

ANNUAL PAYMENTS CONFERENCE  
SPONSORED BY  
CHICAGO CLEARING HOUSE ASSN.  
WESTIN HOTEL  
OCTOBER 7, 1985

I. INTRODUCTION - BRIEF ECONOMIC REVIEW

A. TO SURPRISE YOU - NOT WHAT YOU CAME TO HEAR

1. BUT IT SETS AN ENVIRONMENT FOR MY LATER COMMENTS

B. THE OUTLOOK FOR THE NEXT FEW QUARTERS IS POSITIVE

1. WOULD ANTICIPATE GNP GROWTH OF, SAY, 2-1/2 TO 3%

FOR THE NEXT 3 OR 4 QUARTERS

2. RISK OF A RENEWED RECESSION IN NEAR TERM

DIMINISHING

3. CONSUMPTION MOVING AHEAD EVEN MORE RAPIDLY

A. 3%/4% DURING FIRST HALF OF THE YEAR VERSUS

THE 1% GROWTH IN GNP

B. FROM A CONSUMPTION POINT OF VIEW, CURRENT AND

PROSPECTIVE ECONOMIC SITUATION IS STRONG

*Positive*

II. BUT AGAINST THAT ~~BACKGROUND~~ <sup>POSITIVE</sup> BACKGROUND THERE IS, ON A GLOBAL BASIS,  
THE BUILDUP OF SOME VERY UNSETTLING IMBALANCES/~~RISKS~~

~~—~~ A. THE AGRICULTURAL SECTOR — *issue well known — This District*

1. FARM CREDIT SYSTEM — *growing problems well publicized*

2. AGRICULTURE BANKS — *problem banks, closures*

3. RURAL AMERICA — *main street*

~~—~~ B. THE ENTIRE INTERNATIONAL SITUATION

1. THE ENORMOUS TRADE DEFICIT

2. VERY HIGH VALUE OF THE DOLLAR

A. BASED ON ACTIVITIES TWO WEEKENDS AGO MAY BE

IN THE PROCESS OF AMELIORATING

*of LDC countries*

3. ~~THE~~ EXTERNAL DEBTS, *SHOWING SIGNS OF STRAIN* AFTER A PERIOD OF

IMPROVEMENT, THE SITUATION IS AGAIN ~~DETERIORATING~~

~~—~~ C. THE INEXORABLE BUILDUP OF DEBT *across all segments of economy*

1. PERSONAL DEBT — *rising to record levels*

A. THE STRONG CONSUMPTION NUMBERS SUPPORTED BY

SIGNIFICANT INCREASE IN CONSUMER DEBT

2. CORPORATE DEBT

A. ACCELERATED BY MERGERS AND TAKEOVERS

B. THE ~~RELATIVE~~ BALANCE TOWARD HIGHER DEBT <sup>Relative</sup> ~~ROLE~~  
TO CAPITAL IS INCREASING

3. FEDERAL DEBT *Fueled by*

A. THE DEFICIT

B. THE ACCELERATION OF THE OUSTANDING DEBT LEVEL  
OF GREAT CONCERN  
IS ~~ALMOST INCREDIBLE~~

~~D.~~ D. GOVERNMENT SECURITIES DEALERS

1. SOME PROBLEMS AT THE SECONDARY DEALER LEVEL

~~E.~~ E. THRIFTS/BANKS

1. OHIO/MARYLAND

2. GIVEN SOME OF THE PROBLEMS <sup>*Just enumerated*</sup> ~~NOTED ABOVE~~, MANY  
BANKS DEALING WITH SOME DIFFICULT CIRCUMSTANCES

