Transmittal

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On December 24, 2008 the Board of Governors of the Federal Reserve System adopted revisions to part II of its Policy on Payment System Risk (PSR) that are designed to improve intraday liquidity management and payment flows for the banking system.

holding company and/or to acquire the assets or the ownership of, control of, or the power to vote shares of a bank or bank holding company and all of the banks and nonbanking companies owned by the bank holding company, including the companies listed below.

The applications listed below, as well as other related filings required by the Board, are available for immediate inspection at the Federal Reserve Bank indicated. The applications also will be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing on the standards enumerated in the BHC Act (12 U.S.C. 1842(c)). If the proposal also involves the acquisition of a nonbanking company, the review also includes whether the acquisition of the nonbanking company complies with the standards in section 4 of the BHC Act (12 U.S.C. 1843). Unless otherwise noted, nonbanking activities will be conducted throughout the United States. Additional information on all bank holding companies may be obtained from the National Information Center website at *www.ffiec.gov/nic/*.

Unless otherwise noted, comments regarding each of these applications must be received at the Reserve Bank indicated or the offices of the Board of Governors not later than January 19, 2009.

A. Federal Reserve Bank of Richmond (A. Linwood Gill, III, Vice President) 701 East Byrd Street, Richmond, Virginia 23261–4528:

1. Community Bank Investors of America, L.P., and FA Capital, LLC, both of Richmond, Virginia, to retain control of 5.81 percent, and to acquire up to 9.90 percent of the voting shares of ICB Financial, and thereby indirectly acquire additional voting shares of Inland Community Bank, National Association, both of Ontario, California.

2. Community Bank Investors of America, L.P., and FA Capital, LLC, both of Richmond, Virginia, to retain control of 6.82 percent, and to acquire up to 7.55 percent of the voting shares of Commonwealth Bankshares, Inc, and thereby indirectly acquire additional voting shares of Bank of Commonwealth, both of Norfolk, Virginia.

B. Federal Reserve Bank of Atlanta (Steve Foley, Vice President) 1000 Peachtree Street, N.E., Atlanta, Georgia 30309:

1. Security Bancorp, Inc., to become a bank holding company by acquiring 100 percent of the voting shares of Security Federal Savings Bank of McMinnville, both of McMinnville, Tennessee, upon its conversion to a state chartered bank.

Board of Governors of the Federal Reserve System, December 19, 2008.

Robert deV. Frierson,

Deputy Secretary of the Board.

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FEDERAL RESERVE SYSTEM

[Docket No. OP–1345]

Policy on Payment System Risk

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy statement.

SUMMARY: The Board of Governors of the Federal Reserve System (Board) has adopted revisions to part II of its Policy on Payment System Risk (PSR) that are designed to improve intraday liquidity management and payment flows for the banking system, while also helping to mitigate credit exposures of the Federal Reserve Banks (Reserve Banks) from daylight overdrafts. The adopted changes to the PSR policy are substantially the same as those proposed for comment, including a new approach that explicitly recognizes the role of the central bank in providing intraday balances and credit to healthy depository institutions, a zero fee for collateralized daylight overdrafts, a 50 basis point (annual rate) charge for uncollateralized daylight overdrafts, and a biweekly daylight overdraft fee waiver of $150. The implementation of the changes will take place between the fourth quarter of 2010 and first quarter of 2011. A specific date will be announced by the Board at least 90 days in advance. The Board also approved for foreign banking organizations (FBO) an interim policy change related to the calculation of the deductible amount from daylight overdraft fees under the existing policy and early implementation of the proposed streamlined procedure for maximum daylight overdraft capacity (max cap). The interim policy change for the deductible and streamlined max cap procedure will be effective on March 26, 2009. In addition, the Board endorsed a four-prong strategy, which includes these policy changes, through which the Federal Reserve and industry will address related intraday liquidity, operational, and credit risks in the wholesale payment system.

DATES: *Effective Dates:* The policy will take effect between the fourth quarter of 2010 and first quarter of 2011 with a specific date announced at least 90 days in advance.

The interim policy for the deductible and streamlined max cap procedure will be effective on March 26, 2009.

FOR FURTHER INFORMATION CONTACT: Jeffrey Marquardt, Deputy Director (202–452–2360) or Susan Foley, Assistant Director (202–452–3596), Division of Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System; for users of Telecommunications Device for the Deaf (''TDD'') only, contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

I. Background

On March 7, 2008, the Board requested comment on a new approach to intraday central bank balances and credit that formally recognizes the role of the central bank in providing such balances and credit to depository institutions and encourages them to collateralize explicitly their daylight overdrafts.[1] The Board proposed a policy of supplying intraday balances to healthy depository institutions predominantly through explicitly collateralized daylight overdrafts. Under this proposal, the Board would allow depository institutions to pledge collateral voluntarily to secure daylight overdrafts, and collateralized daylight overdrafts would be charged a zero fee. To further encourage the voluntary use of collateral, the Board would raise the fee for uncollateralized daylight overdrafts to 50 basis points (annual rate) from the current 36 basis points. The Board also proposed increasing the biweekly daylight overdraft fee waiver to $150 from $25 to minimize the effect of the proposed policy changes on institutions that use small amounts of daylight overdrafts. In addition, the Board proposed changes to other elements of the PSR policy dealing with daylight overdrafts, including adjusting net debit caps, streamlining max cap procedures for certain FBOs, eliminating the current deductible for daylight overdraft fees, and increasing the penalty daylight overdraft fee for ineligible institutions to 150 basis points (annual rate) from the current 136 basis points.

The Federal Reserve has been reviewing for several years the long-term effects of operational, market, and policy changes by the industry and the Federal Reserve on intraday liquidity, operational, and credit risks in the payment system, including intraday account overdrafts at the Reserve

[1] See 73 FR 12417, March 7, 2008.

Banks.[2] The proposed changes reflect the culmination of this work, along with companion efforts by the banking industry.

Significant changes to U.S. payment and settlement systems over the past twenty-five years have helped reduce systemic risk. In accord with U.S. and international risk policies and standards, several of these changes have relied increasingly on the use of central bank money—in this context, balances that financial institutions and private clearing and settlement organizations hold in accounts at Reserve Banks—to strengthen the management of credit and liquidity risk in private-sector clearing and settlement arrangements. Such changes have had the effect of increasing significantly the intraday demand for central bank money and hence the demand for daylight overdrafts at the Reserve Banks.

Overall, however, the combined effect of changes at clearing and settlement organizations, depository institutions' intraday liquidity management strategies, and late-day market activity has been to shift the sending of larger Fedwire funds transfers to later in the day. From an operational risk perspective, waiting to send large payments late in the day increases the potential magnitude of liquidity dislocation and risk in the financial industry if late-in-the-day operational disruptions occur. An increase in such risk is particularly troublesome in an era of heightened concern about operational disruptions generally.

To address the combination of intraday liquidity, operational, and credit risks in the wholesale payment system, the Board considered changes to its PSR policy, which sets out the general public policy objectives of safety and efficiency for payment and settlement systems. The changes to the PSR policy, however, are only one effort under a four-pronged strategy involving the Federal Reserve and the financial industry. The second effort involves the Reserve Banks working with the industry to investigate the potential development of a liquidity-saving mechanism for the Fedwire Funds System.[3] The third and fourth efforts involve The Clearing House Interbank Payment System (CHIPS) and Depository Trust & Clearing Corporation identifying opportunities to improve transaction processing and liquidity use in their systems and processes that relate to large-value funds and securities settlement, respectively.[4]

II. Summary of Comments and Analysis

The Board received nineteen comment letters on its proposed policy. The commenters included thirteen commercial banking organizations, four trade organizations, one private-sector clearing and settlement system, and the Federal Reserve Bank of New York's Payment Risk Committee.[5] Most commenters (seventeen) supported the proposed policy changes. One commenter opposed the proposed policy because it does not believe fees are necessary to encourage the pledging of collateral if net debit caps are in place to control the Reserve Banks' risk. One commenter did not indicate support or opposition.

Comments on Proposed PSR Policy Changes

Several commenters noted that the new approach and specifically the zero fee for collateralized overdrafts would contribute to an increase in intraday liquidity and an overall reduction in operational and credit risks in the payment system. They also believed that the proposed policy would provide an incentive for institutions to reduce payments held in internal queues to manage liquidity use, and that the earlier release of these payments would increase the velocity of overall payment flows and liquidity circulation. Other commenters commended the Board for recognizing explicitly its role in providing intraday balances and credit, for introducing a two-tiered pricing system, and for proposing changes that improve the balance between payment system safety and efficiency objectives.

While commenters acknowledged areas where the proposed changes would likely achieve positive outcomes, such as encouraging the release of more payments from internal liquidity queues, a few commenters indicated that they did not believe the proposed policy changes would address fully the late-day compression of Fedwire funds transfers. As of third quarter 2008, 31 percent of the value of Fedwire payments are sent after 5 p.m., a 41 percent increase from just 10 years ago.[6] This growth is driven by the largest-valued payments (the 99th percentile), which averaged about $1.25 billion through mid-2008. The compression results to a certain extent from payments held in liquidity queues until later in the day but is also importantly driven by processes at clearing and settlement organizations and late-day market activity. For instance, private-sector payment systems have created a structural demand for intraday central bank balances and related credit averaging about $50 billion per day. This credit supports these systems' routine settlement and risk management activities, and the associated balances are released late in the day. On peak days, this demand for balances can exceed $150 billion. A significant proportion of such balances are not currently released to depository institutions until after 4:30 p.m. for general use in the payment system. Overall, from an operational risk perspective, the compression of payments, particularly large payments, sent late in the day increases the potential magnitude of liquidity dislocation and risk in the financial

[2] As part of its review, in June 2006, the Board published for public comment the *Consultation Paper on Intraday Liquidity Management and the Payments System Risk Policy* (71 FR 35679, June 21, 2006) seeking information from financial institutions and other interested parties on their experience in managing liquidity, operational, and credit risks related to Fedwire funds transfers, especially late-day transfers. The paper included a list of detailed objectives relating to safety and efficiency that the Board has previously used to conduct payment system risk analysis. An important goal of the consultation process was to identify opportunities to improve the safety/efficiency trade-offs in the payment system over the long run. For a summary of comments on the consultation paper, see 73 FR 12417, March 7, 2008.

[3] The creation of a liquidity-saving mechanism would conserve on account balances or daylight overdrafts and would also reduce the amount of collateral needed to achieve costless daylight overdrafts under the zero fee for collateralized daylight overdrafts. The liquidity-saving mechanism could involve adding new features to the Fedwire Funds Service that depository institutions could use to coordinate better the timing and settlement of their payments as well as to economize on the use of intraday central bank money, daylight overdrafts, and collateral. The existing real-time gross settlement functionality of Fedwire would be retained.

[4] CHIPS is a real-time final payment system operated by The Clearing House Payments Company. In January 2001, The Clearing House implemented operational and rule changes to allow all transactions settled in CHIPS to be final upon release from a central queuing system. Depository Trust & Clearing Corporation operates six subsidiaries that provide clearance, settlement, and information services for many financial instruments, including equities, corporate and municipal bonds, government and mortgage-backed securities, money market instruments, and over-the-counter derivatives.

[5] The Payment Risk Committee (PRC) is sponsored by the Federal Reserve Bank of New York and works to identify and analyze issues of mutual interest related to risk in payments and settlement. The institutions represented on the PRC include Bank of America, Bank of New York Mellon, Bank of Tokyo-Mitsubishi UFJ, Citibank, Deutsche Bank, HSBC, JPMorgan Chase, State Street, UBS, Wachovia, and Wells Fargo. The Wholesale Customer Advisory Group (WCAG) advises the Wholesale Product Office on business issues and is composed of depository institutions that are major users of Fedwire. Institutions represented on this group include ABN AMRO, Bank of America, Bank of New York Mellon, Citibank, Deutsche Bank, HSBC, JPMorgan Chase, Key Bank, Mellon Financial, State Street, SunTrust, UBS, US Bank, US Central Credit Union, Wachovia, and Wells Fargo.

[6] All times referenced are eastern time.

industry if late-in-the-day operational disruptions should occur.

Comments on Four-Prong Strategy Involving Federal Reserve and Industry Efforts

Several commenters recognized that additional efforts are needed to address the late-day compression of payments and strongly encouraged continued work on the three other efforts under the four-prong strategy endorsed by the Board. The three other efforts cover the potential development of a liquidity-saving mechanism for the Fedwire Funds Service, improvements in payments processing for CHIPS, and improvements in liquidity usage within the Depository Trust & Clearing Corporation, particularly its Depository Trust Company (DTC) subsidiary.[7] These initiatives have been a collaborative effort by the Federal Reserve and industry and are ongoing.

