

# BBW News

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## A MESSAGE FROM THE PRESIDENT

### Near-term obstacles must not obscure long-term goals



Bill Mitchell  
BBW President & CEO

**R**esidual effects of a tough economy have kept the banking sector preoccupied for several years now. It's as though we've kept one collective eye on asset quality and the other on the regulatory environment for

so long that hiccups seem normal. In this climate, it's easy to get bogged down in day-to-day problem solving. Allowing that to happen at the expense of the big picture would be a mistake, however.

Strategic business objectives are important in any economy because they represent the future. A Yogi Berra one-liner restates this idea humorously: "If you don't know where you are going, you might end up somewhere else." So as we bankers are putting negative issues behind us, we must also be clear about where we're headed. That direction will help determine how to compete on the post-recession landscape.

The core of Bankers' Bank of the West's strategy is to continually identify products, services and efficiencies that will benefit our customer banks. With this in mind, I'm pleased to report that BBW has partnered with Bling Nation, a provider of mobile payment services, to enable tap-and-pay purchases at the point of sale across the West and Midwest.

Through this new relationship with Bling Nation, our customers—numbering more than 330 community banks—will be equipped to compete against the largest financial institutions in payment innovation. Mobile payments are becoming increasingly desirable to consumers, and therefore they represent great potential for the community banks we serve. Our alliance with Bling Nation gives you, our community bank clients, another arrow in your quiver.

Despite this exciting news, we're not about to call off the search. BBW's strategic objective demands that we continue looking for ways to level the playing field for your bank. Our future is linked with yours, and adding value to customer relationships will always be paramount at BBW. ▲

### Abundant industry expertise, individual strengths distinguish board

**T**he recent election of four new members to the board of Bankers' Bank of the West Bancorporation, Inc., brings the total number of directors to 12 this year. With a nod to the importance of a well-rounded group of directors to the leadership of any financial institution, the BBW executive team points out the current board is exceptionally strong in the following respects:

**Peer representation.** Eight directors (see list on page 2) currently hold executive offices at community banks in our service area. Their firsthand understanding of community banks' special needs, interests, and contribution to the vitality of their communities ensures that the interests of BBW's customers will be expressed and fully considered at all times.

**Varied perspectives.** In addition to differences in geographical roots and specialized education

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## Taking note

### ■ Safekeeping reports

Some time next month, daily safekeeping payment details will be available through the Bankers Internet Data System.

For banks using BIDS, these reports will be available only through BIDS. Safekeeping clients will receive an email notice when this BIDS function becomes active and payment reports are ready to pull. At that point, all payments, trades and month-end reports will be accessible through BIDS. Please call **Sandy Gerk** at BBW (direct 303-313-8102) with any questions about this function.

### ■ Treasury Tax & Loan to go paperless

A recently announced initiative of the U.S. Department of the Treasury aims to sharply reduce the volume of paper transactions by moving them to electronic systems. Under the proposed rule change, financial institutions will be unable to accept TT&L coupons after Dec. 31, 2010.

You can ease your customers' transition to paperless payments by urging them to enroll in the Treasury's free Electronic Federal Tax Payment System soon ([www.eftps.gov/eftps](http://www.eftps.gov/eftps)). Moving to electronic transactions will benefit both taxpayers—in terms of security and reliability—and the environment.

A news release detailing the initiative is posted at [www.ustreas.gov/press/releases/tg644.htm](http://www.ustreas.gov/press/releases/tg644.htm).

### ■ Weighting of DDA balances

Keep in mind that the balances your bank keeps in DDA accounts with BBW are considered zero percent risk weighted per the regulatory clarification issued last month by the federal banking agencies—a big advantage for your bank.

### ■ Vault cash module on BIDS

LendingTools activated the “ship/charge date” field in the BIDS vault cash order module last month. This feature enables BIDS customers to comply with the Federal Reserve Bank's requirement of a ship date on all vault cash orders.

