THE FEDERAL RESERVE BANK of ST. LOUIS

Central Banker

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News and Views for Eighth District Bankers

Little Rock and Louisville Nearing Dates for Check Conversions

Check processing restructuring for the Eighth District's Little Rock and Louisville branches will occur this summer. In recent letters, the St. Louis Fed notified Little Rock and Louisville customers of the dates for the check volume shifts, as well as new deadlines and accounting/billing changes. To recap:

Little Rock—After the 11 a.m. city fine sort deadline on Friday, July 23, the Little Rock office will no longer accept checks for processing. All items will be delivered to the Memphis Branch for processing. Customers are requested to either send their work directly to the Memphis Branch or deposit their items at the Little Rock transit location.

Louisville—After the 10 a.m. city fine sort deadline on Friday, Aug. 27, the Louisville office will no longer accept checks for processing. All items will be delivered to the Cincinnati Branch of the Cleveland Fed for processing. Customers are requested to either send their work directly to the Cincinnati Branch or deposit their items at the Louisville transit location.

The Bank is finalizing details on the Little Rock and Louisville transit point locations and will notify customers in the coming weeks. More information about the Federal Reserve check restructuring initiative is available at www.frbservices.org. ■

U.S. Treasury Unveils Redesigned $50 Bill

The $50 bill is the second denomination in the Series 2004 currency that has been redesigned, and it is scheduled for release this fall. The new $20 bill was released in October 2003, and plans for a new $100 bill are in development. (Decisions about new designs for the $5 and $10 notes are still under consideration; however, the U.S. Treasury is not planning a redesign of the $1 and $2 notes.)

In addition to the traditional green and black inks, the new $50 bill will include touches of purple and gold and a distinctive red and blue American flag design behind a larger portrait of Ulysses S. Grant. Some of the other security features include:

- **a watermark**—This faint image is similar to Grant's portrait.
- **a security thread**—The words "USA 50" and a small flag, which glow yellow when held under an ultraviolet light, are visible from both sides of the note.
- **color-shifting ink**—The number "50," which is located in the lower-right corner on the face of the bill, changes from copper to green.
- **microprinting**—This special feature appears in three areas on the face of the note.

The confidence in American currency is made possible through continuous improvements in currency design and aggressive law enforcement, both of which protect U.S. currency against counterfeiting.

For more information on the new $50 bill, visit the Bank's web site at www.stlouisfed.org/news or the Bureau of Engraving and Printing's new currency web site, www.moneyfactory.com/newmoney/main. cfm/currency/new50.

Feditorial

Expecting the Best—Preparing for the Worst

By Julie Stackhouse, senior vice president, Banking Supervision and Regulation

It's your worst nightmare. An unexpected disaster occurs, threatening the lives of your bank's employees and customers and your community's vitality. Catastrophic events such as earthquakes, tornadoes, floods, fires and those that occurred Sept. 11, 2001, pose substantial risks to financial institutions.

No matter how severe the disaster, there are many preparations your bank can make to reduce your risks. A good first step is to prepare your employees and their families to survive the immediate effects of a disaster—both at work and at home. At a minimum, your plan should include the following components:

- access to emergency supplies—inside and outside of your facility,
- evacuation procedures and
- methods of communicating with your employees.

Remember, cellular networks often interface with landline networks. This means that many telephones will not work during a regional disaster. Establish an off-site meeting location where key employees can gather; then, conduct drills periodically.

Contingency preparedness also involves protecting your bank's physical assets. Building codes are intended to keep buildings standing during a disaster; however, they do not ensure that a damaged facility can support continued business operations. To ensure that your bank can function properly:

- maintain up-to-date insurance for recently purchased equipment;
- back up data regularly, and store it off-site;
- consider alternative power sources;
- have your building evaluated by a professional engineer to ensure it will be safe and structurally sound during disasters; and
- establish strategic partnerships with other businesses that can provide assistance—such as backup facilities, equipment and supplies—during an emergency.

Finally, don't forget about contingency liquidity planning. Your bank's traditional funding sources may not be readily available during a disaster. The Federal Reserve discount window can provide credit to eligible institutions that experience temporary funding needs, and we encourage you to file a Board of Directors resolution and to pledge contingency collateral.

