



**FEDERAL RESERVE BANK
OF DALLAS**

WILLIAM H. WALLACE
FIRST VICE PRESIDENT
AND CHIEF OPERATING OFFICER

DALLAS, TEXAS 75222

December 6, 1990

Circular 90-90

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

SUBJECT

**Request for Public Comment on Proposed Modifications
to the Criteria for Offering a Tiered Pricing Structure
in the Check Collection Service**

DETAILS

The Board of Governors of the Federal Reserve System is requesting comment on proposed modifications to the check collection service. The proposed modifications would allow tiered pricing in all check collection zones; would allow for more than two tiers where clear cost differences exist; would eliminate the current requirement to offer a blended (fixed) fee within each zone; and would conform the approval process for implementation of tiered pricing to the approval process for other price and service level changes. The proposed modifications would enable Reserve Banks to reflect more precisely their costs to collect checks, based on the location of each endpoint and the volume of checks presented to each endpoint. The Board anticipates that the revised criteria, if adopted, would become effective in mid-1991.

The Board must receive comments by January 25, 1991. Comments should be addressed to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, N.W., Washington, D.C. 20551. All comments should refer to Docket No. R-0712.

ATTACHMENT

A copy of Federal Reserve System Docket No. R-0712 is attached.

MORE INFORMATION

For 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) 978-1402, at the San Antonio Branch. For additional copies of this circular, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

A handwritten signature in cursive script, reading "William H. Wallace". The signature is written in dark ink and is positioned below the typed name "William H. Wallace".

Federal Reserve System
Docket No. R-0712
Federal Reserve Fees for Check Collection Services
Modification of Criteria for Tiered Pricing Structure

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment.

SUMMARY: The Board is requesting comment on proposed modifications to the criteria for offering a tiered pricing structure in the check collection service. The proposed modifications would allow tiered pricing in all collection zones; would allow for more than two tiers where clear cost differences exist to justify them; would eliminate the current requirement to offer a blended (fixed) fee within each collection zone; and would conform the approval process for the implementation of tiered pricing in other Federal Reserve Bank offices to the approval process for other price and service level changes. The proposed modifications would enable Reserve Banks to reflect more precisely their costs to collect checks drawn on paying banks within a given check collection zone. These costs are generally based on the location of, and volume of checks presented to, each endpoint. If adopted, the Board anticipates that the revised criteria would become effective mid-1991.

DATES: Comments must be submitted on or before January 25, 1991.

ADDRESSES: Comments, which should refer to Docket No. R-0712, 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) or Nalini Rogers, Senior Financial Services Analyst (202/452-3801), 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:

In November 1986, the Board approved a proposal to implement tiered pricing as a permanent price structure for RCPC deposits in the Minneapolis office and country deposits in the Kansas City office, and to establish criteria for the expansion of tiered pricing in other Federal Reserve Bank offices. [51 FR 43470, December 2, 1986]. Under a tiered pricing structure, different fees are assessed depending on whether a check is presented to a high-cost or low-cost endpoint¹ in a given check collection zone². A high-cost endpoint is typically defined as one

¹An endpoint refers to the physical location designated by the paying bank as the location at which the Federal Reserve is authorized to deliver items drawn on the paying bank for presentment.

²A collection zone is a geographic subdivision of a Federal Reserve territory. Each collection zone has a specified availability schedule under which credit will be given for a check deposited for collection at the Federal Reserve office serving that territory.

on which a low volume of checks is drawn, and/or one that is located in a remote location. A low-cost endpoint would typically be presented with high volumes of checks, and/or be centrally located. A small, remotely located paying bank could be included in the low-cost tier if its checks are presented to an intercept processor that also received presentments on behalf of other paying banks and is designated as a low-cost endpoint. Tiered pricing was originally proposed because the costs of clearing checks in collection zones may vary considerably between high- and low-cost endpoints and charging a single average blended fee does not reflect costs as precisely. The criteria that were approved by the Board in 1986 are as follows:

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 they have the potential to provide net savings for a substantial amount of deposited volume or a substantial number of depositing institutions.

In addition, the Board indicated that tiered pricing could be applied to all types of deposits in RCPC and country collection zones and that the number of price tiers within a collection zone should generally be limited to two.

Currently, 48 percent of the RCPC volume in the Minneapolis office and 77 percent of the country volume in the Kansas City office is deposited under the tiered pricing structure. In October 1990, the Board approved the implementation of tiered pricing in seven additional Federal Reserve offices; effective January 1991, tiered RCPC pricing will be implemented in the Lewiston, Philadelphia, Cleveland, Pittsburgh, Cincinnati, and Columbus offices; tiered country pricing will be implemented in the Denver office.