The Reserve Banks have been exploring with the industry the possibility of developing a liquidity-saving mechanism for the Fedwire Funds Service. Such a mechanism would also potentially economize on the amount of collateral needed to settle a given value of transactions. For example, the creation of the mechanism could further encourage the coordinated release of payments held in the liquidity queues of depository institutions by reducing the total liquidity (and collateral) used to fund those payments. Four comment letters, one of which represented sixteen large depository institutions, strongly supported the development of a liquidity-saving mechanism. One commenter specifically discussed the efficiency gains of moving payments from individual institution queues to a centralized queue that would enable timely matching and offsetting of payments.

As part of industry efforts, CHIPS, working with its members, has pursued ideas to facilitate faster matching and offsetting of large-value payments throughout the day to reduce the number of unresolved payments that need to be settled at the end of the CHIPS operating day. Similarly, DTC has explored possible operational and technical changes that may reduce liquidity used in its systems and processes related to securities settlement. The money market instrument clearing and settlement processes, in particular, currently requires a substantial amount of liquidity to be transferred to and remain at DTC until end-of-day settlement around 4:30 p.m. when the liquidity is released back to DTC's participants. Several comment letters strongly supported ongoing efforts by CHIPS and DTC. Many of these commenters stressed the importance of taking further steps to ease end-of-day liquidity ''traps.''

The Board fully supports continued progress on the three efforts. The Board agrees that the approved changes to the PSR policy alone are not sufficient to address late-day payment compression and liquidity pressures in the payment system. The Board approved the revised PSR policy based on the expectation that the financial industry will continue to pursue the elements of the four-prong strategy to address the combination of related intraday liquidity, operational, and credit risks in the wholesale payment and settlement system. In addition, further efforts may be needed to review market clearing and settlement practices that help push payments later in the day than may be necessary.

Revised PSR policy

As noted in the Board's Consultation Paper on Intraday Liquidity Management and the Payments System Risk Policy and in its request for comment on proposed changes to the PSR policy, the Board conducted a broad policy review.[8] A key component of this review included assessing anew the role of the central bank in the payment system. Current thinking about the role of central banks in providing intraday balances to the payment system has evolved significantly over the past twenty years and now explicitly recognizes that central banks have an important role in providing intraday (central bank money) balances to foster the smooth operation and settlement of payment systems.[9]

In view of this perspective, the Board proposed adopting a new approach to enhance intraday liquidity and the flow of payments, while controlling risk to the Reserve Banks. The approach would

(1) Explicitly recognize that the Federal Reserve has an important role in providing intraday balances and credit to foster the smooth operation of the payment system.

(2) Provide temporary, intraday balances to healthy depository institutions predominantly through collateralized intraday overdrafts.

(3) Reduce over time the reliance of the banking industry on uncollateralized daylight credit if this can be done without significantly disrupting the operation of the payment system or causing other unintended adverse consequences.

Commenters generally supported this new approach and did not recommend changes. Several commenters requested information about how collateral management and monitoring systems would be changed in implementing the approach. One commenter also noted that the complexity of collateral management could introduce a new type of operational risk that would need to be managed. The Board recognizes that under the revised policy depository institutions will have an increased need to manage actively their collateral pledged to the Reserve Banks. In the past, depository institutions have pledged significant amounts of loans as collateral for discount window and PSR purposes, along with smaller amounts of securities. Loan collateral traditionally has had a low opportunity cost. For some institutions and at certain times, however, securities can be an important source of collateral pledged to the Reserve Banks and could play an important role in fine-tuning collateral positions to meet daily PSR needs. In some cases, institutions may also seek to pledge securities on an intraday basis and not keep them on deposit at a Reserve Bank overnight. The Reserve Banks will be implementing changes over both the short and long term to their operational systems and processes in anticipation of depository institutions' changing needs for collateral management. These changes are discussed later in the collateral section.

The Board also received one comment letter that supported the collateralization portion of the new approach but opposed moving to a mandatory collateral regime. The move toward voluntary collateralization under the new approach reflects the Board's sensitivity to sudden and disruptive changes in policy, the possibility of creating unintended intraday liquidity and operational risks for the payment system, and the potential burden on the banking industry. An important aspect of the new approach is the shift to a greater use of collateral in a way that minimizes the cost and administrative burden of the policy on most users of daylight overdrafts.

Overall, the Board believes the new approach significantly improves the tradeoffs between safety and efficiency

[7] DTC provides custody and settlement services for corporate and municipal securities and money market instruments. DTC is a member of the Federal Reserve System and a clearing agency registered with the Securities and Exchange Commission.

[8] See 71 FR 35679, June 21, 2006, and 73 FR 12417, March 7, 2008.

[9] See ''The Role of Central Bank Money in the Payment System,'' Committee on Payment and Settlement Systems, August 2003 at *http://www.bis.org/publ/cpss55.pdf*.

objectives of the PSR policy for the payment system and its participants. In approving this approach, the Board expects institutions to reduce over time their reliance on uncollateralized daylight credit. If this does not occur, the Board may choose, for example, to evaluate the effectiveness of the level of the fee for uncollateralized overdrafts in encouraging the transition to a predominantly collateralized daylight overdraft regime. The Board will also continue to monitor developments over time, and at some future date, may evaluate the costs and benefits of moving further toward a fully collateralized structure.

Specific Changes to Revised PSR policy

To implement the new approach, the Board has approved changes to certain terms and fees for providing daylight overdrafts. The following table summarizes the specific elements of the current and revised PSR policy.

TABLE—SUMMARY OF KEY ELEMENTS OF THE CURRENT AND REVISED PSR POLICY *

	Current policy	Revised policy
Collateral	Required for problem institutions** and institutions with max caps. Collateral eligibility and margins same as for discount window.	Additional provision that explicitly applies collateral pledged by institutions to daylight overdrafts for pricing purposes.
Fee for collateralized daylight overdrafts.	36 basis points	Zero fee.
Fee for uncollateralized daylight overdrafts.	36 basis points	50 basis points.
Deductible	10 percent of an institution's capital measure	Replaced by zero fee for collateralized daylight overdrafts and fee waiver.
Fee waiver	Up to $25 biweekly	$150 biweekly ***.
Net debit cap	Two-week average limit and higher single-day limit. Ex post counseling if exceed limit.	Two-week average limit eliminated; single-day limit retained. Flexibility in ex post counseling if fully collateralized.
Max cap	Additional collateralized capacity above net debit cap for self-assessed institutions.	Streamlined process for certain FBOs up to a limit (effective March 26, 2009). Minor changes apply for all institutions.
Penalty fee for ineligible institutions.	136 bps	150 bps.

* Access to daylight credit would continue to be available only to institutions with regular access to the discount window as is the case today.

** Problem institutions are institutions that are in weak financial condition and should refrain from incurring daylight overdrafts and institutions that chronically incur daylight overdrafts in excess of their net debit caps in violation of the PSR policy.

*** The proposed $150 waiver would be subtracted from the gross fees (in a two-week reserve-maintenance period) assessed on any depository institution eligible to incur daylight overdrafts. This procedure differs from the current policy in which the waiver only eliminates gross fees of institutions that have charges less than or equal to $25 in a two-week period but includes a deductible.

To assist institutions in understanding the effect of the revised policy on their daylight overdraft fees, the Board has made available a simplified fee calculator. The calculator enables institutions to provide daylight overdraft and collateral data to estimate their daylight overdraft fees under the revised PSR policy. The calculator will be available until 30 days after the to-be-announced effective date of the revised policy and is located on the Board's Web site at *https://www.federalreserve.gov/apps/RPFCalc/*.

A. Collateral

The Board proposed supplying intraday balances to healthy depository institutions predominantly through explicitly collateralized daylight overdrafts provided by Reserve Banks. The Board proposed allowing the use of collateral to be voluntary to avoid disrupting the operation of the payment system and increasing the cost burden of the policy on a large number of smaller users of daylight overdrafts. As part of the proposal, collateral eligibility and margins would remain the same for PSR policy purposes as for the discount window.[10] The pledging of in-transit securities would remain a collateral option for PSR purposes at Reserve Banks' discretion.[11]

The comment letters generally supported the application of collateral to daylight overdrafts, specifically with a zero fee. Several commenters noted that, broadly across the industry, institutions will likely increase the amount of collateral pledged to Reserve Banks. Several commenters addressed how their individual institutions may adjust collateral positions or payments activities in response to a zero fee for collateralized overdrafts and higher fee for uncollateralized overdrafts. Three commenters stated they would increase collateral pledged with their Reserve Bank. Two commenters stated that they had enough collateral to cover any potential daylight overdraft and would not pledge additional collateral. In addition, six commenters noted that deciding whether to pledge collateral would depend on the opportunity cost of collateral in relation to the cost of the daylight overdraft.

Commenters overall believed there could be a substantial opportunity cost to pledge collateral depending on market conditions and whether the lowest-cost collateral has already been pledged for discount window purposes by a depository institution. One commenter estimated the cost of collateral at between 26 and 50 basis points for collateral that has already been pledged but potentially much higher for currently unpledged collateral that might be needed to obtain incremental intraday liquidity. Another commenter estimated the cost of additional collateral to exceed 50 basis points. Other commenters discussed the potential high cost to pledge additional collateral but did not provide estimates. Two commenters noted that the cost of collateral would be relatively high in a volatile market when demand for collateral increases and supply is scarce. Another commenter noted that, in order to cover all potential daylight overdrafts, the institution would incur a high monthly expense to

[10] See *http://www.frbdiscountwindow.org/* for information on the discount window and PSR collateral acceptance policy and collateral margins.

[11] In-transit securities are book-entry securities transferred over the Fedwire securities system that have been purchased by a depository institution but not yet paid for or owned by the institution's customers.

overcollateralize its daylight overdraft balance. For many of these institutions, the decision to pledge higher-cost collateral would depend on the opportunity cost of pledging a particular asset relative to the level of the uncollateralized daylight overdraft fee.

Some commenters also responded to the Board's question on the potential effects of the collateral policy on other financial market activities. Five commenters noted that pledging collateral for daylight overdraft purposes would reduce the pool for funding or investing activities. Conversely, two commenters believed that the policy would not have an effect on market activity because of the wide range of collateral accepted by Reserve Banks.

Two commenters requested that collateral pledged for daylight overdrafts be automatically available to cover unforeseen overnight overdrafts, which in effect creates an overnight discount window loan. Two commenters wanted the ability to pledge collateral through a central cross-border utility accessed by multiple central banks. The cross-border utility would enable global institutions to manage more effectively collateral held in different jurisdictions and to take advantage of differences in time zones. Finally, one commenter asked that deadlines to pledge and withdraw collateral be extended to cover the settlements of DTC and CHIPS and be as late as the close of the Fedwire Funds Service. Today, the Reserve Banks accept pledges of some securities up until 3 p.m. Securities held in the Fedwire Securities Service, however, can be pledged to the Reserve Banks up until 7 p.m. (or a half-hour after the Fedwire Funds Service closes).

While commenters raised several points for the Board's consideration, commenters appeared to have few significant concerns with the proposed voluntary collateralization regime. The most significant concern, which was raised by the majority of commenters, related to system and process enhancements for collateral management and monitoring at the Reserve Banks. For some commenters, support for the proposed policy was contingent on increased efficiency in collateral processing and real-time or near-real-time information on collateral pledged. About half the commenters expressed strong preferences that the Reserve Banks' collateral management systems facilitate the pledging and withdrawal of securities intraday. Five commenters also made suggestions to expand the range of eligible collateral, including additional types of cross-border securities. The Board recognizes that enhancements to collateral management systems and processes are an important aspect of implementing the revised PSR policy, and the Federal Reserve is developing a plan to mitigate the concerns raised as discussed in the next section.

On balance, the Board believes that the proposed voluntary collateralization regime will better meet the needs of the Reserve Banks and industry than the current policy. The Board also believes that unencumbered collateral pledged to Reserve Banks should be available to support the use of intraday credit.[12] In addition, the Board believes that it is important for consistency to maintain for PSR policy purposes the same collateral eligibility and margins as for the discount window.[13]

Collateral management. The Federal Reserve is in the process of assessing its collateral-management systems and processes. It has identified a number of possible improvement opportunities and has begun engaging the industry in dialogue about needed and desired functionality and process improvements.[14]

Based on comment letters and initial industry discussions, the Federal Reserve identified a number of changes that it intends to implement prior to the effective date of the revised policy. This short-term strategy involves several initiatives to improve the pledging and withdrawal of specific types of securities. The strategy also includes increasing information available intraday and interday on pledged collateral through the Reserve Banks' Account Management Information application (AMI).[15] In addition, the Federal Reserve will be publishing general timing guidelines for collateral pledging and withdrawal to help institutions better track when collateral is determined to be pledged to and released by the Reserve Banks.

Following the effective date for the revised PSR policy, the Reserve Banks will continue with initiatives to improve the pledging and withdrawal process for securities collateral. These initiatives will largely be similar to those in the short-term strategy but include enhancements involving sufficient complexity and resource requirements that completion may not be possible before the implementation date of the new policy. Some of these enhancements may take place relatively soon—perhaps within six months—after the implementation date, while others may take somewhat longer. Collectively, these enhancements should enable greater rates of straight-through processing of securities collateral by the Reserve Banks and quicker withdrawal of unencumbered securities, and should provide tools to assist institutions in monitoring intraday their daylight overdraft and collateral positions.

