FEDERAL RESERVE SYSTEM

[Docket No. R–0866]

Federal Reserve Bank Services

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice.

SUMMARY: The Board has approved a firm closing time of 3:15 p.m. Eastern Time (ET) for transfer originations and 3:30 p.m. ET for reversals for the Fedwire book-entry securities transfer system. Periodic extensions of this closing time may be granted only in response to significant operating problems at a major bank or dealer or to prevent market disruption. The Board also has authorized the Reserve Banks to continue to close the Fedwire securities transfer service earlier than the scheduled closing time on certain days when the U.S. government and mortgage securities markets observe partial-day or full-day holiday operations. The Board believes that the new schedule will benefit market participants by reducing uncertainty about the final closing time of the system, thus enabling participants to manage resources more effectively and control costs with greater certainty than today.

EFFECTIVE DATE: January 2, 1996.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Associate Director (202/452–2789), Gayle Brett, Manager (202/452–2934), or Lisa Hoskins, Project Leader (202/452–3437), Division of Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System. For the hearing impaired only: Telecommunications Device for the Deaf, Dorothea Thompson (202/452–3544).

SUPPLEMENTARY INFORMATION:

I. Background

In January 1995, the Board issued for comment a proposal to establish a firm closing time of 3:00 p.m. ET[1] for Fedwire book-entry securities transfer originations and 3:30 p.m. ET for reversals, beginning in January 1996 (60 FR 123, January 3, 1995).[2] The Board also requested comments on the potential benefits, costs, and market implications of opening the on-line Fedwire book-entry securities transfer service earlier in the day and on new service capabilities that would give depository institutions the option of participating in the Fedwire securities transfer system during earlier hours. In addition, the Board requested comment on new service capabilities that would allow depository institutions to control their use of intraday credit during expanded and/or core business hours.

The Board's action at this time is limited to establishing a firm closing time for the Fedwire securities transfer service. The Board is continuing to evaluate comments received on the potential benefits, costs, and market implications of an earlier opening of the on-line securities transfer service and potential new service capabilities.

Thirty-six commenters responded to the Board's proposal. About 60 percent of the commenters were commercial banks or bank holding companies, including banks that provide government securities clearing and settlement services to dealers and other firms. The following table identifies the number of commenters by type of organization:

Commercial Banking Organizations[3]	21
Credit Unions	2
Broker/Dealers[4]	2
Clearing House Associations	2
Clearing Organization	1
Trade Associations	3
Federal Home Loan Banks	2
Federal Reserve Banks	2
State Government	1
Total public comments	36

Thirty-one commenters addressed the issue of a firm closing time for the book-entry securities service. The major topics discussed by these commenters include: (1) benefits of a firm closing time; (2) selection of an appropriate closing time; and (3) extensions of the scheduled closing time. The following discussion provides a summary of the comments received and the Board's analysis of the issues raised.

II. Benefits of Firm Closing Time

Thirty commenters supported the establishment of a firm closing time for the Fedwire book-entry securities transfer service. Almost half of these commenters stated specifically that a firm closing time would reduce uncertainty about the final close and allow them to better plan staffing and other resource needs, thus improving their ability to control costs. In addition, Aubrey Lanston & Co. noted that ''a firm closing time would complement advances that have been made in the last year to reduce daylight overdraft charges, thus benefitting market participants with little additional costs.''

Roughly one-third of the commenters addressing the concept of a firm closing time expressed support for the concept if the Federal Reserve Banks would exercise flexibility in granting ''emergency'' extensions. A few commenters believed that the current practice of granting frequent extensions is adequate for their processing and planning needs.

Market participants have made significant operational improvements over the last ten years, including increased reliability and processing capability of their automated systems, that have affected average daily volume patterns. In addition, a number of initiatives implemented by the Federal Reserve Banks and market participants have altered the intraday pattern of Fedwire securities transfers.[5] For example, prior to the implementation of daylight overdraft fees in April 1994, about 20 percent of the value of securities transfers on Fedwire was processed by 10:00 a.m., 40 percent by noon, and 75 percent by 2:00 p.m. Since January 1995, roughly 36 percent of the value of securities transfers on Fedwire was processed by 10:00 a.m., 65 percent by noon and 92 percent by 2:00 p.m. Over the last ten years, the average actual closing time of the Fedwire securities transfer system has moved from 5:30 p.m. to 3:15 p.m.

