Federal Reserve Bank of Dallas

HELEN E. HOLCOMB
FIRST VICE PRESIDENT AND
CHIEF OPERATING OFFICER

July 3, 2001

DALLAS, TEXAS
75265-5906

Notice 01-51

TO: The Chief Executive Officer of each financial institution and others concerned in the Eleventh Federal Reserve District

SUBJECT

Request for Comment on a Proposed Interim Policy Statement and a Package of Short- and Long-Term Proposals Regarding the Board's Payments System Risk Policy; Rescission of the Board's Interaffiliate Transfer Policy

DETAILS

The Board of Governors of the Federal Reserve System has requested public comment on the desirability of retaining the current $50 million limit on the transaction size of book-entry securities transfers on Fedwire. Comments must be received by August 6, 2001, and must refer to Docket No. R-1110.

The Board also has requested public comment on a change to the procedures for measuring daylight overdrafts in depository institutions' Federal Reserve accounts. The modification will allow debits associated with electronic check presentment transactions to post at 1:00 p.m. local time. Comments must be received by August 6, 2001, and must refer to Docket No. R-1109.

The Board also has issued and requested comment on an interim policy statement that allows a depository institution that has a self-assessed net debit cap (average, above average, or high) to pledge collateral to its Federal Reserve Bank to access additional daylight overdraft capacity above its net debit cap level. Comments must be received by August 6, 2001, and must refer to Docket No. R-1107.

The Board also has requested comment on a proposal that would modify the criteria used to determine the U.S. capital equivalency for foreign banking organizations (FBOs). Specifically, the proposal would accomplish the following:

(1) Eliminate the Basel Capital Accord (BCA) criteria used in the current policy to determine U.S. capital equivalency for FBOs,

(2) Replace the BCA criteria with the strength of support assessment rankings and financial holding company status in determining U.S. capital equivalency for FBOs, and

(3) Raise the percentage of capital used in calculating U.S. capital equivalency for certain FBOs.

Comments must be received by August 6, 2001, and must refer to Docket No. R-1108.

In addition, the Board has requested public comment on the benefits and drawbacks of various policy options that it is evaluating as part of a potential longer-term direction for its payments system risk policy. The longer-term policy options include the following:

(1) Lowering single-day net debit cap levels to approximately the current two-week average cap levels and eliminating the two-week average net debit cap,

(2) Implementing a two-tiered pricing regime for daylight overdrafts such that institutions pledging collateral to the Reserve Banks pay a lower fee on their collateralized daylight overdrafts than on their uncollateralized daylight overdrafts, and

(3) Monitoring in real time all payments with settlement-day finality and rejecting those payments that would cause an institution to exceed its net debit cap or daylight overdraft capacity level.

Comments must be received by October 1, 2001, and must refer to Docket No. R-1111.

Please address comments to any of the above requests to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Also, you may mail comments electronically to the following e-mail address: **regs.comments@federalreserve.gov**.

Finally, the Board is rescinding section I.F., entitled Interaffiliate Transfers, of its payments system risk policy, effective January 1, 2002. The interaffiliate transfer policy was adopted in 1987 to address potential risks resulting from a lack of an arm's length credit decision among affiliates.

A PDF copy (requires Adobe Acrobat® for viewing) of the Board's notices as they appear on pages 30193–214, Vol. 66, No. 108 of the *Federal Register* dated June 5, 2001, is available on our web site at **http://www.dallasfed.org/banking/notices/index.html**. Additionally, you may obtain a hard copy of the documents by contacting the Public Affairs Department at (214) 922-5254.

MORE INFORMATION

For more information, please contact this Bank's Reserve and Risk Management Division at (214) 922-5584. For additional copies of this Bank's notice, contact the Public Affairs Department at (214) 922-5254 or access District Notices on our web site at **http://www.dallasfed.org/banking/notices/index.html.**

Sincerely,

Helen E. Holcomb

FEDERAL RESERVE SYSTEM

[Docket No. R–1110]

Policy Statement on Payments System Risk; $50 Million Fedwire Securities Transfer Limit

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment on policy.

SUMMARY: The Board is requesting comment on the desirability of retaining the current $50 million limit on the transaction size of book-entry securities transfers on Fedwire.

EFFECTIVE DATE: Comments must be received by August 6, 2001.

ADDRESSES: Comments, which should refer to Docket No. R–1110, may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551 or mailed electronically to regs.comments@federalreserve.gov. Comments addressed to Ms. Johnson also may be delivered to the Board's mailroom between 8:45 a.m. and 5:15 p.m. and to the security control room outside of those hours. Both the mailroom and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in Room MP–500 between 9:00 a.m. and 5:00 p.m. weekdays, pursuant to § 261.12, except as provided in § 261.14, of the Board's Rules Regarding Availability of Information, 12 CFR 261.12 and 261.14.

FOR FURTHER INFORMATION CONTACT: Paul Bettge, Associate Director (202/452–3174), Stacy Coleman, Manager (202/452–2934), or Doug Conover, Financial Services Analyst (202/452–2887), Division of Reserve Bank Operations and Payment Systems.

SUPPLEMENTARY INFORMATION: This is one of five notices regarding payments system risk that the Board is issuing for public comment today. Two near-term proposals concern the net debit cap calculation for U.S. branches and agencies of foreign banks (Docket No. R–1108) and modifications to the procedures for posting electronic check presentments to depository institutions' Federal Reserve accounts for purposes of measuring daylight overdrafts (Docket No. R–1109). In addition, the Board is requesting comment on the benefits and drawbacks to several potential longer-term changes to the Board's payments system risk (PSR) policy, including lowering self-assessed net debit caps, eliminating the two-week average caps, implementing a two-tiered pricing system for collateralized and uncollateralized daylight overdrafts, and rejecting payments with settlement-day finality that would cause an institution to exceed its daylight overdraft capacity level (Docket No. R–1111). The Board is also issuing today an interim policy statement and requesting comment on the broader use of collateral for daylight overdraft purposes (Docket No. R–1107). Furthermore, to reduce burden associated with the PSR policy, the Board recently rescinded the interaffiliate transfer (Docket No. R–

1106) and third-party access policies (Docket No. R–1100).

The Board requests that in filing comments on these proposals, commenters prepare separate letters for each proposal, identifying the appropriate docket number on each. This will facilitate the Board's analysis of all comments received.

I. Background

Beginning in 1985, the Board adopted and subsequently modified a policy to reduce the risks that payment systems present to the Federal Reserve Banks, to the banking system, and to other sectors of the economy. An integral component of the PSR policy was to control depository institutions' use of intraday Federal Reserve credit, commonly referred to as ''daylight credit'' or ''daylight overdrafts.'' The Board's intention was to address the Federal Reserve's risk as well as risks on various types of private-sector networks, primarily large-dollar payments systems.

As part of modifications to the PSR policy in 1988, the Board imposed a $50 million limit on the par value of individual book-entry securities transfers on the Fedwire system (52 FR 29255, August 6, 1987).[1] The purpose of the $50 million limit was to encourage government securities dealers to split large trades into multiple partial deliveries and, thereby, reduce subsequent book-entry securities-related daylight overdrafts. The Board anticipated that government securities dealers' practice of building securities inventories to meet large trade obligations would diminish and book-entry securities transfer volume would be distributed more evenly throughout the day. The Board recognized, however, that the effectiveness of the $50 million limit depended on dealers accepting multiple deliveries for the completion of a single trade obligation. As a result, Federal Reserve staff worked with the Public Securities Association (PSA) to develop delivery guidelines that incorporated necessary changes related to the $50 million limit.[2]

Prior to the implementation of the $50 million limit, the PSA's delivery guidelines required trade obligations to be delivered in full. As a result, dealers often had to accumulate securities in the full amount of the trade before they could deliver them. Partial deliveries, those for less than the full amount of the trade obligation, were typically returned to the sending institution. The incentives to minimize fail-to-deliver costs and maximize fail-to-receive benefits strongly influenced dealers' decisions regarding their settlement of government securities trades.[3] Because fail costs are proportional to the size of unfulfilled obligations, dealers typically organized their deliveries to fulfill their largest obligations first. In addition, in order to maximize fail benefits, a dealer selling and buying the same type of security could strategically delay its deliveries of that security until the end of the day, hoping that counterparties trying to deliver the same securities would be unable to settle their obligations before the close of the securities transfer system.[4] These incentives often led dealers to stockpile large amounts of securities until very near the end of the day.

To stockpile large amounts of securities until very near the end of the day in a delivery-versus-payment environment, dealers often used daylight credit at their clearing banks. The clearing banks, in turn, had to hold positive balances in their Federal Reserve accounts or use Federal Reserve daylight credit. As a dealer accumulates securities and holds them during the day to deliver on its largest obligations first, its overdraft becomes larger and lasts longer. In the absence of charges for daylight credit, however, the dealers' had no incentive to economize on daylight credit but had a strong incentive to avoid the substantial costs associated with failing to deliver on large obligations. In addition, because securities deliveries were often delayed until near the close of the Fedwire book-entry security transfer system, the Federal Reserve frequently extended the system's operating hours.

Although the Board intended the $50 million limit to promote the acceptance of partial deliveries, dealers had limited incentive to change their delivery practices. Under the PSA good delivery guidelines, dealers no longer needed to stockpile securities. As soon as an inventory of $50 million in a particular security was obtained, dealers could immediately deliver that $50 million to a different counterparty, receiving funds to cover any overdraft associated with the original receipt of that security. In effect, the transfer limit and the PSA's modified delivery guidelines allowed dealers to accept partial deliveries and effectively reduced the maximum size of any required position to $50 million. Nonetheless, without fees on daylight overdrafts, dealers could continue to stockpile securities without incurring any explicit costs. Most dealers, therefore, did not change their behavior significantly, and the limit had very little impact on the clearing banks' use of daylight credit.

When the Board began charging a fee for daylight overdrafts in 1994, most clearing banks decided to pass on these charges to their government securities dealers. Because government securities dealers generally relied heavily on intraday credit to conduct their transactions, the fee provided a strong incentive for most major dealers to send securities earlier in the day while the limit and the PSA delivery guidelines allowed dealers to send and required their counterparties to accept partial deliveries in $50 million increments. As dealers began to send securities earlier in the day, Federal Reserve daylight overdrafts decreased substantially.[5]

II. Effectiveness of the $50 Million Limit

As part of a broad review of the Federal Reserve's daylight credit policies, the Board considered the effectiveness of the $50 million limit policy, with a focus on whether the limit imposes an undue regulatory burden. To understand better the industry's view of the limit, Federal Reserve staff met with representatives of primary dealers, clearing banks, and industry utilities. Federal Reserve staff

[1] The $50 million limit does not apply to original issue deliveries of book-entry securities from a Reserve Bank to a depository institution or transactions sent to or by a Reserve Bank in its capacity as fiscal agent for the United States or international organizations.

[2] The PSA is now known as the Bond Market Association.

[3] Fail costs are the costs dealers incur if they fail to deliver securities to a counterparty on the agreed settlement day. These costs can be significant because a dealer that fails to deliver securities may have to obtain overnight financing as well as forego any interest that the security accrues between the agreed and actual settlement days. The purchasing counterparty that does not receive its securities on the agreed settlement day benefits because that party typically receives the accrued interest on those securities, yet postpones financing the securities until they are actually delivered.

[4] Because many government securities dealers take long and short positions in the same security among a relatively small group of counterparties, a dealer could be expected to deliver a security to one counterparty and receive the same security from another counterparty.

[5] Because the limit forced receiving dealers to accept multiple deliveries for the settlement of one trade, the receiver could not force the sender to stockpile securities. For example, if a dealer had an obligation to deliver $100 million of a certain security, expected to receive $90 million of the same issue, and already held $10 million of that security in its account, delivery of its obligation would be dependent upon first receiving the expected $90 million, if a limit were not present. With the limit in place, the dealer could immediately forward $50 million of that security as soon as it was received, rather than waiting for the entire $90 million. To the extent that a dealer buys securities from many counterparties and that deliveries from these counterparties are dependent on receipt of their own purchases, the limit allows deliveries to occur earlier than otherwise possible, reducing the liquidity required to settle the total amount of transactions.

learned that many government securities dealers and their clearing banks support retaining the $50 million limit. These representatives believe that removing the limit could increase position building and securities-related overdrafts despite the existence of daylight overdraft fees. In addition, the representatives stated that removing the limit would likely require costly system changes throughout the industry. Given that the industry bears a significant portion of the costs and benefits of the limit, both in terms of transaction fees and reduced overdraft fees, the support of the limit voiced by industry representatives reflects their perception that the limit has a positive net effect on the government securities settlement system.

Industry representatives indicated that removal of the limit would likely lead the industry to demand that securities trades be settled in full and to reject partial deliveries. While current delivery guidelines encourage acceptance of partial deliveries, industry representatives expressed concern that there would be no technical mechanism to enforce these guidelines. The Board believes the $50 million limit on book-entry securities transfers in combination with daylight overdraft fees has been effective in reducing daylight overdrafts. Because the limit appears to have a net positive effect, the Board is disposed to retaining the limit. The Board, however, would like to ensure that it considers the perspectives of all parties before making a final determination regarding the retention of this limit.

III. Request for Comment

The Board is proposing to maintain its current policy limiting the size of individual book-entry security transfers on Fedwire to $50 million in par value. The Board is requesting comment on all aspects of the $50 million limit as well as on the following questions:

1. Should the limit be retained?

If yes, is $50 million a reasonable level for the limit? Do the benefits of the limit support a reduction of the limit to $25 million? Or, would a higher limit reduce transaction costs but maintain the existing benefits of the limit? Would changing the limit require costly system changes?

If no, what would be the effect of eliminating the $50 million limit on delivery fails, daylight overdrafts, and dealer costs? In particular, would eliminating the limit require costly system changes?

2. Does the limit impose any significant costs on dealers or clearing banks, net of any benefits from reduced overdrafts?

3. Does the limit promote specific benefits in the government securities market other than reduced overdrafts?

IV. Competitive Impact Analysis

Under its competitive equity policy, the Board assesses the competitive impact of changes that have a substantial effect of payments system participants.[6] The Board believes that retention of the $50 million securities transfer limit will have no adverse effect on the ability of other service providers to compete effectively with the Federal Reserve Banks in providing similar transfer services.

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. ch. 3506; 5 CFR 1320 appendix A.1), the Board has reviewed the request for comments under the authority delegated to the Board by the Office of Management and Budget. The collection of information pursuant to the Paperwork Reduction Act contained in the policy statement will not unduly burden depository institutions.

By order of the Board of Governors of the Federal Reserve System, May 30, 2001.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 01–13981 Filed 6–4–01; 8:45 am]

BILLING CODE 6210–01–P

[6] These assessment procedures are described in the Board's policy statement entitled ''The Federal Reserve in the Payments System'' (55 FR 11648, March 29, 1990).

FEDERAL RESERVE SYSTEM

[Docket No. R–1109]

Policy Statement on Payments System Risk; Modifications to Daylight Overdraft Posting Rules for Electronic Check Presentments

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment on policy.

SUMMARY: The Board is requesting comment on a change to the procedures for measuring daylight overdrafts in depository institutions' Federal Reserve accounts. The Board proposes to modify the procedures to allow debits associated with electronic check presentment (ECP) transactions to post at 1:00 p.m. local time.[1] The current posting times for ECP transactions often create a disincentive for depository institutions to use Federal Reserve electronic check presentment services, and the Board proposes to remove barriers that may discourage their use.

EFFECTIVE DATE: Comments must be received by August 6, 2001.

