Research Department
Federal Reserve
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Business & Financial Letter

Computer Money

The computer will remain a revolutionary force for change in the American financial system, especially in view of the pressure it creates for a standardized system of money payments. That seems to be the gist of the message of the National Commission on Electronic Fund Transfers, which released last week what is in effect the first draft of its final report. In this report, the EFT Commission tried to define the future roles of the financial institutions, regulators and consumers who are participating in the rapidly evolving world of computer-based banking.

The Commission explicitly accepted the argument that electronic money is here to stay. Some market participants might still question that notion, in view of the low volume and high losses experienced by some of the pioneers in the field. But they tend to forget that this happens with most such innovations—credit cards, for example, which eventually gained universal acceptance despite the problems encountered by many early participants. In the present case, cost-saving possibilities seem to dictate growing use of the computer, since unit automation costs tend to decline every year as much as unit labor costs increase—about 7 percent annually.

Hardware: terminals

Many of the Commission's recommendations on the surface seemed to be only hardware decisions, affecting the terminals and clearinghouses which handle electronic payments. But these could be life-or-death decisions to many of the institutions involved. One such issue was the question of computer terminals vs. bricks-and-mortar branches, on which the Commission made probably its most controversial recommendation—that banks and other EFT firms be allowed to cross state lines with terminals to collect deposits, and also to accommodate credit and debit transfers in contiguous "national market" areas. In fact, 4 of the 26 commissioners (generally members of state regulatory agencies), rejected that recommendation because they felt it ignored the "precipitous changes or serious consequences" resulting from any such attempt to restructure the financial industry.

The issue goes back to the legal overturning of the decision made two years ago by the Comptroller of the Currency, where he ruled that customer-bank communications terminals (CBCT's)—the general classification of automated-teller machines and point-of-sale devices—would not be considered branches of nationally chartered banks. Since the Supreme Court refused last October to hear an appeal in those several cases in which the Comptroller's ruling had been overruled, CBCT's must still be considered bank branches. But under terms of the 1927 McFadden Act, national banks may branch only to the same extent that the

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states in which they are located permit their state-chartered banks to branch—which means not at all in unit banking states.

The EFT Commission recommended lifting restrictions on national-bank CBCT's within individual states, and moreover permitting state-wide branching for all financial institutions. The Commission also would have Congress permit the interstate deployment of terminals (between contiguous states) for all Federally regulated financial institutions after some fixed date. Under this approach, individual states would then be forced to change restrictive branching laws if they wanted state-chartered institutions to have a fair chance to compete. Otherwise, the Commission would recommend that both state- and federally-chartered depository institutions be empowered to offer debit services (but not deposit taking) nationally through terminal-based EFT systems.

Hardware: clearinghouses
The Commission also considered several policy issues surrounding the operation of automated clearinghouses (ACH's). These facilities clear payments in the same way that conventional clearinghouses handle checks, but they do so much more efficiently by substituting magnetic tapes for checks and other paper items. ACH's have been organized regionally by groups of financial institutions that establish members' responsibilities and operational procedures. Two of the 28 ACH's now operating—one in Chicago and the other in New York—are privately operated. In all other cases, regional Federal Reserve banks provide the facilities for the clearing operations, at no charge to users.

The operation of these 28 ACH's has been oriented to specific geographic areas, but the Federal Reserve plans an experimental link-up of several ACH's to provide an interregional exchange of electronic items. On this point, the EFT Commission left undecided the question of whether private or public entities should operate the national EFT network which may ultimately develop from regional link-ups. In addition, it argued that for the foreseeable future, the Federal Reserve should not get into the business of offering point-of-sale switching and clearing facilities for stores or other merchant locations, and it should not discriminate against private firms that might want to offer their own clearing networks.

The Commission recommended that the Federal Reserve charge banks for the ACH services it now provides free, but with "due consideration" to the reserve balances held by participating member banks. In addition, it argued that the Fed should force bank-run ACH's which operate with a Fed computer to permit access to any kind of depository institution that wants to join.

Basic issue: consumers
Throughout the report, the Commission emphasized its primary concern with the welfare of the American consumer in any new electronic system. It said that consumers can benefit in a number of significant ways from EFTS, primarily from a more convenient, secure, and less expensive method of payment. To secure these benefits, however, legislation might be required to set forth consumers' specific rights and responsibilities.

The report recommended that financial institutions generally be liable for all billing and crediting errors in an EFT system, unless they could prove fraud or negligence on the part of customers. However, consumers would have to report statement errors within "a reasonable time" to obtain redress. Financial institutions would not have to utilize a specific type of form or descriptive bill, although competitive pressures would probably force them to provide adequate reports to consumers.

The Commission did not side with all consumer demands. It saw no problem with the loss of "float," or payment delays from checks in the process of collection. It found scant evidence that consumers would be damaged by the loss of ability to stop payments, especially since "only 0.29 percent" of all checks are actually stopped in the present system. Both problems of this type must still be dealt with, involving as they do some intrusion into what consumers might consider their inalienable rights. At the same time, the Commission expressed fears that EFT would create the potential for increased abuse of personal privacy. It said that government access to computerized financial records should be obtained only with the depositor's permission or with a court order, and it called on Congress to pass legislation to safeguard consumer rights in this respect.

The Commission's final report, due this fall, may not add much to the just-released interim report. The fireworks may come later, when Congress tries to evaluate the merits of the Commission's recommendations amid all the conflicting pressures generated by consumers, regulators, banks, thrift institutions, and myriad other interests. (For example, small banks in unit banking states have already objected strenuously to the proposal to permit interstate operation of electronic terminals.) Nonetheless, the EFT Commission report, like other recent studies of the nation's financial system, underlines the fact that technological and other pressures are pushing the nation in the direction of a simplified type of payments system operating through a standardized type of depository institution.

William Burke

BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 2/23/77	Change from 2/16/77	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	92,094	- 205	+ 5,341	+ 6.16
Loans (gross, adjusted)—total	70,356	- 12	+ 5,903	+ 9.16
Security loans	1,546	+ 97	+ 836	+ 117.75
Commercial and industrial	23,035	+ 175	0	0.0
Real estate	21,933	+ 32	+ 2,347	+ 11.98
Consumer instalment	12,370	- 30	+ 1,611	+ 14.97
U.S. Treasury securities	8,747	- 111	- 850	- 8.86
Other securities	12,991	- 82	+ 288	+ 2.27
Deposits (less cash items)—total*	91,320	- 418	+ 5,016	+ 5.81
Demand deposits (adjusted)	25,324	- 630	+ 1,995	+ 8.55
U.S. Government deposits	313	- 81	- 5	- 1.57
Time deposits—total*	63,968	- 54	+ 2,607	+ 4.25
States and political subdivisions	5,773	- 55	- 1,015	- 14.95
Savings deposits	31,063	+ 124	+ 6,364	+ 25.77
Other time deposits‡	25,192	- 95	- 2,174	- 7.94
Large negotiable CD's	8,692	- 163	- 3,405	- 28.15

Weekly Averages of Daily Figures	Week ended 2/23/77	Week ended 2/16/77	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (-)	+ 61	- 23	+ 28
Borrowings	2	2	7
Net free(+)/Net borrowed (-)	+ 59	- 25	+ 21
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales (-)	+ 716	+ 539	+ 1,588
Transactions with U.S. security dealers			
Net loans (+)/Net borrowings (-)	+ 67	+ 196	+ 101

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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