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FEDERAL RESERVE BANK OF KANSAS CITY

April 2006

Fed Letter



Changes to Federal Reserve cash services policy

The Federal Reserve Board on March 17 announced the approval of policy changes that seek to reduce the overuse of Federal Reserve Bank cash-processing services by providing incentives for depository institutions to recirculate currency among their customers. For details on the policy changes, visit www.FRBservices.org.

Manufacturing Survey released

The monthly manufacturing survey for the Tenth Federal Reserve District was released Feb. 23. The survey asks plant managers about a variety of manufacturing indicators. The information is compiled into a snapshot of manufacturing in the District. Manufacturing activity in the District expanded at a somewhat slower pace in February than in recent months. However, expectations for future production and shipments were the highest in a year. While the price indexes in the survey remained high by historical standards, expectations for future finished goods prices continued to be moderate.

To view the current survey, visit <http://www.KansasCityFed.org/mfgsurv/2006Feb23mfg.htm>.

Latest issue of *Main Street Economist* available

The first 2006 issue of *The Main Street Economist* is now available. In "A Robust Rural Economy," Jason Henderson reviews the performance of the rural economy in 2005 and provides an outlook for 2006. The article discusses agriculture, rural job growth, and the impacts that energy is having on the rural economy. For a more detailed analysis of this topic, refer to Henderson's *Economic Review* article (listed below). *The Main Street Economist* is available at <http://www.KansasCityFed.org/RuralCenter/mainstreet/MainStMain.htm>.

Beige Book released

The latest edition of the Beige Book was released March 15. The Beige Book is a summary of current economic conditions in each Federal Reserve District. Economic activity continued to expand in January and February, according to reports from the 12 Federal Reserve District Banks. Most Districts characterized the pace of expansion as moderate or steady. San Francisco said that the "solid expansion remained on track," and Dallas indicated that activity strengthened. In contrast, the pace of growth moderated in the Richmond District, and Philadelphia said activity expanded at a low pace.

For details about national and Tenth District economic activity, visit <http://www.FederalReserve.gov/fomc/beigebook/2006/20060315/default.htm>.

Latest issue of *Economic Review* available

The first quarter 2006 edition of *Economic Review* is now available. This edition features five articles.

“Rethinking Federal Policy for Regional Economic Development,” by Mark Drabentstott, examines how globalization has fundamentally changed the rules of the game in regional economic development and how federal policy might shift to align with the new global economy.

Jason Henderson’s “A Robust Rural Economy in 2006?” offers a detailed analysis of the rural economy’s 2005 performance and discusses the prospects for 2006 amid soaring energy prices.

In “Interchange Fees in Credit and Debit Card Markets: What Role for Public Authorities? A Conference Summary,” Barbara Pacheco and Richard Sullivan summarize the proceedings of a May 2005 conference sponsored by the Federal Reserve Bank of Kansas City to examine interchange fees and associated policy issues.

Craig Hakkio and Elisha Wiseman, in “Social Security and Medicare: The Impending Fiscal Challenge,” provide a framework for understanding the nature of the serious fiscal challenge posed by the Social Security and Medicare programs—a prerequisite for finding specific solutions.

Finally, in “The Trend Growth Rate of Employment: Past, Present, and Future,” Todd Clark and Taisuke Nakata examine declines in the growth rates of population and labor force participation that have caused the trend growth rate of employment to slow.

Economic Review is available at <http://www.KansasCityFed.org/PUBLICAT/ECONREV/ermain.htm>.

Regulatory developments

Interagency guidance on sharing suspicious activity reports

The federal bank and thrift regulatory agencies announced on Feb. 24 the publication of the *Summary Findings of the Fourth Quantitative Impact Study* (QIS-4). The agencies initiated the QIS-4 on Oct. 29, 2004, with the objective of gaining a better understanding of the potential effects of a Basel II-based regulatory capital framework on U.S. institutions.

The results of the study indicated that aggregate minimum risk-based capital requirements would fall 15.5 percent for the 26 institutions in the QIS-4 participant population, when moving from the current Basel I-based framework to a Basel II-based framework. The results also showed material dispersion in minimum risk-based capital requirements across institutions and portfolios.

As indicated in an April 2005 press release, the agencies were concerned about the magnitude of the drop in QIS-4 minimum risk-based capital requirements and the dispersion of those requirements and decided to undertake further analysis. After analyzing QIS-4 results, the agencies believed that a multitude of factors contributed to the observed drop and dispersion in capital requirements. These factors and other comments about the QIS-4 analysis are contained in the *Summary Findings* document.

