



fed LETTER

Colorado ★ Kansas ★ Missouri ★ Nebraska ★ New Mexico ★ Oklahoma ★ Wyoming

April 2010

FEDERAL RESERVE BANK of KANSAS CITY

COMMUNITY BANKS THE FOCUS
OF SPEECH BY KANSAS CITY
FED PRESIDENT

In a March 18 speech to the American Bankers Association Government Relations Summit, Kansas City Fed President Thomas M. Hoenig discusses the importance of community banks to the nation's financial system. Read the speech, titled "[Are Community Banks Important?](#)" on the Kansas City Fed's website.

SURVEY UNDER WAY TO
COLLECT MERCHANTS' INPUT
ON CARD FRAUD

Payment card fraud is one of the most important issues currently facing the payment industry. However, little is known about its effect on merchants. The Kansas City Fed is conducting an anonymous, Web-based survey of merchants to obtain estimates of 2009 loss rates and loss amounts for merchants due to card payment fraud. The survey ends April 26, and summary results will be published in the second half of 2010. For more information, visit the [Payments System Research section](#) of the Kansas City Fed's website.

MAIN STREET ECONOMIST
EXPLORES FINANCIAL CHALLENGES
FACING FARM ENTERPRISES

With fragile financial markets and increasing lending risks, agricultural bankers have raised their credit standards. As profit opportunities in the farm sector emerge, many potential borrowers wonder if credit will be available for all segments of the agricultural industry. The Kansas City Fed's latest [*Main Street Economist*](#) explores this issue, based on research by Omaha Branch Executive and Vice President Jason Henderson and Associate Economist Maria Akers.

SHOULD POLICYMAKERS
REGULATE DEBIT CARD
FEE STRUCTURES?

New research from the Kansas City Fed shows that when card networks and merchants both have market power, card networks earn a higher profit by charging *ad valorem* fees rather than fixed per-transaction fees. At the same time, merchant profits are reduced—yet both consumer surplus and social welfare are increased. Therefore, caution should be taken when policymakers consider intervening in the debit card market.

Read more on this and other research topics in the Kansas City Fed's first-quarter edition of [*Economic Review*](#).

MANUFACTURING SECTOR SHOWS
STEADY GROWTH

Tenth District manufacturing activity continued to grow steadily in March, according to the latest [**Survey of Tenth District Manufacturing**](#). Survey respondents reported that production is almost back to year-ago levels. Expectations for future factory activity rebounded after moderating slightly in February. Price indexes were mixed, with some moderation in raw materials price increases, but more producers planned to pass through cost increases than in previous months.

The monthly survey monitors manufacturing plants selected according to geographic distribution, industry mix and size. Survey results reveal changes in several indicators of manufacturing activity, including production and shipments, and identify changes in prices of raw materials and finished products.

FINANCIAL STRESS DECLINES,
ACCORDING TO INDEX

The latest reading of the [**Kansas City Financial Stress Index**](#) (KCFSI) suggests financial stress declined in February. The decrease continues a general downward trend in the index since its peak in October 2008, bringing the index closer to its long-run average. The index was 0.11 in February, down from 0.31 in January. A positive value indicates that financial stress is above the long-run average, while a negative value indicates stress is below the long-run average.

The KCFSI is a monthly measure of stress in the U.S. financial system based on 11 financial market variables. [**More information**](#) is available from the Kansas City Fed's website.

REGULATORY
DEVELOPMENTS
*Fourth quarter 2009 Tenth District
banking conditions available*

The nationwide decline of [**banking conditions**](#) continued, driven by deteriorating asset quality. Bank earnings declined in 2009, with more than 29 percent of all banks posting a loss for the year. Loan loss provisions increased but have steadied the last few quarters. Noncurrent loans continued to rise, driven particularly by construction and land development and one- to four-family residential loans.

Guidance on Obtaining and Retaining Beneficial Ownership Information

On March 5, the federal regulatory agencies issued interagency **Guidance on Obtaining and Retaining Beneficial Ownership Information**. The guidance clarifies and consolidates existing regulatory expectations for obtaining beneficial ownership information for certain accounts and customer relationships. Information on beneficial ownership in account relationships provides another tool for financial institutions to better understand and address money laundering and terrorist financing risks, protect themselves from criminal activity, and assist law enforcement with investigations and prosecutions.

