

TEN

FEDERAL RESERVE BANK OF KANSAS CITY

Summer 2005

As Payments Go Plastic

Understanding
the costs of credit
and debit cards

Inside:

Currency Exchange

Workers' Compensation

Corporate Governance



TEN

S U M M E R 2 0 0 5

**AS PAYMENTS GO PLASTIC
UNDERSTANDING THE COSTS OF CREDIT AND DEBIT CARDS 16**
Electronic payments continue to skyrocket. Are providers and merchants getting any closer to common ground on interchange fees?

FEATURES



QUESTIONING CONVENTIONAL WISDOM: DO HIGHER WORKERS' COMPENSATION COSTS DRIVE COMPANIES OUT OF STATE?.....2

Workers' compensation has come under fire recently, and lawmakers say the programs' escalating costs cause job losses in their states; however, little research exists to support or deny these claims.



IS THE PLAYING FIELD CHANGING FOR BANKERS AND SUPERVISORS?8

An excerpt from a speech delivered by Bank President Thomas M. Hoenig at the 2005 forum for community bank examiners.



TWO SIDES OF THE COIN: PROS AND CONS OF THE FALLING DOLLAR..... 12

The impact of the dollar's fall on businesses has been keenly felt by some firms, while others have little noticed it at all.



WHO'S MINDING THE BANK?: GOVERNANCE PRACTICES AT TENTH DISTRICT INSTITUTIONS...22

One need not look hard to find instances of banks brought down by corporate malfeasance—often the result of poor management or a lack of internal controls.

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DEPARTMENTS

- 1 PRESIDENT'S MESSAGE**
- 28 NOTES**
- 30 ABOUT...**
- 33 FED DIRECTORY**
- 33 FURTHER RESOURCES**

Not quite 92 years in the making

You don't have to look back 92 years to see how much the world has changed since Congress passed legislation creating the Federal Reserve.

The Federal Reserve Act, approved in 1913, called for the creation of a central bank "to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

In the intervening years, those other purposes, like the world, have evolved.

A little more than a decade ago, for many Americans the debit card was something used for a cash withdrawal at their bank's automated teller machine. Today, ATMs dot the landscape while the debit card is becoming the preferred choice at the checkout as consumers favor the speed and convenience of electronic payments over the checkbook. In response, the Federal Reserve Bank of Kansas City's Payments System Research staff is among the leaders in this highly-specialized research, recently hosting a conference on specific fees, known as interchange, that are a part of each credit and debit card transaction. The conference, along with research on an array of banking and business related topics, is featured in this debut issue of TEN, a quarterly publication for the Tenth Federal Reserve District from the Federal Reserve Bank of Kansas City.

The rapid rise in debit card use may be the most visible, but certainly not the only, example of a changing financial world that's reflected in the expansion of research at the Federal Reserve Bank of Kansas City.

While much of our research remains focused on banking, the economy and monetary policy, our mandate has broadened in recent years, encompassing studies in areas including the pay-

ments system as well as community and rural economic development. In the same way our research is broadening, TEN is expanding the distribution of the research. The work of our economists will provide a foundation for magazine articles that will illustrate our academic research with the business and industry of the Tenth

District. Meanwhile, the core research, like the publication's content, will be available on our website: www.kansascityfed.org.

TEN will also include articles focused specifically on the Federal Reserve, including its history, structure and operations. With these articles, TEN will provide some insight into the purpose and function of both this region's central bank and the broader work of the entire Federal Reserve System.

I hope you find this debut issue and future editions of TEN to be insightful and worthy of sharing with others who are involved in the banking, business and industry of the Tenth Federal Reserve District. To start a subscription or to comment, email us at teneditors@kc.frb.org. TEN will be distributed at no charge, so there's no need to use your debit card.



A handwritten signature in black ink that reads "Thomas M. Hoenig".

THOMAS M. HOENIG, PRESIDENT
FEDERAL RESERVE BANK OF KANSAS CITY

Questioning Conventional Wisdom...

Do Higher Workers' Compensation Costs Drive Companies Out of State?

BY KELLY EDMISTON,
SENIOR ECONOMIST, COMMUNITY AFFAIRS

Un 1910, Missouri's governor appointed a commission to investigate the feasibility of a workers' compensation law. So contentious was the issue, that it took 16 years for the state to enact legislation because of fears that a measure would drive business away.

Fast forward to the 21st century, and you'll find there are still fears in Missouri and other states that their workers' compensation programs spur businesses to relocate to less-costly states. Comprehensive reforms of the workers' compensation system have been on the table in almost every state in recent years. At least nine states undertook major reforms of their

workers' compensation systems in 2004 alone, although few states enacted substantial reforms.

In most cases, the impetus for reform has been the perception that higher workers' compensation costs send businesses and jobs to less-expensive states. In his 2004 state of the state speech, California Governor Arnold Schwarzenegger asserted that "California employers are bleeding red ink from the workers' comp system. Our high costs are driving away jobs and businesses."

California went on to enact worker compensation reforms in April 2004. A bill to further reform the system was introduced in January 2005.

Despite nearly universal claims of job losses from escalating workers' compensation costs, little research exists to either support or deny these claims.

The U.S. system of workers' compensation is actually a set of 51 different systems representing each of the 50 states and the District of Columbia, and a federal system to cover federal employees, coal miners suffering from black lung disease, veterans injured on active duty, and longshore and harbor workers. In virtually all states participation is mandatory for all but the smallest employers, generally those with fewer than five workers. Compensable injuries and illnesses, benefit levels, and other administrative characteristics vary widely across the states.

According to the National Academy of Social Insurance, roughly 45 percent of workers' compensation benefits are for medical care, with the remainder going toward cash benefits. Cash benefits for total disability typically equal some fraction of the predisability average weekly wage (often two-thirds) up to a maximum benefit. Cash benefits for a partial disability typically conform to a schedule of benefits linked to spe-

death and disfigurement benefits for injured workers.

And back in Missouri, the governor signed a bill in March that will allow employers to require workers to use sick time or paid time off to recover from a work-related injury. The measure also requires physicians to use only "objective" medical findings about a worker's injury, not "subjective" information about pain. Another section of the law requires that the workplace be the "prevailing" factor in a worker's injury, where it previously only had to be a "substantial" factor.

The legislation will only serve to delay injured workers from getting medical care, says a national labor leader.

"The bill in Missouri is frankly right out of the playbook that's been offered by insurance," says Robert McGarrah Jr., workers' compensation coordinator for the AFL-CIO. Requiring the workplace to be the "prevailing" cause of an injury is unfair, he says.

"Anyone can have a back problem, go to work and lift a box or slip, and the insurance company is going to say it's not the prevailing factor. The insurance company is looking for

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The U.S. system of workers' compensation is actually a set of 51 different systems.

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cific impairments. Because workers' compensation benefits are excluded from income taxation and wage replacement rates are relatively high, the system can lead to after-tax wage replacement greater than the worker's actual wages.

Efforts in the Tenth District

Echoing the fear that high costs drive away business, Oklahoma House Minority Leader Todd Hiatt, a Republican, judged that the state's "expensive, lawyer-friendly workers' comp system is a leading cause of 'job flight' from Oklahoma, as employers move to states with more business-friendly environments."

Oklahoma's House approved a reform package in March that would encourage mediation between injured workers and their employers, take steps to reduce injured workers' medical costs, increase marketplace competition for workers compensation insurance and increase

ways to avoid paying the claim. That's the distressing thing that's happening with the insurance drive to cut costs. It's going to hurt businesses in the long run."

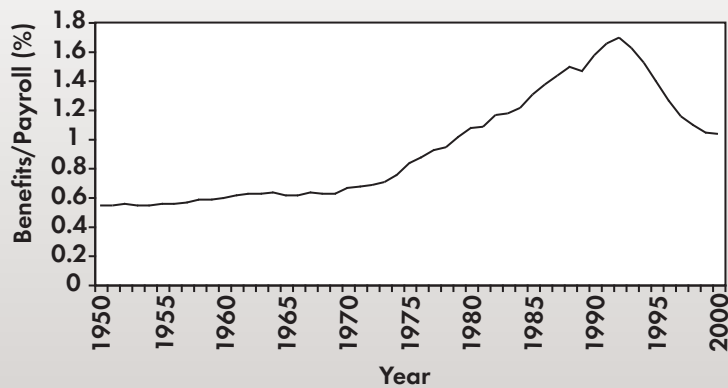
Reducing costs by restricting covered care will be counterproductive, he says, as workers resort to litigation to get their medical care compensated.

However, labor leaders are not against workers' compensation reforms. Nearly all parties involved agree that it's worthwhile to look at updating these programs to reflect changes in health care and occupational trends.

In Nebraska, a coalition that includes business and labor leaders will be reviewing its program this summer.

"We're equally concerned about safety, and the care and service of the injured," says Terry Moore of the Omaha Federation of Labor. "But it has to be a fair process for both labor

FIGURE ONE: Benefits as a Percentage of Covered Payroll
United States, 1950-2000



and business, and the only way to accomplish that is for business and labor to work together with government.”

Trends in workers' comp

Given the importance of the workers' compensation system in providing injured workers with sufficient, timely and certain benefits, and the role of workers' compensation insurance in limiting employers' liabilities, a proper analysis of the relationship between workers' compensation and employment is critical to developing sound policy options. Results from an analysis conducted at the Federal Reserve Bank of Kansas City reveal that higher workers' compensation costs relative to other states or time periods do indeed lead to lower employment levels, but the impact is small and not likely a significant factor in explaining cross-state variation in employment over time.

Workers' compensation benefits as a share of covered payroll increased at moderate rates from 1950 to 1970, rising less than 10 percent over each decade (Figure 1). The 1970s and 1980s saw much more dramatic growth in benefits, with 10-year increases of roughly 60 percent and 45 percent, respectively. The 1990s ushered in a remarkable turnaround, however, as benefits as a percentage of covered payroll declined 38 percent.

Although numerous states undertook major workers' compensation reforms in the 1990s, recent research suggests that other factors were the major force in the decline in benefits pay-

ments. The decline was due largely to reductions in injury-induced days-away-from work and restricted workdays, but economists from Boston University and the Bureau of Economic Analysis recently found that workers' compensation reforms in the 1990s were responsible for only 7 percent to 9.4 percent of the substantial nationwide decline. Other likely factors, according to research from the Department of Labor, include a shift in employment away from injury-prone sectors, increases in underreporting of workplace injuries and illnesses, cost-containment measures on the part of employers and insurers, elimination of workplace hazards, and improved Occupational Safety and Health Administration enforcement.