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## Bankers' Bank of the West Board of Directors

Brian D. Esch ..... Chairman of the Board  
*McCook National Bank* ▪ *McCook, Neb.*

Chad S. Adams ..... Board member  
*Adams Bank & Trust* ▪ *Ogallala, Neb.*

Michael M. Bass ..... Board Member  
*First National Bank* ▪ *Hugo, Colo.*

Richard J. Fulkerson ..... Board Member  
*Patten, MacPhee & Assoc.* ▪ *Denver, Colo.*

Dan Godec ..... Board Member  
*Consultant* ▪ *Denver, Colo.*

Larry W. Martin ..... Board Member  
*Bank Strategies, LLC* ▪ *Denver, Colo.*

Darrell McAllister ..... Board Member  
*Bank of Choice* ▪ *Greeley, Colo.*

William A. Mitchell Jr. .... Board Member  
*Bankers' Bank of the West* ▪ *Denver, Colo.*

Roger R. Reiling ..... Board Member  
*Bankers' Bank of the West (ret.)* ▪ *Denver, Colo.*

John A. Sneed ..... Board Member  
*Fort Morgan State Bank* ▪ *Fort Morgan, Colo.*

Jeffrey C. Wallace ..... Board Member  
*Wyoming Bank and Trust* ▪ *Cheyenne, Wyo.*

James W. Wyss ..... Board Member  
*Integrity Bank and Trust* ▪ *Monument, Colo.*

## Abundant industry expertise, individual strengths distinguish board

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and training, members of our board represent more varied career paths than was typical in the past. While all have a solid foundation in banking and financial services, these individuals bring fairly diverse professional backgrounds and points of view to bear on the decision-making process.

**Institutional knowledge and continuity.** Both the current president and CEO of BBW and his predecessor, Roger Reiling, continue serving on the board. Having held director positions on the BBW Bancorp board in the past, two of the recently added members are well-schooled in the organization's history. Rounding out the group are two first-time members of the board.

Ultimately, the anticipated effect of these and other board characteristics will be optimal corporate governance.

The four directors added in 2010 are:

**Chad S. Adams.** Chad is a fourth-generation banker and a previous BBW director. An alumnus of the University of Nebraska, he is the president

and legal counsel for Adams Bank & Trust in Ogallala, Neb.

**Michael M. Bass.** The seasoned president of the First National Bank of Hugo, Colo. is also active in banking trade groups and a board officer for the Plains Medical Center. He served two prior terms on BBW's board, one as its president.

**Richard J. Fulkerson.** This first-term BBW director served many years in the public sector before joining Patten, MacPhee & Associates, Inc., in Denver. He began work with the Colorado Division of Banking in 1995 and began 12 years of service as Colorado Banking Commissioner the following year. Richard previously worked for the Federal Home Loan Bank of Topeka and the Office of Thrift Supervision in Kansas City.

**Larry W. Martin.** Also a first-term BBW board member, Larry is the managing principal of the Denver-based consulting firm Bank Strategies, LLC. He has 35 years of experience in banking and providing strategic planning assistance to bank executives. Larry is frequently consulted by the media for background on industry matters. ▲

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## Broad participation of financial industry stakeholders facilitates development of industry standards and system efficiency

*Ellen Heffner, Director, Product Management  
Electronic Check Clearing House Organization*

**T**he Electronic Check Clearing House Organization celebrates its 20<sup>th</sup> anniversary in 2010. Formed by banks as a cooperative venture to encourage the use of electronics to enhance the check collection system, ECCHO has focused primarily on check image exchange since the passage of the Check 21 Act in 2003.

ECCHO rules are discussed and updated regularly through an inclusive, representative process via the Operations Committee. Through this group over the last year, the membership has focused on defining and approving numerous updates to this comprehensive rule set created and maintained by ECCHO and available to all members.

This article offers a glimpse at two recent updates that underscore the need for comprehensive rules

coverage for the exchange of electronic check images in a rapidly evolving check image environment.

### Adjustments

In response to a request from the membership, a subcommittee was formed to research and recommend image adjustment rules. The subcommittee's recommendation was reviewed and approved by the Operations Committee in late 2009 and, once approved by the board of directors, became effective in November. Part of the new image adjustments rule is an Adjustments Matrix, which details permitted adjustment types and requirements for making a claim. The details cover the timing, dollar minimums, and acceptance criteria for each adjustment type. The new provision

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## The “inflation versus deflation” debate

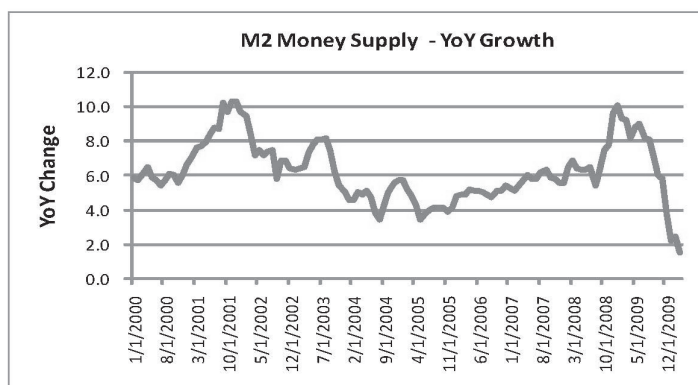
John Kershner  
BBW Capital Advisors, LLC