The Board believes that a firm closing time for the Fedwire securities transfer service would allow market participants and the Federal Reserve Banks to manage resources more effectively and control costs with greater certainty than today. A firm closing time that accommodates the large majority of actual current closing times will reduce the frequency and duration of extensions and thus provide increased certainty with respect to the final closing time.

III. Selection of Appropriate Closing Time

Twenty-five commenters supported the proposed closing time of 3:00/3:30 p.m. Eleven commenters noted that establishing a closing time that is later

[1] All times are Eastern Time. For ease of reference throughout this document, the closing time may be identified as 3:00/3:30 p.m., for example.

[2] Currently, the Fedwire book-entry securities transfer service has a published closing time of 2:30 p.m. for transfer originations and 3:00 p.m. for reversals. Some Reserve Banks permit the movement of securities within a participant's account (also called repositioning) after the close of the reversal period.

[3] Banks, bank holding companies, and operating subsidiaries of banks or bank holding companies.

[4] Entities extensively involved in trading book-entry U.S. government or federal agency securities.

[5] Specific initiatives include: a $50 million maximum transaction limit for Fedwire book-entry securities transfers; Public Securities Association's ''good delivery guidelines'' designed to encourage earlier-in-the-day settlement of large securities deliveries; and the assessment of fees for daylight overdrafts incurred in accounts held at the Federal Reserve.

than the current published closing time of 2:30/3:00 p.m. will provide extra processing time for securities transfers, which may be useful for some participants. Two commenters noted that the extra time would relieve some of the pressure of acting upon late instructions for outright sales and repo collateral activity and would facilitate a smooth daily transition from securities to cash processing. One commenter suggested that expanding the closing time in this manner would relieve industry bottlenecks on heavy settlement days and help prevent ''fails'' [6] on numerous occasions.

Seven commenters believed there would be no benefit to changing the current closing time of 2:30/3:00 p.m. These commenters stated that the current schedule is adequate for their processing needs and should not be changed. For example, the Public Securities Association (PSA) noted that the current closing time provides sufficient certainty to the market for participants to plan for staffing and other needs. In addition, while Chemical Bank stated that it did not oppose a 3:00/3:30 p.m. closing time, it indicated that it has been able to process successfully its two highest volume days on record within the current 2:30 p.m. closing time for securities transfer originations. Chemical Bank stated that there is no need to change the closing time, as long as the Federal Reserve Banks have the flexibility to extend the closing time when there are significant systems problems for a major participant.

Eight commenters believed that the Board should establish a firm closing time later than the proposed time of 3:00/3:30 p.m. While the American Bankers Association (ABA) expressed support for the proposed closing time, it noted that several of its members would support a 3:30/4:00 p.m. closing time to allow extra securities processing time. Harris Trust and Savings Bank stated that while its customers would benefit from the additional processing time associated with a 3:00/3:30 p.m. closing time, the bank prefers extending the closing time to 3:30/4:00 p.m. to facilitate its broker customers' needs arising from afternoon margin calls at the exchanges. The BOTCC argued that a 6:00 p.m. closing time would facilitate: (1) the afternoon settlement of futures transactions by permitting securities to be sold or pledged to meet related settlement obligations; (2) the collection of original margin deficits in the afternoon by permitting the transfer of securities to meet margin requirements; and (3) market participants' ability to adhere to firm closing times. In addition, the BOTCC suggested that a 6:00 p.m. closing time could benefit customers of clearing members by increasing the likelihood that they would receive the proceeds of payments from clearing members on a same-day basis.

Some commenters observed that a later close of the Fedwire book-entry securities transfer service will compress further the limited time available to complete overnight batch accounting cycles in anticipation of the 12:30 a.m. opening of the Fedwire funds transfer service, beginning in late 1997. Specifically, seven commenters indicated a fairly broad spectrum of end-of-day processing requirements and capabilities, ranging from 4–5 hour to 10–12 hour processing cycles. One commenter was unable to provide an estimate of the amount of time required for overnight batch processing because of systems changes it needed to make to accommodate interstate branch banking. In addition, one commenter noted that a later closing time could cause some participants to deliver securities ''at the last minute'' and another commenter argued that a later closing time would delay its funds settlement process.

The current published closing time has been in place since the system was implemented in the late 1960s. Historically, the service has routinely closed later than 2:30/3:00 p.m. to accommodate operating problems and volume backlogs incurred by major participants. Recent experience indicates that although market participants have made substantial improvements to their automated systems and internal operations, the increased efficiency has not enabled a stable closing time of 2:30/3:00 p.m. During the first half of 1995, the Fedwire securities transfer system was extended beyond the scheduled closing time on 61 out of 126 days, or 48 percent of the business days; most of these extensions were due to system/operating problems at a bank or major dealer. Extensions were granted on eight occasions to allow one of the clearing banks to complete its daily volume; generally, these volume backlogs were satisfied by 3:30 p.m.

