

Tennessee Automated Clearing House Association

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Good morning. First, let me say that I appreciate the opportunity to be here this morning and to meet with you. Obviously, I spend a lot of my time talking about subjects like economic conditions, monetary policy, and banking regulations. But today my purpose is to address some more fundamental operating issues that are no less important to the smooth functioning of our economy. I am frequently reminded by Mel Purcell and some of our other managers that one of the primary missions of the Federal Reserve is to provide efficient and effective banking services. In fact, about 40% of all employees in the Federal Reserve System work in operations that are responsible for payments services, and hundreds more work in related support and overhead areas.

The payments system is truly a big business that undergirds our economy and culminates in the variety of customer accounts that each of you services. I also know that your institutions, like mine, are constantly grappling with the financial impacts of new technology to deal with our payments processing business, whether it be ACH, Fedwire, ATMs, point of sale, or cash management systems.

For years, the Federal Reserve has focused extensive efforts on improving the efficiency of our check processing areas, and I think it's fair to say that we have become very good at it. In addition, it is undeniable that in check processing, as in most businesses, computer technology and electronics offer dramatic opportunities for improvement in efficiency. For example, we are looking at check truncation and image capture as the technologies of the future. Nevertheless, we believe that in the long run check processing will decline in importance relative to other aspects of the payments system. In fact, it looks as though a real watershed will be reached in 1991 when Federal Reserve processed check volumes will decline for the first time in my career--26 years--at the Fed. This will happen not because of competition but because other payments technologies are becoming more popular.

For this reason, we are focusing greater attention on a technology we have long viewed as the "rising star" of the payments system--the ACH. We think that its time has finally come and that many of the factors that at first discouraged customer acceptance, such as cost, loss of float, and questions about reliability have been addressed. In some cases they have been virtually eliminated. Let me give you some examples:

- In the last 3 years, the average price of an ACH item to our customers has been reduced nearly 20%.

- During the same time period, reliability of the computer systems used for ACH processing has increased from 99.06% to 99.75%, and the percentage of successful exchanges of ACH files has increased from 98.60 to 99.31.
- Finally, almost all of our interviews with corporate and bank cash managers have revealed that the use of ACH for payments automation is one of their top priorities.

I think that these facts are harbingers of things to come. In turn, they demand action on the part of the Reserve Banks to facilitate and encourage change. I'd like to take a few minutes to share with you some of the efforts that are underway to move the ACH system forward.

First, the Federal Reserve made a decision last year to invest over 15 million dollars in a research and development effort aimed at investigating new technologies for the future processing of electronic payments. A challenging set of business requirements was developed, including objectives such as 100% availability of our EFT processing systems, 24 hour operations, 15 second response time, and the ability to recover from a site disaster, such as fire or flood, in 15 minutes at a remote location. About half our investment was committed to the development and testing of fault-tolerant minicomputer technology,

using the ACH system as a prototype. The hardware and software for this system are being provided on a turnkey contract basis by the IBM Corporation. The other half of our investment has been committed to determining if our current mainframe systems can be upgraded to meet the same rigorous business requirements. The early returns from both of these approaches have already shown that the business requirements I mentioned can, in fact, be met. Therefore this fall, when choosing between the fault tolerant minicomputer and mainframe enhancement alternatives, we can be confident of ending up with a better system than we have today.

One of the most difficult objectives we have set for ourselves as new technologies are implemented is to reduce the cost of ACH services. There is one thing that I know for certain--the banking industry demands a low-cost, high-volume electronic payment service as a replacement for checks. If we cannot provide this, we will be saddled with the inefficiencies of a paper-based payments system much longer than we would like to be. In fact, our commitment to reducing costs in ACH is so strong that by mid-year we will overcome our normally decentralized--some would call them "colonial"--tendencies by reducing the number of Federal Reserve ACH processing locations from over 30 to just 13. Additionally, we are designing a new communications network for the 1990's that promises to reduce costs further while providing our customers with easier access to Fed services.

At the heart of our strategy for the future of ACH is another very important objective--the creation of an all-electronic ACH environment. For years, the ACH has been well served by the Fed's ability to deliver ACH entries to a large number of smaller financial institutions through the use of courier services or the mail. This practice allowed corporations to originate payments to all their customers or employees wherever they were located. However, it also caused the processing schedule to be extended by several hours. Over time, this flexibility has become a liability. In an effort to improve those schedules and provide banks with the chance to post their customer accounts on a timely basis, we are committed to providing a low-cost, on-line delivery alternative for every institution. In fact, we have developed options to meet the needs of each principal customer segment.

Fundamental to the growth of any service is the participants' trust in its quality. Therefore, we are devoting a good deal of time to assuring that the quality of our ACH service continues to improve. Now, I know a little about this from first hand experience. In 1973, the Federal Reserve Bank of Atlanta became the first company in Georgia to use the ACH for direct deposit, and you will never guess whose payroll didn't get deposited--that's right, the Bank's General Counsel at that time, Robert Forrestal. The good news is that it hasn't happened since then. Thus, my experience makes clear to me the importance of

customers being paid on time, cash managers receiving timely funds availability, and corporate trade payments being made in accordance with trade terms. To that end, we have developed formal ACH performance standards that all Reserve Banks will be expected to meet.

My point in relating all this information is to emphasize the Fed's belief that ACH is going to be at the core of our future payments system. There are those who have treated ACH as a stepchild for a number of years because ACH growth has not approached the overly optimistic levels forecast by its founders in the early to mid-1970's. But, it is a business growing at 25% per year, a rate that most corporate executives would envy. Last year, we processed over one billion ACH entries for the first time--still a small number by check-clearing standards, but an important milestone, nonetheless. Our commitments of staff and resources and the long-term investments we are making are clear indicators of the strong belief that the Federal Reserve has in the importance and potential of the ACH. For you, our commitment to ACH may point to a great opportunity. Many institutions are of the opinion that the ability to offer a wide range of progressive EFT services may become a key competitive factor in the provision of wholesale banking services.

In closing, I feel a line from Shakespeare summarizes the point at which we stand in the development of the ACH: "There is a tide in the

affairs of men, which, taken at the flood, leads on to fortune." As providers and as users we need to maintain the momentum behind this exciting technology and make the ACH an integral part of the payments system of the future.