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WASHINGTON, D.C.--The Federal Reserve today announced planned revisions in priced services offered to depository institutions.

The changes were announced by E. Gerald Corrigan, president of the Federal Reserve Bank of Minneapolis and chairman of the System's Pricing Policy Committee. The changes will be phased in over a number of months beginning in August.

Among the changes announced are technical revisions in the method for pricing Federal Reserve services and accelerations in the collection of certain classes of checks. Also announced were plans for further reduction of Federal Reserve float and pricing of automated clearinghouse (ACH) services. Plans for an electronic check collection (ECC) program that had been under discussion will be discontinued.

The Federal Reserve Board intends to consider in the week of August 2 a proposal to seek public comment on the issue of noon presentment. The Board's decision in this, and perhaps in other matters, will have an impact on the effective dates mentioned in the pricing policy document.

In announcing the pricing and service changes, Mr. Corrigan emphasized that the Federal Reserve System's continuing objective is to enhance the efficiency of the payments mechanism in a manner consistent with the Fed's overall public responsibilities.

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The System's initial pricing strategy was based on detailed cost estimates and involved calculating individual product costs, then adding a private sector adjustment factor (PSAF). The revised pricing technique recognizes that the value of some services might be different from their costs and takes into account prevailing market practices. The most important and widespread use of this technique will be reflected in prices for handling certain types of cash letter deposits (checks deposited with the Federal Reserve for clearance) where major improvements have been made in the availability of funds to depositing institutions.

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FEDERAL RESERVE SYSTEM PRICING: AN OVERVIEW

Presented by

E. Gerald Corrigan

Chairman, Pricing Policy Committee

and

President, Federal Reserve Bank of Minneapolis

July 29, 1982

## I. Introduction

My purpose today is to provide an overview of the Federal Reserve Banks' experience during the first year of pricing and to share with you our plans for the next year or so with respect to our priced services activities. I am sensitive to our responsibilities to keep depository institutions informed of our intentions in this area. Now, with a year or so of pricing experience behind us, we are in a position to better formulate and articulate a reasonably comprehensive overview of those plans. Before getting into the specific elements of our plans, let me begin by providing perspective on where we are right now and a brief overview of how we see our role in the payments area.

## II. The Role of the Fed in the Priced Services Environment

The basic purpose to be served by a continued Federal Reserve presence in the payments service--indeed, the purpose intended by the Congress--is to contribute to the efficiency and integrity of the payments mechanism. As a corollary to this, it is simple enough to say that as long as we are serving that purpose, we should remain in the business and, on the contrary, if we are not serving that purpose, we should get out of the business. While the logic of this proposition is clear enough, it is not as simple to develop an operational and functional approach that should guide our day-to-day actions.

On the surface, the issue would seem to come down to the question, How will we know if we are contributing to the efficiency of the payments mechanism? In one sense the "market" should answer that question. If there are enough takers of our services at prices that will generate sufficient revenue to cover our costs in a highly competitive market, the presumption

would be strong that our presence in the market is contributing to that underlying goal of efficiency. However, even that seemingly acid test cannot be a sufficient guide to our conduct. For example, the Monetary Control Act of 1980 (MCA) speaks of costs matching revenues "over the long-run," giving due regard to "competitive factors and the provision of an adequate level of such services nationwide." That language alone suggests to me--as does our initial experience with pricing--that there is no cookbook-like formula that can or should serve as a one dimensional guide to our actions--particularly in a context in which it is recognized that we remain a public entity. Taken in historical perspective, the Federal Reserve also has inescapable responsibilities for the safety of the payments mechanism as well as for insuring the overall adequacy of payments services. We cannot back away from these responsibilities even in the so-called pricing environment.

Since we do not have the luxury of a one-dimensional guide to our actions, it will, I am sure, come as no surprise to most of you that we in the Fed have given extensive thought to devising an operational approach that will permit us to best meet the pricing provisions of the MCA while continuing to serve our historical public responsibilities regarding the payments mechanism. Our first attempt--as reflected in our initial schedule of fees--was rather simple. We essentially calculated our costs for each individual

product, added on the private sector adjustment factor (PSAF), mailed out the resulting price schedule and, in effect, let nature run its course. Despite our conservative but reasonable initial approach--or perhaps because of the approach--we have learned much in our first year of pricing.

