



FEDERAL RESERVE BANK
OF DALLAS

TONY J. SALVAGGIO
FIRST VICE PRESIDENT

November 21, 1991

DALLAS, TEXAS 75222

Notice 91-95

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

SUBJECT

**Withdrawal of a Proposed Modification to the Price Structure
for the Interdistrict Transportation System**

DETAILS

The Federal Reserve Board has withdrawn a proposed modification to the price structure for the Interdistrict Transportation System (ITS) component of the Federal Reserve's check collection service.

This modification, which was issued for public comment in August 1990 (Circular 90-68), would have capped the cumulative amount of per-item fees assessed to a bank for each shipment of checks to a specific Federal Reserve Office.

The Board concluded that the proposed cap structure did not accurately reflect costs.

ATTACHMENT

A copy of the Board's notice (Federal Reserve System Docket No. R-0705) is attached.

MORE INFORMATION

For more information regarding the ITS, please contact Robert Whitman, (214) 698-4357, at the Dallas Office; Eloise Guinn, (915) 521-8201, at the El Paso Branch; Luke 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,

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: Final Action.

SUMMARY: The Board has decided not to implement the proposed modification to the price structure for the Interdistrict Transportation System (ITS) component of the Federal Reserve Banks' check collection service. The proposed price structure, which includes an overall cap on charges assessed to the shipper, does not accurately reflect the marginal cost of shipping checks via ITS. The Board has not adopted an alternate price structure at this time due to a broad review of ITS that has been undertaken by the Federal Reserve Banks.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Assistant Director (202/452-3874), Julius Oreska, Manager (202/452-3878), or Kathleen M. Connor, Senior Financial Services Analyst (202/452-3917), Division of Reserve Bank Operations and Payment Systems; Stephanie Martin, Senior Attorney (202/452-3198), Legal Division; for the hearing impaired only: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION:

Background

The Federal Reserve Banks strive to provide an efficient nationwide check collection service. Accordingly, to facilitate interdistrict check collection, the Federal Reserve Banks have established their own delivery system, known as the

Interdistrict Transportation System (ITS), for transporting between Federal Reserve Bank offices checks collected by the Federal Reserve Banks as well as other Federal Reserve materials.

ITS is an air transportation network that uses mostly air but also ground couriers that are privately operated on a contract basis. The network links the 48 Federal Reserve offices in five "hub and spoke" configurations. Checks and other Federal Reserve materials are transported between the "hub" cities and also between the hubs and their respective "spoke" cities. ITS is configured to provide the Reserve Bank offices a means to collect checks nationwide on an overnight basis on Monday through Thursday nights, and over the weekend.

A bank may collect nonlocal checks through the Federal Reserve Banks in several ways. First, a bank may collect checks drawn on banks in other Federal Reserve check processing regions by depositing the checks in a mixed or Other Fed cash letter at its local Federal Reserve office. The local Federal Reserve office sorts these checks by receiving Federal Reserve office and ships them via ITS to the Federal Reserve offices serving the paying banks. Second, a bank may deposit at its local Federal Reserve office separately sorted cash letters containing checks drawn on banks located in another check processing region. The local Federal Reserve office does not have to process these checks on its automated equipment due to the sorting performed by the depositing bank. These checks are sent via ITS in "consolidated shipments" to other Federal Reserve offices. Third, a bank may "direct send" a cash letter for deposit to the

Federal Reserve office serving the paying bank, using transportation other than ITS.

A per-item fee is currently assessed for ITS transportation. The fee is imbedded in the mixed and Other Fed check collection fees or, in the case of consolidated shipments, is assessed separately. A higher ITS fee is typically assessed for transportation during the week than for transportation during the weekend, when time pressures are less stringent.

In August 1990, the Board proposed a modification to the ITS pricing structure [55 FR 34075, August 21, 1990]. Specifically, the Board proposed that the cumulative fees assessed to a bank for each shipment to a specific Federal Reserve office destination be limited or capped at a predetermined level. Thus, under the proposal, an ITS user would pay the per-item fee for checks in an ITS shipment up to the volume threshold that is determined by the cap amount, but would pay nothing for checks that exceed the threshold. Accordingly, large-volume depositors that ship checks in excess of the threshold volume in a single shipment would benefit from the proposed structure. The Board anticipated that the weekday cap initially would be set in the range of \$25 to \$35 and the weekend cap would be set in the range of \$20 to \$30 per Reserve Bank office destination. The Board has decided not to implement the proposed price structure or an alternative new price structure at this time. Following is a summary of the comments

received on the proposal together with staff's analysis of the comments.