3. ASSET QUALITY HAS DETERIORATED - ENERGY - REAL  
ESTATE - AGRICULTURE

4. ALL OF THIS AGAINST THE BACKGROUND OF DEREGULATION

Reviewing all of these imbalances suggests and

III. ENVIRONMENT OF SOME INSTABILITY

*From a Regulatory point of view*

A. ~~AS A REGULATOR,~~ VERY LITTLE WE CAN DO TO DEAL WITH

MOST OF THE RISKS ENUMERATED

1. THEY ARE COMPLEX, DIFFICULT ISSUES

2. WE ARE GOING TO HAVE TO GO THROUGH A CONSIDERABLE

ADJUSTMENT PHASE

B. BUT IT IS A PERIOD IN WHICH A HIGH LEVEL OF CAUTION

IS MERITED

1. AND AREAS/ISSUES THAT CAN BE CONTROLLED AND DEALT

WITH SHOULD BE

IV. THERE ARE SOME THINGS THAT LEND THEMSELVES TO REGULATORY

REVIEW AND ACTION

A. CAPITAL - WE ARE MOVING TO ~~A HIGHER LEVEL OF~~ CAPITAL *an event Greater emphasis on*

1. YOU HAVE SEEN THE EARLY ~~SIGNS OF~~ A SHIFT FROM 6% *Comments indicating*

TO 9% *an capital adequacy guidelines*

A. WITH MUCH OF THE INCREASE TO BE PERMITTED IN

THE FORM OF SUBORDINATED DEBT

2. AND WE WILL BE ASSESSING THE RISK PROFILE OF THE  
BANK BALANCE SHEET IN OUR CAPITAL CONSIDERATIONS

~~A. OFF BALANCE SHEET ACTIVITY~~

*Qualitative aspects*

B. ~~QUALITY~~ OF LOAN PORTFOLIO, THE WHOLE ISSUE OF  
MOVING ASSETS OFF THE BALANCE SHEET TO DEAL  
WITH A CAPITAL GUIDELINE THAT HAS BEEN VERY  
ARITHMETIC IN ITS APPROACH

B. DIVIDENDS

1. OUR APPROACH TO THE DIVIDEND ISSUE WITH REGARD TO  
TROUBLED BANKS HAS BEEN SOMEWHAT AD HOC

2. WE WILL BEGIN TO FORMALIZE OUR PROCEDURES

C. INCREASED RELATIONSHIP OF THE REGULATORS WITH BANK  
BOARDS OF DIRECTORS

1. HIGHER LEVEL OF SENIORITY IN THE REPRESENTATION

2. COVERAGE OF ISSUES BEYOND THE ~~SHEER~~ *More than* REVIEW OF AN  
EXAMINATION

*Does Finally*  
V. THIS BRINGS ME TO THE PAYMENTS SYSTEM *- actually why you are here*  
*As I view it*

A. THE PIPELINE THROUGH WHICH ALL FINANCIAL TRANSACTIONS  
ARE PROCESSED

1. ABSOLUTELY FUNDAMENTAL TO THE PROPER FUNCTIONING  
OF THE FINANCIAL MECHANISM

2. THE FED HAS AN APPROPRIATE AND VERY IMPORTANT  
RESPONSIBILITY *in the payments mechanism.*

*In order to fulfill this responsibility*

3. MUST BE AN ACTIVE AND MAJOR PARTICIPANT

A. HANDS ON INVOLVEMENT

*Most of the*

B. ~~ANY~~ ISSUES ARISING FROM OUR REGULATORY ~~ROLE~~

*direct role*  
*largely*

AS WELL AS AN OPERATOR HAVE BEEN OVERCOME

*There has been a*

VI. THE BUILDUP OF VOLUME IN THE EVOLVING PAYMENTS SYSTEM

A. ALL SECTORS OF THE PAYMENTS MECHANISM HAVE  
EXPERIENCED SIGNIFICANT GROWTH OVER THE LAST 30 TO 35  
YEARS

1. FROM 1950 THROUGH 1984, THE VOLUME OF ANNUAL  
PAYMENTS PROCESSED THROUGH THE PAYMENTS MECHANISM  
ROSE FROM 2 TIMES GNP TO 45 TIMES GNP

A. A VERY SIGNIFICANT INCREASE IN PAYMENT  
VELOCITY

B. FROM THE POINT OF VIEW OF VOLUME, MOST OF THE  
INCREASE CAN BE ATTRIBUTED TO WIRE TRANSFER  
*accounted for by*  
WITH ONLY 5% <sup>^</sup> OF CHECKS

B. THE ADVANCEMENT OF THE MECHANICAL INFRASTRUCTURE HAS  
SUPPORTED THIS RAPID GROWTH IN THE PAYMENTS VOLUME

1. COMPUTER ADVANCEMENTS AND THE RESULTING  
AUTOMATION OF THE PAYMENTS PROCESS HAS PROVIDED  
THE MECHANISM FOR THE INCREASE