Changes to discount window primary credit administration

On Feb. 18, the Board announced **changes to primary credit** at the discount window. An increase in the primary credit rate to 75 points became effective on Feb. 19. Additionally, the typical maximum maturity for primary credit loans was returned to overnight effective March 18. The increase in the primary credit rate and reduction in maximum maturity are intended to encourage depository institutions to rely on private funding markets for short-term credit and to use the Federal Reserve's primary credit facility only as a backup source of funds.

Questions on discount window lending should be directed to the Kansas City Fed's credit staff at (800) 333-2987.

Proposed amendments to Regulation Z

The Federal Reserve is proposing **amendments to Regulation Z** to incorporate the third stage of credit card changes required by the Credit Card Accountability, Responsibility and Disclosure Act. These proposed changes will address practices related to excessive penalty fees and require credit card issuers to inform consumers of the reasons for increases in rates. In addition, issuers that have increased rates since Jan. 1, 2009, must evaluate whether the reasons for the increase have changed and, if appropriate, reduce the rate. The comment period closes on April 14, 2010.

Revised interagency questions and answers on Community Reinvestment Act

Revised questions and answers (Q&As) that interpret the Community Reinvestment Act regulations were released by the federal financial institutions regulatory agencies. This version consolidates and supersedes all previously published versions and is being released by the Federal Reserve under Consumer Affairs (CA) Letter 10-2.

This version includes several changes:

- examples of ways an institution could determine that its community services are targeted to low- and moderate-income individuals;
- “primary purpose” now allows pro-rata consideration for providing affordable housing for low- and moderate-income individuals through mixed-income housing;
- revised reporting requirements for community development loans;
- examples of “other loan data.”

FFIEC Retail Payments Booklet

On Feb. 26, the Federal Financial Institutions Examination Council (FFIEC) issued **updated guidance** for examiners, financial institutions and technology service providers on the risks and risk-management practices applicable to financial institutions' retail payment systems activities. The guidance, which is included in the *FFIEC Information Technology Examination Handbook*, is an update to the "Retail Payments Systems Booklet" issued in March 2004.

*Interagency Policy Statement
on Funding and Liquidity
Risk Management*

The Board of Governors of the Federal Reserve System and the other supervisors of U.S. depository institutions have issued a **policy statement** providing guidance on sound practices for managing the funding and liquidity risks of depository institutions. The practices set forth in this guidance are entirely consistent with established Federal Reserve guidance contained in the Commercial Bank Examination Manual and the Trading and Capital-Markets Activities Manual. The interagency guidance is also consistent with the principles of sound liquidity risk management issued in September 2008 by the Basel Committee on Banking Supervision titled "Principles for Sound Liquidity Risk Management and Supervision." Therefore, this interagency guidance represents the formal codification of international supervisory guidance and provides a unified set of supervisory expectations among the U.S. supervisors.

The guidance articulates the process that depository institutions should follow in appropriately identifying, measuring, monitoring and controlling their funding and liquidity risks. In particular, the guidance reemphasizes the importance of cash flow projections; diversified funding sources; stress testing; a cushion of liquid assets; and a formal, well-developed contingency funding plan as primary tools for measuring and managing funding and liquidity risks. The Federal Reserve expects all supervised financial institutions to manage their liquidity risk using processes and systems that are commensurate with their complexity, risk profile and scope of operations.

The interagency guidance targets funding and liquidity risk management at insured depository institutions, including state member banks. The basic principles presented in this policy statement also apply to bank holding companies, which should manage and control aggregate risk exposures on a consolidated basis, while recognizing legal distinctions and possible obstacles to cash movements among subsidiaries.

*Lapse of FEMA authority to issue
flood insurance contracts*

The authority of the Federal Emergency Management Agency (FEMA) to issue flood insurance contracts under the National Flood Insurance Program (NFIP) lapsed at midnight on March 28. Informal guidance for lenders and borrowers concerning loans that are or will be secured by property located in a Special Flood Hazard Area is being provided by the Federal Reserve System under [Consumer Affairs \(CA\) Letter 10-3](#). This guidance applies to this current lapse period and will continue to apply if there are any future lapses in the NFIP.

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