



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

September 19, 1990

DALLAS, TEXAS 75222

Circular 90-68

TO: The Chief Operating Officer of
each financial institution in the
Eleventh Federal Reserve District

SUBJECT

**Request for Public Comment on Proposed Change
to the Price Structure for the Consolidated Shipment of
Checks Using the Interdistrict Transportation System**

DETAILS

The Board of Governors of the Federal Reserve System is requesting comment on a proposed change to the price structure for shipping checks using the Interdistrict Transportation System (ITS). The modifications would introduce a cap on the cumulative amount of per-item fees paid to ship checks from one Reserve Bank office to another office via ITS. The proposed price structure is designed to better reflect the underlying cost function of interdistrict check transportation. Comments must be submitted to the Board on or before October 19, 1990, in accordance with Federal Reserve System Docket No. R-0705.

ATTACHMENT

A copy of Federal Reserve System Docket No. R-0705 is attached.

MORE INFORMATION

If you have any questions or need additional information, please contact Robert L. Whitman, (214) 698-4357, at the Dallas Office; Eloise Guinn, (915) 544-4730, at the El Paso Branch; Luke E. Richards, (713) 652-1544, at the Houston Branch; or Herb Barbee, (512) 224-2141, at the San Antonio Branch. For additional copies of this circular and the Federal Reserve System Docket, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

A handwritten signature in cursive script that reads "William H. Wallace".

FEDERAL RESERVE SYSTEM
Docket No. R-0705
Federal Reserve Bank Services
Interdistrict Transportation System Price Structure

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment.

SUMMARY: The Board is requesting comment on a proposed change to the price structure for shipping checks using the Interdistrict Transportation System (ITS). The modification would introduce a cap on the cumulative amount of per-item fees paid to ship checks from one Reserve Bank office to another office via ITS.

Currently, depository institutions are charged a per-item surcharge in addition to check collection processing fees for each item shipped on ITS. The Board proposes retaining the per-item surcharges and establishing a dollar cap on the total amount charged for each shipment. The proposed price structure is designed to better reflect the underlying cost function of interdistrict check transportation. If approved, the modified price structure would be implemented in mid-1991.

DATES: Comments must be submitted on or before October 19, 1990.

ADDRESSES: Comments, which should refer to Docket No. R-0705, may be mailed to the Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551.

Attention: Mr. William W. Wiles, Secretary; or may be delivered to Room B-2223 between 8:45 a.m. and 5:00 p.m. All comments received at the above address will be included in the public file and may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202/452-3874), Gayle Brett, Manager (202/452-2934), or Kathleen M. Connor, Senior Financial Services Analyst (202/452-3917), Division of Federal Reserve Bank Operations; for the hearing impaired only: Telecommunications Device for the Deaf, Earnestine Hill or Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Among the goals of the Federal Reserve's check collection service are ensuring an adequate level of service nationwide and developing improvements to accelerate the collection of checks. Pursuant to these goals, the Federal Reserve developed the Interdistrict Transportation System (ITS) network to facilitate and accelerate the transportation and collection of checks between the 48 Federal Reserve Bank offices. Currently, a depository institution can collect checks drawn anywhere in the United States by depositing checks at its local Federal Reserve Bank office, with the Federal Reserve System assuming "end-to-end" accountability for collection. A depository institution generally can receive funds availability for those checks within one or two business days from the date of deposit at the institution.

The ITS network is solely an internal delivery system connecting Federal Reserve offices, transporting primarily checks collected by the Federal Reserve as well as other Federal Reserve materials. The network segments the country into six regional zones. Within each zone, planes fly into and out of a "hub" city to deliver checks to and from the Federal Reserve "spoke" cities in the region. A national "connector zone" carries checks

between the hub cities. Close coordination and timing among the various air couriers under contract to the Federal Reserve is essential for the network to operate smoothly.

The ITS network has separate weekday and weekend schedules. The weekday schedule operates Monday through Thursday and accounts for the majority of network volume. The weekend schedule is less time-critical; typically, ITS picks up checks at Reserve Bank offices on Saturday afternoon or evening and delivers them to other Reserve Bank offices by Sunday afternoon or evening. Much of the weekend ITS transportation uses ground couriers, with some use of air couriers.

Under the current ITS price structure, the amount of Federal Reserve charges paid by depository institutions that collect checks shipped on ITS varies according to the number of checks shipped. Each Federal Reserve Bank office maintains a weekday and weekend schedule of per-item surcharges to ship checks to each of the other 47 offices. ITS surcharges are in two forms: 1) explicit surcharges paid by depository institutions for checks shipped via consolidated shipments¹, and 2) surcharges imbedded in the mixed or Other Fed per-item check collection processing fees charged by Reserve Bank offices.

ITS network costs are essentially fixed. Of total 1990 network costs, more than 90 percent do not vary with volume.

¹Depository institutions that choose to collect checks through Reserve Bank offices outside of their local Federal Reserve territory can send their checks to other Reserve Bank offices as direct-send shipments transported by a private courier or as consolidated shipments transported on the ITS network.

Once the Federal Reserve enters into multi-year contracts with couriers to provide aircraft, pilots, ground operations, and other components of the network, those costs are fixed. The only significant costs that vary with volume are for fuel and for the limited use of commercial flights to ship checks. Thus, the Federal Reserve uses an entirely variable price structure to recover largely fixed costs.

Current ITS pricing differs significantly from the price structures of the major private sector providers of air courier services for check collection. Numerous companies provide regional air delivery services to collect checks for banks. A few of these companies offer multi-regional or national courier services. As far as the Board can determine, none of these couriers uses an entirely variable price structure. In most cases, weekday pricing is entirely fixed: either a fixed dollar amount per endpoint, or a fixed dollar amount per night to deliver checks to a certain maximum number of endpoints. This market practice reflects the essentially fixed cost structure of a large air transportation network. It also reflects a preference among many banks for relative simplicity in estimating their check transportation costs.