2. BUT THE MACHINERY HAS GOTTEN WELL AHEAD OF SOME  
OF THE OTHER CRITICAL ISSUES - NAMELY, THE  
CONTROL OF RISK

3. OVER THE LAST DECADE OR SO GROUPS OF BANKS HAVE  
DEVELOPED A VARIETY OF PRIVATE WIRE TRANSFER  
SYSTEMS - CHIPS, CASHWIRE AND CHES AND MOST  
RECENTLY A NEW SYSTEM IN CALIFORNIA CALLED PRESS

4. THE MONETARY CONTROL ACT OF 1980 PROVIDED ACCESS  
TO THE FEDWIRE BY ALL DEPOSITORY INSTITUTIONS

5. THE FOUR LARGEST NETWORKS ARE NOW HANDLING MORE  
THAN \$6 HUNDRED BILLION IN WIRE TRANSFERS EVERY

DAY

*This has caused a*  
VII. ~~THE~~ INCREASE IN RISK FACTORS

A. THE ELECTRONIC FUNDS TRANSFER NETWORKS HAVE CREATED A  
NEW SETTING FOR AN OLD BANKING RISK

1. RELEASING FUNDS BEFORE FINAL SETTLEMENT HAS TAKEN

PLACE, *For example both Inter Bank  
as well as Corporate payments*

2. THIS CREATES THE DAYLIGHT OVERDRAFT<sup>A</sup> - ~~THE~~ GARDEN

VARIETY CREDIT RISK

3. THE DAYLIGHT OVERDRAFT IS SIMPLY THE RESULT OF AN

INSTITUTION SENDING MORE PAYMENTS OVER THE WIRE

THAN IT HAS RECEIVED OR HAS IN ITS ACCOUNT AT THE

FEDERAL RESERVE



4. WITH THE DOLLAR VOLUME OF TRANSFERS ACCELERATING  
AND THE INCREASING NUMBER OF PARTICIPANTS IN THE  
SYSTEM, THE DAYLIGHT OVERDRAFT PROBLEM HAS BEEN

~~INCREASING~~ *Growing*

B. MAGNITUDE OF THE RISKS *Also Growing*

1. IN AGGREGATE ON A TYPICAL DAY DAYLIGHT OVERDRAFTS  
ON LARGE DOLLAR TRANSFER SYSTEMS AMOUNT TO \$110  
TO \$120 BILLION

*OVER ONE HALF*

A. EQUIVALENT TO ~~TWO-THIRDS~~ OF THE TOTAL CAPITAL  
OF ALL U.S. FINANCIAL INSTITUTIONS

*the*  
C. CAUSES OF DAYLIGHT OVERDRAFTS

1. ~~THEY~~ FOLLOW A TYPICAL PATTERN - 95% OF THE  
MAXIMUM DAYLIGHT OVERDRAFT AMOUNTS OCCUR BETWEEN  
10 A.M. AND 4 P.M.

A. MOST INSTITUTIONS ON FEDWIRE REACH THEIR  
MAXIMUM DAILY OVERDRAFT AROUND 1:30 P.M.

B. OVERDRAFTS ARE DRIVEN BY TRANSFERS OF BOOK ENTRY SECURITIES, TRANSFERS ON FEDWIRE AND TRANSFERS ON PRIVATE WIRE SYSTEMS

