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CONSUMERS AND INNOVATION IN MONEY

Remarks

of

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The saying that the ". . . world will beat a path to the door of the man who builds a better mousetrap. . ." is a part of our folklore of superficial observations. Apocryphal at best, the implication of this old saw is that innovation is self-selling and that innovation and acceptance of change by consumers proceed pari passu. Today's innovators know better. The record of innovation in our time, and there has been much, is a catalogue of hardships and disappointments. It portrays the difficulties of reaching potential customers, of displacing established products or services, of coping with vested interests that have been built up around the "old ways" and of achieving a profitable scale of operation. Without skillful promotion and costly selling programs, few innovations escape the laboratory and many that do have incredibly long periods of infancy.

We are concerned today with innovation in the spending, receiving and storing of money. Looking at the unchanging nature of money itself--whether the sovereign's coin and currency or the banker's checks and drafts--we should not be surprised that adaptations of electronic technology to its use have been so slow in coming. For example, the public has been exposed to no real change in coinage for a century or more other than a shift from precious metals to metallic compounds, a non-technological evolution growing out of economic necessity. Similarly, present-day currency is like that of 1862 except for a change in bill size, the discontinuance of very large denominations, and the periodic death or resurrection of the two-dollar bill. No significant

denominational change in currency or coin has occurred as the dollar's value has eroded over the past century. No differentiation in paper currency color or size by denomination has been made to help transactors avoid errors.

Bankers' money is even more innovation resistant. The check celebrated its bicentennial-plus this year too. It is still a two-sided instrument of varied size, difficult to store, often cluttered with house advertising and undecipherable bank endorsements. It is of a design totally unrelated to present-day transaction technology. The grafting of the MICR onto the check is the only development which has saved it from extinction. Today, it is a basically obsolete instrument that could not survive outside of a sheltered environment.

Thus, innovation in our time of the money which people perceive and use in their daily transactions has been virtually nonexistent. But innovation in the infrastructure of money handling by banks is an entirely different matter. Though the check maintains its "untouchable" status as evidence of customer action, record-keeping for bank money--customer credits, debits and balances--has been almost entirely converted to electronic technology. The check is not quite vestigial yet but there is talk about truncating its movement which would be a significant step in that direction.

There are several reasons why money and money use is innovation resistant. Some have anthropological roots going back to primitive moneys which were treasure often with mystical properties. Today's money, except for pennies, has little or no intrinsic value; most of

our money is in the form of deposits which cannot be seen or fondled. But the manifestations of human behavior evoked by money as treasure, such as secretiveness and miserliness, are still with us. As time goes on, the idea that money is treasure or has intrinsic value will die out and will be replaced by the concept of money as a flow of purchasing power used to buy goods and services and to acquire earning assets, the real treasure of our time.

Since innovators are too impatient to even try to adjust to the pace of anthropology, I must turn your attention to something you can do, and some of you are doing, to accelerate the acceptance of your products by inducing consumers as money users to displace checks with electronic transfers.

Our check system today handles roughly 100 million payments every business day among 100 million deposit accounts. The system is not nearly as cost- or convenience-effective as a modern electronic transfer system. Because cost-effectiveness of electronic transfer requires transactions in volume, the conversion from checks must be relatively rapid. To accomplish this, successor electronic systems must be designed to handle the most pervasive and repetitive types of present-day transactions.

These are predominantly of two types, one, payments flowing from businesses and governments to consumers and the other a reverse flow of payments from consumers to businesses. Businesses and governments as payors make periodic income payments for salaries, wages,

commissions, interest, dividends, annuities, social security, welfare, retirement and the like. Nearly all of these transactions are initiated in volume from a very small percentage of the total number of demand deposit accounts, probably no more than 3-5 per cent. They are destined for consumer accounts in banks, savings and loan associations, mutual savings banks and credit unions.

The payments by consumers for the purchase of goods and services involve transfers with very different characteristics. They are originated one at a time from literally millions of vendors' shops, they involve debits (charges) to the great preponderance of demand deposit accounts at commercial banks--95 to 97 per cent--and they move funds to a comparatively small number of accounts.

EFT technology has been directed at serving these two major payment flows. In the vernacular of electronic transfer, ACH (the automated clearing house) is the essential feature of the system for handling payments initiated in large volumes, and POS (point of sale terminal) is the essential feature of the system for handling payments for individual purchases of goods and services.

The ACH is analogous to a traditional banking clearing house in that it represents a system for the interbank clearing of debits or credits. The main difference between automated and conventional clearing houses is that the debit and credit items in an ACH exist in electronic form instead of paper. The fact that some items may be converted to paper form in order to effect delivery is a purely transitory

feature in the evolution from paper to electronics. ACH's are especially suited for handling large volumes of payments which can be scheduled in advance, namely: income credits for payrolls, social security or dividends or debits for insurance premiums, public utility bills, mortgage payments and the like.

POS systems initiate transfers at check-out counters usually in conjunction with electronic cash registers. They may be on-line terminals or they may accumulate transactions on tape for subsequent wire or courier delivery to the merchant's bank. They can be used for immediate or for a scheduled deferred payment.

Because of their convenience and cost-effectiveness compared to cash or checks, these two electronic systems have a potential for significant change in the manner of providing deposit and withdrawal for certain money services. As their acceptance grows, major economies in the operation of conventional facilities now used by commercial banks and others to supply such services should be forthcoming.

