



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

October 17, 1986

DALLAS, TEXAS 75222

Circular 86-87

TO: The Chief Executive Officer of all
depository institutions in the
Eleventh Federal Reserve District

SUBJECT

**Request for public comment on a proposal for recovery of automated
clearing house float**

DETAILS

The Board of Governors of the Federal Reserve System is requesting public comment on a proposal to recover the cost to the Federal Reserve of automated clearing house float using a float factor pricing methodology. The Board proposes to assess a float factor based on the dollar value of ACH debit transactions processed at night. This float factor would be equal to the ratio of the projected cost of net debit float to the projected value of ACH debit transactions processed at night.

The float factor would replace most of the current \$.06 per item surcharge applied to ACH debit items processed at night. Because the current night cycle surcharge recovers both float cost and higher operating expenses, the Board has proposed to adjust the surcharge to recover only the higher cost of nighttime operations. The proposal would establish a uniform night cycle surcharge estimated at \$.015 for both debit and credit ACH transactions.

ATTACHMENTS

The Board's press release and document requesting public comment are attached.

MORE INFORMATION

For further information, please contact Jonnie K. Miller, Manager, Electronic Payments Division at (214) 651-6290, or Larry C. Ripley, Assistant Vice President, at (214) 651-6118.

Sincerely yours,
William H. Wallace

For additional copies of any circular please contact the Public Affairs Department at (214) 651-6289. Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank (800) 442-7140 (intrastate) and (800) 527-9200 (interstate).

FEDERAL RESERVE press release



For immediate release

September 17, 1986

The Federal Reserve Board today issued for public comment a proposal to modify the method of recovering the cost of automated clearing house (ACH) float and to establish a night-cycle surcharge to compensate for the higher operating costs during this time. Comment is requested by November 21.

Federal Reserve float is generated if there are delays in the System's handling of debit and credit transactions. Debit float occurs when the System credits the originator of a debit transaction before the receiver is charged. Credit float results when the System receives funds from the originator of a credit transaction before the receiver's account is credited.

To recover ACH float, the Board proposes to assess a float factor based on the dollar value of ACH debit transactions processed at night because the majority of ACH float occurs during this time when large-dollar debit transactions, primarily intra-corporate cash consolidations, are processed. This float factor would be equal to the ratio of the projected cost of net debit float to the projected value of ACH debit transactions processed at night. The factor would then be applied to the value of all debit transactions deposited by an originating institution at night to determine the fee for float to be assessed to that institution.

Because the current night-cycle surcharge recovers float costs and higher operating expenses, the Board has proposed to adjust the surcharge to recover only the higher costs of nighttime operations. The proposal would establish a uniform night-cycle surcharge, estimated at \$.015, for both debit and credit ACH transactions.

The Board's notice is attached.

FEDERAL RESERVE SYSTEM

(Docket No. R-0579)

AUTOMATED CLEARING HOUSE FLOAT RECOVERY

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Proposed rule; request for comment.

SUMMARY: The Board of Governors of the Federal Reserve System ("Board") is requesting comments on a proposed method of recovering the cost of float generated by automated clearing house ("ACH") transactions processed during the night cycle and a corresponding reduction of the current per item surcharge assessed on night cycle ACH transactions.

Specifically, the Board proposes to establish each year a "float factor" equal to the ratio of the projected cost of float to the projected value of ACH debit transactions processed at night. This factor would then be applied to the value of all debit transactions deposited by an originating institution at night to determine the charge for float to be assessed to that institution. The float factor charges would be included in the institution's regular billing invoice.

Because this float factor would recover the costs of float, the night cycle surcharge, currently set to recover float and the higher costs of operating at night, could be reduced to cover only the higher operating costs. Accordingly, the Board proposes to set the nighttime surcharge to cover only these higher operating costs, currently estimated at \$.015 each for both debit and credit transactions.

DATE: Comments on the proposal should be submitted no later than November 21, 1986.

ADDRESS: Interested parties are invited to submit written data, views and other comments to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N. W., Washington, D. C. 20551, or to deliver such comments to the guard station in the Eccles Building Courtyard on 20th Street, N. W. (between Constitution Avenue and C Street, N. W.) Written comments should refer to Docket No. R-0579. Comments received may be inspected in Room B-1122 between 8:45 a.m. and 5:15 p.m. weekdays, except as provided in section 261.6(a) of the Board's Rules Regarding Availability of Information. (12 C.F.R. § 261.6(a)).

FOR FURTHER INFORMATION CONTACT: Earl G. Hamilton, Assistant Director, (202/452-3879), Florence M. Young, Advisor (202/452-3955), or Julius F. Oreska, Manager, (202/452-3878), Division of Federal Reserve Bank Operations; Elaine Boutilier, Senior Attorney, Legal Division (202/452-2418); or Telecommunications Device for the Deaf ("TDD") users, Earnestine Hill or Dorothea Thompson (202/452-3544), Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

SUPPLEMENTARY INFORMATION: The Monetary Control Act (12 U.S.C. 248a) requires the Federal Reserve to recover the costs of Federal Reserve float generated by priced services. Both debit and credit ACH transactions may generate float, which occurs when processing delays are experienced. When debit

transactions are processed, funds flow to the originator from the receiver of the transactions. Should a debit transaction be delayed in processing, debit float would be created because the originator's reserve or clearing account would be credited before the receiver's account would be charged. In the case of credit transactions, funds flow from the originator to the receiver. Should processing delays occur, credit float is generated because the originator is charged for the transactions before the receiver's account is credited. In 1985, the daily average ACH net debit float was \$24.5 million, resulting in total float cost of \$1.68 million.^{1/}

The majority of ACH float occurs during the night processing operations because most large-dollar debit transactions, primarily intra-corporate cash consolidations transactions, are processed at night. Float is rarely generated by the daytime operations because transactions held up by processing delays during the day can be processed at night without a delay in settlement. Also, there is generally less time between processing and settlement for transactions handled at night.