C. IN AGGREGATE THE DISTRIBUTION IS NEARLY EVEN - ABOUT A THIRD OF THE DAYLIGHT OVERDRAFTS

RESULT FROM EACH *OF THESE ACTIVITIES*

D. FOR BANKS IN THE MIDWEST (AND THERE IS <sup>*certainly*</sup> A

PURCHASED FUNDS MESSAGE IN THIS COMMENT), THE

MAIN CAUSE OF DAYLIGHT OVERDRAFTS IS THE

UNFUNDING OF BORROWED POSITIONS AT THE

OPENING OF BUSINESS ~~AND~~ PRIOR TO RECEIPT OF

NEWLY BORROWED FUNDS RESULTING FROM TRADING

ACTIVITIES DURING THE DAY

VIII. THE SYSTEMIC RISK - THE OVERRIDING CONCERN OF THE FEDERAL RESERVE SYSTEM

A. WE WORRY ABOUT ANY DEVELOPMENTS THAT MAY DESTABILIZE FINANCIAL MARKETS

1. OUR CONCERN HEAVILY FOCUSES ON OUR RESPONSIBILITY  
FOR MAINTAINING THE SAFETY AND SOUNDNESS OF THE  
BANKING SYSTEM

2. AND THERE ARE SOME OBVIOUS MONETARY POLICY  
RESPONSIBILITIES INVOLVED HERE

B. OUR CONCERN IS THAT GIVEN THE

1. SHEER VELOCITY <sup>and volume</sup> OF THE ~~NUMBER~~ OF FUNDS IN THE  
PAYMENTS MECHANISM

<sup>and, until recently, the growing</sup> 2. ~~THIS HIGH~~ LEVEL OF DAYLIGHT OVERDRAFT THAT ~~IS~~ <sup>has been</sup>  
OCCURRING

3. THAT AN ADVERSE EVENT COULD DRAMATICALLY IMPACT  
THE FINANCIAL SYSTEM

C. OUR INITIAL FOCUS WAS ON PROBLEMS ASSOCIATED WITH  
DAYLIGHT OVERDRAFTS ON FEDWIRE

1. BUT LACKING A PROGRAM OF CONTROL THAT COVERED  
RISKS ON ALL WIRE NETWORKS, THE SYSTEMIC RISK  
WOULD NOT BE REDUCED

*clearly* AN issue with

D. CERTAINLY THIS IS ~~NOT A PROBLEMATIC AREA WITH~~

SOME PRECEDENT

1. WE CAN ALL REMEMBER THE TRAUMA THAT THE COLLAPSE

OF ~~BANKHAUS HERSTATT~~ <sup>BANKS</sup> CAUSED

2. A SMALL INSTITUTION <sup>that Failed</sup> SOME YEARS AGO WHEN VOLUMES

WERE MUCH LOWER

3. THE FAILURE OF A LARGER INSTITUTION GIVEN ~~OUR~~ THE

CURRENT ENVIRONMENT COULD BE MUCH MORE TRAUMATIC

E. THE FEDERAL RESERVE BELIEVES SEVERAL IMPORTANT GOALS

CAN BE ATTAINED THROUGH A <sup>Program To Reduce</sup> LARGE DOLLAR TRANSFER

SYSTEM RISK <sup>that will provide for the:</sup> ~~REDUCTION PROGRAM~~

1. CONTAINMENT OF A SETTLEMENT FAILURE

2. REDUCTION OF VOLUME OF INTRA-DAY CREDIT EXPOSURE

3. RESTRAINT IN THE EXTENSION OF INTRA-DAY CREDIT

4. THE RESULTING SMOOTH OPERATION OF THE PAYMENTS

MECHANISM

- IX. LET ME MOVE TO OUR APPROACHES TO REDUCE THE RISK ELEMENT
- A. THE PROPER FUNCTIONING OF THE FINANCIAL PIPELINE -  
THE PAYMENTS MECHANISM—IS AN ESSENTIAL INGREDIENT TO  
THE DEVELOPMENT OF THE ECONOMY
1. TOO HEAVY-HANDED AN APPROACH TO OUR REGULATORY  
CONCERN WOULD IMPEDE THE DEVELOPMENT OF THE  
ECONOMY
  2. YET IT'S CLEAR THAT WE MUST REDUCE THIS EXPOSURE  
AND BRING IT UNDER BETTER CONTROL
  3. OBVIOUSLY THE PROPER BALANCE WILL BE DIFFICULT TO  
ACHIEVE
  4. PARTICULARLY WHEN ONE CONSIDERS THE DIVERSITY OF  
THE PARTICIPANTS INVOLVED IN THE SYSTEM
- B. THERE HAS BEEN A SHIFT IN THE ATTITUDE OF THE  
FINANCIAL SERVICES INDUSTRY