Over the longer term, the Reserve Banks intend to collaborate with the industry to identify additional enhancements that will continue to improve the efficiency and effectiveness of processes for pledging, withdrawing, and monitoring of collateral. The Federal Reserve expects that institutions' needs will evolve and grow as they gain experience with the revised PSR policy and with the collateral-management enhancements the Reserve Banks implement in the short and medium term.

Over time, the Federal Reserve will be providing more-specific information to the industry about upcoming enhancements to collateral and information systems. This communication will help institutions understand the forthcoming changes and will also help them identify any changes they may need to make to their systems.

B. Fees for Collateralized Daylight Overdrafts

The Board proposed lowering the fee for collateralized daylight overdrafts to zero and raising the uncollateralized daylight overdraft fee to 50 basis points to encourage institutions to pledge collateral and to reduce payments held in liquidity-management queues. The commenters strongly supported the proposal of a zero fee for collateralized daylight overdrafts. Most commenters believed that a zero fee for collateralized daylight overdrafts will encourage institutions that queue payments for liquidity purposes to release more of those payments earlier in the day.

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[12] Under some circumstances, rules for determining whether collateral is available may differ for PSR and discount window purposes. For example, under term lending (announced July 30, 2008), institutions requesting an advance of more than 28 days will need to hold an additional 33 percent of collateral in excess of the collateral required for the advance. This additional collateral may not available for discount window purposes but would be considered available (unencumbered) for PSR purposes.

[13] In-transit securities would also remain an eligible collateral option for PSR policy purposes at the Reserve Banks' discretion. Reserve Banks will require detailed information on a minute-by-minute basis to be submitted.

[14] The Federal Reserve is also in dialogue with depository institutions interested in pledging in-transit collateral for pricing purposes to discuss new data requirements and processes.

[15] AMI is an online tool offered by the Reserve Banks that supplies real-time information about an institution's Federal Reserve account balance and provides access to a variety of summary and detail reports.

Commenters acknowledged that institutions may still hold some payments in liquidity queues for reasons including counterparty risk, internal comfort with daylight overdraft levels, and uncollateralized daylight overdraft fee management. One institution noted that it believed the zero fee would help change certain depository institutions' tactical behavior of only sending payments when payments are received in order to reduce daylight overdraft costs. Another commenter believed a zero fee was appropriate because charging for collateralized overdrafts would amount to an unfair tax.

The majority of commenters noted that the zero fee for collateralized daylight overdrafts would also likely lead depository institutions to increase collectively intraday credit use. Five commenters believed that their individual institution's intraday credit use would increase, while three other commenters estimated no change to their institution's use. The credit risk to the Reserve Banks from the predicted increases in daylight overdraft use would be controlled by traditional banking tools used in providing credit (eligibility requirements, collateral, caps, and monitoring). In addition, as institutions release payments earlier from liquidity queues, liquidity should circulate more quickly with a resulting faster flow of payments and thus on net mitigate somewhat the predicted increase in daylight overdraft use. On balance, the Board believes that setting the collateralized daylight overdraft fee at zero will improve tradeoffs among liquidity, operational, and credit risks in the payment system.

The Board requested comment on two possible changes in market practices as a result of the zero fee for collateralized daylight overdrafts. One question covered the possible effect on the market for early return of fed funds loans. Several commenters believed that the practice of returning fed funds loans earlier would be positively affected, at least somewhat, by the proposed two-tiered pricing. Specifically, the fee reduction could increase the incentive to return fed funds loans earlier for institutions that have sufficient collateral to cover any overdraft incurred. One commenter believed a change would not happen automatically without market intervention to encourage the early return. Another commenter was unsure of any changes because of uncertain market dynamics and the historical resistance to return funds early. Some comments suggest that certain institutions may be more willing to return fed funds loans earlier. At the same time, institutions that, under the revised policy, have sufficient collateral to cover their daylight overdrafts may not have a significant incentive to demand the early return of funds. Overall, it is difficult at this stage to predict the net effect on the market for the early return of fed funds loans.

The Board also requested comment on whether collateralized overdrafts at a zero fee would eliminate incentives for depository institutions and their customers to process securities used in repurchase agreements early in the morning. The Board was concerned that a zero overdraft fee could remove the incentive for the early processing of securities, which it has viewed as an important operational success by the banking and securities industry from the time daylight overdraft fees were first implemented. Prior to the introduction of daylight overdraft fees in 1994, U.S. government securities dealers would arrange for and deliver securities designated for repurchase agreements largely after noon, creating a late-day compression of payments and securities deliveries in the Fedwire Securities Service operating day. Consequently, it was not uncommon for the Fedwire Securities Service operating day to be extended until 4 p.m. or later to address the volume of transfers that arrived late in the afternoon.[16] In anticipation of being charged daylight overdraft fees, the U.S. government securities dealers (and their clearing banks) introduced processes and technology that facilitated the arrangement of repurchase agreements and delivery of the securities early in the morning. By arranging trades and delivering securities early in the morning, dealers gained use of the incoming cash from their counterparties in the repurchase agreements, reducing the duration of their daylight overdrafts. On the return leg, counterparties to the repurchase agreements also began sending back the securities to the dealers first thing in the morning. This market movement shifted the peak in daylight overdrafts significantly earlier in the morning and reduced dramatically securities-related daylight overdrafts.

Most commenters believed that practices either would not change or were unsure if practices would change because of well-established current procedures and technology that support the market. One commenter, however, expressed concern that the zero fee for collateralized daylight overdrafts may have unintended consequences on the government securities market. The commenter believed that over time certain participants in the government securities market will revert to pre-1994 behavior without the cost incentive rooted in daylight overdraft fees to deliver securities early.

While it is not possible at this stage to know how U.S. government securities dealers will respond to a zero fee for collateralized daylight overdrafts for depository institutions, the Board does believe that competing business or processing incentives, such as managing securities inventories, may result in some change in behavior to shift later the delivery of securities. The change initially may be limited to certain types of securities or to specific dealers and thus would be of minor consequence. The main concern is that a change will become pervasive, undoing the successes achieved under the initial regime of charging for daylight overdrafts.

Some mitigating factors may influence the magnitude of behavioral changes. The market for early deliveries is well entrenched today and is supported by automation. A significant change in this market may require institutions to make systems changes, which could be costly. In addition, the $50 million limit on the size of securities transfers over Fedwire Securities Service reduces the incentive to build positions. Securities dealers in the past held securities until near the close of the Fedwire Securities Service operating day to ensure they could complete the delivery in full and avoid costly failures to deliver. This practice is said to continue in some cases even today.

While the Board continues to be concerned about the possible effect of a zero fee on the timing of securities transfers, it believes there are significant benefits in reducing the fee to zero for collateralized daylight overdrafts. This view is also strongly supported by the comment letters. The Board believes that a zero fee for collateralized daylight overdrafts provides incentives for institutions to release funds transfers held in internal queues for liquidity reasons, improving liquidity circulation and reducing operational risk in the Fedwire Funds Service. A zero fee also creates incentives to pledge additional collateral to the Reserve Banks, mitigating their credit risk in providing intraday balances. On balance, the Board believes the expected benefits warrant reducing the fee for collateralized daylight overdrafts to zero.

The Board, however, will monitor delivery practices in the securities market to determine if securities transfers shift later in the day. To assist

[16] The Fedwire Securities service operating hours today are 8:30 a.m. to 3:30 p.m.

in this monitoring, the Board will require government securities clearing banks to submit data to the Board before and after the implementation of the revised policy to help identify shifts in behavior by dealers; the data collection requirements will be discussed directly with the clearing banks.[17] If a substantial shift does occur, the Board will take appropriate steps as needed. The Board strongly believes that reverting to pre-1994 behavior of late deliveries of securities poses unacceptable operational risks to the payment system.

C. Fees for Uncollateralized Daylight Overdrafts

The Board proposed raising the fee to 50 from 36 basis points (annual rate) for uncollateralized daylight overdrafts to encourage the collateralization of daylight overdrafts.[18]

While acknowledging the intent of increasing the uncollateralized fee, some commenters raised concerns that the higher fee may introduce liquidity challenges for collateral-constrained institutions. These commenters generally believed that institutions without sufficient collateral to support daylight overdrafts would have an incentive to hold payments for liquidity purposes to avoid daylight overdraft charges. Commenters, including an organization representing sixteen large depository institutions, stated that the collective benefits from speeding up the flow of payments would only be attained if all participants acted for the collective good rather than minimizing individual institutions' own costs and risks. These commenters also indicated that they would not continue to release payments from queues if counterparties did not reciprocate.

To mitigate the risk that institutions do not act for the overall benefit of the industry, several commenters discussed options for monitoring and promoting bilateral payment flows. Two commenters suggested individual institutions monitor counterparties, while two other commenters recommended the Federal Reserve monitor institutions' activities. Two commenters also suggested that the Federal Reserve devise incentives for institutions to release payments queued prior to 2 p.m., including time-of-day pricing.

It will be important for the industry and Federal Reserve to monitor changes in payment activities over time to evaluate whether institutions continue to hold payments for liquidity reasons. It is not fully clear, however, whether the fee increase to 50 basis points would exacerbate this problem for some institutions and whether institutions will queue payments to some degree at any positive fee, including at a zero fee, for reasons of internal liquidity risk management. On balance, the Board believes that the increase to 50 basis points for uncollateralized daylight overdrafts is appropriate in conjunction with the fee reduction to zero for collateralized daylight overdrafts. The changes together balance the overall tradeoffs between safety and efficiency by providing incentives to pledge collateral, which mitigates the Reserve Banks' risks, and incentives to increase the flow of payments, which increases liquidity circulation.

D. Deductible and Fee Waiver

The Board proposed eliminating the deductible as a source of free intraday credit with the intent of providing such credit through collateralized daylight overdrafts charged at a zero fee. The Board also proposed to increase the fee waiver to $150 from $25 to reduce the burden of the PSR policy on institutions that use small amounts of daylight overdrafts. As proposed, the $150 waiver would be subtracted from the gross fees (in a two-week reserve-maintenance period) assessed on any user of daylight overdrafts in contrast to the current waiver that only applies to gross fees of institutions that have charges less than or equal to $25 (in a two-week reserve-maintenance period).[19]

While none of the comment letters explicitly addressed the introduction of a higher fee waiver, two commenters strongly supported the elimination of the deductible. These commenters believed this change would remove a competitive disparity they have identified between FBOs and U.S.-chartered depository institutions. Under the current policy, U.S.-chartered depository institutions receive a net debit cap and deductible based on their worldwide capital, while FBOs receive a net debit cap and deductible based on no more than 35 percent of their worldwide capital. By eliminating the deductible for all depository institutions and providing free collateralized intraday credit to eligible depository institutions, including FBOs, the revised policy will address the concerns that some commenters expressed regarding the negative incentive effects of the deductible calculations.

The Board believes it is still appropriate to provide some amount of free uncollateralized liquidity to depository institutions to reduce the administrative burden on Reserve Banks and on a large number of depository institutions that incur small amounts of uncollateralized daylight overdrafts. The Board believes that the $150 fee waiver will serve those purposes under the revised PSR policy. With the Board adopting these changes, institutions should receive ample free liquidity through zero-priced collateralized daylight overdrafts. In addition, most small users of uncollateralized intraday credit should not observe a change in their daylight overdraft charges between the current and revised PSR policies.

E. Net Debit Caps[20]

The Board proposed eliminating the current two-week average cap on daylight overdrafts for healthy depository institutions while retaining the higher single-day cap. Under the proposal, the single-day cap would apply to the total of collateralized and uncollateralized daylight overdrafts.[21] The Board did not receive specific comments on the removal of the two-week net debit cap or retention of the single-day net debit cap.

The Board also proposed providing Reserve Banks additional flexibility in

[17] While the Board has access to data indicating the timing of transfers by depository institutions over the Fedwire Funds Service and Fedwire Securities Service, these data do not provide sufficiently detailed information to track effectively when dealers are delivering securities designated for repurchase agreements.

[18] In calculating an institution's fees, the value of unencumbered collateral pledged to the Reserve Banks will be subtracted from negative Federal Reserve account balances at the end of each minute to determine the institution's uncollateralized negative Federal Reserve account balance. The uncollateralized negative Federal Reserve account balance per minute will be summed and divided by the number of minutes in the Fedwire Funds Service operating day to arrive at the average daily uncollateralized daylight overdraft, which will be assessed a 50 basis point fee (annual rate). The value of collateral pledged is the same for PSR and discount window purposes.

[19] The waiver would not result in refunds or credits to an institution and cannot be carried to another reserve maintenance period. The waiver would not apply to institutions subject to the penalty fee.

[20] Net debit caps limit the aggregate amount of daylight credit that the Reserve Banks extend. Net debit caps are a function of qualifying capital and a multiplier per cap category. There are four cap categories: (in ascending order) zero, exempt-from-filing, de minimis, and self assessed (which includes high, above-average, and average multipliers).

