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# THE ACH IN PERSPECTIVE

Remarks of

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at the

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# THE ACH IN PERSPECTIVE

It is a pleasure to have the opportunity to speak in this forum about the automated clearing house program. Last year was an important year in the development of the ACH, but what happens in 1979 and in the early 1980's will be even more important. Included in my remarks this morning are some of the recent major accomplishments in the ACH and the objectives which I believe need to be accomplished during 1979. I intend also to brief you on the pricing question and then conclude with a progress report on our efforts to implement the Electronic Fund Transfers Act of 1978.

The most significant ACH accomplishment of 1978, in my view, was the linking of the ACH's into a nationwide network. This implementation was completed on time and is now operating quite well. NACHA and the local ACH associations deserve special recognition for their persistence in preparing for and implementing this program, which is having a noticeable and positive impact on commercial ACH volume. With the interregional network operational, commercial volume in the fourth quarter of 1978 was up 150% over the previous fourth quarter. Treasury Department direct deposit volume also was up in the fourth quarter by 50% over the comparable period in 1977. It appears that total ACH volume may exceed 200 million payments by year-end 1979, a considerable accomplishment in the short span of time the ACH has been operational.

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In terms of generating future volume, NACHA's action to adopt rules and formats for customer initiated entries, will generate additional applications such as telephone bill payments and automated teller machine transactions. Check truncation is also suitable for ACH conversion and could very well be another application which will increase volume substantially.

Last year at this conference it was suggested that delivery of ACH transfers must shift from check couriers to electronic delivery. During 1978 the Federal Reserve System anticipated this shift by upgrading our communications network to handle an increased volume. All Federal Reserve Head Offices are now linked together through 50 kilo bit lines, which means that the Federal Reserve System can transmit up to a million ACH items per hour among the 12 Districts. The year also saw an increase in the number of data links between Reserve offices and member bank offices. There are now 13 such links, and the number is expected to grow substantially in 1979. Admittedly, this communication linkage does not represent the ultimate, but it certainly is aimed in the right direction as we will be headed for trouble if we continue to rely upon surface transportation. You should be scrutinizing your delivery system to modernize it and prepare for the enlarged volumes ahead.

But these increased volumes and new applications are not likely to just happen by themselves. As I said last year there is an urgent need for intensified and broader marketing. I am confident that most, if not all, of the participants of this conference believe that the ACH

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will become the prime center of activity in an electronic payment mechanism. In order to achieve that promise, it seems to me that top level, aggressive, attention should be given to marketing the ACH product. In my view such emphasis on marketing has been lacking and I see little evidence of vigorous promotion today.

The success of the Social Security Direct Deposit Program, where the participation rate among beneficiaries is close to 50% in many states, demonstrates that consumer education and aggressive marketing will develop volume. Our research shows a demand for ACH services but that demand will be translated into volume only if financial institutions commit full-time resources to marketing.

Over 10,000 financial institutions are now participating in the ACH and every region in the country has an ACH that is linked into a nationwide network. The ACH movement is now over five years old and the gestation period is over. In my view, it is time to stress the marketing aspects of the ACH.

Does this mean that the operating people will no longer have a role in the growth of the ACH? Of course not! There is still plenty of important work for the operating people to do. A successful foundation has been laid for the processing of recurring payments through the ACH. Much work has been done to construct a foundation for customer initiated entries but work is just beginning on check truncation which may very well have a dramatic impact on future ACH volume.

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At the Federal Reserve one of our objectives is to reduce the use of paper in clearing payments, but some consumers, businesses, and governments will continue to write checks. In order to process these payments effectively and at a reasonable cost, paper checks should be converted to electronic items as they enter the clearing system. In other words, the check itself may be an important input vehicle to the ACH.

To make truncation viable, procedures for converting checks to ACH items involve more than preparation for electronic clearing. What is done with the check? Who does it? What is the nature of priorities for access to checks or MICR-images? Preliminary work is now under way to identify various types of checks that need not be returned and how to convert them quickly and easily into electronics. Using pilot evaluation projects, we expect to gain operational knowledge and uncover unanticipated obstacles. This experience we would expect to share with NACHA, regional ACH associations, and the banking industry with the hope that additional pilots could be developed as needed.

To illustrate the type of applications being considered, let me describe the concept of using the ACH to electronically settle large dollar-value checks. A definitive cutoff would be established--of, say, $10,000--with the idea that the data on machine-readable magnetic ink would be captured by an ACH originating bank and sent through the ACH for settlement. The checks would be temporarily held to allow for timely return of unpaid items and then disposed of, shipped or stored according to their character and subsequent need.