Summary of Comments and Analysis

The Board received 71 comments on the proposed price structure change.¹ The following table reflects comments by category of respondent:

	<u>Comments Received</u>
Commercial banks/Bank holding companies	43
Air couriers	10
Clearinghouses	6
Trade associations	5
Savings institutions	2
Credit unions	1
Government agencies	1
Federal Reserve Banks	<u>3</u>
Total	71

Sixty-three commenters opposed the proposed price structure. Eight commenters, including three Federal Reserve Banks, supported the proposed change. The major issues raised by the commenters opposed to the proposal related to the proposed price structure's deviation from prevailing market pricing practice, its anticipated effects on correspondent banks and private air couriers, the proposal's fixed cost assumption, and the competitive impact analysis.

¹Seven commenters initially submitted requests for extension of the comment deadline and later submitted comment letters on the proposal. Letters requesting an extension of the comment deadline are not included in the count of comments received. The Board extended the public comment period until January 18, 1991 [55 FR 41387, October 11, 1990].

Pricing Issues. Four bank commenters indicated in their letters, and in subsequent discussions with Board staff, that it is fairly common for private-sector air couriers to employ price structures that assess lower average per-item fees to large-volume customers than to small-volume customers. According to these commenters, couriers frequently charge a fixed fee to ship a standard weight of checks and usually assess additional but lower per-pound fees for additional standard-weight increments in the shipment. Eleven commenters generally agreed with the intent of the Federal Reserve Banks to move closer to prevailing market pricing practices (i.e., volume-sensitive pricing), but did not believe that the proposed price structure, which included an overall cap on charges assessed to the shipper, was consistent with market practice.

Nine commenters were concerned that the proposed price structure would not reflect the cost per shipment. For example, the Federal Trade Commission (FTC) indicated that the proposal assumes that costs per shipper do not increase at all with any volume larger than that eligible for the ceiling or maximum charge.

The Board agrees that, although the concept of volume-sensitive pricing is consistent with market pricing practices, the proposed cap structure does not accurately reflect cost. The marginal cost of shipping incremental volume on ITS is minimal but does not fall to zero when a threshold volume is exceeded, as is implied in the proposed price structure. For

this reason, the Board believes that the proposed price structure should not be implemented.

Fixed Cost Assumption. Twenty-five commenters did not believe that 90 percent of ITS costs are fixed and do not vary with volume. Both bank and air courier commenters believed that a much lower percentage of ITS costs is fixed.

Only a small portion of ITS cost varies directly with volume. Two ITS cost components that vary based on volume are fuel costs and air freight forwarding charges. Fuel expenses comprise 20 percent of total ITS cost; however, less than 20 percent of fuel cost varies directly with volume. Air freight forwarding charges vary directly with the number of pounds of freight shipped. Air freight charges, however, constitute only three percent of ITS costs.

Generally, other ITS costs are fixed over broad volume ranges. Fixed price contracts for air charters and ground services are set for three or four years and constitute 75 percent of ITS costs. These contracts are based primarily on business requirements and on the overall design of the network, rather than on the volume of checks shipped via ITS between Federal Reserve offices.

Twelve commenters predicted that a rapid volume increase on ITS, resulting from a price change, would consume the network's excess capacity. They stated that the Federal Reserve Banks would have to add equipment and personnel to handle the additional volume, which would increase cost and prices. ITS can accommodate a twenty percent volume increase on all routes and a

doubling of existing volume on almost half of the network's routes without increasing the capacity of the network.

ITS Performance. Thirty commenters discussed the current level of ITS service and generally stated that private air couriers provided more flexible and more reliable service at significantly later deadlines. Twenty of these commenters believed that private couriers had better on-time performance than ITS. Seventeen commenters indicated that they prefer the later deposit deadlines that private couriers offer, which can be up to two hours later than ITS deadlines.