In 2002, the latest year for which complete data are available, the average benefits per \$100 of covered payroll was \$1.17 nationwide, but values ranged from \$0.41 in the District of Columbia to \$4.49 in West Virginia. West Virginia was a substantial outlier; the high cost of benefits can probably be attributed to the fact that mining, perhaps the most injury-prone sector of the economy, is an important industry in that state.

In the Tenth District, states averaged \$1.23 in workers' compensation benefits per \$100 of covered payroll in 2002, slightly higher than the U.S. average (Figure 2). New Mexico paid the fewest benefits relative to covered payroll in the Tenth District with \$0.98, while Wyoming paid the most at \$1.59. The Tenth District states roughly followed national trends in workers' compensation benefits over the 1976-2000 study period.

Workers' compensation costs and employment

If states are seeking to reform their workers' compensation laws with the sole intent of lowering costs to attract or keep businesses, they might be disappointed.

The analysis evaluates the claim that high workers' compensation costs drive jobs to lower-cost states by estimating the relationship between workers' compensation costs and state employment from 1976 to 2000. The goal of the analysis was to isolate the role that workers'

compensation costs play in the determination of state employment from other likely factors.

Results of the analysis suggest that workers' compensation costs have a negative effect on both employment and wages, but the magnitude of the effect is quite small: a 10 percent increase in workers' compensation benefits would be expected to yield only a 0.11 percent decline in employment and 0.10 percent decline in real wages. To put these results in perspective, consider the effect of motor fuel prices on wages, which also was estimated in the model. A 10 percent increase in motor fuel prices would lead to a 0.5 percent decline in wages, fully five times the effect on wages of an increase in workers'

Mexico (lowest in the Tenth District), for example, a drop of nearly 40 percent, employment in Wyoming would be expected to be higher by roughly 1,100 jobs, or 0.4 percent, about equal to the number of jobs created in the Wyoming economy in the first quarter of 2005.

Of course, states such as Oklahoma and Missouri are hoping this will be the case with their reforms. Federal Reserve Bank of Kansas City Board of Directors Chairman Robert Funk of Oklahoma City has worked on a reform bill crafted by the Oklahoma House with the intent to reduce legal fees but increase death benefits for workers. He holds a monthly business forum with 15 randomly selected companies to gauge

“ **Fourteen of the 15 businesses said their major concern was workers' compensation costs.** ”

compensation costs of similar magnitude. A 10 percent increase in wages would be expected to lead to a 2.1 percent decline in employment, according to model results, roughly 20 times the effect of a 20 percent increase in workers' compensation costs.

Although the estimated impact of workers' compensation costs on employment and wages is small in relative terms, large changes in workers' compensation costs could still lead to substantial changes in employment. If workers' compensation benefits in Wyoming (highest in the Tenth District) were to drop to the level in New

the business climate.

“Fourteen of the 15 businesses said their major concern was workers' compensation costs,” said Funk, who is also the chief executive of Express Personnel Services International.

“One said they only had 20 employees; if they moved 20 miles down the road to Kansas, they would save \$87,000 in workers' compensation costs. That's quite a lot of money for a small employer,” said Funk.

In another case, representatives of a larger national employer told Funk that their company, operating in three states—Indiana,

FIGURE TWO: Workers' Compensation Benefits per \$100 Payroll
Tenth District, 2000

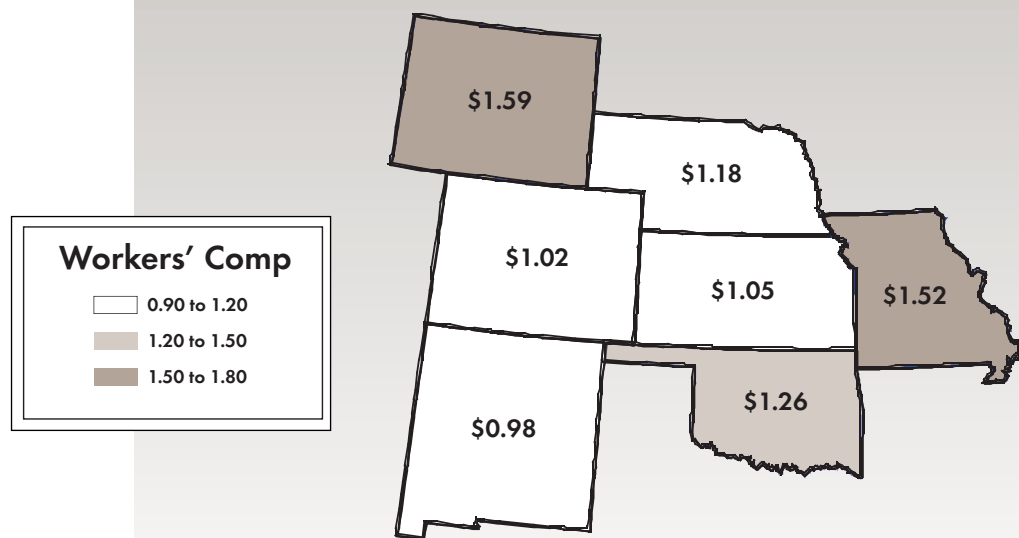
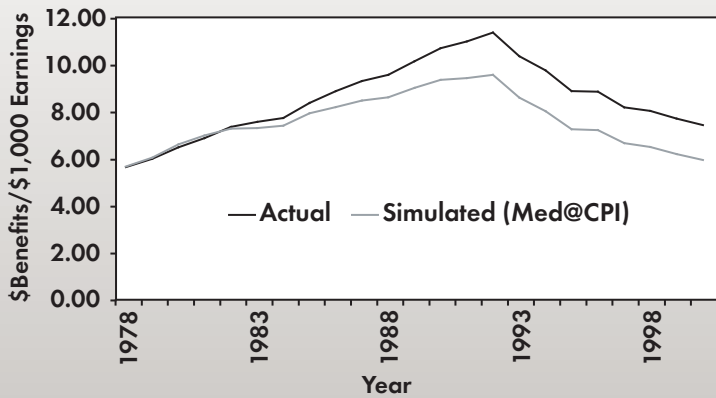


FIGURE THREE: Simulated Workers' Compensation Benefits Medical Cost Index=CPI, 1978-2000



An analysis shows workers' comp costs would have been 80% of what they were in 2000 if medical costs had kept pace with the Consumer Price Index.

Tennessee and Oklahoma—found workers' compensation costs in Oklahoma to be three times higher than in the other states. Should the employer decide to expand, it will likely choose to do so in the other states rather than Oklahoma, said Funk.

To what degree workers' compensation costs will motivate a company in its decision to relocate is unclear. Funk concedes that other factors will play into that decision—quality of life, cost

medical cost inflation of 10 percent leads to workers' compensation cost inflation of 4.7 percent. Over the time period of this analysis, medical costs increased approximately 356 percent, suggesting that workers' compensation costs would be much lower today had medical costs kept pace with consumer prices, which advanced only 177 percent over the period. In fact, the results suggest that workers' compensation costs would have been roughly 80 percent of what they were in 2000, all else equal. Figure 3 compares actual workers' compensation benefits for the average state over the period 1978-2000 to simulated workers' compensation benefits if medical costs were to have risen at the same rate as consumer prices. The large difference in workers' compensation costs would not have made much of a difference in national employment, however. Total U.S. nonfarm employment would likely have been only 0.1 percent higher in 2000 had medical costs merely kept up with consumer prices, yielding 158,000 additional jobs.

Other results indicate areas with higher union density tend to have lower workers' compensation costs, likely reflecting more regulated working conditions imposed by unions. Other

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Higher medical costs lead to substantially higher workers' compensation costs.

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of living and ease of transportation, for instance. In Oklahoma's case, the state boasts a highly productive work force, Funk says.

Anecdotal evidence suggests that workers' compensation costs are no doubt a heavy burden for some companies, and these companies may well seek relief in another state with lower costs. But the more systematic evidence suggests that these cases are isolated, and that workers' compensation cost disadvantages do not lead to widespread shifts in employment to lower-cost states.

The reason for rising costs

A secondary objective of the analysis was to estimate the determinants of workers' compensation costs.

The most salient result from the model is that higher medical costs lead to substantially higher workers' compensation costs. Specifically,



key determinants of workers' compensation costs include wage levels (greater pay increases costs), higher poverty rates (increases costs), older workforce (increases costs) and education levels (surprisingly, the higher the proportion of uneducated workers, the lower the costs).

Data from the National Academy of Social Insurance indicates that 75 percent to 80 percent of employers' costs are benefits; the remaining portion covers administration and legal costs.

What impact?

The study by the Federal Reserve Bank of Kansas City evaluates the impact of workers' compensation costs on total employment and average wages across states over time. The main finding is that higher workers' compensation costs lead to lower wages and employment levels, but that the effects are relatively small. The study also evaluates the determinants of differences in workers' compensation costs and suggests that medical costs are a substantial factor. Although workers' compensation costs have declined overall since the 1990s, all else the same, benefits, and therefore costs, would have been much

lower had medical costs merely grown at the same rate as consumer prices.

There has been and continues to be a loud and consistent clamoring for workers' compensation reform across the states. The results here suggest that efforts to reform workers' compensation systems, to the extent the reforms reduce costs, are likely to have a positive modest impact on employment and wages and may be worth undertaking. However, workers' compensation reforms are unlikely to be the great boon to employment that policy makers would like to see. Policy makers may instead want to turn their efforts to addressing the skyrocketing costs of medical care.

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TONI LAPP, senior writer, also contributed to this article.

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

Other research available

from The Federal Reserve Bank of Kansas City

The Supervisory Framework Surrounding Non-Bank Participation in the U.S. Retail Payments System: An Overview

http://www.kc.frb.org/FRFS/PSR/Sullivan_Supervision_nonbank_pmt_providers_WP0403.pdf

Do Only Big Cities Innovate? Technological Maturity and the Location of Innovation

<http://www.kansascityfed.org/PUBLICAT/ECONREV/ermain.htm>

Credit Union Growth in the Tenth Federal Reserve District: How Legal and Regulatory Changes Have Affected Credit Union Expansion

<http://www.kansascityfed.org/PUBLICAT/FIP/Fipmain.htm#2005>

Consumption Taxes: Macroeconomic Effects and Policy Issues

<http://www.kansascityfed.org/PUBLICAT/ECONREV/ermain.htm>

A Puzzle of Card Payment Pricing: Why Are Merchants Still Accepting Card Payments?

