For release at 12 noon (EST)
Monday, February 26, 1973

RECENT DEVELOPMENTS IN MONEY TRANSFERS

Remarks of George W. Mitchell

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at a symposium

"The Development of an Electronic Funds Transfer System"

sponsored by

The Atlanta Committee on Paperless Entries

Atlanta, Georgia

February 26, 1973

RECENT DEVELOPMENTS IN MONEY TRANSFERS

This Conference is a significant demonstration of the mounting interest in and progress toward a national electronic payments system. Your agenda of operational issues and alternatives gives the sessions of the Conference a real nuts and bolts flavor. This is very much to the good.

Innovation where competitive interests are involved gets its greatest thrust from an operational demonstration. It is not enough for the technology to be ready, the overall cost-benefit analysis to be overwhelmingly favorable, and the market to be in clear view. Someone has to verify the prognosis and show how it is done, by doing it. Banking managements are more cautious than most and in addition few top bank executives are really grounded in what goes on in back offices where checks are processed. Thus, a successful demonstration on a significant scale of an electronic transfer system is exactly what is needed today and is, I have little doubt, a dividend that is about to emerge from the Atlanta Project.

My purpose today, however, is not to tout the efforts of our Atlanta friends but briefly to comment on two recent payments mechanism developments which have a direct or indirect bearing on the subject matter of this meeting--the emerging role of the Federal Reserve in check handling and recent activities of savings institutions.

It has been less than four months since the Federal Reserve's Regulation J was changed to bring the nation's payments mechanism closer to a "good money" status, "good money" being money that can be spent as soon as it is in hand. The regulatory change was attacked in the courts but the Board's action was sustained by the Federal Courts in Washington and Los Angeles.

While the legal attack on the Regulation J change attracted a good deal of banker attention, the more fundamental change--the shift toward overnight handling of transit items and the enlarged Federal Reserve role in pick up, processing and delivery of checks--was largely ignored except by processing technicians.

The change in Regulation J was a necessary ingredient to this program, but it takes far more than a stroke of the pen to improve the economics of the payments mechanism. The economies that were sought in the Federal Reserve's check handling program will show up in the total costs--public and private--of check payment. Some of these costs are difficult to identify; others are obvious savings in personnel, transportation and equipment. Such savings can be documented as a reduction in the number of times a check is reintroduced as a document for entering an electronic processing operation; or as the number of unnecessary and circuitous check movements that are eliminated; or in the reduction of duplicating transportation facilities between sites.

Good progress is being made on the expansion of Federal Reserve clearing facilities and within a period of a year or so we probably will be close to achieving as efficient performance as we can derive from check technology.

At present the Federal Reserve is operating 6 regional centers in addition to 12 head offices and 24 branches. Head offices and branches have been extending, by stages, their overnight check service areas and by mid-1973 most will have been pushed about as far out as now seems economically feasible. It is also expected that two new centers will be opened early in 1973 and at least two or three thereafter. The total number of full-scale processing centers, however, does not now seem likely to exceed fifty for some time to come.

It is too early to attempt a preliminary evaluation of all the changes growing out of moves toward overnight clearing and the evolving and complementary roles in check handling of the Federal Reserve and commercial banks. Basically, we intend the Federal Reserve to serve, on equal terms, as an interface among all the banks, large and small, in the U.S. It should not handle "on-us" items nor do any internal phase of check sorting or accounting for an individual bank. Its concern is solely with "transit" items. Increasingly, commercial banks are using their own or contractual electronic processors for their entire internal check operation. This trend lessens or alters the role and cost of Federal Reserve participation in check handling, because items coming out of an electronic processing center are fully qualified and machinable.

However, there are some regions in the country where a significant number of banks forward items to the Federal Reserve that are not fully qualified and machinable. This adds to our costs and processing times. There is no doubt that as processing facilities become more conveniently available, all banks will come to use such facilities. In the meantime, the Federal Reserve serves a transitional need for smaller member banks. In the larger and longer run view, the Federal Reserve's basic task is to move its weekly workload of 150 million checks to overnight settlement as rapidly as is economically feasible. In considerable measure progress toward that goal depends on reducing the number of items that require preliminary preparation in our facilities.

Let me turn now to the most provocative of recent developments on the payments mechanism front. It comes from the activity of savings institutions that, for the most part, have heretofore had little or no money role and have not been active to any significant degree in the development of the electronic transfer system.

While they have been actively considering the Hunt Commission proposals which would entail a money role for them, I believe that the recent burst of interest in providing a money transfer service for savings customers is the result of their thinking through the implications of a shift from check to electronic transfer and a judgment, with which I agree, that a large and rapidly growing volume of electronic credits and debits is in the offing.

Thus, the savings and loan industry is actively seeking to become a participant in the California SCOPE system.

The mutual savings bank industry incorporated MINTS (Mutual Institutions National Transfer System) as an affiliate of their Association last July. The president of MINTS has just recently stated, "If savings banks hope to provide their customers with a full package of family financial services in the near future, it is essential that they participate in the mainstream of these new developments in funds transfer systems." And, finally, we have the meteoric appearance over New England of the NOW account--and this is not a reference to the National Organization for Women!

