

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. 10,065]
August 1, 1986

**PROPOSAL REGARDING TIERED PRICING
FOR FEDERAL RESERVE CHECK COLLECTION SERVICES**

Comments Due by September 19, 1986

*To All Depository 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:

The Federal Reserve Board issued for public comment a proposal to allow the head offices of the Federal Reserve Banks of Minneapolis and Kansas City to continue a tiered-pricing structure for check collection services.

The proposal also outlines the conditions under which other Reserve Bank offices could establish tiered pricing for check collection services. Comment is requested by September 19.

Under tiered pricing, different fees could be charged to financial institutions depending upon whether a check was sent to a high- or low-cost presentment point. This fee structure was first tested at the head offices of the Minneapolis and Kansas City Reserve Banks in April 1985 because of the significant differences in the unit cost of clearing checks drawn on high- or low-volume presentment points.

If the proposal is adopted, Reserve Banks will be able to offer collecting institutions check collection services at prices that more accurately reflect actual costs. This should result in a more efficient allocation of resources in the payments mechanism.

Printed on the following pages is the text of the proposal, which has been reprinted from the *Federal Register* of July 25. Comments thereon should be submitted by September 19, 1986, and may be sent to the Board of Governors, as specified in the notice, or to John F. Sobala, Vice President, Check Processing Function at this Bank.

E. GERALD CORRIGAN,
President.

FEDERAL RESERVE SYSTEM

[Docket No. R-0532]

Fees for Federal Reserve Bank Check Collection; Request for Comment

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comments.

SUMMARY: The Board is requesting public comment on proposals to:

1. implement the tiered pricing structure for check collection services, currently being piloted at the head offices of the Federal Reserve Banks of Minneapolis and Kansas City, as a permanent component of the fee structures at these two Reserve Banks; and
2. establish criteria for determining the conditions under which a tiered fee structure would be extended to other offices of Federal Reserve Banks.

DATE: Comments must be received by September 19, 1986.

ADDRESS: Comments, which should refer to Docket No. R-0532, may be mailed to the Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue NW., Washington, DC 20551, to the attention of Mr. William W. Wiles, Secretary, or delivered to Room B-2223 between 8:45 A.M. and 5:15 P.M. Comments may be inspected in room B-1122 between 8:45 A.M. and 5:15 P.M., except as provided in § 261.6(a) of the Board's Rules Regarding the Availability of Information, 12 CFR 261.6(a).

FOR FURTHER INFORMATION CONTACT: Elliott C. McEntee, Associate Director (202/452-2231), or Gayle Thompson, Senior Analyst (202/452-2934), Division of Federal Reserve Bank Operations, or Earnestine Hill or Dorothea Thompson, Telecommunication Device for the Deaf (TDD) (202/452-3544), Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

Background

The Federal Reserve Banks price their check collection services on a per item basis, with the per item fees generally based on the average cost of collecting items to be presented within a single collection zone.¹ The actual costs of collecting items, however, may vary

¹ A "collection zone" is a geographic subdivision of a Federal Reserve territory. Each collection zone has a specified availability schedule under which credit will be given for a check deposited for collection with the Federal Reserve office serving that territory. Collection zones are referred to as either city, RCPC (for "Regional Check Processing Center"), or country.

depending on whether the place where an item is to be presented (the "endpoint") receives a relatively large or small number of items. Costs generally are higher for items destined for low-volume endpoints because transportation and other fixed processing costs, which do not vary with volume, are spread across fewer items.

If prices for the check collection service were to reflect costs more accurately, collecting institutions could choose better the most effective method of clearing checks. More informed choices should result in a more efficient allocation of resources in the payments mechanism. Accordingly, the Board requested comment on a proposal to test tiered pricing through pilot programs at the head offices in the Minneapolis and Kansas City Federal Reserve Districts. 40 FR 44, 679 (Nov. 8, 1984).

The response to the request for public comment was largely negative, with 43 of 57 commenters (75 per cent) opposed to the proposal. These commenters expressed concern about the impact on billing complexity and the cost to the depositor of verifying Federal Reserve charges and accurately passing back those charges to the depositor's customers. Another concern was that tiered pricing might provide Reserve Banks with advantages over private sector correspondents. Commenters also questioned whether this proposal was a first step toward substantially greater use of tiered prices at many or all Federal Reserve offices. The 11 supporting commenters took the view that pricing at cost more accurately would allow collecting institutions to use the most efficient clearing method available.