<http://www.kc.frb.org/FRFS/PSR/WP04MerchCardAcceptance12-28-04.pdf>

What Do Expected Changes in U.S. Job Structure Mean for States and Workers in the Tenth District?

<http://www.kansascityfed.org/PUBLICAT/ECONREV/ermain.htm>



Is the Playing Field Changing for Bankers and Supervisors?

This is an excerpt from a speech delivered by Bank President Thomas M. Hoenig at the 2005 forum for community bank examiners. To read the full text of the speech, visit the Bank's website at www.kansascityfed.org.

The critical role that smaller banks play in their communities was something that became very apparent to me as a bank supervisor in the 1980s. In our District, this period provided firsthand experience with what happens in communities when banks encounter problems and no longer have the financial resources to adequately serve their customers. While none of us want to repeat that experience, it provided

detailed insights regarding the many different and crucial roles bankers play in their communities and what can happen when these links are disrupted.

In today's environment, we can cite a variety of financial needs that community banks serve, including lending to such groups as small businesses, home buyers and real estate developers, consumers, and farmers. In addition, community bankers meet their customers' needs for transaction and savings services and provide much in the way of leadership and financial advice in their communities.

Larger banks and other financial institutions provide many similar, competing services. However, community banks have traditionally found a unique and essential role in picking up business that doesn't quite fit the parameters under which other institutions operate. This business, for instance, often includes small companies and individuals without extensive track records and detailed financial statements,

customers seeking more personalized services and treatment, and communities or markets with smaller volumes of financial activity.

I think the type of small business lending community banks do is a striking example of the flexible and innovative nature of these institutions. Such lending also fulfills a need that might not otherwise be met so effectively in our financial markets. In fact, the role and importance of community banks is linked hand in hand with that of many small businesses.

In a study our Bank completed two years ago, we found that community banks—those with less than \$1 billion in assets—accounted for one-third of the small business lending done by banks. This lending role is much larger than the share of all bank deposits held by community banks—19 percent of bank assets—15 percent. Community banks even provide additional support to small businesses through nonresidential real estate lending and individual lending to the owners of small business.

Small business lending by community banks also is important because of the unique form it often takes. In contrast to the “credit scored” and credit card loans that large banks typically offer to small businesses, community banks have made a market for themselves in relationship lending. Such lending involves taking time to thoroughly investigate and understand a small business, especially in cases where there may be little credit history or collateral to support a loan. Good relationship lending also entails closely monitoring a borrower after a loan is made and then being in a position to continue meeting the needs of a small business as its operations prove successful. The strength of community banks in relationship lending makes them particularly adept at meeting the needs of small businesses and businesses serving unique and innovative markets.

How important is this small business lending role to the overall economy? A few statistics on small businesses provide a good indication of their importance. According to the U.S. Small Business Administration, small businesses—those with fewer than 500 employees—represent 99.7 percent of all employers and employ one-half of all private sector employees

—including much of the high-tech workforce. In addition, small businesses generated 60 to 80 percent of net new jobs annually during the 1990s, created more than 50 percent of nonfarm private GDP, and produced many of the most commonly cited patents in the United States.

The role of small businesses was perhaps even more critical in the recent recession. While large businesses experienced a net decrease in employment in 2000 and 2001, small businesses hired more than 1.1 million new employees, thus creating all of the net gain in jobs for the U.S. economy.

In many ways, the importance of community banks parallels that of small businesses. While a community bank as a single unit might not appear to be too important in the overall context of U.S. banking, community banks are important individually to their communities and, in the aggregate, to the national economy. Equally significant, they have served as a testing point or incubator for many start-up businesses and concepts that later assume a much larger role in the economy.

What are the challenges community banks face?

A key set of questions for community bankers is: What challenges will they have to address, and what will the future hold for them? In other words, is the playing field changing for community bankers? I think that these are interesting and important questions for us to explore today—in part because we all play a role in the future of community banks, but also because the outcome is by no means clear.

Community bankers typically express a positive, optimistic outlook while mentioning a host of things that must be done to improve their situation. According to a survey we conducted last year of the community bankers in our District, we found that virtually all of the respondents had a positive outlook—94 percent of those responding to our survey, for example, believed that it was “likely” or “very likely” that they would operate under the same ownership and operating structure for the next five years. In addition, more than half of the bankers anticipated opening or acquiring additional branch

offices during this period, thus indicating that many plan to expand their operations soon.

Undoubtedly, a key factor in the optimism of community bankers is the record levels of profitability they are achieving—a performance that comes just after banks went through some of the most challenging times in the industry. For instance, today's community bankers have successfully dealt with such challenges as the banking crisis of the 1980s and early 1990s, when more than 1,600 banks failed. They also have survived interest rate deregulation, the relaxation of geographic constraints on bank expansion, and rapid technological innovation in banking, including Internet banking. At the time, most thought that each of these events would greatly favor large banks and place community banks at a severe disadvantage.

Although community banks may play a somewhat smaller role than they once did, their record demonstrates that they have been

assets, meeting competition from other community banks, dealing with technological change, and meeting regulatory compliance requirements. Banks in slow-growing markets also mentioned the challenge of dealing with this slow growth and finding opportunities for diversification.

These responses all seem to reflect concerns about the competitive environment community banks will face and whether they can generate the business and revenue streams to be competitive players. As a result, we should take a step back and have a broader look at the competitive framework in our financial markets and the underlying factors that will test community banks.

First, we all think that we have seen a lot of consolidation in banking, and a recent Federal Deposit Insurance Corporation study predicts that the pace of consolidation is likely to slow down now that the industry has largely adjusted to the relaxation of bank expansion

Record levels of profitability for community bankers attributes to a positive outlook for the next five years.

remarkably innovative and flexible during periods of considerable stress. This record also shows that they fill an important need in our financial system.

However, it would be a mistake for community bankers to become complacent and think that they will not face strong challenges going forward. In many ways, I think community bankers may face comparable, if not stronger, challenges than in the recent past. Consequently, while it is difficult to see how everything will play out for community banks, I would like to spend some time looking at the possible challenges for community banks.

One indication of the challenges community banks will face comes from our survey of community bankers in the Tenth District. When we asked them about the challenges they expect over the next five years, the most common responses were developing new sources of noninterest income, maintaining and attracting retail deposits, and achieving satisfactory loan growth. Other popular responses were achieving satisfactory net interest margin and return on average

laws. While this might be of some comfort to community bankers, there also are strong reasons for believing that consolidation will continue—including much at the community bank level.

In fact, if we look at other industries, they seem to be experiencing continued pressure for consolidation and in the context of an evermore competitive environment. This is particularly true for telecommunications, transportation, retail trade, and a number of other service sectors. Wal-Mart, for example, still continues a strategy of rapid expansion. While Wal-Mart first focused on rural markets where it faced weaker competition, it has continued to work on improving its distribution system and is now assuming an important and growing role in many metropolitan markets. Similar patterns can be seen in other retailers, grocery stores, and restaurants, and franchising is leading to other forms of consolidation.

A number of lessons for banking can be drawn from these trends in other industries. One key lesson is that those best able to master their product distribution channels will find further

opportunities for expansion. In this regard, larger banking organizations appear to have become better in handling their acquisitions, and there are signs that community banks are no longer benefiting much from customer fallout after big mergers. Also, many larger banks are now paying more attention to their retail business in an effort to lower their funding costs and make up for recent declines in large corporate lending. In fact, many large banks are expanding their branching networks in metropolitan markets, thereby bringing community banks and their larger counterparts into more direct competition. An additional lesson is that consolidation in other industries will continue to reduce the traditional customer base of community banks as more “ma and pa” businesses are replaced by “big box” retailers and franchises.

Another factor in the competitive framework that is likely to become more of a test for community banks is funding costs. Banks, particularly community banks, have benefited over the past few years from increased liquidity and low rates on deposits. Declining returns in the stock market and in other markets also have made deposits more attractive. Rising interest rates, better stock returns, and the increased attention large banks are giving to retail banking all suggest that community bank funding will again become more challenging. In addition, credit unions continue to expand rapidly and are attracting funds from many customers that would otherwise turn to community banks.

A third factor to consider as we look forward is technology. Community banks have been remarkably successful in finding third-party vendors to meet their growing needs in technology. These vendors have allowed community banks to match many of the services offered by larger banks and in a reasonably efficient manner. However, technological innovation raises a number of competitive issues for community banks. Some of the more important include: Can community banks continue to be efficient and innovative as they rely on others to provide their technology? Will scale economies and the cost of technology give large banks a clear advantage at some point in the future, and will community banks have greater

problems gaining access to payments and clearing networks? Will declining information costs allow big banks to reach more of the traditional customer base of community banks?


One other consideration is that many rural community banks are located in small communities with limited growth prospects and declining populations. Such markets pose another set of challenges for these banks. An important question for such banks is: Can they continue to generate enough business from their own community to operate efficiently or should they look for expansion and consolidation opportunities in other markets?

A final factor is regulation. The fixed cost of regulation has a particularly high impact on community banks since they have to become familiar with and comply with many of the same regulations as large banks, while having much less of a customer base over which to spread these compliance costs. An even better explanation of this was provided by a banker in our District who stated, “The regulation of small banks is like killing a gnat with a sledgehammer.”

All of these challenges thus suggest that the playing field and the competitive environment facing community banks will continue to increase in its intensity.

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COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.



Two sides of the coin: Pros & Cons of the Falling Dollar

BY TONI LAPP, SENIOR WRITER

Sales are so strong for industrial products made at Clay & Bailey Manufacturing Co. in Kansas City, Mo., that the company is adding workers to meet the demand. Why? The depreciating dollar is making their products more competitive against foreign-made products. Meanwhile, the company president is concerned over the cost of imported raw materials—up sharply, due in part to the falling dollar.

Such is the world of currency exchange, producing winners and losers, sometimes within the same company. Clay & Bailey's mixed results reflect many other firms' experience, says Bill

Keeton, assistant vice president and economist at of the Federal Reserve Bank of Kansas City, who has spoken on the issue.

"The weak dollar is having a positive effect on exports, but a negative effect due to the higher cost of raw materials," he said.

In the world of foreign exchange, the terms "strong" and "weak" get tossed around a lot. A strengthening dollar means its value is rising in relation to other currencies. A weakening dollar means it is losing value against other currencies.

Over the last three years the dollar has fallen about 35 percent against the

European Union's euro and 24 percent against the Japanese yen.

While it may seem counterintuitive to wish for a weak dollar, some U.S. firms are reaping benefits.

