concerned and are considering using consultants to manage vault cash balances more efficiently.

Discussions with some St. Louis banks have revealed that prior to reclassification of customer accounts, the primary concern regarding vault cash was to limit the amount for security reasons. Now that these banks have reduced their reserve requirements significantly, they plan to investigate ways to economize on vault currency.

Some of the factors banks must consider in deciding to implement optimum vault cash management programs include the foregone interest from surplus vault currency, the cost of running out of currency (in ATMs, for example), and the cost of more frequent shipments of currency. The direction of future policies regarding payment of interest on required reserves and commercial customer accounts, and currency access (such as the Fed's new Uniform Cash Access Policy, limiting the number of free weekly deliveries of currency from the Fed) also must be considered.

The degree to which banks implement these optimum cash management programs is of interest to the Fed because it affects cash operations and monetary policy. In a transition period, there may be a net inflow of currency to the Federal Reserve Banks, while measurement of monetary aggregates may become noisier.



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#### Endnotes

1. Required reserves do not earn interest, but banks can earn credits on reserves on deposit with the Fed that may be used to offset fees for Fed services. In addition, banks that maintain clearing balances at the Fed have an incentive to keep more required reserves as deposits to help avoid overdrafts. These benefits may not be enough to persuade banks to hold reserves at the Fed instead of the vault.[back to text]



## What Financial Institutions Should Know about FEDEDI

- Under EFT 99, all entities selling goods and services to the federal government must accept payments and payment-related information electronically.
- Effective in the fall of 1998, a new NACHA addenda reporting mandate requires that all ACH-receiving institutions be capable of sending payment-related information attached to corporate ACH items to receivers at the receivers' request.
- FEDEDI allows financial institutions to translate EDI messages on customer request. Those messages can be translated into human-readable form for paper delivery by mail, fax or customer pickup. Also, messages can be translated into computer-readable form for electronic file delivery by modem or diskette delivery (by mail or customer pickup).
- FEDEDI will be made available by Federal Reserve Banks in September/October 1998.
- FEDEDI resides outside Fedline®, so a financial institution can use its Fedline® PC or another PC.
- FEDEDI will be available for the DOS and Windows 95/NT® operating systems--Windows3.1 will not support FEDEDI.
- Education and software training provided by the Federal Reserve will accompany the distribution of FedEDI software.
- Regular updates will be provided to keep FEDEDI up-to-date with developing EDI format standards.



CENTRAL BANKER | SUMMER 1998

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## Direct Payment Campaign Surges Forward in St. Louis

In the past year, more than 75,000 St. Louis utility payments have been converted to direct payment, or automated bill payment, thanks in part to the efforts of the joint direct payment campaign, an effort by the St. Louis Fed, Mid-America Payment Exchange and several St. Louis utility companies to increase awareness of the service. That figure is expected to increase as a result of the second phase of the campaign, which began in May.

The latest phase is a three-pronged push that includes employee sign-up days, marketing efforts by individual financial institutions, and media coverage. Participating St. Louis-area utility companies include: AmerenUE, Charter Communications, City of St. Louis Water Company, Laclede Gas Company, Metropolitan Sewer District, St. Louis County Water Company and Southwestern Bell Telephone.

The St. Louis Fed has developed a direct payment educational insert for financial institutions to enclose with their customers' monthly statements. The insert lists a phone number at each utility that a customer may call to begin setting up direct payment. Institutions also may choose to provide the inserts to their customers in the lobby. To date, more than 20 financial institutions in the St. Louis area have ordered a supply. To order, call Carrie Andert at (314) 444-8946.

The St. Louis Fed encourages financial institutions to take a leading role in promoting the benefits of direct payment to their customers. Recent research has revealed that people generally are not as clear about direct payment as they are about direct deposit. More significantly, the research also showed that most customers prefer to learn about electronic methods of payment directly from their financial institution rather than through other sources (see Regional Roundup).



CENTRAL BANKER | SUMMER 1998

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## Treasury Direct Investment Participants Received Highest Return

The first quarter of 1998 saw 13 of the 143 Eighth District Note Option participants earn approximately 40 percent of the total investment returns. The disproportionately high return to these relatively few institutions is attributed to their acceptance of Treasury Direct Investments.

The Direct Investment program allows institutions to receive excess Treasury funds and invest them in a variety of investment vehicles, typically Fed Funds and Commercial Paper. Eighth District Note Option participants that invested in these instruments earned a minimum additional aggregate \$176,000 from Treasury funds accepted during the first three months of this year.

"Financial institutions can take full advantage of much higher returns through the Direct Investment program," said Judie Courtney, assistant vice president of Treasury Relations at the St. Louis Fed. "We strongly encourage all institutions that use the Note Option to look into this program."

Note Option participants can sign up for the Treasury Direct Investment Program by calling Scott Davis at (314) 444-8972.



CENTRAL BANKER | SUMMER 1998

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## Fed to Unveil Financial EDI Software This Fall

Beginning this fall, the Federal Reserve will distribute, at no additional cost, new software that will allow the 12,000 Fedline® users to receive financial Electronic Data Interchange (EDI) information. The software will be known as FEDEDI and will allow institutions to translate the payment-related information contained in ACH addenda records in a standardized computer-readable format.

The Fed's action is in response to the government's Electronic Funds Transfer initiative (EFT 99) that most government payments be made electronically by Jan. 1, 1999. In addition, the National Automated Clearing House Association (NACHA) mandated that by fall 1998, all ACH-receiving institutions be capable of sending payment related information attached to corporate ACH items to receivers at the receivers' request.

