To All Banking 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 announced today [May 14] its intention to participate in an experimental test of a new financial service aimed at speeding and improving the clearing of large dollar value checks.

The concept, called Electronic Settlement, is to be tested in the last half of this year. The experimental program initially will affect only checks of $100,000 or more issued by corporate customers of a small number of large banks. No small consumer checks will be involved in the test.

Electronic settlement is envisioned as a system in which the usual process of clearing and settling paper checks is discontinued beyond the first banks where checks are deposited, and the process is shifted to electronic means of clearance and settlement. This process will be used in the experimental test to permit speedier clearance of large value checks. The process would work as follows:

—A business in Minneapolis sends a check for $100,000 or more to a company in Atlanta. The company deposits the check in its Atlanta bank.

—That bank—instead of sending the check to the Federal Reserve for collection—transfers the payment instructions on the check to magnetic tape. It does the same for all other checks of $100,000 or more it receives that day. The payment instructions include the amount of the check, the identification of the bank on which the check is drawn, and the account number of the business issuing the check.

—The magnetic tape would be deposited at the Atlanta Federal Reserve office. Using its computers, the Atlanta Federal Reserve would sort the payment instructions by destination and would transmit these instructions to the appropriate Federal Reserve office. In the case being described, Atlanta would transmit the information to the Minneapolis Fed.

—The Minneapolis office would deliver by the most expeditious means the payment instructions to the bank on which the check is drawn. That bank would debit its customer's account.

It is estimated that checks for over $100,000 cleared by the Federal Reserve account for about one tenth of 1 percent of total Federal Reserve check volume and in some districts about 50 percent of the total dollar value of checks.

The Board's action is prompted by two concerns:

• Transportation delays caused by weather, aircraft malfunctions and other factors have generated an increased level of check clearing float within the Federal Reserve check clearing system.

• The Federal Reserve and private sector check clearing systems rely heavily on special air and surface transportation systems which consume fuel and could be subject to reduced reliability as fuel become scarce.

(Over)
Electronic settlement will ameliorate the problem of transportation delays and thus the risk of Federal Reserve float for large dollar value checks. In addition, by removing the large items from the check collection system, there is less need for special priority transportation systems. Electronic settlement of large checks can also provide certainty of time of settlement to business customers, enabling them to achieve better cash management.

Results of testing electronic settlement should provide valuable insight and operating experience in support of financial industry efforts to develop new and more convenient financial services.

The pilot test is expected to begin in the second half of the year. It will involve from six to ten banks in three Federal Reserve Districts. If the test proves successful, the electronic settlement system will be enlarged and the dollar limit may be lowered, perhaps eventually to $1,000. During the pilot test, the paper checks will be forwarded on a delayed basis to the banks on which they are drawn. The Federal Reserve has no present plans for electronic settlement of consumer checks.

The Board may also consider reassessing, for high value checks, its policy of making credit available to depositing banks based on fixed time schedules, and is studying the possibility of making credit schedules reflect accurately actual collection times.

Questions regarding this matter may be directed to our Check Processing Function (Tel. No. 212-791-6009 or 6334).

Paul A. Volcker.
President.