



NEWS RELEASE

Statement on
ELECTRONIC FUNDS TRANSFER SYSTEMS

Submitted to the
Subcommittee on Bank Supervision and Insurance
Committee on Banking and Currency
House of Representatives

by

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Mr. Chairman, with the Subcommittee's permission, I would like to file this statement of FDIC's views on developments in the area of electronic funds transfer systems, or "EFTS."

Electronic fund transfer systems utilize technology to replace paper checks and money with electronic information. EFTS is now a reality in the commercial banking world. Innovations in the development and implementation of EFTS have given rise to a rapidly growing industry and have led to frequent changes in the design and manufacture of EFTS hardware.

The Congress now has some familiarity with the EFTS issue. The potential impact of electronic systems upon various sectors of the banking community was briefly discussed in the Hunt Commission Report and in the hearings on NOW accounts which were held by Congress earlier this year.

There are three major areas which involve the application of EFTS: automated clearinghouses, point-of-sale systems, and automated teller facilities. Automated clearinghouses are the electronic equivalents of the traditional, paper-based clearinghouse. The primary purpose of the traditional clearinghouse is to process items drawn on checking accounts at participating banks. The automated clearinghouse performs essentially the same function. Whereas the traditional clearinghouse handles paper

items, the participating banks in an automated system send debit and credit entries to the clearinghouse via magnetic tape. The clearinghouse then assimilates these magnetic entries and makes electronic debits and credits to the respective banks.

One of the major services which would normally be performed by an automated clearinghouse is the payment of recurring obligations between individuals and companies. Examples of such recurring obligations include the crediting of an employee's pay directly to his bank account, the payment of dividends to investors, and the payment of routine household bills. The automated clearinghouses which are operational in San Francisco, California, and Atlanta, Georgia, perform this service for their members. These clearinghouses are being operated by the Federal Reserve System. Similar clearinghouses are planned for other metropolitan areas.

Point-of-sale systems involve the use of a bank card by its customers to make purchases at retail outlets in a given area. Terminals are located at the cashiers' stations in the retail outlet and a specially encoded card is inserted into the terminal when a purchase is made. If the terminals are on-line to a central switching and data processing center operated by the bank, the amount of the purchase will be debited automatically to the customer's credit card or demand deposit account.

The customer will subsequently receive a statement showing the charges billed to his account.

Various pilot programs using point-of-sale terminals on a limited basis have been conducted in such places as Columbus, Ohio, and Syosset, New York. Other point-of-sale systems are being planned for Atlanta, Georgia, Los Angeles and San Francisco, California, and Cleveland and Columbus, Ohio.

The third area involving the application of EFTS technology is that of automated teller facilities. There are basically two different types of facilities involved. The first type is the cash dispenser which performs the single function of dispensing cash when the depositor inserts a card into the cash dispensing machine. The second is the automated total teller which can perform approximately a dozen different routine banking functions. These facilities can be located either on or off a bank's premises and can be either on or off-line to its computer.

The use of automated teller facilities by banks is becoming widespread. One particular manifestation of this activity is the interchange system. In an interchange system, automated teller facilities are located at several different banks and a customer of one bank can use the facilities at any of the participating banks. Interchange systems are presently operational in several cities in Ohio, in Dallas and Austin, Texas,

Wilmington, Delaware, and Minneapolis, Minnesota. It is expected that additional interchange systems in other cities will become operational in the near future. Conceivably, there could be an interchange program in which some or all of the automated facilities would be located separate and apart from the premises of any particular bank.

Most of the issues surrounding the implementation of EFTS involve both legal and policy considerations. We do not believe it possible at this time to articulate all of the issues which may be involved since electronic funds transfer systems are still in the process of evolution. While the Federal Deposit Insurance Corporation is making every effort to keep abreast of developments in EFTS, certain legal and policy considerations appear to fall outside the purview of the FDIC's regulatory and supervisory authority.

Branch banking is one issue in which the FDIC is directly involved. All insured State nonmember banks are required to obtain the prior approval of the FDIC before they establish new branches. Section 3(o) of the Federal Deposit Insurance Act defines the term "branch" as a place at which deposits are received, checks paid or money lent. The question arises as to whether certain automated teller facilities and point-of-sale systems constitute branch banks.

We are all aware that the States play a significant role in our dual banking system. There have been certain recent developments on the State level with regard to automated facilities and the branch banking issue which have potential significance for the supervision and regulation of such facilities. Legislation has been introduced in over half a dozen State legislatures which would permit the installation of automated teller facilities off a bank's premises without violating applicable branching restrictions. The Oregon Legislature passed such a bill this year and it is reasonable to expect that similar legislation will be enacted in other States.

