

FEDERAL RESERVE BANK OF DALLAS

DALLAS, TEXAS 75222

Circular No. 82-149
November 15, 1982

PROPOSED CHANGES IN PROCEDURES
REGARDING ELIMINATION OF FLOAT

TO ALL DEPOSITORY INSTITUTIONS IN THE
ELEVENTH FEDERAL RESERVE DISTRICT:

The Federal Reserve Board has requested comment on proposed changes that would eliminate, or subject to pricing, nearly \$1 1/2 billion of daily Federal Reserve float. A summary of the proposals are as follows:

1. Allow Federal Reserve Banks to offer depository institutions two or more options for receiving credit for direct send and consolidated items.
2. Eliminate or price Federal Reserve float associated with the return of interterritory checks which are not accepted for payment by the depository institutions on which they are drawn.
3. Explicitly price holdover float and "other intraterritory float".

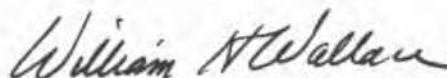
A detailed discussion of each of these proposals is provided in the enclosed Board press release and Federal Register notice.

Interested parties are invited to submit their comments on the proposed changes should be submitted to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C., 20551. Comments should refer to Docket No. R-0433 and must be received by December 15, 1982.

If you have any questions, please contact Mary M. Rosas, (214) 651-6336 at the Head Office; Robert W. Schultz, (915) 544-4730 at the El Paso Branch; Sammie Clay, (713) 659-4433 at the Houston Branch; or John A. Bullock, (512) 224-2141 at the San Antonio Branch.

Additional copies of this circular will be furnished upon request to the Department of Communications, Financial and Community Affairs, Extension 6289.

Sincerely yours,



William H. Wallace
First Vice President

Enclosure

Banks and others are encouraged to use the following incoming WATS numbers in contacting this Bank: 1-800-442-7140 (intrastate) and 1-800-527-9200 (interstate). For calls placed locally, please use 651 plus the extension referred to above.

FEDERAL RESERVE press release



For immediate release

November 1, 1982

The Federal Reserve Board today requested comment on proposed changes in procedures that would eliminate, or subject to pricing, nearly \$1 1/2 billion dollars of Federal Reserve float.

The Board asked for comment by December 15, 1982.

The Board acted under the directives of the Monetary Control Act of 1980 which require the Federal Reserve to charge for its services and to price float. Federal Reserve float is the value of checks for which the Federal Reserve has given credit to the institution that gave the checks to the Federal Reserve for collection, but for which the Federal Reserve has not yet received payment.

Federal Reserve float averages about \$1.8 billion daily. The measures on which the Board requests comment are expected to result in the elimination or pricing of about 80 percent of this amount. Priced float will be valued at the federal funds rate.

The Board's proposals follow adoption of a number of measures over the past several years that have substantially reduced float, chiefly by means of improved internal operating procedures. In 1979, Federal Reserve float averaged \$6.7 billion daily. In 1980, following initial moves by the Federal Reserve, daily average Federal Reserve float was reduced to \$4.2 billion and at current levels is running 73 percent below the 1979 average.

The Board made its proposals after extensive review of suggestions for additional float reduction and pricing developed under the direction of the Federal Reserve's Pricing Policy Committee. Following this review, the Board settled on several proposals on which it desires to receive comment.

These proposals represent a combination of changes in Federal Reserve operating procedures that could further reduce float and subject the remaining float to pricing.

The proposals -- spelled out in the accompanying notice of the Board action -- are:

1. Allow the Federal Reserve banks to offer depository institutions whose checks they clear two or more options for receiving credit for checks given to the Federal Reserve for collection. (See Pages 2 and 3 of the attached notice.) In general, the options would permit Federal Reserve banks to eliminate this type of float by not giving credit for checks until they are collected, or to charge banks to which credit is given while checks are being collected.

It is expected that the proposed revised crediting procedures could reduce daily average Federal Reserve float by some \$900 million, or approximately half of the current amount.

2. Eliminate or price another important component of Federal Reserve float associated with the return of interterritory checks which are not accepted for payment by the depository institution on which they are drawn. These "return items" generate float because the Federal Reserve gives credit for them to the returning institution before it collects from the institution that originally deposited the checks with the Federal Reserve.

The proposal is to debit the account at the Federal Reserve of the institution which originally deposited the checks with Federal Reserve. The debit would be for large (\$50,000 or more) interterritory return items and would be made on the same day the items are received from the returning institution by the Federal Reserve. The depositing institution would be advised by wire, not

later than 3 p.m., of the returns. It is expected that this would eliminate some \$150 million of the daily average of \$200 million in float caused by returned checks.

3. Explicitly price two other types of Federal Reserve float -- holdover float, and "other intraterritory float." Holdover float results when a Federal Reserve office is unable to process checks it receives on a timely basis. Other intraterritory float results from delays in collection of checks due to severe weather, equipment failure or operational factors.