A recent manufacturing survey conducted by the Bank speaks to the beneficial effects. The instrument shows the district's year-over-year export index has edged up recently, and the six-month-ahead index has increased even more, suggesting that the lower dollar is having some positive impact on manufacturing exports.

But manufacturing is not the only sector feeling an effect—good or bad.

"It impacts a lot of industries—from shipping, to agriculture, to the manufacture of actual products," says Mary Pyle, managing director of the Greater Kansas City Chamber of Commerce World Trade Center.

And what of the "desirability" of a strong dollar?

"When the dollar peaked in the 1990s, it dampened our exports," says Burbach.

The flip side

Not all Tenth District manufacturers are beaming about the falling dollar.

Kawasaki's U.S. plant should realize a boom, right? Not so, says Shin-ichi Tamba, president of Kawasaki Motors Manufacturing Corp., U.S.A. in Lincoln, Nebraska. Kawasaki is spending more for inputs, says Tamba.

"We are going to spend about 5 percent to 10 percent more than before because of down-sized dollars," he laments. Kawasaki imports parts such as electrical control units and shock absorbers. And because the United States is the leading market for the all-terrain vehicles and

“The weak dollar is having a positive effect on exports but a negative effect on raw materials.”

Grain traders in Kansas City credit the dollar with creating a more favorable market for U.S. wheat exporters. A liquor-store retailer blames the dollar for sending the price of French wine soaring. A Colorado ski resort attributes a boom in foreign visitors to the dollar.

The impact of the dollar's fall on businesses in the Tenth Federal Reserve District has been keenly felt by some firms, while others have little noticed it at all.

"Manufacturing is considered to be one of the sectors most exposed to changes in exchange rates," says Keeton.

Nebraska-based Behlen Manufacturing is a prime example. Its products, fabricated metal storage containers and sheet-metal joining presses, are in demand in developing countries. Lyle Burbach, president of Behlen's International and Diversified Products Division, estimates that exports have risen 30 percent over the last three years.

"It's been helpful for us," he says of the plummeting dollar. "It's spurred exports."

Put simply: "We are winning more contracts."

Because Behlen's products are sold in dollars, the manufacturer is at a competitive advantage over European firms whose goods are sold in euros, says Burbach.

jet skis produced at the Lincoln, Neb., plant, exports are not increasing dramatically.

The extent to which a fall in the dollar increases the cost of imports is known as "pass-through." Foreign manufacturers usually pay their workers and suppliers in foreign currency, so when the dollar falls, they charge higher dollar prices to their U.S. customers to cover their costs. Sometimes, though, foreign companies refrain from raising their dollar prices the full amount to avoid losing business.





A conventional estimate is that import prices rise by half the amount of a fall in the exchange rate, though some economists have found evidence of smaller pass-through during the last decade.

Some analysts have claimed that the use of imported inputs has increased greatly in U.S. manufacturing, eliminating the benefit to manufacturers of a fall in the dollar.

Although the cost of imports has not totally eliminated its gains from increasing sales, Clay & Bailey Manufacturing Co. certainly counts both positives and negatives of the falling dollar.

“ **Manufacturing is considered to be one of the sectors most exposed to changes in exchange rates.** ”

The manufacturer of construction castings saw a double-digit sales increase in 2004, says company President Ron Borst. But costs have increased faster. This is partly due to rising worldwide demand, but the fact that the dollar has slid 33 percent against the Brazilian currency over the past two years surely has contributed. Borst says raw materials such as iron from Brazil increased from \$180 a ton to \$560 a ton in 14 months.

But all things considered, Clay & Bailey is better off as a result of the dollar's depreciation, says Borst. He need only look at his customers' orders as of late. To complement his offerings of plumbing hardware, he distributes a French product; about 40 percent of customers once opted for that product over the higher-quality,

more expensive U.S. product made at Clay & Bailey. Now the French product is not such a good buy, reflected in the sales ratio: 10 percent for the French product versus 90 percent for the domestic product. “It's to the point where the French are grumbling,” said Borst.

Beyond the plant

Manufacturing is not the only industry suffering the woes of pass-through.

“French wines have gone through the roof because of the euro,” says Ralph Bondon, owner of Berbiglia Wine & Spirits in Kansas City, Mo. He has adjusted to the changing economy: He is buying less high-end French wine—bottles now selling in the \$400 range—with the assumption that consumers won't have the appetite for it that they did a few years ago. He is now concentrating on buying the many midpriced wines that offer good value, he says.

A sector that's feeling a positive impact is tourism. Domestic tourism, that is.

“You definitely heard a lot more British accents on the chairlifts,” said Kelly Ladyga, spokeswoman for Vail Resorts. “Our domestic guests even commented on it.”

Vail has capitalized on the weakening dollar by ramping up overseas marketing, not just in Europe and Mexico, but also to Australia, in an

effort to woo skiers who in the past may have headed for the Canadian Rockies. Americans too, previously lured by favorable exchange rates, have found it more economical to stay home, says Ladyga.

However, the Tenth District in general does not rely heavily on travel expenditures by international visitors; Rocky Mountain ski resorts are the exception to the rule. Overall, foreign visitors are much less important to tourism in the district than to the nation, says Keeton.

Homegrown advantage

One sector that is more important to the Tenth District than to the rest of the nation is agriculture.

Witness the sale of Midwestern grain.

“There’s no question that a cheaper dollar helps to trade at higher prices,” says Randall Stone, trader with FCStone LLC. The price of hard red winter wheat worldwide is set at the Board of Trade in Kansas City, Mo. World prices are based on U.S. currency. As the dollar falls in value, U.S. commodities become cheaper overseas and U.S. exports rise. This reduces domestic supplies, which has the effect of keeping domestic commodity prices relatively high.

“If the dollar rallies, we’d have to drop our price in order to compete,” says Stone.

Because so many factors affect the price grain sells at, wheat farmers are little aware of the effect of the dollar, said Stone. Or at least American wheat farmers. Foreign farmers will more likely have a surplus at the end of the season because of the low dollar.

“It’s going to have a mixed impact on U.S. agriculture,” says Jason Henderson, senior economist with the Federal Reserve Bank of Kansas City’s Center for the Study of Rural America. “Mainly because it hasn’t fallen uniformly.”

A large part of the U.S. agriculture exports go to China and other Asian countries, says Henderson, and China keeps its currency pegged to the dollar.

And in some cases, the effects of the fluctuating dollar are offset by other factors. For in-

stance, the price of grain is affected by weather conditions, political events, world supply and demand, and myriad other variables. And in the beef industry, which otherwise may have been able to capitalize on the currency’s condition, producers are not reaping any benefits because the mad cow scare has caused countries such as Japan to ban import of U.S. beef.

Nevertheless, economists predict an opening for firms in the Tenth District to expand their business overseas.

“It gives them an opportunity,” says Keeton of U.S. manufacturers. “Maybe some markets that may not have been open to them before, will be open now.”

District businesses are taking note. Borst of Clay & Bailey Manufacturing went to Mexico in 2004 in an attempt to attract new distributors for his product. Recognizing the importance of the global economy to the region, organizations such as Kansas City’s World Trade Center lead trade missions overseas. This summer the WTC will lead a tour to China.

Meanwhile, manufacturers such as Borst will continue to celebrate the low dollar.

His only wish? “I would like to see the whole world go to devalued currency.”

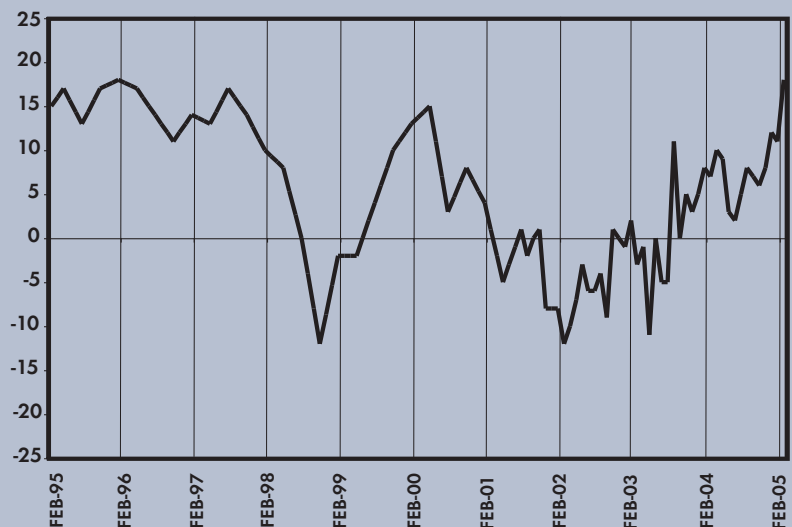
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COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

Net Percentage of Tenth District Manufacturers

reporting increased export orders from the year before

Percent reporting increases minus percent reporting decreases



A close-up photograph of a hand holding a credit card over a calculator. The calculator is in the foreground, slightly out of focus, with its black buttons visible. The background is a bright, out-of-focus white surface. The text 'As Payments Go Plastic' is overlaid in a large, green, sans-serif font.

As Payments Go Plastic

Understanding the costs of credit and debit cards

BY TONI LAPP, SENIOR WRITER

Un Santa Fe, New Mexico, recently, a passerby browsing a street vendor's wares asked, "Do you take credit cards?"

"No," he said. Then he quipped, "This is sacred ground," referring to the sidewalk surrounding the centuries-old Palace of the Governors.

Ironically, a topic that has become sacred ground in the payments industry was under discussion nearby at a conference organized by the Federal Reserve Bank of Kansas City: Interchange.

The fee that merchants' banks pay

for handling credit and debit card payments has become the center of heated debate between retailers and the credit card industry. The purpose of the conference was to discuss what role, if any, public authorities should have to intervene in the markets for credit and debit card payments. In addition, regulators from other countries, academics and industry participants had the opportunity to exchange views to further understand what drives these markets.

Both credit and debit cards have been growing strongly in recent years.

The distinction between the two is that credit card transactions are, in effect, short-term loans, whereas debit card transactions are immediately withdrawn from the cardholders' accounts. Interchange fees are involved in both transactions.

Held May 4-6, the meeting came just weeks after a round of increases in interchange fees from MasterCard and Visa. A recent Morgan Stanley report found that the weighted average for Visa and MasterCard credit interchange had increased from 1.58 percent of the value of a transaction in 1998 to 1.75 percent in 2004. Some of the new rates are as high as 2.9 percent, particularly for new higher-rate premium cards, which credit card giants have been pushing over lower-rate standard cards.

