



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

December 12, 1986

DALLAS, TEXAS 75222

Circular 86-108

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

SUBJECT

Request for public comment on proposed factors to be considered when consolidating Federal Reserve priced services across District lines and approval of consolidating municipal bond and coupon collection activities of the Federal Reserve Bank of San Francisco at the Minneapolis Reserve Bank.

DETAILS

The Board of Governors of the Federal Reserve has issued for public comment a list of factors to be considered when Reserve Banks propose to consolidate a priced service across District lines. The Dallas Fed encourages your comments and suggestions on this important topic which has the potential to change traditional operating patterns. As the interstate banking environment grows, the Federal Reserve will continue to look for better methods to provide financial services to meet the needs of institutions operating locally as well as those operating nationwide. If you do choose to comment, please provide us with a copy. Comments are requested by January 28, 1987. Please send copies of your comments to: Mr. Richard D. Ingram, Federal Reserve Bank of Dallas, Station K, Dallas, Texas 75222.

In addition to this request, the Board approved consolidation of the municipal bond and coupon collection activities of the Federal Reserve Bank of San Francisco at the Minneapolis Reserve Bank.

ATTACHMENTS

The Board's notice is attached for your review.

MORE INFORMATION

For more information on this topic, contact Mr. Robert Smith, III at (214) 651-6207 or Mr. Richard D. Ingram at (214) 651-6212.

Sincerely yours,

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 SYSTEM

[Docket No. R-0586]

FEDERAL RESERVE BANK SERVICES

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment.

SUMMARY: The Board is requesting comment on proposed factors to be considered in evaluating proposals to consolidate Federal Reserve Bank priced service activities across District lines. The Board also has approved the consolidation of the noncash collection activities of the Federal Reserve Bank of San Francisco at the Federal Reserve Bank of Minneapolis.

DATE: Comments must be received by January 28, 1987.

ADDRESS: Comments, which should refer to Docket No. R-0586, may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551, or delivered to Room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m., except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information, 12 C.F.R. § 261.6(a).

FOR FURTHER INFORMATION CONTACT: Elliott C. McEntee, Associate Director (202/452-2231) or Donna DeCorleto, Senior Analyst (202/452-3956), Division of Federal Reserve Bank Operations; Daniel L. Rhoads, Senior Attorney (202/452-3711), Legal Division; or Earnestine Hill or Dorothea Thompson, Telecommunication Device for the Deaf (202/452-3544), Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: In October 1985, the Board requested public comment on the issue of consolidating Federal Reserve Bank priced service activities across District lines (50 F.R. 45938, Nov. 5, 1985). Public comment was also

requested on a proposal to make permanent a pilot program involving the consolidation of the noncash (e.g. municipal bond and coupon) collection activity of the Federal Reserve Bank of San Francisco at the Federal Reserve Bank of Minneapolis.

General Issue of Consolidation. The Board received 19 comments discussing the concept of interdistrict consolidation of Federal Reserve priced service activities. Ten commenters were not opposed to interdistrict consolidation. However, nine of these commenters expressed concern about the impact of interdistrict consolidations and suggested that conditions or restrictions on interdistrict consolidations be developed. Nine commenters opposed the concept of interdistrict consolidation.

Commenters not opposed to consolidation expressed the opinion that interdistrict consolidation can increase operating efficiencies and reduce costs while maintaining service levels. Twelve commenters expressed concern about the effects consolidation would have on the level or quality of service provided by the Federal Reserve to depository institutions. Commenters also expressed concern about the impact that interdistrict consolidation may have on potential providers of competing services. Some commenters believed that consolidation would be anticompetitive by permitting the Reserve Banks to locate operations in low-cost areas, thus achieving economies not available to the private sector. Six commenters stated that interdistrict consolidation was not in accord with the pricing provisions of the Monetary Control Act of 1980 ("MCA") (12 U.S.C. § 248a). In their view, the MCA requires each Reserve Bank to match costs and revenues for each service and interdistrict consolidation will result in cross-district subsidization of services. Several commenters suggested conditions under which interdistrict consolidations would be acceptable, and seven commenters suggested that all future interdistrict consolidation proposals be published for public comment.

One of the results of pricing of Federal Reserve service has been an increased focus on efficiency. The Board believes that in situations efficiency may be gained by consolidating some services currently offered by Reserve Banks at fewer locations. Circumstances that may warrant consideration of consolidating one or more services include revenue shortfalls, potential cost reductions, changes in payment volume and clearing patterns, improved communication and automation technology, or the need for contingency programs to ameliorate disaster recovery.

