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MICR IN THE "CHECKLESS" SOCIETY

September 1 was a milestone in the annals of our check collection system--one that marks the end of an era of low-speed operations and the beginning of another era that should make life simpler and less expensive for all of us (the commercial banks as well as the Fed). On September 1, the Federal Reserve System, as advertised, implemented its previously-announced policy of no longer processing as cash items those checks without the ABA routing-transit symbols printed in magnetic ink.

To permit the Fed and the commercial banks to take full advantage of high-speed computer facilities, checks not properly encoded will be returned to the sending bank, or will be processed as noncash collection items, thereby delaying presentation and payment. This means, in effect, that banks sending to the Fed items not bearing the MICR routing and transit symbol will lose interest on their money as a result of an increase in their float.

Up to September 1, the main office of the Federal Reserve Bank of Cleveland was supplying ABA encoding on approximately 6,000 checks each day, and our two branches combined were encoding approximately the same number. These items are now being returned to the sending banks or are being charged back and processed as noncash collection items.

The Federal Reserve banks will not handle noncomplying checks unless, in their judgment, special circumstances justify such handling. Full compliance with the September 1 announcement is expected; but the Federal Reserve Bank of Cleveland and its branches will police the new ABA encoding program with discretion and will not bludgeon the banks into 100% compliance--at least in the early part of the program.

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As you all know, the September 1 cut-off for unencoded items was announced well over a year ago, and a great deal of promotional work and some "moral suasion" has been used to reduce to manageable proportions the number of checks not bearing the MICR routing-transit symbol. Figures obtained from three Federal Reserve surveys show that this program has been highly successful, and that the problem was largely licked by September 1. In January of this year, about 3% of the checks cleared through the Federal Reserve's national collection system did not bear the ABA encoding; by April the figure had dropped to a little over 2% and by June to just over 1.5%.

Progress at our main office and our two branches has been somewhat uneven, although the results are encouraging in all areas. The June survey revealed that at the main office in Cleveland just under 1% of the checks received for processing did not bear the MICR symbol, and a special one-day survey made late last month indicated that the figure had dropped further to only one-half of 1%. The June figures are the latest available for the branches: they are 1.67% for Cincinnati (the clearing center for "foreign" items from eastern Kentucky) and 2.03% for Pittsburgh. In June, the figure for the Louisville Branch of the Federal Reserve Bank of St. Louis (the clearing center for checks from western Kentucky) was 2.72%. In all cases, good progress had been made since the beginning of the year.

In our three offices and at the Louisville branch, checks drawn on corporate accounts were the overwhelming offenders, followed by personal checks. Counter checks were significant only in Cincinnati and Louisville, and were much less important in this area than in other sections, such as the deep south and the southwest.

Obviously, further missionary work needs to be done with corporations and individuals, and we must also continue to work to get counter checks off the counters. Even a very small proportion of unencoded checks presented for processing can put a crimp in the whole program in view of the large number of checks that must be handled every day through the transit system of the Federal Reserve.

Some idea of the educational and promotional job undertaken up to this point may be of interest to you as observed from our vantage point at the main office of the Federal Reserve Bank of Cleveland. Since the beginning of the year our office alone has written more than 2,000 letters; in those letters, we enclosed more than 6,000 copies of noncomplying checks to drawee banks, requesting them to seek compliance from the makers of the checks. In addition, upon special request of our member banks, we have written numerous letters soliciting the cooperation of large corporations that were issuing checks not bearing the necessary ABA encoding. We were highly gratified to receive in almost every instance favorable replies to these requests.

The Federal Reserve System has always tried to improve the means of payment--partly because an economical and efficient payments mechanism promotes commerce and industry. In addition, of course, we must work hard to keep up with the increasing flow of paper checks that would otherwise engulf us if we did not utilize the most efficient techniques available. Manual processing of checks, as a prime example, is extremely expensive and inefficient. When a check not bearing the ABA encoding in magnetic ink is presented to the Federal Reserve Bank of Cleveland, it requires three additional manual operations, and raises the processing cost by approximately five times that of a fully qualified check. The aggregate dollar cost of unqualified items is not negligible, when you realize that the Cleveland bank and its two branches handle an average of about 1,500,000 checks a day, and that the cost of handling fully qualified country checks is between $5 and $6 per thousand, excluding postage and expressage. Now I'll let you in on a little secret. The Federal Reserve Bank of Cleveland and its branches are among the lowest cost transit operators in the Federal Reserve System, figured on a unit-cost basis. We're proud of our record and we intend to keep it. And the only way that we can maintain our position is by eliminating the nonencoded items.