Let me mention a few things that stand out in my mind. First, it does appear that Fed prices are generally within the range of private suppliers' prices. That, in turn, implies that the visible presence of our prices in the marketplace should be working in the direction of lowering the overall costs to society of payment services. Second, although we have lost volume, there are literally thousands of institutions--including approximately 3,000 nonmember institutions that heretofore did not have full access to Fed services--that are securing at least some services from the Fed. The fact that so many institutions choose to obtain services from the Fed when alternatives are often so readily available also says something. We want Fed pricing to have the desirable effect of causing all market participants--the Fed included--to sharpen their pencils in search of lower costs and better services. If we accomplish this, the Fed's operational presence in the payments mechanism will contribute further to the efficiency and integrity of the payments mechanism, while permitting us to retain the capability of providing minimal levels of services at reasonable prices in the event such services might not otherwise be available.

### III. The Transition to Pricing

As you are aware, Fed pricing is only about a year old. As I have implied, the transition from an environment of "giving it away" to the priced and competitive setting has not been easy. However, I suspect that our situation, while more difficult in degree, has something in common with the problems faced by many financial institutions in learning to price their products in a deregulated setting as well as something in common with the problems the airline industry is grappling with in the face of deregulation. But whatever problems the banks and the airline industry have had in adjusting to deregulation, our problems have been different. In part our problems are different because pricing is entirely new to the Fed, and in part because we must not, in the interests of pricing, back away from our essential and ongoing public responsibilities.

To some extent, the situation we have faced in making the transition to pricing was heavily conditioned by developments that pre-dated pricing. For example, for reasons quite apart from the prospect of pricing, the Federal Reserve Banks had--in the years prior to 1980 when the MCA was enacted--done quite a good job of resource management. For example, between 1974 and 1980, employment in our payments service operations was reduced by more than 17 percent and our expense growth was held significantly below the rate of inflation. During that same period, productivity rose by a rather remarkable 77 percent. Thus, long before pricing was upon us, the Fed had been moving aggressively in a direction that would serve it well, from a cost point of view, in the pricing environment.

If that was the good news, there was also some bad news. For example, in the 1978-1979 period, the Fed made a commitment to expend tens of millions of dollars on its long-range automation program. The rationale for this decision was heavily, if not totally, dictated by considerations relating to the effective discharge of our public responsibilities--including those related to monetary policy--rather than in anticipation of pricing our payments services. That program, taken in the context of the sharp reductions in personnel over the 1974-1980 period, has had the effect of significantly shifting the weight of our costs to the "fixed" or "overhead" variety. Thus, our current cost structure is one in which, in most cases, making quick adjustments to even relatively modest changes in volume is not easy nor, in some cases, even desirable.

If the transition to pricing has had its uncertainties--and it surely has--none were greater than those relating to what would happen to Fed processing volume under pricing. And, our initial pricing endeavor--wire transfer services--would, because of the nature of the product, tell us little about this phenomenon. The big test would come with check pricing because it constitutes three-quarters of our overall costs of priced services and because alternatives to Fed check services are so readily available in virtually every location in the country.

In any event, I think it is fair to say that, on balance, the volume drops we have experienced were faster than we anticipated. We expected--and welcomed--a drop in check volume due to the emergence or reemergence of local clearing operations. We welcomed this development because it contributed to efficiency even if it did cut into our volume.

Let me be specific. Since pricing began and through the first quarter of 1982, we estimate that the total volume of our priced services activities has dropped by about 20 percent. To be even more specific, the volume of checks actually processed by the Fed Banks has dropped by 22 percent.

Almost half of the drop in processed check volume has been offset by a sharp rise in handling of fine sort or packaged checks. Most, if not all, of the drop in processed check volume occurred in the period August 1981 through February 1982. The speed with which check volume fell off, together with the fact that the volume drop has been very uneven from Fed office to Fed office, suggests that, in fact, much of it has been due to the resurgence of local clearing arrangements. It is also relevant to note that the gains in fine sort volume suggest that the Fed provides a necessary and vital coupling link between collecting and paying banks that facilitates the delivery and settlement of those payments.