ADDRESSES: Comments, which should refer to Docket No. R–1109, may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551 or mailed electronically to regs.comments@federalreserve.gov. Comments addressed to Ms. Johnson also may be delivered to the Board's mailroom between 8:45 a.m. and 5:15 p.m. and to the security control room outside of those hours. Both the mailroom and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in Room MP–500 between 9:00 a.m. and 5:00 p.m. weekdays, pursuant to § 261.12, except as provided in § 261.14, of the Board's Rules Regarding Availability of Information, 12 CFR 261.12 and 261.14.

FOR FURTHER INFORMATION CONTACT: Paul Bettge, Associate Director (202/452–3174), Stacy Coleman, Manager (202/452–2934), or Jeffrey Yeganeh, Senior Financial Services Analyst (202/728–5801), Division of Reserve Bank Operations and Payment Systems.

SUPPLEMENTARY INFORMATION: This is one of five notices regarding payments system risk that the Board is issuing for public comment today. Two near-term proposals concern the net debit cap calculation for U.S. branches and agencies of foreign banks (Docket No. R–1108) and the book-entry securities transfer limit (Docket No. R–1110). In addition, the Board is requesting comment on the benefits and drawbacks to several potential longer-term changes to the Board's payments system risk (PSR) policy, including lowering self-assessed net debit caps, eliminating the two-week average caps, implementing a two-tiered pricing system for collateralized and uncollateralized daylight overdrafts, and rejecting payments with settlement-day finality that would cause an institution to exceed its daylight overdraft capacity level (Docket No. R–1111). The Board is also issuing today an interim policy statement and requesting comment on the broader use of collateral for daylight overdraft purposes (Docket No. R–1107). Furthermore, to reduce burden associated with the PSR policy, the Board recently rescinded the

[1] In the event an electronic check presentment is delayed past 12:00 p.m. local time, the Reserve Banks will post the transaction on the next clock hour that is at least one hour after presentment takes place but no later than 3:00 p.m. local time.

interaffiliate transfer (Docket No. R–1106) and third-party access policies (Docket No. R–1100).

The Board requests that in filing comments on these proposals, commenters prepare separate letters for each proposal, identifying the appropriate docket number on each. This will facilitate the Board's analysis of all comments received.

I. Background

The Board's PSR policy establishes maximum limits (net debit caps) and fees on daylight overdrafts in depository institutions' accounts at Federal Reserve Banks. When the Board adopted daylight overdraft fees, the Federal Reserve Banks began measuring depository institutions' intraday account balances according to a set of ''posting rules'' established by the Board. These rules comprise a schedule for the posting of debits and credits to institutions' Federal Reserve accounts for different types of payments.[2] The Board's objectives in designing the posting rules include minimizing intraday float, facilitating depository institutions' monitoring and control of their cash balances during the day, and reflecting the legal rights and obligations of parties to payments. The Board's objective of minimizing intraday float is especially important in light of the daylight overdraft fee, which gives intraday credit an explicit value. The posting rules attempt to eliminate aggregate Federal Reserve intraday float because such float would be equivalent to unpriced Federal Reserve daylight credit.

As part of a broad review of its PSR policies, the Board evaluated the effectiveness of the current posting rules and found these rules to be generally effective and well understood by the industry. In reviewing the posting rules, however, the Board found that the posting times for ECP transactions often create a disincentive for depository institutions to use Federal Reserve electronic check services. The Federal Reserve Banks deliver the majority of electronic check presentments in the morning, and the delivery of the ECP files constitutes legal presentment of the checks under the terms of the Federal Reserve's uniform Operating Circular 3. In accordance with the Board's objectives in designing the posting rules, the current posting rules stipulate that debits to depository institutions' Federal Reserve accounts for check presentments occur on the next clock hour that is at least one hour after presentment takes place, beginning at 11:00 a.m. Eastern Time (ET) and no later than 3:00 p.m. local time.[3] Because the Reserve Banks generally deliver electronic check presentments in the morning, the corresponding debits occur at 11:00 a.m. ET. As a result, for many depository institutions, the posting times for electronic check presentments are earlier than the posting times associated with their paper check presentments.

The often earlier debit posting times associated with electronic check presentments have caused some depository institutions to incur daylight overdrafts earlier in the day and, in many cases, for longer periods of time. Because the Reserve Banks charge depository institutions a fee for the amount and duration of their Federal Reserve daylight credit use, the daylight overdraft charges of some institutions that have moved to electronic check services have grown substantially. As a result, some depository institutions have asserted that the increases in their daylight overdraft charges have reduced or eliminated the benefits of using Federal Reserve electronic check services.

The Federal Reserve is interested in removing barriers that may discourage depository institutions from using electronic check services. For several years, the Federal Reserve has been working on various initiatives to apply electronic technologies to the check collection process to gain efficiencies and to reduce the associated costs and risks. Electronic check services provide operational efficiencies, improve accuracy of information, reduce costs, improve the likelihood of timely presentment, and improve opportunities for accessing and using cash management information. The Board is requesting comment on a proposed change to the posting times for ECP transactions to remove a barrier to the use of ECP.

The Board also notes that its daylight credit policies are primarily intended to address intraday risk to the Federal Reserve arising from daylight overdrafts. Most transactions that lack settlement-day finality, such as checks, however, pose primarily interday, rather than intraday, risk. Modifying the posting times associated with ECP transactions should not create significant, if any, additional credit risk for the Reserve Banks.

II. Posting Times for ECP Transactions

The Board proposes modifying the daylight overdraft posting rules to allow debits associated with ECP transactions to post at 1:00 p.m. local time in order to remove the disincentive created by the current posting rules for depository institutions to use Federal Reserve electronic check presentment services.[4] A 1:00 p.m. local time posting time should remove the disincentive to move to electronic check presentment services created by the current posting rules. The Reserve Banks generally deliver electronic check presentment files by 10:00 a.m. ET; and, therefore, many depository institutions currently receive the related debits at 11:00 a.m. ET.[5] For many depository institutions, especially those not located in the Eastern Time zone, the 11:00 a.m. ET posting time is substantially earlier than the posting times associated with their paper check presentments. A posting time of 1:00 p.m. local time should reduce or eliminate the increase in daylight overdraft charges potentially created by the difference between the posting times of ECP and paper check presentment transactions.

The Board also considered posting ECP debits at the time the paying bank's paper check presentments would have been posted. The problem with matching the posting times of ECP and paper check presentments is that, over time, as electronic check presentments replace the physical delivery of the paper checks for a larger proportion of banks and courier routes are modified or eliminated, there is no longer a reasonable basis for determining specific ECP posting times for each depository institution. Moreover, a single debit posting time in each time zone for ECP transactions is more straightforward than a debit posting time that matches the posting time of paper check presentments. In determining a single debit posting time, the Board considered the aggregate value of checks posted to depository institutions' Federal Reserve accounts by each hour of the day. Currently, the Reserve Banks post the vast majority of check transactions, on average approximately 90 percent, by 1:00 p.m. local time. Because the Reserve Banks already post most checks by 1:00 p.m.

[2] See ''Federal Reserve Policy Statement on Payments System Risk,'' section I.A (57 FR 47093, October 14, 1992).

[3] On the day a paying bank receives a cash item from a Reserve Bank, it shall settle for the item so that the proceeds of the settlement are available to its Administrative Reserve Bank, or return the item, by the latest of (1) the next clock hour that is at least one hour after the paying bank receives the item; (2) 9:30 a.m. Eastern Time; or (3) such later time as provided in the Reserve Banks' operating circulars (12 CFR 210.9(b)).

[4] The Reserve Banks would modify the operating circulars as necessary.

[5] The Reserve Banks usually deliver electronic check presentment files by 12:00 p.m. ET in the Pacific Time zone.

local time, the Board believes that applying this posting time to ECP transactions should minimize any disincentive created by the posting rules to move to electronic check presentment services.

The primary drawback of posting ECP debits later in the day is the associated shift in posting credits to depository institutions' Federal Reserve accounts for check deposits to later in the day.[6] Institutions must choose one of two check credit posting options: (1) All credits posted at a single float-weighted posting time or (2) fractional credits posted throughout the day. The first option allows an institution to receive all of its check credits at a single time, which may not necessarily fall on a clock hour, for each type of cash letter. The second option lets the institution receive a portion of its available check credits on the clock hours between 11:00 a.m. and 6:00 p.m. ET. The option selected by an institution applies to all of its check deposits, including those for its respondents. Because the crediting fractions and single float-weighted posting times are based upon the Reserve Banks' ability to present checks and obtain settlement from payor institutions, posting times for check credits would become concentrated around 1:00 p.m. local time as more depository institutions began using Federal Reserve electronic check services. Consequently, depository institutions would receive their check credits somewhat later than they do today.[7] In addition, changes to the posting rules might entail some costs for depository institutions that may have developed internal monitors and controls for the management of their daily account balances around current posting times; however, the Board believes that such costs would be minimal.

III. Request for Comment

The Board proposes changing the posting times associated with ECP transactions to 1:00 p.m. local time. This revised posting time would allow the Federal Reserve to remove the barriers associated with the current posting rules for ECP transactions while providing a single and straightforward posting time that should not adversely affect depository institutions' account management procedures and practices or Federal Reserve credit risk. The Board requests comment on all aspects of the proposed modification to the posting rules. The Board is also requesting specific comments on the following questions:

1. Are there significant benefits or drawbacks associated with a posting time of 1:00 p.m. local time not identified in this notice?

2. Does the proposed posting time provide Federal Reserve Banks an inappropriate competitive advantage relative to the ability of private-sector banks or other service providers to compete in the provision of check collection services? If so, how?

IV. Competitive Impact Analysis

The Board has established procedures for assessing the competitive impact of rule or policy changes that have a substantial effect on payments system participants.[8] Under these procedures, the Board assesses whether a change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services due to differing legal powers or constraints, or due to a dominant market position of the Federal Reserve deriving from such differences. If no reasonable modifications would mitigate the adverse competitive effects, the Board will determine whether the expected benefits are significant enough to proceed with the change despite the adverse effects.

To obtain settlement from paying banks for checks presented, the Reserve Banks debit directly the account of the paying bank or its designated correspondent (12 CFR 210.9(b)(5)). In contrast, a paying bank settles for checks presented by a private-sector bank for same-day settlement by sending a Fedwire funds transfer to the presenting bank or by another agreed-upon method (12 CFR 229.36(f)(2)). In addition, the Reserve Banks have the right to debit the account of the paying bank for settlement of checks on the next clock hour that is at least one hour after presentment (12 CFR 210.9(b)(2)) whereas a paying bank becomes accountable to a private-sector collecting bank if it does not settle for the check by the close of Fedwire on the day of presentment (12 CFR 229.36(f)(2)). In March 1998, the Board requested comment on whether these legal differences between the Reserve Banks and the private sector provided the Reserve Banks with a competitive advantage and, if so, whether these legal differences should be reduced or eliminated (63 FR 12700, March 16, 1998). Based on an analysis of the comments received, the Board concluded that these legal disparities do not materially affect the efficiency of or competition in the check collection system (63 FR 68701, December 14, 1998). The proposed posting rule change for ECP transactions decreases, rather than exacerbates, the legal disparities between the Reserve Banks and the private sector. The Board, therefore, believes that the proposed change would not have a direct or material adverse effect on the ability of other service providers to compete effectively with the Reserve Banks' payments services.

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. ch. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the policy statement under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the policy statement.

VI. Policy Statement on Payments System Risk

The Board proposes to amend section I.A. under the heading *''Modified Procedures for Measuring Daylight Overdrafts''* as follows with changes identified by *italics:*

*   *   *   *   *

Modified Procedures for Measuring Daylight Overdrafts [3]

Opening Balance (Previous Day's Closing Balance)

Post at 1:00 p.m. Local Time:

—Electronic check presentments

[3] The posting changes do not affect the overdraft restrictions and overdraft-measurement provisions for nonbank banks established by the Competitive Equality Banking Act of 1987 and the Board's Regulation Y (12 CFR 225.52).

By order of the Board of Governors of the Federal Reserve System, May 30, 2001.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 01–13980 Filed 6–4–01; 8:45 am]

BILLING CODE 6210–01–P

[6] The Federal Reserve calculates the posting times for check credits based on surveys of check presentments in each time zone.

[7] If the Board modifies the posting rules to permit Reserve Banks to post debits for ECP transactions at 1:00 p.m. local time, the Federal Reserve will update the credit schedule concurrent with the effective date of the policy change and, as needed, thereafter. As a result, aggregate net intraday float would continue to be close to zero because the amounts of intraday credit and debit float created for brief periods generally would offset one another.

[8] These procedures are described in the Board's policy statement ''The Federal Reserve in the Payments System,'' as revised in March 1990. (55 FR 11648, March 29, 1990).

FEDERAL RESERVE SYSTEM

[Docket No. R–1106]

Policy Statement on Payments System Risk Interaffiliate Transfers

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy statement.

SUMMARY: The Board is rescinding section I.F., entitled Interaffiliate Transfers, of its payments system risk (PSR) policy. The Board adopted the interaffiliate transfer policy in 1987 to address potential risks resulting from a lack of an arm's-length credit decision among affiliates.

EFFECTIVE DATE: January 1, 2002.

FOR FURTHER INFORMATION CONTACT: Paul Bettge, Associate Director (202/452–3174) or Stacy Coleman, Manager (202/452–2934), Division of Reserve Bank Operations and Payment Systems.

SUPPLEMENTARY INFORMATION: The Board is issuing this notice in conjunction with five other notices requesting comment on the PSR policy. Three near-term proposals concern the net debit cap calculation for U.S. branches and agencies of foreign banks (Docket No. R–1108), modifications to the procedures for posting electronic check presentments to depository institutions' Federal Reserve accounts for purposes of measuring daylight overdrafts (Docket No. R–1109), and the book-entry securities transfer limit (Docket No. R–1110). In addition, the Board is requesting comment on the benefits and drawbacks to several potential longer-term changes to the Board's policy, including lowering self-assessed net debit caps, eliminating the two-week average caps, implementing a two-tiered pricing system for collateralized and uncollateralized daylight overdrafts, and rejecting payments with settlement-day finality that would cause an institution to exceed its daylight overdraft capacity level (Docket No. R–1111). The Board is also issuing today an interim policy statement and requesting comment on the broader use of collateral for daylight overdraft purposes (Docket No. R–1107). Furthermore, to reduce burden associated with the PSR policy, the Board recently rescinded the third-party access policy (Docket No. R–1100).

I. Background

In April 1985, the Board adopted the PSR policy to reduce the risks that large-dollar payments systems presented to the Federal Reserve Banks, to the banking system, and to other sectors of the economy (50 FR 21120, May 22, 1985). An integral component of this policy is a program to control the use of intraday Federal Reserve credit, commonly referred to as daylight overdrafts. The PSR policy establishes maximum limits (net debit caps) on daylight overdrafts in depository institutions' accounts at Federal Reserve Banks.

At the time it adopted the PSR policy, the Board also explored allowing depository institutions affiliated through common holding company ownership to consolidate their Fedwire activity and net debit caps for the purpose of monitoring compliance with the PSR policy. The Board determined, however, that while the operations of some holding companies are centrally managed, the regulatory and supervisory framework within which their subsidiaries operate is based on the separate corporate charter of each subsidiary. Therefore, the PSR policy requires that depository institutions be monitored for compliance on a separate legal-entity basis.