The first proposed procedure, if adopted, would be implemented after the Board has made decisions on two outstanding proposals for speeding up check collection, involving noon presentment of checks and modification of deadline for the deposit of checks for collection.

The second proposal would be implemented, if adopted, during the second quarter of 1983; the third at the end of that quarter.

Remaining Federal Reserve float -- currently about \$250 million daily average -- arises primarily from noncheck operations such as securities transfers, wire transfers, and from the operations of automated clearing houses. These categories of float are being studied further by the System. It is expected that the results of these studies and recommendations for pricing of this type of float will be considered by the Board in 1983.

FEDERAL RESERVE SYSTEM

[Docket No. R-0433]

Reduction and Pricing of Federal Reserve Float

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment.

SUMMARY: The Board of Governors is requesting public comment on several proposals to reduce and price Federal Reserve float. Public comment is requested on proposals to change Reserve Bank crediting procedures for interterritory check deposits, adopt a new procedure for handling large dollar return items and explicitly price several float categories.

DATE: Comments must be received by December 15, 1982.

ADDRESS: Comments, which should refer to Docket No. R-0433, may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N. W., Washington, D. C. 20551, or delivered to Room B-2223 between 8:45 a.m. and 5:15 p.m. Comments may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m., except as provided in § 261.6(a) of the Board's Rules Regarding the Availability of Information, 12 C.F.R. § 261.6(a).

FOR FURTHER INFORMATION CONTACT: Elliott C. McEntee, Assistant Director (202/452-2231) or Morgan J. Hallmon, Program Manager, Payments Mechanism Planning (202/452-3878), Division of Federal Reserve Bank Operations; or Gilbert T. Schwartz, Associate General Counsel (202/452-3625) or Daniel L. Rhoads, Attorney (202/452-3711), or Robert G. Ballen, Attorney (202/452-3265), Legal Division, Board of Governors of the Federal Reserve System, Washington D. C. 20551.

SUPPLEMENTARY INFORMATION: The Monetary Control Act of 1980 (P. L. 96-221) ("MCA") requires that fees be established for Federal Reserve Bank services and that the Board shall begin putting into effect a schedule of fees not later than September 1, 1981. The MCA sets forth specific services to be priced and requires the Board to establish principles on which the schedules of fees for priced services are to be based.

On December 31, 1980, the Board adopted a set of pricing principles and fee schedules for certain Federal Reserve services. Subsequently, the Board adopted fee schedules for virtually all Reserve Bank services in accordance with the MCA. In its December 31, 1980 action, the Board determined, in response to comments received to the Board's proposals to reduce and price float (45 FR 58689), to proceed with internal operational improvements with high benefit/cost ratios to reduce float before initiating

changes in availability schedules and explicit pricing of float. The Board directed the staff to continue studying methods of changing availability schedules as an alternative to explicit pricing of float and report back to the Board.

For several years, the Federal Reserve System has been taking action to reduce float. Since passage of the Monetary Control Act of 1980, float reduction efforts have been intensified. In 1979, daily average Federal Reserve float was \$6.7 billion. In 1980, daily average Federal Reserve float decreased to a level of \$4.2 billion. During the second quarter of 1982, Federal Reserve float averaged \$1.8 billion daily--73 percent below 1979 levels.

After review of proposals to implement additional float reduction efforts and pricing, the Board has determined to solicit comment on three proposals which, collectively, could result in the elimination or pricing of about 80 percent of the \$1.8 billion daily average float. The proposals represent a combination of operational changes to reduce Federal Reserve float and explicit pricing of such float remaining after operational improvements are implemented. It is expected that these proposals, if adopted, would be implemented during the second quarter of 1983. The value of Federal Reserve float would be calculated on the basis of the Federal funds rate published in the Board's H.15 (519) release titled "Selected Interest Rates."

The Board believes these proposals are: 1) consistent with the MCA and previous Board decisions, 2) reasonable in their impact on depository institutions, and 3) operationally feasible for the Reserve Banks. Moreover, these proposals, together with steps taken previously, should contribute to the efficiency of the payments mechanism.

The largest component of Federal Reserve float is associated with the shipment of checks (cash items) between Federal Reserve offices. This interterritory float is created when a Reserve Bank credits, on the basis of a fixed availability schedule, the institution that deposits the checks, but the checks are not received by the paying institution's Federal Reserve office on a timely basis and thus the charge to the paying institution is delayed. Interterritory float arises from checks, including checks contained in "Other Fed" cash letters, shipped on Federal Reserve arranged transportation as well as those shipped on transportation arranged by depository institutions. The Board is requesting comment on a proposal to eliminate or price this category of float by permitting Reserve Banks to modify their crediting practices for interterritory check shipments. The Board expects these crediting procedures, if adopted, to reduce daily average Federal Reserve float by approximately \$900 million. Specifically, each Reserve Bank would offer depository institutions in its district a choice between two or more of the following crediting options:

1. Credit would be given on the day the checks are received on a timely basis by the collecting Federal Reserve Bank ("actual availability");

2. Credit would be given on the basis of a fixed availability schedule (unique to each institution) so that part of an institution's credit for a deposit are deferred an additional day, and, on average, float is zero ("fractional availability"); and

3. Credit would be given on the basis of a fixed availability schedule, with compensation for float being made through either

a. "as of" adjustments to correct for float after it occurs ("fixed availability with 'as of' adjustments"), or

b. earnings credits on a clearing balance maintained by the depository institution, with the value of float determined at the Federal funds rate, which is the same rate used to compute the earnings credits.