These potential entrants into the money business have raised a number of issues which probably can only be resolved by Congressional action. Most of them relate to the rules of the game and how they should, or should not, be modified for both old and new players. Do new players have to ante up reserves before they enter? Can new players bid higher for chips than old? Is the house "take" to be the same for everyone? Are novices entitled to a wild card or two, or should they play a separate game over in the corner?

The resolution of these allegorical issues and others are of great importance to the players--old and new. They have considerable interest to those of us who have been trying to adapt electronic technology to money settlement and to bring it off by trying to mobilize the requisite economic incentives through the reduction of costs which are fractionated and dispersed throughout the economy. At this point in time the research and development outlays have been almost entirely borne by the Federal Reserve and the commercial banks.

While there have been ups and downs in adapting technology to money transfer such setbacks have not been the major barrier to greater progress. Customer enthusiasm for electronic payment has been lacking. Convenience, the major advantage to individuals, has generated little spontaneous enthusiasm thus far. The potential advantages of income crediting have not caught the attention of consumer groups, associations of retirees or labor unions, even though such advantages to their members are substantial. Financial benefits to individuals have not been offered and probably depend upon competitive pressures. To some degree acceptance is held back by custom and adherence to old ways; money mores change slowly. Also many individuals do not identify with the ephemeral character of an electronic "byte," and would prefer "real" money or evidence thereof--coin, currency, or even a bank statement.

But it may be that public attitudes toward changes in money are not what we thought or marketing analysts have told us they were. It may only be that we did not have the right handle--one such handle may have been discovered in Massachusetts. Mr. Ronald Haselton of the Consumer Savings Bank of Worcester, Massachusetts, introduced his savings bank customers to the Negotiable Order of Withdrawal and the NOW account. The feature he offered--unabashedly and ultimately with the approval of the Massachusetts Supreme Court--was a checking account that pays interest.

I am, of course, aware that there is much concern in the commercial banking community about the impact--both actual and potential--

of extending money transfer services to savings accounts in thrift institutions. But that concern, as I understand it, comes from the fear that such services will be authorized on terms and conditions that are unequal as between banks and savings and loan associations, mutual savings banks, or credit unions. Defining terms and conditions of equality will not, I am sure, be as simple as it sounds. As a matter of public policy, substantial equality should be achieved; as a practical matter it can be achieved. Given that fact I see no basis for apprehension by institutions who have had a lifetime of experience with money transfer services and have served their customers well.

Turning to the question of paying interest on demand deposits, commercial bank checking accounts have always paid some implicit interest in the form of the money transfer services provided for depositors. Deposits and withdrawals are not costless for banks, and banks cover such costs by interest earnings on the invested proceeds of their outstanding deposit balances, often supplemented by service charges. Banks are prohibited by law from paying interest on demand deposits but not from rendering "free" services to demand deposit customers. They have planned their merchandising of demand deposit services accordingly.

Mr. Haselton was able to give his customers a different slant and his product a new appeal. In effect he revised the typical bank's marketing strategy: he paid interest on a checking account and charged fees for the transfer services instead of foregoing fees and not paying interest. In doing so he has found a service combination that appears to have a great potential for promotion.

For some time many economists have been agitating for the payment of interest on demand deposits--some apparently without realizing that an implicit interest payment in the form of money transfer services has come to be a well-established banking practice. Large customers who monitor their bank accounts closely now typically maintain demand balances at the level just required to cover the cost of the money services they need. As our financial markets and intermediaries have provided more and more options for short-term investment, those legendary demand balances far in excess of transaction needs have virtually disappeared; such excess funds have long since gone into market instruments or into interest-bearing depositary arrangements.

Consequently, as an economic issue, payment of interest on demand deposits is--or should be--a small shadow of its former self. The NOW account may be another factor eroding the concept of an unrequited balance in a financial institution. There is no doubt that electronic crediting and debiting, by eliminating teller and other money transfer costs, can bring the personal account still closer to a status in which at least some types of money transfers can be regarded as a low cost fringe benefit to the account holder who, in addition, can expect payment of interest.

It may very well be that electronic credits and debits and the payment of interest on accounts to and from which such transfers can be made, are two features that combine substantial and realizable advantages for both institutions and depositors. It certainly appears that Mr. Haselton has opened up a marketing approach of considerable promise. This combination of service and income may be presently illegal in many jurisdictions, and frowned upon in others, but the fundamental logic of its value to customers is powerful, indeed.

The interest being shown by savings and loan associations in participation in California SCOPE seems to me to be another recognition of the potential for customer convenience of electronic credits and debits. Even though such transfers are originated by demand deposit customers of commercial banks as transferors of income credits or transferees of debits for goods or services, as seems most likely, the potential ability to route these transfers to savings accounts either in banks or savings and loan associations, may have an important marketing impact on the demand for electronic transfers.

We are seeing, almost unexpectedly, a conjunction of events and judgments which are quite likely to provide the incentive to use the planning, the tools, and the forethought that this group represents. I hope so.

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