Although the Board prohibited affiliated depository institutions from outright consolidation of their Fedwire activity and net debit caps, a depository institution could simulate consolidation by sending Fedwire funds transfers to an affiliated institution in amounts not to exceed its net debit cap. The institution would have to repay the funds before the end of the day. The Board, however, identified two potential risks associated with depository institutions transferring their net debit caps to affiliated institutions: Increased credit risk to the Federal Reserve Banks and systemic risk among affiliated depository institutions, resulting from a lack of an arm's-length relationship among affiliates. The Board believed that this lack of an arm's-length relationship among affiliates, in some cases, might weaken the independence of credit judgment exercised by one affiliate in advancing funds to another. The concern that common ownership erodes an arm's-length credit decision grew out of the bank failures in the 1930s, which pointed to the relationship between depository institutions and their affiliates as a source of instability for the depository institutions.[1]

To address these risks, the Board modified the PSR policy in 1987 to permit interaffiliate transfers that are intended to concentrate the daylight overdraft capacity of affiliated institutions in one or more institutions provided that: (1) Each sending institution's board of directors specifically approves, at least once each year, the intraday extension of credit to the specified affiliate(s) and sends a copy of the directors' resolution to its Federal Reserve Bank and (2) during regular examination, each sending institution's primary federal supervisor reviews the timeliness of board-of-directors resolutions, the establishment by the institution of limits on credit extensions to each affiliate, the establishment by the institution of controls to ensure that credit extensions stay within such limits, and whether credit extensions have in fact stayed within those limits (52 FR 29255, August 6, 1987).

II. Discussion

Recognizing that significant changes have occurred in the banking, payments, and regulatory environment in the past few years, the Board decided to conduct a broad review of the Federal Reserve's daylight credit policies. As part of its review, the Board considered the effectiveness of the interaffiliate transfer policy. Because of the policy's limited use and the credit risk management techniques available to the Reserve Banks, the Board decided to rescind the policy.

The Board evaluated the interaffiliate transfer policy's effectiveness and found that very few institutions are using interaffiliate transfers to consolidate their Fedwire activity and daylight overdraft capacity. The Board also notes that those institutions engaging in interaffiliate transfers, primarily insured depository institutions owned by the same bank holding company, appear to be managing their Federal Reserve accounts prudently. In addition, subsequent to the adoption of the interaffiliate transfer policy, the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 included a cross-guarantee provision that allows the Federal Deposit Insurance Corporation (FDIC) to recover part of its resolution cost by seeking reimbursement from affiliated institutions.[2] The Board notes that, under the cross-guarantee provisions, an insured depository institution is generally liable for any loss incurred by the FDIC in connection with the default of a commonly controlled insured depository institution. Furthermore, the Federal Reserve Banks retain the right to reduce or eliminate the credit exposure that they will accept for any depository

[1] In addition, the Basle Committee's Core Principles requires that transactions between banks and related companies and individuals should be on an arm's length basis, be effectively monitored, and appropriate steps should be taken to mitigate risks. *Core Principles for Effective Banking Supervision,* Basle Committee on Banking Supervision, September 1997.

[2] 12 U.S.C. 1468.

institution by reducing the institution's net debit cap or monitoring the institution's Fedwire funds transfers and enhanced net settlement transactions in real time. The Board believes that these controls mitigate any increased credit risk to the Federal Reserve or systemic risk from interaffiliate transfers intended to simulate daylight overdraft cap consolidation.

The Board also believes that any institution-specific supervisory concerns associated with interaffiliate credit extensions are more appropriately addressed through the existing supervisory process, including through regulatory restrictions on interaffiliate transactions embodied in sections 23A and 23B of the Federal Reserve Act.[3] Sections 23A and 23B of the Federal Reserve Act are intended to limit the risks to an insured depository institution from transactions with its affiliates. In May 2001, the Board published an interim final rule that (1) requires, under section 23A, that institutions establish and maintain policies and procedures to manage the credit exposure arising from the institutions' intraday extensions of credit to affiliates and (2) clarifies that intraday extensions of credit by an insured depository institution to an affiliate are subject to the market terms requirement of section 23B (Docket No. R–1104).

The Board notes that the interim rule under sections 23A and 23B could restrict the ability of depository institutions to consolidate their daylight overdraft caps. Because of statutory exemptions, however, the market terms requirement of section 23B and the policies and procedures requirement of the interim rule generally would not apply to intraday credit extensions between affiliated insured depository institutions. Thus, intraday credit extensions between affiliated depository institutions, including the consolidating transfers discussed above, would generally be permissible under sections 23A and 23B provided they are conducted in a safe and sound manner. On the other hand, intraday credit extensions designed to transfer the daylight overdraft cap of an insured depository institution to an affiliate that is not an insured depository institution, such as a branch or agency of a foreign bank affiliate, would be subject to the market terms requirement of section 23B and the policies and procedures requirement of the interim rule.

Because the risks addressed by the interaffiliate transfer policy are appropriately addressed through the existing supervisory process, the Board is rescinding the interaffiliate transfer policy, part I, section F of the Policy Statement on Payments System Risk.[4] Upon rescission of the interaffiliate transfer policy, depository institutions will no longer be required to submit a board-of-directors resolution to their Reserve Banks; however, institutions are expected to comply with supervisory and regulatory requirements regarding affiliate relationships and exposures, including sections 23A and 23B, as described in 12 CFR 250.248, 12 CFR Part 223, and any future rulemaking.

By order of the Board of Governors of the Federal Reserve System, May 30, 2001.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 01–13977 Filed 6–4–01; 8:45 am]

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[3] 12 U.S.C. 371c.

[4] The current part I, section G of the policy, Monitoring, will be designated as section F.

FEDERAL RESERVE SYSTEM

[Docket No. R–1107]

Policy Statement on Payments System Risk

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Interim policy statement with request for comment.

SUMMARY: The Board is issuing and requesting comment on an interim policy statement that allows a depository institution that has a self-assessed net debit cap (average, above average, or high) to pledge collateral to its Federal Reserve Bank in order to access additional daylight overdraft capacity above its net debit cap level. The Board may modify the final policy statement after considering the comments received.

DATES: The interim policy statement is effective on May 30, 2001. Comments on the interim policy must be received by August 6, 2001.

ADDRESSES: Comments, which should refer to Docket No. R–1107, may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551 or mailed electronically to regs.comments@federalreserve.gov. Comments addressed to Ms. Johnson also may be delivered to the Board's mailroom between 8:45 a.m. and 5:15 p.m. and to the security control room outside of those hours. Both the mailroom and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in Room MP–500 between 9 a.m. and 5 p.m. weekdays, pursuant to § 261.12, except as provided in § 261.14, of the Board's Rules Regarding Availability of Information, 12 CFR 261.12 and 261.14.

FOR FURTHER INFORMATION CONTACT: Paul Bettge, Associate Director (202/452–3174) or Stacy Coleman, Manager (202/452–2934), Division of Reserve Bank Operations and Payment Systems.

SUPPLEMENTARY INFORMATION: This is one of five notices regarding payments system risk that the Board is issuing for public comment today. Three near-term proposals concern the net debit cap calculation for U.S. branches and agencies of foreign banks (Docket No. R–1108), modifications to the procedures for posting electronic check presentments to depository institutions' Federal Reserve accounts for purposes of measuring daylight overdrafts (Docket No. R–1109), and the book-entry securities transfer limit (Docket No. R–1110). In addition, the Board is requesting comment on the benefits and drawbacks to several potential longer-term changes to the Board's payments system risk (PSR) policy, including lowering self-assessed net debit caps, eliminating the two-week average caps, implementing a two-tiered pricing system for collateralized and uncollateralized daylight overdrafts, and rejecting payments with settlement-day finality that would cause an institution to exceed its daylight overdraft capacity level (Docket No. R–1111). Furthermore, to reduce burden associated with the PSR policy, the Board recently rescinded the interaffiliate transfer (Docket No. R–1106) and third-party access policies (Docket No. R–1100).

The Board requests that in filing comments on these proposals, commenters prepare separate letters for each proposal, identifying the appropriate docket number on each. This will facilitate the Board's analysis of all comments received.

I. Background

Beginning in 1985, the Board adopted and has subsequently modified a policy to reduce the risks that payments systems present to the Federal Reserve Banks, to the banking system, and to other sectors of the economy. An integral component of the current PSR policy is a program to control depository institutions' use of intraday Federal Reserve credit, commonly referred to as "daylight credit" or "daylight overdrafts." The Board's intention was to address the Federal Reserve's risk as well as risks on private-sector networks, primarily large-dollar payments systems. Risk can arise from transactions on the Federal Reserve's wire transfer system (Fedwire); from other types of payments, including checks and automated clearing house (ACH) transactions; and from transactions on private large-dollar networks.

The Federal Reserve Banks face direct risk of loss should depository institutions be unable to settle their daylight overdrafts in their Federal Reserve accounts before the end of the day. Moreover, systemic risk may occur if an institution participating on a private large-dollar payments network were unable or unwilling to settle its net debit position. If such a settlement failure occurred, the institution's creditors on that network might also be unable to settle their commitments. Serious repercussions could, as a result, spread to other participants in the private network, to other depository institutions not participating in the network, and to the nonfinancial economy generally. A Reserve Bank could be exposed to indirect risk if Federal Reserve policies did not address this systemic risk.

The 1985 policy required all depository institutions incurring daylight overdrafts in their Federal Reserve accounts as a result of Fedwire funds transfers to establish a maximum limit, or net debit cap, on those overdrafts (50 FR 21120, May 22, 1985).[1] Initially, the Board exempted book-entry securities overdrafts from quantitative overdraft controls because of concerns about the effect that overdraft restrictions could have on the U.S. government securities market and on the Federal Reserve's ability to conduct monetary policy through open market operations. In 1990, however, the Board announced that a depository institution's funds and book-entry securities overdrafts would be combined for purposes of determining the institution's compliance with its cap (55 FR 22087, May 31, 1990).

The Board recognized that receivers of book-entry securities generally cannot control the timing of their book-entry securities overdrafts, but that intraday book-entry securities overdrafts, like funds overdrafts, have the potential to become overnight overdrafts. Given the seller-driven nature of the book-entry system and the Board's sensitivity to the markets it supports, the Board determined that only collateralized book-entry securities overdrafts would be exempt from cap limits.[2] This aspect of the policy was designed to protect the Reserve Banks from the very large exposures that can result from book-entry transfers without creating serious disruptions in the market.

In 1989, the Board requested comment on a proposed change to its payments system risk reduction program that would assess a fee of 60 basis points, phased in over three years, for average daily overdrafts in excess of a deductible of 10 percent of risk-based capital (54 FR 26094, June 21, 1989). In October 1992, the Board approved charging a fee for daylight overdrafts, which was to be phased in as 24 basis points in 1994, 48 basis points in 1995, and 60 basis points in 1996 (57 FR 47084, October 14, 1992).[3] The purpose of the fee was to induce behavior that would reduce risk and increase efficiency in the payments system.

Some depository institutions and securities dealers commented that they opposed a fee on book-entry securities overdrafts that were collateralized. These depository institutions and securities dealers argued that pricing book-entry securities overdrafts was inequitable because collateral protected the Federal Reserve against losses and there are already costs associated with pledging collateral. For that reason, these institutions and securities dealers argued that pricing and requiring collateral for book-entry securities overdrafts was unduly burdensome. The Board stated, however, that allowing collateral to substitute for daylight overdraft fees would not provide a meaningful incentive for depository institutions or their dealer customers to change their procedures and reduce daylight overdrafts.[4]

In March 1995, the Board decided to raise the daylight overdraft fee to 36 basis points instead of 48 basis points (60 FR 12559, March 7, 1995). Because aggregate daylight overdrafts fell approximately 40 percent after the introduction of fees, the Board was concerned that raising the fee to 48 basis points could produce undesirable market effects contrary to the objectives of the risk-control program. The Board believed, however, that an increase in the overdraft fee was needed to provide additional incentives for institutions to reduce overdrafts related to funds transfers. The Board stated it would evaluate further fee increases two years after the 1995 fee increase.[5]

In considering its obligation to evaluate further fee increases, the Board recognized that significant changes have occurred in the banking, payments, and regulatory environment in the past few years and, as a result, decided to conduct a broad review of the Federal Reserve's daylight credit policies. During the course of its review, the Board evaluated the effectiveness of the current daylight credit policies and determined that these policies appear to be generally effective in controlling risk to the Federal Reserve and creating incentives for depository institutions to manage their intraday credit exposures. In addition, the Board determined that the current policy is well understood by the industry and that private-sector participants generally have benefited from the policy's risk controls. The Board also recognizes, however, that the policy has imposed costs on the industry and is considered burdensome by some depository institutions.

In conducting its review, the Board evaluated the impact of past policy actions on depository institutions' behavior and on the markets generally. The Board also took into consideration the effect of various payment system initiatives on payments activity and the demand for daylight credit. While the Board believes that the current policy is generally effective, it did identify growing liquidity pressures among certain payment system participants. Specifically, the Board learned that a

[1] Net debit caps are calculated by applying a cap multiple from one of six cap classes (zero, exempt, de minimis, average, above average, and high) to a capital measure. Cap multiples are determined through either a self-assessment process (for average, above average, and high cap classes) or a board-of-directors resolution or assigned by the Reserve Bank. Requests for a particular cap multiple are granted at the discretion of the Reserve Bank.

[2] The policy requires that depository institutions with "frequent and material" book-entry securities overdrafts fully collateralize these overdrafts. Book-entry daylight overdrafts become frequent and material when an account holder exceeds its net debit cap, because of book-entry securities transactions, on more than three days in any two consecutive reserve maintenance periods and by more than 10 percent of its capacity.

[3] To facilitate the pricing of daylight overdrafts, the Federal Reserve also adopted a modified method of measuring daylight overdrafts that more closely reflects the timing of actual transactions affecting an institution's intraday Federal Reserve account balance. This measurement method incorporates specific account posting times for different types of transactions.

[4] The Board also stated that collateral is required for large book-entry overdrafters as an exception that permits clearing banks and similarly situated institutions to exceed their caps because of the difficulty of controlling book-entry securities overdrafts.

[5] On an average annual basis since 1995, overdrafts caused by book-entry securities transfers have decreased almost 10 percent per year and the value of book-entry securities transfers has grown more than 5 percent per year; whereas funds overdrafts and the value of Fedwire funds transfers have grown between 15 and 18 percent per year. The growth in funds overdrafts appears to be directly related to the growth in large-value funds transfers.

small number of financially healthy institutions regularly find their net debit caps to be constraining, causing them to delay sending payments and, in some cases, to turn away business.[6] Payment system initiatives, such as the Clearing House Interbank Payments System with intraday finality (new CHIPS), the Continuous Linked Settlement (CLS) system, and the Federal Reserve's settlement-day finality for ACH credit transactions, may exacerbate these institutions' liquidity needs at specific times during the day.[7]

II. Interim Policy Statement

The Board is adopting an interim policy statement that allows depository institutions with net debit caps derived through a self-assessment to pledge collateral voluntarily to the Federal Reserve Banks in order to access additional daylight overdraft capacity above their net debit cap levels.[8] The Board's analysis of overdraft levels, liquidity patterns, and payment system developments revealed that while net debit caps provide sufficient liquidity to most institutions, some depository institutions are experiencing liquidity pressures. The Board recognizes that the interim policy could increase the public sector's credit exposure but believes that requiring collateral will allow the Federal Reserve to protect the public sector from additional credit exposure while providing extra liquidity to the few institutions that might otherwise be constrained. Providing extra liquidity to constrained institutions should help prevent liquidity-related market disruptions. The option to pledge collateral for additional daylight overdraft capacity would provide the private sector with the flexibility that it has requested to relieve liquidity pressures that have arisen or may arise from payment system innovations such as new CHIPS, CLS, and ACH finality as well as other payment system initiatives.