No business can be completely prepared for every contingency; however, the tips I've outlined here can help you build a solid plan. For more information on making discount window credit a part of your contingency planning, contact Frank Bufe, discount window manager, at 1-866-666-8316, or visit the discount window website at www.frbdiscountwindow.org. ■

St. Louis Fed Implements Fuel Surcharges for Cash Letters and Check Services

The rising cost of fuel has had a significant impact on business operations at the Federal Reserve. Specifically, because the contracts we have with vendors include fuel-increase clauses, we have seen aviation fuel prices for transporting checks increase substantially. The Fed expects significant increases in transportation costs; therefore, we must offset this increase by establishing the following surcharges:

Cash Letters: We will assess a surcharge of $0.35 per cash letter on all forward and return cash letters that contain "Other Fed" items. This will include all mixed and "Other Fed" items.

Check Relay Network: We will assess a surcharge of $0.0005 for each consolidated item shipped via the Check Relay network.

Private Vendors: We will not assess a surcharge for direct send cash letters sent via private vendors.

These surcharges became effective June 1 and are expected to remain in effect at least until the end of 2004. We will continue to monitor how the cost of fuel affects our business operations and review these surcharges within 120 days. If you have any questions, please contact your account executive. ■

The FACT Act Helps Bankers Mitigate Risks

Customers continue to increase their use of remote electronic access to conduct financial transactions with their banks. While this method is convenient, it also increases the risk of doing business with unauthorized or incorrectly identified parties. Last year, the Federal Trade Commission received more than 500,000 consumer-fraud and identity-theft complaints—up from 400,000 in 2002—with losses of more than $400 million. Approximately half of all identity-theft complaints in Eighth District states included credit card and bank fraud.

The Fair and Accurate Credit Transactions Act (the FACT Act) is a comprehensive statute that, in part, enhances a consumer's ability to combat identity theft. It also increases the accuracy of consumer reports. Here is a brief summary of what your bank needs to know about certain provisions of the FACT Act.

Fraud Alerts

The FACT Act contains a new provision permitting a consumer to place a "fraud alert" on a consumer credit report. If a financial institution obtains a consumer report that contains a fraud alert, the institution *cannot*:

- extend new credit—other than an open-end credit plan,
- issue an additional card in the consumer's name or
- increase any credit limit without taking additional steps to identify the person making the request.

If consumers who request a fraud alert provide a contact telephone number for verifying their identities, financial institutions must either use the contact number provided or take other reasonable steps to verify a consumer's identity. As part of this process, the financial institution must confirm that the request for new or additional credit is not the result of identity theft.

Encountering an Identify Thief

The FACT Act imposes new obligations on a financial institution that enters into a transaction with an alleged identity thief. Within 30 days of an identify-theft victim's request, the institution must provide copies of records that document the transaction, regardless of whether those records are maintained by the institution or another business entity on the institution's behalf.

Before disclosing these records, the institution may require that requestors provide proof of their identities and also prove that a claim of identity theft has been made. The institution must also provide certain documents related to the transaction to law-enforcement agencies.

In some situations, a consumer reporting agency may block information from a consumer report—if the consumer adequately documents that the transaction resulted from identity theft. In that case, the consumer reporting agency will notify the furnisher of the information that the information has been blocked. This affects financial institutions because they must have reasonable procedures in place that prevent the resending of the previously blocked information. Additionally, the institution may not sell or place the related debt into collection.

Mortgage Lenders and Credit Scores

The FACT Act also includes new rules for mortgage lenders that disclose credit scores. Any lender that uses a consumer credit score to arrange a residential mortgage loan must provide the consumer a:

- copy of the credit score information obtained from a consumer reporting agency or developed and used by the lender,
- copy of the key factors that affected the consumer's credit score and
- new notice to the applicant—explaining the credit score in general terms.

Creating Guidelines and Plans

Finally, the FACT Act directs the federal banking agencies, the NCUA and the FTC to adopt identity-theft guidelines for a creditor's account holders and/or customers. These new guidelines are in addition to those adopted in 2001 by federal banking agencies for Safeguarding Customer Information.

The Guidelines for Safeguarding Customer Information Act required institutions to:

- establish an information-security program to identify and assess the risks that may threaten customer information, and
- develop a written plan that contains policies and procedures to manage and control these risks.

In addition to implementing and testing the plan, institutions also must adjust the plan periodically to account for changes in technology, sensitivity of customer information and internal or external threats to information security.

Because of significant increases in the new crime of identity theft, part of your bank's information-security plan must include an effective authentication program that verifies new customers and authenticates existing customers. All financial institutions will be required to establish policies and procedures for implementing the FACT Act guidelines while also ensuring the security and confidentiality of customer records. ■

Fed Ceases Print Subscriptions for Data Publications

Beginning in January 2005, *Monetary Trends, National Economic Trends* and *International Economic Trends* will be available only in electronic form via our web site. Printed copies of these publications will continue to be mailed to all current print subscribers through the last issue of 2004. All subscribers may take advantage of the Research Division's e-mail notification system, which is a timely and flexible method for receiving updates to these publications.

