



FEDERAL RESERVE BANK
OF DALLAS

ROBERT D. McTEER, JR.
PRESIDENT
AND CHIEF EXECUTIVE OFFICER

DALLAS, TEXAS 75222

May 28, 1991

Notice 91-43

TO: The Chief Executive Officer of each member bank and others concerned in the Eleventh Federal Reserve District

SUBJECT

Modifications to the Criteria for Offering a Tiered Pricing Structure in the Check Collection Service

DETAILS

The Federal Reserve Board has adopted modifications to the criteria for offering a tiered pricing structure in the check collection service. The revised criteria will enable Federal Reserve Banks to set fees that more precisely reflect their costs of collecting checks drawn on paying banks within a given check collection zone. In addition, the Board has provided clarification on several existing tiered pricing criteria. The Board has not adopted the proposed modification to eliminate the current requirement to offer a blended fee as an alternative to tiered prices within each collection zone where a tiered pricing structure has been implemented.

Specifically, the Board has adopted the following modifications:

- Tiered pricing may be applied to deposits in all collection zones, provided clear cost differences exist.
- Reserve Banks may offer more than two price tiers within a collection zone, provided clear cost differences exist to justify more than two tiers.
- 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.

The modifications are effective January 1, 1992.

ATTACHMENT

A copy of the Board's notice as it appears on pages 22168-72, Vol. 56, No. 93, of the Federal Register dated May 14, 1991, is attached.

MORE INFORMATION

For more information, please contact Robert L. Whitman, (214) 698-4357, at the Dallas Office; Eloise Guinn, (915) 521-8201, 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 Bank's notice, please contact the Public Affairs Department at (214) 651-6289.

Sincerely yours,

Robert D. McTeer, Jr.

SUPPLEMENTARY INFORMATION:
Background

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 to other Federal Reserve Bank offices. (51 FR 43470, December 2, 1986). Tiered pricing enables Federal Reserve Banks to establish prices that more precisely reflect their costs to collect checks drawn on paying banks within a given check collection zone. 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.² These costs are generally based on the volume of checks presented to, and the location of, each endpoint. A high-cost endpoint is generally one that receives a low volume of check presentments and/or one that is located in a remote location. A low-cost endpoint typically would be presented high volumes of checks and/or be centrally located. A small, remotely located paying bank may be included in the low-cost tier if its checks are presented to an intercept processor that also receives presentments on behalf of other paying banks. Tiered pricing may be adopted by Federal Reserve offices because the costs of clearing checks in collection zones may vary considerably between high- and low-cost endpoints and charging a single average fee does not reflect costs as precisely. The criteria for adopting a tiered pricing structure that were approved by the Board in 1986 are as follows:

1. Adoption of tiered pricing by an 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

¹ An endpoint refers to the physical location at which the Federal Reserve Bank presents checks drawn on the paying bank.

² A 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.

[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: Final action.

SUMMARY: The Board has adopted modifications to the criteria for offering a tiered pricing structure in the Federal Reserve's check collection service. The modifications allow tiered pricing in all collection zones; allow for more than two tiers of prices where cost differences exist to justify them; and conform the approval process for the implementation of tiered pricing to the approval process for other price and service level changes. The Board has not adopted the proposed modification to eliminate the current requirement to offer a blended fee alternative to tiered prices within each collection zone where a tiered pricing structure has been implemented. In addition, the Board has clarified several existing tiered pricing criteria. The revised criteria will enable Federal Reserve Banks to set fees that more precisely reflect their costs of collecting 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.

EFFECTIVE DATE: The modifications are effective January 1, 1992.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202)452-3874), Julius Oreska, Manager (202/452-3878), or Nalini T. Rogers, Senior Financial Services Analyst (202/452-3801), Division of Reserve Bank Operations and Payment Systems; for the hearing impaired only: Telecommunications Device for the Deaf, Dorthea Thompson (202/452-3544).

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 generally should be limited to two.

Proposed Modifications to the Tiered Pricing Criteria

The Board believes that the ability of Federal Reserve Banks to reflect their costs more precisely 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. Therefore, in November 1990, the Board requested comment on four proposed modifications to the criteria for offering a tiered pricing structure in the check collection service (55 FR 47804, November 15, 1990). The proposed modifications are as follows:

1. Tiered pricing may be applied to deposits in all collection zones, provided clear cost differences exist.
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.
3. Blended fees will not be offered as an alternative to tiered prices in a collection zone in which tiered pricing has been implemented.
4. The approval process for implementation of tiered pricing in additional Federal Reserve offices will be the same as the approval process for other price and service level changes.