The Board believes it is important to provide an environment in which payment systems may function effectively and efficiently and remove barriers, as appropriate, to foster risk-reducing payment system initiatives. The Board recognizes that large-dollar networks are an integral part of clearing and settlement systems, that it is of considerable importance to keep the payments system operating without significant disruption, and that some intraday credit may be necessary to keep the payments system running smoothly and efficiently. Given these principles, the Board believes that allowing depository institutions with self-assessed net debit caps to pledge collateral for additional daylight overdraft capacity will continue to promote the PSR policy's risk-reduction efforts while minimizing disruptions to the payments system. In addition, daylight overdraft fees will continue to apply to all overdrafts, collateralized or uncollateralized, as the fee provides a meaningful incentive for depository institutions to manage efficiently their use of Federal Reserve daylight credit.

A. Payment System Initiatives

CHIPS Real-Time Final Settlement

On January 22, 2001, the Clearing House Interbank Payments Company L.L.C. (CHIPCo) converted CHIPS from an end-of-day multilateral net settlement system to one that provides real-time final settlement for all payment orders as they are released.[9] Under an end-of-day system, the delay between the release of a payment order and its settlement results in the risk that the failure of one or more participants could trigger a failure of the system to settle. In response to demands of CHIPS participants to eliminate any possibility of an unwind, CHIPCo developed a method to achieve real-time final settlement of CHIPS payment orders. Under real-time final settlement, all CHIPS payment instructions are settled against a positive current position in the CHIPS prefunded balance account held at the Federal Reserve Bank of New York (FRBNY) or simultaneously offset by incoming payments or both. As a result, real-time final settlement eliminates the complexity and potential systemic risks of an end-of-day settlement failure that could lead to a general unwinding of CHIPS payments. In addition, the real-time final settlement of new CHIPS reduces credit and liquidity risks.

To accomplish real-time final settlement, each CHIPS participant must transfer (directly or through another participant) a predetermined amount into the CHIPS "prefunded balance account" on the books of FRBNY. While new CHIPS settles all of the payment orders when they are released, some payment orders remain unreleased at the end of the day. These payment orders are netted and set off against one another on a multilateral basis, with each participant in a net debit closing position transferring the amount of its closing position requirement into the prefunded balance account. Many CHIPS participants use Federal Reserve daylight credit to pay their end-of-day closing position requirements on CHIPS. Some of these participants have stated that making these Fedwire payments has, on occasion, increased their demand for intraday credit.

CLS Bank

CLS Bank is being designed as a multi-currency facility for settling foreign exchange transactions. Under the proposed procedures, participating institutions will be required to make daily U.S. dollar payments to CLS Bank over Fedwire during the early hours of the Fedwire funds transfer operating day. Because U.S. financial money markets are not currently active during those hours, a number of CLS members assert that they will use Federal Reserve daylight credit to fund their CLS-related payment obligations and have requested that the Federal Reserve grant them additional intraday credit.[10]

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[6] Current net debit cap levels provide sufficient liquidity for the majority of depository institutions. Approximately 97 percent of depository institutions with positive net debit caps use less than 50 percent of their daylight overdraft capacity for their average daily peak overdrafts.

[7] New CHIPS was implemented on January 22, 2001, CLS is scheduled for implementation in the fourth quarter of 2001, and ACH credit transactions will be final on the settlement date beginning in mid-2001. Settlement-day finality for ACH credit transactions may exacerbate liquidity pressures for credit originators on the real-time monitor that must prefund.

[8] Depository institutions that wish to have access to larger amounts of intraday credit than that provided by the exempt-from-filing and de minimis net debit caps must perform a self-assessment of their creditworthiness, intraday funds management and control, customer credit policies and controls, and operating controls and contingency procedures to support a higher daylight overdraft cap.

[9] CHIPCo is the affiliate of The New York Clearing House Association L.L.C. that owns and operates CHIPS.

[10] For additional information on payment system initiatives, refer to the Payments Risk Committee's report entitled "Intraday Liquidity Management in the Evolving Payment System: A Study of the Impact of the Euro, CLS Bank, and CHIPS Finality," New York, April 2000. *http://www.ny.frb.org/prc/intraday.html.*

ACH Settlement-Day Finality In November 1999, the Board announced a decision to make the settlement of ACH credit transactions processed by the Federal Reserve final when posted to the accounts of the receivers, which is currently 8:30 a.m. ET on the day of settlement (64 FR 62673, November 17, 1999). The Board noted that, in order to protect the Federal Reserve from the credit risk of granting finality to receiving depository institutions, the Reserve Banks would require settling depository institutions that are monitored in real time to prefund the total of their ACH credit originations before the transactions are processed. Settlement-day finality for ACH credit transactions reduces risk to receiving depository institutions and receivers while the prefunding requirement permits the Reserve Banks to manage their settlement risk for ACH credit transactions as they do for other services with similar finality features.

When the Board requested comment on the ACH finality proposal, a number of depository institutions asked that the Federal Reserve allow the flexibility of posting collateral as an alternative to the prefunding requirement (63 FR 70132, December 18, 1998). The Board noted that allowing collateral to cover non-securities related overdrafts was not in accordance with the PSR policy. The Board, however, also indicated that it would consider the commenters' request in future reviews of its PSR policies. Under the conditions described in this interim policy, some depository institutions submitting ACH credit transactions on the day of settlement will be able to secure additional daylight overdraft capacity.[11]

B. Collateralized Daylight Overdraft Capacity

Depository institutions with self-assessed net debit caps that wish to expand their daylight overdraft capacity levels by pledging collateral should consult with their Reserve Banks. In developing guidelines for approving maximum limits on collateralized daylight overdraft capacity beyond net debit cap levels, the Board and Reserve Bank staff will consider financial and supervisory information. The financial and supervisory information may include, but is not limited to, potential daylight credit usage, capital and liquidity ratios, the composition of balance sheet assets, CAMELS or other supervisory ratings and assessments, and the Strength of Support Assessment rankings for U.S. branches and agencies of foreign banks.

Depository institutions may pledge the same types of collateral they do today for discount window or PSR purposes. In addition, the Board believes that it would be reasonable for depository institutions to use collateral pledged to the discount window for additional daylight overdraft capacity and notes that more than 25 percent of account holders already have collateral pledged to the Reserve Banks.[12] While several hundred depository institutions have collateral pledged to the Federal Reserve, the Board expects that very few depository institutions will seek to expand their daylight overdraft capacity levels by pledging collateral because approximately 97 percent of all account holders use less than 50 percent of their net debit caps for their average peak overdrafts. This modification of the PSR policy, allowing depository institutions with self-assessed net debit caps to pledge collateral for extra daylight overdraft capacity, affects other areas of the policy, including the policy's treatment of U.S. branches and agencies of foreign banks, book-entry securities transfers, and account monitoring procedures.

U.S. Branches and Agencies of Foreign Banks

For U.S. branches and agencies of foreign banks, net debit caps on daylight overdrafts in Federal Reserve accounts are calculated by applying the cap multiples for each cap category to a foreign banking organization's (FBO's) consolidated ''U.S. capital equivalency.''[13] U.S. capital equivalency is calculated in one of several ways. In the case of FBOs whose home-country supervisors adhere to the Basle Capital Accord, U.S. capital equivalency is equal to the greater of 10 percent of worldwide capital or 5 percent of the liabilities to nonrelated parties of each agency or branch.[14] For FBOs whose home-country supervisors do not adhere to the Basle Capital Accord, U.S. capital equivalency is measured as the greater of (1) the sum of the amount of capital (but not surplus) that would be required of a national bank being organized at each agency or branch location, or (2) the sum of 5 percent of the liabilities to nonrelated parties of each agency or branch.

The current policy allows U.S. branches and agencies of FBOs whose home-country supervisors do not adhere to the Basle Capital Accord to incur daylight overdrafts above their net debit caps up to a maximum amount equal to their cap multiples times 10 percent of their FBOs' capital, provided that any overdrafts above the net debit caps are collateralized. The interim policy offers all foreign banks, under terms that reasonably limit Reserve Bank risk, a level of overdrafts based on the same proportion of worldwide capital. Under the interim policy statement, the above distinction is no longer pertinent because any U.S. branch or agency of a foreign bank that has a self-assessed net debit cap and that would like to access daylight credit above its net debit cap level may consult with its Administrative Reserve Bank to discuss an appropriate daylight overdraft capacity level.[15] In addition, a notice published elsewhere in today's **Federal Register** requests comment on the net debit cap calculation for U.S. branches and agencies of foreign banks (Docket No. R–1108).

Book-Entry Securities Transactions

The current policy stipulates that depository institutions with book-entry securities overdrafts that meet the frequency and materiality thresholds must *fully* collateralize these overdrafts, not only the overdraft amount that exceeds the net debit cap level.[16] Under the interim policy statement, the Board is eliminating the frequent and material collateralization requirement for self-assessed depository institutions' book-entry securities overdrafts. Instead, the policy statement will allow Reserve Banks to require collateral from self-assessed depository institutions that frequently exceed their caps as a result of transactions with settlement-day

[11] Federal Reserve systems in place today would not be effective for monitoring the collateralization of ACH credit transactions over several days.

[12] The Board notes that the majority of Federal Reserve daylight credit extensions are currently implicitly collateralized because depository institutions that have pledged collateral must sign Operating Circular 10, which provides the Reserve Banks with a secured interest in any collateral recorded on the Reserve Banks' books.

[13] The term ''U.S. capital equivalency'' is used in this context to refer to the particular capital measure used to calculate daylight overdraft net debit caps and does not necessarily represent an appropriate capital measure for supervisory or other purposes.

[14] Liabilities to nonrelated parties include acceptances but excludes accrued expenses and amounts due and other liabilities to offices, branches, and subsidiaries of the foreign bank.

[15] The Administrative Reserve Bank is responsible for managing an institution's account relationship with the Federal Reserve.

[16] Book-entry daylight overdrafts become ''frequent and material'' when an account holder exceeds its net debit cap, due to book-entry securities transactions, by more than 10 percent of its capacity and on more than three days in any two consecutive reserve maintenance periods.

[17] These transactions include Fedwire funds and book-entry securities transfers, enhanced net settlement service transactions, and ACH credit originations (beginning in mid-2001).

finality.[17] [18] While the interim policy statement requires collateralization of overdrafts *only* above net debit cap levels, which could increase the Federal Reserve's credit exposure, the Board believes an increase in Federal Reserve credit risk would be minimal given that very few institutions that participate in the government-securities market meet the frequent and material criteria. The Board also believes that eliminating the frequent and material collateralization requirement for book-entry securities overdrafts specifically and developing guidelines that require collateralization of overdrafts above net debit cap levels regardless of the cause would simplify administration of and compliance with the policy.

The changes described above do not apply to institutions with exempt-from-filing or de minimis net debit caps. Under the interim policy, the Board plans to continue to allow depository institutions with exempt-from-filing or de minimis caps to collateralize voluntarily all or part of their book-entry securities overdrafts. The Board also intends to continue:

• Requiring depository institutions with exempt-from-filing or de minimis caps that frequently exceed their caps, even if only partly because of book-entry securities transactions, to collateralize all of their book-entry securities overdrafts.

• Prohibiting depository institutions with exempt-from-filing or de minimis caps to pledge collateral to increase their daylight overdraft capacity for funds overdrafts.

• Requiring depository institutions with zero caps that have access to the discount window to collateralize fully all book-entry securities overdrafts.

With the adoption of a final policy statement, the Board intends to eliminate the current policy's separate treatment of book-entry securities overdrafts. The policy will require any depository institution with an exempt-from-filing or de minimis cap to apply for a higher net debit cap if the institution frequently exceeds its cap because of transactions with settlement-day finality. The Board believes that such a change would simplify administration and compliance with the policy. Furthermore, the Board notes that very few depository institutions (currently there are six) with exempt-from-filing or de minimis caps voluntarily hold collateral to cover their book-entry securities overdrafts and would not be adversely affected by the proposed policy change.[19]

Account Monitoring

Currently, a depository institution's funds and book-entry securities overdrafts are combined for purposes of determining the institution's compliance with its cap. Under the ex post monitoring procedures, the Reserve Banks contact and counsel institutions with net debit positions in excess of their caps, discussing ways to reduce their excessive use of intraday credit. Each Reserve Bank retains the right to protect its risk exposure from individual institutions by unilaterally reducing net debit cap levels, imposing collateralization or clearing-balance requirements, holding or rejecting Fedwire transfers or enhanced net settlement service transactions during the day until the institution has collected balances in its Federal Reserve account, or, in extreme cases, prohibiting it from using Fedwire.

The Board does not intend to modify significantly the Federal Reserve's ex post monitoring procedures. The Board notes, however, that three aspects of the ex post monitoring procedures warrant clarification with implementation of the interim policy. First, the Reserve Banks will monitor the net debit positions of depository institutions with self-assessed caps that choose to pledge collateral voluntarily for additional overdraft capacity against these institutions' daylight overdraft capacity levels and not their net debit cap levels.

Second, Reserve Banks may require depository institutions with self-assessed net debit caps that frequently exceed their daylight overdraft capacity levels to collateralize the difference between their peak daylight overdrafts and their net debit cap levels. Depository institutions have some flexibility as to the specific types of collateral they may pledge to the Reserve Banks; all collateral, however, must be acceptable to the Reserve Banks.

Finally, the policy will continue to allow administrative counseling flexibility for institutions that frequently exceed their net debit caps due to the posting of transactions that do not have settlement-day finality, such as checks and ACH debit originations.[20] Escalated counseling or requiring collateral for daylight overdrafts caused by these transactions may be of limited use in reducing associated overdrafts.

III. Request for Comment

The Board requests comment on all aspects of the interim policy statement. The Board is also requesting specific comments on the following questions:

1. What are the benefits and drawbacks of allowing depository institutions with self-assessed net debit caps to pledge collateral for additional daylight overdraft capacity?

2. Would a policy change that requires depository institutions with exempt-from-filing and de minimis caps to apply for higher net debit caps if they frequently exceed their caps because of book-entry securities transfers simplify the policy or create an undue burden?

3. Would the interim policy cause institutions to pledge additional collateral to the Federal Reserve or would they primarily use collateral already pledged to a Reserve Bank?

IV. Competitive Impact Analysis

The Board has established procedures for assessing the competitive impact of rule or policy changes that have a substantial impact on payments system participants.[21] Under these procedures, the Board assesses whether a change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services due to differing legal powers or constraints, or due to a dominant market position of the Federal Reserve deriving from such differences. If no reasonable modifications would mitigate the adverse competitive effects, the Board will determine whether the expected benefits are significant enough to proceed with the change despite the adverse effects.

The Board does not believe that the broader use of collateral for daylight overdraft purposes will have a direct and material effect on the ability of other service providers to compete with the Reserve Banks' payments services. The Board notes that the interim policy

[18] Under the interim policy, ''frequently'' will continue to mean more than three days in any two consecutive reserve maintenance periods. In the vast majority of cases where depository institutions' overdrafts exceed their net debit cap levels, the materiality threshold is met. The Board, therefore, is eliminating the ''materiality'' criteria entirely from the policy because it has little practical purpose.

[19] Currently there are no depository institutions with exempt-from-filing or de minimis caps that are required to pledge collateral for book-entry securities overdrafts as a result of meeting the frequency and materiality criteria.

[19] Currently there are no depository institutions with exempt-from-filing or de minimis caps that are required to pledge collateral for book-entry securities overdrafts as a result of meeting the frequency and materiality criteria.

[20] In October 1994, the Board approved administrative counseling flexibility for institutions that continue to exceed their net debit caps due to the posting of non-Fedwire transactions (59 FR 27122, November 2, 1994).

