

FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 10101
November 17, 1986]

PROPOSED REDEPOSIT SERVICE
FOR SMALL DISHONORED CHECKS

Comments Due by December 18, 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 has issued for public comment a proposal to provide a redeposit service for small checks that are returned because of insufficient or uncollected funds. Comment should be received by December 18.

Under this service, Reserve Banks would intercept dishonored checks and redeposit them for a second presentment on behalf of the collecting institution. This practice would speed processing times and reduce costs.

A recent study showed that slightly less than 1 percent of all checks written annually are returned unpaid. Of these, about 53 percent have a dollar value of less than \$100. A test program by the Federal Reserve Banks of St. Louis, Cleveland and Atlanta showed that roughly 60 percent of these checks are paid upon second presentment.

Under the proposal, each Reserve Bank would set its own limit on the dollar amount of checks eligible for the "return item reclearing service." The Reserve Banks would charge a fee to offset all costs associated with the service.

Printed below is the text of the proposal, which has been reprinted from the *Federal Register* of November 7. Comments thereon should be submitted by December 18, 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.

E. GERALD CORRIGAN,
President.

[Docket No. R-0582]

**Fees for Federal Reserve Bank Check
Collection Services; Request For
Comment**

AGENCY: Board of Governors of the
Federal Reserve System.

ACTION: Request for comments.

SUMMARY: The Board is requesting public comment on a proposal to allow the Federal Reserve Banks to provide a redeposit service for low-dollar cash items that are returned unpaid. Under this service, Reserve Banks, following the instructions of their senders, would intercept low-dollar cash items being returned for insufficient or uncollected funds, and redeposit them for collection.

DATE: Comments must be received by December 18, 1986.

ADDRESS: Comments, which should refer to Docket No. R-0582, 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: Earl G. Hamilton, Assistant Director (202/452-3879), 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: Currently, approximately 42-44 billion

checks are written each year. According to a study conducted by the Bank Administration Institute in 1985, slightly less than one per cent of all checks are returned unpaid. Of these, 53 per cent had a dollar value of less than \$100. Many collecting institutions routinely redeposit for collection low-dollar checks returned for insufficient funds, because a large proportion of these items are paid upon their second presentment. The collecting institutions find this practice to be simpler and less expensive than returning the items to their depositing customers. Several years ago, institutions engaging in this practice requested that the Federal Reserve consider offering a service to accelerate this process.

In response to these requests, a pilot program was implemented in the St. Louis Federal Reserve District in July, 1984, to test the feasibility of accelerating the reclearing of certain low-dollar return items. The pilot was

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designed to determine what benefits could be provided to collecting institutions and the payments mechanism if the Reserve Banks were to intercept and redeposit these items on behalf of their senders.¹

In May, 1985, based on encouraging results from the initial St. Louis program, the pilot was expanded to include the Atlanta and Cleveland Reserve Banks. The purpose of the expansion was to provide comparative data to enable the System to evaluate more accurately the benefits of the return item reclearing service.

During the pilot, the reclearing service was offered as an optional service to senders. The pilot Reserve Banks would intercept cash items below a specified dollar value² being returned for the first time due to insufficient or uncollected funds.

Thirty-three senders located in the three pilot Districts chose to participate in the pilot. The majority were in the original pilot District (St. Louis), where the service was provided to a cross-section of senders, including large commercial banks, small commercial banks, and thrifts.

Data collected by the three pilot Districts show that substantial proportions of the senders' return items are eligible for the reclearing service. In St. Louis and Cleveland, approximately 40 per cent of the items to be returned to the participating senders are eligible to be redeposited. In Atlanta, where the dollar cutoff for some institutions is higher, eligible volume is 55 per cent. Approximately 64 per cent of the recleared checks are paid on the second presentment in St. Louis. In Cleveland and Atlanta, the success rates are 57 and 58 per cent, respectively.

Results of the pilot indicate that the reclearing service can benefit senders by reducing the costs associated with low-dollar return items and by accelerating collection times. A survey of selected users of the pilot service found that depositor savings will vary based on the degree that special handling services are provided to corporate customers, procedures for charging the item back to the institution's depositors, and the overall volume of returned checks. While senders of all sizes indicated cost savings, large senders reported labor savings averaging \$.034 per redeposited

check. Other types of savings include fewer out-of-balance conditions and missing items, postage expense for notifying depositing customers of returned checks, and elimination of the need to expand their return items processing facilities.