The Board received 36 comments on the proposed modifications to the tiered pricing criteria. The following table reflects comments by category of respondents:

	Comments received
Commercial banks/Bank holding companies.....	19
Clearinghouses.....	5
Trade associations.....	5
Credit unions.....	3
Savings institutions.....	1
Federal Reserve Banks.....	3
Total.....	36

The following discussion describes the four proposed modifications, the comments that were received on each modification, and the final Board action with respect to each modification. A discussion of additional issues raised by the commenters is also provided.

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. City zone collection products were not considered likely candidates for tiered pricing because the Federal Reserve believed that, due to the compact geographic nature of a city zone, the cost differences that warrant tiered pricing generally would not exist. Subsequent analyses have indicated, 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 city endpoints are very low or nonexistent.

The Board received ten comments that specifically addressed the modification to expand tiered pricing to all collection zones. Six commenters (three of whom were Federal Reserve Banks) supported the proposed modification, and four opposed the proposal. One commenter that supported the proposal recommended that the Board require tiered pricing in all collection zones. One commenter that opposed the proposal expressed doubt that cost differences within city zones would be sufficient to justify tiered pricing.

Eleven commenters (including one commenter that specifically opposed the proposal to expand tiered pricing to all collection zones) expressed concern that expanded use of tiered pricing would result in reductions in Federal Reserve prices for low-cost endpoints, in particular city endpoints, and would lead to shifts in volume from correspondent banks to Federal Reserve Banks. Two commenters indicated that tiered pricing may also result in a shift of mixed deposit volume from correspondent banks to Federal Reserve Banks. Seven commenters were concerned that tiered pricing provides the Federal Reserve the opportunity to randomly place selected endpoints in the low-cost tier category in order to attract additional check volume drawn on those endpoints.

The Board believes that Federal Reserve Banks should be permitted to implement tiered pricing in all collection zones, including city zones, provided that clear cost differences exist. The Board believes that pricing check collection products more accurately to reflect the cost of collecting checks drawn on different endpoints results in a more efficient payments mechanism.

The Board does not believe, however, that tiered pricing should be mandatory in all collection zones, because clear cost differences may not exist in particular collection zones to warrant the adoption of tiered pricing. The Board has adopted the modification to apply tiered pricing to deposits in all collection zones, as proposed. A discussion of the competitive impact of the modifications to the tiered pricing criteria is provided later in this notice.

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 may request public comment on a proposal to expand beyond two tiers if conditions warranted. In certain collection zones, the variation in processing and transportation costs of collecting checks presented to different endpoints may result in a range of costs that can be grouped into more than two cost tiers. The Board therefore proposed a modification to the current tiered pricing criteria to allow more than two tiers within a collection zone.

Twelve comments were received on this proposed modification. Seven commenters (including three Federal Reserve Banks) supported the proposal, and five commenters opposed the proposed modification. One commenter that supported the modification recommended that multiple pricing tiers be required in all collection zones. Three commenters that opposed this proposal were concerned about the reconciliation complexities that more than two pricing tiers may create. Two of these commenters recommended that the number of permissible pricing tiers be limited to three.

The Board has adopted the proposed modification to permit more than two price tiers within a collection zone. The Board acknowledges that expansion of the permissible number of price tiers within a collection zone may complicate the billing reconciliation for some banks that deposit checks subject to tiered pricing, but believes that retention of the blended fee alternative, which is discussed below, addresses this concern. The Board does not believe that it should limit the number of tiers within a collection zone to three, if clear cost differences exist to justify additional tiers. The Board believes that such limitations may unnecessarily restrict Federal Reserve Banks' abilities

to set fees to reflect their costs of collecting checks drawn on paying banks within a certain collection zone. The Board anticipates that Federal Reserve offices that adopt tiered pricing generally will implement two price tiers. Although three tiers may be used in certain circumstances in which there are significant cost differences between groups of endpoints, the Board does not envision the adoption of more than three price tiers in the foreseeable future.

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, Federal Reserve Banks are required to offer a blended fee as an option to the tiered pricing structure. This requirement was initially adopted to provide a pricing alternative primarily to smaller depositors concerned with the potential difficulties they would face in reconciling their bills under tiered pricing. The Board believed, that with the experience of the past several years, users of Federal Reserve check services 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 smaller depositors.³ The elimination of a blended fee in the tiered pricing structure would thus have been consistent with the Federal Reserve's policy of pricing mixed deposits based on the actual composition of checks in a given deposit. Further, the Board believed that depository institutions that collected checks through the Federal Reserve could easily use the reconciliation procedures applicable to mixed cash letter deposits to reconcile the component pricing associated with tiered pricing. The Board therefore requested comment on a proposal to eliminate the requirement that blended fees be offered as an alternative to tiered pricing structures.

