

Excerpts

Remarks of George W. Mitchell
Member, Board of Governors
Federal Reserve System
at
The ABA Marketing Conference
San Francisco, California
March 23, 1972

It is a great pleasure for me to hear a description of technology that five years ago was non-existent, and to know that there are people now engaged in a massive marketing effort to meet the challenge of selling an electronic system for the transfer of funds to the nation's bank customers.

My job today is the less exciting one of telling you about the transitional step of improving the check payments system while the electronic systems you have heard described come into full flower. While this transitional step is--as such a step must be--pedestrian compared to the quantum jump you are contemplating, it is a necessary upgrading in check handling technique. We must be sure present-day methods will serve our needs until we are up to the various electronic jumping-off points.

The Federal Reserve's principal effort at this time has to do with the reorganization of its check clearance facilities. By expanding the areas served by each of our 37 offices, we are putting together a much more efficient nation-wide system of check clearing. We refer to these facilities as Regional Check Processing Centers--RCPC's. Last month the Federal Reserve Board issued guidelines covering the organization of such Centers and the clearing arrangements that will be followed. They are to be operated by the

Federal Reserve Banks, and will for the most part be located at Federal Reserve Banks or Branches. They will make maximum use, consistent with improved service to the public, of data processing centers operated by commercial banks or service bureaus.

These centers operate essentially as typical city clearing houses, except that they cover larger areas and costs of operation are borne by the Federal Reserve. There will be a center wherever there is a Federal Reserve office, or where it is desirable for us to establish an office.

What we are doing, initially, is expanding the area of overnight check processing and clearing around existing offices, reaching as far out into the surrounding area as transportation realities make feasible. Expansion is in stages. Our intent is to make the present-day system of check handling involving the transportation, the proofing, the sorting, and the accounting for checks as economical as possible. We are trying to get the last ounce of economical and efficient performance out of checks.

This first objective--getting the most out of checks--is, as I have indicated, a way station on the road to an electronic payments mechanism. Our second objective in improving the efficiency of the check payments system has its own and a permanent rationale. It is to reduce Federal Reserve float. Everyone thinks that float is a free good. But float is not free--somebody has to pay for it. To us, it represents a daily average investment of some \$3 to \$3-1/2 billion. I do not know what float costs the commercial banking

system; but it must be a substantial amount. And the beneficiaries in this case are banking's customers including some individual banks. Of course, the customers of banks whose cost accounting system works pay for commercial bank float even though they may not realize it. Any kind of a system that produces float involves hidden costs that are exactly equivalent to what people believe to be evident benefits. Everyone would like to be paid electronically, but many people try to pay by pony express. The illusion that float is costless because it is not itemized on the price tag should be dispelled. It will be as the payments system moves toward simultaneity in charging and crediting accounts of payors and payees.

Let me return to some further details regarding our clearing centers. We are attempting overnight transportation, processing, and clearing of checks for larger and larger areas around Federal Reserve offices. But the constraint of completing these operations between the close of business on one day and the opening of business on the next makes it impossible to cover the entire nation from our existing locations. We are going to have to open a few new Federal Reserve operated centers. To date, Miami is the only new center we have placed in operation. But there are proposals under study for at least five or six others. Plans for the expansion of present clearing centers and the opening of new regional centers are being worked out in terms of the public interest and economic feasibility and in cooperation with commercial banks in the affected areas.

Some of these expansions are perfectly obvious and we are moving ahead rapidly on them. Others are not so obvious. Operating and economic constraints dictate the areas that can be covered and which banks ought to be included or excluded from a given center. We have an econometric model of check flows and processing costs built by TRW to help answer such questions. With this model, it is possible to simulate the flows and costs of alternative arrangements. At the present time, check flows and cost data for several areas in various parts of the United States are being gathered to be fed into the TRW model. The results should help us to reach a decision as to the most expeditious and economical check clearing arrangement for those areas.

The RCPC's, insofar as practicable, are dealing in fully qualified items; that is to say, that when checks come into the center, they have been amount encoded and are fully machinable. Such a requirement brings into focus the importance of commercial bank services in the clearing process for it means, generally, that items must have been through someone's processing center before they are ready for entry into an RCPC.

What has been the users' reaction to the RCPC? Our main customers are, obviously, participating banks. It is a little early to make an evaluation of their mature reaction to speeded up settlement and availability, lowered footings, and savings in processing and transportation costs. The center that has been in operation for the longest period of time, excluding St. Louis which has had several decades of experience, is the Baltimore-Washington center. We

surveyed bank reaction in that area last year and the results indicated general acceptance and satisfaction.

At the present time we are operating expanded clearing centers at Kansas City, St. Louis, Washington-Baltimore, and Denver, and have recently started up a new center in Miami. On the whole, the results so far have satisfied our requirements and met with general approval from participating banks. We plan to expand the program to cover most of the United States as soon as it is operationally feasible. Chicago will open an expanded facility the first of April, Dallas and Fort Worth will open a combined center early in the summer; and there are several others in the pipeline. We have announced that we intend to convert the long-standing cooperative clearing arrangements in Bergen County and Long Island into full-scale RCPC's.

Once the nation's clearing facilities have been connected to a predominately overnight basis, we will have done about as much to expedite check handling as can be done. And from there on, it is going to be up to electronic systems processing and wire transfer systems to effect further improvements in the payments mechanism.

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