Tiered pricing enables Reserve Banks to establish prices that more precisely reflect their costs to collect checks drawn on paying banks within a given check collection zone. These costs are generally based on the location of, and volume of checks presented to each endpoint. The Board believes that the ability of Reserve Banks to reflect more precisely their costs through the use of tiered pricing would be facilitated if certain modifications were made to the tiered pricing criteria that were approved by the Board in November 1986. The Board is proposing the following modifications to the criteria:

1. Tiered pricing may be applied to deposits in all collection zones, provided clear cost differences exist. In 1986, the Board indicated that the application of tiered pricing would be

restricted to RCPC and country collection zones. The city zone was not included in the tiered pricing approach because the Federal Reserve believed that, due to the compact geographic nature of a city zone, the cost differences that warrant a tiered approach to pricing would not exist. Analyses of city zones have shown, however, that the volume distribution of checks among endpoints has a significant impact on check processing costs. In certain city zones, approximately 20 percent of the endpoints receive 70 to 90 percent of all checks presented in that zone. The checks drawn on these high-volume city endpoints are less costly to process than are checks drawn on lower-volume city endpoints. In addition, the transportation costs for certain high-volume city endpoints are low or nonexistent.

2. Reserve Banks may offer more than two price tiers within a collection zone, provided that clear cost differences exist to justify more than two tiers. When the Board authorized tiered pricing in 1986, it indicated that, although there were no plans to approve more than two tiers to the price structure at that time, the Board might approve additional tiers and would request public comment on a proposal to expand beyond two tiers if conditions warranted. Currently, in certain collection zones, the variation of processing and transportation costs to collect checks presented at different endpoints could result in a range of costs that can be clearly grouped into more than two cost tiers. The Board anticipates that if this modification were

adopted, certain Reserve Bank offices would be able to justify three pricing tiers in a collection zone.

3. Blended fees will not be offered as an alternative to tiered prices in a collection zone in which tiered pricing has been implemented. Currently, Reserve Banks are required to offer a blended fee as an option to the tiered pricing structure. This requirement was initially adopted to offer a pricing alternative to small depositors concerned with the potential reconciliation difficulties associated with tiered pricing. Over the past several years, however, Federal Reserve depositors have become accustomed to component pricing, i.e., pricing individual checks within a given deposit at different prices, since this is the billing procedure for the mixed deposit option used primarily by small depositors.³ The elimination of a blended fee in the tiered pricing structure is consistent with the Federal Reserve's policy of pricing mixed deposits based on the actual composition of checks in a given deposit.

The Board believes that Federal Reserve depositors can easily use the reconciliation procedures related to mixed cash letter deposits to reconcile the component pricing associated with

³Checks deposited in mixed cash letters are charged separate fees depending on whether the check is drawn on a bank in that Reserve Bank office's city, RCPC, or country zone, or a paying bank located in another Federal Reserve territory. Collecting banks are billed for the checks in mixed deposits based on the actual composition of checks in a given mixed cash letter.

tiered pricing. Experience has shown that billing for tiered pricing has been easily incorporated by the depositors in the Minneapolis and Kansas City offices that have opted for the tiered prices rather than the blended fee. These depositors have not indicated any billing difficulties. (Currently, there are 352 tiered pricing depositors in these offices, which represent 39 percent of all Minneapolis RCPC and Kansas City country depositors.) Federal Reserve billing statements clearly indicate the breakdown of volume for high- and low-cost tiers with appropriate prices; this detailed information should facilitate reconciliation.

4. The approval process for implementation of tiered pricing in additional Federal Reserve offices will be the same as the approval process for other routine price and service level changes. Given the fact that the adoption of a tiered pricing structure would be subject to the specific criteria established by the Board, the Board is proposing to handle approval of tiered pricing structures in additional Federal Reserve offices in the same manner as other routine price and service level changes. The Director of the Division of Federal Reserve Bank Operations, under delegated authority from the Board, has the authority to approve routine price and service level changes.

If the Board were to approve the proposed modifications to the tiered pricing criteria, the revised criteria would be as follows:

1. Tiered prices may be used only where clear cost differences exist between groups of checks within a collection zone.
2. Tiered prices may be used only where they have the potential to provide net savings for a substantial amount of deposited volume or a substantial number of depositing institutions.
3. Tiered pricing may be applied to deposits in all collection zones, provided clear cost differences exist.
4. Reserve Banks may offer more than two price tiers within a collection zone, provided clear cost differences exist to justify more than two tiers.

If adopted, the Board anticipates that the revised criteria would become effective mid-1991. Reserve Bank offices that implemented tiered pricing under the original criteria would eliminate the blended fee option no later than January 1992.

Competitive Impact Analysis. All operational and legal changes considered by the Board that have a substantial effect on payments system participants are subject to the competitive impact analysis described in the March 1990 policy statement "The Federal Reserve in the Payments Mechanism." In this analysis, the Board determines whether the proposed change would have a direct and material 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 the proposed tiered pricing structure will not have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve. Tiered pricing is an accepted structure in the banking industry and is utilized by other providers of check collection services. The proposed modifications will more accurately reflect the cost of collecting checks drawn on a particular paying bank in the price assessed for collecting those checks. A more precise alignment of costs and prices will not adversely effect the ability of other service providers to compete effectively with the Federal Reserve.

Board of Governors of the Federal Reserve System,
November 8, 1990.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board