1. AT THE OUTSET THERE WAS THE CONCERN THAT PERHAPS  
*TO borrow a phrase*  
THE REGULATORS WERE QUOTE TRYING TO FIX SOMETHING  
THAT WAS NOT BROKE ~~UNQUOTE~~
2. BUT I THINK THIS ATTITUDE HAS CHANGED VERY  
CONSIDERABLY
3. INDUSTRY GROUPS SUCH AS THE ASSOCIATION OF  
*Association*  
RESERVE CITY BANKERS, THE AMERICAN BANKERS ROBERT  
MORRIS ASSOCIATES, THE CHICAGO CLEARING HOUSE AND  
OTHERS HAVE CONDUCTED STUDIES AND HAVE HELD  
SYMPOSIUMS TO UNDERSTAND THE PROBLEM AS WELL AS  
WORK TOWARD A SOLUTION
4. WITH THE PASSAGE OF TIME AND THESE INDUSTRY  
EFFORTS, FINANCIAL INSTITUTIONS HAVE DEVELOPED A  
MUCH HIGHER LEVEL OF SENSITIVITY TO THE PROBLEM
5. THROUGHOUT, THE FEDERAL RESERVE SYSTEM HAS TRIED  
TO USE A VOLUNTARY APPROACH TO THIS ISSUE

6. AND THE PROGRAM WE'VE ADOPTED IMPLIES VOLUNTARY PARTICIPATION WITH, ADMITTEDLY, A DEGREE OF EXAMINER OVERSIGHT LOOKING OVER THE SHOULDER

7. THE FED HAS BEEN SENSITIVE TO INDUSTRY COMMENTS - HAVE FORMED THE LARGE DOLLAR PAYMENT SYSTEM ADVISORY GROUP TO THE BOARD OF GOVERNORS TO PROVIDE THIS INPUT

A. 2 REPRESENTATIVES FROM OUR DISTRICT SERVE ON THIS COUNCIL - DON HOLLIS, SENIOR VICE PRESIDENT, FIRST <sup>OF</sup> CHICAGO CORPORATION, AND JAY TOMSON, A DIRECTOR OF OUR BANK AND PRESIDENT OF THE CITIZENS NATIONAL BANK OF CHARLES CITY, IOWA

X. LET ME NOW SHIFT TO A DESCRIPTION OF THE PROGRAM

A. ROLE OF THE PRIVATE NETWORKS

1. THE POLICY STATES THAT ANY LARGE DOLLAR NETWORK OBTAINING NET SETTLEMENT SERVICES FROM A FEDERAL RESERVE BANK
  - A. MUST REQUIRE EACH OF ITS PARTICIPANTS TO ESTABLISH BILATERAL NET CREDIT LIMITS FOR ALL OTHER PARTICIPANTS OF THAT NETWORK
  - B. A SYSTEM MUST BE INSTALLED THAT REJECTS OR HOLDS ANY PAYMENTS THAT WOULD BREACH SUCH LIMITS
  - C. NETWORKS MUST ESTABLISH SENDER NET DEBIT CAPS FOR ITS PARTICIPANTS DESIGNED TO REDUCE INSTITUTION RISK EXPOSURE ON THAT NETWORK
- B. THESE LIMITS SHOULD ENABLE PARTICIPANTS TO BETTER IDENTIFY AND CONTROL THE EXPOSURE THEY WOULD FACE IN THE EVENT OF A SETTLEMENT FAILURE
  1. IN EFFECT, IT BRINGS THE CREDIT RISK ASSESSMENT PROCEDURE INTO THE WIRE TRANSFER OPERATION



2. THE PROCEDURE EXTENDS RISK EVALUATION AND ASSESSMENT TO THIS ACTIVITY ON A BASIS SIMILAR TO OTHER ASPECTS OF BANKING

3. CHES, THE CHICAGO CLEARING HOUSE ELECTRONIC SETTLEMENT SYSTEM, IS, OF COURSE, ONE OF THESE PRIVATE NETWORKS THAT IS COMPLYING WITH THE POLICY

*with regard to*

C. THE ROLE OF FINANCIAL INSTITUTIONS IN THESE PROCEDURES. FOR ANY INSTITUTION PARTICIPATING IN THESE ACTIVITIES AND THAT INCUR DAYLIGHT OVERDRAFTS

1. THE FIRST STEP IN THE PROCESS IS TO PERFORM A SELF-EVALUATION

A. THIS PROCESS INVOLVES EXAMINATION OF CREDIT WORTHINESS

B. OPERATIONAL POLICIES AND PROCEDURES

C. CREDIT POLICIES AND PROCEDURES

2. AFTER EVALUATING ITSELF IN EACH OF THESE 3 AREAS, THE INSTITUTION THEN DEVELOPS A RATING FOR EACH

3. THE 3 RATINGS ARE COMBINED TO YIELD AN  
*which translates into a*  
INSTITUTION'S OVERALL ASSESSMENT OR CAP  
CLASSIFICATION

