

Fed Letter



Beige Book released

The latest edition of the Beige Book was released Oct. 19, 2005. The Beige Book is a summary of current economic conditions in each Federal Reserve district. Nationally, economic activity continued to expand in all 12 districts in September, with increases in the manufacturing and service sector activity and strong real estate activity. Locally, the Tenth District's economy continued to expand moderately in September and early October. The District's retailers reported moderate sales. Manufacturing activity expanded strongly, and labor markets continued to be strong.

For details about national and Tenth District economic activity, visit <http://www.federalreserve.gov/fomc/beigebook/2005/20051019/default.htm>.

Manufacturing Survey released

The monthly Manufacturing Survey for the Tenth Federal Reserve District was released Sept. 28, 2005. The survey asks plant managers about a variety of manufacturing indicators. The information is compiled into a snapshot of manufacturing in the District. Manufacturing activity in the Tenth District grew strongly in September. Expectations for future factory production remained solid. To view the current survey, visit <http://www.kansascityfed.org/mfgsurv/2005Sep28mfg.htm>.

Latest issue of *Economic Review* available

Over the last 20 years or so, the volatility of aggregate economic activity has fallen dramatically in most of the industrialized world. The timing and nature of the decline vary across countries, but the phenomenon has been so widespread and persistent that it has earned the label "the Great Moderation." This is discussed in the article "What Caused the Great Moderation? Some Cross-Country Evidence," which is included in the third quarter 2005 issue of *Economic Review*. A second article in the publication, titled "The Shared Fortunes of Cities and Suburbs," examines the main forces that have influenced the growth of cities and suburbs over the past century. A third article in the *Economic Review*, "Gauging a Region's Entrepreneurial Potential," looks at new ways to measure both the quantity and quality of entrepreneurs in a region.

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

Latest issue of *The Main Street Economist* is available

Most analysts look to the annual flow of income as the most appropriate measure of economic well-being, but income is just the tip of the iceberg. In the article "Regional Asset Indicators: The Wealth of Regions," which is included in the September 2005 issue of *The Main Street Economist*, the author takes a closer look at three components of wealth—residential real estate and financial and rental real estate investments. She discusses the availability of wealth in rural America as well as how it can be better used by rural communities to tap new business opportunities.

The Main Street Economist is available at http://www.kansascityfed.org/RuralCenter/mainstreet/MSE_0905.pdf.

Regulatory developments

Supervisory practices regarding banking organizations and consumers affected by Hurricane Katrina

On Sept. 15, the Federal Reserve issued a statement to advise banking organizations that it will actively work to respond to issues that arise in the wake of the damage caused by Hurricane Katrina. In particular, it is the long-standing policy of the Federal Reserve to encourage bankers to work with borrowers and other customers in communities and regions affected by disasters. The Fed also wishes to remind banking organizations that there is regulatory flexibility available to facilitate recovery in the affected areas. In this spirit, it encourages banking organizations to work with supervisory staff at their Reserve Banks for further guidance on issues related to this disaster.

The Fed will continue to monitor closely the situation and the needs of banking organizations and their customers, and it will provide additional guidance and take further action as necessary or appropriate to help address those needs. Consistent with long-standing practices, the Federal Reserve will consider the unusual circumstances that organizations in the affected area have faced with respect to safety and soundness or compliance issues, including those regarding Bank Secrecy Act/anti-money laundering requirements, in determining the appropriate supervisory response.

Information on Hurricane Katrina-related issuances can be found on the Board's website at <http://www.federalreserve.gov/hurricanekatrina.htm>.

Katrina-related marketing practices

On Sept. 22, the Federal Reserve issued, under Supervision and Regulation (SR) Letter 05-17, a caution on certain marketing practices by service providers. The Fed has learned that certain firms, as a way of promoting their services to banking organizations, may be claiming that the Fed plans increased scrutiny of banking organizations' business continuity and disaster recovery plans in the wake of Hurricane Katrina. These promotional claims may target banking organizations in Alabama, Mississippi, and Louisiana, including organizations headquartered elsewhere that have operations in those states. These promotional claims also may imply that the Federal Reserve will find deficiencies in the business continuity or disaster recovery plans of the targeted organizations or in the execution of such plans.

Banking organizations supervised by the Federal Reserve can be assured that it does not have any plans at this time to conduct special investigations of the business continuity and disaster recovery plans of banking organizations with offices in Alabama, Mississippi, and Louisiana as a result of Katrina. Business continuity and disaster recovery plans routinely are reviewed in the course of regularly scheduled safety and soundness examinations. The Federal Reserve does not anticipate any additional or more intensive reviews of these plans stemming from Katrina.

Banking organizations should be wary of marketing efforts that make claims or express beliefs regarding unannounced or unanticipated Fed supervisory plans or actions. If contemplating whether to engage the services of firms on the basis of such representations, a banking organization should contact the appropriate Federal Reserve Bank. The Federal Reserve does not endorse any private party, including any service provider or service providers. In addition, banking organizations may want to review the official policies of the Federal Reserve, which appear at <http://www.federalreserve.gov/hurricanekatrina.htm>.