[21] Under the current policy, net debit caps limit the amount of uncollateralized daylight overdrafts, while max caps limit the amount of approved collateralized capacity in addition to the uncollateralized amount allowed under net debit caps. Under the revised policy, the single-day cap will limit the total of collateralized and uncollateralized daylight overdrafts within the predefined net debit cap amount, and any collateralized portion would not increase the total amount. Institutions needing capacity that exceeds the net debit cap will still need to apply for a max cap.

the administration of net debit caps for fully collateralized daylight overdrafts. The Reserve Bank may forgo ex post counseling for two incidents of fully collateralized overdrafts per two consecutive reserve-maintenance periods (four weeks).[22] The additional flexibility would apply to institutions that have de minimis or self-assessed net debit caps or max caps.[23] Exempt-cap institutions are excluded from this additional flexibility because they already are allowed to exceed their cap limit twice in two consecutive reserve-maintenance periods. Zero cap institutions will not be eligible. The Board did not receive any comments on the proposed additional flexibility for ex post counseling.

The Board continues to believe that it is appropriate and prudent to have limits on intraday credit even when the credit is fully collateralized. Collateral may not always be sufficient to protect against credit risks. While haircuts on collateral help mitigate the risk that the liquidation value of collateral will fall below the credit exposure, they are not designed to eliminate the risk entirely. Thus, limits or caps complement the use of collateral in risk mitigation. Among other things, caps provide a risk management tool for institutions and the Reserve Banks in measuring and managing the size of exposures and take some pressure off the use of haircuts to address credit risks.

The Board also continues to believe that flexibility may be appropriate in counseling an institution if the daylight overdraft is fully collateralized. This flexibility to waive counseling reflects the lower risk of a fully collateralized daylight overdraft relative to an uncollateralized daylight overdraft. The limited number of waivers reflects the fact that collateral may not fully protect a Reserve Bank and that frequent violations of agreed caps may suggest other concerns about a depository institution.

Based on this analysis, the Board adopted the proposed changes to net debit caps. The elimination of the two-week average cap will increase the routine daylight overdraft capacity of institutions with self-assessed caps approximately 50 percent from the current policy. The Board also adopted the proposed additional flexibility in counseling an institution exceeding its cap when its daylight overdrafts are fully collateralized.

F. Maximum Daylight Overdraft Capacity

During its policy review, the Board evaluated potential simplifications to the current process through which institutions may apply for max caps. First, the Board proposed removing the requirement that institutions must have already explored other alternatives to address their increased liquidity needs before considering a max cap. A depository institution interested in obtaining a max cap would contact its administrative Reserve Bank, which would work with the institution to determine an appropriate capacity level based on the business case and would assess relevant financial and supervisory information in making such a credit decision. None of the comment letters addressed this proposed change.

Second, the Board proposed a streamlined max cap procedure that would allow eligible FBOs to acquire additional capacity that in total would provide up to 100 percent of worldwide capital times the self-assessed cap multiple. The streamlined procedure would enable a financial holding company or SOSA 1-rated institution to request from its administrative Reserve Bank a max cap without documenting a specific business need for additional capacity or providing a board of directors resolution authorizing the request for a max cap.[24] The Reserve Bank would assess the ability of eligible FBOs to manage the intraday capacity permitted by the max cap as part of its review of relevant financial and supervisory information. The Reserve Bank, in consultation with the home country supervisor, would engage in initial as well as periodic dialogue with the institution that would be analogous to the periodic review of liquidity plans performed with U.S.-chartered institutions to ensure the institution's intraday liquidity risk is managed appropriately. Under this proposal, however, if an FBO requests capacity in excess of 100 percent of worldwide capital times the self-assessed cap multiple, it would be subject to the general max cap procedure applicable to all institutions.

Four commenters supported the proposed streamlined max cap procedure for FBOs that are financial holding companies or SOSA 1-rated institutions. The commenters believed that the streamlined max cap would facilitate institutions' managing their payments activity. Three of these commenters, however, requested that the Board reconsider calculating the net debit cap for financial holding company or SOSA 1-rated FBOs on 100 percent (rather than up to 35 percent) of their worldwide capital without requiring collateral for the additional capacity. The commenters stated that the streamlined max cap would continue to create a competitive disadvantage for FBOs by not allowing them to decide whether to pledge collateral to support daylight overdrafts, while U.S.-chartered depository institutions can make business decisions regarding how much, if at all, to collateralize. One commenter believed that a mandatory collateralized regime would resolve this disparity by requiring all institutions to collateralize 100 percent of their overdrafts. Another commenter representing several FBOs noted that if all institutions collateralized their daylight overdrafts as a result of the proposed policy changes, the streamlined max cap procedure would make any differences largely moot as a practical matter.

The Board continues to view the max cap as an important tool in helping Reserve Banks and depository institutions manage intraday risk in a manner that supports the payment needs of individual institutions and the payment system as a whole. The Board believes the proposed changes will introduce additional flexibility into this program, thereby improving the flow of payments and liquidity in the payment system, and will more effectively reflect the strategic direction of the new policy. The Board also continues to believe the streamlined max cap procedure effectively balances the safety and efficiency objectives of the PSR policy and improves the position of FBOs. The procedure provides a more efficient method for FBOs to gain additional capacity than current procedures while helping to resolve the increased risk

[22] The ex post counseling regime includes a series of actions by the Reserve Bank that are aimed at deterring an institution from violating the PSR policy by exceeding its net debit cap. These actions may include an assessment of the causes of the overdrafts, a counseling letter to the institution, a review of the institution's account-management practices, and an assessment of whether a higher net debit cap may be warranted. In situations involving problem institutions, the Reserve Bank may assign the institution a zero cap and impose other account controls, such as requiring the institution to pledge collateral; imposing clearing balance requirements; rejecting Fedwire funds transfers, ACH credit originations, or National Settlement Service transactions that would cause or increase an institution's daylight overdraft; or requiring the institution to prefund certain transactions.

[23] FBOs will continue to be monitored at their cap level in real time. If an institution's account is monitored in real time, any outgoing Fedwire funds transfer, National Settlement Service transaction, or ACH credit origination that exceeds available funds is rejected. If an FBO exceeds its cap periodically due to payments, such as securities transactions, that are not covered under a real-time monitor, the Reserve Bank may waive counseling if the daylight overdrafts are fully collateralized.

[24] The FBO would still be required to complete a self-assessment and provide a board of directors resolution for the self-assessed cap.

associated with FBOs because of the timeliness and scope of available supervisory information and other supervisory issues that may arise because of the cross-border nature of the FBO's business (for example, application of different legal regimes).

The Board has adopted the proposed change to remove the requirements to pursue first all other options. The Board has also approved the proposed streamlined max cap procedure. In addition, the Board has approved an early implementation date for the streamlined max cap procedure on March 26, 2009. The early implementation should help FBOs manage their payment activity more effectively, particularly when combined with the deductible changes under the interim policy (discussed later).

G. Penalty Fees

The Board proposed to increase the penalty fee for daylight overdrafts to 150 from 136 basis points. The penalty rate structure has traditionally been the regular daylight overdraft fee plus 100 basis points. The Board did not receive any comments related to the increase in fees.

The Board continues to believe that it is appropriate to maintain a 100 basis point spread between the regular and penalty rates for daylight overdrafts and adopted the proposed penalty fee of 150 basis points. The penalty rate will continue to be applied to institutions that incur daylight overdrafts but do not have regular access to the discount window and thus are not eligible under the PSR policy for intraday credit.

H. Implementation

Along with the general support for the proposed PSR policy changes, the Board received several requests to shorten the time until implementation. The Board proposed that the policy changes could be implemented approximately two years from the announcement of a final rule. Six commenters requested that the Board implement the proposed policy within one year of publication of the final rule so that they may take advantage sooner of the zero fee for collateralized overdrafts. Another commenter believed that institutions should have the ability to take advantage of the proposed policy in six months from the final rule.[25] Most commenters believed that they would only need to make minimal procedural or systems changes to be prepared for the policy change, although two commenters noted that the degree of procedural or systems modifications would depend on changes the Reserve Banks make to their collateral-management and collateral-monitoring systems. One commenter believed that a two-year time frame was appropriate to provide all institutions sufficient time to make the necessary modifications to internal processes and systems.

The Board recognizes the industry's interest in an earlier implementation of the revised policy. Many commenters, however, requested changes to Reserve Banks' systems and processes for enhanced collateral management and monitoring. The Reserve Banks' plan to make several systems changes, discussed in a previous section, related to collateral management and monitoring, and these changes will require time to implement. Given the importance of these and other systems' changes, the Board approved an implementation window from the fourth quarter of 2010 to the first quarter of 2011 with a specific effective date to be announced at least 90 days in advance. The implementation window provides needed flexibility to the Reserve Banks for systems changes not only to enhance collateral management and monitoring but also to implement all aspects of this policy as well as other important policies.

In the near term, the Board approved, effective March 26, 2009, the streamlined max cap procedure that will allow certain FBOs to obtain more quickly additional collateralized capacity up to 100 percent of worldwide capital times the self-assessed cap multiples. Eligible FBOs interested in the streamlined max cap should contact their administrative Reserve Banks.

III. Interim Policy

In addition to the comments on the proposed PSR policy changes, two commenters requested that the Board consider an interim policy change to the calculation of the current deductible for FBOs to reflect 100 percent of worldwide capital rather than the current level of up to 35 percent. These commenters indicated that the current deductible calculation puts FBOs at a competitive disadvantage relative to comparable U.S.-chartered depository institutions, and although the proposed elimination of the deductible addresses this issue, the changes will not take effect for more than a year.

The deductible calculation has prompted some FBOs to delay payment flows. Several commenters to the Consultation Paper on Intraday Liquidity Management and the Payments System Risk Policy stated that FBOs instituted the process of queuing payments for liquidity reasons to respond to the lower deductible that is based on up to 35 percent of worldwide capital.[26] Commenters discussed minimizing fees in some cases by managing payment flows to the level of free credit provided by the deductible. A deductible based on 100 percent of capital, however, would provide additional free credit that should enable the release of payments being held in internal liquidity queues.

The Board considered the concerns raised regarding competitive disparities created by the current deductible calculation as well as the implications for holding payments. The Board also considered the increased risk associated with FBOs related to the timeliness and scope of available supervisory information and other supervisory issues that may arise because of the cross-border nature of the FBO's business (for example, application of different legal regimes). In weighing these factors, the Board approved an interim policy that will use 100 percent of worldwide capital for eligible FBOs rather than up to 35 percent in calculating the deductible amount.[27] An eligible FBO must request and receive Reserve Bank approval for a streamlined max cap and have collateral pledged at all times to its Reserve Bank equal to or greater than the amount of the deductible.[28]

The Board sought to balance efficiency and safety objectives in its interim policy. The increased deductible provides eligible institutions with an increase from potentially 35 percent to 100 percent of worldwide capital, significantly increasing the amount of free credit provided by the Reserve Banks to eligible FBOs. At the same time, the increased deductible is available only to the highest-rated FBOs that would also be eligible for the

[25] The commenter wanted to implement the proposed PSR policy changes in tandem with the proposed posting rule changes affecting ACH debit transfers. The Board had proposed to shift from 11 a.m. to 8:30 a.m., eastern time, the posting time for commercial and government ACH debit transfers that are processed by the Reserve Banks' FedACH service. See 73 CFR 12443, March 7, 2008. The Board issued a separate notice today in the **Federal Register** with its decision not to pursue at this time the proposed posting rules changes.

[26] See 71 FR 35679, June 21, 2006.

[27] The deductible calculation involves the fraction of eligible worldwide capital times 10 percent.

[28] If an FBO meets the criteria for the streamlined procedure for max caps but was granted a max cap before implementation of the streamlined procedure (effective March 26, 2009) or is approved for a max cap under the general procedure because the limit being requested is greater than 100 percent of worldwide capital, the FBO would still qualify for the higher deductible if it also met the collateralization requirement.

streamlined max cap and those FBOs that hold collateral up to the amount of the deductible. These requirements help limit the Reserve Banks' exposure from the greater risk associated with FBOs and the likely increase in daylight overdraft use.

The interim policy will be effective on March 26, 2009 and will remain in effect until implementation of the revised PSR policy. The effective date is consistent with the early implementation of the streamlined max cap procedure.

IV. Competitive Impact Analysis

The Board has established procedures for assessing the competitive impact of a rule or policy change that has a substantial effect on payment systems participants.[29] 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 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 modification 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.