Currently, the cost of net debit float attributable to processing delays is recovered through a surcharge applied to all debit transactions processed at night, which recovers the

^{1/} Total ACH float cost is determined by multiplying the daily average net debit float by the Fed Funds rate.

cost of the majority of ACH processing float. However, this uniform surcharge creates inequities among users of the ACH service because an institution originating a small (e.g. \$100) debit transaction will pay the same 6¢ surcharge as an institution originating a large (e.g. \$10,000) debit transaction, yet the cost of float on the larger dollar transactions would be significantly higher. Thus, originators of small dollar transactions are subsidizing originators of large dollar transactions.

In addition to the cross-subsidies caused by the current night surcharge for debit transactions, it appears that the level of the fee has been a disincentive for using the ACH to clear some time-critical, small dollar payments, such as point-of-sale and automated teller machine transactions. To address these concerns, the Board considered two alternatives and also reevaluated the current surcharges that are assessed to recover the higher costs of nighttime operations.

Float Recovery -- Two alternatives for recovering ACH net debit float were identified and evaluated. Under the first alternative, originators of debit transactions would be charged the cost of float ("charge-back") that would be generated when transactions they originated are delayed. This method would be similar to the procedures the Federal Reserve Banks use to recover certain categories of check clearing float. Under the second alternative, a "float factor" would be developed. The factor would equal the ratio of the projected cost of net debit float to the projected value of ACH debit transactions

processed at night.^{2/} The factor would then be applied to the value of all debit transactions deposited by an originating institution at night. Based on the cost of ACH debit float and the value of debit transactions processed at night during 1985, the float factor would have been \$.0012 per thousand dollars of debit transactions originated. For an originator of a \$3 million debit transaction, the float charge would be \$3.60. The float charge would be in addition to the basic fee to process the transaction during the night cycle.

Both the float factor and the charge-back alternatives have significant advantages over the current surcharge. Each alternative reduces the inequity associated with the surcharge and removes a barrier to small-dollar payments processed at night. Also, each alternative would increase the cost of processing large-dollar payments on the ACH and would likely cause some of these payments to migrate to the large-dollar wire transfer networks, thereby reducing payment system risk.

The charge-back alternative is more equitable than the current surcharge, because the depository institutions whose customers benefit from the float, that is, the institutions originating the debit transactions, would be charged for the cost of the float. However, the charge-back alternative would be complex operationally, because float would have to be tracked at the individual payment level. The cost of

^{2/} It is expected that the float factor would be set once a year, like other ACH fees, and would be based on budget information supplied by the Reserve Banks.

developing a mechanism to track float at the individual payment level and the costs of additional staff would not make this method of float recovery cost effective. Therefore, the Board is not proposing adoption of this alternative.

The float factor has the advantage that it is both equitable and simple to implement. The float factor would be assessed on all night cycle transactions based on the value of each transaction.^{3/} Currently, the originating depository institution's Reserve office collects information on each ACH transaction, so no additional monitoring capability would be needed. The Reserve Banks estimate that the cost of modifying existing software to implement the float factor would be less than \$50,000 and would require no additional staff in the operations at the Reserve offices.

A disadvantage of the float factor alternative is that the factor is set to recover estimated float cost, and consequently, may underrecover or overrecover actual float cost. In this regard, however, the float factor is not unlike other fees for payments services.

Because the float factor alternative is equitable to depository institutions and does not have the operational complexity and high cost associated with the direct charge-back

^{3/} Although ACH debit float is primarily attributable to interregional transactions, the Board is proposing to assess the float factor to all nighttime debit transactions to maintain the low administrative costs and operational simplicity of this alternative.

alternative, the Board is proposing to adopt this method for ACH float recovery.

Nighttime Surcharges -- As part of the study of float recovery alternatives, the current nighttime processing surcharges were reviewed. The present surcharge for debit transactions is \$.06, which is intended to recover the cost of float and the higher operating costs of night processing. The night surcharge for one-day credit transactions is \$.03 and is set to cover the additional operating cost of nighttime operations. Currently, two-day credit transactions are not assessed the night surcharge, in order to encourage earlier delivery of payroll transactions. At the time these fees were implemented, it was believed that assessing a surcharge for two-day credit transactions would discourage use of the nighttime operations for these transactions. Given that the costs of processing two-day credit transactions is the same as for other transactions, and many institutions believe that the added delivery time is important, it is now believed that assessing a small surcharge for two-day credit transactions should not affect significantly the use of this option.

After reviewing nighttime processing costs, the Board proposes that the additional cost of processing ACH transactions at night should be recovered through a uniform surcharge applied to all debit and credit transactions processed at night. The reduction in the debit surcharge from \$.06 is based on the assumption that float cost would be

recovered through the float factor. In the case of credit transactions, the cost of processing one and two-day credits is the same. Therefore, it is proposed that a uniform night surcharge be applied to both types of credit transactions. Based on current information, it is estimated that the nighttime surcharge for both debit and credit transactions should be approximately \$.015. It is expected that the new night surcharge would provide for a more equitable fee structure, as the fees would reflect actual operating costs for all types of transactions processed.

Therefore, the Board requests comments from interested members of the public on the proposed "float factor" to be used to recover the costs of ACH net debit float and the proposed adoption of a uniform surcharge for ACH transactions originated at night calculated to reflect the actual nighttime operating costs.

Board of Governors of the Federal Reserve System,
September 17, 1986.

(signed) William W. Wiles

William W. Wiles
Secretary

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