There are a number of ways in which your bank can cooperate to reduce costs, not only for the Fed, but for your correspondents, and for yourselves as well, if you are fortunate enough to have a fully automated transit operation, or are anticipating using off-premises services. Let me give you a few illustrations:

(1) Police checks prior to mailing statements to see that they contain the ABA routing symbol (as indicated earlier, 99.5% of our receipts now have the ABA routing symbol, and 95% have the amount encoded).

(2) Inform customers of problems resulting from checks drawn on multiple-payor banks, or from scratched-over checks.

(3) Discourage customers from giving their blank checks to others.

(4) Work closely with suppliers and printers of checks. The cost of MICR encoding is no greater than that of preprinting a customer's name, address, and account number. In fact, MICR is now so widespread that many printers charge more when it is omitted because it deviates from the normal pattern.

(5) Corporate, political, and fraternal organizations should be contacted, since many of them order their checks directly from printers not qualified to do MICR encoding. (If you prefer, we will contact your customers for you.)

(6) Put your own house in order. Make certain your own bank drafts, such as cashiers' checks, money orders, and Christmas Club accounts, are preprinted.

(7) Discontinue supplying universal checks to local merchants and remove all counter checks from lobbies.

(8) Purchase or lease a small full-field encoder so that you can prepare a small supply of checks properly encoded for customers opening new accounts. The cost of this device is less than $250. Do not give new customers blank counter checks.

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(9) Utilize a unit encoder to prequalify all checks before dispatch to a correspondent or to the Fed. This will assure faster collection of these items and reduce float. The cost of such a machine is approximately $100 per month, if rented, or it can be purchased for under $4,000. Such a machine is a "must" if you are thinking about automating your bookkeeping operations. Incidentally, I believe that the time has now come when, for most banks, fully automated bookkeeping is less costly than the old-fashioned hand operations. When this is recognized generally, all checks will not only bear the routing symbol, but the amount and the account number as well.

Some of you by now must be wondering why the banking system--the Fed, the ABA, and commercial banks generally--is spending so much time automating the check clearing system, when as we have been told repeatedly, the "checkless" society is just around the corner. If checks are soon to be replaced by blips on rolls of computer tape, why try to automate the old paper check?

The answer is that while the equipment and techniques are already available for the checkless society, the need is not yet apparent to the users of checks. The banks have sold the public on the desirability of checking accounts, and the public will not easily be unsold on an idea that has been found to be so agreeable.

Since World War II the volume of checks written in the United States has been growing at an annual rate of about 6%. If the checkless society is just around the corner (and to some enthusiasts the corner has already been turned) we should expect by now to see some evidence of decrease in the annual growth rate of checks written, say to 3%, and then to 1%, before the check becomes obsolete. Yet the ABA, normally conservative in these matters, estimates that 19 billion checks will be written in the United States in 1967, up 6% from last year, and that by 1970 the number of checks written will be 23 billion, again an increase of just about 6% each year. [1]

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[1] These figures are obtained by applying a constant blowup factor to the number of checks cleared through the Federal Reserve System. Since the total dollar volume of bank debits has been rising at a faster rate than the volume cleared through the Federal Reserve, the presumption is that the above figures underestimate the growth rate in the total number of checks. To put the matter differently, the volume of checks cleared through local and regional clearing houses appears to be growing at a faster rate than interregional settlements. This matter is being investigated by the Research Department of the Federal Reserve Bank of Cleveland.

Whenever there is such a sharp conflict between theory and practice, as in this case, the theory is at fault. The present system of paper checks will not give way easily to a checkless society in which individual checking accounts are automatically debited and credited through a wire transfer system. The reason is that the public likes to have an up-to-date record of its account balances, which the checking account gives, and likes to have control over the use of that balance, to adjust payments to convenient future dates. The experience of the Bank of Delaware at Wilmington, working with some 200 depositors and Storm's Shoe Store (three outlets) with a prototype "electronic credit card" is illustrative of the difficulties. When a man buys a pair of shoes at Storm's, his card and that of the store are inserted in a touchtone phone, and the salesman dials the bank and punches out the details of the sale. Walter Trabbold, Comptroller of the Bank of Delaware, is quoted by Forbes Magazine as follows: "The money was to be transferred immediately from the customer's account in the bank to the store's account, but we had problems. Many customers didn't want the money to leave their account that fast. They were accustomed to at least a month's delay in paying their bills. So we worked out a system whereby the computer would record the sale but wouldn't debit the customer's account until several weeks later."