For more information about how to subscribe to this system, visit www.research.stlouisfed.org. If you have additional questions about print subscriptions for these data publications, contact the Research Division at stlsFRED@stls.frb.org. ■

St. Louis Fed Releases Its 2003 Annual Report

The Eighth District's decision to consolidate cash and check business has dramatically changed the roles the branch offices will play and the value they will add to their communities. The Bank's 2003 annual report, *Branching Out*, examines how these decisions triggered the District to recommit itself to our branch communities by increasing intellectual resources and endeavors.

This year's annual report recently was mailed to District financial institutions. To order additional copies, contact Debbie Dawe at (314) 444-8809 or toll-free at 1-800-333-0809, ext. 44-8809. The report also is available on our web site, www.stlouisfed.org/publications/ar/default.html. ■

Eighth District Leads Conversion to Actual Availability

The St. Louis Fed recently led the conversion to Actual Availability—new accounting practices for cross-district check deposits. Actual Availability gives banks that deposit checks with a non-local Fed office immediate credit for their deposits. The goal of this new service is to decrease reconcilement issues and help financial institutions reduce incorrect entries. Additionally, Actual Availability aligns the Fed's accounting practices with those of the private sector.

To view the Actual Availability Depositor Reference Guide, visit the national financial services web site: www.frbservices.org/Retail/pdf/ActualAvailabilityGuide.pdf. ■

U.S. Postal Service Asks Banks to Help Fight Money Order Fraud

The U.S. Postal Service is seeing an increase in counterfeit U.S. Postal Money Orders (PMOs). Redemption of counterfeit notes creates significant losses for financial institutions nationwide; so, the Postal Service has redesigned the PMOs and begun a campaign to help cashiers identify counterfeit items.

Some of the PMO's new security features include:

- use of colored inks;
- a crisp, textured paper stock;
- a silver "USPS" security thread embedded in the paper;
- a watermark of Benjamin Franklin, which appears on the left side of the PMO when it is held up to the light;
- the U.S. Postal Service shield, which appears on the right side of the PMO; and
- red ink bleeds, which appear on the back side of the paper.

Additionally, denominations are placed in two locations on the PMO and cannot be greater than $1,000. Also, discoloration appears around the denomination amounts if they have been erased.

The Postal Service is asking cashiers to:

- thoroughly inspect PMOs at the time of presentment;
- read the warning instructions, which are listed on the reverse side of the PMO;
- look for the PMO security features; and
- intercept all PMOs they suspect are fraudulent.

More information about the new security features can be obtained by calling 1-800-ASK-USPS or by visiting www.usps.com/missingmoneyorders/security.htm. If your bank intercepts a counterfeit item, contact your local post office and ask for the local postal inspection service office, or call Postal Inspector Travist C. Wiggins at (314) 436-6895. ■

Budget Deficits and Interest Rates: What Is the Link?

By Edward Nelson, economist and research officer, and Jason Buol, research associate.

An earlier version of this article appears in the March issue of *Monetary Trends,* which can be found at www.research.stlouisfed.org/publications/mt/20040301/mtpub.pdf.

The Office of Management and Budget in February released the president's projections for the federal budget, which included an estimated federal budget deficit of $521 billion for fiscal 2004. The return of substantial budget deficits in the United States has reignited the debate on how budget deficits influence the economy.

Deficits can be a source of inflation if they are accommodated by monetary policy—that is, if the Federal Reserve responds to higher deficits by increasing the growth of money. The Federal Reserve has two ways of responding to higher deficits:

1) The central bank directly purchases the securities issued by the government to finance the deficits.

2) The private sector purchases these same securities; then, the central bank attempts to limit any potential interest rate increases.

Under either scenario, deficits lead to greater money base growth, which can create inflationary pressure.

Warnings about the consequences of U.S. budget deficits, while not new, have shifted over time. During the 1970s, emphasis was on the inflationary consequences of deficits. For example, in 1975, Ronald Reagan stated that inflation "has one cause and one cause alone: government spending more than government takes in." By contrast, the concern voiced since the 1980s rests on the argument that deficits put upward pressure on interest rates.

