

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 8249]
January 4, 1978]

PLANS FOR IMPROVED PAYMENTS SERVICES

To All Banking Institutions, and Others Concerned,
in the Second Federal Reserve District:

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System, announcing plans to enhance and improve payments services:

The Board of Governors of the Federal Reserve System today invited comment on plans to enhance and improve payments services to financial institutions and the public.

The Board requested comment by February 28, 1978.

These plans are expected to encourage private sector development of competitive payments services and to encourage broader use of electronic fund transfers as a more efficient, lower cost means of payment.

The two programs on which the Board invited comment are:

1. To make available Federal Reserve net settlement services to member banks, on their reserve accounts, for wire transfers conducted on Bankwire.

Bankwire is a communications network operated by Payments and Communications Administrative Communications Corporation and owned by an association of banks. It provides interbank funds transfer services to about 200 banks throughout the country.

2. To provide a nationwide Federal Reserve service for clearing and settlement of electronic payments through automated clearinghouses (ACH's).

An *automated clearinghouse association* is a local or regional association of banks and other depositories agreeing to make and receive electronic payments among themselves on behalf of the customer. The Federal Reserve currently operates 33 *automated clearinghouses* where magnetic tapes bearing the payments instructions of members of the local clearinghouse associations are sorted and cleared. At present, payment instructions are exchanged generally only locally among members of the various regional clearinghouse associations.

Use of these electronic payments systems would be voluntary.

In making these proposals the Board said:

"We expect that the program to carry out net settlement for Bankwire transactions will stimulate private sector alternatives in the payments mechanism leading to lower cost provision of banking services throughout the nation. The Board will consider other requests for such settlement services on a case-by-case basis to ensure that the cost and operational impacts and the public service benefits are consistent with the Board's overall responsibilities.

"With respect to providing interregional clearing and settlement facilities for ACH's, we hope to encourage the use of electronic fund transfers as a more efficient and less costly alternative to check payments. The Board recognized the evolutionary nature of the program and the need for continuing analysis of Federal Reserve operational involvement. However, we would emphasize the compatibility of this program with the traditional wholesale level services which the Federal Reserve has provided historically. We have basic responsibilities to provide a minimum service capability to the public and to ensure the certainty and reliability of payments as well as to encourage improved methods of meeting the credit and debit transfers of the public. Our payments system is important to the smooth functioning of the whole economy. Not least, we attach importance to the fact that this project has been recommended by the National Commission on Electronic Fund Transfers."

The terms of the project under which the Federal Reserve would settle wire transfers made over Bankwire were based on a request to the Federal Reserve by member banks participating in Bankwire. Under these terms, member banks would appoint Bankwire their agent, and settlement would be effected by crediting or debiting member bank reserve accounts. Bankwire would be responsible for supplying information

needed for settlement: net amounts to be credited or debited to participating member banks, in accordance with payment instructions received during the day on Bankwire from all Bankwire members.

The planned connection of automated clearinghouses to form a national network was based on a request by the National Automated Clearing House Association comprised of some 9,000 member and nonmember banks, and 1,000 thrift institutions.

Under the planned linkage a member bank or other financial institution in the Dallas automated clearinghouse association, for example, could present to the Federal Reserve automated clearinghouse at Dallas electronically recorded instructions to make a payment to a member of the San Francisco clearinghouse association. The Federal Reserve would — as it does with payments instructions recorded on checks — forward the instructions from Dallas to San Francisco. But ACH transactions would be forwarded over the Federal Reserve's communications system, rather than by mail or courier. The Federal Reserve would collect the amount involved from the Dallas depository and pay the amount to the San Francisco depository. The Dallas and San Francisco depositories would credit or debit their customers.

The feasibility of connecting these facilities has been shown in two recent programs. One is the Treasury's program of direct deposit of social security and other recurring Federal payments. In place of sending out checks, the Treasury — at the request of beneficiaries — will send their payments directly to depository institutions through automated clearing facilities operated by the Reserve Banks.

More recently, the feasibility of interregional commercial payments through the automated facility was tested during a nine-month pilot test conducted by the National Automated Clearing House Association and the Federal Reserve.

Today's proposal does not alter the Treasury's procedures in its direct deposit program.

Printed below is the text of the Board's plans. Comments thereon should be submitted by February 28 and may be sent to this Bank, addressed to Thomas C. Sloane, Senior Vice President and Senior Adviser.

