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[Electronic Funds Transfer System]

Statement by . . .
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Comptroller of the Currency
before the
Subcommittee on Bank Supervision
and Insurance
of the
House Committee on Banking and Currency
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I appreciate the opportunity to discuss with this Committee the impact of electronic funds transfer systems (EFTS) on the banking industry and on the general public. Technological developments in the EFTS area have been so rapid in recent years that the capability exists to create and operate more sophisticated EFTS systems than have been put in place to date. The timing of advances from this point forward will be largely determined by the statutory and regulatory framework and by the extent of anticipated lower costs through the use of more complex systems.

Our basic policy position in this area can be stated as follows: the public must be allowed to gain the full benefits available from all technological advances. Where this is not possible because of existing statutory or regulatory restrictions, we favor making the requisite changes.

A second general principle that we believe should be used to test the wisdom of policy actions in the EFTS area relates to competition. Wherever consistent with attaining an efficient use of resources, we believe that competition among financial institutions should be encouraged. Another way of saying this is that we would place the burden of proof on those who hold that certain EFT systems can be operated efficiently only if established as a quasi-utility with monopoly powers.

From the standpoint of the payments mechanism in our country, appropriate public policy calls for encouraging those developments that would reduce the flow of paper required to carry out and record

financial transactions. Twenty-five billion checks now pass through the banking system each year; the figure has been increasing on the order of 7 percent annually. The clearing mechanisms have absorbed substantial increases in this flow over the years. However, in its recent release relating to proposed revisions in Regulation J, the Federal Reserve Board held out the possibility that "...the growth in check usage may eventually impede the flow of funds in the economy and make the use of checks slow and expensive." Certainly the costs associated with the current procedures for handling payments will, over time, become larger and larger relative to the costs associated with alternative EFTS methods.

Discussions of EFTS are often broken down into three topics: automated clearing houses; point-of-sale systems; and automated tellers. I would like to look at each of these in turn.

Groups of banks have traditionally established clearing houses on a joint basis to carry out clearing transactions. A major function of the automated clearing house is to achieve the same end as the traditional clearing house but in a more efficient manner. Automated clearing houses also can be used to facilitate certain transactions that were not historically associated with clearing houses. One of these concerns the direct deposit of payrolls without the use of any checks. An employer sends a tape to his bank showing the amounts to be credited to the deposits of each of his employees.

The employer's bank, in conjunction with the automated clearing house, is able to arrange the appropriate credits for employees in their accounts in their respective banks. The system can also involve a guaranteed credit for employees on a given date on a regular basis. Systems for pre-authorization of bill payments for bank customers can also be established through the facilities of an automated clearing house.

Automated clearing houses are in operation in San Francisco and Atlanta, and it is anticipated that perhaps as many as 10 additional ones will come into being over the next year. The policy issue that has gained most attention in connection with automated clearing houses relates to the tests for admission to membership. Although savings and loan associations have applied for membership, none have yet been admitted. The bank founders of the San Francisco automated clearing house have justified the non-admission of savings and loan associations by noting that the latter in general do not possess third party payment powers. The banks note that the traditional function of clearing houses relates to interbank clearing of third party payment items.

I would like to emphasize that adoption of the Administration proposals for financial reform, which I strongly support, will make this issue moot. The reform package will give to thrift institutions third party payment powers, and at that point, their admission to clearing houses would become virtually automatic.

The immediate question, of course, relates to the interim prior to the adoption of the Administration package. In my view, the development of integrated clearing systems in each area or region is consistent with the public interest. Thus, it would be appropriate over time for arrangements to be worked out that would allow participation of all financial institutions within a clearing system, at least to the extent necessary to allow them to perform the services they are currently offering to the public. Consideration must also be given to the antitrust question concerning exclusion of competitors from a facility. It is my understanding that the determination of any possible antitrust violation hinges on the question of whether institutions are being barred from a facility which is "essential" to their continued successful operation.

Point-of-sale terminal systems have been operated to date only on a scattered experimental basis. Yet, it is these systems that have generated the most imaginative speculation as to the form of our future payments mechanism.

In a point-of-sale system, terminals are located in retail outlets. These terminals are linked to a central computer facility. A purchase by a customer from a merchant can be paid for through crediting of the merchant's account and debiting of the customer's account on a same-day basis. If both merchant and customer have deposits at the bank associated with the point-of-sale system, the transaction can occur without reference to other financial institutions. However, it is apparent that for any widespread use of point-of-sale systems

to develop, it would be necessary for most or all of the financial institutions in an area to be linked to a communications network.