Extension of comment period on interagency guidance on concentrations in commercial real estate lending

The federal financial regulatory agencies on March 9 extended the comment period on the proposed guidance *Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices*. The comment period was extended for 30 days to **April 13**.

Final rule expanding the definition of a small bank holding company

On Feb. 27, the Federal Reserve Board approved a final rule raising the asset size threshold under which a bank holding company (BHC) qualifies for the Small BHC Policy Statement and clarifying the treatment of subordinated debentures issues in connection with the issuance of trust preferred securities. In addition, the rule outlines resultant changes in the Capital Adequacy Guidelines for BHCs.

The Board has raised the small BHC asset size threshold from \$150 million to \$500 million in consolidated assets, with some exceptions, and has amended the related qualitative criteria for determining eligibility as a small BHC. The Board has clarified in the revised Small BHC Policy Statement that subordinated debt associated with trust preferred securities is to be considered debt, for most purposes, subject to a transition period. A qualifying small BHC, however, may exclude from debt an amount of subordinated debt associated with trust preferred securities equality up to 25 percent of the small BHC's stockholders' equity, less parent company goodwill.

Final community reinvestment guidance

On March 2, the federal banking agencies announced final guidance implementing the recent changes to their Community Reinvestment Act (CRA) regulations. The guidance clarifies, among other things, the availability of CRA consideration for bank activities that revitalize or stabilize designated disaster areas.

The guidance describes the loans, investments, and services in support of disaster recovery that receive CRA "community development" consideration, including the time periods and possible extensions following the designation of an area. The guidance also addresses the availability of CRA community development consideration for bank activities that revitalize or stabilize underserved or distressed middle-income rural areas. The other major issue it addresses is the implementation of the new community development test for banks with assets between \$250 million and \$1 billion.

The guidance, which takes the form of questions and answers, was proposed for public comment on Nov. 10, 2005. It implements changes to the agencies' CRA regulations that took effect on Sept. 1, 2005, and was effective on **March 10**.

Influenza pandemic preparedness

On March 15, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision jointly issued an advisory on influenza pandemic preparedness. The advisory was intended to raise awareness regarding the threats of a pandemic influenza outbreak and its potential impact on the delivery of critical financial services, and to provide references to information that may help financial institutions prepare for such an event. Financial institutions provide essential financial services and, as such, should consider what actions, if any, are appropriate for preparing and responding to a pandemic.

Imposition of special measures against Commercial Bank of Syria

The Board of Governors of the Federal Reserve System issued Supervision and Regulation Letter (SR) 06-6 on March 15 to advise banking organizations under its supervision of new obligations relating to the Commercial Bank of Syria imposed by the U.S. Department of the Treasury's Financial Crime Enforcement Network (FinCEN). On March 15, FinCEN issued a final rule that imposes special measures under section 311 of the USA PATRIOT Act against the Commercial Bank of Syria.

The final rule prohibits all covered financial institutions from opening or maintaining a correspondent account in the United States for or on behalf of the Commercial Bank of Syria and its branches, offices, and subsidiaries. Covered financial institutions also are required to apply special due diligence to their correspondent accounts for foreign banks that is reasonably designed to guard against the indirect use of the account by the Commercial Bank of Syria. The final rule is effective as of **April 14**.

Accuracy of consumer credit reports

On March 22, the federal financial institution regulatory agencies and the Federal Trade Commissioner issued for comment an Advanced Notice of Proposed Rulemaking (ANPR) on section 312 of the Fair and Accurate Credit Transactions Act (FACT Act). Comments are invited for the purpose of developing guidelines and rules to implement section 312.

Section 312 requires the agencies to: 1) establish guidelines regarding the accuracy and integrity of information furnished to consumer reporting agencies; and 2) prescribe regulations that require the entities that furnish such information to establish reasonable policies and procedures for implementing the guidelines. The FACT Act requires the agencies to consider specific issues as they develop guidelines and rules to implement section 312. The ANPR invites comment on issues relating to: 1) the factors the agencies must consider for developing the accuracy and integrity guidelines; and 2) the considerations that the agencies must weigh before adopting rules that identify the circumstances in which entities that furnish information to consumer reporting agencies must reinvestigate direct consumer disputes.

Comments on the ANPR are due by **May 22**.

Internet access

Regulatory developments like those above can be obtained from our website at www.KansasCityFed.org. Point to "Banking Information" on the home page, then click "Regulations/Guidance," and select either of the first two categories, as appropriate.

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