Authorities in Australia, Mexico and the United Kingdom have examined and, in Australia's case, acted to force reductions of in-

plays in setting fees is in question. In most industries, competition brings down prices. But this hasn't been the case with interchange; indeed, the more competitors there are, the higher the fees seem to climb.

When someone talks about a competitive market, they talk about a market in which price is set by supply and demand, says Mallory Duncan, general counsel of the National Retail Federation. "The problem is (retailers) are nowhere in the equation with interchange fees."

Duncan calls the fees a "hidden tax" on consumers.

"Say a retailer is willing to sell a product for \$99 in dirty, old cash," says Duncan. "If they're going to sell to someone with a credit card they'll have to charge \$101."

One merchant says consumers are ill-informed.

“ **In most industries, competition brings down prices. But this hasn't been the case with interchange.** ”

terchange rates in those countries, yet the fees are the highest in the United States. Some wonder why there have been no regulatory moves here. New entrants to the industry are rare, and accusations of antitrust have been made. In the United States, the last company to enter the market was Discover Card, in 1985.

Whither interchange

Credit card companies maintain that interchange has provided issuers the funding to promote cards as a more convenient way to pay for purchases. Credit cards bring higher sales, quicker checkout and lower risk versus handling cash or checks.

Merchants, on the other hand, complain about the fees cutting into their profit margin and artificially raising the price of goods for all consumers, whether they pay with cash or plastic.

Certain aspects of the industry have confounded economists, who lament the complexity of the fee structures and the lack of solid data.

For instance, the role that competition

"I don't think customers understand the expenses to the merchant, and that in turn, it affects (the customers') bottom line," said Marilyn Taylor, owner of M. Taylor gift store in Prairie Village, Kan.

Taylor says she was exasperated to see a mail insert from one bank's credit card encouraging customers to charge small purchases and offering an incentive—entry for a contest—for each charged purchase under \$25.

But Noah Hanft, general counsel of MasterCard International points to the benefits that merchants realize: reduced costs for cash handling, bounced checks, and collections.

"Because we are replacing far more costly and less beneficial payment forms, it is both logical and appropriate to charge these merchants for the extraordinarily valuable service provided to them," he said.

The business model

Credit card companies are similar to dating services in their function, suggest two economists. In their paper presented at the Santa Fe conference, David S. Evans and

Further Resources: INTERCHANGE FEES

THE FOLLOWING PAPERS AND REMARKS were presented during the International Payments Policy Conference, "Interchange Fees in Credit and Debit Card Industries: What Role for Public Authorities?" sponsored by the Federal Reserve Bank of Kansas City. Full text of the papers can be downloaded at www.kansascityfed.org/FRFS/PSR/2005/05prg.htm.

CONFERENCE OVERVIEW/CLOSING REMARKS, by **Hendrik J. Brouwer**, Executive Director of **Nederlandsche Bank N.V.**

INTERCHANGE FEES IN VARIOUS COUNTRIES: DEVELOPMENTS AND DETERMINANTS, by **Stuart E. Weiner**, Vice President and Director of Payments System Research, Federal Reserve Bank of Kansas City, and **Julian Wright**, Associate Professor, National University of Singapore

INTERCHANGE FEES IN VARIOUS COUNTRIES: COMMENTS ON WEINER AND WRIGHT, by **Alan S. Frankel**, Senior Vice President, **Lexecon**

ECONOMIC RATIONALE FOR INTERCHANGE FEES, by **David S. Evans**, Vice Chairman, **LECG Europe**, and **Richard Schmalensee**, Dean, Sloan School of Management, Massachusetts Institute of Technology

INTERCHANGE FEES MYSTERIES, by **Jean-Charles Rochet**, Professor, University of Toulouse

THE NEED FOR FEDERAL RESERVE AND ANTITRUST INTERVENTION IN THE FAILED U.S. DEBIT AND CREDIT CARD MARKETS, by **Lloyd Constantine**, Chairman, **Constantine Cannon PC**

INTERCHANGE FEES IN CREDIT AND DEBIT CARD INDUSTRIES: WHAT ROLE FOR PUBLIC AUTHORITIES?, by **John Gove**, Director, **TransAction Resources Pty Ltd**

INTERPAY, AN INTRODUCTION, by **B.J. Haasdijk**, Chief Executive Officer, **Interpay**

INTERCHANGE REIMBURSEMENT FEES DELIVERING VALUE AND DRIVING INNOVATION, by **William Sheedy**, Executive Vice President, **Visa U.S.A.**

"LET'S GET REAL", an address by **Noah J. Hanft**, General Counsel and Corporate Secretary, **MasterCard International**

PUBLIC POLICY AND THE INVISIBLE PRICE: COMPETITION LAW, REGULATION AND INTERCHANGE FEE, by **John Vickers**, Chairman of the Board, **Office of Fair Trading**

PAYMENTS SYSTEM REFORM: THE AUSTRALIAN EXPERIENCE, by **Philip Lowe**, Assistant Governor, **Reserve Bank of Australia**

INTERCHANGE IN A CHANGING MARKET: OBSERVATIONS FROM THE EURO AREA PERSPECTIVE, by **Gertrude Tumpel-Gugerell**, Member of the Executive Board, **European Central Bank**

OTHER PAPERS AND REMARKS from the conference will be added to the website as they become available.

Richard Schmalensee used that parallel to illustrate a two-sided platform—one in which the business is a matchmaking intermediary that adds value by bringing individuals of two types together. Skewed pricing occurs when the intermediary strives to balance participation to increase the volume of transactions or customers—for instance, allowing women free

memberships to a dating service in order to attract men.

Data have been insufficient to support a conclusion on the effects of the fees, said Stuart Weiner, vice president and director of the Federal Reserve Bank of Kansas City's Payments System Research Department. The business model of credit card companies such

as MasterCard and Visa is unique in that it serves dual customers: cardholders and issuing banks.

“The nature of these markets isn’t well understood,” said Weiner. “In a two-sided market it’s possible that free market forces could actually raise interchange fees.”

In this scenario, credit card companies are competing for issuers; thus the higher the interchange fee, the more attractive a card becomes to issuing banks.

An October 2004 Supreme Court ruling found that MasterCard and Visa violated antitrust laws by barring banks that issued their cards from also issuing other cards; within months, two banks had already moved to issue American Express.

“In light of the enhanced competition, Visa and MasterCard have to raise their rates so other banks don’t jump on the bandwagon to issue American Express,” says Weiner.

Credit industry insiders say merchants paint a misleading picture. The effect of interchange rate increases has been overstated, said Hanft of MasterCard.

“Interchange has always been set to maximize the outputs of the payments system,



annual volume, and whether they take sales in person, via the Internet or by phone.

Most payment card transactions involve four parties: the cardholder, the bank that issued the card (the “issuer”), the merchant who receives payment, and the bank that deals with the merchant (the “acquirer”).

With a typical purchase, the acquirer will deduct a percentage known as the “merchant

“ In a two-sided market it’s possible that free market forces could actually raise interchange fees. ”

meaning, more cards, more merchants and more transactions,” he said.

Research shows that consumers who use credit cards make larger expenditures than those paying with cash, he noted.

Some large retailers choose not to accept MasterCard; it’s their choice, says Hanft.

However, some small merchants say they don’t have any choice but to cater to consumers’ preference for plastic.

“It becomes a customer service issue,” said Taylor, proprietor of M. Taylor. “You don’t want to cause ill will.”

The players

Not all card transactions are created equal. A number of factors will affect the fee a merchant pays on credit card and debit card transactions: a merchant’s average ticket value, the

discount” from the sale. For instance, if the discount rate is 2 percent, the acquirer will pay the merchant 98 percent of the purchase. If the interchange rate is 1.7 percent, the issuer would deduct this from the amount of the transaction and pay the acquirer 98.3 percent of the transaction. Thus, the issuer would net 1.7 percent and the acquirer 0.3 percent from the transaction.

Not all payment card transactions follow the four-party scheme. Historically, Discover Card and American Express have been three-party schemes, having direct relationships with cardholders and merchants (although with a Supreme Court ruling this is changing). The issuer and acquirer are the same entity, therefore there are no interchange fees. Instead, American Express charges merchant discount fees of about 2.5 percent. Discover Card is regarded as having the lowest merchant discount fee.

Credit Cards: from inception to interchange

Billions of dollars worth of products are bought and sold today without a single dollar bill being exchanged, but this hasn't always been the case. Individual stores were the first to see the benefit of offering a store card that made credit available to preferred customers.

"Promoting customers' loyalty was the rationale behind many of the first credit cards," said Richard Sullivan, economist in the Federal Reserve Bank of Kansas City's Payments System Research Department. The automobile suddenly gave people mobility to shop at a number of retailers in a day; thus oil companies and department stores offered credit to lure customers from competitors.

Such lines of credit were limited to purchases at that particular merchant, however.

The precursor to the modern multi-store credit card, Diners' Club, began in 1950 as an intermediary between merchants and customers. The companies that accepted the arrangement paid Diners' Club 7 percent for each transaction; cardholders paid an annual fee of \$3. Diners' Club would bill the cardholders and pay the restaurants the total minus the merchant discount fee—a unitary system in its simplest form.

Diners' Club had to relax its fee when it began expanding its merchant base beyond restaurants. Hotels and airlines balked at paying 7 percent of each sale, so the charge was abandoned in favor of a sliding fee structure that varied according to average ticket charge.

In 1958, American Express and Bank of America (whose BankAmericard later became Visa) entered the scene. Initially, both organizations operated as a unitary system, in that they acted as issuer (dealing with cardholders) and acquirer (dealing with merchants) themselves.

American Express targeted a niche of "travel and entertainment" consumers with a card that could be used in hotels and restaurants. BankAmericard went after a broader group of retailers by decreasing its merchant fees.

In 1966, Bank of America rolled out a franchise in which other banks were enlisted as issuers. Bank of

America required the acquiring bank to pass the full merchant discount to the issuing bank, an arrangement that was flawed. Acquiring banks received no revenue for transactions made by cards they did not issue. These terms gave acquiring banks incentive to be less than honest about their merchant discount. And because acquiring banks received nothing in a two-bank transaction, there was little incentive to add merchants.

The BankAmericard system became a membership corporation in 1970, and thus, the multi-party system was born. The interchange fee was established soon after to facilitate transactions in which acquiring banks and issuing banks were different.

Although National Bancard Corp., or NaBanco—an organization that specialized in acquiring and processing merchant credit card transactions—filed suit in 1979, contending that those fees amounted to price-fixing, an appeals court ruled in Visa's favor in 1986, and the model has stood ever since.