~~4. THE INSTITUTION MUST NEXT ESTABLISH ITS NET~~

~~SENDER DEBIT CAP~~  
*The established*

4 \* ~~SENDER~~ NET DEBIT CAP IS THE MAXIMUM  
AGGREGATE NET DEBIT ON PRIVATE WIRE SYSTEMS  
PLUS THE MAXIMUM OVERDRAFT IN A FEDERAL  
RESERVE BANK ACCOUNT THAT AN INDIVIDUAL  
DEPOSITORY INSTITUTION CAN INCUR AT ANY TIME  
DURING THE DAY

5. THE CAP, IN EFFECT, PLACES AN AGGREGATE LIMIT ON  
*that*  
THE DAYLIGHT CREDIT AN INSTITUTION CAN PROVIDE TO  
OTHER INSTITUTIONS DURING THE DAY ACROSS ALL  
NETWORKS

6. FINALLY, AN INSTITUTION'S BOARD OF DIRECTORS MUST *Review*  
*and* APPROVE ~~AND REVIEW~~ THE SELF-EVALUATION PROCESS  
AND RESULTING CAPS

A. THE INSTITUTION MUST THEN NOTIFY ITS FEDERAL  
RESERVE BANK OF THE <sup>*Final*</sup> SELECTED CAP

CLASSIFICATION (*a preliminary cap*  
*is Requested by Year-End*)

*Year*  
*Year*  
B. ~~AT LEAST ONCE IN EACH 6 MONTH PERIOD THE~~  
*Going Forward, Twice each Year the*  
INSTITUTION'S BOARD OF DIRECTORS MUST APPROVE  
AND REVIEW THE CAP CLASSIFICATION

C. THE INITIAL CAP CLASSIFICATION MUST BE  
REVIEWED BY INDIVIDUAL BOARDS OF DIRECTORS BY  
THE END OF FEBRUARY 1986 TO PROVIDE FOR  
POLICY IMPLEMENTATION ON MARCH 27, 1986

## XI. THE ROLE OF THE FEDERAL RESERVE

A. FEDERAL RESERVE BANKS WILL MONITOR DAYLIGHT OVERDRAFT  
OCCURRENCES DAILY ON AN EX-POST BASIS

*The District Federal Reserve Bank*

1. UNDER THIS MONITORING PROCEDURE, ~~AN INSTITUTION'S~~  
*will collect and Review*

~~DAYLIGHT OVERDRAFT DATA WILL BE COLLECTED FROM FROM~~

~~ALL WIRE SYSTEMS AND REVIEWED~~

2. REPORTS WILL BE PROVIDED TO ALL INSTITUTIONS

INCURRING DAYLIGHT OVERDRAFTS

*Should*

B. ~~WHENEVER~~ AN INSTITUTION ~~HAS~~ INCURRED ~~AN~~ OVERDRAFT IN

EXCESS OF ITS DETERMINED CAP, THE FEDERAL RESERVE

BANK WILL COUNSEL WITH THE INSTITUTION TO DETERMINE

*(TO Review*

*appropriate* JUST WHY THE EXCESSIVE OVERDRAFT OCCURRED AS WELL AS

~~THE~~ IMPLEMENTATION ~~OF~~ PROCEDURES TO REDUCE THE EXCESSIVE

USE OF INTRA-DAY CREDIT

C. AS A PART OF THE EXAMINATION PROCESS, EXAMINERS WILL

REVIEW THE CONTENTS OF THE CONFIDENTIAL

SELF-EVALUATION FILE - *specifically*

*1. The Resolutions approved by the Board of Directors*

*2. one* PURPOSE OF THE REVIEW IS TO ASSURE THAT AN

INSTITUTION HAS REASONABLY PERFORMED THE

APPROPRIATE SELF-EVALUATION AND ~~THAT THE RESULTS~~  
~~OF THIS EVALUATION ARE GENERALLY CONSISTENT WITH~~  
~~THE EXAMINER REPORT~~

