

FEDERAL RESERVE BANK
OF NEW YORK

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Board of Governors' Policy Statement on Payments Mechanism

*To All Banks, and Others Concerned,
in the Second Federal Reserve District:*

The following statement was made public today by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today issued a policy statement calling for basic changes in the nation's system for handling money payments. These are, essentially, transitional steps toward replacing the use of checks with electronic transfer of funds.

The Board's Statement was directed to the Presidents of the 12 Federal Reserve Banks. It said that modernization of the nation's means of making financial transactions through the banking system "is becoming a matter of urgency."

The Board's sense of urgency was based upon estimates that check volume will at least double in the present decade. Some 62 million checks a day—about 22 billion a year—are written in the United States, setting in motion the transfer of more than \$16 trillion a year at the present time. In 1970, the Federal Reserve System cleared approximately 8 billion checks, transferring just over \$3 trillion from one account to another.

An average check passing through the clearing process is handled 10 times under present procedures. Despite the progress to date in mechanization and automation, increases in productivity are limited by the fact that the processing of checks continues to require a substantial amount of hand labor. This, together with mounting check volumes, presents banks with a problem of constantly rising costs for their check handling operations. The Board's Policy Statement addresses itself to this mounting problem.

The Board's Policy Statement placed "high priority" upon providing the public with faster, more convenient and more dependable check clearing services, by increasing the speed and efficiency of check handling. In part, the Board's plans called for this to be accomplished through establishment of new regional clearing centers throughout the country.

The Board asked for action "to achieve as soon as possible an accelerated flow of funds along more optimal routing patterns" across the nation, in two initial ways:

1. *Structural changes* in handling and settlement of checks:

This would involve two alterations in the existing money payments system. First, zones of same-day settlement—in immediately available money—now operating in cities with Reserve Bank offices, would be expanded geographically. Second, new regional centers would be established, wherever warranted, for rapid check clearance in immediately available funds.

In both cases, the Board has in mind clearing areas as large as permitted by reliable arrangements for overnight presentation and settlement of items.

2. *Operational changes:*

These would be aimed at reducing dependence upon checks by encouraging banks and their customers to make greater use of the expanded capabilities of the Federal Reserve System's communications network.

Inducements to begin replacement of money transfers by check with transfers via wire would be offered by (1) removing charges and other restrictions upon the use of the Federal Reserve's wire network by member banks for transfers of \$1,000 or more for their customers, (2) increasing the number of hours the network is open for business daily, and (3) expanding facilities at Reserve offices, where justified by traffic potentials, to equip them for high speed tape transmission and computer-to-computer communications.

This would permit linkups, chiefly of commercial bank computers through the use of Federal Reserve facilities, allowing virtually instantaneous payment, without charge for the wire service, from a commercial bank in one part of the nation to a commercial bank in any other part, where both banks are Federal Reserve members and have computerized accounting of their customers' deposit balances.

With respect to timing, the Policy Statement said:

"The first objective should be expansion of the geographic area of existing immediate payment zones. This should be accomplished as soon as necessary arrangements can be made. Meantime, studies looking to the establishment of new clearing centers, wherever warranted, should be undertaken promptly by each Federal

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Reserve Bank, and submitted to the Board for review. Expansion of facilities at Federal Reserve offices for increased access to the Reserve System's wire network should be concluded at the earliest practicable time . . . "

The Board's Policy Statement was prepared in collaboration with the Federal Reserve System Steering Committee on Improving the Payments Mechanism, headed by Reserve Board Governor George W. Mitchell. Other members are Governors Sherman J. Maisel and William W. Sherrill, Reserve Bank Presidents George H. Clay of Kansas City, Aubrey N. Heflin of Richmond, and Eliot J. Swan of San Francisco, and the First Vice Presidents of the Chicago and the New York Reserve Banks, Ernest T. Baughman and William F. Treiber. The Steering Committee was assisted by the Committee and Subcommittee on Collections of the Conference of First Vice Presidents of the Reserve Banks. Preparation of the statement involved extensive consultation among Reserve Banks and with commercial banks.