Credit card pioneer Diners' Club introduced its card in 1950, and the payments industry hasn't been the same since.



Rewards

In a radio spot for one bank's Visa card, two friends are feuding because one paid for lunch with his card and earned reward points. They decide the other friend will pay for lunch for the next week so he, too, can earn reward points.

Are consumers expecting a free lunch? "Everyone would like to get something for free," said Duncan of the retailers federation. "But consumers are not getting a free lunch. They're paying for these rewards every time they make a purchase, whether it's with cash or with a card."

Taylor says credit card incentives are increasingly prompting her customers to whip out the plastic. "They'll ask which cards we accept, and then say, 'Oh, I get airline miles for that one,' and pay with that," she said.

The issue at hand, says Thomas Hoenig, president of the Federal Reserve Bank of Kansas City, is what is in the public's best interest. Historically, the free market has been sacred ground for the U.S. economy.

Will the Federal Reserve System intervene in the battle over interchange? "Economists talk about market failure as a rationale for intervening in the market," said Weiner of the Bank's Payments System Research Department. "But such a conclusion would require considerably more knowledge about the market. Our focus is to become better informed."

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COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

Interchange Fees on Credit and Debit Cards

—American Banker and ATM & Debit News

for a \$50 Transaction

NETWORK	1999	2000	2001	2002	2003	2004
Mastercard (Credit)	\$0.79	\$0.79	\$0.79	\$0.80	\$0.80	\$0.88
Visa (Credit)	\$0.74	\$0.74	\$0.74	\$0.79	\$0.82	\$0.87
Mastercard (Signature Debit)	\$0.78	\$0.78	\$0.78	\$0.79	\$0.59	\$0.68
Visa (Signature Debit)	\$0.73	\$0.73	\$0.73	\$0.73	\$0.49	\$0.68
Star (PIN Debit)	\$0.08	\$0.17	\$0.17	\$0.34	\$0.34	\$0.45
NYCE (PIN Debit)	\$0.08	\$0.13	\$0.13	\$0.34	\$0.40	\$0.43
Pulse (PIN Debit)	\$0.10	\$0.10	\$0.10	\$0.15	\$0.18	\$0.18
Interlink (PIN Debit)	\$0.20	\$0.20	\$0.20	\$0.45	\$0.45	\$0.45
Maestro (PIN Debit)	\$0.10	\$0.10	\$0.10	\$0.10	\$0.29	\$0.45
Accel/Exchange (PIN Debit)	\$0.08	\$0.08	\$0.08	\$0.18	\$0.18	\$0.40
Shazam (PIN Debit)	\$0.00	\$0.00	\$0.10	\$0.10	\$0.10	\$0.10
Networks (PIN Debit)	\$0.15	\$0.15	\$0.15	\$0.15	\$0.15	\$0.15

These fees are for a typical retail store and may vary for a number of reasons. Debit card charges at a grocery store and credit card charges at a gas station or convenience store will be different.



Who's Minding the Banks?

GOVERNANCE PRACTICES AT TENTH DISTRICT INSTITUTIONS

BY FOREST MYERS,

ECONOMIST, BANKING STUDIES AND STRUCTURE

Probably at no other time in recent history has there been so much attention paid to how companies run their businesses. Well-publicized abuses at publicly traded corporations have prompted lawmakers to craft legislation to improve corporate accountability.

What about accountability at banks? One need not look hard to find instances of banks brought down by corporate malfeasance—often the result of poor management or a lack of internal controls.

The results can be disastrous: In 2002, the chief executive of an Oakwood, Ohio, bank confessed to embezzling more than \$40 million, rendering the institution insolvent. He later told regulators that he had received online orders for certificates of deposit sold on the bank website and had diverted the funds to gambling operations he partly owned.

“A combination of poor internal controls and a lax board opened the door for this individual,” said Esther George, senior

vice president in charge of banking supervision at the Federal Reserve Bank of Kansas City.

“That is why we’re always interested in governance at banks and open to ways to improve it,” George said.

Like other corporations, banks must comply with newly mandated governance requirements if their stocks are publicly traded or if they are subject to certain provisions of banking law. However, only about 13 percent of U.S. bank holding companies fall into those categories.

Even banks that are not compelled by law to change their governance practices may want to review their processes to ensure a profitable and safe operation, as well as to avoid litigation.

and owner-managed. Their governance structure tends to be less formal and less structured than that at larger, publicly traded institutions.

“That doesn’t mean that governance is any less important,” George said. “It couldn’t be any further from the truth. Over the years, we’ve seen cases where poor governance contributed to bank failure and cost the FDIC insurance fund millions of dollars.”

Indeed, the Oakwood bank, small by most standards with assets of \$73 million, has cost the FDIC’s insurance fund \$64.8 million at last accounting.

Finding out about governance practices was largely why the Reserve Bank’s bank supervision

“ **Bank supervisors have always recognized good governance as an important determinant of bank safety and soundness.** ”

Earlier this year, shareholders of Allfirst Financial Inc. filed a civil suit, contending that higher-ups of the Baltimore bank should have known about fraud conducted by a currency trader.

Federal banking agencies such as the Federal Deposit Insurance Corporation, Comptroller of the Currency, and the Federal Reserve System, as well as state banking authorities are concerned with such issues as capital adequacy, market risk management, and internal audit and its outsourcing. They also see good governance as the foundation for a soundly run bank.

“Bank supervisors have always recognized good governance as an important determinant of bank safety and soundness, and our examiners review governance practices at banks and bank holding companies we supervise,” George said.

“More generally, policy guidance issued by the federal banking agencies stresses the role of the board of directors and senior management, two important factors in the governance process, in addressing the supervisory matters covered in the guidance. It doesn’t matter if the bank is publicly traded, large, or small; governance practices enter into our management assessment.”

Smaller institutions are the norm for Tenth District banks. The median-size bank at year-end 2003 had total assets of \$61 million. Many of these banks are closely held, family-owned,

area surveyed Tenth District community banks—banks with total assets under \$1 billion. A seven-part survey asked bankers for their views on many matters, including governance at their banks. The Federal Reserve Bank of Kansas City has published bankers’ responses and a summary article on governance practices at Tenth District community banks at <http://www.kansascityfed.org/Publicat/FIP/Fipmain.htm#2004>.

“I think people will find the survey results interesting,” George said. “Little is known about governance practices at community banks outside the supervisory community. The information we’ve gathered gives an insider’s look at how community banks organize themselves to run their business.”

Checks and balances

Most people associate governance with a corporation’s board of directors. Governance, however, includes many participants internal and external to a corporation, each with a role in the governance process. Certainly, the board, as overseer and protector of stakeholder interests, is an important internal player. However, other important players include senior management, which has responsibility for running the business on a daily basis, and shareholders who are own-

ers of the business and on whose behalf it is run. A less frequently mentioned player is internal audit, responsible for ensuring that the business is run in keeping with management dictates and reports information accurately.

Beyond these internal players, there is a wide array of governance players outside the corporation. Included among the external actors are government and regulatory agencies, auditing firms, securities exchanges, rating agencies, stock analysts, and others. In general, these players establish the legal framework in which the corporation operates, police compliance with this framework, independently evaluate and offer opinions on the corporation's financial reporting, and monitor and analyze financial performance.

Together, the governance players form a system of checks and balances. Among this system's many purposes is to protect the interests of stakeholders in the corporation, including shareholders, employees, and customers. For banks, an important stakeholder is the FDIC and its deposit insurance fund. The FDIC wants to ensure that banks, whose depositors it protects, don't expose the insurance fund to excessive risk.

Certain basic assumptions are implicit in the governance process. Among these are that participants act independently of one another, that they act ethically, that they have the necessary skills to perform their duties, and that they are active in meeting their responsibilities.

"Many times these assumptions aren't met,"

Governance Scorecard—Tenth District Banks

SOURCE: *Survey of Community Banks in the Tenth Federal Reserve District*, Federal Reserve Bank of Kansas City, February 2004

GOVERNANCE PRACTICE	ASSETS UNDER \$150 MILLION		ASSETS OVER \$150 MILLION	
	FAMILY-OWNED	NON-FAMILY OWNED	FAMILY-OWNED	NON-FAMILY OWNED
Moderate board size with frequent enough board meetings to conduct bank's business	VERY GOOD	VERY GOOD	VERY GOOD	VERY GOOD
Board make-up—majority of board made up of outside directors	FAIR	GOOD	FAIR	VERY GOOD
Built board skill set by stressing business expertise as a major director recruiting factor	POOR	FAIR	POOR	FAIR
Board/committee structure included audit, compensation, and nominating committees made up of outside directors	FAIR	GOOD	GOOD	VERY GOOD
Outside directors* make up majority of audit committee to separate management from assessment of management	FAIR	GOOD	FAIR	VERY GOOD
CEO/outside directors* had ownership in the bank to better align their interests with shareholders	FAIR/POOR	POOR/POOR	FAIR/POOR	POOR/POOR
The bank had a written succession plan to ensure orderly management transition	FAIR	FAIR	FAIR	POOR
The bank adopted a written code of ethics to guide director, officer, and employee behavior	FAIR	FAIR	GOOD	GOOD
The bank performed director assessments to judge the contribution of board members and to identify needed additions to the board	FAIR	POOR	FAIR	FAIR
Directors attended training to increase banking knowledge and strengthen oversight skills	FAIR	GOOD	GOOD	GOOD

* Outside directors are directors who do not also serve as officers or management officials of the bank or own more than five percent of its stock

George said. "Our examiners find instances where a chief executive officer dominates the affairs of a bank or board members are so closely tied to the CEO that there is no meaningful board oversight. It is a one-man show."

Some boards are ineffective for other reasons, noted George.

"A Federal Reserve staff member attended a meeting with senior FDIC and state banking department officials where the board was told the bank would fail without a capital injection," she said. "One of the bank's directors fell asleep during this important meeting, making us wonder about how active this director was in the bank's oversight."

Poor management has figured prominently in the fate of failed banks. In an accounting by the FDIC, only one bank since 1997 failed due to economic conditions. Poor management was blamed in 95 percent of cases.

"Where poor management is present, lack of internal controls and fraud have often followed," George said.

The accounting by FDIC bears this out: Of 28 cases where fraud has been alleged at failed banks, poor management has been blamed in all cases but one.

Over the years, pension funds, consultants, academics, and others have pushed for measures



focused on those often stressed by proponents of good governance. The survey asked about board size, composition, committee structure, and meeting frequency. It asked about outside director leadership; director compensation, assessments, and education; management succession planning; and a host of other governance matters.