The Board shares the concerns expressed by commenters that interdistrict consolidation may affect competition among service providers as well as the level or quality of service offered. To assure that these concerns are considered in any future proposal for interdistrict consolidation of Federal Reserve priced services, the following list of factors to be considered in reviewing interdistrict consolidation proposals has been developed. These factors include:

- a. Maintenance or improvement of cost recovery in a service.
- b. Improvement of the efficiency of Federal Reserve Bank operations.
- c. Maintenance or improvement of the level or quality of service.
- d. Responsiveness to changes in the financial services industry.
- e. Impact on private sector providers of the service that is being consolidated.
- f. Amount of advance notice that would be needed prior to effecting an interdistrict consolidation.

Comment is requested on these factors, as well as any additional factors commenters believe should be considered by the Federal Reserve in deciding whether to consolidate services

across district lines. It is not anticipated that any single factor would be determinative of a proposed interdistrict consolidation. Rather, the list of proposed factors indicates those issues to be weighed in consideration of whether a specific consolidation proposal should proceed.

With regard to the suggestion that each proposed consolidation, including pilot programs, be published for public comment, the Board does not believe such an approach is necessary. The Board's Pricing Principle Number 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. Most consolidation efforts likely would not have such an effect, however, and soliciting public comment on every proposal would not be necessary. In the event that a consolidation proposal would appear to have significant, longer-run effects on the nation's payments mechanism, the Board would solicit public comment.

Finally, contrary to the suggestion of some commenters, the MCA does not require recovery of costs on a district-by-district basis. The MCA requires the Federal Reserve, over the long run, to establish fees on the basis of all direct and indirect costs incurred in providing priced services, including costs that would have been incurred if the services were provided by a private sector firm. The Board's Pricing Principle Number 5 states that the fees be set so that revenues for major service categories match costs Systemwide, in most circumstances. In addition, as a matter of practice, the Board expects each Reserve Bank to recover its costs and contribute to the private sector adjustment factor for locally priced services.

San Francisco-Minneapolis Consolidation of Noncash Collection.

The Board also requested public comment in October 1985 on a proposal to make permanent the pilot consolidation of the

noncash collection service of the San Francisco Reserve Bank at the Minneapolis Reserve Bank. The noncash collection service involves primarily the collection of maturing definitive securities such as municipal bonds and coupons. Of the 15 commenters addressing this issue, eight commenters did not oppose it and seven commenters did oppose it. The eight commenters who did not oppose the proposal focused on the fact that consolidation would enable the Reserve Banks to control or reduce costs and maintain service levels in the noncash collection function. They cited the negative impact that the Tax Equity and Fiscal Responsibility Act (TEFRA) has had on noncash volume, making cost recovery in this service increasingly difficult. One commenter mentioned its positive experience as a participant in the pilot program.

The seven commenters opposed to the San Francisco-Minneapolis consolidation cited the same concerns that they had expressed regarding consolidation in general. A few commenters considered this consolidation proposal inappropriate because, at the time public comment was solicited, the Federal Reserve was projecting for 1986 an increase in volume of 1.7 percent. Finally, some commenters contended that inadequate information on accounting and billing procedures was provided about the pilot program.

The Board believes the benefits demonstrated by the pilot consolidation of the San Francisco Reserve Bank noncash collection activity at the Minneapolis Reserve Bank warrant making the pilot program permanent. The consolidation resulted in a \$1.00 decrease in the per-coupon-envelope fee for depositors presenting Twelfth District payable items to Minneapolis rather than San Francisco. It also enabled those depositors to obtain payment quicker and improved the cost recovery rate for the Minneapolis Reserve Bank and the Federal Reserve System. The consolidation of San Francisco noncash collection at Minneapolis is also viewed as important to the

ability of the Federal Reserve to continue offering a nationwide noncash collection service.

With regard to comments that the noncash collection consolidation was inappropriate in view of a projected increase in Federal Reserve volume of 1.7 percent for 1986, preliminary data indicates that noncash collection volume may decline for 1986. Further, volume will decline in the future due to TEFRA.

The Board believes the concerns expressed by commenters regarding accounting and billing practices for service users have been addressed in procedures developed for the pilot program. Depository institutions, except for those located in Federal Reserve Districts where a mixed deposit service is available, that wish to present Twelfth District municipal coupons through the Federal Reserve noncash collection network should forward these items to the Minneapolis Reserve Bank. Depository institutions in a mixed deposit program would continue to send their coupons to their local Federal Reserve Bank. A depository institution's account at its local Reserve Bank will be credited with coupon redemption proceeds on a predetermined availability schedule. Bond redemption proceeds would be credited when payment is received by the Minneapolis Reserve Bank. Additional details concerning fees, crediting and billing procedures may be obtained from local Reserve Banks or the Federal Reserve Bank of Minneapolis. The Board believes these procedures should not cause problems for users of the noncash collection service.

By order of the Board of Governors of the Federal Reserve System, November 26, 1986.

(signed) William W Wiles

William W. Wiles
Secretary of the Board