This shift is apparent in the market's current expectation that the Federal Reserve will not accommodate deficits with money creation. Since 1982, U.S. inflation has been controlled despite several years of high deficits. Fiscal 1983's $208 billion deficit was approximately 6 percent of GDP; this year's estimated deficit represents 4.5 percent of GDP. This demonstrates that monetary policy is capable of keeping inflation low even in the face of large deficits.

Why might interest rates rise in response to deficit financing? When you rule out monetary accommodation of the deficit, the government needs to create an incentive for the private sector to buy more government bonds. If the private sector's purchase of government bonds does not increase one-for-one with the higher deficit, the government must borrow more money, which leaves less money for financing private projects, such as investment in residences or factory equipment. This is sometimes referred to as the "crowding-out" effect.

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Higher interest rates also can reduce the private sector's demand for capital, thereby reducing the demand for commercial and retail borrowing. This underlies what Douglas Holtz-Eakin, the director of the Congressional Budget Office, has summarized as a "modestly negative" effect of long-term budget deficits.

Two recent studies have measured the influence of budget deficits on interest rates. The first of these studies, by Thomas Laubach, finds a "statistically and economically significant" relationship between higher deficit projections and future long-term interest rates. According to Laubach's estimates, when the projected deficit to GDP ratio increases by one percentage point, long-term interest rates increase by roughly 25 basis points. A more recent working paper, by Eric Engen and R. Glenn Hubbard, found that when government debt increased by 1 percent of GDP, interest rates would increase by about two basis points.

The Laubach study implies that moving to a balanced budget would tend to reduce interest rates by about one percentage point; however, the Engen and Hubbard study suggests that interest rates would only fall by roughly a tenth of that amount. While recent research confirms there is a significant relationship between budget deficits and interest rates, just how much deficits affect interest rates is still being debated. ■

Out for Comment

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

On April 21, the Board of Governors requested public comment on proposed revisions to Part II of its Policy Statement on Payments System Risk, which addresses risk management for payments and securities settlement systems.

The proposed revisions update the policy in light of current industry and supervisory risk management approaches and new international risk management standards for payments and securities settlement systems. In addition, the proposed revisions provide further clarification regarding the policy's objectives, scope and application.

Direct all comments to: Jennifer Johnson, secretary, Board of Governors of the Federal Reserve System, 20th St. and Constitution Ave., N.W., Washington, D.C. 20551. Comments are due by July 26, 2004.

For more information about this proposal, visit www.federalreserve.gov/boarddocs/press/bcreg/2004/20040421/default.htm. ■

Fed Facts

Federal Reserve Revises Regulation Z

The Federal Reserve Board has revised Regulation Z, which implements the Truth-in-Lending Act, and its staff commentary on the rule. The changes include a new definition of the word "amount" in disclosure requirements, referring to a numerical amount. Additionally, revisions to the staff commentary provide guidance on consumers' exercise of rescission rights for certain home-secured loans.

The revisions took effect April 1, and the deadline for mandatory compliance is Oct. 1. For more information, contact Henry F. Dove Jr., at (314) 444-8846 or 1-800-333-0810, ext. 44-8846. ■

Regulators Create New Web Site for Call Reports

The Federal Reserve Board, FDIC and OCC have contracted to build a Central Data Repository and web site, which is called FIND, to help modernize Call Reports. Under this new system, institutions will file their Call Report data via the Internet using software that contains the FFIEC's edits for validating Call Report data before submission.

Call Report software vendors are modifying their software to incorporate these edits. Implementation of the new CDR system is expected to start with the submission of Call Report data for Sept. 30. For more information, visit www.FFIEC.gov/find. ■

Calendar Events

UPCOMING FED-SPONSORED EVENTS FOR EIGHTH DISTRICT DEPOSITORY INSTITUTIONS

Global Pressures on Local Autonomy: Challenges to Urban Planning for Sustainability and Development

Louisville
Sept. 4-8

The International Urban Planning and Environment Association's sixth international symposium, which is co-sponsored by the Federal Reserve Bank of St. Louis and the Center for Environmental Policy and Management at the University of Louisville. For more information, visit www.stlouisfed.org/community/conferences.html or www.cepm.louisville.edu.

Brownfields 2004: Gateway to Revitalization

St. Louis
Sept. 20-22

An annual event co-sponsored by the Environmental Protection Agency and the International City/County Management Association. The conference will feature interactive discussions, educational presentations and opportunities to network with business, government and nonprofit organizations working in brownfield redevelopment. For more information, visit www.stlouisfed.org/community/conferences.html or www.brownfields2004.org.

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