FYI: An Update on Emerging Issues in Banking

The Impact on U.S. Banking of Payment System Changes

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Although the much-heralded check-less society has yet to arrive, major changes are underway in retail non-cash payment systems. Today's issue of *FYI* surveys the implications of the rising use of electronic payments. After rising for many years, the number of checks used in retail transactions declined from 49.5 billion in 1995 to 42.5 billion in 2000—the latest year for which comparable data are available. The table below shows that the number of retail electronic payments increased from 14.7 billion to 28.9 billion.

The Use of Checks Has Declined While the Use of Retail Electronic Payments Has Increased

	Number (Billions)		
Type of Payment	**1979**	**1995**	**2000**
Check	32.8	49.5	42.5
Retail Electronic Payments	5.5	14.7	28.9
Debit Card	0.0	1.4	8.3
Credit Card			
General Purpose	1.5	7.8	12.3
Private Label	3.8	2.6	2.7
Retail ACH	0.2	2.8	5.6

Source: George R. Gerdes and Jack K. Walton II, The Use of Checks and Other Noncash Payment Instruments in the United States, Federal Reserve Bulletin 88, no.8 (August 2002), 361.

While fewer checks are being written, the number is still very large in absolute terms and in comparison with a number of other countries, some of which have virtually eliminated the use of checks. Therefore, efforts are being made to "electronify" the checks early in the process of clearing and settlement, sending the information forward electronically, which is expected to be a faster and less expensive process than current methods that require the physical transportation of large amounts of paper.

Banks will have to adapt product offerings and pricing as well as back-office processing to reflect these payment system changes. Since more electronic transactions are cheaper to process, as is the conversion or truncation (or both) of checks, banks that do not explicitly charge for transaction services on a per-item basis will see a reduction in costs. For banks that have explicit fees for each service (mainly banks that supply cash management services), it will be necessary to ensure that the profit margins on the electronic transaction services are commensurate with those on the paper transaction services. Banks of all sizes should be able to continue to serve their customers with a mix of capabilities, including ATMs, on and off-line debit cards, credit cards, and other services.

Bank regulators must be aware of the risk implications of the changes in payment systems and must adapt their approaches accordingly. Operational risk is obviously an important issue. In this regard, the ownership of funds transfer networks has changed dramatically as the number and proportion owned and operated by non-bank entities has increased, while those owned by joint ventures of banks have declined. Because the operation of these networks has a direct effect on the risk exposure of the banks, the risk management practices of the network providers may have important implications for the banking industry and the bank regulatory community. Additionally, further consolidation among network providers—especially those for ATMs, debit cards, and credit cards—raises concerns about pricing, service quality, and product innovation in a market for which bank regulators have no direct responsibility.

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FYI is an electronic bulletin summarizing current information about the trends that are driving change in the banking industry, plus links to the wide array of other FDIC publications and data tools.

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