Like EDI, financial EDI is used to replace traditional paper documents. But financial EDI incorporates the electronic transfer of funds, as well. To complete this transfer, financial institutions typically utilize the ACH network. When the federal government begins using financial EDI for its payments, businesses of all sizes will be looking to their financial institutions for assistance in translating payment-related information to human-readable form and forwarding it to them either on paper or electronically.

FEDEDI will enable institutions to provide their customers with essential payment information, such as invoice numbers, purchase order numbers, payment amounts, etc. The software can be used through Fedline or through any electronic connection with the Fed and will be available in DOS and Windows 95/NT® platforms.

The use of financial EDI is expected to increase dramatically in the next few years, so it is important for financial institutions to be prepared. The Fed will be providing more information in the coming months about FEDEDI, including information on software training in September and October.



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CENTRAL BANKER | SUMMER 1998

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## Regional Roundup

### Attitudes Toward ACH Payments Revealed in Study

The Federal Reserve System recently finished some extensive market research on electronic payments. The study, which included a review of existing ACH statistics, focus groups and detailed questionnaires, revealed current awareness levels and attitudes that consumers and companies have toward direct payment and direct deposit.

One of the most significant research discoveries is that both businesses and consumers have extremely high confidence in the advice they receive from their bankers, and they want to learn about electronic payments through their financial institution. The Fed also found that businesses and consumers often are confused by the term direct payment and don't understand that it refers to automatic bill payment.

Regarding direct deposit, many companies don't offer it because they don't think their employees want the service; however, 30 percent surveyed indicated that they do. More results are available on the St. Louis Fed's web site at [www.frbstlouis.org/communications/payment\\_system\\_research.html](http://www.frbstlouis.org/communications/payment_system_research.html).

### Comments Requested on Same-Day Settlement Rule

On March 10, the Federal Reserve Board released a document requesting public comment on the benefits and drawbacks associated with the 1994 same-day settlement rule. This rule requires paying banks to provide same-day settlement for checks presented by private-sector banks by 8 a.m. local time. The Board also is requesting comment on the implications of potential additional rule changes to reduce legal disparities between Federal Reserve Banks and private-sector banks in the presentment and settlement checks.

Comments must be submitted on or before July 17, 1998, and should be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C., 20551.

For additional information, please contact Bill Leslie at (314) 444-8470.

### Redesigned \$20 Note Introduced

In May, the U.S. Treasury and the Federal Reserve System jointly introduced the newly designed \$20 note. The Federal Reserve Banks will begin shipping the new notes to financial institutions later this fall. Because the \$20 note is one of the most widely used bills, the Fed will continue to recirculate the old-style notes as the new bills replace those that wear out.

The new \$20 note follows the introduction of redesigned \$100 and \$50 notes and incorporates many of the security features that were introduced with those bills. At no charge, the Fed will offer bankers educational tools that can be used to familiarize currency handlers with the new note and assist them with authenticating

it. Those tools include: an interactive CD-ROM, a videotape, posters, tent cards and color pamphlets. Single copies will be available from local Federal Reserve Banks, while bulk requests should be directed to the Omaha Branch of the Federal Reserve Bank of Kansas City at (402) 221-5500.

## **St. Louis Names New Customer Service Rep**

The Federal Reserve Bank of St. Louis has named Bobbi Antoff as Financial Services Customer Service Representative (CSR) in the St. Louis Office. Antoff joined the Bank in March and has eight years of banking experience. She is available to assist St. Louis zone customers in answering financial services questions, getting started on new services, and resolving problems.

To help customers with these issues in the rest of the Eighth District, each Branch Office also has assigned an employee as CSR for its zone. Customers may call them directly at the following numbers: Little Rock zone: Gerry Gray, (501) 324-8265; Louisville zone: Lisa Locke, (502) 568-9224; and Memphis zone: Nikita Little, (901) 579-2435.

## **St. Louis Fed Publishes 1997 Annual Report**

The Federal Reserve Bank of St. Louis has published its 1997 annual report titled *Making Change: Reinventing the Federal Reserve*. The report explains how recent changes in three areas—policy, bank supervision and financial services—have kept the St. Louis Fed at the forefront of the banking industry.

The annual report is available on the St. Louis Fed's web site ([www.stlouisfed.org](http://www.stlouisfed.org)). Printed copies of the report are available by calling Debbie Dawe at (314) 444-8809.



CENTRAL BANKER | SUMMER 1998

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## FedFacts

### **New Services Directory Available**

The *1998 Directory of the Federal Reserve Bank of St. Louis* now is available. This publication gives an up-to-date listing of frequently contacted departments, people and phone numbers at all Eighth District offices. To order copies of the directory, call Anne Guthrie at (314) 444-8810.

### **Fed's Retail Payments Office Moves to Atlanta, Cleveland**

The Federal Reserve has announced that the Atlanta Fed, in partnership with the Cleveland Fed, will manage its Retail Payments Product Office. Previously, the Boston Fed handled the Retail Payments Office, which is responsible for overseeing the Fed System's check and ACH services nationwide and for developing strategic plans for these functions.

The Federal Reserve also announced that it has established a Business Development Office at the Chicago Fed to coordinate and oversee product and service development, marketing and customer relationships.

### **CDC Testing with the Fed**

Starting July 1, financial institutions will be able to test their major applications for Century Date Change (CDC) compliance. In the coming weeks, the Fed will send out a survey to institutions asking about their specific plans for testing with the Federal Reserve.

At a minimum, customers with interfacing front- and back-end systems, Fedwire Funds Transfer, National Book-Entry Securities and other mission-critical applications should test in the Fed's CDC test environments. For additional information about the Eighth District's CDC program, call Jeff Dale at (314) 444-8400.