Intraday balances of central bank money help ensure the smooth flow of payment and settlement in systems whether they are operated by the Reserve Banks or private-sector organizations. The demand for intraday balances at the Reserve Banks for processing payments for private-sector clearing and settlement systems can in normal market conditions substantially exceed the supply of overnight balances in Federal Reserve accounts, making intraday credit from the Reserve Banks the key marginal source of intraday funding for the market and for making payments, particularly over the Reserve Banks' payment systems. For some large users of intraday credit, the adopted PSR policy changes may result in a reduction in daylight overdraft fees and thus lower explicit costs of using central bank money to fund payments activity. The lower explicit cost of using intraday balances of central bank money will lower the implicit cost of using the Reserve Banks' payments services. The Board, however, does not believe this lower cost will have an adverse material effect on the ability of other service providers to compete with the Reserve Banks because private-sector clearing and settlement systems will gain from the lower explicit cost of funding net debit caps and other risk and operational controls employed by those systems. Generally, the Board expects that both the Reserve Banks and private-sector clearing and settlement systems will benefit to some extent from the reduced costs for collateralized daylight overdrafts.

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3506; 5 CFR 1320 Appendix A.1), the Board reviewed the policy statement under the authority delegated to the Board by the Office of Management and Budget. The revised policy statement does not contain any new or revised collection of information pursuant to the Paperwork Reduction Act.

VI. Federal Reserve Policy on Payment System Risk (Effective March 26, 2009)

Effective March 26, 2009, the ''Federal Reserve Policy on Payment System Risk'' is amended to change all references to payments systems or payments system to payment systems or payment system and make other conforming changes. It is also amended as follows.

Introduction [No Change]

Risks in Payment and Settlement Sytems [No Change]

I. Risk Management in Payment and Settlement Systems [No Change]
- A. Scope
- B. General Policy Expectations
- C. Systemically Important Systems
- 1. Principles for Systemically Important Payment Systems
- 2. Minimum Standards for Systemically Important Securities Settlement Systems and Central Counterparties
- 3. Self-Assessments by Systemically Important Systems

II. Federal Reserve Intraday Credit Policies [II C.3. and II. D Revised]
- A. Daylight Overdraft Definition and Measurement [No Change]
- B. Pricing [No Change]
- C. Net Debit Caps
- 1. Definition [No Change]
- 2. Cap Categories [No Change]
- a. Self-Assessed [No Change]
- b. De Minimis [No Change]
- c. Exempt-From-Filing [No Change]
- d. Zero [No Change]
- 3. Capital Measure
- a. U.S.-Chartered Institutions [No Change]
- b. U.S. Branches and Agencies of Foreign Banks
- D. Maximum Daylight Overdraft Capacity
- 1. General Procedure
- 2. Streamlined Procedure for Certain FBOs

E. Special Situations [No Change]
- 1. Edge and Agreement Corporations [No Change]
- 2. Bankers' Banks [No Change]
- 3. Limited-Purpose Trust Companies [No Change]
- 4. Government-Sponsored Enterprises and International Organizations [No Change]
- 5. Problem Institutions [No Change]

F. Monitoring [No Change]
- 1. Ex post [No Change]
- 2. Real time [No Change]
- 3. Multi-District Institutions [No Change]

G. Transfer-Size Limit on Book-Entry Securities [No Change]

Introduction [No Change]

Risks in Payment and Settlement Systems [No Change]

I. Risk Management in Payment and Settlement Systems [No Change]

II. Federal Reserve Intraday Credit Policies [II C.3. and II D Revised]

A. Daylight Overdraft Definition and Measurement [No Change]

B. Pricing [No Change]

C. Net Debit Caps

1. Definition [No Change]

2. Cap Categories [No Change]

3. Capital Measure

As described above, an institution's cap category and capital measure determine the size of its net debit cap. The capital measure used in calculating an institution's net debit cap depends upon its chartering authority and home-country supervisor.

a. U.S.-chartered institutions. [No change]

b. 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 the FBO's U.S. capital equivalency measure.[30] U.S. capital equivalency is equal to the following:

- 35 percent of capital for FBOs that are financial holding companies (FHCs). [31]

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

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

[31] The Gramm-Leach-Bliley Act defines a financial holding company as a bank holding company that meets certain eligibility requirements. In order for a bank holding company to become a financial holding company and be eligible to engage in the new activities authorized under the Gramm-Leach-Bliley Act, the Act requires that all depository institutions controlled by the bank holding company be well capitalized and well managed (12 U.S.C. 1841(p)). With regard to a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, the Act requires the Board to apply comparable capital and management

• 25 percent of capital for FBOs that are not FHCs and have a strength of support assessment ranking (SOSA) of 1.[32]

• 10 percent of capital for FBOs that are not FHCs and are ranked a SOSA 2.

• 5 percent of ''net due to related depository institutions'' for FBOs that are not FHCs and are ranked a SOSA 3.

An FBO that is a FHC or has a SOSA rating of 1 may be eligible for a streamlined procedure (see section II.D.) for obtaining additional collateralized intraday credit under the maximum daylight overdraft capacity provision.

Granting a net debit cap, or any extension of intraday credit, to an institution is at the discretion of the Reserve Bank. In the event a Reserve Bank grants a net debit cap or extends intraday credit to a financially healthy SOSA 3-ranked FBO, the Reserve Bank may require such credit to be fully collateralized, given the heightened supervisory concerns with SOSA 3-ranked FBOs.

For purposes of calculating the deductible for daylight overdraft pricing, eligible FBOs will be granted a capital measure of 100 percent of capital. Eligible FBOs must have requested and been approved for a streamlined max cap and have unencumbered collateral pledged at all times to their Reserve Bank equal to or greater than the amount of the deductible.[33] [34]

D. Maximum Daylight Overdraft Capacity

The Board recognizes that while net debit caps provide sufficient liquidity to most institutions, some institutions may still experience liquidity pressures. The Board believes it is important to provide an environment in which payment systems may function effectively and efficiently and to remove barriers, as appropriate, to foster risk-reducing payment system initiatives. Consequently, certain 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, subject to Reserve Bank approval.[35] [36] This policy is intended to provide extra liquidity through the use of unencumbered collateral by the few institutions that might otherwise be constrained from participating in risk-reducing payment system initiatives.[37] The Board believes that providing extra liquidity to these few institutions should help reduce liquidity-related market disruptions.

1. General Procedure

An institution with a self-assessed net debit cap that wishes to expand its daylight overdraft capacity by pledging collateral should consult with its administrative Reserve Bank. Institutions that request daylight overdraft capacity beyond the net debit cap must have already explored other alternatives to address their increased liquidity needs.[38] The Reserve Bank will work with an institution that requests additional daylight overdraft capacity to determine the appropriate maximum daylight overdraft capacity level. In considering the institution's request, the Reserve Bank will evaluate the institution's rationale for requesting additional daylight overdraft capacity as well as its financial and supervisory information. The financial and supervisory information considered may include, but is not limited to, capital and liquidity ratios, the composition of balance sheet assets, CAMELS or other supervisory ratings and assessments, and SOSA rankings (for U.S. branches and agencies of foreign banks). An institution approved for a maximum daylight overdraft capacity level must submit at least once in each twelve-month period a board of directors resolution indicating its board's approval of that level.

If the Reserve Bank approves an institution's request, the Reserve Bank approves a maximum daylight overdraft capacity level. The maximum daylight overdraft capacity is defined as follows: maximum daylight overdraft capacity = net debit cap + collateralized capacity.[39]

The Reserve Banks will review the status of any institution that exceeds its maximum daylight overdraft capacity limit during a two-week reserve-maintenance period and will decide if the maximum daylight overdraft capacity should be maintained or if additional action should be taken (see section II.F.).

Institutions with exempt-from-filing and de minimis net debit caps may *not* obtain additional daylight overdraft capacity by pledging additional collateral without first obtaining a self-assessed net debit cap. Likewise, institutions that have voluntarily adopted zero net debit caps may *not* obtain additional daylight overdraft capacity without first obtaining a self-assessed net debit cap. Institutions that have been assigned a zero net debit cap by their administrative Reserve Bank are *not* eligible to apply for any daylight overdraft capacity.

2. Streamlined Procedure for Certain FBOs

An FBO that is a FHC or has a SOSA rating of 1 and has a self-assessed net debit cap may request from its Reserve Bank a streamlined procedure to obtain a maximum daylight overdraft capacity. These FBOs are not required to provide documentation of the business need or obtain the board of directors' resolution for collateralized capacity in an amount that exceeds its current net debit cap (which is based on up to 35 percent worldwide capital times its cap multiple), as long as the requested total capacity is 100 percent or less of worldwide capital times a self-assessed

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standards that give due regard to the principle of national treatment and equality of competitive opportunity (12 U.S.C. 1843(l)).

[32] 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.

[33] If an FBO meets the criteria for the streamlined procedure for max caps but was granted a max cap before implementation of the streamlined procedure (effective March 26, 2009) or is approved for a max cap under the general procedure because the limit being requested is greater than 100 percent of worldwide capital, the FBO would still qualify for the higher deductible if it also met the collateralization requirement.

[34] Under some circumstances, rules for determining whether collateral is available may differ for PSR and discount window purposes. All collateral must be acceptable to the Reserve Banks.

[35] The administrative Reserve Bank is responsible for the administration of Federal Reserve credit, reserves, and risk-management policies for a given institution or other legal entity.

[36] All collateral must be acceptable to the Reserve Banks. The Reserve Banks may accept securities in transit on the Fedwire book-entry securities system as collateral to support the maximum daylight overdraft capacity level. Securities in transit refer to book-entry securities transferred over the Fedwire Securities Service that have been purchased by an institution but not yet paid for and owned by the institution's customers. Collateral eligibility and margins are the same for PSR policy purposes as for the discount window. See *http://www.frbdiscountwindow.org/* for information.

[37] Institutions may consider applying for a maximum daylight overdraft capacity level for daylight overdrafts resulting from Fedwire funds transfers, Fedwire book-entry securities transfers, National Settlement Service entries, and ACH credit originations. Institutions incurring daylight overdrafts as a result of other payment activity may be eligible for administrative counseling flexibility (59 FR 54915–18, Nov. 2, 1994).

[38] Some potential alternatives available to an institution to address increased intraday credit needs include shifting funding patterns, delaying the origination of funds transfers in a way that does not significantly increase operational risks, or transferring some payments processing business to a correspondent bank.

[39] Collateralized capacity, on any given day, equals the amount of collateral pledged to the Reserve Bank, not to exceed the difference between the institution's maximum daylight overdraft capacity level and its net debit cap.

cap multiple.[40] In order to ensure that intraday liquidity risk is managed appropriately and that the FBO will be able to repay daylight overdrafts, eligible FBOs under the streamlined procedure will be subject to initial and periodic reviews of liquidity plans that are analogous to the liquidity reviews undergone by U.S. institutions.[41] If an eligible FBO requests capacity in excess of 100 percent of worldwide capital times the self-assessed cap multiple, it would be subject to the general procedure.

E. Special Situations [No Change]

F. Monitoring [No change]

G. Transfer-Size Limit on Book-Entry Securities [No Change]

VII. Federal Reserve Policy on Payment System Risk (Effective When Announced)

The ''Federal Reserve Policy on Payment System Risk'' is amended as follows when announced in a subsequent **Federal Register** notice.

Introduction [Revised]

Risks in Payment and Settlement Systems [Revised]

I. Risk Management in Payment and Settlement Systems [No Change]
A. Scope
B. General Policy Expectations
C. Systemically Important Systems
1. Principles for Systemically Important Payment Systems
2. Minimum Standards for Systemically Important Securities Settlement Systems and Central Counterparties
3. Self-Assessments by Systemically Important Systems
II. Federal Reserve Intraday Credit Policies [II and II B Through II G Revised]
A. Daylight Overdraft Definition and Measurement [No Change]
B. Collateral
C. Pricing
D. Net Debit Caps
1. Definition
2. Cap Categories
a. Self-Assessed
b. De Minimis
c. Exempt-From-Filing
d. Zero
3. Capital Measure
a. U.S.-Chartered Institutions
b. U.S. Branches and Agencies of Foreign Banks
E. Maximum Daylight Overdraft Capacity
1. General Procedure
2. Streamlined Procedure for Certain FBOs
F. Special Situations
1. Edge and Agreement Corporations
2. Bankers' Banks
3. Limited-Purpose Trust Companies
4. Government-Sponsored Enterprises and International Organizations
5. Problem Institutions
G. Monitoring
1. Ex Post
2. Real Time
3. Multi-District Institutions
H. Transfer-Size Limit on Book-Entry Securities [No Change]

Introduction

Payment and settlement systems are critical components of the nation's financial system. The smooth functioning of these systems is vital to the financial stability of the U.S. economy. Given the importance of these systems, the Board has developed this policy to address the risks that payment and settlement activity present to the financial system and to the Federal Reserve Banks (Reserve Banks).

In adopting this policy, the Board's objectives are to foster the safety and efficiency of payment and settlement systems. These policy objectives are consistent with (1) The Board's long-standing objectives to promote the integrity, efficiency, and accessibility of the payment system; (2) industry and supervisory methods for risk management; and (3) internationally accepted risk-management principles and minimum standards for systemically important payment and settlement systems.[42]

Part I of this policy sets out the Board's views, and related principles and minimum standards, regarding the management of risks in payment and settlement systems, including those operated by the Reserve Banks. In setting out its views, the Board seeks to encourage payment and settlement systems, and their primary regulators, to take the principles and minimum standards in this policy into consideration in the design, operation, monitoring, and assessing of these systems. The Board also will be guided by this part, in conjunction with relevant laws and other Federal Reserve policies, when exercising its authority over certain systems or their participants, when providing payment and settlement services to systems, or when providing intraday credit to Federal Reserve account holders.