2. ANY COMMENTS THAT THE EXAMINER MAY HAVE REGARDING  
THE SELF-EVALUATION PROCESS AND THE RATING WILL  
BE FORWARDED TO THE INSTITUTION'S BOARD OF  
DIRECTORS

XII. TO CONCLUDE

A. THIS WHOLE ISSUE IS ONE THAT HAS GOTTEN THE ATTENTION  
AND INTEREST OF VERY SENIOR MANAGEMENT IN FINANCIAL  
INSTITUTIONS

1. WHEREAS, AS I SUGGESTED, THE INDUSTRY MIGHT HAVE  
BEEN SLIGHTLY BEHIND THE CURVE AT THE OUTSET
2. IT'S MY SENSE THAT MANY INSTITUTIONS ARE AT LEAST  
ON THE CURVE OR PERHAPS A BIT AHEAD

A. THERE ARE GROWING INDICATIONS THAT MANY  
INSTITUTIONS ARE ALREADY MANAGING THEIR

DAYLIGHT OVERDRAFTS AND REDUCING THEIR  
EXPOSURES

B. AND I DON'T THINK THE MOTIVATION FOR DOING  
THIS HAS COME SOLELY FROM THE PROGRAM THAT IS  
BEING IMPLEMENTED BY THE FED

C. THERE HAVE BEEN ENOUGH SPECIFIC EXAMPLES THAT  
HAVE CAUSED MANagements TO TAKE ACTION ON  
THEIR OWN

D. AGAIN, CREDIT RISK ASSESSMENT IS BEING  
BROUGHT INTO THE PROCEDURE IN AN APPROPRIATE  
MANNER

3. THERE IS ALSO THE REALIZATION ON THE PART OF  
OTHERS WHO MAY PERHAPS HAVE BEEN A LITTLE MORE  
RELUCTANT

A. THAT THIS IS A NO-FOOLING ISSUE FOR THE  
FEDERAL RESERVE

B. THAT A LACK OF PROGRESS BY THE INDUSTRY ON A  
VOLUNTARY BASIS WOULD RESULT IN A HEAVIER  
REGULATORY RESPONSE

C. OPERATIONALLY THE PROCEDURE MIGHT BE A LITTLE  
LESS FLEXIBLE

B. BUT, IF THE PROGRAM I HAVE OUTLINED DOES NOT ACHIEVE  
THE DESIRED GOALS. THE BOARD OF GOVERNORS MAY FEEL IT  
NECESSARY TO CONSIDER A MORE RIGOROUS APPROACH,  
~~INCLUDING REGULATORY LIMITS AND OVERDRAFTS~~

1. FROM OUR VIEW, DAYLIGHT OVERDRAFTS ARE AN

OPERATIONAL ISSUE THAT IN SOME MAGNITUDE AND

FREQUENCE WE WILL BE WILLING TO ~~TOLERATE~~ - *accept - But do*

*Want to point out that*

*(*OVERDRAFTS ARE NOT A PRIVILEGE

~~2. THEREFORE, WE MAY NEED TO BECOME A LITTLE BRISKER~~

~~TO ENCOURAGE THE FURTHER REDUCTION OF THESE RISKS~~ *containment*

C. BUT, MORE POSITIVELY, SO FAR THE PROGRAM HAS ~~BEEN GOOD~~

*made good progress*

1. THERE IS THIS BROAD UNDERSTANDING BY THE INDUSTRY  
OF THE PROBLEM
2. THE PROGRAM THAT HAS BEEN DEVELOPED SO FAR IS A  
CONSTRUCTIVE APPROACH TO THE ISSUE
3. I FIND THE VOLUNTARY ASPECT TO BE HIGHLY POSITIVE
4. THIS RECORD WOULD SUGGEST THAT THE REALIZATION OF  
THE GOALS OF THE FEDERAL RESERVE SYSTEM TO REDUCE  
THIS RISK, AGAIN IN AN ENVIRONMENT THAT IS FACING  
A VERY WORRYING BUILDUP OF OTHER RISKS, CAN BE  
ACHIEVED
5. AND THAT'S OBVIOUSLY IN THE BEST INTEREST OF THE  
FINANCIAL INSTITUTIONS THAT WE SERVE *and more  
broadly the national and international  
economy,*

THANK YOU

\* \* \* \* \*