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MONEY PAYMENTS IN PERSPECTIVE

Remarks of

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at the

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MONEY PAYMENTS IN PERSPECTIVE

When one is waist deep in the riffles of his favorite trout stream, he has little occasion to speculate on where the waters are coming from and where they are going. Luring a fish with his fly, retaining his footing and retrieving his catch absorb all of his energy and attention.

When I am asked to make a perspective review of recent developments in the payments mechanism, I find myself in a payments trout stream handicapped by a very immediate interest and concern with the consequences of current payments developments on banking relationships and the financial environment. These consequences are not unimportant; they involve such issues as (1) the relationship of banks to other depository institutions in payments services; (2) the problems for effective monetary control that can arise from conferring payments powers on thrift institutions; and (3) possible anticompetitive implications of a payments technology which may entail neither public participation nor public regulation. At the moment these problems and issues are uppermost in my thinking.

In my perception, then, it is not surprising that the highlight of the past year and the current scene has been the emergence in Massachusetts and New Hampshire of the interest-bearing NOW account, evidencing both a desire on the part of mutual savings banks in those States to participate in the payments mechanism--and a way of doing so that is appealing to customers. At the same time, the savings and loan industry has been showing an intense interest in electronic payroll crediting in two operating areas--California and Atlanta. This Fall the Congress will probably begin consideration of the Hunt Commission recommendations on the roles and powers of depository institutions. Thus, the "thrifts" today evidence a keen desire to be participants to at least some degree in the money transfer system in order to broaden their competitive base or, at a minimum, to retain their present access to depository customers.

All of these developments may seem at least once removed from your interests and problems but, I think, they have several implications for charge account bankers. The most obvious is that another "outside" competitive force may be in process of developing. It would use as its transactions base savings accounts in mutual savings banks, savings and loan associations and professionally managed credit unions. Commercial banks would presumably be offering a similar service. Such competition is virtually nonexistent today, but it can grow rapidly by taking advantage of the technological achievements in the banking industry to get off to a flying start. Given a Congressional endorsement to the general tenor of the Hunt Commission recommendations, the "thrifts" have a large and loyal clientele to which they could offer various kinds of payments services.

The second implication for your industry is the feature of greatest appeal (and controversy) in the NOW account--the offering of interest on balances in an account from which, as well as to which, transfers can be made. Explicit interest in the form of credits, instead of implicit interest in the form of transfer privileges, will raise, in my opinion, the whole issue of pricing money transfer services not just in the two States, but generally.

Traditionally, checking account services have been priced with a deposit balance roughly set or fine-tuned, depending on the customer and the institution. However well suited to the past this practice may have been, a casual or indifferent attitude toward pricing transfers from accounts paying competitive interest rates would be unrealistic. Unless such services can be produced so cheaply they can be regarded as "throw-aways", their pricing will need to be stated specifically. If household accounts are to yield a competitive interest return, many account owners will want to know how much a debit will cost them or how it will impact on their interest accruals.

I believe the Massachusetts-New Hampshire experiment raises a vital issue for your industry because it has now become an adjunct to the payments system and is offering a service whose cost (apart from the explicit credit charge) is hidden from the customer's view because it is subsumed in the price of the commodity or service which he purchases. To be sure, "convenience credit" was not your invention but was taken over as a well-established retail practice; however, as your business extends to more consumer markets and as the credit card displaces more and more cash transactions, the hidden charge becomes more and more incongruous with consumer interests. It presses convenience services and costs upon users without giving them a clear-cut opportunity to evaluate that service by its price and to adjust their utilization accordingly. In effect, it can discriminate against transactions on a cash basis.

Of course, paying by cash in the form of currency and coin involves hidden costs too, which are not known either by consumers or vendors. They are, in fact, so widely dispersed in the form of protection, insurance and handling expenditures by vendors, buyers, banks, and governments that no one, so far as I am aware, has been able to add up their total resource utilization.

Another pricing anomaly in the payments field is the so-called "free" checking account. To be sure, banks offering such services can provide for interest charges on their customers in a variety of ways, but these charges may bear little relation to the total costs involved. We know something about the costs of check payment within and without the banking system, including such cost factors as merchants' experience with returned checks. However, how the burden of check costs is split up between the bank on which the checks are written, the banks in which they are deposited and the intermediate institutions, including the Federal Reserve, which handles them in the collection process, is ordinarily a case-by-case study.