Part II of this policy governs the provision of intraday credit or ''daylight overdrafts'' in accounts at the Reserve Banks and sets out the general methods used by the Reserve Banks to control their intraday credit exposures.[43] Under this part, the Board explicitly recognizes that the Federal Reserve has an important role in providing intraday balances and credit to foster the smooth operation of the payment system. The Reserve Banks provide intraday balances by way of supplying temporary, intraday credit to healthy depository institutions, predominantly through collateralized intraday overdrafts.[44] The Board believes that such a strategy enhances intraday liquidity, while controlling risk to the Reserve Banks. Over time, the Board aims to reduce the reliance of the banking industry on uncollateralized intraday credit by providing incentives to collateralize daylight overdrafts. The Board also aims to limit the burden of the policy on healthy depository institutions that use small amounts of intraday credit.

Through this policy, the Board expects financial system participants, including the Reserve Banks, to reduce and control settlement and systemic risks arising in payment and settlement systems, consistent with the smooth operation of the financial system. This policy is designed to provide intraday balances and credit while controlling the Reserve Bank risk by (1) Making financial system participants and system operators aware of the types of basic risks that arise in the settlement process and the Board's expectations with regard to risk management, (2) setting explicit risk-management expectations for systemically important systems, and (3) establishing the policy conditions governing the provision of

[40] For example, a financial holding company is eligible for uncollateralized capacity of 35 percent of worldwide capital times the cap multiple. The streamlined max cap procedure would provide such an institution with additional *collateralized* capacity of 65 percent of worldwide capital times the cap multiple.

[41] The liquidity reviews will be conducted by the administrative Reserve Bank, in consultation with each FBO's home-country supervisor.

[42] For the Board's long-standing objectives in the payment system, see ''The Federal Reserve in the Payments System,'' September 2001, FRRS 9–1550, available at *http://www.federalreserve.gov/paymentsystems/pricing/frpaysys.htm.*

[43] To assist depository institutions in implementing this part of the Board's payment system risk policy, the Federal Reserve has prepared two documents, the *Overview of the Federal Reserve's Payment System Risk Policy* and the *Guide to the Federal Reserve's Payment System Risk Policy,* which are available on line at *http://www.federalreserve.gov/paymentsystems/PSR/relpol.htm.* The *Overview of the Federal Reserve's Payment System Risk Policy* summarizes the Board's policy on the provision of intraday credit, including net debit caps and daylight overdraft fees. The overview is intended for use by institutions that incur only small amounts of daylight overdrafts. The *Guide to the Federal Reserve's Payment System Risk Policy* explains in detail how these policies apply to different institutions and includes procedures for completing a self-assessment and filing a cap resolution, as well as information on other aspects of the policy.

[44] The term ''depository institution,'' as used in this policy, refers not only to institutions defined as ''depository institutions'' in 12 U.S.C. 461(b)(1)(A), but also to U.S. branches and agencies of foreign banking organizations, Edge and agreement corporations, trust companies, and bankers' banks, unless the context indicates a different reading.

Federal Reserve intraday credit to account holders. The Board's adoption of this policy in no way diminishes the primary responsibilities of financial system participants generally and settlement system operators, participants, and Federal Reserve account holders more specifically, to address the risks that may arise through their operation of, or participation in, payment and settlement systems.

Risks in Payment and Settlement Systems

The basic risks in payment and settlement systems are credit risk, liquidity risk, operational risk, and legal risk. In the context of this policy, these risks are defined as follows.[45]

Credit Risk. The risk that a counterparty will not settle an obligation for full value either when due or anytime thereafter.

Liquidity Risk. The risk that a counterparty will not settle an obligation for full value when due.

Operational Risk. The risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events. This type of risk includes various physical and information security risks.

Legal Risk. The risk of loss because of the unexpected application of a law or regulation or because a contract cannot be enforced.

These risks arise between financial institutions as they settle payments and other financial transactions and must be managed by institutions, both individually and collectively.[46] [47] Multilateral payment and settlement systems, in particular, may increase, shift, concentrate, or otherwise transform risks in unanticipated ways. These systems also may pose systemic risk to the financial system where the inability of a system participant to meet its obligations when due may cause other participants to be unable to meet their obligations when due. The failure of one or more participants to settle their payments or other financial transactions, in turn, could create credit or liquidity problems for other participants, the system operator, or depository institutions. Systemic risk might lead ultimately to a disruption in the financial system more broadly or undermine public confidence in the nation's financial infrastructure.

These risks stem, in part, from the multilateral and time-sensitive credit and liquidity interdependencies among financial institutions. These interdependencies often create complex transaction flows that, in combination with a system's design, can lead to significant demands for intraday credit, either on a regular or extraordinary basis. The Board explicitly recognizes that the Federal Reserve has an important role in providing intraday balances and credit to foster the smooth operation of the payment system. To the extent that financial institutions or the Reserve Banks are the direct or indirect source of intraday credit, they may face a direct risk of loss if daylight overdrafts are not extinguished as planned. In addition, measures taken by Reserve Banks to limit their intraday credit exposures may shift some or all of the associated risks to private-sector systems.

The smooth functioning of payment and settlement systems is also critical to certain public policy objectives in the areas of monetary policy and banking supervision. The effective implementation of monetary policy, for example, depends on both the orderly settlement of open market operations and the efficient distribution of reserve balances throughout the banking system via the money market and payment system. Likewise, supervisory objectives regarding the safety and soundness of depository institutions must take into account the risks payment and settlement systems pose to depository institutions that participate directly or indirectly in, or provide settlement, custody, or credit services to, such systems.

I. Risk Management in Payment and Settlement Systems [No Change]

II. Federal Reserve Intraday Credit Policies [II and II B Through II G Revised]

This part outlines the methods used to provide intraday credit to ensure the smooth functioning of payment and settlement systems, while controlling credit risk to the Reserve Banks associated with such intraday credit. These methods include voluntary collateralization of intraday credit, a limit on total daylight overdrafts in institutions' Federal Reserve accounts, and a fee for uncollateralized daylight overdrafts. This part also provides a fee waiver to limit the impact of collateralization on depository institutions that use relatively small amounts of intraday credit.

To assist institutions in implementing this part of the policy, the Federal Reserve has prepared two documents: the *Overview of the Federal Reserve's Payment System Risk Policy on Intraday Credit* (Overview) and the *Guide to the Federal Reserve's Payment System Risk Policy on Intraday Credit* (Guide).[48] The Overview summarizes the Board's policy on the provision of intraday credit, including net debit caps, daylight overdraft fees, and the fee waiver. This document is intended for use by institutions that incur only small amounts of daylight overdrafts. The Guide explains in detail how these policies apply to different institutions and includes procedures for completing a self-assessment and filing a cap resolution, as well as information on other aspects of the policy.

A. Daylight Overdraft Definition and Measurement [No Change]

B. Collateral

To help meet institutions' demand for intraday balances while mitigating Reserve Bank credit risk, the Board sets forth this policy whereby the Reserve Banks supply intraday balances and credit predominantly through explicitly collateralized daylight overdrafts to healthy depository institutions.[49] This policy offers pricing incentives to encourage greater collateralization (see section II.C.). To avoid disrupting the operation of the payment system and increasing the cost burden on a large

[45] These definitions of credit risk, liquidity risk, and legal risk are based upon those presented in the Core Principles for Systemically Important Payment Systems (Core Principles) and the Recommendations for Securities Settlement Systems (Recommendations for SSS). The definition of operational risk is based on the Basel Committee on Banking Supervision's ''Sound Practices for the Management and Supervision of Operational Risk,'' available at *http://www.bis.org/publ/bcbs96.htm*. Each of these definitions is largely consistent with those included in the Recommendations for Central Counterparties (Recommendations for CCP).

[46] The term ''financial institution,'' as used in this policy, includes a broad array of types of organizations that engage in financial activity, including depository institutions and securities dealers.

[47] Several existing regulatory and bank supervision guidelines and policies also are directed at institutions' management of the risks posed by interbank payment and settlement activity. For example, Federal Reserve Regulation F (12 CFR 206) directs insured depository institutions to establish policies and procedures to avoid excessive exposures to any other depository institutions, including exposures that may be generated through the clearing and settlement of payments.

[48] Available at *http://www.federalreserve.gov/paymentsystems/PSR/relpol.htm*.

[49] Collateral is also used to manage risk posed by daylight overdrafts of problem institutions (institutions in a weak or deteriorating financial condition), entities not eligible for Federal Reserve intraday credit (see section II.F.), and institutions that have obtained maximum daylight overdraft capacity (see section II.E.).

number of institutions using small amounts of daylight overdrafts, the use of collateral is generally voluntary.[50]

Collateral eligibility and margins remain the same for PSR policy purposes as for the discount window.[51] Unencumbered collateral can be used to collateralize daylight overdrafts.[52] In-transit securities are eligible collateral to pledge for PSR purposes at Reserve Banks' discretion.[53] All collateral must be acceptable to the Reserve Banks.

C. Pricing

Under the voluntary collateralization regime, the fee for collateralized overdrafts is zero, while the fee for uncollateralized overdrafts is 50 basis points. The two-tiered fee for collateralized and uncollateralized overdrafts is intended to provide a strong incentive for a depository institution to pledge collateral to its Reserve Bank to reduce or eliminate the institution's *uncollateralized* daylight overdrafts and associated charges for its use of intraday credit.

Reserve Banks charge institutions for daylight overdrafts incurred in their Federal Reserve accounts. For each two-week reserve-maintenance period, the Reserve Banks calculate and assess daylight overdraft fees, which are equal to the sum of any daily uncollateralized daylight overdraft charges during the period.

Daylight overdraft fees for uncollateralized overdrafts (or the uncollateralized portion of a partially collateralized overdraft) are calculated using an annual rate of 50 basis points, quoted on the basis of a 24-hour day and a 360-day year. To obtain the effective annual rate for the standard Fedwire operating day, the 50-basis-point annual rate is multiplied by the fraction of a 24-hour day during which Fedwire is scheduled to operate. For example, under a 21.5-hour scheduled Fedwire operating day, the effective annual rate used to calculate daylight overdraft fees equals 44.79 basis points (50 basis points multiplied by 21.5/24).[54] The effective daily rate is calculated by dividing the effective annual rate by 360.[55] An institution's daily daylight overdraft charge is equal to the effective daily rate multiplied by the institution's average daily uncollateralized daylight overdraft.

An institution's average daily uncollateralized daylight overdraft is calculated by dividing the sum of its negative uncollateralized Federal Reserve account balances at the end of each minute of the scheduled Fedwire operating day by the total number of minutes in the scheduled Fedwire operating day. A negative uncollateralized Federal Reserve account balance is calculated by subtracting the unencumbered, net lendable value of collateral pledged from the total negative Federal Reserve account balance at the end of each minute. Each positive end-of-minute balance in an institution's Federal Reserve account is set to equal zero. Fully collateralized end-of-minute negative balances are similarly set to zero.

The daily daylight overdraft charge is reduced by a fee waiver of $150, which is primarily intended to minimize the burden of the PSR policy on institutions that use small amounts of intraday credit. The waiver is subtracted from gross fees in a two-week reserve-maintenance period.[56]

Certain institutions are subject to a penalty fee and modified daylight overdraft fee calculation as described in section II.F. The fee waiver is not available to these institutions.[57]

D. Net Debit Caps

1. Definition

In accord with sound risk-management practices, to limit the amount of intraday credit that a Reserve Bank extends to an individual institution and the associated risk, each institution incurring daylight overdrafts in its Federal Reserve account must adopt a net debit cap, that is, a ceiling on the total daylight overdraft position that it can incur during any given day. An institution must be financially healthy and have regular access to the discount window in order to adopt a net debit cap greater than zero. Granting a net debit cap, or any extension of intraday credit, to an institution is at the discretion of the Reserve Bank.

An institution's cap category and capital measure determine the size of its net debit cap. More specifically, the net debit cap is calculated as an institution's cap multiple times its capital measure: Net debit cap = cap multiple × capital measure.

Cap categories (see section II.D.2.) and their associated cap levels, set as multiples of capital measure, are listed below:

NET DEBIT CAP MULTIPLES

Cap category	Cap multiple
High	2.25
Above average	1.875
Average	1.125
De minimis	0.4
Exempt-from-filing[58]	$10 million or 0.20
Zero	0

The cap is applied to the total of collateralized and uncollateralized daylight overdrafts.[59] For the treatment of overdrafts that exceed the cap, see section II.G.