It is difficult to draw comparisons between ITS and private couriers, because the ITS network delivers checks only to Federal Reserve Banks, while private couriers typically deliver checks to depository institutions as well as to Federal Reserve Banks. Also, the ITS network is designed to support the Federal Reserve Banks' nationwide check collection service, while private couriers may tailor their services to specific collection routes in order to maximize profit. The Federal Reserve Banks are currently conducting a comprehensive review of ITS, including the network's design, dispatch times, and performance. The review will address those issues related to the performance of ITS that were raised by the commenters, and adjustments may be made to the network based on the results of the review. Due to the current review of ITS, the Board believes that the Federal Reserve Banks should not implement an alternative ITS price structure at this time.

Seven commenters indicated that the Federal Reserve Banks should expand ITS to provide check transportation to private-sector banks as well as to Federal Reserve Banks. An analysis of whether the Federal Reserve Banks should allow conjunctive business on the ITS network and whether a new transportation service should be offered is provided in the Board's request for comment on proposed services that Federal Reserve Banks may offer in a same-day settlement environment [56 FR 10429, March 12, 1991]. The Board concluded that conjunctive business on ITS could disrupt ITS delivery schedules (resulting in higher levels of debit float) and would reduce the Federal Reserve Banks' control over ITS, which would have a detrimental effect on the Federal Reserve Banks' check collection service. For these reasons, the Board concluded that the Federal Reserve Banks should not allow conjunctive business on the ITS network.

Other Issues. Commenters raised several other issues concerning the ITS price structure proposal. Twenty-two commenters indicated a need for detailed data concerning ITS operations in order to thoroughly assess the implications of the proposal. The Board, however, generally does not provide data on Federal Reserve Bank operations at the level of detail requested by some commenters.

One commenter was concerned that the private sector might not be given an opportunity to comment on ITS price or cap changes in the future, if the proposed ITS price structure were adopted. The Board requests public comment on significant price structure changes and would request comment on any proposed

significant modifications to the ITS price structure. Comment generally is not requested when adjusting the levels of fees within an existing price structure.

Competitive Impact Analysis. The Board received 66 comments on the analysis of the competitive impact of the proposed ITS price structure. Both bank and air courier commenters believed that the proposed price structure would adversely affect the ability of other service providers to compete with the Federal Reserve Banks.

Twelve commenters disagreed with the assumption that private couriers do not compete directly with the Federal Reserve Banks. The FTC, for example, stated that "A vertically integrated supplier [such as the Federal Reserve System] does compete with firms that supply one stage of the vertical process whenever single stage suppliers can be linked with suppliers at other stages to provide a close substitute for the integrated service."

The Board believes that the Federal Reserve Banks compete directly with other depository institutions that offer check clearing services, but do not compete directly with private-sector air couriers. This view is consistent with the decision reached by the United States Sixth Circuit Court of Appeals in the 1983 Jet Courier court case [See Jet Courier Services v. Federal Reserve Bank of Atlanta, 713 F.2d 1221 at 1227 (6th Cir. 1983)]. One commenter raised questions about the Court's decision in that case, based on subsequent court decisions in other business areas. The Jet Courier decision,

however, remains the only court decision that specifically addresses the implications of the Monetary Control Act in the context of air couriers.

One commenter noted that the proposal failed to comply with the Monetary Control Act and the Board's pricing principles, because the proposed price structure could result in a mismatch of ITS cost and revenue. Section 11A of the Federal Reserve Act [12 USC 248a] requires that the Federal Reserve set its fee schedule for priced services to recover all direct and indirect costs actually incurred in providing Federal Reserve priced services over the long run. Neither the Monetary Control Act nor the Board's pricing guidelines require that the Federal Reserve Banks match costs and revenues for individual components of a priced service, such as ITS. Nevertheless, the Federal Reserve Banks historically have matched cost and revenue for the ITS component of the check collection service.

Thirty-four commenters were concerned that the proposed price structure would shift checks from private check collection and transportation alternatives to the Federal Reserve Banks, thereby resulting in a diminution of, and corresponding increase in the cost of, private-sector alternatives. Six commenters noted that a reduction of private-sector alternatives primarily would harm small depository institutions.

Nine commenters asked that the Federal Reserve establish a competitive fairness advisory committee to review proposed payments system changes before proposals are issued for public comment. The Board does not believe that such an advisory

committee is necessary, because the public comment process gives the industry an opportunity to share its views on payments system issues. In addition, the Federal Reserve staff routinely briefs trade association representatives on proposed changes affecting the payments system, which provides an additional opportunity for dialogue on these issues.

By order of the Board of Governors of the Federal Reserve System, October 30, 1991.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board