To help discern patterns in governance, the survey data were segmented into four groups based on ownership and bank asset size. Family-

The results from the survey on community bank governance practices are for the most part positive.

they consider important in achieving effective corporate governance. The aim of many of their proposals is to enforce the basic assumptions behind the governance process.

So what is the state of governance at Tenth District banks? Have Tenth District community banks seen value in what experts propose? Even when they are not required to do so, have they adopted any strong governance recommendations?

Survey results

The 2004 Survey of Community Banks in the Tenth Federal Reserve District attempted to answer these questions by providing a glimpse of governance practices at these institutions. Governance topics addressed in the survey

owned banks were separated from non-family-owned banks. Within these ownership groups, banks were divided between small banks, those with assets less than \$150 million, and large banks, those with assets greater than \$150 million. Summary data for the four bank groups were used to create a scorecard or profile of governance practices at each. The scores assigned were "poor," "fair," "good," or "very good" based on the proportion of banks within each group engaging in a particular practice (See the scorecard on page 24).

In general, the scorecard shows that Tenth District community banks engage in many practices advocated by strong governance proponents. Further, it shows that larger organizations

Governance Improvements

Developing formal strategic plans and management succession plans

This includes involving the board of directors in strategic planning for the bank. It also includes developing a written management succession plan for the bank and periodically reviewing that plan for its appropriateness. Any succession plan developed should include establishing a process for finding replacement management in an emergency, identifying the experience and traits the board wants in a successor, and ensuring that needed experience and traits are developed within the bank's management team.

Performing self-assessments of board performance and member contributions

The contributions of individual board members, the board as a whole, and board committees to the bank's oversight should be evaluated at least annually. The evaluation should be used to judge board effectiveness and to determine if additional experience or skills are needed. A sample assessment form that can serve as a starting point for a bank's own assessment form is at <http://www.kansascityfed.org/bs&s/confer/2004RegUpdate/SampleDirectorSelfAssessment.doc>.

Adopting a formal ethics policy and/or codes of conduct

The bank should develop a "no-nonsense" code of ethics and ensure employees are trained on the board's expectations regarding adherence to the code. After that, the board should enforce the code rigidly from its own members and the CEO down to the lowest level employee.



Providing formal training for the directorate

The bank should provide its directors with formal training to help improve oversight. If directors aren't knowledgeable on banking matters, the effectiveness of the board is diminished and the contribution of the board to bank management is lessened. Today, there are a good number of low-cost training programs for directors available from trade associations, banking supervisors, and others. One such resource is Insights for Bank Directors, a free online director

training program available at www.stlouisfed.org/col/director. This course provides information that directors, particularly outside directors, will find useful in evaluating their banks' condition and financial performance and aid their understanding of controlling and monitoring credit, liquidity, and market risks, basic portfolio risks that all banks face.

Establishing an audit committee and/or audit-like function in the bank

The bank should consider establishing an audit committee and specifying its responsibilities in a charter. Even if the bank is too small to have a full-time internal auditor, it should designate an employee to be responsible for reviewing internal controls throughout the bank. This person should report to the audit committee, not the president, cashier, or CFO. If financial statements aren't audited, the bank may want consider a periodic review of internal controls by a qualified, independent expert.

are more likely to have adopted recommended governance principles than smaller banks. Finally, non-family-owned organizations, regardless of size, proportionately engage in more of the recommended practices than do family-owned organizations.

“The results from the survey on community bank governance practices are for the most part positive,” George said. “One important

With respect to groups of banks, larger and non-family-owned banks tend to do better in adopting these practices than do smaller and family-owned banks.

Despite this positive report card, Tenth District banks can take a few low-cost actions to strengthen their governance. These include developing formal strategic and management succession plans, periodically assessing board and

“ **Where management processes are strong, banking problems are kept to a minimum.** ”

‘take-away’ from the survey is the key role family ownership plays in the governance process. The governance structure at family-owned banks tends to be less formal. Although survey information doesn’t tell us why this is so, anecdotal information from examiners and studies done by others indicate that many important management decisions in family-owned businesses—such as who will serve as CEO or who will serve on the board—are made at the family level rather than the corporate level.”

Despite the positive governance report card for Tenth District community banks, there is room for improvement.

“Many of the governance suggestions we would make cost little to implement and can yield a much stronger governance process,” George said. “In some instances, they can prevent a tragic event like the unexpected loss of a key employee causing costly harm to a bank, help create a positive environment in which a bank’s internal controls operate, or provide directors with the skills necessary to make meaningful contributions to a bank’s management.”

Towards higher marks

Good governance is key to a strong management process. Where management processes are strong, banking problems are kept to a minimum, and, when problems do occur, they are caught quickly and corrected before they become costly to fix.

Overall, the governance report card for Tenth District community banks gives them high marks, with many banks adopting practices suggested by proponents of strong governance.

individual director performance, adopting and enforcing a formal code of ethics, providing the directorate with training to enhance banking knowledge, and instituting some form of audit program for evaluating internal controls. These low-cost additions will strengthen an already strong governance and help contribute to a stronger management process.

The Oakwood bank failure has been a painful and costly lesson in what can happen when poor management is not checked. In that case, the surrounding community paid dearly and many were left questioning the trust they had placed in the institution. One bank shareholder summed it up well: “I feel somebody should have known.”

That is what good governance is all about.

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COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

CONSTRUCTION TO BEGIN ON NEW KANSAS CITY HEADQUARTERS



On June 6, the Federal Reserve Bank of Kansas City broke ground on its new headquarters. Construction of the 600,000-square-foot building will begin later this year, with completion expected in spring 2008.

The building will be located on a 15.7-acre site along Main Street, just south of Kansas City's Liberty Memorial and next to Penn Valley Park. The facility will allow the Bank to house all of its operations in a single complex. Currently, the Bank's headquarters is spread among three locations including some leased office space.

For more information on the Bank's new building, go to www.kansascityfed.org.

KANSAS CITY TO HOST AUDITOR AND ACCOUNTANT ROUNDTABLE SESSIONS

The Federal Reserve Bank of Kansas City's Supervision and Risk Management (SRM) Division is hosting the 13th annual Auditor and Accountant Roundtable sessions for banking accountants. The sessions will be Sept. 12 and 13 at the Denver Branch, 1020 16th St., Denver and Sept. 14 and 15 at One Kansas City Place, 1200 Main Street, Kansas City, MO. During the roundtables, Arthur Lindo, Accounting Policy and Disclosure, Board of Governors; SRM staff members; and bank examiners will make presentations, followed by a question-and-answer session. The topics of discussion will center on emerging issues in accounting and auditing for financial institutions.

Although invitations will be sent out for this event, there will be room for more attendees. If you

are interested in attending, contact Jane Padget, Kansas City office, 800-333-1010, extension 2147, or by e-mail at jane.m.padget@kc.frb.org.

COMMUNITY AFFAIRS FOCUSING EFFORTS ON ENTREPRENEURSHIP, FINANCIAL EDUCATION

The Community Affairs Office is part of the 17th annual Housing Colorado conference Oct. 17-20, the affordable housing conference in the Rocky Mountain West. Housing Colorado will offer workshops about housing finance, tax credits, fund-raising, rental housing, advocacy and more.

The department will host the National Congress of American Indians Annual Conference Oct. 30-Nov. 4. During the conference, department staff will discuss opportunities for displaying financial education and asset-building information and resources with the Native Financial Education Coalition and the National Congress of American Indians.

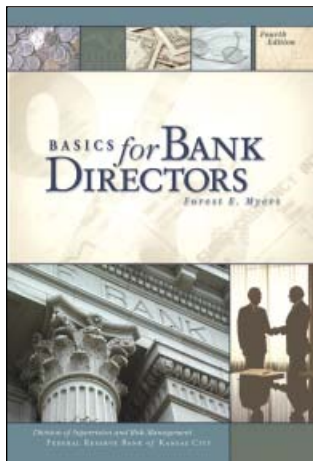
In November, the department will partner with the Ewing Marion Kauffman Foundation to sponsor a national research conference, "Entrepreneurship in Low- and Moderate-Income Communities." The conference will feature presentations by leading scholars about the role a higher pace of entrepreneurship might play in boosting economic activity in low- and moderate-income communities.

The department also partnered with the Kauffman Foundation in May, sponsoring a roundtable event among regional business school deans and directors of entrepreneurship centers to discuss ways that regional collaborations may enhance efforts to boost entrepreneurship in the Federal Reserve Bank of Kansas City's seven-state area.

In July, the department will host a discussion among several "angels," individual investors who provide start-up funding for new businesses. The discussion is part of a research project designed to learn more about funding sources for entrepreneurs.

For more information on these events or other programs, go to www.kansascityfed.org/comaffrs/camain.htm.

LATEST EDITION OF BASICS FOR BANK DIRECTORS NOW AVAILABLE



The fourth edition of *Basics for Bank Directors*, a guide for bank directors to help them more effectively supervise banks, is now available. The book, by Forest Myers, policy economist, Banking Studies & Structure, is divided into three chapters: regulatory compliance; bank

performance and financial soundness; and other resources for bank directors. Printed copies of the book may be obtained by contacting Helgard Elliott, Omaha Branch of the Federal Reserve Bank of Kansas City at (402) 221-5692 or e-mail at helgard.g.elliott.frb.org. The book may also be downloaded from the Federal Reserve Bank of Kansas City's website at <http://www.kansascityfed.org/BS&S/Publicat/Bks&pamp.htm#basics>.

The book is a companion piece to the free online course, "Insights for Bank Directors," which is available at <http://www.stlouisfed.org/col/director>. This introductory course is intended for outside directors with little banking experience; however, more experienced directors may find it useful. It is not intended to make new directors experts on banking, but to provide them with the information to detect and seek solutions for potential problems. Course content includes: bank financial analysis, managing credit, liquidity and market risks; and target questions to ask when risk controls may not be working.

In addition to the online course, banks can request to have an onsite "Basic Training for Bank Directors" class taught at their place of business. For more information about booking a class, contact Forest Myers, (800) 333-1010, extension 2879, e-mail: forest.e.myers@kc.frb.org.

