



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

December 4, 1986

DALLAS, TEXAS 75222

Circular 86-104

TO: The Chief Operations Officer of
all financial institutions in the
Eleventh Federal Reserve District

SUBJECT

Approval of tiered pricing for check services at the Federal Reserve Banks of Minneapolis and Kansas City

DETAILS

The Federal Reserve Board of Governors has approved a proposal to allow the head offices of the Federal Reserve Banks of Minneapolis and Kansas City to use a tiered pricing structure for check collection services. These two offices have been using tiered pricing under a pilot program since November 1984. Currently, the Federal Reserve Bank of Dallas has no plans to implement tiered pricing in the Eleventh District.

A tiered pricing structure allows different fees to be assessed depending upon whether a check is sent to a high-cost or low-cost presentation point. Offering a tiered pricing structure more accurately reflects actual Federal Reserve costs and allows financial institutions to choose the most cost effective method of clearing checks.

In addition to adopting the proposal, the Board also established criteria under which tiered pricing could be used for check collection services at other Reserve Bank offices.

ATTACHMENTS

Attached is the Federal Register document describing tiered pricing and its implementation.

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).

MORE INFORMATION

For more information, please contact the following individuals:

Dallas Office	Robert L. Whitman	(214) 698-4357
El Paso Branch	Robert W. Schultz	(915) 544-4730
Houston Branch	Vernon L. Bartee	(713) 659-4433
San Antonio Branch	John A. Bullock	(512) 224-2141

Sincerely yours,

William H. Wallace

FEDERAL RESERVE SYSTEM

[Docket No. R-0532]

Fees for Federal Reserve Bank Check Collection Service

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Approval of pricing proposal.

SUMMARY: The Board has approved:

1. making the tiered pricing structure, currently piloted at the head offices of the Federal Reserve Banks of Minneapolis and Kansas City, a permanent component of the fee structures at those Reserve Banks; and
2. criteria for determining the conditions under which a tiered fee structure may be extended to other offices of Federal Reserve Banks.

EFFECTIVE DATE: November 25, 1986.

FOR FURTHER INFORMATION CONTACT: Earl G. Hamilton, Assistant Director (202/452-3879) or Gayle Thompson, Senior Analyst (202/452-2934), Division of Federal Reserve Bank Operations; or Earnestine Hill or Dorothea Thompson, Telecommunications Device for the Deaf (202/452-3544); Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION:

BACKGROUND

In November 1984, the Board requested comment on a proposal to permit Federal Reserve Banks to use a tiered fee

schedule for checks to be presented within a single collection zone;^{1/} that is, different fees would be assessed depending upon whether a check is sent to a high- or low-cost endpoint^{2/} in a Regional Check Processing Center (RCPC) or country zone. The Board also proposed that a pilot program be conducted at the head offices of the Federal Reserve Banks of Minneapolis and Kansas City to test the feasibility of tiered pricing.

The Board proposed tiered pricing because, in some Federal Reserve Districts, the cost of clearing checks drawn on institutions in the same zone varied considerably, and the Reserve Banks at that time were charging only one average price. If prices reflected these cost variances more accurately, collecting institutions could choose the best and most cost effective method of clearing checks, resulting in a more efficient allocation of resources in the payments mechanism.

In response to the public comment received on the November 1984 proposal, the Board modified the pilot program, which the Minneapolis and Kansas City Reserve Banks implemented

^{1/} A collection zone is a geographic subdivision of a Federal Reserve territory. Each collection zone has a specified availability schedule under which the Reserve Bank will give credit for a check deposited for collection at the Reserve Bank's office serving that territory. Collection zones are referred to as either city, RCPC, or country.

^{2/} An endpoint refers to the location at which a Federal Reserve Bank presents checks and other items to the payor for payment. A payor may designate a place of presentment under 12 C.F.R. § 210.7(b).

in April 1985. After analyzing the results of the pilot, the Board, in July 1986, issued for public comment a proposal to make tiered pricing a permanent part of the fee structure at the Minneapolis and Kansas City head offices and establish criteria for the expansion of tiered pricing to other Federal Reserve offices.

ANALYSIS OF COMMENTS

Thirty-nine of the 67 comments received were in favor of the July 1986 proposal to make tiered pricing a permanent component of the fee structure for check collection services at the Minneapolis and Kansas City Reserve Banks. Of the 39 respondents who commented on the proposed criteria for expansion of the service, 21 were in favor of them.

Thirty-nine commenters supported the concept of tiered pricing. These commenters stated that because the tiered fee structure more accurately reflects Federal Reserve costs, it allows collecting institutions to make better decisions in choosing the most cost effective method of clearing checks. Some of the commenters who participated in the pilot reported cost reductions. In addition, some commenters stated that the Federal Reserve's use of tiered pricing parallels the pricing practice of other service providers in their areas.

The 23 commenters opposing the proposal expressed many of the same concerns as those raised in response to the November 1984 proposal; these included billing complexity and the inability of the depositor to reconcile its charges from

the Federal Reserve and accurately pass back those charges to its depositors. When these comments were first made, the Board responded by modifying the original proposal, making tiered pricing an option for those institutions sending checks and other items to Reserve Banks for collection. The voluntary nature of the program allows any institution with concerns about the complexity of the fee structure or reconciliation problems to opt for the average price rather than the new tiered structure.