Nineteen comments were received on the proposal to eliminate the blended fee alternative. Thirteen commenters opposed the proposed modification, while six commenters (including three Federal Reserve Banks) supported the proposed change. Eight commenters based their opposition on the increased billing reconciliation complexities associated with tiered pricing. (Fifteen

commenters, including the eight commenters referenced above, indicated general concern with the billing reconciliation problems associated with a tiered pricing structure.) Commenters noted that without a blended fee alternative, depository institutions that collect checks through the Federal Reserve would be forced to alter their billing reconciliation procedures significantly or to accept charges from the Federal Reserve without attempting to reconcile those charges. In addition, several of these commenters noted that tiered pricing of Federal Reserve check collection services would complicate the billing of correspondent bank check collection services to respondent banks. Four small and seven large depository institutions commented that they would experience difficulty monitoring and reconciling their bills from the Federal Reserve under a tiered pricing environment. Commenters opposed to the elimination of the blended fee alternative believed that depositors should be given the choice of a blended price or a tiered price option.

Based on an analysis of the comments received, the Board has determined that the blended fee should be retained as an alternative to the tiered pricing structure and has not adopted the proposed modification eliminating the blended fee alternative. The Board believes that retention of the blended fee option addresses commenters' concerns regarding the complexities associated with billing reconciliation.

A Federal Reserve Bank that adopts tiered pricing will provide a blended fee option to its depositors, if this form of pricing is requested by the depositor. A depository institution is not permitted to deposit checks under both the tiered and blended price options, thereby preventing depositors from depositing their low-tier checks under the tiered pricing option and their high-tier checks under the blended fee option. Because the blended fee is based on the composition of checks that is deposited under that option, if, in practice, depository institutions deposit under the blended fee option checks drawn on predominately high-cost endpoints, then the blended price will tend to approach the high-tier price over time. The Board will continue to evaluate the need to offer a blended fee option and may determine to discontinue the blended fee alternative at some point in the future if circumstances warrant. For example, if the difference between the blended fee and the high-tier fee becomes insignificant due to the composition of checks deposited under the blended fee alternative, the Board

may determine to discontinue the blended fee.

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.*

The Board approves the prices and service levels for all Federal Reserve Banks on an annual basis. In addition, Board approval is required for other proposed changes to the price or level of Federal Reserve Bank services, if the proposal raises significant policy or operational issues. The Board has delegated authority to the Director of the Division of Reserve Bank Operations and Payment Systems to approve routine price and service level changes.

Given that the adoption of tiered pricing in a Federal Reserve office is approved pursuant to the criteria that have been established by the Board, the Board proposed to handle approval of tiered pricing structures under delegated authority, to conform the approval process with that used in other routine price and service level changes. The Board received eleven comments on the proposal to modify the approval process for tiered pricing structures. Eight commenters opposed the proposed modification, while three commenters (including two Federal Reserve Banks) supported the change. Three commenters that opposed this proposal believed that all tiered pricing proposals should be issued for public comment and be considered by the Board because of potential competitive implications. An additional five commenters that opposed the proposal indicated that each proposed tiered pricing application should, at a minimum, be subject to Board review and approval.

The Board believes that it is appropriate to conform the approval process for adoption of tiered pricing to the process used for other routine proposals. The adoption of a tiered pricing structure by a Federal Reserve office does not raise significant policy or operational issues because approval is subject to the criteria established by the Board. Consequently, the Board has adopted the proposal to amend the approval process for implementation of tiered pricing in additional Federal Reserve offices.

Additional Issues

Commenters raised several additional issues related to the pricing of Federal Reserve check collection services. Eleven commenters stated that the existing guidelines for tiered pricing structures should be further clarified.

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

and thus were opposed to, or had reservations concerning, one or more of the proposed modifications. Specifically, ten commenters suggested that the Board provide greater specificity regarding the criterion permitting tiered pricing only where "clear cost differences exist between groups of items within a collection zone." Three commenters requested clarification of the criterion that "tiered prices may only be used where they have the potential to provide net savings for a substantial amount of deposited volume or a substantial number of depositing institutions."

The Board adopted the guideline that "clear cost differences" exist between groups of items in a collection zone to ensure that tiered pricing is implemented only in those situations where the resulting price differences between the tiers would be material. Currently, the Board considers the "clear cost difference" guideline to be met if the difference in cost between groups of endpoints supports at least a twenty percent difference in price between each tier, or, alternately, at least a 2 mill difference in price between each tier. The Board may modify this test in the future if it determines that changes in the cost basis and fee schedules for check collection services warrant a change in determining what constitutes "clear cost differences."

