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Business Review

Higher Payout?

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... A moderate budget for the typical urban Western family probably now costs over \$12,000.

RCPC's—Transitional Step

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RCPC's - Transitional Step

A major transitional step towards the payments system of the future has been taken with the development of a nationwide network of facilities for the overnight processing and settlement of checks—the regional check processing centers (RCPC's). In the San Francisco Federal Reserve District, this step encompasses the opening of RCPC's this summer at the Seattle, Portland and Salt Lake City branches of the bank. (Los Angeles and San Francisco are scheduled to open centers later in the year.) Nationwide, the Federal Reserve System may soon have close to 50 such centers in operation, mostly at existing locations—12 head offices and 24 branches—but also at some newly developed sites.

The Federal Reserve Board of Governors issued guidelines in early 1972 authorizing Reserve Banks to operate regional check-processing centers in "communities whose trade, business and financial activities are substantially related". The objective was to ensure that most of the 62 million checks written every day be cleared and paid by the opening of business the day following the deposit of those checks.

An RCPC accepts from participating banks in its clearing region all checks written on other banks in the region. It also accepts from Federal Reserve member banks all checks drawn upon banks outside their region. In addition, it accepts from participating banks all U.S. Government checks, postal money orders and other items payable at Federal Reserve offices, regardless of origin.

Huge workload

The Federal Reserve's emphasis on the development of a speedier and more efficient check-handling and clearing system comes from the realization of the huge size of the present workload—some 25 billion checks transferring about \$13 trillion annually—and from the expectation that this workload will double by the end of the decade. (The Federal Reserve processes about 30 percent of the nation's checks, and commercial-bank facilities handle the rest.) For the same reasons, the System believes that an improved check-payments system should be regarded as a transitional step

towards the use of electronic transfers rather than checks for transferring funds. System guidelines thus specify that each RCPC should be provided with an automated clearing and telecommunications ability, to provide a basis for a system of electronic transfers.

The present system of check processing typically involves two or three banks between the time a check is deposited and the time it is presented for payment. During this period, uncollected funds are not available to the checks' depositor—nor to his bank for loans or investments. The aim of regional centers is to reduce the number of times a check is handled. Each RCPC serves a specific geographic area, processing checks written and deposited within the area. The system builds upon the fact that about 70 percent of all checks remain within the metropolitan area in which they originate.

From credits to debits

With RCPC's, the Federal Reserve in a sense converts an inflow of credits into an outflow of debits. The checks that a regional center receives are credits to the bank which sends them into a center, so that when these items are resorted and rebatched they leave the RCPC transformed into charges on other banks. The

process is ideally accomplished when the crediting and debiting effects are simultaneous, and when the shipping, sorting, accounting, and processing procedures can be performed between the close of business one day and the opening of business the next day.

The new system will bring about an earlier receipt of funds due to individuals and businesses, as well as an earlier payment of funds that they are transferring to others. To assist this development, the Federal Reserve revised its Regulation J in November 1972 to promote faster check collection. This amended regulation requires all banks to pay in immediately available funds on the day when checks are presented. Previously, banks located outside cities containing Federal Reserve offices (and other designated areas) had paid the Fed for checks presented in funds collectable one or more days after presentation.

Interface with the banks

Federal Reserve banks, when operating RCPC's, will expand the overnight check-settlement arrangements they have maintained for years with banks in major metropolitan centers. In addition, new RCPC's are envisioned as operating in areas not reached by existing Fed offices,

wherever check volume and the absence of alternative facilities make additional Federal Reserve services essential. The system is designed to tie-in with commercial-bank processing centers, where checks from a number of correspondent banks are sorted and otherwise made ready for clearance.

The Federal Reserve's role is to serve as an interface among all banks in the nation. However, it is concerned only with "transit" items, not with the internal work of check sorting and accounting for individual banks. Commercial banks increasingly are using their own or contractual electronic-processing units for their internal check-processing operations.

The resultant economies in the Federal Reserve's check-handling program should show up eventually in reduced costs of personnel, transportation and equipment, considering as a whole all private and public check-processing costs. Savings could develop, for example, by reducing the number of times a check is reintroduced as a document in electronic processing operations. Similarly, savings could result by reducing duplicate transportation facilities between sites, and also by eliminating unnecessary and circuitous movements of checks.

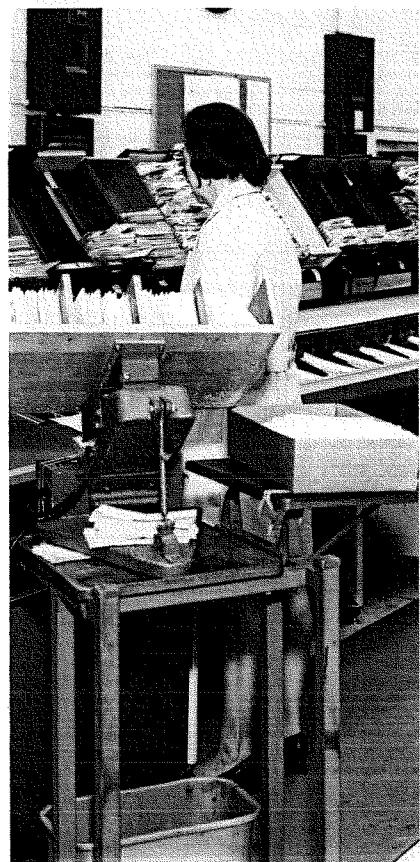
Regional variation

Operating arrangements at different clearing centers may vary somewhat, because of the substantial differences that exist in banking structure, population density, the volume of check traffic, and the geographic and topographic influences on transportation routes. In the latter regard, the size of an RCPC service area is determined chiefly by the time required to pick up during an afternoon the day's volume of checks deposited in participating banks, to bring these to a clearing center for processing and settlement during the night, and to deliver them early the next morning to banks against which checks were drawn the day before.