PAUL A. VOLCKER,
President.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
Announcement of Proposed Actions Regarding Net Settlement of
Member Bank Reserve Accounts and Automated Clearing Houses
(Docket No. R-0138)

SUMMARY STATEMENT: The Board of Governors has announced its intention to take two actions regarding its funds transfer and clearing services. The first action is the approval of a request from a group of member banks participating in a private clearing and settlement organization that Federal Reserve Banks make available to them a net settlement service for their funds transfer messages. In the second action, the Board has approved plans to provide, by year end 1978, interregional clearing and settlement services for funds transfers originated at automated clearing house associations. The Board intends to take these actions in order to improve the efficiency of the nation's payments mechanism and to encourage private-sector development of electronic payments services for the public. The Board has invited public comment on these actions by February 28, 1978.

FOR FURTHER INFORMATION CONTACT:
James R. Kudlinski, Director, Division of Federal Reserve Bank Operations ((202) 452-3985); or Allen L. Raiken, Assistant General Counsel ((202) 452-3625), Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

I. INTER-DISTRICT NET SETTLEMENT BY FEDERAL RESERVE BANKS FOR MEMBER BANKS.

The Board of Governors has considered a request from an organization of member banks that Federal Reserve assistance be provided to member banks participating in an independent privately-owned organization providing interbank funds transfer services. The member banks participating in this organization have requested assistance from the Federal Reserve System in an arrangement to use their reserve account balances at Federal Reserve Banks to settle for payment transactions that have been exchanged through a private clearing organization known as the Bankwire to which these member banks belong. Bankwire is operated by the Payment and Administrative Communications Corporation, a privately owned corporation. The proposed arrangement would allow the Federal Reserve member banks in this organization, during daily operations, to transfer among themselves payment instructions throughout the country via Bankwire and then to settle for those funds transfers on that same day using the Federal Reserve Communications System to make appropriate adjustments to member bank reserve account balances.

The member banks participating in the Bankwire organization have indicated that significant efficiencies in their current clearing and settlement services will be achieved through the receipt of the net settlement service requested. The proposed net settlement service would consist of Federal Reserve Banks making debit and credit entries to the reserve accounts of member banks that are members of Bankwire. Bankwire would be appointed the agent of the participating member banks, and would be responsible for providing a designated Federal Reserve office with a list of debit and credit settlement instructions necessary to effect the net settlement. Upon obtaining this information, which would be received through a link-up of the Federal Reserve Communications System and the Bankwire system, the designated Federal Reserve office would distribute the accounting entries to the Federal Reserve Banks for posting to the reserve accounts of the participating member banks. This posting would represent the net amount "due from" or "due to" the member bank resulting from payment transactions exchanged that day through the Bankwire system.

For some time the Federal Reserve has provided settlement services for member banks that, within individual Federal Reserve Districts, participate in privately run local and regional clearing organizations by charging and crediting net entries to the member banks' reserve accounts. The proposed settlement service differs from such existing services in that it will be offered on an inter-District, rather than an intra-District basis. The Board perceives that adoption of this proposal will enhance the settlement services that it offers to member banks. The Board expects that the availability of these settlement services will facilitate member bank participation in private-sector payments clearing arrangements and will result in same-day funds availability for member banks participating in this private-sector clearing organization. The Board views these services as consistent with the Federal Reserve System's commitment to provide assistance to private sector initiatives directed towards improving the efficiency of the nation's payments mechanism. Providing this net settlement service should permit the Bankwire organization and its member banks to offer improved funds transfer services to the public.

Should other requests by member banks for specialized settlement services be received in the future, the Board will review these requests on a case-by-case basis considering among other matters overall System capabilities and consistency with the Federal Reserve's traditional payments mechanism responsibilities.

II. INTERREGIONAL CLEARING AND SETTLEMENT SERVICES THROUGH AUTOMATED CLEARING HOUSES

On the basis of its review of the recently completed pilot study, the Board of Governors has determined that it is appropriate for the Federal Reserve System to establish an Interregional Automated Clearing House system. The Board believes that interregional clearings will facilitate the development of a more efficient nationwide payments system available to depository institutions and will provide research and development data and experience that should be of assistance to other

potential developers of automated clearing services. Provision of this interbank service also should enhance the opportunities open to depository institutions for developing improved "retail" payments services for the public. The Board intends to have the Federal Reserve interregional ACH system operational by the end of 1978.

