

BOARD OF GOVERNORS  
**FEDERAL RESERVE BANK  
OF NEW YORK**

[ Circular No. 9287 ]  
[ April 30, 1982 ]

**AUTOMATED CLEARING HOUSE SERVICES**

**Plan To End Incentive Pricing By 1985**

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

The following statement has been issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has announced a plan to end incentive pricing of Automated Clearing House services by 1985.

To achieve a smooth transition, the Board will increase its ACH prices in stages as follows: new ACH prices to be announced later this year will amount to 40 percent of the current costs plus the private sector adjustment factor. This ratio will rise to 60 percent in 1983, 80 percent in 1984 and 100 percent in 1985.

Announcement of the program came in a letter to Senator John H. Chafee, chairman of the Subcommittee on Consumer Affairs of the Senate Banking, Housing and Urban Affairs Committee. A copy of the letter to Senator Chafee is attached.

When the Board originally established its pricing policies following passage of the Monetary Control Act in 1980, the ACH was still in the development stage and needed encouragement to grow. Consequently, the Board established an incentive pricing policy to encourage growth to the point where economies of scale could be realized.

In making the announcement, the Board said the development of business plans in the private sector should benefit from the knowledge of when full-cost pricing of ACH services by the Federal Reserve will begin.

The Board determined that incentive pricing should be phased out rather than ended abruptly because an abrupt change in ACH prices could very well cause many ACH users to revert to paper checks. This would jeopardize the future of a cost-effective and efficient service. One necessary ingredient in the private sector's determining whether to provide ACH services is a volume of sufficient size to allow potential operators to offer the service at an attractive price.

Printed on the following pages is the letter on ACH pricing to Senator Chafee referred to in the above statement. Questions on this matter may be directed to James O. Aston, Vice President, Check Processing Function.

ANTHONY M. SOLOMON,  
*President.*



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

LYLE E. GRAMLEY  
MEMBER OF THE BOARD

April 26, 1982

The Honorable John H. Chafee, Chairman  
Subcommittee on Consumer Affairs  
Committee on Banking, Housing, and  
Urban Affairs  
United States Senate  
Washington, D. C. 20510

Dear Chairman Chafee:

In view of the cancellation of my appearance before your Subcommittee, I thought it might be helpful to you if I outlined the substance of the ACH pricing testimony I had planned.

When the Board originally established its pricing policies the Automated Clearing House was still in a developmental stage and needed encouragement to grow. Consequently, the Board established an incentive pricing policy for ACH operations to encourage this growth to the point where economies of scale could be realized.

We believe that this is still the proper decision, but we also recognize that the development of business plans in the private sector would benefit from knowledge of when full-cost pricing of ACH services by the Federal Reserve will begin.

The Board has therefore decided to phase out the incentive pricing policy and to establish a specific date to begin pricing of ACH services based on the full costs of providing the service, including the private sector adjustment factor. To achieve a smooth transition, the Board plans to increase its ACH prices in stages as follows:

--New ACH prices to be announced later this year will amount to 40 percent of the current full cost of production.

--This ratio will rise to 60 percent in 1983, 80 percent in 1984 and 100 percent in 1985.

There were several factors that led us to the conclusion that we should phase down our incentive pricing policy through 1985 rather than end it

abruptly. The present ACH prices of one cent for local ACH items and one and one-half cents for interregional items are quite low. If fully costed prices were implemented immediately, the price increases would be substantial and could very well cause many users of the ACH service to revert to paper checks. Since commercial ACH volume is growing at a rapid pace, although it still constitutes only a small fraction of total payments, we believe such an action would jeopardize the future of a cost effective and efficient service.

More than 60 percent of all payments processed through the ACH are originated by the Treasury Department. As fiscal agent for the United States government, the Federal Reserve is obligated to disburse payments for the Treasury Department. Because of this responsibility we would continue to operate ACH facilities regardless of our policy towards commercial payments. As a result of the Treasury volume processed and the economies of scale inherent in ACH operations, the Federal Reserve's ACH unit costs should be lower than those of the private sector.

One very necessary ingredient in the private sector's determining whether to provide ACH services is a volume level of sufficient size to allow potential providers to offer ACH services at an attractive price. At present, commercial volume appears to be too low for anyone to produce ACH services and sell them profitably.

Despite the cost savings that studies have shown can be achieved through the use of the ACH, and the security and convenience of the service, there are several factors that still act as disincentives when corporations and consumers compare the ACH to checks. First, the value of float resulting from the check collection process is lost to originators when payments are initiated electronically. At today's interest rates, the benefits of check float can be substantial. Second, depository institutions do not currently price check services on a fully costed basis. The costs for a depository institution to process a check are estimated to range from \$0.24 to \$0.59 per item. But depository institutions' fees range from minimum balance requirements to explicit fees of around \$0.10 to \$0.20 per check. Because originators pay very little of the costs of making check payments, they currently do not have an economic incentive to change their payment practices.

We recognize that our decision to phase out incentive pricing may initially be a setback to ACH volume growth. But there are reasons to be moderately optimistic about the future of the ACH. Significant changes are taking place in the banking industry that will help to place increasing emphasis on explicit pricing to cover the costs of providing payment services. Such changes may very well provide the stimulus for rapid growth of the ACH within the

the next several years. By that time, the marketplace should be in a position to evaluate the costs and benefits of the ACH service and thus to decide whether competitive ACH facilities and networks would provide an adequate return on investment.

I trust that this information will be helpful to you.

Sincerely,

Lyle E. Gramley