In the context of reviewing changes to the final closing time, State Street Bank and Trust suggested that the Board also review the need for a dealer-turnaround deadline, which currently is 2:45 p.m. State Street suggested that the original reasons for granting broker/dealers additional delivery time to customers are no longer valid in today's automated environment and stated that this intermediary deadline becomes more difficult to justify as operating hours are expanded. State Street indicated that there are no ''class'' distinctions within other depositories.

Dealer-turnaround time was established by the PSA as an industry guideline to promote the smooth functioning of the government securities market. Operationally, broker/dealers prioritize their work based on the PSA good delivery guidelines; processing transfers during the day first to other broker/dealers and later to their customers. The dealer-turnaround deadline has been reflected in the Federal Reserve Banks' operating circulars; however, the Reserve Banks do not police participant activity with respect to this time.

Whereas the Board's original proposal suggested a closing time of 3:00/3:30 p.m., the Board believes that establishing a firm closing time of 3:15 p.m. for transfer originations and 3:30 p.m. for reversals is consistent with current practice [7] and would enable an orderly close of the government securities market. The Board believes that these closing times will satisfy adequately the known processing needs of market participants with respect to interbank transfers. The Board believes that the new closing time provides sufficient opportunity for market participants to complete daily deliveries, absent unusual operating or computer problems.[8] In addition, the Board's action does not preclude the continuation of an industry standard for a dealer-turnaround time if the industry believes it is needed.[9] The Board also believes that this new closing time will not interfere with the normal end-of-day processing requirements of market participants and Federal Reserve Banks. The Board encourages market participants to continue efforts to improve the efficiency of back-office operations, especially as these may be necessary in anticipation of expanded Fedwire funds transfer service operating hours in late 1997.

The Board believes that establishing a closing time later than 3:15/3:30 p.m. for the Fedwire securities transfer service is not warranted at present. It is

[6] A ''fail'' occurs when the securities and cash are not exchanged as agreed on the settlement date, usually because of technical problems.

[7] The existing 2:45 p.m. deadline for dealer-to-customer deliveries effectively results in a reversals-only period of 15 minutes.

[8] Those Reserve Banks that permit repositioning after the close of the reversal period may continue to do so.

[9] The Federal Reserve Banks' book-entry securities operating circulars will be modified to eliminate reference to a separate deadline for dealer-to-customer deliveries.

not clear that the potential benefits of closing later than 3:15/3:30 p.m. are sufficient to outweigh the costs of a later close. The existing characteristics of the Fedwire securities transfer service, especially the inability to control the receipt of securities transfers delivered against payment, compel on-line participants to actively monitor their accounts throughout the operating day. It is difficult to justify requiring participants to incur the additional expense associated with monitoring their Fedwire securities activity when there is relatively little volume to be processed later in the day.[10] While the BOTCC pointed out that a significantly later close of 6:00 p.m. would facilitate the afternoon settlement of futures transactions and permit the transfer of securities to meet margin requirement, there are significant costs associated with delaying the back-end processing that takes place at depository institutions after the close of the Fedwire book-entry securities transfer service. In addition, a 6:00 p.m. closing time for the Fedwire securities service may require a later third-party deadline and final close for the Fedwire funds transfer service. Also, decreasing the time between the close of the Fedwire book-entry securities transfer service and the close of the Fedwire funds transfer service allows less time to accommodate securities-related extensions without resulting in Fedwire funds transfer extensions. The Board is concerned about the possibility of securities-related extensions affecting the ability of the funds transfer service to close timely in light of its decision to open the Fedwire funds transfer service at 12:30 a.m. ET, beginning late 1997. Despite these concerns, the Board is willing to consider later closing times for the book-entry securities transfer service in the future and will continue to assess changes in market behavior and intraday volume patterns, as well as improvements in the efficiency of back office operations, that may call for such modifications.