Whatever its origins, the volume drops have put the Fed in a difficult position with respect to the task of generating sufficient revenues to cover its costs and the PSAF. Sharp resource adjustments have been made as indicated by the fact that our System-wide work force in check operations is expected to drop by more than 10 percent in 1982. However, while the amount

of real resources devoted to our priced services activities has remained about flat in the last year or so, volume declines and the rise in nominal costs have produced a short-run divergence between our costs (including the PSAF) and our revenues. For example, in February that gap reached 28 percent, but preliminary estimates suggest that by May the gap had been narrowed to a little bit less than 18 percent. The latter, of course, means that as of May, we were covering almost all costs but not the 16 percent PSAF. As we see it, however, our shortfall does not so much reflect the fact that we are wildly out of line in costs or prices as much as it does the difficulties of adjusting our cost structure in the short-run and the "mechanical" problems associated with a first cut at pricing.

Against this background, in February we began a basic reassessment of our approach to pricing. In that process, considerable weight was given to developing plans which would permit an orderly narrowing and elimination of the cost-revenue gap growing out of the volume declines experienced. Thus, the program we have embarked upon anticipates that by the fourth quarter of 1982 the Reserve Banks, as a group, will be generating sufficient revenues to cover all costs and part of the PSAF. Several individual banks that have experienced more modest volume drops are expected to cover all costs and the full amount of the PSAF in that time frame. On the other hand, a couple of banks which have had substantial volume drops will take longer to make the adjustments needed to match revenues with costs. In any event, we expect that all Reserve Banks will have made the transition to a cost plus PSAF/revenue match by late 1983.

The cost-revenue gap situation we faced brought into sharp focus a series of both strategic and tactical questions concerning our approach to pricing. Indeed, given the drops in volume and the resulting cost/revenue gaps, we had three basic choices. First, we could simply conclude that we should begin a planned, wholesale withdrawal from the payments business; second, we could drift along in much the same mode we had adopted in our first year of pricing and more or less let the cards fall as they might; or third, we could take a more responsive and flexible approach to pricing.

After due consideration, we have chosen the third alternative. We did so for a number of reasons. On the one hand, a planned withdrawal from the payments business does not seem compatible with the objective of working toward the efficiency of the payments mechanism nor is it compatible with those other essential public responsibilities mentioned earlier. Moreover, most financial institutions--small and large institutions alike--seem to agree that the Fed must play a role in the payments process. This, of course, does not mean that we will not drop an individual service component where the market tells us we have nothing to offer or where there is no public benefit associated with our activities. Nor does it mean that, in time, we would not drop full lines of service if events so dictate. However, it does say to us that we should make an honest effort to maintain a viable presence where that presence is demonstrably compatible with the efficiency goal and compatible with our overall public responsibilities.

We have also concluded that a continuation of the passive--if not mechanistic--approach we had initially adopted was not likely to provide much of a test of the extent to which the Fed's operational presence in payments activities was working to increase overall efficiency. Thus, if we are to genuinely help insure that payment services are delivered in the most effective and cheapest manner possible, we should emphasize a coordinated program of cost containment, product enhancement and product promotion. This does not mean that we will behave like a private correspondent bank. We are a public institution and we will remain so. Similarly, this approach does not mean that we covet any particular share of the market. Our fundamental mission, as we see it, is to contribute to the efficiency and safety of the payments mechanism and the program I will outline below has been developed with this underlying objective fully in mind.

#### IV. Prospective Changes in Check Services and Prices

In mid-August, the Federal Reserve Banks will be announcing new check prices and services which will take effect on September 30, 1982. In the same general time frame we will be implementing a number of important changes in service levels, a modified approach to price determination, and completing the job of eliminating or pricing Federal Reserve float. To put the overall program into perspective, let me comment briefly on those major elements of the check repricing effort.

##### A. Price Setting Methodology

The new check prices which will be promulgated in mid-August reflect some departure from our earlier pricing methodology. As I mentioned earlier, our initial price setting exercise was rigid, mechanistic, and solely driven by costs. No effort was made to price in a manner that recognized that the value of some services might be different than their "costs" nor was any effort made to take account of prevailing market practices.

Essentially, the new pricing approach starts with the proposition that, for the full line of check processing services, costs (including the PSAF) and revenue must match. However, within the overall check service line, we wanted to build in more flexibility to vary prices in line with market forces. Therefore, the approach we have adopted is one which says that for any individual product within an overall service line the prices must at least cover direct production costs. Of course any shortfall from total cost recovery for one product in the check service line must be compensated for in the prices of other check products. In effect, therefore, we have built an element of flexibility into the pricing methodology which permits overhead costs to be spread among individual components of an overall service line in accordance with judgments concerning the relative demand for these individual service components. Rigorous control and monitoring procedures have been established to insure that this added degree of flexibility is used conservatively and judiciously. We believe that this is a more appropriate approach to pricing and that it is more in line with typical pricing practices.