Since 1968 the Federal Reserve System has assisted groups of depository institutions in the development and operation of automated clearing houses (ACHs) that provide facilities for the exchange of payment information on magnetic tape (1976 *Fed. Res. Bull.* 481). These facilities were developed as a means of reducing the growing volume and increased cost of processing paper checks. At the present time, the Federal Reserve provides processing, settlement and delivery services on a regional basis for 31 automated clearing house associations and makes available settlement and delivery services for two privately operated ACHs. These facilities are also used in connection with the Federal Reserve's participation as fiscal agent in the Federal government's recurring payments program. At the present time the major portion of Federal Reserve System ACH transactions consist of direct deposit and other funds transfers for the United States Treasury.

In 1976, the National Automated Clearing House Association (NACHA) requested Federal Reserve participation in a pilot study to determine the feasibility of handling inter-District ACH items over the Federal Reserve Communications System. Ten ACHs participated in the interregional pilot. Depository institutions belonging to the participating ACH associations received instructions from corporate customers to pay out or collect funds from customers who elected to participate in the program. Generally, under the pilot, the instructions were for the collection of insurance payments and for income payments. The customers deposited these instructions on magnetic tape with their local Federal Reserve clearing and settlement facility, and the instructions were transmitted to the receiving facility using the Federal Reserve Communications System. The receiving Federal Reserve ACH facility processed and delivered the instructions to the appropriate depository institutions for debiting and crediting to the accounts of their customers. Settlement for the funds transferred was through the reserve accounts of member banks.

The feasibility and potential benefits of a nationwide ACH facility has been demonstrated in the Treasury's direct deposit program and in the pilot test of interregional commercial payments. The Board believes that the probable long run efficiencies resulting from interconnection of all operating ACH facilities justify the Board's action at this time to provide these services to the Treasury, member banks and other members of ACH associations. Moreover, the Board regards its action to interconnect the current regional ACH facilities as a research and development program that will provide technical data and experience in the operation of nationwide ACH facilities. The Federal Reserve System intends to make this information available to those in the private sector interested in the development of alternative systems.

The Board intends to continue to reevaluate Federal Reserve participation in the ACH program in order to assure that its actions remain consistent with its payment mechanism responsibilities. In this regard, the Board views its participation in a nationwide ACH facility providing services to member banks, other depository institutions and the U.S. Treasury as an appropriate activity. The Board has carefully considered the report of the National Commission on Electronic Fund Transfers to the President and Congress with regard to the Federal Reserve's role in the development of ACH systems. The Board's participation in a national ACH system for depository institutions was specifically considered by the Commission and was determined to be a proper action for the Federal Reserve (Final Report — National Commission on Electronic Fund Transfers (1977), p. 214). In addition, upon review of the results of the interregional pilot, the National Automated Clearing House Association, comprised of 9,000 member and nonmember banks and 1,000 thrift institutions offering ACH retail payment services to their customers, has requested that the Federal Reserve take action to interconnect local ACH facilities nationwide in order to provide financial depository institutions with access to a basic level of automated clearing and settlement nationwide, as in the check system.

The technical procedures and time schedule employed in the pilot test of interregional clearing and settlement are expected to serve as the model to be used in providing such service nationwide. The longer-term objective is to provide a clearing and settlement system that is more efficient than the check system. The Board anticipates that Reserve Banks will work closely with the national and the local ACH associations in imple-

menting interregional ACH services as it believes such cooperative efforts are necessary and have been successful in the past.

Currently, member banks and members of automated clearing house associations, including thrift institutions, may utilize the ACH clearing and settlement facilities operated by Reserve Banks locally in 31 regions for commercial payments. The procedures described in Treasury regulations for the delivery of government payments nationwide by Reserve Banks are not affected by today's announcement.

In a related matter, the Board is continuing to develop a regulatory framework for Federal Reserve Bank ACH clearing and settlement operations that will accommodate current ACH arrangements. The proposed Subpart C to Regulation J has been revised since its most recent publication for comment in January 1976 (30 *Federal Register* 32952 and 41 *Federal Register* 3097) when it was proposed along with Subpart B to that Regulation. Subpart B was adopted by the Board in September 1977 (42 *Federal Register* 31763). The Board intends to republish the proposed Subpart C in revised form for public comment in the near future.

To aid the Board in its final consideration of these plans, interested persons are invited to submit comments, views or arguments. Any such material should be submitted in writing to the Secretary, Board of Governors of the Federal Reserve System, Washington, D.C. 20551, to be received not later than February 28, 1978. Such material will be made available for inspection and copying upon request except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information.