Currently, the Board believes that the "net savings" guideline would be satisfied if either twenty percent of depositing institutions would have the potential to realize a net savings or twenty percent of deposited volume would be classified as low-tier. In instances where a Federal Reserve Bank is implementing more than two tiers in a collection zone, the "net savings" guideline for volume would be satisfied if twenty percent of deposited volume would be classified as being in a tier(s) with a lower per item fee than the existing fee. These figures may also be subject to change in the future if the Board determines that market conditions support a change in the definition of "net savings." A Federal Reserve Bank must meet this guideline when it initially implements a tiered price structure in a collection zone.

Five commenters requested that the Board indicate the frequency with which endpoints in a collection zone will be reviewed to determine whether they should be classified as either low-tier or high-tier and the amount of advance notice a Federal Reserve Bank would provide prior to reclassifying an endpoint in a different price tier. The classification of endpoints as either low-

tier or high-tier will be reviewed annually in conjunction with the Board's review of all Federal Reserve check collection prices. In addition, redesignation of selected endpoints to a different tier may occur at other times during the year, if conditions warrant. The Federal Reserve provides a minimum of 30 days advance notice of price and service level changes, including reclassification of endpoints to a different price tier.

The Board received eight comments on the relationship between the proposal to modify the tiered pricing criteria and the Board's proposals to amend Regulation CC to provide for same-day settlement for checks presented by private-sector presenting banks and to modify the Interdistrict Transportation Service (ITS) price structure. Six commenters requested that the Board not take action on the proposed modifications to the tiered pricing criteria until the Board takes final action on the proposed same-day settlement rule, due to the competitive implications of both proposals. One commenter stated that the ITS, same-day settlement, and tiered pricing proposals should have been issued for comment simultaneously due to the potential cumulative impact on correspondent banks. Another commenter requested that the Board defer final action on the modifications to the tiered pricing criteria until the issue of ITS cost determination has been acted upon by the Board. The Board believes that the tiered pricing proposal is sufficiently independent of these other proposals and final action need not be deferred until the Board acts on the other proposals.

Two commenters questioned whether tiered pricing would adversely affect the negotiability of checks drawn on high-cost endpoints, given that the cost to collect those checks would increase under a tiered pricing structure. Significantly different Federal Reserve check collection fees currently apply to checks drawn on various endpoints and these existing price differences have not affected the negotiability of checks drawn on the relatively high-cost endpoints. While tiered pricing may result in an increase in the collection fee spread for checks drawn on low- and high-cost endpoints, the Board does not expect that this fee spread will negatively affect the negotiability of checks drawn on high-cost endpoints.

The criteria for offering a tiered pricing structure in the Federal Reserve's check collection service, as modified by the Board, are as follows:

1. Tiered pricing may be applied to deposits in any collection zone, provided clear cost differences exist between groups of checks within that collection zone.

2. Tiered prices may be used only where they have the potential to provide net savings for a substantial number of depositing institutions or a substantial amount of deposited volume.

3. A blended per item fee will be offered as an alternative to tiered prices for each deposit category.

4. Federal Reserve Banks may offer more than two price tiers within a collection zone, provided clear cost differences exist to justify more than two tiers.

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." (53 FR 11648, March 29, 1990) 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.

Six commenters expressed reservations about the competitive impact analysis provided with the Board's proposal to modify the tiered pricing criteria. Four commenters requested additional information on Federal Reserve volumes, costs, and price projections. Two commenters stated that a detailed competitive impact analysis should be performed with the respect to each tiered pricing proposal based on potential competitive implications.

The Board does not believe that tiered pricing will affect the ability of other service providers to compete effectively with the Federal Reserve in providing similar services. The Board acknowledges that in some instances tiered prices may result in volume shifts between correspondent banks and Federal Reserve Banks; however, any volume shifts that may occur due to the adoption of tiered pricing by a Federal Reserve office would not be due to differing legal powers or constraints or due to a dominant market position of the Federal Reserve deriving from such legal differences. Tiered pricing is an

accepted price structure in the banking industry and is used by other providers of check collection services. The effect of the proposed modifications to the tiered pricing criteria will be to 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 affect the ability of other service providers to compete effectively with the Federal Reserve.

By order of the Board of Governors of the Federal Reserve System, May 8, 1991.

William W. Wiles,

Secretary of the Board.

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