IV. Extensions of the Scheduled Closing Time

Nine commenters emphasized the need for Federal Reserve flexibility in granting extensions for unusual circumstances. In addition, five commenters encouraged the Board to provide guidance as to what circumstances would warrant extension of the scheduled closing time. Specifically, some commenters argued that extensions should be granted only to accommodate significant operating or computer problems at a depository institution or major dealer or to prevent market disruption. PSA suggested that extensions also should be granted to accommodate the processing volume of large market participants. Two commenters stated that the Board should develop more ‘‘equitable’’ guidelines for granting extensions, arguing that the criteria should be more relevant to the industry as a whole. For example, State Street Bank and Trust observed that the ‘‘current extension guidelines ($500 million or more in straight sells) favor the few banks which process the majority of securities transfers.’’

Although market participants have improved significantly their automated systems over time, operational problems occasionally arise that interfere with the timely settlement of a participant’s Fedwire securities transfers. An operating problem at a participant that originates and/or receives a significant volume of daily Fedwire securities transfers could affect the government securities market broadly by contributing to settlement gridlock. Settlement gridlock, if prolonged, could lead to systemic liquidity problems among dealers and other financial institutions, which could contribute to increased credit risks.

The Board believes that it is essential for the Federal Reserve Banks to have the flexibility to extend the closing time of the Fedwire book-entry securities transfer system on an as-needed basis to facilitate the smooth functioning of the government securities market and to minimize the systemic risks that may arise due to significant operating problems at one or more depository institutions or major dealers. The Board believes that granting extensions in such circumstances provides for the orderly functioning of the government securities market and minimizes the number of failed trades. Because the Board expects all on-line participants to invest in the necessary automation resources to process peak volumes as well as normal volumes, the Federal Reserve Banks generally will not grant extensions based on circumstances arising from volume backlogs at a participant.

V. Other Issues

Commenters raised several other issues relating to the closing time for the Fedwire book-entry securities transfer service. Specifically, these suggestions include implementing a free delivery period, considering an earlier close on certain days, and monitoring/disciplining participants for improper actions during the reversal processing period.

A. *Free Delivery Period*

Bank of America suggested that in conjunction with implementing a firm closing time of 3:00/3:30 p.m., the Board should consider allowing depository institutions to make bank-to-bank transfers free-of-payment (also called ‘‘free deliveries’’) for an hour after the close of the reversal period. Bank of America noted that depository institutions and their customers could use this processing window (i.e., from 3:31 p.m. to 4:30 p.m) to resolve major difficulties, such as correcting any operational errors or financing securities that inadvertently remained in the dealer’s account. The bank stated that if payment were required for a securities transfer to be delivered during this period, the buyer could send the payment via the Fedwire funds transfer system. Bank of America believes that this new service should be implemented in January 1996.

At present, the Federal Reserve Banks’ Fedwire book-entry securities transfer applications are unable to establish different closing times for interbank transfers that are ‘‘free’’ versus those that are against payment. The Federal Reserve Banks plan to implement new software for the book-entry securities transfer service, called the National Book-Entry System (NBES), beginning in 1996. NBES will have the capability to differentiate certain types of transactions by time-of-day, which would enable the Reserve Banks to establish a special period for free deliveries of securities, for example. The functionality for processing ‘‘free’’ bank-to-bank transfers after the close of the period for delivery-versus-payment transfers may be made operational in the future pending additional analysis.

B. *Earlier Close on Certain Market Holidays*

Crestar Financial Corporation suggested that the Board should consider closing the Fedwire book-entry securities transfer service earlier on days when the government securities market is closed and/or closes early. Crestar stated that ‘‘typically these are days when staff schedules vacations and there might be significant system wide savings if coverage did not have to be provided.’’

Each year, PSA announces a holiday schedule recommending full-day and partial-day closings of markets for U.S. government and mortgage securities and money market instruments. Typically, there is little Fedwire securities transfer volume to be processed on such days. As a result, the Federal Reserve Banks

[10] Recent data indicate that, on average, less than one percent of the aggregate value of securities transfers processed over Fedwire remains to be processed after 3:00 p.m.

generally have been able to close the Fedwire securities transfer system earlier than 2:30/3:00 p.m. on certain days designated in the PSA holiday schedule, such as Good Friday. For example, on April 14, 1995 (Good Friday), depository institutions in the Second Federal Reserve District originated a combined total of about 650 securities transfers, which were all completed by noon, compared with average volume of over 38,000 securities transfers originated per day during March 1995. Thus, the Federal Reserve Banks were able to close the system at 1:30 p.m. on that day.

As noted earlier, the characteristics of the Fedwire securities transfer service, especially the inability to control the receipt of securities transfer delivered against payment, compel on-line participants to actively monitor their accounts throughout the operating day. It is difficult to justify requiring participants to incur the additional expense associated with monitoring their Fedwire securities activity on those days when no volume is processed later in the day.