And in general, owners of checking accounts show little enthusiasm for automatic billing, automatic handling of regular payments, and automatic loan payments. A survey conducted recently by Opinion Research Corporation for the Foundation for Commercial Banks indicates that 19% of the respondents would be likely to authorize their banks to make automatic bill payments, 11% would authorize the bank to handle regularly recurring payments, and 11% would authorize automatic deductions of loan payments. Evidently, the other 80 to 90% would not be likely to use these services if available or at least so the replies to the questions would imply. I conclude that the public will not be ready for the full-blown, completely automated checkless society in the foreseeable future. We may, and probably will, evolve gradually into a society in which less checks will be used than would otherwise have been the case if we had not had such things as electronic wire transfers of account balances. Instead of a "checkless" society we will have a "less check" society.[2] Payments will still be made with cash and with checks, but they will be made through electronic wire transfers as well. Just as the radio did not go out of style with television, or the automobile with the helicopter, so the paper check will not

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[2] In effect, most bank and nonbank credit cards (multi-purpose and narrow purpose, such as those used at restaurants, gas stations, etc.) activate charge accounts, and when used, reduce the use of cash and defer payment, usually by check, to a later date. In theory, such cards could reduce the number of check payments, but in practice they usually have not. In the case of bank credit cards that provide for one lump-sum debit to the cardholder's checking account, the impact on the use of checks is not clear. In many instances, the owner of a bank credit card will have charge accounts at leading stores, which he may prefer to use, or may have to use if the bank card is not accepted at all establishments. In any event, the volume of items (checks and/or invoices) to be handled in the collection process can be expected to increase. Moreover, public acceptance of those bank cards that provide for instantaneous payment by debiting the cardholder's checking account at the time of purchase has not been enthusiastic to date. Experience thus far suggests that the public dislikes instantaneous debiting, and prefers to use charge accounts at retail establishments when they are available, because of the automatic deferral of payment by the stores. Conceivably, such cards could reduce the use of checks but in practice probably will not, unless some way is found to provide discounts for instantaneous debits or for the deferral of payment to a future date.

be eliminated by the computer. We must improve the present checking system in every way possible, automating it so as to be ready for the huge flow of checks in the future. To put the matter as succinctly as possible, I quote Governor Mitchell of the Federal Reserve Board: "The mess has just been getting too big to handle."

Of course, "improvement" represents a break with the past, a learning of something new, and the learning process is never easy. In the case of the September 1 deadline, not only must we learn a new process, but the change marks a clear break with traditional folkways of finance. In addition, a compulsory program of this type will seem to some to bring us one step further down the road of dehumanizing the individual as he relates to society. Once in awhile, quite refreshingly, the individual is not content to be reduced to a cipher, and he stands up and speaks his piece. My good friend, Edw. A. Wayne, President, Federal Reserve Bank of Richmond, recently told me about such an instance that occurred several weeks ago at his bank.

The individual in question wrote to President Wayne to explain that a check he had written while on a vacation trip had been returned with the notation, "Place of payment not definitely designated." He had used a counter check from his bank because he did not have his regular checks with him, and was indignant because the check showed plainly his home town below the name of his bank. This was, he explained, the first time in more than 40 years that a check of his had ever been returned. To add insult to injury, a $1 service charge had been levied and the merchant who had received the check had written him for a replacement check plus the $1.

Clearly, this was an error in judgment on the part of the Federal Reserve and the gentleman had just cause for complaint. He wrote Mr. Wayne as follows: "I think you will agree that the endless march of efficiency and use of numbers has just about wiped out what we oldsters used to know as 'service'.... I realize that come September 1 the lines on use of checks are to be still more rigidly drawn to accommodate mechanical banking. To my mind at age 69 this does not constitute service, but this is no time to fight City Hall, much less the Post Office Department with its zip code numbers system or the telephone company and its mechanized setup. But I do reserve the right not to like it......"

President Wayne, in a masterful rejoinder remarked as follows: "Just when the pressures seem overwhelming, along comes a ray of sunshine to make the day worthwhile......With you, I have pleasant recollections of the days when we were names and not numbers. Those were ancient days when the volume of checks flowing through here was small enough to permit handsorting..... A couple of weeks ago, when our high-speed machines went out on us, we were almost drowned in a sea of paper before we could get them going again. It is this unremitting increase in volume which is forcing us to the more rigid requirements which will become effective September 1.....I am almost glad we made the error, for at least it brought me a letter from a kindred soul who has not lost his sense of humor." I should add, to complete the story, that President Wayne enclosed a bank check for the out-of-pocket one dollar.

Thus a difficult situation was handled deftly, with understanding, and with a full realization of the value of human dignity. I might say that I wish I had written that letter.

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