The adoption of this approach to pricing will, of course, mean that our prices, when published in mid-August, will look a bit different than they do today. It also means that there could be more variability in specific prices among Federal Reserve offices. By and large, however, the extent to which this added flexibility has been used by the Reserve Banks will be quite limited. The most important and widespread use of this technique will be reflected in prices for certain types of cash letter deposits where we have

made major improvements in availability and have thereby vastly enhanced the value of the service. Thus, the modified approach to price determination is not only one that provides somewhat more flexibility, but more importantly, it will provide the opportunity to create price incentives that will work in the direction of making the payments system work better.

#### B. Improvements in Availability

While the individual Federal Reserve Banks have already implemented or are planning to implement a number of enhancements in check processing services, the most important change will come about due to dramatic accelerations in the collection of certain classes of checks. The principal catalyst for these enhancements will be a reconfiguration of the Interdistrict Transportation Network (ITS) used by the Fed in moving checks around the country. The new ITS network--which will be operated for about the same overall cost as the Fed's current overall air transportation network--will be phased into operation beginning August 1, 1982.

The new transportation network is structured on a "spoke and hub" concept. That is, five hubs around the country will serve a series of spokes, the endpoint of each being a Fed office. Charter planes will make multiple flights nightly between the respective hubs and their spoke endpoints. Checks will be exchanged at the hubs for delivery either to endpoints connected to the same hub and/or for shipment to other hubs with subsequent dispatch to endpoints at those more distant hubs.

By using these transportation arrangements, and by moving to later deposit deadlines for inter-zone checks that are deposited with and transported by the Fed for next-day or same-day credit, we expect to effect major enhancements to the check collection process. For example, under current Fed transportation arrangements and with Fed collection schedules, most inter-district RCPC items are two-day availability points. Under the new arrangements, we expect that 50 to 70 percent of these inter-district items will be collected and credited within one day--thereby accelerating by 24 hours the collection of items valued at between \$1.6 and \$2.6 billion per day. At current interest rates, the value of their acceleration in collection can be as much as \$1 million per day or a staggering \$360 million per year.

This change--while clearly in the interest of improving the speed and efficiency of the overall check collection process--is not one without its own problems and transitional difficulties. At the Federal Reserve Banks, for example, processing windows for late delivery work will be shortened.

Similarly, with the related shift to 12:00 noon presentment for city checks, the processing windows for at least some banking organizations will also be shortened. Over time, a more generalized shift to a later presentment may also create some transitional problems for other classes of payor banks and to certain of their corporate customers. On the other hand, many depositing banks will have considerably more time to get interzone checks into the Fed network for same day or next day presentment and credit. For example, under current arrangements, checks deposited at the New York Fed drawn on a Chicago city bank must be at the New York Fed by 12:30 a.m. for same-day availability. With the restructured transportation arrangements such checks can be deposited at the New York Fed as late as 3:00 a.m.

Let me digress here for a bit and speak directly to the 12:00 noon presentment issue which I know has been a source of contention to some institutions. While we have talked informally about moving to later presentment for quite sometime, and have provided reasonable advance notice of our intent to shift to 12:00 noon presentment for city items, we did not necessarily do either of these things within a context that made readily apparent the rationale for changing presentment hours. In some ways, the most essential ingredient in that missing context is, of course, the overall acceleration in check collection we expect to achieve by a combination of initiatives-including, but not limited to, 12:00 noon presentment. Also, it was not necessarily apparent to all that the shift to later presentment would be accompanied by substantially later deposit hours for certain classes of cash letters.

In any event, a number of banks and some of their corporate customers have indicated that they may have some transitional problems associated with 12:00 noon presentment. While we are sensitive to those problems, we also believe that they are manageable, because most checks will still be presented to city banks much in accordance with existing schedules.

Indeed, the noon presentment hour should be viewed as the latest hour at which time presentment will take place. In practice, the presentment of most checks by virtually all Federal Reserve offices will take place in advance of the noon deadline. However, in order to ensure that these changes in check collection procedures are digested by banks and their customers with a minimal amount of difficulty, we have modified the schedule for implementation of later presentment to provide a further six-week period over which the changes will be phased in.

