FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10123**
December 23, 1986]

FEDERAL RESERVE PRICED SERVICES

— Proposal to Consolidate Priced Services Across District Lines; Comment Requested by January 28, 1987

— Consolidation of Noncash Collection Activities Between the San Francisco-Minneapolis Reserve Banks

— Adoption of Tiered Pricing Structure for Check Collection Services

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

The Board of Governors of the Federal Reserve System has requested comment on a list of those factors to be considered in evaluating proposals to consolidate Federal Reserve Bank priced service activities that extend across District lines. The text of that proposal, which has been reprinted from the *Federal Register*, is set forth below; comments thereon should be submitted by January 28, 1987, and may be sent to the Board of Governors, as specified in the notice, or, at this Bank, to Howard F. Crumb, Senior Bank Services Officer.

The Board of Governors has also approved the consolidation of the municipal bond and coupon collection activities of the San Francisco Reserve Bank at the Minneapolis Reserve Bank. The text of the Board's order in this regard has also been reprinted from the *Federal Register*.

The Board of Governors has also announced its approval of a proposal to permit the head offices of the Federal Reserve Banks of Minneapolis and Kansas City to use a tiered pricing structure for check collection services on a permanent basis. The following is quoted from the text of the Board's statement announcing its adoption of that structure:

> Since November 1984, both Reserve Bank head offices have been conducting a pilot program to test the feasibility of tiered pricing. The current pilot program will be made a permanent structure of their check collection services, effective immediately.
>
> A tiered pricing structure allows different fees to be charged to sending institutions for check presentment based on whether the payor institution wants the checks sent to a high- or low-cost presentment point.
>
> There is a significant difference between the unit cost of clearing checks drawn on high- or low-cost presentment points in some collection zones. Tiered pricing more accurately reflects Federal Reserve costs of processing. It also allows financial institutions to make better decisions in choosing the most cost effective method of clearing checks.
>
> In addition to adopting the proposal, the Board also established criteria under which tiered pricing could be used for check collection services at other Reserve bank offices.

Printed on the following pages is the text of the Board's orders in the above matters, including the notice approving the tiered pricing proposal announced by the Board of Governors. Questions regarding any of the above matters may also be directed to Mr. Crumb (Tel. No. 212-720-6812).

E. Gerald Corrigan,
President.

[Docket No. R-0586]

Federal Reserve Bank Services; Request for Comments

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment.

SUMMARY: The Board is requesting comment on proposed factors to be considered in evaluating proposals to consolidate Federal Reserve Bank priced service activities across District lines. The Board also has approved the consolidation of the noncash collection activities of the Federal Reserve Bank of San Francisco at the Federal Reserve Bank of Minneapolis.

DATE: Comments must be received by January 28, 1987.

ADDRESS: Comments, which should refer to Docket No. R-0586, may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551, or delivered to Room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may be inspected at 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 Availability of Information, 12 CFR 261.6(a).

FOR FURTHER INFORMATION CONTACT: Elliott C. McEntee, Associate Director (202/452-2231) or Donna DeCorleto, Senior Analyst (202/452-3956), Division of Federal Reserve Bank Operations; Daniel L. Rhoads, Senior Attorney (202/452-3711), Legal Division; or Earnestine Hill or Dorothea Thompson, Telecommunication Device for the Deaf (202/452-3544), Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION: In October 1985, the Board requested public comment on the issue of consolidating Federal Reserve Bank priced service activities across District lines (50 FR 45938, Nov. 5, 1985). Public comment was also requested on a proposal to make permanent a pilot program involving the consolidation of the noncash (e.g. municipal bond and coupon) collection activity of the Federal Reserve Bank of San Francisco at the Federal Reserve Bank of Minneapolis.

General Issue of Consolidation. The Board received 19 comments discussing the concept of interdistrict consolidation of Federal Reserve priced service activities. Ten commenters were not opposed to interdistrict consolidation. However, nine of these commenters expressed concern about the impact of interdistrict consolidations and suggested that conditions or restrictions on interdistrict consolidations be developed. Nine commenters opposed the concept of interdistrict consolidation.

Commenters not opposed to consolidations expressed the opinion that interdistrict consolidation can increase operating efficiencies and reduce costs while maintaining service levels. Twelve commenters expressed concern about the effects consolidation would have on the level or quality of service provided by the Federal Reserve to depository institutions. Commenters also expressed concern about the impact that interdistrict consolidation may have on potential providers of competing services. Some commenters believed that consolidation would be anticompetitive by permitting the Reserve Banks to locate operations in low-cost areas, thus achieving economies not available to the private sector. Six commenters stated that interdistrict consolidation was not in accord with the pricing provisions of the Monetary Control Act of 1980 ("MCA") (12 U.S.C. 248a). In their view, the MCA requires each Reserve Bank to match costs and revenues for each service and interdistrict consolidation will result in cross-district subsidization of services. Several commenters suggested conditions under which interdistrict consolidations would be acceptable, and seven commenters suggested that all future interdistrict consolidation proposals be published for public comment.