BANKS MARKING MILESTONES AS FEDERAL RESERVE MEMBERS

UINTA CITY STATE BANK Mountain View, WY	85
SUNDANCE ST. BANK Sundance, WY	74
WAHOO STATE BANK Wahoo, NE	73
FIRST NEBRASKA BANK Valley, NE	71
GUNNISON BANK & TRUST Gunnison, CO	65
FARMERS STATE BANK Stanberry, MO	64
UNION STATE BANK Clay Center, KS	63
FIRST STATE BANK & TRUST CO. OF LARNED Larned, KS	63
BANK OF HOLYROOD Holyrood, KS	62
FARMERS BANK OF LINCOLN Lincoln, MO	60
SECURITY STATE BANK Basin, WY	57
BANK OF CUSHING & TRUST CO. Cushing, OK	25
COMMUNITY BANKS OF COLORADO Greenwood Village, CO	5
COMMUNITY BANK OF RAYMORE Raymore, MO	5
BANK OF LOCUST GROVE Locust Grove, OK	5
PEOPLES BANK Oklahoma City, OK	5
SECURITY BANK Oklahoma City, OK	5
FIRST PRYORITY BANK Pryor, OK	5
LAKESIDE BANK OF SALINA Salina, OK	5
VALLEY STATE BANK Syracuse, KS	1
ALL NATIONS BANK Calumet, OK	1
BANK 7 Medford, OK	1

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Drawing the Federal Reserve Districts

The Federal Reserve Act, approved by Congress on December 23, 1913 and signed later that same day by President Woodrow Wilson, created a central bank with a unique “decentralized” structure: a network of banks serving local districts with national coordination by a Board of Governors in Washington D.C. But when it came to locating the regional banks, both the cities where they would operate and the districts they would serve, the Act was intentionally vague, offering only a few requirements:

- There would be between eight and 12 Federal Reserve districts.
- The districts would “be apportioned with due regard to the convenience and customer course of business.”
- A Reserve Organizing Committee comprised of the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency would determine the districts and designate “Federal Reserve cities” where the regional banks would be located.
- The act gave the committee a deadline to complete their work “as soon as practicable.”

Realizing the scope of the task ahead, the Committee took the somewhat ambiguous deadline seriously, convening for the first time three days later on Friday, Dec. 26.

“Nothing had aroused such scorn and ridicule, nothing had been so fiercely fought in Congress, nothing had so generally been pronounced impossible, as the division of the country into several banking districts in each of which there should be a separate and independent institution,” Henry Parker Willis wrote in his 1923 book *The Federal Reserve System*. “On no point had there been sharper controversy than as to the issue whether banks should be four, eight, twelve or some other number. Yet this politically contested issue, and the much more difficult problem (of) how to construct the several banking districts, were now to be quickly disposed of by a committee which had scant time for theoretical inquiry or practical observation.”

And much of the work would be done by only a partial committee. President’s Wilson’s nominee for the Comptroller of Currency, John Skelton Williams, would not be confirmed for several weeks, leaving the bulk of the Committee’s work in the hands of Agriculture Secretary David F. Houston and Treasury Secretary William G. McAdoo.

Twelve districts

Although the number of Reserve Districts was hotly debated prior to the Act’s approval, for the Committee, the issue would be among the first, and perhaps the easiest, to resolve.

It “became obvious that if we created fewer banks than the maximum fixed by law, the Re-

serve Board would have no peace till that number was reached,” Houston would later write.

For the more difficult questions on locating the Reserve Banks and determining the Districts, the committee would seek input through three initiatives:

- Ballots were sent to 7,471 national banks asking each their preferences for Reserve Bank cities.
- A Preliminary Committee on Organization, headed by Willis, was appointed to address several issues related to the internal organization of the Federal Reserve. Willis, who would go on to become the first secretary to the Federal Reserve Board, would also prepare some preliminary maps for the Committee’s consideration.
- The Reserve Organizing Committee began a tour of the United States with a travel schedule that might be considered aggressive even by today’s standards. Over a six-week span Houston and McAdoo would log 10,000 miles, convene hearings in 18 communities, hear presentations from 37 would-be Federal Reserve cities and receive 5,000 pages of testimony.

The hearings would receive widespread media attention. The testimony, which the Committee likely envisioned as being focused on banking and business relationships, was instead perhaps somewhat similar to a modern day municipality courting a professional sports franchise.

Willis later wrote that the would-be Federal Reserve cities saw in the new banking system a means of self-aggrandizing or self-advertising.

“Much of the testimony and many of the briefs that were filed read like land or travel prospectuses in which the good gifts of Providence to the different parts of the country were enumerated in the most glowing colors,” Willis wrote.

In an apparent attempt to try to refocus the hearings, on repeated occasions McAdoo publicly stated that a designation of Reserve Bank city was not as important to future eco-

nomic development as some citizens appeared to believe.

Houston would later write that it quickly became clear they committee would be “in for a great deal of roasting,” regardless of their decisions.

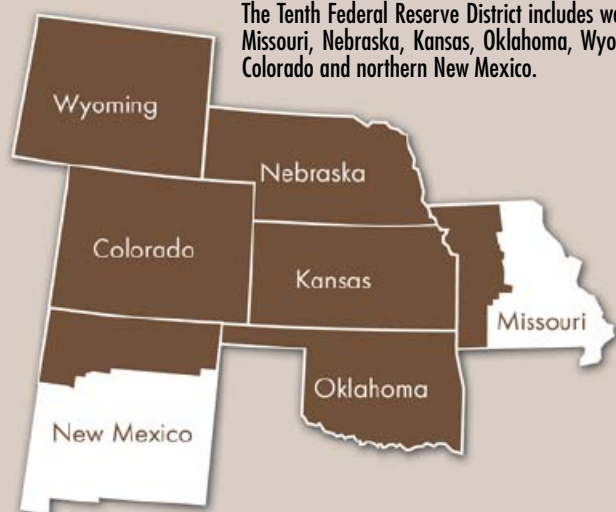
“There was a vast amount of state and city pride revealed to us in the hearings; and to hear some of the speeches one would have thought that not to select the city ... would mean its ruin,” he wrote.

The committee would hear from three cities in what would become the Tenth Federal Reserve District: Kansas City, Omaha and Denver.

On Jan. 23, 1914, The Associated Banks of Greater Kansas City presented its plan for a Federal Reserve District that included western Missouri, southwest Iowa, all of Nebraska, Kansas and Oklahoma, the northern half of Texas, western Arkansas, all of New Mexico and all of Colorado.

“Kansas City with her splendid railroad facilities and excellent mail service, has become the natural market, financial and distributing center of the riches and most rapidly developing agricultural and mineral district in America,” the bankers’ group said in its written testimony.

The Tenth District



The Federal Reserve Bank of Kansas City “would be a commanding institution with ample capital and deposits to protect and properly care for the legitimate business needs of this district,” the bankers said.

The following day, the committee moved on to Lincoln, Neb. where the Banks of Omaha and South Omaha suggested an Omaha-based Reserve District encompassing western Iowa, southern South Dakota, a northern tier of

- Geographical factors including transportation and communication.
- The population, area and prevalent business activities of the district.

In the Tenth Federal Reserve District, the boundary lines were very similar to what was proposed by the Kansas City bankers.

“The region in the middle and far West presented problems of difficulty,” the committee

“Nothing had so generally been pronounced impossible, as the division of the country into several different banking districts.”

Kansas, and all of Nebraska, Montana, Idaho, Wyoming, Colorado and Utah.

On February 9, Denver made its bid for a Reserve Bank with a presentation calling for a district bounded on the east by the 100th meridian that bisects Nebraska and cuts across western Kansas. For the western edge of its proposed district, the Denver contingent proposed a line near the eastern boundaries of Washington, Oregon. They proposed a district spanning nearly 1,200 miles from north to south, covering the country from border to border.

The decision

A few Reserve Bank cities were obvious choices for the Committee. New York, Chicago and St. Louis were major population centers already serving as reserve cities in the national banking system. To some degree, the committee’s challenge was then to fill in the rest of the nation.

In its report, the Reserve Bank Organization Committee spelled out its selection criteria:

- The ability of the member banks within the district to provide the minimum capital of \$4 million required for each Reserve Bank by law.
- Existing mercantile, industrial and financial connections.
- The probable ability of the Reserve Bank to meet demands placed upon it.
- The fair and equitable division of available capital among the districts.

wrote. “Careful consideration was given to the claims of Omaha, Lincoln, Denver and Kansas City, which conflicted in this region.”

In announcing the decision, the Committee noted the results of the banker balloting. Kansas City received the most first place votes within the District: 355, followed by Omaha, 191 and Denver, 132. The Committee also noted that the vast majority of banker support for both Denver and Omaha was confined to their respective states while Kansas City enjoyed wider support including substantial backing in Kansas and Oklahoma.

“It seemed impossible to serve the great section from Kansas City to the mountains in any other way than by creating a district with Kansas City as the headquarters,” the committee wrote, noting also that Kansas City was the region’s “dominant banking and business center.”

“The relations of that territory on the whole are much more largely with Kansas City than with any other city in the Middle West with which it could have been connected,” the committee wrote, noting that most of the trade moved toward the east.

The committee completed its work in 98 days. By November 16, 1914, less than a year after McAdoo and Houston convened their first meeting, the nation’s “decentralized” central bank opened for business in all 12 districts.

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THE BANK HAS A NUMBER OF ONLINE RESOURCES AVAILABLE ON BANKING AND ECONOMIC ISSUES:

BOARD OF GOVERNERS: www.federalreserve.gov

FEDERAL RESERVE PUBLICATIONS: www.newyorkfed.org/publications/frame1.cfm

EDUCATOR AND STUDENT RESOURCES: www.FederalReserveEducation.org

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Kansas City MO, 64198

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www.kansascityfed.org

WORKERS' COMPENSATION

- National Academy for Social Insurance, August, 2004 "Workers' Compensation: Benefits, Coverage, and Costs, 2002: Highlights." Available at http://www.nasi.org/usr_doc/Workers_Comp_2002_-_Highlights.pdf.
- Alan B. Krueger and Bruce D. Meyer, June, 2002, "Labor Supply Effects of Social Insurance," NBER Working Paper No. 9014, National Bureau of Economic Research. Available at <http://www.nber.org/papers/w9014>.

CORPORATE GOVERNANCE

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- Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), Policy Statement on Corporate Governance, 2004, 730 Third Avenue, New York, New York. (www.tiaacref.org/pubs/pdf/governance_policy.pdf)
- The Conference Board, The Commission on Public Trust and Private Enterprise, Findings and Recommendations, 845 Third Street, New York, NY (www.conference-board.org/pdf_free/758.pdf) See "Part II, Corporate Governance," pp. 15-35, originally published in January 2003.

Further resources

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