Since money, of necessity, must be universally acceptable to perform its function, the money services of all banks and other depository institutions are, to a degree, interlocked. Currency as money is accepted everywhere. Checks as money are acceptable regardless of the institution on which drawn if the drawer of the check is judged responsible. Electronic transfers must enjoy a similar universal acceptance. We cannot expect the public to differentiate the money of First National Bank from that of the First State Bank or First Federal. Exclusivity of this kind is incompatible with the concept of money.

Universal acceptance of money is the reason for government involvement and regulation of the financial institutions offering money service. The public is not prepared to entrust its money to entrepreneurial incentives of a single financial institution or consortia of such institutions. Nor, so far as I am aware, are there any institutions or consortia who seek such a responsibility.

The technique for achieving a more cost- and convenience-effective money system lies in clearly recognizing and differentiating the public role in money service from that of the entrepreneur. One useful role entrepreneurship might play is to give users of money, through pricing, the ability to choose the form of payment they employ. But this is not easily done. Since by its nature payment involves several parties--the payor, the payee, their respective banks, and a clearing facility--costs are dispersed and many are not identified. It is not even clear who pays for the cost of payment--the payor or the payee. In general, under the existing check system the party originating the transaction appears to pay directly or indirectly; i.e., credit transfers are on the payor, debit transfers on the payee. The government program offering electronic crediting of social security, retirement and salaries is revealing some interesting facts about payment services and costs including substantial advantages for EFT.

Another role for entrepreneurship is implied in the emergence of consumerism and growing government concern for consumer interests in financial practices. While the issue is controversial, government

action in this area would not have been taken had entrepreneurial competition provided the range of service alternatives that consumers could obtain by political action. Granted that consumerism can be carried too far, particularly when it becomes so encumbered with regulatory procedures and administrative cost as to abort its purpose, the status it enjoys today is a response to real issues and abuses.

The extent to which legislation and regulation will be adopted to protect the interests of consumers in EFT transactions will depend on the skill with which technology and entrepreneurial resources are used. If they enrich consumer money service, the need for public involvement or regulation will be limited. If consumer interests are given short shrift, greater public involvement seems to me inevitable.

There are several examples of consumer concern. Proof of payment is one. Diminished control over bank balances which might result from uncertainty as to the timing of preauthorized deposits or withdrawals is another. Some consumers want to retain existing stop-payment privileges and most are concerned about acceleration in the timing of charges to their accounts involving a loss of float. Others wonder if errors in their accounts might turn out to be costly to them. If cancelled checks are phased out most consumers will want the transaction record on their bank statement to be of comparable value in disclosing payees and establishing proof of payment.

Uncertainty regarding these considerations will act as a constraint on the many potential advantages that EFT offers consumers unless attention is given to dealing with them.

Let me be more specific. Consider consumer interest in the timing of debits to bank accounts for local purchases. Under present-day practices checks written on local banks on any given day are usually charged to consumer accounts on the next business day and certainly not later than the day after unless the merchant is indifferent as to his funds availability. A POS terminal has the capacity to make immediate payment or to defer payment for one or two days or longer at the option of the merchant. In fact, some deferral makes it possible to avoid the cost of an on-line system and accumulate transactions on tape for day-end delivery to the merchant's bank. Deferral also makes it possible to conform to present-day timing, i.e., next-business-day funds transfer for local transactions, and thus gives the consumer the same leeway in stopping payment.

Customers accustomed to a check as a receipt can use an equally valid receipt printed by the POS terminal. Thus, elimination of a hard copy sales receipt, while possible under EFT, would not meet the needs of most consumers relying upon proof of payments such as a voucher or receipt at the point of sale. I doubt any system of payment which does not generate a hard copy consumer record can survive the volume of disputed transactions that the absence of such a record would generate.

Consumers will not forego cancelled checks with their bank statements unless such statements are descriptive and include the names of payees as well as the dates and amounts of the transactions. They will want preauthorized payees to be identified. A timely bank statement with an accurate identification or description of transactions is essential to dealing with the burden of proof in resolving errors. In addition to a tangible record in cases of disputed billing, personnel error, and system malfunction, descriptive statements are of value to consumers in personal financial management and for tax purposes. All of the foregoing suggests bank statements meeting standards similar to those imposed on two- and three-party credit cards. These needs may make EFT services somewhat more expensive but they seem essential if EFT is to be acceptable for broad consumer use.

Billing and statement uncertainties or errors will arise and take other forms under EFT. Because any system generates errors and, of necessity, a system for dealing with them, a procedure for detecting and correcting EFT errors is needed to enable consumers to raise questions and get prompt and accurate responses and adjustments where appropriate. A pattern for such consumer protection exists under the Fair Credit Billing Act which allows consumers to challenge the accuracy of their credit bills.

Another aspect of consumer concern has become manifest in direct deposit of salary, social security and other types of income payments. Recipients have been uncertain that scheduled deposits have been

credited to their accounts on a given date. Mail notices of receipt detract from the efficiency of the system and probably should be replaced by warranties of receipt unless a notice of non-receipt is given the customer.

To conclude, there is no doubt in my mind that, inherently, EFT is more convenient, more secure, more private and less costly than currency or checks. But in order to attract customers it must not only have these characteristics, it must be perceived as having them.

To work, EFT needs the rapid build up in volume which goes with widespread public acceptance; it cannot be cost-effective without consumer acceptance. The best approach to the development of EFT, therefore, is to focus on features which offer the greatest promise for meeting the needs of consumers. Those consumer rights and protections which have been established for other types of financial transactions are a guide to the consumer interests to be safeguarded in electronic funds transfers. They must be served one way or another through technology, entrepreneurship or regulation.