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).

FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

Sunshine Act Meeting

TIME AND DATE: 10:00 a.m. (EDT), June 11, 2001.

PLACE: 4th Floor, Conference Room 4506, 1250 H Street, N.W., Washington, D.C.

STATUS: Open.

MATTERS TO BE CONSIDERED:

1. Approval of the minutes of the May 14, 2001, Board member meeting.

2. Thrift Savings Plan activity report by the Executive Director.

CONTACT PERSON FOR MORE INFORMATION: Thomas J. Trabucco, Director, Office of External Affairs, (202) 942–1640.

Elizabeth S. Woodruff,

Secretary to the Board, Federal Retirement Thrift Investment Board.

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