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Many factors should motivate the banking industry to work on such projects; earlier availability; non-return or limited return of checks to customers; avoidance of the delays and costs involved in physical movement and handling of checks, and the prospects for sharp reductions in float.

Many of these improvements and other schedule enhancements depend critically upon generating volume for the ACH. A successful marketing program is a condition precedent to the growth of ACH's and to further increases in Federal Reserve capabilities. Unless a real marketing effort is launched resulting in steadily rising volume of ACH payments, enthusiasm will wane and so will the support for the whole concept. I urge you to put your best marketing men in the field, innovate new applications, and support the expansion of ACH into the truncation of checks.

Let me now turn to pricing of ACH services. In November of last year the Board released for comment a preliminary schedule of prices for ACH clearing and settlement services. The preliminary prices were set at 1.4 cents for local items and 2.0 cents for interdistrict items. These prices were based upon estimates of the unit processing cost associated with projected future volume. The prices were set well below current costs but above estimated long-run cost because of the inherent uncertainties in estimating cost at mature volumes, and to recover research and development expenditures. There was no price differentiation on a district basis because Federal Reserve ACH costs are primarily equipment and wire use which do not vary significantly from district-to-district.

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We believe that basing prices on near-term, but not present-day, volumes has advantages. First, these prices will encourage banks, businesses and consumers to reduce costs by converting to this new, more efficient and more secure electronic payments medium. And second, our analysis shows that sufficient economies of scale exist at an annual volume of about 1.5 billion items (about 10 times present volume but only 10 percent of check volume) to drop Federal Reserve ACH costs below our current check costs. Given a vigorous marketing effort, a 1.5 billion item annual rate is not a remote objective.

As stated at the time of release of the tentative pricing schedule, we expected to implement it if the burden of membership were alleviated. Unfortunately the membership legislation seems stalled for the moment and new ideas must be generated to move ahead. For pricing, this legislative hiatus means further time for consideration and a real question about implementation.

The solution to this impasse may very well be in your hands. If a full marketing program can generate the volume needed to support enhancements in operating schedules and new electronic delivery systems, the Federal Reserve can divert funds from check processing to ACH programs. Whether a specific price is to be levied, returns again to the membership burden, and perhaps to our ability to reduce check float.

A few comments are in order on the regulation drafting responsibility Congress, in the Electronic Fund Transfer Act of 1978, imposed on the Federal Reserve Board. Regulation E is the result. Two provisions of the Act, Sections 909 and 911, dealing with the issuance

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of debt cards and liability for unauthorized use, went into effect on February 8, 1979; the remainder of the Act becomes effective in May 1980. The Board issued Regulation E last week implementing the two provisions. A complete regulation covering ACH transfers and also implementing the remainder of the Act should be ready for initial consideration by the Board in a few months.

Congress established an earlier effective date for the two sections apparently because it felt that precautions in the issuance of cards needed legal sanctions and that consumers' maximum liability for unauthorized use should be fixed. Currently, there are no limits on issuance of EFT cards and consumers' liability for unauthorized use is determined by private contract. The Act specifically recognizes, however, that consumer liability may be less than the Federal standard either by contract or State law. You should be aware that Section 909 substantially increases the consumer's exposure to liability for unauthorized transfers of funds--well in excess of his liability for such unauthorized transfers involving use of the check and the credit card. I should also caution you in reading these two sections that the definitions, exemptions, and disclosures contained in the release relate only to Sections 909 and 911. Definitions, exemptions, and disclosures that relate to other provisions in the Act will be considered in the context of the entire regulation.

The remainder of the regulation, when implemented, will impose significant new responsibilities on financial institutions. They will be required to prepare and print detailed disclosure of terms, conditions and fees involved in their provision of EFT services; to establish error

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resolution and stop payment procedures; to program their computers to generate periodic statements; and, of course, in effect to educate their customers and their own personnel. Our experience with other laws suggests that the quality of compliance is enhanced and the cost of compliance reduced by providing a lead time of several months between the issuance of regulations in final form and their effective date. This group could assist us in this regard by providing us with your views on the impact of Regulation E on ACH operations.

The Board's tentative schedule for implementing the remainder of the regulations is as follows: by April 1, publish a draft regulation for a 60-day comment period, ending May 31. Sixty days have been allowed for analyzing the comments and redrafting the regulation and it is expected the revised regulations will be published for another 60-day comment period running to September 30. Analysis of these comments and redrafting will be completed by November 30 and the final regulation will be published about December 1.

In conclusion it is my hope that a year from now we can look back upon an aggressive marketing program resulting in expanding volumes, new applications and growing public acceptance, an improved delivery system, and a harmonious partnership of banks, customers, and the Federal Reserve with clearly-defined legal and operating responsibilities.

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