One of the results of pricing of Federal Reserve service has been an increased focus on efficiency. The Board believes that in situations efficiency may be gained by consolidatng some services currently offered by Reserve Banks at fewer locations. Circumstances that may warrant consideration of consolidating one or more services include revenue shortfalls, potential cost reductions, changes in payment volume and clearing patterns, improved communication and automation technology, or the need for contingency programs to ameliorate disaster recovery.

The Board shares the conerns expressed by commenters that interdistrict consolidation may affect competition among service providers as well as the level or quality of service offered. To asure that these concerns are considered in any future proposal for interdistrict consolidation of Federal Reserve priced services, the following list of factors to be considered in reviewing interdistrict consolidation proposals has been developed. These factors include:

a. Maintenance or improvement of cost recovery in a service.

b. Improvement of the efficiency of Federal Reserve Bank operations.

c. Maintenance or improvement of the level or quality of service.

d. Responsiveness to changes in the financial services industry.

e. Impact on private sector providers of the service that is being consolidated.

f. Amount of advance notice that would be needed prior to effecting an interdistrict consolidation.

Comment is requested on these factors, as well as any additional factors commenters believe should be considered by the Federal Reserve in deciding whether to consolidate services across district lines. It is not anticipated that any single factor would be determinative of a proposed interdistrict consolidation. Rather, the list of proposed factors indicates those issues to be weighed in consideration of whether a specific consolidation proposal should proceed.

With regard to the suggestion that each proposed consolidation, including pilot programs, be published for public comment, the Board does not believe such an approach is necessary. The Board's Pricing Principle Number 7 states that public comment will be requested when changes in fees and service arrangements are proposed that would have significant longer-run effects on the nation's payments mechanism. Most consolidation efforts likely would not have such an effect, however, and soliciting public comment on every proposal would not be necessary. In the event that a consolitation proposal would appear to have significant, longer-run effects on the nation's payments mechanism, the Board would solicit public comment.

Finally, contrary to the suggestion of some commenters, the MCA does not require recovery of costs on a district-by-district basis. The MCA requires the Federal Reserve, over the long run, to establish fees on the basis of all direct and indirect costs incurred in providing priced services, including costs that would have been incurred if the services were provided by a private sector firm. The Board's Pricing Principle Number 5 states that the fees be set so that revenues for major service categories match costs Systemwide, in most circumstances. In addition, as a matter of practice, the Board expects each Reserve Bank to recover its costs and contribute to the private sector adjustment factor for locally priced services.

San Francisco-Minneapolis Consolidation of Noncash Collection. The Board also requested public comment in October 1985 on a proposal to make permanent the pilot consolidation of the noncash collection service of the San Francisco Reserve Bank at the Minneapolis Reserve Bank. The noncash collection service involves primarily the collection of maturing definitive securities such as municipal bonds and coupons. Of the 15 commenters addressing this issue, eight commenters did not oppose it and seven commenters did oppose it. The eight commenters who did not oppose the proposal focused on the fact that consolidation would enable the Reserve Banks to control or reduce costs and maintain service levels in the noncash collection function. They cited the negative impact that the Tax Equity and Fiscal Responsibility Act (TEFRA) has had on noncash volume, making cost recovery in this service increasingly difficult. One commenter mentioned its positive experience as a participant in the pilot program.

The seven commenters opposed to the San Francisco-Minneapolis consolidation cited the same concerns that they had expressed regarding consolidation in general. A few commenters considered this consolidation proposal inappropriate because, at the time public comment was solicited, the Federal Reserve was projecting for 1986 an increase in volume of 1.7 percent. Finally, some commenters contended that inadequate information on accounting and billing procedures was provided about the pilot program.

The Board believes the benefits demonstrated by the pilot consolidation of the San Francisco Reserve Bank noncash collection activity at the Minneapolis Reserve Bank warrant making the pilot program permanent. The consolidation resulted in a $1.00 decrease in the per-coupon-envelope fee for depositors presenting Twelfth District payable items to Minneapolis rather than San Francisco. It also enabled those depositors to obtain payment quicker and improved the cost recovery rate for the Minneapolis Reserve Bank and the Federal Reserve System. The consolidation of San Francisco noncash collection at Minneapolis is also viewed as important to the ability of the Federal Reserve to continue offering a nationwide noncash collection service.

With regard to comments that the noncash collection consolidation was inappropriate in view of a projected increase in Federal Reserve volume of 1.7 percent for 1986, preliminary data indicates that noncash collection volume may decline for 1986. Further, volume will decline in the future due to TEFRA.