It is at this point -- the interface between point-of-sale systems and automated clearing houses -- that most of the sticky policy questions appear. Many of these will not be resolved for some time. A major reason is that the experience with point-of-sale systems is so fragmentary to date that it is difficult to create the factual base necessary to arrive at intelligent policy decisions.

A crucial question is whether the economies of scale are such that duplicate communication networks for handling point-of-sale transactions are not feasible from a cost standpoint. This question is still open, and we hope that some experimental moves, now in the planning stage in several cities, will shed some additional light on the matter. Even if it turns out that only a single area communications network is economically feasible, the question remains whether there are methods and devices that will allow competition to occur among various groups of users of the network.

Another issue with which regulators must be concerned is the consumer reaction to EFTS developments in general, and to point-of-sale systems in particular. Scattered surveys indicate that there is considerable consumer resistance to payment methods that have the effect of removing float, and that remove the option normally held by customers as to the precise order in which bills are paid.

If it becomes obvious over time that the economies associated with point-of-sale systems are too great to pass up, an intensive program of consumer education may have to be mounted. I think that the point made by Governor Mitchell in this connection has considerable relevance. He holds that customer resistance will be overcome only if there is monetary benefit associated with immediate payment as opposed to deferred payment. While such a differential appears economically sound, it is often absent under current payment methods.

I would like to conclude by giving attention to automated tellers and cash machines. The impact of these machines on the banking industry and on bank customers can be distinguished from that of automated clearing houses and point-of-sale systems. The automated teller need not have any communications link with any institutions other than the parent. In simplest terms, these machines offer a new dimension in customer convenience. The principal customer advantages offered relate to location and hours of availability. In the absence of regulatory or statutory prohibitions, these machines can be placed at numerous locations that would not merit a full-scale branch. As to hours, these machines are operable 24 hours a day, except for downtime.

The placement of automated tellers has inevitably become associated with the branching question. A recent survey appearing in The Magazine of Bank Administration revealed that 1,430 automated tellers and 355 cash dispensers had been installed as of two months ago. In

addition, about 1,300 additional machines are on order. The survey also indicated that over 90 percent of the installations are located on the outside wall of existing bank offices. On-premise locations do not raise the branching issue. However, about 4 percent of all machine installations are located off existing premises, and the number will grow if regulatory barriers can be removed.

In general, in those states whose branch law would allow a full-scale branch at a given site, we have approved and certificated locations for free-standing machine installations. In a number of non-branching states, the use of machines is currently restricted to existing bank premises.

We are sympathetic to the efforts under way in several states to liberalize the use of automated tellers. The banking commissioner of Ohio is supporting legislation that would eliminate the need for a branch application procedure in connection with machines. An Antitrust Division official has testified before this Committee that the Division may look with favor, at some point down the road, at legislation that would allow National banks to establish automated tellers without reference to State branching law. Our Office has not reached such a determination yet; however, if it became apparent that the only way to gain for the banking public the benefits associated with automated tellers is through that approach, we would probably favor it. Whatever legislative developments occur at the State or national level

in this area, it will be necessary to preserve the competitive equality of the dual banking system.

The possibility of two or more banks sharing automated tellers has been raised. From a technological standpoint, machines can easily be linked to the computers of two or more banks. As I understand it, the existing technology allows essentially the same results to be achieved from the customer standpoint when two banks share one automated teller, or alternatively, when two banks install separate machines side by side at a location. The sharing of facilities would again raise an antitrust question. The possibility of shared facilities is under consideration by our Office, but we have not reached any conclusion to date.

Another public policy issue which will become more important in the future relates to the development of interchange systems tying together the automated tellers of various banks. Such a system would yield considerable consumer benefit, since the customer of one bank could carry out the transactions he desired with his own bank through the automated teller of another bank. Such an interchange system is already in use in certain multi-bank holding companies. One may conceive of the development, first of local interchanges, then regional interchanges, and finally, at some point, a national interchange. Such interchanges would require compatible data formats and security systems. The regulatory question here is whether the convenience of an interchange system can be secured without

losing the benefits of competition.

In summary, new technology makes possible a number of developments in the payments mechanism, only a portion of which have yet been implemented. Some further advances await clarification or modification of the statutory and regulatory framework; others depend upon a demonstration that the innovation would yield an acceptable profit. It is our intent to take those steps open to us that will enhance the opportunity of bank customers to gain the benefits made possible by technology. To achieve this, we must allow National banks to be fully responsive to emerging financial needs and to utilize all available means to serve those needs. At the same time, we will insist that vital competitive safeguards be maintained and strengthened.