[21] These procedures are described in the Board's policy statement ''The Federal Reserve in the Payments System,'' as revised in March 1990. (55 FR 11648, March 29, 1990).

statement is intended to facilitate the smooth functioning of private-sector payment systems.

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. ch. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the policy statement under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the policy statement.

VI. Federal Reserve Policy Statement on Payments System Risk

The ''Federal Reserve Policy Statement on Payments System Risk,'' section I is amended, effective *DATE,* as follows with changes identified by *italics:*

I. FEDERAL RESERVE POLICY
A. Daylight overdraft definition
B. Pricing
C. Capital
1. U.S.-chartered institutions
2. U.S. agencies and branches of foreign banks
D. Net debit caps
1. Cap set through self-assessment
2. De minimis cap
3. Exemption from filing
4. Special situations
a. Edge and agreement corporations
b. Bankers' banks
c. Limited-purpose trust companies
d. Zero-cap depository institutions
E. Collateral
F. Book-entry securities transactions
1. Collateralization
2. Transfer-size limit
G. Monitoring
1. Ex post
2. Real time
3. Multi-District institutions
4. ACH controls

The last paragraph in section I.C.2., under the heading ''*U.S. agencies and branches of foreign banks,*'' has been deleted, effective *DATE.*

A new heading ''*Collateral*'' and text have been added to read as follows in section I.E., effective *DATE:*

E. Collateral

Depository institutions with self-assessed net debit caps may pledge collateral to their Administrative Reserve Banks to secure daylight overdraft capacity in excess of their net debit caps. The Reserve Banks will work with self-assessed depository institutions that request additional daylight overdraft capacity to decide on the appropriate maximum daylight overdraft capacity levels, that is, net debit cap levels plus allowable collateralized credit. Depository institutions have some flexibility as to the specific types of collateral they may pledge to the Reserve Banks; all collateral, however, must be acceptable to the Reserve Banks. Depository institutions with exempt-from-filing and de minimis net debit caps may not obtain additional capacity by pledging collateral. These depository institutions must perform a self-assessment of their creditworthiness, intraday funds management and control, customer credit policies and controls, and operating controls and contingency procedures to support a higher daylight overdraft cap.

In addition, Reserve Banks may require depository institutions with self-assessed net debit caps that frequently exceed their caps due to transactions with settlement-day finality to collateralize the difference between their peak daylight overdrafts and their net debit cap levels. For the purposes of this policy, ''frequently'' means more than three occasions in two consecutive reserve-maintenance periods.

The policy allows administrative counseling flexibility for most institutions that frequently exceed their net debit caps because of the posting of transactions that lack settlement-day finality, such as checks and ACH debit originations. The Board's policy on net debit caps is intended to address intraday risk to the Federal Reserve arising from daylight overdrafts. Most transactions that lack settlement-day finality, however, pose primarily interday, rather than intraday, risk. Escalated counseling or requiring collateral for daylight overdrafts caused by these transactions may be of limited use in reducing associated overdrafts. Under administrative counseling flexibility, the Reserve Banks work with affected institutions on means of avoiding daylight overdrafts, but generally do not subject these institutions to escalated levels of counseling, require collateral, or assign a zero cap.

Section I.F.1., under the heading ''*Collateralization*'' is replaced, effective *DATE,* to read as follows:

F. Book-Entry Securities Transactions

1. Collateralization

A depository institution's funds and book-entry securities overdrafts are combined for purposes of determining an institution's compliance with its cap.[18] The policy requires depository institutions with exempt-from-filing or de minimis caps that frequently exceed their caps, even if only partly because of book-entry securities transactions, to collateralize all of their book-entry securities overdrafts. For the purposes of this policy, ''frequently'' means on more than three occasions in two consecutive reserve-maintenance periods. To determine whether an institution exceeds its net debit cap because of book-entry securities transactions, the Reserve Bank determines what activity in an institution's Federal Reserve account is attributable to funds transfers and other payment transactions and what activity is attributable to book-entry securities transactions. A book-entry securities overdraft occurs when an institution's book-entry securities balance, less any credit in its funds balance, is a net debit.

In addition, all depository institutions with exempt-from-filing or de minimis caps may collateralize all or part of their book-entry securities overdrafts. Such secured overdrafts shall not be included with those overdrafts measured against their caps. For example, a depository institution with a de minimis cap of $50 million and a $30 million overdraft—$15 million due to funds transfers and $15 million due to book-entry securities transfers—would ordinarily have excess capacity of $20 million. Such an institution may increase its excess capacity by $15 million by collateralizing all of its book-entry securities overdrafts (or may increase its excess capacity by less than $15 million by collateralizing some portion of its book-entry securities overdrafts). Such an institution may not increase its cap of $50 million by over-collateralizing its book-entry securities overdrafts or by collateralizing any part of its funds overdrafts.

Section I.G.1., under the heading ''*Ex Post*'' is amended, effective *DATE,* as follows with changes identified by *italics:*

G. Monitoring

1. Ex Post

Under the ex post monitoring procedure, an institution with a net debit position in excess of its cap *or daylight overdraft capacity level* will be contacted by its Reserve Bank. The Reserve Bank will counsel the institution, discussing ways to reduce its excessive use of intraday credit. Each Reserve Bank retains the right to protect its risk exposure from individual institutions by unilaterally reducing Fedwire caps, imposing collateralization or clearing-balance requirements, holding or rejecting Fedwire transfers during the day until the institution has

[18] Funds overdrafts refer to overdrafts caused by funds transfers as well as NSS, TIP, cash, ACH, and check transactions.

collected balances in its Federal Reserve account, or, in extreme cases, taking the institution off-line or prohibiting it from using Fedwire.

By order of the Board of Governors of the Federal Reserve System, May 30, 2001.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 01–13978 Filed 6–4–01; 8:45 am]

BILLING CODE 6210–01–P

FEDERAL RESERVE SYSTEM

[Docket No. R–1108]

Policy Statement on Payments System Risk; Daylight Overdraft Capacity for Foreign Banking Organizations

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment on policy.

SUMMARY: The Board is requesting comment on proposed changes to its payments system risk (PSR) policy. The proposal would modify the criteria used to determine the U.S. capital equivalency for foreign banking organizations (FBOs). Specifically, the proposed policy would (1) eliminate the Basel Capital Accord (BCA) criteria used in the current policy to determine U.S. capital equivalency for FBOs, (2) replace the BCA criteria with the strength of support assessment (SOSA) rankings and financial holding company (FHC) status in determining U.S. capital equivalency for FBOs, and (3) raise the percentage of capital used in calculating U.S. capital equivalency for certain FBOs.

EFFECTIVE DATE: Comments must be received by August 6, 2001.

ADDRESSES: Comments, which should refer to Docket No. R–1108, may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551 or mailed electronically to regs.comments@federalreserve.gov. Comments addressed to Ms. Johnson also may be delivered to the Board's mailroom between 8:45 a.m. and 5:15 p.m. and to the security control room outside of those hours. Both the mailroom and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in Room MP–500 between 9 a.m. and 5 p.m. weekdays, pursuant to § 261.12, except as provided in § 261.14, of the Board's Rules Regarding Availability of Information, 12 CFR 261.12 and 261.14.

FOR FURTHER INFORMATION CONTACT: Paul Bettge, Associate Director (202/452–3174), Stacy Coleman, Manager (202/452–2934), Myriam Payne, Project Leader (202/452–3219), or Adam Minehardt, Financial Services Analyst (202/452–2796), Division of Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: This is one of five notices regarding payments system risk that the Board is issuing for public comment today. Two near-term proposals concern modifications to the procedures for posting electronic check presentments to depository institutions' Federal Reserve accounts for purposes of measuring daylight overdrafts (Docket No. R–1109) and the book-entry securities transfer limit (Docket No. R–1110). In addition, the Board is requesting comment on the benefits and drawbacks to several potential longer-term changes to the Board's policy, including lowering self-assessed net debit caps, eliminating the two-week average caps, implementing a two-tiered pricing system for collateralized and uncollateralized daylight overdrafts, and rejecting payments with settlement-day finality that would cause an institution to exceed its daylight overdraft capacity level (Docket No. R–1111). The Board is also issuing today an interim policy statement and requesting comment on the broader use of collateral for daylight overdraft purposes (Docket No. R–1107). Furthermore, to reduce burden associated with the PSR policy, the Board recently rescinded the interaffiliate transfer (Docket No. R–1106) and third-party access policies (Docket No. R–1100).

The Board requests that in filing comments on these proposals, commenters prepare separate letters for each proposal, identifying the appropriate docket number on each. This will facilitate the Board's analysis of all comments received.

I. Background

In April 1985, the Board adopted a policy to reduce risk on large-dollar payments systems (50 FR 21120, May 22, 1985). This policy established maximum amounts of uncollateralized daylight credit, or net debit caps, that depository institutions are permitted to incur in their Federal Reserve accounts. Net debit caps for U.S. branches and agencies of foreign banks are calculated in the same manner as for domestic banks, by applying cap multiples from one of the six cap classes to a capital measure.[1] [2] A depository institution's cap class and associated cap multiple either are determined through a self-assessment or a board-of-directors resolution or are assigned by the Administrative Reserve Bank.[3] All net debit caps, including those requested by an institution's board of directors, are granted at the discretion of the Federal Reserve. Under the current policy, the Federal Reserve Banks apply the cap multiple to 100 percent of domestic depository institutions' risk-based (or equivalent) capital. The capital measure used for an FBO, known as the U.S. capital equivalency, however, is substantially less than the FBO's total capital.

In 1987, the Board considered and decided against changing the original definition of U.S. capital equivalency (52 FR 29255, August 6, 1987). At the request of several FBOs, however, the Board requested comment again in June 1989 on alternatives for determining FBOs' U.S. capital equivalency used in calculating net debit caps for U.S. branches and agencies of foreign banks (54 FR 26108, June 21, 1989). After further analysis, in 1991, the Board adopted the current policy based on the BCA distinction (55 FR 22095, May 31, 1990).[4]

FBOs from countries that adhere to the BCA are currently eligible to use as their U.S. capital equivalency the greater of 10 percent of their capital or 5 percent of their liabilities to nonrelated parties.[5] FBOs from countries that do not adhere to the BCA may use as their U.S. capital equivalency the greater of 5 percent of

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[1] U.S. branches and agencies of foreign banks are entities contained within and controlled by a foreign banking organization. For the definition of ''branch'' and ''agency'', refer to 12 U.S.C. 3101 and 12 CFR.

[2] The net debit cap classes and their associated single-day multiples are a zero cap (0), an exempt-from-filing cap (equal to the lesser of $10 million or 0.2 times a capital measure), a de minimis cap (0.4); and three self-assessed caps, average (1.125), above average (1.875), and high (2.25). A net debit cap is calculated for the FBO and then distributed among its U.S. branches and agencies at the discretion of the FBO and the Administrative Reserve Bank.

[3] The Administrative Reserve Bank is responsible for managing an institution's account relationship with the Federal Reserve.

[4] The BCA was developed by the Basel Committee on Banking Supervision and endorsed by the central bank governors of the Group of Ten countries. The BCA provides a framework for assessing the capital adequacy of a depository institution by risk weighting its assets and off-balance sheet exposures primarily based on credit risk.

[5] Liabilities to nonrelated parties include acceptances, but exclude accrued expenses and mounts due and other liabilities to offices, branches, and subsidiaries of the foreign bank of each agency or branch.

their liabilities to nonrelated parties or the amount of capital that would be required of a national bank being organized at each location.[6] Under the current policy, if the home country supervisor of an FBO does not adhere to the BCA, the U.S. branch or agency of the FBO may still incur daylight overdrafts above its net debit cap up to a maximum equal to its cap multiple times 10 percent of its capital, provided that any overdrafts above the net debit cap are collateralized.

In 2000, as part of a broad review of the PSR policy, the Board again assessed the determination of U.S. capital equivalency for FBOs. The review included analysis of trends of daylight credit, consideration of supervisory issues, analysis of new or emerging payments system initiatives, and discussions with FBOs.

II. Discussion

A. FBO Liquidity Issues

A few FBOs have indicated that their net debit caps constrain their business activity and place them at a competitive disadvantage to U.S. depository institutions. These FBOs assert that certain U.S. depository institutions hold a significant portion of their assets in foreign markets but are able to use 100 percent of their total risk-based capital in establishing their caps, while the PSR policy does not recognize the FBOs' worldwide financial strength. During 2000, approximately 35 percent of U.S. branches and agencies of foreign banks with nonzero net debit caps had cap utilization levels of 75 percent or more.[7] In contrast, less than 5 percent of domestically chartered institutions use more than 50 percent of their net debit caps for their average daily peak daylight overdrafts.

A number of FBOs have expressed concern over being able to meet the intraday liquidity requirements of the Continuous Linked Settlement (CLS) system and the new Clearing House Interbank Payments System with intraday finality (new CHIPS). CLS Bank is being designed as a multi-currency facility for settling foreign exchange transactions. Under the proposed procedures, participating institutions will be required to make daily U.S. dollar payments to CLS Bank over Fedwire during the early hours of the Fedwire funds transfer operating day. Because U.S. financial money markets are not currently active during those hours, a number of CLS members assert that they will use Federal Reserve daylight credit to fund their CLS-related payment obligations and have requested that the Federal Reserve grant them additional intraday credit.[8]

On January 22, 2001, the Clearing House Interbank Payments Company L.L.C. converted CHIPS from an end-of-day multilateral net settlement system to one that provides real-time final settlement for all payment orders as they are released.[9] To accomplish real-time final settlement, each CHIPS participant must transfer (directly or through another participant) a predetermined amount into the CHIPS ''prefunded balance account'' on the books of the Federal Reserve Bank of New York. While new CHIPS settles all of the payment orders when they are released, some payment orders remain unreleased at the end of the day. These payment orders are netted and set off against one another on a multilateral basis, with each participant in a net debit closing position transferring the amount of its closing position requirement into the prefunded balance account. Many CHIPS participants use Federal Reserve daylight credit to pay their end-of-day closing position requirements on CHIPS. Some of these participants have stated that making these Fedwire payments has, on occasion, increased their demand for intraday credit.

In addition to the concerns raised by FBOs, the Board recognizes the continued globalization of the financial industry and that many FBOs have established substantial operations within the United States. Furthermore, FBOs might increase their U.S. activities with the business opportunities created by the Gramm-Leach-Bliley Act (Public Law 106–102) (GLB Act). As their U.S. business expands, FBOs could have a corresponding increase in their need for use of the U.S. payments system and daylight credit.

B. National Treatment Considerations

While the Board understands the concerns of the foreign banking community, FBO participants in the payments system present risks that domestic depository institutions do not pose to the same extent and, accordingly, some differential treatment is warranted. Additional risks posed by FBOs include increased legal risk in pursuing claims against insolvent FBOs under the laws of various countries and increased supervisory risk in the monitoring of FBOs.

FBOs present special legal risks to the Federal Reserve because of the differences in insolvency laws and public policy associated with the various FBOs' home countries. In international financial transactions, the overall risk borne by each party is affected not only by the governing law set out in the contract, but also by the law governing the possible insolvency of its counterparty. The insolvency of an international bank presents significant legal issues in enforcing particular provisions of a financial contract (such as close-out netting or irrevocability provisions) against third parties (such as the liquidator or supervisor of the failed bank). The insolvent party's national law also may permit the liquidator to subordinate other parties' claims (such as by permitting the home country tax authorities to have first priority in bankruptcy), may reclassify or impose a stay on the right the nondefaulting party has to collateral pledged by the defaulting party in support of a particular transaction, or may require a separate proceeding to be initiated against the head office in addition to any proceeding against the branch.