The Board's policy on net debit caps is based on a specific set of guidelines and some degree of examiner oversight. Under the Board's policy, a Reserve Bank may further limit or prohibit an institution's use of Federal Reserve intraday credit if (1) The institution's supervisor determines that the institution is unsafe or unsound; (2) the institution does not qualify for a positive net debit cap (see section II.D.2.); or (3) the Reserve Bank determines that the institution poses excessive risk.

While capital measures differ, the net debit cap provisions of this policy apply similarly to foreign banking organizations (FBOs) as to U.S. institutions. Consistent with practices for U.S.-chartered depository institutions, the Reserve Banks will advise home-country supervisors of the daylight overdraft capacity of U.S. branches and agencies of FBOs under their jurisdiction, as well as of other pertinent information related to the

[50] The Reserve Banks may require collateral in certain circumstances, such as when institutions breach their net debit caps.

[51] See *http://www.frbdiscountwindow.org/* for information on the discount window and PSR collateral acceptance policy and collateral margins.

[52] Under some circumstances, rules for determining whether collateral is available may differ for PSR and discount window purposes.

[53] In-transit securities are book-entry securities transferred over the Fedwire Securities Service that have been purchased by a depository institution but not yet paid for or owned by the institution's customers.

[54] A change in the length of the scheduled Fedwire operating day should not significantly change the amount of fees charged because the effective daily rate is applied to average daylight overdrafts, whose calculation would also reflect the change in the operating day.

[55] Under the current 21.5-hour Fedwire operating day, the effective daily daylight-overdraft rate is truncated to 0.0000124.

[56] The waiver shall not result in refunds or credits to an institution and cannot be carried to another reserve maintenance period.

[57] The fee waiver is not available to Edge and agreement corporations, bankers' banks that have not waived their exemption from reserve requirements, limited-purpose trust companies, and government-sponsored enterprises and international organizations. These types of institutions do not have regular access to the discount window and, therefore, are expected not to incur daylight overdrafts in their Federal Reserve accounts.

[58] The net debit cap for the exempt-from-filing category is equal to the lesser of $10 million or 0.20 multiplied by the capital measure.

[59] Collateral will not increase the net debit cap limit. Institutions seeking capacity that exceeds the net debit cap need to apply for the maximum daylight overdraft capacity (see section II. E).

Office of Thrift Supervision **January 12, 2009**

Department of the Treasury

Transmittal

TR-428

Federal Register, Vol. 73, No. 248, pp. 79109-79127 **Number TR-428**

On December 24, 2008 the Board of Governors of the Federal Reserve System adopted revisions to part II of its Policy on Payment System Risk (PSR) that are designed to improve intraday liquidity management and payment flows for the banking system.

their Federal Reserve accounts that exceed the lesser of $10 million or 20 percent of their capital measure are excused from performing self-assessments and filing board of directors resolutions with their Reserve Banks. This dual test of dollar amount and percent of capital measure is designed to limit the filing exemption to institutions that create only low-dollar risks to the Reserve Banks and that incur small overdrafts relative to their capital measure.

The Reserve Banks will review the status of an exempt institution that incurs overdrafts in its Federal Reserve account in excess of $10 million or 20 percent of its capital measure on more than two days in any two consecutive two-week reserve-maintenance periods. The Reserve Bank will decide whether the exemption should be maintained, the institution should be required to file for a cap, or counseling should be performed (see section II.G.). The Reserve Bank will assign the exempt-from-filing net debit cap.

d. Zero. Some financially healthy institutions that could obtain positive net debit caps choose to have zero caps. Often these institutions have very conservative internal policies regarding the use of Federal Reserve intraday credit. If an institution that has adopted a zero cap incurs a daylight overdraft, the Reserve Bank counsels the institution and may monitor the institution's activity in real time and reject or delay certain transactions that would cause an overdraft. If the institution qualifies for a positive cap, the Reserve Bank may suggest that the institution adopt an exempt-from-filing cap or file for a higher cap if the institution believes that it will continue to incur daylight overdrafts.

In addition, a Reserve Bank may assign an institution a zero net debit cap. Institutions that may pose special risks to the Reserve Banks, such as those without regular access to the discount window, those incurring daylight overdrafts in violation of this policy, or those in weak financial condition, are generally assigned a zero cap (see section II.F.). Recently chartered institutions may also be assigned a zero net debit cap.

3. Capital Measure

As described above, an institution's cap category and capital measure determine the size of its net debit cap. The capital measure used in calculating an institution's net debit cap depends upon its chartering authority and home-country supervisor.

a. U.S.-chartered institutions. For institutions chartered in the United States, net debit caps are multiples of ''qualifying'' or similar capital measures that consist of those capital instruments that can be used to satisfy risk-based capital standards, as set forth in the capital adequacy guidelines of the federal financial regulatory agencies. All of the federal financial regulatory agencies collect, as part of their required reports, data on the amount of capital that can be used for risk-based purposes—''risk-based'' capital for commercial banks, savings banks, and savings associations and total regulatory reserves for credit unions. Other U.S.-chartered entities that incur daylight overdrafts in their Federal Reserve accounts should provide similar data to their Reserve Banks.

b. 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 the FBO's U.S. capital equivalency measure.[65] U.S. capital equivalency is equal to the following:

- 35 percent of capital for FBOs that are financial holding companies (FHCs).[66]
- 25 percent of capital for FBOs that are not FHCs and have a strength of support assessment ranking (SOSA) of 1.[67]
- 10 percent of capital for FBOs that are not FHCs and are ranked a SOSA 2.
- 5 percent of ''net due to related depository institutions'' for FBOs that are not FHCs and are ranked a SOSA 3.

An FBO that is an FHC or has a SOSA rating of 1 may be eligible for a streamlined procedure (see section II.E.) for obtaining additional collateralized intraday credit under the maximum daylight overdraft capacity provision.

In the event a Reserve Bank grants a net debit cap or extends intraday credit to a financially healthy SOSA 3-ranked FBO, the Reserve Bank may require such credit to be fully collateralized, given the heightened supervisory concerns with SOSA 3-ranked FBOs.

E. Maximum Daylight Overdraft Capacity

The Board recognizes that while net debit caps provide sufficient liquidity to most institutions, some institutions may still experience liquidity pressures. The Board believes it is important to provide an environment in which payment systems may function effectively and efficiently and to remove barriers, as appropriate, to foster risk-reducing payment system initiatives. Consequently, certain 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, subject to Reserve Bank approval.[68] [69] This policy is intended to provide extra liquidity through the pledge of collateral to the few institutions that might otherwise be constrained from participating in risk-reducing payment system initiatives.[70] The Board believes that providing extra liquidity to these few institutions should help reduce liquidity-related market disruptions.

1. General Procedure

An institution with a self-assessed net debit cap that wishes to expand its daylight overdraft capacity by pledging collateral should consult with its administrative Reserve Bank. The Reserve Bank will work with an institution that requests additional

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

[66] The Gramm-Leach-Bliley Act defines a financial holding company as a bank holding company that meets certain eligibility requirements. In order for a bank holding company to become a financial holding company and be eligible to engage in the new activities authorized under the Gramm-Leach-Bliley Act, the Act requires that all depository institutions controlled by the bank holding company be well capitalized and well managed (12 U.S.C. 1841(p)). With regard to a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, the Act requires the Board to apply comparable capital and management standards that give due regard to the principle of national treatment and equality of competitive opportunity (12 U.S.C. 1843(l)).

[67] 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.

[68] The administrative Reserve Bank is responsible for the administration of Federal Reserve credit, reserves, and risk-management policies for a given institution or other legal entity.

[69] All collateral must be acceptable to the Reserve Banks. The Reserve Banks may accept securities in transit on the Fedwire Securities Service as collateral to support the maximum daylight overdraft capacity level. Collateral eligibility and margins are the same for PSR policy purposes as for the discount window. See *http://www.frbdiscountwindow.org/* for information.

[70] Institutions may consider applying for a maximum daylight overdraft capacity level for daylight overdrafts resulting from Fedwire funds transfers, Fedwire book-entry securities transfers, National Settlement Service entries, and ACH credit originations. Institutions incurring daylight overdrafts as a result of other payment activity may be eligible for administrative counseling flexibility (59 FR 54915–18, Nov. 2, 1994).

daylight overdraft capacity to determine the appropriate maximum daylight overdraft capacity level. In considering the institution's request, the Reserve Bank will evaluate the institution's rationale for requesting additional daylight overdraft capacity as well as its financial and supervisory information. The financial and supervisory information considered may include, but is not limited to, capital and liquidity ratios, the composition of balance sheet assets, CAMELS or other supervisory ratings and assessments, and SOSA rankings (for U.S. branches and agencies of foreign banks). An institution approved for a maximum daylight overdraft capacity level must submit at least once in each twelve-month period a board of directors resolution indicating its board's approval of that level.

If the Reserve Bank approves an institution's request, the Reserve Bank approves a maximum daylight overdraft capacity level. The maximum daylight overdraft capacity is defined as follows: Maximum daylight overdraft capacity = net debit cap + collateralized capacity.[71]

The Reserve Banks will review the status of any institution that exceeds its maximum daylight overdraft capacity limit during a two-week reserve-maintenance period and will decide if the maximum daylight overdraft capacity should be maintained or if additional action should be taken (see section II.G.).

Institutions with exempt-from-filing and de minimis net debit caps may *not* obtain additional daylight overdraft capacity by pledging additional collateral without first obtaining a self-assessed net debit cap. Likewise, institutions that have voluntarily adopted zero net debit caps may *not* obtain additional daylight overdraft capacity without first obtaining a self-assessed net debit cap. Institutions that have been assigned a zero net debit cap by their administrative Reserve Bank are *not* eligible to apply for any daylight overdraft capacity.

2. Streamlined Procedure for Certain FBOs

An FBO that is an FHC or has an SOSA rating of 1 and has a self-assessed net debit cap may request from its Reserve Bank a streamlined procedure to obtain a maximum daylight overdraft capacity. These FBOs are not required to provide documentation of the business need or obtain the board of directors' resolution for collateralized capacity in an amount that exceeds its current net debit cap (which is based on up to 35 percent worldwide capital times its cap multiple), as long as the requested total capacity is 100 percent or less of worldwide capital times a self-assessed cap multiple.[72] In order to ensure that intraday liquidity risk is managed appropriately and that the FBO will be able to repay daylight overdrafts, eligible FBOs under the streamlined procedure will be subject to initial and periodic reviews of liquidity plans that are analogous to the liquidity reviews undergone by U.S. institutions.[73] If an eligible FBO requests capacity in excess of 100 percent of worldwide capital times the self-assessed cap multiple, it would be subject to the general procedure.

F. Special Situations

Under the Board's policy, certain institutions warrant special treatment primarily because of their charter types. As mentioned previously, an institution must have regular access to the discount window and be in sound financial condition in order to adopt a net debit cap greater than zero. Institutions that do not have regular access to the discount window include Edge and agreement corporations, bankers' banks that are not subject to reserve requirements, limited-purpose trust companies, government-sponsored enterprises (GSEs), and certain international organizations. Institutions that have been assigned a zero cap by their Reserve Banks are also subject to special considerations under this policy based on the risks they pose. In developing its policy for these institutions, the Board has sought to balance the goal of reducing and managing risk in the payment system, including risk to the Federal Reserve, with that of minimizing the adverse effects on the payment operations of these institutions.

Regular access to the Federal Reserve discount window generally is available to institutions that are subject to reserve requirements. If an institution that is not subject to reserve requirements and thus does not have regular discount-window access were to incur a daylight overdraft, the Federal Reserve might end up extending overnight credit to that institution if the daylight overdraft were not covered by the end of the business day. Such a credit extension would be contrary to the quid pro quo of reserves for regular discount-window access as reflected in the Federal Reserve Act and in Board regulations. Thus, institutions that do not have regular access to the discount window should not incur daylight overdrafts in their Federal Reserve accounts.

Certain institutions are subject to a daylight-overdraft penalty fee levied against the average daily daylight overdraft incurred by the institution. These include Edge and agreement corporations, bankers' banks that are not subject to reserve requirements, and limited-purpose trust companies. The annual rate used to determine the daylight-overdraft penalty fee is equal to the annual rate applicable to the daylight overdrafts of other institutions (50 basis points) plus 100 basis points multiplied by the fraction of a 24-hour day during which Fedwire is scheduled to operate (currently $21.5/24$). The daily daylight-overdraft penalty rate is calculated by dividing the annual penalty rate by 360.[74] The daylight-overdraft penalty rate applies to the institution's daily average daylight overdraft in its Federal Reserve account. The daylight-overdraft penalty rate is charged in lieu of, not in addition to, the rate used to calculate daylight overdraft fees for institutions described in this section.

Institutions that are subject to the daylight-overdraft penalty fee are not eligible for the $150 fee waiver and are subject to a minimum fee of $25 on any daylight overdrafts incurred in their Federal Reserve accounts. While such institutions may be required to post collateral, they are not eligible for the zero fee associated with collateralized daylight overdrafts.