Lately we have noticed much dismay over excess government spending and consequent high inflation and interest rates. Even though the trend concerns us also, we continue to feel rising inflation is likely at least another year or two away. The economic evidence actually points toward a near-term deflationary environment. This would be constructive for future bond prices.

The recent Consumer Price Index (CPI) print came in at 2.3% year on year change (YoY), with the core (excluding food and energy) CPI rate at 1.1%. However, annualizing the last three months of headline inflation shows the rate is only 1.2% and core is -0.2%, pointing to a downward trend in inflation. This is the sharpest such contraction in 50 years. These low inflation prints are not unusual after a recession. Fully 87% of the time over the past half-century, core inflation was lower one year after a recession ended; 75% of the time, it was lower two years after.

This downward trend in inflation likely stems from slack in the economy arising from joblessness—currently at 9.7% after 8.4 million jobs lost in the last two years—and excess capacity. Capacity utilization is currently at 73.2%, almost 10 points below the maximum level over the last 10 years.

Chart 1



Source: Bloomberg

The other major factor pushing down prices is the reduction in the growth of the M2 money supply (Chart 1) arising from a decrease in bank lending and money velocity. Over the last year, U.S. bank balance sheets have shrunk by \$730 billion. Most

of this decrease comes from bank lending, which has shrunk a total of \$640 billion. Nothing we hear from our banking clients leads us to believe this trend will reverse itself any time soon.

What’s keeping consumer spending and the stock market charging forward? The answer is mainly the largesse of the federal government and mortgage defaults. Over the past year we’ve seen:

Government income assistance: ....	\$243 billion
Tax reductions: .....	\$63 billion
Government wages: .....	\$27 billion
Decline in savings rate: .....	\$22 billion
Strategic mortgage defaults: .....	\$120 billion

All totaled, this cash flow boost of \$475 billion equates to 5% of consumer spending. We question its sustainability, especially considering the increasing discontent with Washington’s historic deficit spending and the inevitable tax hikes to follow.

Some argue that deficit spending by the government means higher interest rates ahead. In response, we point to what happened to interest rates in 1999, the largest Treasury surplus year in recent history.

Ten-year Treasury rates soared at that time (+179 basis points) due to a brief episode of inflationary pressure. Then, as the deficit exploded in 2002-2003, bonds rallied significantly (10-year Treasury rates down 154 basis points) because deflationary risks moved to the front burner.

Research shows that over the last 40 years, 10-year Treasury yields have an 87% correlation with Fed policy and a 72% correlation with Core CPI. Inflation, in contrast with only a 17% correlation with budget deficits and almost no correlation with the CRB Commodity index.

Even with all of this evidence backing deflation, we believe the bottom line in the inflation/deflation debate comes from housing, the 600-pound gorilla in inflation calculations. These inflation numbers are shown on the next page.

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## Nostalgic glimpse three decades back

Bankers' Bank of the West was founded in 1980 to serve community banks. That same year:

- Sandra Day O'Connor became the first female Supreme Court Justice.
- At age 21, tennis pro John McEnroe won the U.S. Open Title—his second.
- The U.S. banned paints containing lead.
- Production began on the American Motors Eagle, America's first sport utility vehicle.

Bankers' Bank of the West is participating in the FDIC's Transaction Account Guarantee Program. Under that program, through December 31, 2010, all noninterest-bearing transaction accounts are fully guaranteed by the FDIC for the entire amount in the account. Coverage under the Transaction Account Guarantee Program is in addition to and separate from the coverage available under the FDIC's general deposit insurance rules.

## The "inflation versus deflation" debate

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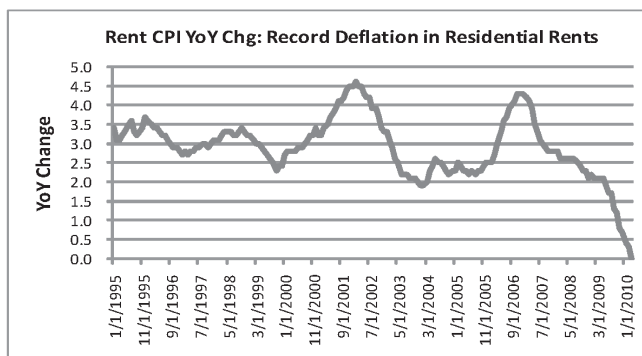
Notice that housing is actually deflating: Making up 42.0% of the CPI and 48.8% of the core CPI, it's bringing both indices down with it.