The Board believes the concerns expressed by commenters regarding accounting and billing practices by service users have been addressed in procedures developed for the pilot program. Depository institutions, except for those located in Federal Reserve Districts where a mixed deposit service is available, that wish to present Twelfth District municipal coupons through the Federal Reserve noncash collection network should forward these items to the Minneapolis Reserve Bank. Depository institutions in a mixed deposit program would continue to send their coupons to their local Federal Reserve Bank. A depository institution's account at its local Reserve Bank will be credited with coupon redemption proceeds on a predetermined availability schedule. Bond redemption proceeds would be credited when payment is received by the Minneapolis Reserve Bank. Additional details concerning fees, crediting and billing procedures may be obtained from local Reserve Banks or the Federal Reserve Bank of Minneapolis. The Board believes these procedures should not cause problems for users of the noncash collection service.

By order of the Board of Governors of the Federal Reserve System, November 26, 1986.

William W. Wiles,

Secretary of the Board.

[FR Doc. 86-27094 Filed 12-1-86; 8:45 am]

BILLING CODE 6210-01-M

[Docket No. R-0532]

Fees for Federal Reserve Bank Check Collection Service

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Approval of pricing proposal.

SUMMARY: The Board has approved:

1. Making the tiered pricing structure, currently piloted at the head offices of the Federal Reserve Banks of Minneapolis and Kansas City, a permanent component of the fee structures at those Reserve Banks; and
2. Criteria for determining the conditions under which a tiered fee structure may be extended to other offices of Federal Reserve Banks.

EFFECTIVE DATE: November 25, 1986.

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, Telecommunications Device for the Deaf (202/452-3544); Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION:

Background

In November 1984, the Board requested comment on a proposal to permit Federal Reserve Banks to use a tiered fee schedule for checks to be presented within a single collection zone;[1] that is, different fees would be assessed depending upon whether a check is sent to a high- or low-cost endpoint[2] in a Regional Check Processing Center (RCPC) or country zone. The Board also proposed that a pilot program be conducted at the head offices of the Federal Reserve Banks of Minneapolis and Kansas City to test the feasibility of tiered pricing.

The Board proposed tiered pricing because, in some Federal Reserve Districts, the cost of clearing checks drawn on institutions in the same zone varied considerably, and the Reserve Banks at that time were charging only one average price. If prices reflected these cost variances more accurately, collecting institutions could choose the best and most cost effective method of clearing checks, resulting in a more efficient allocation of resources in the payments mechanism.

In response to the public comment received on the November 1984 proposal, the Board modified the pilot program, which the Minneapolis and Kansas City Reserve Banks implemented in April 1985. After analyzing the results of the pilot, the Board, in July 1986, issued for public comment a proposal to make tiered pricing a permanent part of the fee structure at the Minneapolis and Kansas City head offices and establish criteria for the expansion of tiered pricing to other Federal Reserve offices.

Analysis of Comments

Thirty-nine of the 67 comments received were in favor of the July 1986 proposal to make tiered pricing a permanent component of the fee structure for check collection services at the Minneapolis and Kansas City Reserve Banks. Of the 39 respondents who commented on the proposed criteria for expansion of the service, 21 were in favor of them.

Thirty-nine commenters supported the concept of tiered pricing. These commenters stated that because the tiered fee structure more accurately reflects Federal Reserve costs, it allows collecting institutions to make better decisions in choosing the most cost effective method of clearing checks. Some of the commenters who participated in the pilot reported cost reductions. In addition, some commenters stated that the Federal Reserve's use of tiered pricing parallels the pricing practice of other service providers in their areas.

The 23 commenters opposing the proposal expressed many of the same concerns as those raised in response to the November 1984 proposal; these

[1] A collection zone is a geographic subdivision of a Federal Reserve territory. Each collection zone has a specified availability schedule under which the Reserve Bank will give credit for a check deposited for collection at the Reserve Bank's office serving that territory. Collection zones are referred to as either city, RCPC, or country.

[2] An endpoint refers to the location at which a Federal Reserve Bank presents checks and other items to the payor for payment. A payor may designate a place of presentment under 12 CFR 210.7(b).

included billing complexity and the inability of the depositor to reconcile its charges from the Federal Reserve and accurately pass back those charges to its depositors. When these comments were first made, the Board responded by modifying the original proposal, making tiered pricing an option for those institutions sending checks and other items to Reserve Banks for collection. The voluntary nature of the program allows any institution with concerns about the complexity of the fee structure or reconcilement problems to opt for the average price rather than the new tiered structure.

Several small institutions responding to the November 1984 proposal commented that the proposal discriminated against small institutions by increasing their costs because the majority of their collection volume would be drawn on other low-volume, high-cost institutions. In fact, many small institutions are part of the low-cost tier because their checks are presented to private sector processors designated as high-volume, low-cost endpoints. Four commenters reiterated this concern in response to the July 1986 proposal; however, all four of these commenters were large correspondent banks.