Actual availability would be implemented through an interterritory cash letter monitoring system whereby a Reserve Bank and the depositing bank would know early in the day which cash letters arrived timely at the processing Federal Reserve office. Since the Reserve Banks would be passing credit when charges are made to payor institutions, no float would be created. With fractional availability, a depositing institution would receive partial availability for its interterritory check shipments on the basis of a fixed schedule. This availability would be based on the Reserve Bank's actual experience during a prior period in collecting items for that institution. On average, Federal Reserve float under this procedure should be about zero during the course of a year. Under the fixed availability with "as of" adjustments crediting procedure, the Federal Reserve office in whose territory the depositing institution is located would give provisional credit, based on fixed availability schedules, for check deposits (both direct and consolidated shipments) sent to other Federal Reserve offices. Float incurred by a depositing institution during a reserve maintenance period (Week one) would be calculated by a Federal Reserve office during the following reserve maintenance period (Week two). An "as of" adjustment would then be made to the depositing institution's account to be effective during the next reserve maintenance period (week three). More detailed descriptions of the four options may be obtained from the Reserve Banks.

As an alternative to changing crediting procedures, it has been suggested that Reserve Banks could explicitly price interterritory check float by charging payor institutions directly for "actual" float or by folding the value of float into check prices. Charging payor institutions directly for float entails complex technical, administrative, accounting, and legal issues. With respect to folding the value of

float into check prices, the Federal Reserve does not believe that a consensus exists within the banking industry with respect to the best approach to be taken. The Federal Reserve believes further that to explicitly charge for this float category in an equitable manner would necessitate keeping track of the float created by each individual check. This would be operationally burdensome and would increase costs to depository institutions using Federal Reserve check services.

Another significant component of float is associated with return items. Return item float generally occurs with interterritory shipments when a Reserve Bank office receives from a payor institution within its territory a returned check deposited originally by an institution outside its territory ("depositing institution"). Current System procedures specify that payor (returning) institutions receive immediate credit for return items. Float arises since current interterritory accounting procedures do not provide for immediate debiting of the depositing institution's account for return items prior to receipt of the items by the depositing institution's local Federal Reserve office. The Board is requesting comment on a proposal to eliminate or price this float by charging the depositing institutions' account for large interterritory return items (\$50,000 or more) based on receipt of a wire notification from the returning Federal Reserve office. The depositing institution whose account was being charged would receive from its Reserve Bank the wire notifications as they become available, but in no event later than 3:00 p.m. As an alternative to having its account debited immediately, a depository institution could compensate for return item float through an "as of" adjustment to its account. The accounting notification would reduce return item float by permitting Reserve Banks to make same-day debits and credits. It is contemplated that the notification would contain information concerning the returned item; for example, the notification may state the name of the drawee bank, dollar value of check, payee, reason for return, etc. The dollar cut-off for the wire notification would be reviewed periodically to determine the feasibility of lowering the cut-off value. This proposal would eliminate approximately \$150 million of the \$200 million in return item float and, if adopted, would be implemented during the second quarter of 1983. Remaining return item float would be valued at the average Federal funds rate and be added to the overhead costs for the check collection service.

Public comment is also requested on a proposal to explicitly price two additional categories of float: holdover float and other intraterritory float. During the first two quarters of 1982, these two categories averaged \$390 million daily. Holdover float, resulting when a Federal Reserve office is unable to process for collection check deposits received on a timely basis, would be valued at the average Federal funds rate and added to the overhead costs for the check collection service. Other intraterritory float, resulting primarily from the inability of a Federal Reserve office to make presentment of checks to payor institutions as a result of severe weather, transportation equipment failure, or operational delays, would be priced in the same method as holdover float.

Comment is also requested on operational difficulties that depository institutions may encounter as a result of the anticipated implementation of these proposals, if they are adopted, during the second quarter of 1983.

Further study will be done on the pricing of two other categories of float; float associated with non-check activities such as wire transfers, securities transfers, automated clearing house items and other miscellaneous items ("non-check float"), and float incurred by the System incident to the maintenance of an efficient and reliable payments system during times of a natural disaster and other extraordinary circumstances ("residual float"). It is expected that the results of these further studies and recommendations for pricing these categories of float will be presented to the Board in 1983.

By order of the Board of Governors, November 1, 1982.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

[SEAL]