

FEDERAL RESERVE BANK
OF NEW YORK

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January 19, 1976]

WIRE TRANSFER AND AUTOMATED PAYMENT OPERATIONS
Proposals and Interim Guidelines

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

The following is quoted from the text of a statement issued today by the Board of Governors of the Federal Reserve System:

The Board of Governors of the Federal Reserve System today issued for comment a revised proposal to amend its Regulation J to deal with clearing and settlement of wire transfers and payment instructions recorded on magnetic tape.

The Board provided a comment period of 60 days — through March 19 — to allow time for the newly established National Commission on Electronic Fund Transfers, as well as other interested parties, to submit their views.

In addition to the Regulation J proposal to deal with the electronic transfer of funds, the Board also:

- Announced adoption of an interim policy on the deposit and delivery of payments on magnetic tape that are cleared by depository institutions through Federal Reserve facilities.
- Announced the Board's intention to publish for comment, in the near future, a pricing schedule for users of Federal Reserve check and electronic clearing settlement facilities.

The three subjects . . . pertain to wire transfer and automated payment operations that the Federal Reserve has performed for some time.

The Federal Reserve has operated wire transfer services since 1915. This service allows member banks to transfer funds instantaneously from their reserve balances to the reserve accounts of other member banks, on their own account or on the order of a customer.

Automated electronic payment operations were initiated in 1972. Essentially, they parallel the existing system for payment by paper check, except that the payment instructions are contained on a magnetic tape. At the present time, the Air Force and the Social Security Administration, some State and local governments, and some corporations are using automated payment operations to effect payroll deposits and other recurring payments. Most of these payments are now being cleared and settled through Federal Reserve facilities.

The proposed amendments to Regulation J were originally published for comment in November 1973 and have been refined in light of the responses received on that original proposal. They would assemble, in regulatory form, the duties and liabilities of participants in the Federal Reserve's wire transfer and automated payment services. These duties and liabilities have been prescribed under rules and procedures contained in Reserve Bank operating circulars and legal agreements with associations of financial institutions which have become known as automated clearing house associations.

The increased use of these services has led to numerous questions concerning the relationships among depository institutions and their customers. It is in the light of these developments that the Board has concluded that it should propose a regulatory framework that defines the rights and responsibilities of all users of such Federal Reserve services.

Payments exchanged on magnetic tape, in a mature automated clearing house system, can be made at considerable cost savings to depository institutions, the U. S. Treasury and the Federal Reserve System compared to the cost of exchanging payments by check. Further, consumers are afforded greater convenience and security in making payments in this manner.

The second element . . . is an announcement of an interim policy on access to Federal Reserve clearing and settlement facilities for the deposit, delivery, and settlement of automated payments. Use of these services has progressed beyond the experimental stage, and the Board has received numerous requests for clarification of the Federal Reserve System's policy governing participation in the automated payments area. To deal with these requests, the Board believes that an interim statement is necessary, setting forth temporary rules under which depository institutions may use Federal Reserve facilities while further study continues.

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Finally, the Board intends to establish a pricing schedule to be applicable to the users of Federal Reserve check and automated clearing and settlement facilities. When such a pricing structure is established the Board also intends to review the interim policy announced today regarding access to these facilities.

Printed below is the text of a supplemental memorandum issued by the Board of Governors with respect to the proposed revision of Regulation J and with respect to the interim guidelines for the use of Federal Reserve facilities for electronic fund transfers. The text of the revised proposed amendments to Regulation J will be sent to you shortly.

Questions regarding this matter may be directed to James O. Aston, Assistant Vice President (Tel. No. 212-791-6334) or John C. Houhoulis, Manager, Payment Systems Department (Tel. No. 212-791-5997).

PAUL A. VOLCKER,
President.

Supplemental Memorandum on Proposed Revision of Regulation J and Electronic Fund Transfer Guidelines

The proposed revision of Regulation J would:

—Leave unchanged present rules governing Federal Reserve handling and clearing of checks, but make the present regulation on this subject *Subpart A* of the proposed amended regulation.

—Codify in regulatory form—as *Subpart B*—rules for credit transfers—i.e., forwarding of credits by wire over Federal Reserve communications facilities as has been done for decades under operating rules issued by Federal Reserve Banks. *Subpart B* would also establish rules for the handling of recurring preauthorized deposit instructions recorded on magnetic tape, such as recurring payroll, interest and dividend payments.

—Add a proposed new section to Regulation J that would be known as *Subpart C*. *Subpart C* would provide rules for the use of Federal Reserve facilities for debit transfers of funds on magnetic tape. Those transactions generally involve the payment of recurring bills, such as utility and mortgage payments.

The proposed rules cover only transactions cleared through Federal Reserve facilities. They do not pertain to such electronic funds transfer facilities as point-of-sale systems or use of automated teller facilities.

A typical payroll deposit under *Subpart B* would work in the following manner. If a company offers the option of direct payroll deposit, and an employee enrolls in the program, he completes a form which authorizes his company to deposit his pay in his bank or other depository institution. Prior to payday, the company delivers a magnetic tape of payroll information to its depository institution. The company's depository institution delivers the tape to the Federal Reserve. The Federal Reserve sorts the information according to the depository institutions designated to receive deposits. The employee's depository institution, in turn, credits the employee's pay to his account, on the payment date.

Under *Subpart C*, a typical debit transfer, such as a mortgage payment, would be made as follows. A homeowner would sign a form authorizing his mortgage company to request a transfer that would move money from the homeowner's bank or other depository institution to the mortgage company's depository institution. Before the mortgage payment date, the mortgage company would deliver to its depository institution a magnetic tape containing the debit transfer that the mortgage company's customers have au-

thorized. The depository institution would deliver the tape to the Federal Reserve, which sorts the transfer requests on the tape according to the various depository institutions which are to pay the amounts authorized. They, in turn, effect the transfer from its customer's account on the payment date.

The interim guidelines adopted by the Board and announced today cover the handling by the Federal Reserve of payments instructions on magnetic tape received from depository institutions. The interim guidelines are listed below:

Depository institutions eligible to deposit magnetic tapes:

- Member banks of the Federal Reserve System.
- Depository institutions that are members of an automated clearing house association.

Delivery will be made under conditions specified in the Federal Reserve's formal announcement . . . to:

- Member banks of the Federal Reserve System.
- Depository institutions that are members of an automated clearing house association.

Settlement

—Settlement for payments cleared under the interim arrangements will be made by credit and debit entries to reserve accounts of member banks of the Federal Reserve System.

Other provisions

—Items deposited on magnetic tape may originate from any account having third-party payment powers, e.g., savings, NOW, and share draft accounts.

—Volume floors for the direct delivery of items will be set by the local Reserve Bank to insure a cost-effective operation.

—However, all financial depositories have the options of receiving their items through another bank or other depository institution, or of picking up directly from the Federal Reserve.

In providing clearing and settlement services for automated clearing house associations the Board anticipates that these services will be made reasonably available on a comparable basis to depository institutions having need for such services.