Several small institutions responding to the November 1984 proposal commented that the proposal discriminated against small institutions by increasing their costs because the majority of their collection volume would be drawn on other low-volume, high-cost institutions. In fact, many small institutions are part of the low-cost tier because their checks are presented to private sector processors designated as high-volume, low-cost endpoints. Four commenters reiterated this concern in response to the July 1986 proposal; however, all four of these commenters were large correspondent banks.

Comments on Pilot Results

Ten commenters stated that the pilot did not support a need for tiered pricing because a minority of depositors elected to participate in the pilot and a minority of eligible volume was deposited under the tiered pricing option. Pilot results indicate that 34 per cent and 24 per cent of the eligible depositors in the Minneapolis and Kansas City

Districts, respectively, participated in the pilot. In both cases, about 40 per cent of the eligible volume is being deposited under the tiered pricing option. While these figures represent less than half of the eligible participants and volume and thus constitute a "minority," the Board believes that the levels of participation are adequate to justify continuance of the tiered pricing option in the pilot offices.

Proposed Criteria

Thirty-nine respondents commented on the criteria proposed for expansion of tiered pricing to other Federal Reserve offices, 21 of them supporting the criteria as proposed. The remaining 18 commenters suggested modifications to the criteria.

Nine commenters said that public comment should be required each time tiered pricing is proposed. An equal number of commenters opposed the criterion requiring Board review as too stringent, because it would result in unnecessary delays in implementing tiered pricing. The Board's Pricing Principle No. 7 states that public comment will be requested when changes in fees and service arrangements are proposed that would have significant longer-run effects on the nation's payments mechanism. Generally, a Reserve Bank's adoption of tiered pricing should not have a significant longer-run impact on the nation's payments mechanism, and soliciting public comment on every proposal is not necessary. The issues relating to the

adoption of tiered pricing in individual Federal Reserve offices are likely to be similar to those of the pilot offices. Experience of the pilot indicates that tiered pricing has not had a significant impact.

The Board does not believe that it is appropriate to request comment in those cases where there is no likelihood of significant longer-run effects on the payments mechanism. To request comment in every case would impede the implementation of many routine price and service level changes. Nevertheless, the Board does believe that depository institutions should be consulted prior to implementing tiered pricing in other Federal Reserve office territories.

Four commenters stated that tiered pricing should only be implemented after a phase-in period. Various time-frames were suggested. Currently, Reserve Banks are generally required to announce new services and prices implemented between the annual repricing exercises 30 days prior to implementation. The annual fee announcements for all prices generally are distributed 60 days in advance. The Board believes that a 60-day announcement period should be sufficient to allow institutions to adjust to tiered pricing.

Several commenters expressed concern that the terms "clear" and "substantial" as used in the criteria were not well defined. Given the variety of conditions that exists among the Federal Reserve collection zones, including the number of institutions, the geographical size of the zone, and other

factors, the Board believes that these terms are sufficient guides to its analysis of future proposals to expand the tiered pricing structure to other Federal Reserve offices.

Several suggestions were made by various commenters regarding clarification of the fee structure for tiered pricing. Suggestions included indicating how many tiers should be allowed, what type of deposits should be eligible for tiered pricing, how high- or low-cost endpoints should be selected, how often endpoints should be reviewed and revised, and how fee differentials should be calculated.

The Board has determined that tiers will generally be limited to two in each collection zone, unless clear cost differences can be demonstrated that would justify further tiers. Tiered pricing may be applied to all types of deposits within an RCPC or country zone. High- or low-cost endpoints will be selected and fee differentials calculated based on clear cost differences as stated in the proposed criteria. Reserve Banks offering tiered prices must review designation of endpoints as high- or low-cost at least annually, but a particular endpoint may not be redesignated more often than quarterly.

BOARD ACTION

After analyzing the comments and the results of the pilot program, the Board has approved making tiered pricing a permanent component of the fee structure at the head offices of the Federal Reserve Banks of Minneapolis and Kansas City.

The Board has also determined that other Federal Reserve Banks may introduce tiered pricing into the fee structures of one or more of their office territories if they meet the following criteria:

1. Adoption of tiered pricing by any additional Federal Reserve Bank will require approval by the Board.
2. Tiered pricing will be offered as an option to the sender; an alternative fixed per item fee also will be offered for each deposit category.
3. Tiered prices may be used only where clear cost differences exist between groups of items within the collection zone.
4. Tiered prices may be used only where the introduction of tiered prices has the potential to provide net savings for a substantial amount of deposited volume or a substantial number of depositing institutions.

Before seeking Board approval of tiered pricing for a collection zone within its District, a Federal Reserve Bank, together with Board staff, will consult with banking and thrift

industry representatives to ascertain their views on the effects of the particular tiered pricing proposal. At this time, there are no plans to approve more than two tiers to the price structure in each collection zone, although the Board may approve additional tiers if the proposal is consistent with the criteria listed above. The Board may request public comment on proposals to expand beyond two tiers if conditions warrant. In no case will a Reserve Bank implement tiered pricing unless it has given all affected parties at least 60 days advance notice of the availability of the tiered pricing option.

By order of the Board of Governors of the Federal Reserve System, November 25, 1986.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board