The reclearing service accelerates presentment times for most returned checks by one day, because the item no longer travels back to the sender before being redeposited. Thus, for most of the returns that clear when redeposited, the time required for the check to be finally paid³ is also reduced by at least one day. One pilot participant reported that the increased availability reduces clearing float costs by approximately \$.021 per item.

One potential disadvantage to senders using the service is the delay in learning of each specific return. For those returned items that are not paid upon their second presentment, the sender will not be able to associate a particular returned item with a customer's account until it has received the actual item. This time delay could be several days. Nevertheless, the Board believes that this disadvantage is minimized because the dollar value of redeposited items is minimal, and in most cases the sender will still be able to recover the funds from its depositor. In any event, participation by senders will be voluntary, and those senders that believe this factor will be a serious disadvantage to them may opt not to participate.

The experience of the pilot indicates that allowing Reserve Banks to offer this service on a voluntary basis could be beneficial to both the participating senders and the payments mechanism. Participating senders will have the opportunity to lower their cost and final payment of recleared items will be advanced by at least one day. To the extent that an optional reclearing service could make the processing of low-dollar returns more efficient, it could provide significant improvements for the overall return process. Removing these items from the return items processing at the senders and prior collecting institutions also allows these institutions more resources to devote to the processing of large-dollar returns.

The incremental costs to the Reserve Banks of providing this service are minimal. Because the service can be provided using existing equipment, incremental costs to the Reserve Banks consist primarily of labor costs associated with sorting, listing, balancing, and preparing the items for collection. To recover these costs, the Board proposes that the Federal Reserve Banks establish a two-part price structure for the service, consisting of a

fixed daily fee for reclearing items up to a volume level specified by the Reserve Bank and a per item fee for any additional volume above the specified level. The fixed daily fee will recover from each participating sender the daily costs of ascertaining whether there are returns eligible for redeposit. Even if no eligible returns are found on a given day, the Reserve Bank should charge a fee for the service.

The Board is also proposing that Reserve Banks allow participating senders to select their own dollar limits for reclearable returns. Pilot experience suggests that, although preferences may vary considerably regarding the dollar threshold used to select items for automatic redeposit, most institutions would select a cutoff of \$100 or less.

In its policy statement, "The Federal Reserve in the Payment System" August 14, 1984, the Board established a policy that before the Federal Reserve introduces a new service or a major service enhancement, all of the following criteria must be met:

- (1) The Federal Reserve must expect to achieve full recovery of costs over the long run.
- (2) The Federal Reserve must expect its provision of the service to yield a clear public benefit, including, for example . . . improving the efficiency of the payment mechanism or reducing the use of real resources. . . .
- (3) The service should be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity.

The Board believes that the proposed low-dollar reclearing service meets all of these criteria:

- (1) Reserve Banks will recover all costs associated with the service.
- (2) The service will yield clear public benefits through improving the efficiency of the return item process and reducing the amount of real resources expended by collecting institutions in the return item process.
- (3) For checks that are collected through the Federal Reserve, Reserve Banks alone can provide the service to their senders. Thus, while other collecting institutions can and do provide reclearing services for institutions that send items to them for collection, the Federal Reserve must provide this service for it to be available to institutions that choose to collect some or all of their cash items through a Reserve Bank.

Accordingly, the Board is proposing that Reserve Banks be permitted to offer a redeposit service for low-dollar cash items that are returned unpaid, and invites all interested members of the public to comment on all aspects of the proposed service.

By order of the Board of Governors of the Federal Reserve System, November 3, 1986.
Williams W. Wiles,
Secretary of the Board.

[FR Doc. 86-25142 Filed 11-6-86; 8:45 am]

BILLING CODE 6210-01-M

¹ A "sender" is an entity that sends items to a Federal Reserve Bank. A sender may be a depository institution, an international organization, a foreign correspondent, a branch or agency of a foreign bank, or another Reserve Bank. 12 CFR 210.2(k). As Reserve Banks will not be reclearing items for other Reserve Banks, they will be excluded from the meaning of the term "sender" when it is used in this notice.

² The dollar cutoff is \$100 in St. Louis. Atlanta and Cleveland allow the sender to choose its own dollar cutoff. Experience in Cleveland indicates that \$100 is favored by the majority of senders. In Atlanta, however, one sender elected to use a dollar cutoff of \$900.

³ "Final payment" occurs when the paying bank becomes accountable for an item under 12 CFR 210.9(a) and no longer has the right to recover payment under 12 CFR 210.12(a).