In response to these comments, the Board modified the tiered pricing proposal. Most importantly, the pilot programs were made optional. Depositors at the Minneapolis and Kansas City head offices could choose the new tiered price schedule or continue to pay a single fixed fee for all items to be presented in a particular collection zone. For example, in Minneapolis, depositors of RCPC items may choose to pay 2.1 cents for items payable at low-cost endpoints and 3.0 cents for items payable at high-cost endpoints, or an average fee of 2.7 cents for all items payable within that collection zone. In the Kansas City country collection zone, depositors choosing the tiered option would pay 2.3 cents and 3.3 cents for all items payable at low- and high-cost endpoints, respectively, or an average fee of 2.9 cents. These Federal Reserve offices also developed detailed billing

statements to facilitate reconciliation of charges for the depositing institution. The Minneapolis and Kansas City head offices implemented a two-tiered pricing pilot on these terms on April 25, 1985.

Results of the Pilot

During the pilot, one hundred forty depositors of RCPC items in Minneapolis and fifty-five depositors of country items in Kansas City chose to use the optional tiered prices. These institutions represent 34 per cent of the RCPC depositors in Minneapolis and 24 per cent of the country depositors in Kansas City. In both offices, about 40 per cent of the total eligible volume is being deposited under the tiered pricing option. The depository institutions choosing tiered prices represent a cross-section of the industry including large correspondents, community banks, and thrift institutions. Several banks that sent comment letters opposing the initial proposal, nonetheless chose the tiered priced option.

One concern of the commenters was the impact that tiered pricing would have on billing complexity and the depositor's ability to verify charges and accurately passback the appropriate charges to its own customers. Neither Federal Reserve office has received complaints of reconciliation problems from users of the service. Further, responses to a survey of 45 institutions selecting the tiered price option at the Minneapolis office indicated that 73 per cent found no additional reconciliation problems, 20 per cent found reconciliation somewhat more difficult and 7 per cent found it much more difficult. Ninety-six per cent of the respondents favored continued use of a tiered pricing option by Reserve Banks.

Although many private sector service providers use tiered pricing when charging for check collection services, commenters were also concerned that implementation of tiered pricing would disrupt existing clearing patterns by giving the Federal Reserve a competitive advantage over private sector processors. Allowing Reserve Banks to use a fee structure already in common use by the industry should not create any advantage for the Federal Reserve. Further, it does not appear that tiered pricing has led to increases in Federal Reserve check volume. Since the introduction of tiered pricing on an optional basis, the Minneapolis head office's RCPC volume growth has been 4.3 percent, compared to the System average of 4.9 percent for RCPC volume and 5 percent for total volume. The number of institutions depositing checks in the Minneapolis RCPC collection zone was stable, remaining at approximately

300. Kansas City's country volume increased in 1985 by approximately 8.0 percent compared to a Systemwide increase of 4.7 percent; however, a significant improvement in the regular country deadline appears to be the principal reason.²

Finally, commenters were concerned that the implementation of tiered prices at the pilot Federal Reserve offices was only the first step leading to substantial use of multi-tiered pricing at many or all Federal Reserve offices. To address this

² In May, 1985, two weeks after the implementation of tiered pricing, the country deadline was moved from 10:30 p.m. to 12:01 a.m., a one and one-half hour improvement. It is impossible to separate the impact on volume of this deadline change from the impact of the new price option.

concern, the Board is proposing to establish criteria for determining any additional implementation of tiered pricing. In developing these criteria, the Federal Reserve paid close attention to the concerns raised during the previous public comment period.

Proposed Criteria

Under the Board's proposal, the following specific criteria would apply to any Reserve Bank proposal to introduce tiered prices:

1. Adoption of tiered pricing by any additional Federal Reserve office will require approval by the Board.

2. Tiered pricing will be offered as an option to the depositor; an alternative fixed per item fee also will be offered for each deposit category.

3. Tiered prices may be used only where clear cost differences exist between groups of items within a collection zone.

4. Tiered prices may be used only where the introduction of tiered prices has the potential to provide net savings for a substantial amount of depositing institutions.

The Board specifically requests comment on these criteria, and whether additional or different criteria should be adopted.

By order of the Board of Governors of the Federal Reserve System, July 21, 1986.

William W. Wiles,
Secretary of the Board.

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