It is not practicable for the Federal Reserve to undertake and keep current extensive analysis of the legal risks presented by the insolvency law(s) applicable to each FBO with a Federal Reserve account in order to quantify precisely the legal risk that the Federal Reserve incurs by providing intraday credit to that institution. It is reasonable, however, for the Federal Reserve to recognize that FBOs generally present additional legal risks to the payments system and, accordingly, limit its exposure to these institutions.

In addition to the legal risks associated with FBO failures, the Federal Reserve faces elevated supervisory risks when monitoring FBOs. In some countries, supervisory information available to U.S. regulators may be less timely and not comparable to similar information used in the supervision of U.S. depository institutions. U.S. bank supervisors also lack a consolidated view of the FBO's risk management process and are unable to test its implementation on a global basis. Furthermore, FBO risk profiles differ due to varying industry and regulatory structures across countries.

[6] The latter measure is not normally reported to the Federal Reserve. If an FBO desires to use this measure as its capital equivalency, the Administrative Reserve Bank must be notified to make special arrangements.

[7] In this context, cap utilization is equal to an FBO's average daily peak daylight overdraft divided by the FBO's net debit cap.

[8] For additional information on payment system initiatives, refer to the Payments Risk Committee's report entitled ''Intraday Liquidity Management in the Evolving Payment System: A Study of the Impact of the Euro, CLS Bank, and CHIPS Finality,'' New York, April 2000. *http://www.ny.frb.org/prc/intraday.html.*

[9] CHIPCo is the affiliate of The New York Clearing House Association L.L.C. that owns and operates CHIPS.

III. Proposed Changes to PSR Policy

The Board is requesting comment on the following policy changes related to the determination of FBOs' U.S. capital equivalency used in calculating net debit caps for their U.S. branches and agencies. Specifically, the proposed policy would allow

1. FBOs that hold an FHC classification to use 35 percent of their capital as their U.S. capital equivalency. The Board believes that the capital and management requirements for FHCs and the heightened monitoring and supervision to which FHCs are subject justify permitting these FBOs to incur a higher level of daylight overdrafts.

2. FBOs that are not FHCs and are ranked SOSA 1 to use 25 percent of capital as their U.S. capital equivalency. The Board believes that achieving the standards of the SOSA 1 ranking provide sufficient support for increasing the percentage of capital used for net debit cap calculations to 25 percent.[10]

3. FBOs that are not FHCs and are ranked SOSA 2 to use 10 percent of their capital as their U.S. capital equivalency.

4. FBOs that are not FHCs and are ranked SOSA 3 to use 5 percent of the FBO's ''net due to related depository institutions.'' [11] Recognizing that net debit caps are granted at the discretion of the Federal Reserve, the Reserve Banks could require certain SOSA 3-ranked FBOs to fully collateralize their net debit caps.

The Board believes its proposal to permit the use of higher percentages of capital for FBOs that hold an FHC classification or a SOSA 1-ranking will provide sufficiently larger daylight overdraft capacity to those institutions whose payment activity is currently constrained by their net debit caps. The Board believes that the benefits to the payments system of increasing the U.S. capital equivalency for FBOs that hold an FHC classification or a SOSA 1-ranking outweigh the potential increase in credit risk to the Federal Reserve.

In addition, an interim policy statement (Docket No. R–1107) that was published elsewhere in today's **Federal Register** allows depository institutions that have self-assessed net debit caps to pledge collateral to the Federal Reserve Banks in order to incur additional daylight overdrafts above their net debit cap levels. An FBO whose U.S. branch or agency has a self-assessed net debit cap and is in need of additional capacity may consult with its Administrative Reserve Bank on pledging collateral for this purpose.[12]

A. Supervisory Rankings

The Board considered how the SOSA rankings might alleviate some concerns about the timeliness and reliability of supervisory information. SOSA rankings reflect an assessment of an FBO's ability to provide financial, liquidity, and management support to its U.S. operations. In October 2000, SOSA rankings were made available to the FBOs' management and home country supervisor.[13] Previously, SOSA rankings were used for internal Federal Reserve purposes only. SOSA rankings provide broader information about the condition of the FBO, its supervision, and the home country, whereas the BCA distinction provides information only about the home country treatment of bank capital adequacy. Furthermore, the BCA designation reflects the one-time adoption of BCA standards by a country's supervisory authority, while U.S. bank supervisors update the SOSA rankings regularly.

The Board also considered the FHC status created by the GLB Act. The GLB Act authorizes bank holding companies (BHCs) and FBOs that are well capitalized and well managed, as those terms are defined in the statute and the Board's regulations, to elect FHC status and thereby engage in securities, insurance, and other activities that are financial in nature or incidental to a financial activity and that are otherwise impermissible for BHCs. FHCs must continue to meet the applicable capital and management standards in order to maintain their status and are subject to enhanced reporting requirements. The Board believes that, like the SOSA ranking, FHC status is preferable to the BCA distinction in determining the risk posed by FBOs to the U.S. payments system.[14]

The Board, therefore, proposes to replace the current BCA distinction in the PSR policy with a combined SOSA-FHC structure and to increase the percentage of capital used in calculating net debit caps for certain U.S. branches and agencies of foreign banks. The Board believes that the SOSA ranking provides more specific, more comprehensive, and more timely information than the BCA distinction. As result, the Board believes that the definition of U.S. capital equivalency can be expanded further for FBOs that are FHCs or have a SOSA 1 ranking.

B. Alternative Measure of U.S. Capital Equivalency

Under the current policy, an FBO from a country that does not adhere to the BCA must use an alternative measure for its U.S. capital equivalency that is not based on total capital. Currently, the alternative measure is 5 percent of ''liabilities to nonrelated parties'' or the amount of capital that would be required of a national bank being organized at a specific location. The Board believes that using an alternative measure of U.S. capital equivalency when an FBO's home country does not adhere to the BCA is appropriate given concerns over the potential lack of timely supervisory information regarding these FBOs and the Federal Reserve's inability to monitor each FBO's non-U.S. operations.

While the Board proposes to eliminate the BCA criteria used in the current policy, the Board continues to support using an alternative measure of U.S. capital equivalency for U.S. branches and agencies of foreign banks that represent the greatest levels of supervisory concern. The Board believes that this alternative measure should be applied only to those FBOs that may exhibit significant financial or supervisory weaknesses, specifically SOSA 3-ranked FBOs under the proposed policy. In achieving this end, the Board believes that the alternative measure of U.S. capital equivalency for SOSA 3-ranked FBOs should reflect the capital investment of the FBO in its U.S. operations rather than its total capital.

As an alternative measure for U.S. capital equivalency, the Board intends to replace the use of ''liabilities to nonrelated parties'' with ''net due to

[10] The SOSA ranking is composed of four factors including the FBO's financial condition and prospects; the system of supervision in the FBO's home country; the record of the home country's government in support of the banking system or other sources of support for the FBO; and transfer risk concerns. Transfer risk relates to the FBO's ability to access and transmit U.S. dollars, which is an essential factor in determining whether an FBO can support its U.S. operations. The SOSA ranking is based on a scale of 1 through 3 with 1 representing the lowest level of supervisory concern.

[11] The Reserve Banks may review other relevant information when considering whether to permit SOSA 3-ranked FBOs access to intraday credit. The PSR policy allows Reserve Banks to deny any depository institution access to Federal Reserve intraday credit based on any applicable information.

[12] The interim policy statement expands the prior policy that permitted certain FBOs to pledge collateral to reach a maximum daylight overdraft capacity equal to their cap multiple times 10 percent of their capital.

[13] For full text, see SR Letter 00–14 (SUP), *Enhancements to the Interagency Program for Supervising the U.S. Operations of Foreign Banking Organizations,* October 23, 2000.

[14] While applying for FHC status is voluntary, the regulatory burden associated with applying is minimal for most institutions.

related depository institutions.''[15] ''Liabilities to nonrelated parties'' may increase relative to assets when an institution becomes financially weaker and could unduly increase the institution's overdraft capacity. ''Net due to related depository institutions'' reflects the amounts owed to the parent by the branch and can be viewed as the capital investment by the FBO parent in its U.S. operations. In addition, the Board notes that this policy change would not affect any SOSA 3-ranked FBOs at this time.

C. Capital Reporting

In order to comply with the proposed policy changes, most U.S. branches and agencies of foreign banks requesting a net debit cap will need to complete the form ''Annual Daylight Overdraft Capital Report for U.S. Branches and Agencies of Foreign Banks'' (form FR 2225) to report capital that is used as the basis for their caps.[16] Given that the form is short and does not require any calculations, the Board believes the cost of completing this form is not significant or burdensome. Currently, only five FBOs that have nonzero net debit caps do not file form FR 2225. These five FBOs would have to submit form FR 2225 to comply with the revised policy.[17]

IV. Request for Comment

The Board requests comments on all aspects of the proposed policy changes outlined above. The Board is also requesting comments on the following questions:

1. If the proposed policy changes are adopted, will the resulting net debit cap levels combined with the broader use of collateral outlined in the interim policy statement also published today for comment (Docket No. R–1107) provide a reasonable and prudent level of daylight overdraft capacity to address the liquidity needs of FBOs?

2. Recognizing differences in risk between FBOs and domestic depository institutions, would the proposed policy provide FBOs appropriate access to the U.S. payments system?

3. With regard to calculating U.S. capital equivalency, is ''net due to related depository institutions'' an appropriate proxy for SOSA 3-ranked FBOs' U.S. capital equivalency?

V. Competitive Impact Analysis

Under its competitive equity policy, the Board assesses the competitive impact of changes that have a substantial effect of payments system participants.[18] The Board believes these modifications to its payments system risk program will have no adverse effect on the ability of other service providers to compete effectively with the Federal Reserve Banks in providing similar services.

VI. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. ch. 3506; 5 CFR 1320 appendix A.1), the Board has reviewed the request for comments under the authority delegated to the Board by the Office of Management and Budget. The collection of information pursuant to the Paperwork Reduction Act contained in the policy statement will not unduly burden depository institutions.

VII. Federal Reserve Policy Statement on Payments System Risk

The Board proposes to replace section I.C.2. of the ''Federal Reserve Policy Statement on Payments System Risk'' as follows:

2. U.S. Branches and Agencies of Foreign Banks

For U.S. branches and agencies of foreign banks, net debit caps on daylight overdrafts in Federal Reserve accounts are calculated by applying the cap multiples for each cap category to a foreign banking organization's (FBO's) U.S. capital equivalency.[10]

• For FBOs that are financial holding companies (FHCs), U.S. capital equivalency is equal to 35 percent of capital.

• For FBOs that are not FHCs and have a strength of support assessment ranking (SOSA) of 1, U.S. capital equivalency is equal to 25 percent of capital.

• For FBOs that are not FHCs and are ranked a SOSA 2, U.S. capital equivalency is equal to 10 percent of capital.

• For FBOs that are not FHCs and are ranked a SOSA 3, U.S. capital equivalency is equal to 5 percent of the FBO's ''net due to related depository institutions.''

Given the heightened supervisory concerns associated with SOSA 3-ranked FBOs, a Reserve Bank may deny a SOSA 3-ranked FBO access to intraday credit. In the event a Reserve Bank grants a net debit cap to a SOSA 3-ranked FBO, the Reserve Bank may require the net debit cap to be fully collateralized.

[10] The term U.S. capital equivalency is used in this context to refer to the particular capital measure used to calculate daylight overdraft net debit caps and does not necessarily represent an appropriate capital measure for supervisory or other purposes.

By order of the Board of Governors of the Federal Reserve System, May 30, 2001.

Jennifer J. Johnson,

Secretary of the Board.

[FR Doc. 01–13979 Filed 6–4–01; 8:45 am]

BILLING CODE 6210–01–P

[15] Reporting Form FFIEC 002/002S. Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks. Schedule RAL—Assets and Liabilities: Liabilities: item 4—''Liabilities to nonrelated parties'' and item 5—''Net due to related depository institutions.''

[16] SOSA 3-ranked FBOs would not be required to file FR 2225 because they would not be eligible to base their U.S. capital equivalency on capital.

[17] In 1998, the Board surveyed FBOs that filed FR 2225 to estimate the burden to the public of completing the form. As a result of the survey, the Board estimated the annual burden of completing FR 2225 to be one hour per FBO.

[18] These assessment procedures are described in the Board's policy statement entitled ''The Federal Reserve in the Payments System'' (55 FR 11648, March 29, 1990).

FEDERAL RESERVE SYSTEM

[Docket No. R–1111]

Policy Statement on Payments System Risk; Potential Longer-Term Policy Direction

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment on policy.

SUMMARY: The Board is requesting comment on the benefits and drawbacks of various policy options that it is evaluating as part of a potential longer-term direction for its payments system risk (PSR) policy. The longer-term policy options include the following: (1) Lowering single-day net debit cap levels to approximately the current two-week average cap levels and eliminating the two-week average net debit cap, (2) implementing a two-tiered pricing regime for daylight overdrafts such that institutions pledging collateral to the Reserve Banks pay a lower fee on their collateralized daylight overdrafts than on their uncollateralized daylight overdrafts, and (3) monitoring in real time all payments with settlement-day finality and rejecting those payments that would cause an institution to exceed its net debit cap or daylight overdraft capacity level.

EFFECTIVE DATE: Comments must be received by October 1, 2001.

ADDRESSES: Comments, which should refer to Docket No. R–1111, may be mailed to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551 or mailed electronically to *regs.comments@federalreserve.gov.*

Comments addressed to Ms. Johnson also may be delivered to the Board's mailroom between 8:45 a.m. and 5:15 p.m. and to the security control room outside of those hours. Both the mailroom and the security control room are accessible from the courtyard entrance on 20th Street between Constitution Avenue and C Street, NW. Comments may be inspected in Room MP–500 between 9:00 a.m. and 5:00 p.m. weekdays, pursuant to § 261.12, except as provided in § 261.14, of the Board's Rules Regarding Availability of Information, 12 CFR 261.12 and 261.14.

FOR FURTHER INFORMATION CONTACT: Paul Bettge, Associate Director (202/452–3174), Stacy Coleman, Manager (202/452–2934), or John Gibbons, Senior Financial Services Analyst (202/452–6409), Division of Reserve Bank Operations and Payment Systems.

SUPPLEMENTARY INFORMATION: This is one of five notices regarding payments system risk that the Board is issuing for public comment today. Three near-term proposals concern the net debit cap calculation for U.S. branches and agencies of foreign banks (Docket No. R–1108), modifications to the procedures for posting electronic check presentments to depository institutions' Federal Reserve accounts for purposes of measuring daylight overdrafts (Docket No. R–1109), and the book-entry securities transfer limit (Docket No. R–1110). The Board is also issuing today an interim policy statement and requesting comment on the broader use of collateral for daylight overdraft purposes (Docket No. R–1107). Furthermore, to reduce burden associated with the PSR policy, the Board recently rescinded the interaffiliate transfer (Docket No. R–1106) and third-party access policies (Docket No. R–1100).

The Board requests that in filing comments on these proposals, commenters prepare separate letters for each proposal, identifying the appropriate docket number on each. This will facilitate the Board's analysis of all comments received.

I. Background

Beginning in 1985, the Board adopted and subsequently modified a policy to reduce the risks that payment systems present to the Federal Reserve Banks, to the banking system, and to other sectors of the economy. An integral component of the PSR policy was to control depository institutions' use of intraday Federal Reserve credit, commonly referred to as "daylight credit" or "daylight overdrafts." The Board intended to address the Federal Reserve's risk as well as risks to various types of private-sector networks, primarily large-dollar payments systems. Risk can arise from transactions on the Federal Reserve's wire transfer system (Fedwire), from other types of payments, including checks and automated clearing house transactions, and from transactions on private large-dollar networks.