The Policy Statement confirmed the Federal Reserve System's commitment to a nationwide direct, fast and economical system for the transfer of funds and settlement of balances. The immediate aim is a reduction, across the nation, of the volume of items now being handled, speeding settlement by minimizing handling of checks, and reduction of commercial bank and Federal Reserve float resulting from delays in settlements.

Expansion of areas of fast clearing and settlement in immediately available funds is appropriate, in the Board's opinion, due to increasing urbanization and improvement of highway systems surrounding major cities, and the growing utilization, even in small banks, of centralized electronic accounting for demand deposits.

During the past year zones of immediate payment surrounding the Kansas City, the Minneapolis and the Denver Federal Reserve offices have been expanded. The first—experimental—new regional clearing center was established for the Washington-Baltimore area, and is now in its second year of successful operation. The second such regional clearing center will become operational in Miami, Florida, this year.

Looking to the future, the Reserve System has three projects in being for further improvement of the payments mechanism:

1. Construction of a payments mechanism simulation model for the System, to be used both to understand better the present payments system and to indicate in what ways it can and should be improved.
2. An in-depth study of exactly how payments are effected in Florida and Georgia, being done by the Georgia Institute of Technology for the Federal Reserve Bank of Atlanta.
3. The cooperative participation, in California, of the Federal Reserve Bank of San Francisco and its Branch at Los Angeles with a Special Committee on Paperless Entry (SCOPE) through which commercial bank groups are attempting to reduce check volume by substituting electronic means of transferring money.

Meantime, the Reserve System's wire network is being both expanded and converted to higher speed operation. It includes a communications center at Culpeper, Virginia linking the Board and all Reserve offices, and is capable of extension to commercial banks.

A copy of the Board's Policy Statement is printed below.

ALFRED HAYES,
President.

Statement of Policy on the Payments Mechanism

Increasing the speed and efficiency with which the rapidly mounting volume of checks is handled is becoming a matter of urgency. Until electronic facilities begin to replace check transfer in substantial volume, the present system is vulnerable to serious transportation delays and manpower shortages. Structural changes in the present check clearing system can effect significant savings in manpower and unnecessary handling of checks. These changes will result in faster, more convenient, and more economical banking services for the public. They will reduce the cost of operations. The Federal Reserve Board therefore states as a matter of policy that it places high priority upon efforts by the Federal Reserve System to improve the nation's means of making payments, initially along the following lines:

1. *Extending present clearing arrangements, in cities with Federal Reserve offices, into larger zones of immediate payment, consistent with transportation possibilities, check volumes, and the location of check processing centers.*
2. *Establishing other regional clearing facilities, in which settlements are made in immediately available funds, located wherever warranted by the need for more expeditious and economical check handling, or other operating and financial conditions.*
3. *(a) Encouraging banks and their customers to*

make greater use of the expanded capabilities of the Federal Reserve wire transfer system. (b) Removing restrictions on third party transfers of demand deposits, and extending the time period in which the wire transfer system can be used. (c) Expanding facilities at Reserve Bank offices, where justified by traffic potentials, to include high speed tape transmission, and computer-to-computer communications.

Plans for making these basic changes in the present money transfer system should be pursued actively, to achieve as soon as possible an accelerated flow of funds along more optimal routing patterns. These initiatives are generally intended to supplement those efficient direct check exchange programs that are now in existence.

The first objective should be expansion of the geographic area of existing immediate payment zones. This should be accomplished as soon as necessary arrangements can be made. Meantime, studies looking to the establishment of new clearing centers, wherever warranted, should be undertaken promptly by each Federal Reserve Bank, and submitted to the Board for review. Expansion of facilities at Federal Reserve offices for increased access to the Reserve System's wire network should be concluded at the earliest practicable time, generally during the next 12 to 18 months.