Component	1 yr Change	Share of total CPI
CPI	+2.3%	100.0%
Food	+0.2%	13.7%
Energy	+18.3%	8.55%
CPI less Food & Energy	+1.1%	77.7%
Housing	-0.6%	42.0%
All Items less Shelter*	+3.8%	67.7%

\* Because housing includes some aspects of energy costs (e.g. utilities) and other contributions, all items less shelter does not equal 58%.

Granted, home prices have flattened. But rent prices have continued to drop (Chart 2), and with the shadow inventory of housing supply at 7 million units, housing is unlikely to pick up soon.

**Chart 2**



Source: Bloomberg

(Professor Robert Shiller of the Case-Shiller housing index elaborates in "Don't Bet the Farm on Housing Recovery," which appeared in the April 9, 2010 issue of the New York Times.)

Without housing, inflation is up 3.8% in the last year, due mostly to energy prices. Energy prices seem destined to increase. Still, there should be plenty of cover from a weak housing market to give a pass to the Federal Reserve to keep interest rates low. Housing has almost five times the weight of energy in the CPI calculations, after all. In fact, in his April 14 testimony to Congress, Ben Bernanke called attention to the level of the core CPI measure: a tolerable 1.1%.

If the Fed continues to focus on the core CPI number (of which housing makes up 48.8%), we suspect they will not raise rates again for years. Rising stocks are nice for people with large portfolios. Housing represents more wealth for the common folk in this country, though, and the Fed wants to protect housing with low rates. It will be interesting to see what the Fed decides to do with gas at \$5 a gallon and the CPI still only around 2%. We bet Chairman Bernanke will maintain his focus on the CPI ex Food & Energy and keep rates at "exceptionally low levels."▲

**Thank** you to the many sponsors, presenters and participants who made the 2010 BBW Bank Card Conference a success!

## Broad participation of financial industry stakeholders facilitates development of industry standards and system efficiency

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addresses: (1) compliance with requirements of the Adjustments Matrix when making a claim to another ECCHO member; (2) notification when a claim is received; (3) documentation required to submit a claim under the rules; (4) settlement and related timing; and (5) ability to reject a claim.

### Imperfect Images

Nearly 100% of checks are exchanged as images today through both the private sector and Federal Reserve Bank exchanges. Getting the last bit of paper out of the check system is a priority as paper items become more expensive to clear. Two remaining categories of paper items that cannot be processed through check image exchange are:

- “Ineligible” items (U.S. Savings Bonds, TT&L payments, and foreign items); and
- Poor-quality or unusable items considered “non-imageable” items.

Private sector rules such as ECCHO’s do not address the items described above as ineligible. Those items would be channeled through other collection means, as happens with TT&L payments handled electronically through the Electronic Federal Tax Payment Service.

Few options exist to handle non-imageable items electronically. ECCHO’s membership supported

the development of a new rule to facilitate the exchange of items defined by ECCHO as “imperfect images.” Under the new rule, an imperfect image may be sent for forward exchange or return between ECCHO members if the item meets one or both of these criteria: (1) it contains an image that does not conform to industry standards; or (2) it does not pass image quality edits for exchange under ECCHO rules or agreement.

Certain provisions of the ECCHO Rules must be varied to support the exchange of these items, and other rules do not apply to the imperfect image. The new rule lays out requirements for: (1) identification of the imperfect image item; (2) use of applicable industry standards and guidelines; (3) timely return of such items; and (4) creation of a substitute check from an imperfect image and related liability.

These are just two of the newer updates to the ECCHO rules. Visit the ECCHO website ([www.eccho.org](http://www.eccho.org)) for an overview of the rules in the form of a Rules Summary document.

Being a sponsoring organization with ECCHO, BBW is able to provide its cash letter banks ECCHO membership at the most economical level. Contact any BBW cash management officer at **1-800-873-4722** to find out how the rules may benefit your institution. ▲

Please route to:  Pres/CEO  Head of Operations  Loan Officers  Cashier  Inv. Officer



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