The Federal Reserve Banks face direct risk of loss should depository institutions be unable to settle their daylight overdrafts in their Federal Reserve accounts before the end of the day. Moreover, systemic risk might occur if an institution participating on a private large-dollar payments network were unable or unwilling to settle its net debit position. If such a settlement failure occurred, the institution's creditors on that network might also be unable to settle their commitments. Serious repercussions could, as a result, spread to other participants in the private network, to other depository institutions not participating in the network, and to the nonfinancial economy generally. A Reserve Bank could be exposed to indirect risk if Federal Reserve policies did not address this systemic risk.

The 1985 policy required all depository institutions incurring daylight overdrafts in their Federal Reserve accounts as a result of Fedwire funds transfers to establish a maximum limit, or net debit cap, on those overdrafts (50 FR 21120, May 22, 1985). In subsequent years, the Federal Reserve modified and expanded the original PSR policy by reducing net debit cap levels and addressing the risk controls for activities such as book-entry securities transfers, large-dollar multilateral netting systems, and certain private securities clearing and settlement systems.

In 1986, the Board requested comment on reducing net debit cap levels (51 FR 45050, December 15, 1986). At that time, the Board noted that it purposely set the original net debit cap levels relatively high so that institutions and examiners could gain experience with the caps. In 1987, the Board announced that it would reduce cap levels by 25 percent and stated that it would evaluate further reductions in the future (52 FR 29255, August 6, 1987). In May 1990, the Board issued a revised policy statement that incorporated the exempt-from-filing net debit cap, changed the existing de minimis cap, and included book-entry securities transfers in measuring institutions' overdrafts against their caps (55 FR 22087 and 22092, May 31, 1990).

In 1989, the Board requested comment on a proposed change to its payments system risk reduction program that would assess a fee of 60 basis points, phased in over three years, for average daily overdrafts in excess of a deductible of 10 percent of risk-based capital (54 FR 26094, June 21, 1989). The fee was to be phased in as 24 basis points in 1994, 48 basis points in 1995, and 60 basis points in 1996. The purpose of the fee was to encourage behavior that would reduce risk and increase efficiency in the payments system. The Board approved the proposed policy change in 1992 and began pricing daylight overdrafts in April 1994 (57 FR 47084, October 14, 1992).[1]

In March 1995, the Board decided to raise the daylight overdraft fee to 36 basis points instead of the 48 basis points originally announced (60 FR 12559, March 7, 1995). Because aggregate daylight overdrafts fell approximately 40 percent after the introduction of fees, the Board was concerned that raising the fee to 48 basis points could produce undesirable market effects contrary to the objectives of the risk-control program. The Board believed, however, that an increase in the overdraft fee was needed to provide additional incentives for institutions to reduce overdrafts related to funds transfers. The Board stated it would evaluate further fee increases two years after the 1995 fee increase.

In considering its commitment to evaluate further fee increases, the Board recognized that significant changes have occurred in the banking, payments, and regulatory environment in the past few years and, as a result, is conducting a broad review of the Federal Reserve's daylight credit policies. During the course of its review, the Board has evaluated the effectiveness of the current daylight credit policies and determined that these policies appear to be generally effective in reducing risk to the Federal Reserve and creating incentives for depository institutions to control and manage their intraday credit exposures. In addition, the Board determined that the current policy is well understood by the industry and that private-sector participants generally have benefited from the policy's risk controls.

[1] To facilitate the pricing of daylight overdrafts, the Federal Reserve adopted a modified method of measuring daylight overdrafts that more closely reflects the timing of actual transactions affecting an institution's intraday Federal Reserve account balance. This measurement method incorporates specific account posting times for different types of transactions.

As part of this review, the Board refined the objective that would guide its formulation and evaluation of daylight credit policies. The Board's daylight credit policy objective is to attain an efficient balance among the costs and risks associated with the provision of Federal Reserve intraday credit, including the comprehensive costs and risks to the private sector of managing Federal Reserve account balances, and the benefits of intraday liquidity. The Board used certain criteria to evaluate the effectiveness of policy options. These criteria include credit risk to the public sector, Federal Reserve resource costs of monitoring and counseling credit usage, private-sector resource costs of monitoring credit usage, payment delays and gridlock, and private-sector opportunity costs.

II. Potential Longer-Term Policy Options

A. Net Debit Cap Levels

The Board is evaluating the benefits and drawbacks of reducing self-assessed single-day net debit caps to levels near those of the current two-week average caps and eliminating the two-week average net debit caps. Under the Board's PSR policy, the Reserve Banks establish limits or net debit caps on the maximum amount of uncollateralized daylight credit that depository institutions may incur in their Federal Reserve accounts. Net debit caps are calculated by applying a cap multiple from one of six cap classes to a depository institution's capital measure. (See Cap Multiple Matrix below.) A Reserve Bank may assign the exempt-from-filing cap without a depository institution taking any action. A depository institution may request a de minimis cap by submitting a board-of-directors resolution to its Reserve Bank, or the institution may request a self-assessed cap (average, above average, and high) by completing a self-assessment.[2] Reserve Banks may assign a zero cap in consideration of certain factors, or a depository institution that wants to restrict its own use of Federal Reserve daylight credit may request a zero cap.

When the Board adopted its net debit cap framework in 1985, it implemented two cap multiples for depository institutions with self-assessed caps: one for the maximum allowable overdraft on any day (single-day cap) and one for the maximum allowable average of the peak daily overdrafts in a two-week period (two-week average cap). The Federal Reserve implemented the higher single-day cap to limit excessive daylight overdrafts on any day and to ensure that institutions develop internal controls that focus on daily exposures. The purpose of the two-week average cap was to reduce the overall levels of overdrafts while allowing for daily payment fluctuations.

CAP MULTIPLE MATRIX

Cap categories	Cap multiples	
	Single day	Two-week average
Zero	0	0
Exempt-from-filing [3]	$10 million or 0.20	$10 million or 0.20
De minimis	0.40	0.40
Average	1.125	0.75
Above average	1.875	1.125
High	2.25	1.50

As [3] part of the Board's current PSR policy review and its commitment to evaluate further cap reductions, the Board reviewed depository institutions' use of their daylight overdraft capacity. The Board found that more than 96 percent of institutions with self-assessed net debit caps use less than 50 percent of their daylight overdraft capacity for their average peak overdrafts.[4] To evaluate further the effects of reducing the single-day net debit cap to about the two-week average net debit cap, Board staff compared depository institutions' daily peak overdrafts with their respective two-week average caps. Compared with the current single-day net debit cap, an additional 7 percent of depository institutions with self-assessed caps (approximately twenty) would regularly exceed their single-day net debit cap if it were reduced to the two-week average levels. If depository institutions that have pledged collateral with the Reserve Banks were to use their collateral to increase their daylight overdraft capacity, less than 4 percent (approximately twelve) more depository institutions would regularly exceed their reduced net debit caps.[5] In addition, some of these institutions would exceed their reduced net debit caps because of certain non-Fedwire activity. These depository institutions would likely be eligible for counseling flexibility. Because few account holders with self-assessed caps would regularly exceed a net debit cap reduced to the two-week average levels, it appears that most depository institutions generally manage their daily overdraft activity within the two-week average cap level. This analysis suggests that current single-day net debit cap levels may commit Reserve Banks to potential credit exposures in excess of what is needed to facilitate the smooth operation of the payment system. The Board believes that in conjunction with allowing institutions with self-assessed net debit caps to pledge collateral for daylight overdraft capacity above their caps, reducing self-assessed net debit caps could improve the balance between the public-sector costs of providing daylight credit and the net private-sector benefits of using daylight credit.

[2] The self-assessment requires an institution to evaluate and rate its creditworthiness, intraday funds management and controls, customer credit policies and controls, operating controls, and contingency procedures to support a higher daylight overdraft cap.

[3] The net debit cap for the exempt-from-filing category is equal to the lesser of $10 million or 20 percent of risk-based capital.

[4] Approximately 300 depository institutions currently have self-assessed caps. Of these depository institutions, approximately 20 percent use more than 70 percent of their overdraft capacity for their peak overdrafts. The majority of institutions using more than 70 percent of their daylight overdraft capacity for their peak overdrafts are doing so because of substantial non-Fedwire payment activity. The current policy provides "counseling flexibility" for depository institutions with de minimis and self-assessed caps that exceed their net debit caps as a result of certain non-Fedwire payment activity. Most of the institutions referenced above would fall into this category. The Federal Reserve, therefore, would not subject depository institutions that are provided counseling flexibility to additional counseling for certain non-Fedwire related cap breaches and would not require these institutions to post collateral or adopt a zero cap.

[5] Published elsewhere in today's **Federal Register** is the Board's interim policy statement that allows depository institutions with self-assessed caps to pledge collateral above their net debit caps for additional daylight overdraft capacity.

The Board believes that, if it were to reduce single-day net debit caps to about the same level as the current two-week average net debit caps, eliminating the two-week average caps should simplify the policy. Eliminating the two-week average cap also should reduce some of the administrative cost and burden of complying with the policy. The Board, however, recognizes that reducing single-day net debit caps could impose costs on certain depository institutions because some may consider their unused overdraft capacity as a safeguard to manage infrequent or unexpected liquidity needs. Finally, the Board believes that the current daylight overdraft limits for depository institutions with exempt-from-filing and de minimis net debit caps are adequate and should not be modified at this time.

The Board seeks comment on the benefits and drawbacks of reducing self-assessed single-day net debit caps to levels near those of the current two-week average net debit caps and eliminating the two-week average net debit caps. The Board also requests comment on the following questions:

1. In conjunction with the policy change that would allow institutions with self-assessed net debit caps to pledge collateral for Federal Reserve daylight credit above their net debit caps, would reducing self-assessed net debit caps improve the balance between the public-sector costs of providing daylight credit and the net private-sector benefits of using daylight credit?

2. How would a reduction in the single-day net debit cap level affect the way institutions manage their Federal Reserve accounts with respect to daylight overdrafts? Do institutions target a maximum level of daylight overdrafts that is at or below their two-week average caps? How much additional capacity between routine peak overdrafts and the current single-day net debit cap is prudent or necessary?

3. Would lowering the single-day net debit caps for self-assessed institutions cause depository institutions to delay sending payments, potentially increasing overdrafts at other depository institutions?

4. Should the Board consider a policy that gradually moves uncollateralized net debit caps to significantly lower levels (for example, to the levels associated with the de minimis net debit cap) and require all depository institutions to post collateral for overdrafts beyond the net debit cap?

B. Two-Tiered Pricing Regime

The Board is also evaluating the benefits and drawbacks of implementing a two-tiered pricing regime that would assess a lower fee on collateralized daylight overdrafts than on uncollateralized daylight overdrafts. The daylight overdraft fee is a critical component of the PSR policy, and its modification in 1995 was the impetus for the Board's current review of its daylight credit policies.[6] The initial implementation of a 24-basis-point daylight overdraft fee in 1994 caused a 40 percent decrease in daylight overdrafts in Federal Reserve accounts, mostly related to changes in the timing of book-entry securities transfers. Daylight overdrafts caused by Fedwire funds transfers (funds overdrafts) declined slightly after the implementation of fees; however, funds overdrafts began to rise again even before the 1995 modified fee increase. On an average annual basis since 1995, overdrafts caused by Fedwire book-entry securities transfers (book-entry securities overdrafts) have decreased almost 10 percent per year and the value of Fedwire book-entry securities transfers has grown more than 5 percent per year; whereas funds overdrafts and the value of Fedwire funds transfers have grown between 15 and 18 percent per year. The growth in funds overdrafts appears to be directly related to the growth in large-value funds transfers. Even though funds overdrafts have grown substantially, the relationship between average funds overdrafts and the value of Fedwire funds transfers has remained relatively constant since the late 1980s.

In evaluating the level of the daylight overdraft fee, the Board is considering policy changes that might result in a more efficient balance of the costs, risks, and benefits associated with the provision of Federal Reserve intraday credit. The Board believes that daylight overdraft fees have been effective in reducing overdrafts from book-entry securities transfers and provide a strong incentive for institutions to continue controlling their overdrafts. From its inception, the fee was intended to create economic incentives for the largest daylight overdrafters to reduce and allocate more efficiently their use of daylight credit. The Board notes that since the Federal Reserve began pricing daylight overdrafts in 1994, less than 4 percent of account holders pay fees in a given year and the majority of these institutions pay less than $1,000 per year. In addition, the largest users of daylight credit, in general depository institutions with assets greater than $10 billion, pay more than 95 percent of aggregate daylight overdraft fees.

While the Board believes that daylight overdraft fees have been relatively effective, it also recognizes that the daylight overdraft pricing policy has imposed costs on the industry and that some depository institutions consider the policy burdensome. To assess policy alternatives that might create a more efficient balance of the costs, risks, and benefits associated with Federal Reserve intraday credit, the Board compared Federal Reserve daylight credit extensions and private-sector lending under line-of-credit arrangements. The most notable distinction between daylight credit extensions and private-sector lending is that private loans are often collateralized. Collateralized lending generally carries a lower interest rate than uncollateralized lending because taking collateral lowers the lender's risk, allowing for a lower credit risk premium. In most situations, the Reserve Banks do not require collateral when extending daylight credit to depository institutions.[7] When Reserve Banks require collateral for daylight credit extensions, however, the same daylight overdraft fee applies to both collateralized and uncollateralized daylight overdrafts. The Board also notes that the majority of Federal Reserve daylight credit extensions are currently implicitly collateralized because depository institutions that pledge collateral must sign the applicable agreements in Operating Circular 10, which provides the Reserve Banks with a secured interest in any collateral recorded on the Reserve Banks' books.[8]

[6] The current daylight overdraft fee is 36 basis points, quoted as an annual rate on the basis of a 24-hour day. To obtain the daily overdraft fee for the standard Fedwire operating day, the 36-basis-point fee is multiplied by the fraction of the 24-hour day during which Fedwire is scheduled to operate. For example, under the current 18-hour Fedwire operating day, the daylight overdraft fee equals 27 basis points.

[7] The current policy requires that "frequent and material" book-entry securities overdrafters fully collateralize these overdrafts. Book-entry securities overdrafts become frequent and material when an account holder exceeds its net debit cap, solely because of book-entry securities transactions, on more than three days in any two consecutive reserve maintenance periods and by more than 10 percent of its capacity. The policy also allows financially healthy U.S. branches and agencies of foreign banks for which the home-country supervisor does *not* adhere to the Basle Capital Accord to incur daylight overdrafts above their net debit caps up to an amount equal to their cap multiples times 10 percent of their worldwide capital, provided that any overdrafts above the net debit caps are collateralized.

[8] The majority of the collateral pledged to the Reserve Banks is pledged for discount window purposes.