The first phase of implementation will start on August 2, when the Reserve Banks will begin presenting checks to reserve city banks no later than 11:00 a.m., unless the Reserve Bank is currently presenting checks after that time. Presently, Federal Reserve offices in at least four Districts present checks as late as 12:00 noon to some city banks, and offices in eight Districts present checks to some banks outside of the reserve city at 12:00 noon or later.

The second step in the phase-in will occur on August 16 when the Reserve Banks will shift to later deposit deadlines for inter-zone RCPC checks. Of course, these later deposit times will translate into more rapid collection of these items.

The final step of the implementation will occur on September 16 when deposit deadlines for inter-zone city checks will be moved forward. At this time, 12:00 noon presentment will be implemented, but even then we fully expect that the presentment of most city items by Fed offices will occur prior to the noon deadline.

This modification in the program should help minimize transitional problems associated with this change in check collection procedures. Even then, some problems may remain, but I believe these problems must be considered and resolved in the context of the overall benefits of the program in its entirety--including the fact that accelerating the collection of checks should encourage further shifts to electronic payments. In this larger context, we are obviously convinced that the program is appropriate and consistent with our continuing objective of improving the payments process.

### C. Float Reduction and Elimination Program

Financial institutions around the country are quite familiar with the fact that the Fed has made dramatic progress in reducing float--some I suspect are all too familiar with our progress. The record speaks for itself. In the first quarter of 1980, Fed float averaged \$4.9 billion whereas in the second quarter of 1982 float averaged \$1.8 billion. This reduction in float increased our payments to the Treasury by about \$350 million. However, to the extent we have reduced float, someone else--be it a bank, a corporation, a state or local government, etc.--has in one way or another, picked up the tab. That is one of the ironies of float, whether it is Fed float or one of the many other forms of float that, in the aggregate, are symptomatic of inefficiencies in the payment mechanism.

Indeed, the greatest irony of all is that the float game is played with the expectation that there will be net winners when, in fact, float is, by definition, a zero sum game. As a practical matter, however, there are winners--some by accident of location, some by clever design, some by the sheer weight of their relative economic power and even some by outright abuse. However, it is very hard--if not virtually impossible--to identify the specific winners and the specific net losers in float. That reality has had, and will continue to have, an important impact on the Fed's approach to pricing or eliminating float.

Some would suggest that the simplest way to proceed would be for the Fed to immediately and directly price Fed float. A move in that direction could be achieved either by charging payor banks directly for "actual" float or by folding the value of Fed float into our overall check prices. The former approach entails a morass of technical, administrative, accounting, and legal issues. The latter approach just does not make good sense to us because it would not create any incentive to get rid of float. Indeed, to the extent that relative economic power--to say nothing of abusive practices--has anything to do with who benefits from float, this approach could produce perverse results. To state the case more directly, we want to go about the task of eliminating or pricing float in a way that places the incentives and the disincentives where they belong. The costs of float or

float reduction should be borne, to the fullest extent possible, by those who "benefit" from float and particularly by those who are engaged in deliberate efforts to create float.

It is primarily for this reason that the Fed, in its float reduction efforts to date, has placed so much emphasis on float reduction rather than prematurely attempting to explicitly price float. Over the next six to nine months, we will continue to emphasize operational improvements in our efforts to eliminate float. However, beginning in early 1983 the thrust of the program will begin to move in some new directions in that we will begin to alter crediting procedures for interterritory cash letters and/or to explicitly price holdover and intraterritory transportation float.

Specifically, we have developed a comprehensive program which, by roughly the end of the first quarter of 1983, should reduce the level of Fed float to a low frictional level. (See Table I below.)

TABLE I

SUMMARY OF PROPOSED SYSTEM FLOAT REDUCTION PLAN FOR 1982/1983

<u>Approximate Target Date</u>	<u>Proposed Action</u>
September 1982	Charge payor institutions for cash letter presentments on mid-week closings.
September 1982	Wire advice for return items equal to or greater than \$50,000.
September 1982	Wire advice of adjustments equal to or greater than \$50,000 (short-term measure). Automate adjustment process (long-term measure).
January 1983	Change crediting procedures for interterritory cash letter deposits.
Early 1983	Eliminate or price holdover float.
Early 1983	Eliminate or price intraterritory transportation float.
Early 1983	Eliminate or price noncheck float.