The Board believes that it is appropriate for the Federal Reserve Banks to continue to close the Fedwire securities transfer service earlier than the published closing time on all or some days designated by the PSA as full or partial market holidays, when there is relatively little volume to be processed. Shortly after the PSA publishes its annual holiday schedule, the Federal Reserve Banks will issue a notice identifying the days on which it plans to close the securities transfer service earlier than 3:15/3:30 p.m. In addition, the Federal Reserve Banks will notify participants of the scheduled early close approximately two weeks in advance of the particular date that Fedwire will be closed early, coincident with PSA's reminder notices for the recommended market holiday.

C. *Monitoring Improper Actions During Reversal Period*

Two commenters expressed concern about the practices of some institutions that send securities transfer originations during the reversals-only period. One of these commenters inquired about the Federal Reserve's ability to monitor and/or report such practices, indicating that the Federal Reserve should penalize institutions for improper use of the transfer reversal code.

The Federal Reserve Banks' book-entry securities services uniform operating circular sets forth the terms and conditions governing access to the Fedwire book-entry securities transfer service. In particular, paragraph 21 of this circular indicates that a participant should not send a transfer message for the first time during the reversals-only period by using a reversal code and provides the receiver of such a transfer with the ability to request an as-of adjustment for improper use of the reversal code. The circular notes that use of the reversal code to resend a transfer initially sent during the origination period and improperly reversed is not a misuse of the reversal code. The Board believes that this provision provides sufficient protection to receivers of improper transfer messages and, as a result, it is not necessary to institute additional measures at this time.

VI. Effective Date of Proposed Changes

Almost all of the commenters responding to the proposal believed that January 1996 is a reasonable effective date for establishing a firm closing time for the Fedwire book-entry securities transfer service. One commenter, however, suggested that it would be more prudent to establish an effective date that is after the implementation of the National Book-Entry System.

The Board believes that the benefits associated with establishing a firm closing time of 3:15/3:30 p.m. for the Fedwire securities transfer service justify a near-term effective date that permits institutions to make any necessary internal operational/procedural changes. The Board believes that an effective date of January 2, 1996 is reasonable because the new closing time does not represent a material change from average actual experience.

VII. Competitive Impact Analysis

The Board assesses the competitive impact of changes that may have a substantial effect on payment system participants. In particular, the Board assesses whether a proposed change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve Banks in providing similar services and whether such effects are due to legal differences or due to a dominant market position deriving from such legal differences.

Other providers of securities transfer services do not provide services that are directly comparable to the Fedwire book-entry securities transfer service, because only the Federal Reserve Banks can provide final delivery-versus-payment of securities settled in central bank money. There are other private-sector systems, however, such as the Government Securities Clearing Corporation and the Participants Trust Company, that facilitate primary and secondary market trades of U.S. Treasury and/or agency securities. Other transactions involving U.S. government securities may be cleared and settled on the books of depository institutions to the extent that the counterparties are customers of the same depository institution.

The Board does not believe that the establishment of a firm closing time for the Fedwire securities transfer system would have a direct and material adverse effect on the ability of other service providers to offer similar services. The Federal Reserve Banks, however, would maintain their unique position of providing risk-free central bank settlement.

By order of the Board of Governors of the Federal Reserve System, August 9, 1995.

William W. Wiles,

Secretary of the Board.

[FR Doc. 95–20127 Filed 8–14–95; 8:45 am]

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FEDERAL RESERVE SYSTEM

[Docket No. R–0889]

Federal Reserve Payment System Risk Policy

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice; request for comment.

SUMMARY: The Board requests comment on the benefits and costs of adopting a policy to control access to the Federal Reserve Banks' automated clearing house (ACH) service by entities other than the depository institution whose Federal Reserve account will be debited. The controls would apply to ACH credit transactions sent by third-party processors (service providers) and respondent depository institutions directly to a Reserve Bank or a private ACH operator that exchanges transactions with a Federal Reserve Bank. Controlling access to the ACH service will help to ensure the safety and soundness of the ACH system.

The concepts underlying the proposed ACH third-party access policy are similar to the provisions of the Fedwire third-party access policy, which was originally adopted in 1987 and amended today. (See notice published elsewhere in today's **Federal Register**.) The Board requests comment on the specific provisions of the proposed policy and the cost and operational impact of providing risk monitoring capabilities for controlling access to the Federal Reserve Banks' ACH service. The risk monitoring capabilities are intended to permit the depository institutions that are