**Proposed revisions
to 1988 Basel Capital
Accord (Basel I)**

The Federal Reserve Board (in conjunction with a like FDIC issuance) issued a request on Oct. 6 for public comment on proposed revisions to the U.S. risk-based capital standards for banking organizations. These current standards are based upon the 1988 Basel Capital Accord, also known as Basel I. The proposed revisions should align more closely risk-based capital requirements with the risk inherent in various exposures and could mitigate competitive inequalities that may arise as new capital rules, known as Basel II, are implemented for the most complex, internationally active banking organizations.

In considering possible revisions, the agencies are seeking to enhance risk sensitivity without undue complexity or regulatory burden. Specifically, the agencies are soliciting comment on: 1) increasing the number of risk-weight categories; 2) permitting greater use of external ratings as an indicator of credit risk for exposures for purposes of determining the appropriate risk weight; 3) expanding the types of guarantees and collateral that may be recognized; 4) modifying the risk weights associated with one-to-four family residential mortgages; 5) applying credit conversion factors to certain types of commitments, as well as the appropriate risk-based capital treatment of certain securitizations with early amortization provisions; and 6) modifying the risk weights for loans that are 90 days or more past due or in nonaccrual status, as well as for certain commercial real estate exposures and other retail and commercial exposures.

Comments on the possible revisions to Basel I are due by **Jan. 18, 2006**.

**Waiver of appraisal
requirements for
financial institutions
affected by Hurricanes
Katrina and Rita**

Under Supervision and Regulation (SR) Letter 05-18, the Federal Reserve Board announced on Oct. 6 its approval of an order waiving its appraisal requirements for three years for regulated financial institutions affected by Hurricanes Katrina and Rita. This action was coordinated with the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and National Credit Union Administration.

The waiver covers transactions involving real estate located in certain Alabama, Mississippi, and Texas counties and Louisiana parishes that have been designated by the Federal Emergency Management Agency (FEMA) as qualifying for "Individual and Public Assistance (all categories)" and "Individual and Public Assistance (Categories A and B)" as a result of the hurricanes. Exceptions for the major disaster declared due to Hurricane Katrina will expire on Aug. 29, 2008, in Alabama, Mississippi, and Louisiana, and for Hurricane Rita on Sept. 24, 2008, in Louisiana and Texas.

To qualify for the waiver, a financial institution needs to document that: (1) the transaction involves real property located in the designated disaster areas; (2) the property involved directly was affected by the major disaster or the transaction would facilitate recovery from the disaster(s); (3) there is a binding commitment to fund the transaction that is made within three years after the date the major disaster was declared; and (4) the value of the real property supports the institution's decision to enter into the transaction.

**Proposal concerning
the open-end
(revolving) credit rules
of Regulation Z**

On Oct. 11, the Federal Reserve Board issued for public comment a second advance notice of proposed rulemaking (ANPR) concerning the open-end (revolving) credit rules of the Board's Regulation Z, which implements the Truth in Lending Act (TILA). The second ANPR solicits public comments on how the Board should implement amendments to TILA made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Bankruptcy Act). The amendments principally deal with open-end credit accounts and require new disclosures on periodic statements and on credit card applications and solicitations.

In April 2005, the Bankruptcy Act was enacted and contained several amendments to TILA, including provisions requiring new disclosures for open-end credit accounts. The Board plans to implement the amendments as part of its review of Regulation Z and is publishing this second ANPR to reopen and extend the public comment period. Combining the two rulemakings will allow the Board to coordinate the changes to the TILA disclosures and should impose less regulatory burden on creditors.

Comments must be received on or before **Dec. 16, 2005**.

**Interagency guidance
on authentication in
an Internet banking
environment**

On Oct. 13, the Federal Financial Institutions Examination Council (FFIEC) issued guidance titled, *Authentication in an Internet Banking Environment*. This guidance updates and replaces the FFIEC's *Authentication in an Electronic Banking Environment* issued in 2001 and specifically addresses the need for risk-based assessments, customer awareness, and security measures to reliably authenticate customers accessing financial institutions' Internet-based services. The guidance also emphasizes that the agencies consider single-factor authentication, if it is the only control mechanism, to be inadequate for high-risk transactions involving access to customer information or the movement of funds to other parties. The Federal Reserve has issued this guidance under Supervision and Regulation (SR) 05-19.

This guidance applies to both retail and commercial customers and does not endorse any particular technology. Financial institutions should use this guidance when evaluating and implementing authentication systems and practices whether they are provided internally or by a technology service provider. Although this guidance is focused on the risks and risk management techniques associated with the Internet delivery channel, the principles are applicable to all forms of electronic banking activities. Financial institutions will be expected to have achieved conformance with the guidance by year-end 2006.

**Additional supervisory
guidance in response
to Hurricanes Katrina
and Rita**

The federal banking agencies have prepared additional supervisory guidance on regulatory and reporting issues related to Hurricanes Katrina and Rita. The Federal Reserve issued this guidance under Supervision and Regulation (SR) 05-20 on Oct. 14. The questions and answers provide guidance on:

- Regulatory reports, including Bank Reports of Condition and Income (Call Reports) and Bank Holding Company Reports (Y Reports), for the quarter ending Sept. 30, 2005;
- Appropriate allowances for loan and lease losses in third quarter regulatory reports;
- Accounting treatment of sales of held-to-maturity securities to meet increased liquidity needs directly related to the hurricanes; and
- Temporary hardship programs for credit card customers and related delinquency and credit bureau reporting issues.

Internet access

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

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