At present, the largest remaining component of Fed float results from the shipment of interdistrict checks between Federal Reserve offices. Such float now amounts to about \$1 billion on a daily average basis. The current practice is to give credit availability for each category of check deposit according to a fixed (whole day) schedule. As a result, anything that goes amiss in the usual transportation cycle will slow the collection of

a portion of the checks and float results. Therefore, the key to the success of our float program rests with our success in dealing with this element of float. To some extent, we anticipate that the major improvement of the ITS transportation network discussed earlier should get things moving in the right direction. However, the major changes which should do the job will come in January 1983 when the Reserve Banks modify the way in which they credit depositors for interterritory cash letter deposits. The Reserve Banks will be permitted to offer any or all of the following methods:

- (1) Fixed availability initially with "as of" adjustments to correct for float after it occurs;
- (2) Actual availability where credit is passed only when the checks are received on a timely basis by the payor banks' Federal Reserve office;
- (3) Fractional availability, in which fixed but fractional day availability is given so that float is zero on average; and
- (4) Payment for float by holding a clearing balance at Reserve Banks.

We are providing these four options in the interest of trying to satisfy the differing needs of the various types and sizes of banking organizations that receive checks from the Fed. However, as a practical matter, we believe events will gravitate in the direction of actual availability and the use of clearing balances.

In order to execute this program, the Federal Reserve Banks are now developing a Systemwide, automated "cash letter monitoring system." That system will permit us to track and pinpoint almost instantaneously the location of any cash letter in the Fed collection network. We believe that this system will provide major benefits to us, to banking organizations, and to the payments network generally. It may even help us in the execution of monetary policy as it should permit us to provide the Open Market Trading Desk in New York with more accurate and timely estimates of the amount of float that open market operations must offset or accommodate in managing the reserve position of the banking system as a whole. More to the point in the current context, however, the cash letter monitoring system will permit us to take the next and last major step in the float reduction/pricing program in a manner that is consistent with the objectives I outlined earlier.

Assuming these programs, in the aggregate, succeed in getting float down to some low level around mid-1983, we will have another bridge to cross. Namely, what to do about the remaining or frictional levels of float? We have not yet made that decision, in part because we are just now beginning to focus on the question of whether there is some low level of Fed float which might properly be viewed as a necessary lubricant for the payments mechanism. That, of course, is a very complex and undoubtedly controversial question, and it is also one that in the final analysis might require a change in the statute. For now, however, we must wait to evaluate how these other initiatives work. We will then be in a better position to determine the amount of residual float we are left with and what should best be done with that residual.

D. Other Near Term Pricing Initiatives

While most of what I have said is related to the check processing activities of the Federal Reserve Banks, there are a number of other near and intermediate term plans in other areas of which financial institutions should be aware. Let me, therefore, comment briefly on these pending developments.

1. ACH Prices: On or about August 16, the Reserve Banks will be announcing the new schedule of ACH prices. These prices will represent the first step in our stated objective of recovering full costs of ACH operations in 1985. At this time, we fully expect that there will be no further ACH price increases until August of 1983. It is contemplated that the new ACH price schedules will also differ from the current price schedules in that they will incorporate a differential price for originators of debits and the receivers of credits and will also incorporate a night cycle "premium" price. I should also tell you that we have commissioned a number of longer term studies of what can be done--in cooperation with the private sector to promote the use of the ACH.
2. Securities and Noncash Collection Repricing: At the present time we contemplate that new price schedules for our securities processing and safekeeping services, along with coupon collection services, will be announced on or about November 15 to take effect as of the first of the year, 1983. At this time, we are still analyzing our experience with securities pricing and what modifications in prices and the structure of prices would seem most appropriate.
3. Cash Transportation Services: We have not yet begun to focus in detail on the cash service area as it was not initially priced until earlier this year. However, I tentatively expect that we would announce new prices and any service level modifications early in 1983.
4. Clearing Balances: With the phase-down in member bank reserve requirements called for in the MCA, and given certain elements of our float reduction plan, an increasingly large number of institutions may want or need to establish clearing balance relationships with their respective Federal Reserve Banks. Therefore, in mid-August, we will be announcing a series of changes in our rules governing eligibility and administration of clearing balances. These changes are aimed at providing a greater degree of flexibility to depository institutions and to the Reserve Banks in the establishment and use of clearing balances.
5. Electronic Check Collection: For a number of months the Fed has been involved in design work for a particular form of electronic check collection (E.C.C.). While that analysis has