The objective of modifying the price structure for ITS surcharges is to ensure that the price structure reflects the underlying cost function of interdistrict check transportation. A price structure with some fixed element would enable depository institutions, and particularly shippers of large volumes, to enjoy the benefits of the largely fixed cost ITS network. Such a structure would also bring the Federal Reserve closer to

prevailing market pricing practice and would simplify decision-making for banks evaluating check transportation alternatives.

The proposed ITS price structure would retain the current per-item surcharges and would establish a fixed dollar cap on the cumulative surcharges assessed for each shipment. Thus, a user of ITS would experience no change in the total price of a shipment unless the volume of checks shipped to a particular Reserve Bank office would generate per-item charges in excess of the cap. Small-volume depositors would continue to pay per-item surcharges as they do currently and would not be affected by the price structure modification. The proposed structure would give large-volume depositors the opportunity to reduce expenses for large shipments. It also would simplify the pricing and analysis of transportation options for large-volume depositors. If approved, the modified price structure would be implemented in mid-1991.

The Board believes that the proposed price structure strikes the best balance among the goals of adding a fixed element to the ITS price structure, while avoiding disruption and increased costs for current ITS users. In the initial implementation of the proposed structure, Reserve Banks would use one cap for every weekday shipment, and a lower cap for every weekend shipment. The Board anticipates that the initial weekday cap would likely be in the range of \$25 to \$35 per Reserve Bank office endpoint, and the initial weekend cap would likely be in the range of \$20 to \$30.

The weekday or weekend cap would be the same for every check shipment, regardless of origination point or destination.² A more sophisticated approach might use different caps for different destinations, similar to the different per-item surcharges now employed. Over time, the price structure could evolve in that direction if the benefits of a more sophisticated approach outweighed the simplicity of a standard cap. In particular, the Federal Reserve may consider setting caps at the district or office level, rather than nationally, as the new ITS price structure evolves.

For the short-term, a standard cap would lend some desirable simplicity to ITS pricing. In addition, a standard cap is more consistent with private sector pricing practices than an array of caps would be. Moreover, an array of fixed fees would require a level of sophistication in setting such caps that would not exist prior to actual experience with this price structure.

In its analysis, the Board also considered the following two alternative price structures:

1. An entirely fixed-price structure; e.g., \$X per shipment to each Reserve Bank office, regardless of the volume in each shipment; and

²For example, if the cap were set at \$35, an institution shipping 6,000 checks from the Federal Reserve Bank in Boston to the Federal Reserve Bank of Philadelphia at a per item surcharge of \$0.005 per item would pay \$30 ($\$0.005 \times 6,000$) for the shipment. The same institution shipping 6,000 checks to the Federal Reserve Bank of Dallas at a per item surcharge of \$0.009 per item would pay \$54 ($6,000 \times \0.009) for this shipment.

2. A fixed-plus-variable price structure, similar to the use of cash letter fees and per-item fees currently used for other components of the check collection service; e.g., \$X per shipment, plus Y cents per item.

The first alternative reflects the underlying fixed costs of the network and would emulate current market practice. This alternative, however, would be disruptive for most current users of ITS. Many cash letters sent by consolidated shippers to distant Reserve Bank offices contain small volumes of checks. A realistic fixed fee surcharge would constitute a large increase in Federal Reserve charges to such consolidated shippers. The Board estimates that nearly all consolidated shippers using ITS would pay considerably more under this pricing approach than they pay currently.

The second alternative would add a fixed element to ITS pricing and provide for lower effective per-item surcharges as volumes increased. This alternative, however, has two significant problems. It adds complexity to an already large array of more than 4,500 individual prices. Moreover, in the Board's judgment, it would not be possible to implement this structure in a way that would provide appreciable benefits to large-volume depositors without adding significantly to the cost borne by smaller-volume depositors.

Competitive Impact Analysis. The Board formalized its procedures for assessing the competitive impact of changes that

have a substantial effect on payments systems participants³. Under these procedures, the Board will assess whether proposed changes in services or prices would have an adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services due to differing legal powers or constraints or due to a dominant market position of the Federal Reserve deriving from such legal differences.

The Board believes that this proposal would not have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing check collection services. Private-sector correspondent banks that provide check collection services would be the principal potential beneficiaries of this modification to the ITS price structure. Correspondent banks currently use either ITS or direct-send arrangements to ship checks to nonlocal Reserve Bank offices. The proposed modification would give these banks a simpler and potentially more favorable option for their large check shipments and new opportunities to reduce their shipping expenses.

The modified ITS price structure may induce a shift in volume from direct-send arrangements through private air couriers to consolidated shipments on ITS. The Federal Reserve does not compete directly with private sector air couriers. The ITS

³These procedures are described in the Board's policy statement titled "The Federal Reserve in the Payments System," which was revised in March 1990.

network transports only checks that are accounted for on the books of the Reserve Banks and other Federal Reserve materials between Federal Reserve Bank offices. Thus, ITS is an integral part of the Federal Reserve's check collection service. Private air couriers provide a broad range of services, including delivery of checks to correspondent banks and transportation of many other types of cargo.

Even if the Federal Reserve were perceived to be in competition with private air couriers, the proposed ITS price structure would not have a direct and material adverse effect on the ability of air couriers to compete effectively. The proposed price structure is consistent with the current pricing practices of most air couriers.

By order of the Board of Governors of the Federal Reserve System, August 15, 1990.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board