Comments on Pilot Results

Ten commenters stated that the pilot did not support a need for tiered pricing because a minority of depositors elected to participate in the pilot and a minority of eligible volume was deposited under the tiered pricing option. Pilot results indicate that 34 percent and 24 percent of the eligible depositors in the Minneapolis and Kansas City Districts, respectively, participated in the pilot. In both cases, about 40 percent of the eligible volume is being deposited under the tiered pricing option. While these figures represent less than half of the eligible participants and volume and thus constitute a "minority," the Board believes that the levels of participation are adequate to justify continuance of the tiered pricing option in the pilot offices.

Proposed Criteria

Thirty-nine respondents commented on the criteria proposed for expansion of tiered pricing to other Federal Reserve offices, 21 of them supporting the criteria as proposed. The remaining 18 commenters suggested modifications to the criteria.

Nine commenters said that public comment should be required each time tiered pricing is proposed. An equal number of commenters opposed the criterion requiring Board review as too stringent, because it would result in unnecessary delays in implementing tiered pricing. The Board's Pricing Principle No. 7 states that public comment will be requested when changes in fees and service arrangements are proposed that would have significant longer-run effects on the nation's payments mechanism. Generally, a Reserve Bank's adoption of tiered pricing should not have a significant longer-run impact on the nation's payments mechanism, and soliciting public comment on every proposal is not necessary. The issues relating to the adoption of tiered pricing in individual Federal Reserve offices are likely to be similar to those of the pilot offices. Experience of the pilot indicates that tiered pricing has not had a significant impact.

The Board does not believe that it is appropriate to request comment in those cases where there is no likelihood of significant longer-run effects on the payments mechanism. To request comment in every case would impede the implementation of many routine price and service level changes. Nevertheless, the Board does believe that depository institutions should be consulted prior to implementing tiered pricing in other Federal Reserve office territories.

Four commenters stated that tiered pricing should only be implemented after a phase-in period. Various time-frames were suggested. Currently, Reserve Banks are generally required to announce new services and prices implemented between the annual repricing exercises 30 days prior to implementation. The annual fee announcements for all prices generally are distributed 60 days in advance. The Board believes that a 60-day announcement period should be sufficient to allow institutions to adjust to tiered pricing.

Several commenters expressed concern that the terms "clear" and "substantial" as used in the criteria were not well defined. Given the variety of conditions that exists among the Federal Reserve collection zones, including the number of institutions, the geographical size of the zone, and other factors, the Board believes that these terms are sufficient guides to its analysis of future proposals to expand the tiered pricing structure to other Federal Reserve offices.

Several suggestions were made by various commenters regarding clarification of the fee structure for tiered pricing. Suggestions included indicating how many tiers should be allowed, what type of deposits should be eligible for tiered pricing, how high- or low-cost endpoints should be selected, how often endpoints should be reviewed and revised, and how fee differentials should be calculated.

The Board has determined that tiers will generally be limited to two in each collection zone, unless clear cost differences can be demonstrated that would justify further tiers. Tiered pricing may be applied to all types of deposits within an RCPC or country zone. High- or low-cost endpoints will be selected and fee differentials calculated based on clear cost differences as stated in the proposed criteria. Reserve Banks offering tiered prices must review designation of endpoints as high- or low-cost at least annually, but a particular endpoint may not be redesignated more often than quarterly.

Board Action

After analyzing the comments and the results of the pilot program, the Board has approved making tiered pricing a permanent component of the fee structure at the head offices of the Federal Reserve Banks of Minneapolis and Kansas City.

The Board has also determined that other Federal Reserve Banks may introduce tiered pricing into the fee structures of one or more of their office territories if they meet the following criteria:

1. Adoption of tiered pricing by any additional Federal Reserve Bank will require approval by the Board.
2. Tiered pricing will be offered as an option to the sender; 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 the 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 deposited volume or a substantial number of depositing institutions.

Before seeking Board approval of tiered pricing for a collection zone within its District, a Federal Reserve Bank, together with Board staff, will consult with banking and thrift industry representatives to ascertain their views on the effects of the particular tiered pricing proposal. At this time, there are no plans to approve more than two tiers to the price structure in each collection zone, although the Board may approve additional tiers if the proposal is consistent with the criteria listed above. The Board may request public comment on proposals to expand beyond two tiers if conditions warrant. In no case will a Reserve Bank implement tiered pricing unless it has given all affected parties at least 60 days advance notice of the availability of the tiered pricing option.

By order of the Board of Governors of the Federal Reserve System, November 25, 1986.

William W. Wiles,

Secretary of the Board.

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