The Board is considering the benefits and drawbacks of implementing a two-tiered or differential pricing regime for daylight overdrafts. The fundamental argument for a two-tiered pricing regime is that such a regime might achieve a better balance between the benefits and costs of collateralized overdrafts relative to uncollateralized overdrafts, including the public sector's costs and risks as well as the private sector's opportunity costs of pledging collateral. Under a differential pricing regime, depository institutions that have pledged collateral with the Federal Reserve would receive the collateralized price for intraday credit used up to the level of collateral.[9] In addition, while the interim policy statement does not permit depository institutions with exempt or de minimis caps to increase their daylight overdraft capacity by pledging collateral to the Federal Reserve, these institutions would be allowed to pledge collateral in order to receive the lower daylight overdraft fee. A lower fee on collateralized daylight credit than on uncollateralized daylight credit might also provide an extra incentive for the largest daylight overdrafters to maintain their current levels of collateral pledged to the Reserve Banks or to pledge additional collateral. The relative price of collateralized to uncollateralized daylight credit, however, would likely influence the degree to which depository institutions would maintain their collateral levels or pledge additional collateral.[10]

While private-sector lenders generally price collateralized lending cheaper than uncollateralized lending because it is typically less risky, the Board is concerned that differential pricing of daylight credit could have broader public policy implications. For example, the collateralization of daylight credit could disadvantage junior creditors in the event that a depository institution fails in a daylight overdraft position. It is unclear whether junior creditors take the Federal Reserve's extensions of daylight credit into account when making their own loans. Consequently, it may be appropriate when setting the collateralized daylight overdraft fee to include some measure of the additional risk that junior creditors bear as a result of collateralized Federal Reserve daylight credit extensions. If Federal Reserve daylight credit extensions were to dilute private-sector creditors' claims dollar for dollar, it might be appropriate to treat collateralized and uncollateralized Federal Reserve daylight credit extensions as equally risky and price them at the same level. In addition, a marginal increase in collateralized Federal Reserve overdrafts could potentially exacerbate any scarcity of available collateral to support financial market activities.[11]

The Board plans to continue evaluating the benefits and drawbacks of a two-tiered pricing regime for daylight overdrafts. To assess better the impact of such a policy change, the Board requests comment on all aspects of differential pricing. The Board is also requesting comment on the following questions:

1. What are the major drawbacks and benefits of a two-tiered pricing regime for collateralized and uncollateralized daylight overdrafts in Federal Reserve accounts?

2. If Reserve Banks would accept the same types of collateral currently accepted for discount window purposes, how might two-tiered pricing affect the industry, especially with respect to the availability of collateral for other financial market activity? How might two-tiered pricing affect creditors and other participants?

3. Would a two-tiered daylight overdraft pricing regime cause institutions to pledge additional collateral to the Federal Reserve or would they primarily use collateral already pledged to a Reserve Bank?

4. If collateralized daylight overdrafts were subject to a fee lower than the current 36-basis-point fee, would institutions' daylight credit usage change from current levels?

5. Currently, Federal Reserve daylight credit is generally provided only to financially healthy depository institutions that have regular access to the discount window and are subject to supervisory examination. Does taking collateral from these depository institutions provide the Federal Reserve a sufficient reduction in risk to warrant a lower fee?

C. Monitoring in Real Time All Institutions' Payments With Settlement-Day Finality

The Board is also evaluating the benefits and drawbacks of universal real-time monitoring (URTM), which is defined as using the Reserve Banks' Account Balance Monitoring System (ABMS) to reject any payment with settlement-day finality that would cause any account holder's overdrafts to exceed its net debit cap.[12] Payments with settlement-day finality include Fedwire funds and book-entry securities transfers, enhanced net settlement service (NSS) transactions, automated clearing house (ACH) credit transactions, and cash withdrawals.[13][14]

Reserve Banks can monitor any account holder's balance and its payment activities in real time using the ABMS. The Reserve Banks currently reject, for specific depository institutions falling within established parameters, certain final payments that would cause overdrafts to exceed these account holders' available account balances or net debit cap.[15] As a result, Reserve Banks are able to control their credit exposure from certain higher-risk institutions by restricting those institutions' access to Federal Reserve intraday credit to specified levels

[9] To estimate the spread between collateralized and uncollateralized lending, the Board sought a financial market measure of the risk differential between collateralized and uncollateralized credit extensions. Because loans of federal funds are uncollateralized, while loans through repurchase agreements are collateralized, the spread between the federal funds rate and the interest rate for repurchase agreements on general Treasury collateral provides the closest available approximation of this risk differential. The federal funds-repurchase agreement spread averaged 12 to 15 basis points at a 24-hour annualized rate over the period since the mid-1980s. As much as possible, this estimate was adjusted for days of unusual supply pressures in the federal funds-repurchase market.

[10] Administrative costs incurred by depository institutions in identifying, segregating, auditing, or transporting collateral to conform with Reserve Bank requirements could affect the relative price of collateralized to uncollateralized daylight credit.

[11] Bank for International Settlements, Committee on the Global Financial System, *Collateral in wholesale financial markets: recent trends, risk management and market dynamics*, March 2001 (Bank for International Settlements, 2001).

[12] The ABMS provides intraday account information to the Reserve Banks and depository institutions. ABMS serves as both an information source and a monitoring control tool. ABMS is used primarily to give authorized Reserve Bank personnel a mechanism to control and monitor account activity for selected institutions. ABMS also provides a means for institutions to obtain information concerning their intraday balances for managing daylight overdrafts. This information includes opening balances, a depository institution's net debit capacity and collateral limits, Fedwire funds and book-entry securities transfers, enhanced Net Settlement Service (NSS) transactions, and other payment activity from the Integrated Accounting System.

[13] The Board likely would not subject book-entry securities transfers to real-time rejects for institutions that pledge in-transit collateral. In-transit collateral is securities purchased by a depository institution but not yet paid for and owned by its customers.

[14] ACH credit transactions will have settlement-day finality beginning in mid-2001. The Board, however, recognizes that including ACH credit transactions under URTM could have implications for the value dating of ACH transactions, wherein originators may submit transactions for settlement on a later, specified date.

[15] The Reserve Banks monitor in real time Fedwire funds transfers and NSS transactions for institutions meeting the established risk parameters. Currently, the Reserve Banks are monitoring in real time approximately five percent of account holders; however, the number of monitored institutions generally increases as the health of the financial industry weakens.

through real-time monitoring of their account balances.[16]

Real-time enforcement of depository institutions' daylight overdraft capacity levels through URTM could allow the Reserve Banks to manage better the small, yet important, risk that a depository institution could unexpectedly fail with a significant daylight overdraft position that far exceeds its net debit cap. URTM also could assist Reserve Banks and depository institutions in managing Federal Reserve accounts by preventing depository institutions from exceeding their net debit caps with payments that have settlement-day finality. As a result, URTM would likely reduce costs associated with the Reserve Banks' administration of the policy.

The Board is considering URTM for payments with settlement-day finality because they represent greater credit risk to the Federal Reserve than payments without settlement-day finality. Payments with settlement-day finality also represent the majority of the dollar value of payments that the Federal Reserve processes. Because Reserve Banks may return or reverse payments that do not have settlement-day finality, such as checks and ACH debit transactions, these payments pose less risk to the Federal Reserve if the payor institution defaults.

While URTM provides advantages by monitoring all accounts in real time, the Board has concerns about potential negative consequences of URTM. Specifically, the Board is concerned about possible adverse effects on the government-securities market from rejecting book-entry securities transfers. The Board also is concerned about URTM creating disruptions for net settlement arrangements and ACH participants. Finally, URTM raises significant policy issues related to payment delays or gridlock.

To evaluate the potential adverse effects of URTM, the Board reviewed depository institutions' daylight credit use over the past several years and found that the majority of depository institutions generally do not fully use their daylight overdraft capacity. Approximately 97 percent of all account holders use less than 50 percent of their net debit caps for their average peak overdrafts. Even if net debit caps were reduced to the two-week average level, as described previously in the first policy option, most institutions should not experience rejected payments under URTM. In addition, the Board's interim policy statement that allows depository institutions to pledge collateral for additional daylight overdraft capacity should alleviate potential payment disruptions over the long term as depository institutions adjust their behavior.

While the Board does not believe that URTM would disrupt the payments system over the long term, URTM could cause payments gridlock under circumstances of severe financial market stress or significant liquidity shortages. In the event of gridlock, the Federal Reserve has systems and procedures to detect, evaluate, and address payments gridlock. The Federal Reserve's communication protocols and problem escalation procedures are well established and designed to manage any critical payments system problem quickly and effectively.[17]

While several payment types, such as book-entry securities transfers or NSS transactions, raise issues related to implementing URTM, monitoring ACH credit originations for all account holders presents a number of additional issues. The most significant concern is that URTM could compromise ACH value dating. Value dating allows depository institutions to originate credit transactions one or two days in advance of the settlement date. When the Board approved settlement-day finality for ACH credit transactions, it required all institutions monitored in reject mode to prefund their originations at the time the files are processed (64 FR 62673, November 17, 1999). Prefunding was required so that risk controls for ACH credit transactions were similar to those of other payment services with similar finality characteristics, such as Fedwire funds transfers. In the current monitoring environment, only a subset of credit originators are required to prefund. Under a URTM environment, all ACH credit originators would have to prefund. As a result, depository institutions that send files one or two days in advance could perceive prefunding as costly. To avoid prefunding one or two days in advance, many depository institutions might originate their ACH files in the early morning hours of the settlement day, thereby eliminating certain benefits of ACH value dating.

Value dating ACH transactions allows originating and receiving depository institutions to process large numbers of transactions in advance of the settlement date and time. Processing ACH transactions in advance of the settlement date and time often allows institutions to resolve operational problems with minimal effects on ACH participants and to post the transactions to their customers' accounts in a timely manner. In addition, advanced knowledge of the transactions that will settle over the next several days allows institutions to manage their account positions better and to handle incorrect or erroneous transactions before settlement occurs.

A policy change that potentially discourages value dating or encourages originating depository institutions to submit files later than they do today could fundamentally change the nature of the ACH service and disrupt established and effective business practices for ACH participants. For example, an operational problem or funding problem might cause an originating depository institution to miss the close of the ACH processing cycle. By missing the close of the processing cycle, the ACH payments intended for settlement that same day would not settle on a timely basis. Missed settlements could impose undue costs on receiving institutions and their customers and undermine the perceived reliability of ACH. Applying URTM to ACH could, therefore, increase costs to some unknown extent for most ACH participants, including originating institutions, receiving institutions, and their customers.

To alleviate the prefunding issue, some respondents to the request for comment on ACH settlement-day finality proposed collateral as an alternative to prefunding (63 FR 70132, December 18, 1998). Because of the value-dating nature of ACH, the Federal Reserve systems in place today would not be effective for monitoring the collateralization of ACH credit transactions over several days. The ABMS and other systems would have to be modified significantly to substitute collateral for prefunding if the transactions are not submitted on the same day as the intended settlement day; the Board is uncertain of the cost or timing of systems modifications that would be necessary to implement this functionality. Under the conditions described in the interim policy statement, some depository institutions submitting ACH credit transactions on the day of settlement will be able to secure additional daylight overdraft capacity.

The Board plans to continue evaluating the benefits and drawbacks of URTM, including the benefits and drawbacks of implementing URTM for all payments with settlement-day

[16] The account activity of an institution that is not monitored in real time is monitored for compliance with the daylight overdraft posting rules on an after-the-fact or ex post basis.

[17] The Federal Reserve System extensively tested and used these protocols and procedures to prepare for and manage the Y2K rollover period.

finality and implementing URTM for only a subset of those payments. One of the Board's primary concerns with implementing URTM for only a subset of payments, for example for Fedwire funds transfers and NSS transactions, is whether this would create an incentive for liquidity constrained depository institutions to move payments from Fedwire and NSS to the ACH to avoid the real-time monitor. Another concern is whether implementing URTM for only a subset of payments creates a competitive advantage for the Federal Reserve's ACH service.[18] To assess better the effect of such policy changes, the Board requests comment on all aspects of URTM. The Board also requests comment on the following questions:

1. What would be the benefits and drawbacks of URTM?

2. If the Federal Reserve were to implement URTM, should it do so for all payments with settlement-day finality? If not, which payments should the Federal Reserve include under URTM?[19] [20]

3. If the Federal Reserve implemented URTM for only Fedwire funds transfers and NSS transactions, would this action increase risk of large-dollar payments moving from Fedwire or NSS to the ACH?[21] Would this provide the Federal Reserve with a competitive advantage in providing ACH services?

4. What are the most significant benefits and drawbacks of implementing URTM for only Fedwire funds transfers and NSS transactions initially and continuing to evaluate moving other payments to URTM as the Federal Reserve and the industry gain more experience with URTM?

5. What disruptions in the government-securities market, if any, could occur if the Federal Reserve were to implement URTM for Fedwire book-entry securities transfers?

6. What disruptions in settlement arrangements, if any, could occur if the Federal Reserve were to implement URTM for NSS transactions?

7. Would URTM lead to significantly greater payment delays, or would there be little effect?

III. Request for Comment

The Board requests comment on all aspects of the potential policy options outlined above, and on the benefits and drawbacks of implementing these options together or separately.

IV. Competitive Impact Analysis

The Board has established procedures for assessing the competitive impact of rule or policy changes that have a substantial impact on payments system participants.[22] Under these procedures, the Board will assess whether a change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services due to differing legal powers or constraints, or due to a dominant market position of the Federal Reserve deriving from such differences. If no reasonable modifications would mitigate the adverse competitive effects, the Board will determine whether the anticipated benefits are significant enough to proceed with the change despite the adverse effects.

The Board does not believe that the policy options outlined above would have a direct and material impact on the ability of other service providers to compete effectively with the Reserve Banks' payments services. The Board believes that two of the daylight credit policies outlined above, lowering single-day net debit caps and universal real-time monitoring, are generally more restrictive than the current policies. The Board plans to evaluate further whether implementing URTM for only a subset of payments creates a competitive advantage for the Federal Reserve's financial services. More restrictive Federal Reserve credit policies, however, could encourage some depository institutions to seek other payment service providers, thereby encouraging competition with the Reserve Banks. While the two-tiered pricing regime is generally more consistent with private-sector practices, the policy cannot be viewed as being more restrictive or liberal until a more definitive set of fees is recommended.

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. ch. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the policy statement under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the policy statement.

By order of the Board of Governors of the Federal Reserve System, May 30, 2001.

Jennifer J. Johnson,

Secretary of the Board.

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[18] Competitive issues might be raised if the Reserve Banks were to monitor in real time all Fedwire funds transfers and NSS transactions but not all ACH credit transactions. Private-sector ACH operators that use the Federal Reserve's Fedwire-based or enhanced net settlement service might have some participants that experience rejected settlement payments under URTM while most Federal Reserve ACH credit transactions would not be subject to real-time monitoring. Depository institutions that are concerned about settlement disruptions through private-sector ACH operators might find the Federal Reserve's ACH service more attractive; however, these institutions might find that certain benefits from using private-sector ACH services sufficiently offset concerns about settlement disruptions. In addition, under any monitoring environment, depository institutions meeting certain risk parameters would be required to prefund their Federal Reserve ACH credit transactions. For those institutions, the Federal Reserve's ACH service might not be more attractive than private-sector ACH services.

[19] To analyze more fully the potential for payment disruptions, Board staff developed a simulation of URTM for Fedwire funds transfers, book-entry securities transfers, and NSS transactions. The URTM simulation for Fedwire funds, book-entry securities, and NSS activity showed that under current net debit cap levels, ABMS would delay approximately 40 payments out of almost 500,000 per day. In addition, the average value of a delayed payment was about $3.2 million and the average delay was around an hour. Using the two-week average net debit cap levels, the simulation showed that ABMS would delay approximately 50 payments out of almost 500,000 per day and the average value of a delayed payment was about $11.4 million with an average delay of about an hour.

[20] While the URTM simulation did not demonstrate significant NSS transaction delays, the Board notes that given the nature of the net settlement service, the delay of any payment into a net settlement arrangement would hold up settlement for the entire arrangement.

[21] Under any monitoring environment, depository institutions meeting certain risk parameters would be required to prefund ACH credit transactions.

[22] These procedures are described in the Board's policy statement ''The Federal Reserve in the Payments System,'' as revised in March 1990. (55 FR 11648, March 29, 1990).