1. Edge and Agreement Corporations[75]

Edge and agreement corporations should refrain from incurring daylight overdrafts in their Federal Reserve accounts. In the event that any daylight overdrafts occur, the Edge or agreement corporation must post collateral to cover the overdrafts. In addition to posting collateral, the Edge or agreement corporation would be subject to the daylight-overdraft penalty rate levied against the average daily daylight

[71] Collateralized capacity, on any given day, equals the amount of collateral pledged to the Reserve Bank, not to exceed the difference between the institution's maximum daylight overdraft capacity level and its net debit cap.

[72] For example, a financial holding company is eligible for uncollateralized capacity of 35 percent of worldwide capital times the cap multiple. The streamlined max cap procedure would provide such an institution with additional *collateralized* capacity of 65 percent of worldwide capital times the cap multiple.

[73] The liquidity reviews will be conducted by the administrative Reserve Bank, in consultation with each FBO's home country supervisor.

[74] Under the current 21.5-hour Fedwire operating day, the effective daily daylight-overdraft penalty rate is truncated to 0.0000373.

[75] These institutions are organized under section 25A of the Federal Reserve Act (12 U.S.C. 611–631) or have an agreement or undertaking with the Board under section 25 of the Federal Reserve Act (12 U.S.C. 601–604(a)).

overdrafts incurred by the institution, as described above.

This policy reflects the Board's concerns that these institutions lack regular access to the discount window and that the parent company may be unable or unwilling to cover its subsidiary's overdraft on a timely basis. The Board notes that the parent of an Edge or agreement corporation could fund its subsidiary during the day over Fedwire or the parent could substitute itself for its subsidiary on private systems. Such an approach by the parent could both reduce systemic risk exposure and permit the Edge or agreement corporation to continue to service its customers. Edge and agreement corporation subsidiaries of FBOs are treated in the same manner as their domestically owned counterparts.

2. Bankers' Banks [76]

Bankers' banks are exempt from reserve requirements and do not have regular access to the discount window. Bankers' banks should refrain from incurring daylight overdrafts and must post collateral to cover any overdrafts they do incur. In addition to posting collateral, a bankers' bank would be subject to the daylight-overdraft penalty fee levied against the average daily daylight overdrafts incurred by the institution, as described above.

The Board's policy for bankers' banks reflects the Reserve Banks' need to protect themselves from potential losses resulting from daylight overdrafts incurred by bankers' banks. The policy also considers the fact that some bankers' banks do not incur the costs of maintaining reserves as some other institutions and do not have regular access to the discount window.

Bankers' banks may voluntarily waive their exemption from reserve requirements, thus gaining access to the discount window. Such bankers' banks are free to establish net debit caps and would be subject to the same policy as other institutions that are eligible to incur daylight overdrafts. The policy set out in this section applies only to those bankers' banks that have not waived their exemption from reserve requirements.

3. Limited-Purpose Trust Companies [77]

The Federal Reserve Act permits the Board to grant Federal Reserve membership to limited-purpose trust companies subject to conditions the Board may prescribe pursuant to the Act. As a general matter, member limited-purpose trust companies do not accept reservable deposits and do not have regular discount-window access. Limited-purpose trust companies should refrain from incurring daylight overdrafts and must post collateral to cover any overdrafts they do incur. In addition to posting collateral, limited-purpose trust companies would be subject to the same daylight-overdraft penalty rate as other institutions that do not have regular access to the discount window.

4. Government-Sponsored Enterprises and International Organizations [78]

The Reserve Banks act as fiscal agents for certain GSEs and international organizations in accordance with federal statutes. These institutions, however, are not subject to reserve requirements and do not have regular access to the discount window. GSEs and international organizations should refrain from incurring daylight overdrafts and must post collateral to cover any daylight overdrafts they do incur. In addition to posting collateral, these institutions would be subject to the same daylight-overdraft penalty rate as other institutions that do not have regular access to the discount window.

5. Problem Institutions

For institutions that are in weak financial condition, the Reserve Banks will impose a zero cap. The Reserve Bank will also monitor the institution's activity in real time and reject or delay certain transactions that would create an overdraft. Problem institutions should refrain from incurring daylight overdrafts and must post collateral to cover any daylight overdrafts they do incur.

G. Monitoring

1. Ex Post

Under the Federal Reserve's ex post monitoring procedures, an institution with a daylight overdraft in excess of its maximum daylight overdraft capacity or net debit cap may be contacted by its Reserve Bank. Overdrafts above the cap for institutions with de minimis, self-assessed, and max caps may be treated differently, depending on whether the overdraft is collateralized.[79] If the overdraft is fully collateralized, the Reserve Bank may choose not to contact the institution for up to two incidents per two consecutive two-week reserve-maintenance periods (the total of four weeks).

Each Reserve Bank retains the right to protect its risk exposure from individual institutions by unilaterally reducing net debit caps, imposing (additional) collateralization or clearing-balance requirements, rejecting or delaying certain transactions as described below, or, in extreme cases, taking the institution offline or prohibiting it from using Fedwire.

2. Real Time

A Reserve Bank will apply real-time monitoring to an individual institution's position when the Reserve Bank believes that it faces excessive risk exposure, for example, from problem banks or institutions with chronic overdrafts in excess of what the Reserve Bank determines is prudent. In such a case, the Reserve Bank will control its risk exposure by monitoring the institution's position in real time, rejecting or delaying certain transactions that would exceed the institution's maximum daylight overdraft capacity or net debit cap, and taking other prudential actions, including requiring (additional) collateral.[80]

3. Multi-District Institutions

Institutions, such as those maintaining merger-transition accounts and U.S. branches and agencies of a

[76] For the purposes of this policy, a bankers' bank is a depository institution that is not required to maintain reserves under the Board's Regulation D (12 CFR 204) because it is organized solely to do business with other financial institutions, is owned primarily by the financial institutions with which it does business, and does not do business with the general public. Such bankers' banks also generally are not eligible for Federal Reserve Bank credit under the Board's Regulation A (12 CFR § 201.2(c)(2)).

[77] For the purposes of this policy, a limited-purpose trust company is a trust company that is a member of the Federal Reserve System but that does not meet the definition of ''depository institution'' in section 19(b)(1)(A) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)).

[78] The GSEs include Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), entities of the Federal Home Loan Bank System (FHLBS), the Farm Credit System, the Federal Agricultural Mortgage Corporation (Farmer Mac), the Student Loan Marketing Association (Sallie Mae), the Financing Corporation, and the Resolution Funding Corporation. The international organizations include the World Bank, the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank. The Student Loan Marketing Association Reorganization Act of 1996 requires Sallie Mae to be completely privatized by 2008; however, Sallie Mae completed privatization at the end of 2004. The Reserve Banks no longer act as fiscal agents for new issues of Sallie Mae securities, and Sallie Mae is not considered a GSE.

[79] For monitoring exempt institutions, overdrafts above the exempt cap limit, regardless of whether such overdrafts are collateralized or uncollateralized, should occur no more than twice in two consecutive two-week reserve-maintenance periods (the total of four weeks).

[80] Institutions that are monitored in real time must fund the total amount of their ACH credit originations through the Reserve Banks in order for the transactions to be processed by the Federal Reserve, even if those transactions are processed one or two days before settlement.

foreign bank, that access Fedwire through accounts in more than one Federal Reserve District are expected to manage their accounts so that the total daylight overdraft position across all accounts does not exceed their net debit caps. One Reserve Bank will act as the administrative Reserve Bank and will have overall risk-management responsibilities for institutions maintaining accounts in more than one Federal Reserve District. For domestic institutions that have branches in multiple Federal Reserve Districts, the administrative Reserve Bank generally will be the Reserve Bank where the head office of the bank is located.

In the case of families of U.S. branches and agencies of the same FBO, the administrative Reserve Bank generally is the Reserve Bank that exercises the Federal Reserve's oversight responsibilities under the International Banking Act.[81] The administrative Reserve Bank, in consultation with the management of the foreign bank's U.S. operations and with Reserve Banks in whose territory other U.S. agencies or branches of the same foreign bank are located, may determine that these agencies and branches will not be permitted to incur overdrafts in Federal Reserve accounts. Alternatively, the administrative Reserve Bank, after similar consultation, may allocate all or part of the foreign family's net debit cap to the Federal Reserve accounts of agencies or branches that are located outside of the administrative Reserve Bank's District; in this case, the Reserve Bank in whose Districts those agencies or branches are located will be responsible for administering all or part of this policy.[82]

H. Transfer-Size Limit on Book-Entry Securities [No Change]

By order of the Board of Governors of the Federal Reserve System, dated: December 18, 2008.

Jennifer J. Johnson,

Secretary of the Board.

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[81] 12 U.S.C. 3101–3108.

[82] As in the case of Edge and agreement corporations and their branches, with the approval of the designated administrative Reserve Bank, a second Reserve Bank may assume the responsibility of managing and monitoring the net debit cap of particular foreign branch and agency families. This would often be the case when the payments activity and national administrative office of the foreign branch and agency family is located in one District, while the oversight responsibility under the International Banking Act is in another District. If a second Reserve Bank assumes management responsibility, monitoring data will be forwarded to the designated administrator for use in the supervisory process.

FEDERAL RESERVE SYSTEM

[Docket No. OP–1346]

Policy on Payment System Risk; Daylight Overdraft Posting Rules

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice.

SUMMARY: The Board has decided not to pursue at this time its proposal to change the posting time to 8:30 a.m. for commercial and government automated clearinghouse (ACH) debit transfers that are processed by the Federal Reserve Banks' (Reserve Banks) FedACH service. (All times are eastern time.) The proposal would have aligned the posting time for ACH debit transfers with the posting time for ACH credit transfers, which are currently posted at 8:30 a.m. on the settlement date. Commercial and government ACH debit transfers processed by the Reserve Banks' FedACH service will continue to be posted at 11 a.m., while commercial and government ACH credit transfers will continue to be posted at 8:30 a.m. The credit and debit accounting entries associated with ACH credit transfers and ACH debit transfers are posted simultaneously at the appointed posting time. In line with this decision, the Board will not move the posting time for Treasury Tax and Loan (TT&L) investments associated with Electronic Federal Tax Payment System (EFTPS) ACH debit transfers. These transactions will continue to be posted at 11 a.m. The Board will reconsider the proposal in the future.

FOR FURTHER INFORMATION CONTACT: Jeffrey Marquardt, Deputy Director (202–452–2360) or Susan Foley, Assistant Director (202–452–3596), Division of Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System; for users of Telecommunications Device for the Deaf (''TDD'') only, contact (202) 263–4869.

SUPPLEMENTARY INFORMATION:

I. Background

On March 7, 2008, the Board requested comment on changing the posting time for commercial and government ACH debit transfers that are processed by the Reserve Banks' FedACH service to 8:30 a.m. (from 11 a.m.) on the settlement date to coincide with the posting time for commercial and government ACH credit transfers.[1] The Board outlined four potential benefits from shifting earlier the posting time for ACH debit transfers. First, for institutions that originate large values of ACH debit transfers, the liquidity needed to fund the settlement of ACH credit originations at 8:30 a.m. could be largely or entirely offset by the receipt of funds from the settlement of ACH debit transfers also at 8:30 a.m.[2] Second, the change could increase liquidity for institutions that originate ACH debit transfers over the Electronic Payments Network (EPN), the other ACH operator, but have transfers delivered to receiving depository institutions over the FedACH network (inter-operator transactions).[3] All ACH debit transfers would settle at 8:30 a.m. (with all ACH credit transfers) regardless of the operator through which the transfer is originated. Third, moving the posting time for ACH debit transfers to 8:30 a.m. would align the Reserve Banks' FedACH settlement times with those of EPN. The Reserve Banks' Retail Payments Office, which has primary responsibility for FedACH, believed that this change would remove competitive disparities between the two ACH operators and their participants that arise from different settlement times for ACH debit transfers. Fourth, the change would conform more closely to the Board's guidelines for measuring daylight overdrafts, specifically the principle that encourages posting times to be as close as possible to the delivery of payments to the receiving institution. Because FedACH payments are processed in the early morning hours, usually between 2 a.m. and 4 a.m., and payment advices are sent to depository institutions generally by 6 a.m., posting ACH debit transfers at 8:30 a.m. would shift the settlement time closer to the payment delivery time.

In its proposal, the Board also recognized that the simultaneous posting of ACH debit and credit transfers would reduce, on average, the available balances between 8:30 a.m. and 10:59 a.m. for the majority of FedACH participants (approximately 95 percent). The majority of FedACH participants currently gain balances from the posting of ACH credit transfers at 8:30 a.m. If ACH debit transfers are also posted at 8:30 a.m., the gain in balances for these institutions will either diminish or be eliminated. Many institutions would need to fund their Federal Reserve accounts through daylight overdrafts or other funding sources. The vast majority of

[1] See 73 FR 12443, March 7, 2008.

[2] Liquidity refers to balances and intraday credit available in Federal Reserve accounts to make payments.

[3] Inter-operator transactions are posted to the Federal Reserve accounts of the originating and receiving institutions according to the Board's posting rules for the underlying ACH transfers.