provided many valuable insights into the problems and opportunities associated with shifting paper payments to an electronic form, the E.C.C. program that has been discussed with the banking industry will not be pursued further by the Fed at this time. Nevertheless, some of the problems to which E.C.C. had been directed (large checks) and some of its objectives (encouraging the shift to electronic payments) remain every bit as valid today as they were a year ago or five years ago. Thus, we will continue our efforts to develop programs and initiatives which can effectively serve those objectives.

6. FRCS-80: As many of you know, last month the Fed began live processing on FRCS-80, the Fed's new nationwide telecommunications network. At present, the Reserve Banks are in the midst of developing standard software packages to replace the existing funds and securities transfers, bulk data, administrative messages and related systems that will use FRCS-80. Of course, the network is highly powerful and flexible and should be able to meet our existing applications for at least the balance of this decade. Over a longer time frame we believe FRCS-80 will be a tool which can help meet the evolving needs of our national payments mechanism.

#### V. Longer-Term Plans

I cannot tell you with any precision what may develop in the longer term with respect to the nature and extent of the Fed's role and presence in the payments area. I can repeat that we are very much inclined to the view that we should seek to maintain a viable, operational presence in the payments business primarily because we believe that presence is consistent with the goal of improving the efficiency and effectiveness of the payments mechanism. Similarly, I can tell you that there are a number of related objectives to which we remain strongly committed. These would include encouraging a continued shift toward faster, cheaper, and more certain forms of payment and, to the maximum extent possible, encouraging an evolution in payment practices in which institutions, small and large, and individuals will be direct beneficiaries of those constructive changes we help to foster. Achieving those objectives may not require that the Fed perform all of the operational functions it performs today. On the other hand, it may require that we take on some things that we do not do today. If need be, we are prepared to move in that direction as well.

The important point as I see it, however, is not so much the precise role that the Fed plays in this process of change nor is it the precise role that any one institution, or group of institutions, plays in that process. To the contrary, the genuinely important point is to recognize--as I believe we all do--that we in the Fed and you in the financial industry have a common interest in seeing that these objectives are well served.

Having said that, let me say something you already know. There simply is no way that each thing we do can please 15,000 banks, 4,000 S&LS, 400 savings banks, and 20,000 credit unions. If we speed up check collection and reduce float, inevitably, somebody is "hurt" and unhappy. But many others are better off. If we adopt later presentment hours, someone's ox is perceived as being gored, but here too, many others are better off. Those realities should not deter us nor you from seeking out those larger areas where we have common interests and from working together to achieve those larger objectives of which I spoke earlier.

In closing, let me say a few words on a related subject. In virtually every form in which the subject of Fed pricing is discussed among financial institutions, the point is made that the Fed might, could, or perhaps even has, used its regulatory authority to its competitive advantage. We are extremely sensitive to this point of view.

I firmly believe our safeguards against abuse of our regulatory authority are more than adequate. Foremost of those safeguards is our own extremely high level of sensitivity to the issue. In addition, the fact that we operate under such close public scrutiny is, in and of itself, a powerful safeguard. Beyond that, we have also taken steps within the Reserve Banks to create our own version of the "Chinese Wall" by segregating, to the maximum extent possible, priced service activities from other activities within the Banks. Finally, if despite all of this, we appear to cross the line, there are obviously numerous avenues of redress available to those who may perceive that the "Wall" has been breached.

In my judgment, the best way to insure that the problem does not arise is to seek out opportunities for open and frank discussion of our concerns, our plans, our priorities, and our intentions. Consistent with that, I believe the time may be at hand when some degree of more formal and regular communication between the Fed and the financial industry--at the level of the policymakers--may be appropriate, and I would welcome your views as to how that might be accomplished. Earlier, I mentioned two areas--the future of the ACH and moving on with a viable form of E.C.C.--which I believe are ripe candidates for such dialogue. In the meanwhile, I hope that we in the Fed have, through this vehicle, begun to more adequately provide insights into our current plans.

Thank you.