Another issue with which the FDIC is directly concerned is the relationship between third-party payment powers and electronic banking. The FDIC's regulations restricting third-party payments in the case of savings deposits in commercial banks currently prohibit savings depositors in insured nonmember commercial banks from arranging for the automatic transfer of funds from their savings accounts to their demand accounts. This is designed to prevent such depositors from using their savings and demand accounts in tandem to create what amounts to an interest-bearing demand deposit. However, the regulations do not bar the withdrawal of funds from a savings account and the redeposit of those funds in a demand account, regardless of the number of times the depositor chooses to make

such withdrawals. Arguably, there is no violation of the regulations where a bank allows its depositor to request by telephone that the bank withdraw funds from his savings account and redeposit those funds in his demand account. This same result may well apply to the somewhat analogous situation where a depositor uses a card in a machine to transfer funds from his savings account to his demand account. In neither instance does the transfer of funds take place automatically. Depositors have long been permitted to mail their savings account passbooks to their bank and have the bank withdraw funds from their savings accounts and redeposit those funds in their demand account. In fact the regulations do not require the submission of a passbook for this purpose. Much the same process is involved in telephone withdrawals and could presumably be effectuated by using a card in a machine programmed for that purpose. The point here is simply that electronic modes of funds transfer reduce both the time and effort required to shift funds from one account to another, thereby tending to blur any real distinctions between savings and demand deposits.

In each of the three major EFTS categories -- automated clearinghouses, point-of-sale systems, and automated teller facilities -- the Corporation considers competition to be an important element influencing its decisions.

The issue has already been clearly raised in the automated clearinghouse area. The California Automated Clearing House Association (hereinafter "CACHA") has issued a position paper which denies to savings and loan associations direct access to its system with regard to both debit and credit entries. It is my understanding that both this paper and a response by the savings and loan industry are available should the Committee or its staff wish to review them. The question here is whether the exclusion of savings and loan associations from an automated clearinghouse operation would constitute an anticompetitive or unfair trade practice. We note that CACHA has not presented specific evidence to support its claim that savings and loan participation, if limited to credit entries, would constitute an inequitable sharing of the benefits and burdens of APD. On the other hand, the FDIC is presently unaware of any evidence to support a claim by the savings and loan associations that their exclusion from APD, or any other automated clearinghouse activity, would cause them substantial injury, taking into account present limitations on their operating powers.

The exclusion of savings and loan associations and other thrift institutions from direct participation in an automated clearing house operation would certainly be an appropriate subject of concern to both Congress and the Federal agencies charged with primary enforcement

of the Federal Trade Commission Act and the Federal antitrust laws. Even in the absence of a Congressional or a Federal agency resolution of this question, certain other developments might well dictate the entry of savings and loan associations into automated clearinghouse membership. For example, savings and loan associations and other thrift institutions may gain expanded third-party payment powers. Also, automated clearinghouses may expand their range of activities beyond the normal clearinghouse functions. The direct deposit of payroll checks and automated bill payments seem to represent forms of such expansion.

In the area of automated teller facilities, anticompetitive considerations may be involved if a commercial bank is denied access to an interchange system. If such machines are considered branches, then prohibiting a bank from gaining access to an interchange system might preclude that bank from branching into certain locations and thus place it at a competitive disadvantage.

The current definition of "branch" in the Federal Deposit Insurance Act is sufficiently broad to cover many of the activities which may be carried on by automated teller facilities. Arguably, the FDIC cannot divorce itself from its statutory responsibility to approve the establishment of such facilities. However, this is not to imply that the FDIC should apply traditional branching criteria in evaluating proposed

automated facilities. Nor do we suggest that the procedures employed by the FDIC in processing branch applications should be used for automated facilities. These procedures are relatively complex and time-consuming. They are geared in large part to the competitive aspects of branch banking and are mainly designed to insure that the FDIC is apprised of all relevant information necessary to reach an informed decision as to the need for the proposed branch and its impact on potential competitors. Whether or not the installation of automated facilities at locations off the premises of a bank's main or branch offices involves the same competitive considerations may well depend upon the evolution of such facilities. If banks are allowed to use automated teller facilities on an unrestricted sharing or interchange basis, the competitive implications arising from the establishment of such facilities may be minimal or even nonexistent. However, restrictions on such sharing arrangements may well lead to significant competition between institutions or groups of institutions. This would presumably trigger the FDIC's branch approval procedures and substantially increase the time and effort necessary to put a proposed automated facility or group of facilities into operation.

Anticompetitive considerations may also be involved in the operation of point-of-sale systems. Assume that a particular area has only one such system comprising most of the major competing banks but is

capable of supporting several competing systems. In such a case, the question may be raised as to whether this one system constitutes an unlawful monopoly. On the other hand, it should be kept in mind that the cost of operating several competing point-of-sale systems may prove to be prohibitive in some market areas.

The Federal Deposit Insurance Corporation recognizes the need for innovations in banking. It is our view that the various forms of electronic funds transfer are logical progressions for the nation's commercial banks and will benefit bank customers throughout the country. Bank regulatory agencies should be willing to use their good offices to encourage the new banking services which technology makes possible. These agencies should also seek necessary changes in the law and in their supervisory policies that will encourage banks themselves to move forward in this area.

It is our opinion that Congress and the bank regulatory agencies should encourage the development of EFTS along lines that would maximize competition and minimize any potentially unfair or restrictive practices. Taking into account the varying powers of different types of financial institutions, we would favor maximum participation in federally-assisted EFTS facilities by all depository institutions.