As for banking structure, the workload of the San Francisco Federal Reserve Bank is eased because the states in this district generally contain a relatively small number of statewide branch systems, rather than a large number of unit banks. The big branch systems, in effect, have set up their own regional clearing centers, so that the Federal Reserve's task in many cases consists simply of integrating its new RCPC's with ongoing commercial-bank systems.

Under the San Francisco District's plan, an RCPC will be set up at each existing Fed office. Because of the vast geographic size of the areas served by each of these offices, existing transportation arrangements may preclude the timely presentation of checks to payor banks in certain remote locations, meaning that there will be a small number of two-day cash-letter delivery points. The operational plan calls for each RCPC to reduce the number of these two-day points by improving transportation arrangements. All costs of each RCPC, except for transportation costs of incoming cash items, will be borne by the Federal Reserve Bank of San Francisco.

The schedule generally calls for incoming work to arrive at the RCPC late each evening, although some offices (especially Los Angeles) should encounter a substantial inflow of items at other times throughout the day. These items would be processed and ready for dispatch early in the next working day. Outgoing items would be delivered before noon of that day, except for a few remote areas with next-day delivery. Prior to the start-up of operations, however, several important preliminary steps are necessary—for example, conducting orientation meetings for participating banks, organizing



Gearing Up

Gearing up for around-the-clock operations at new regional check-processing centers requires extensive behind-the-scenes planning at this Bank's Seattle, Portland, and Salt Lake City offices. The Seattle office will be the busiest, with the average daily RCPC volume expected to be 450,000 items. This volume will be followed by Portland with 250,000 items and Salt Lake City with 186,000.

There will be 57 employees at the three offices keeping the operation going on the night shift. About a dozen new employees are being added to the RCPC staff, and supplemental mailroom employees are being hired to handle the additional night

volume. More new workers will later be added to staff the Los Angeles and San Francisco RCPC's.

Cafeteria personnel are being mobilized to provide hot meals for those working the night shift, and other arrangements (regarding parking, protection, extra lighting, and so on) are also being made to accommodate the necessary changes in work schedules.

In addition, teams of management personnel have traveled throughout the region to hold at least 17 group bank seminars, in order to acquaint commercial bankers with procedures for the new operation.

air and surface transportation routes, and realigning workshifts to permit three-shift operations (see note).

Demise of the check

The development of regional check-processing centers and the future development of an electronic payments system are tied in with the overwhelming success of the written check, which has been so successful an instrument that it now threatens to engulf the payments system. The check's usefulness to the banking industry has increased because it is highly compatible with advanced technology, typified by magnetic-ink encoding and machine-handling techniques. Similarly, its usefulness to individual users has increased because it is an inexpensive, highly efficient and convenient means for conducting the bulk of financial transactions.

Last year, individuals and institutions wrote more than 25 billion checks, against 94 million accounts with balances aggregating \$192 billion. The check volume by the end of this year could amount to over 27 billion pieces, and with volume increasing by 7 percent annually, the total could double within a decade. (Those are volume figures; in dollar terms, the total could rise one and one-half times in just half that time.)

While the volume should increase because of the growth of the national economy and the growth in the number of check users, the complexity should also increase because of the labor-intensive nature of the check-payments system, involving an inordinate amount of expensive processing and physical transfers of paper. The paper glut may take its toll in the shape of suddenly rising user and purveyor costs, sharp reductions in productivity for making financial transactions, and all the other problems that could result from an overloaded system of payments.

Towards electronic payments

In the long-run, the check cannot survive in an increasingly complex economy which is growing rapidly in both real and money terms. The requirements of an ever-larger and more complex payments mechanism dictate a move away from dependence on paper payments and towards complete reliance on electronic transfer of funds and electronic accounting for those transfers. Thus, the development of RCPC's provides only a short-run structural solution to the payments problem; in the long-run, an operational solution is required through the expanded use of the Federal Reserve's electronic communications network.

Some widely reported experiments in electronic funds transfers are already underway. In California, the banks and clearing-house associations in San Francisco and Los Angeles, with Federal Reserve support, have developed a system of electronic transfers—the California Automated Clearing House Association (CACHA). This system permits an individual bank's customers to authorize employers to deposit their paychecks automatically into checking accounts every payday. In addition, individuals are encouraged to authorize payments by banks of their recurring predictable bills—mortgage and other loan payments, utility bills and insurance premiums. Commercial banks in Georgia meanwhile have developed a system with even greater potential for reducing check usage.

Already individuals account for at least half of all checks written, and this proportion could increase as more households make more purchases out of higher incomes. The obvious solution is to provide for accounting and payments for purchases through the use of electronic point-of-sale terminals. The credit card, or a similar means of activating electronic transfers, should play a major role in this development. Finally, the new RCPC's and the expanded check-clearing arrangements already developed in a number of metropolitan centers should become the nuclei of an interconnected regional-communications network for handling wire transfers of funds.

In any event, the payments mechanism increasingly should evolve in the direction of a system where the credit to a payee's account is made at the same time that a payor's account is charged. The expansion of the RCPC network, with its emphasis on the speeding up of check payments, is a necessary step in this evolution, as the Federal Reserve moves its weekly workload of 150 million checks to an overnight-settlement basis as rapidly as is economically feasible.

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