These illustrations of aberrations in pricing policy for alternate means of payment go a long way to explain the pricing practices adopted by your industry. But that does not mean that such pricing philosophy is optimal, either now or for the long pull. What is needed in your industry, I believe, is a careful evaluation of events in train that are leading toward explicit pricing of transfer services. This issue would become particularly acute if your charge card also serves as a cash card. When will that happen? Essentially, it depends on the evolution of the technical and economic bases for handling immediate and deferred payments, and that issue in turn depends on transaction volumes, communication networks and public and private involvement in the payments mechanism.

I doubt there is much I can add to your knowledge of recent Federal Reserve activities in the payments system evolution. We have attempted to keep the industry pretty well abreast of our thinking and actions. We are still in the process of completing the installation of our new high-speed wire network linking all 43 operating Federal Reserve offices, including new Federal Reserve Clearing Offices. As of now 18 offices are hooked into this network. Early in 1974 another 19 offices will be added and within a year our expectations are that all Federal Reserve offices including two or three that may be opened in 1974 will be included.

The wire links between Federal Reserve offices and the "Street"--the commercial banks with which we expect to generate or receive wire transfers in volumes that justify such links--are being put in place as rapidly as mutually satisfactory arrangements for interface can be worked out. While a relatively small number of commercial banks have been connected with the system up to now, these banks have the capability of providing a very large volume of daily activity. We find that wire transfers through Federal Reserve facilities are rising at a 26 per cent annual rate.

While the volume of work coming into the automated clearing houses in California and Atlanta is less than many expected, the interest in facilities of this type is growing and several ACH arrangements are scheduled to go into effect in the next few months.

A newer development--the point of sale terminal--stimulated by the Atlanta project and experiments in Columbus, Ohio, and Syosset, New York, is attracting considerable interest among commercial banks and within the Federal Reserve. The emergence of POS terminals as an operating reality has a tremendously important bearing on your future.

However, rather than attempt to delineate our interest or project our role in point of sale terminal operations, I think it would be more useful to discuss the problem generally as an issue of interfacing public and private interests in future payments arrangements. In doing so, I hope not to be considered to be denigrating or in any way discounting the very considerable contribution bank credit card sponsors have made in furthering public acceptance of an interest in the practical improvement of the payments mechanism. I doubt anyone outside your ranks is more aware than I of the operational and acceptance difficulties you have faced and surmounted. But I see other challenges ahead, including the problem of pricing to which I have already alluded, and especially the need to assure that the public interest will be adequately represented as the payments system undergoes, as it surely will, general adaptation to electronic technology.

As I interpret Congressional authorizations and relevant provisions of the Uniform Commercial Code, commercial bank practices, Federal Reserve participation in clearing activities and policies, and Department of Justice antitrust posture, present payments practices have been generally consistent with the public interest. Competition governs the services of individual banks, and payments transfer developments are unlikely which will present problems with respect to transfers from one demand deposit account to another within the same institution. It is practicable for any customer who seeks improved or different service to move his account to another bank. However, for payments which involve two banks, one for the payor and another for the payee, the system for clearing becomes more structured--and progressively so as the number of combinations of banks increases and eventuates in various kinds of cooperative arrangements. Absent a public voice or participation, these arrangements can become excessively concerned with corporate interests.

The Federal Reserve has long provided a national clearing system linking all banks--members directly and nonmembers indirectly. This system has not been exclusive--the nonpar system, for example, was, and what is left of it still is, outside of Federal Reserve clearings. Correspondents' balances can function as clearing media also and do so largely outside of the Federal Reserve. The volumes of such clearings has, in general, been roughly in proportion to the quality of service rendered by the Federal Reserve. Large volumes of payments go through city clearing houses in which the Federal Reserve does not ordinarily participate unless it has an office in the clearing city.

All of these arrangements are familiar to you and I only recite them to indicate there is no unequivocal guideline or precedent out of the past which establishes how the public's interest will be protected as the electronic payments system takes over.

Since it appears to me, at this point, that credit cards will probably become cash cards and in that case will, and should, be used to effect money payments directly, I am concerned as to the way in which this money function should be regulated or policed or performed as a joint venture with a public agency so as to assure maximum protection to the public interest.

It is not clear to me that competition can be counted on to play much of a disciplining role when transfer arrangements involve associations of banks. Nor does there seem to be a significant precedent for using public-utility type regulation of money transfers. Therefore, my tentative preference is for continuation or extension of the present degree of Federal Reserve participation in check clearing into the field of electronic funds transfer.

The difficulty at hand as visualized by some who would like a choice of clearing arrangements is whether paperless technology can make competing clearing systems economically feasible. In some degree this is an engineering or management problem; in some degree an issue for public policy. It most certainly is a confrontation you cannot avoid as your activities expand, if your cards, instead of the check, become a general vehicle for transferring funds from one account to another.

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