FEDERAL RESERVE BANK OF DALLAS

Station K, Dallas, Texas 75222

Circular No. 84-27
February 22, 1984

TO: All depository institutions and others concerned in the Eleventh Federal Reserve District

ATTENTION: Chief Executive Officer

SUBJECT: **Amendment to Regulation J -- Collection of Checks and Other Items**

SUMMARY:

The Board of Governors of the Federal Reserve System has approved an amendment to Subpart A of Regulation J, effective April 2, 1984, to permit a Reserve Bank to charge a paying bank for checks it delivers or makes available to an institution which is closed regularly on a weekday when its Reserve Bank is open. A paying bank would not be required to open or begin processing checks on such a midweek closing day because the time for return of the items would not begin until the paying bank's next banking day. The Board also has provided an alternative that enables paying banks to be charged for the value of float created by their regular midweek closing rather than be charged for the value of the checks on that day.

The Board decided not to take similar action--as proposed earlier--affecting institutions closed on a nonstandard holiday (a state or local holiday on which its District Reserve Bank is open for business). Instead, Reserve Banks will be permitted to defer giving credit to sending institutions for one day, for checks drawn on paying institutions closed on nonstandard holidays.

ATTACHMENTS: Board's press release and material as submitted for publication in the Federal Register

MORE INFORMATION: Robert L. Whitman, (214) 698-4357 at the Head Office; Robert W. Schultz, (915) 544-4370 at the El Paso Branch; Vernon L. Bartee, (713) 659-4433 at the Houston Branch; or John A. Bullock, (512) 224-2141 at the San Antonio Branch

ADDITIONAL COPIES: Public Affairs Department, Extension 6289

FEDERAL RESERVE press release

For immediate release January 30, 1984

The Federal Reserve Board today announced an amendment to its Regulation J--collection of checks and other items and wire transfer of funds--to permit a Reserve Bank to charge for checks that it delivers or makes available to an institution that is closed regularly on a weekday when its Reserve Bank is open. It is estimated that this action will eliminate approximately $110 million daily average in Federal Reserve check float.

The amendment becomes effective April 2, 1984.

The Board acted after consideration of comment received on proposals published in September.

The amendment affects institutions that choose to close on a weekday. Such closings may result in Federal Reserve float--the value of checks for which the Federal Reserve has given credit to the institution that sent the checks to it for collection (the sending institution) but for which the Federal Reserve has not yet collected from the institution on which the checks are drawn (the paying institution).

The Board gave paying institutions the alternative of being charged for the value of float created in this way rather than being charged for the value of the checks on that day.

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The Board decided not to take similar action--as earlier proposed--affecting institutions closed on a nonstandard holiday (a State or local holiday on which its District Reserve Bank is open for business). Instead, Reserve Banks will be permitted to defer for a day giving credit to sending institutions, for checks drawn on paying institutions closed on nonstandard holidays. The value of any remaining float arising from nonstandard holidays will be added to the cost base for the check collection service.

The Board took these actions pursuant to provisions of the Monetary Control Act of 1980 requiring the Federal Reserve to eliminate or charge for Federal Reserve float.

The Board's notice is attached.

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Attachment

FEDERAL RESERVE SYSTEM

12 CFR Part 210

(Docket No. R-0481)

Regulation J, Collection of Checks and Other Items
and Wire Transfer of Funds

Midweek Closing and Nonstandard Holidays.

AGENCY: Board of Governors.

ACTION: Final Rule.

SUMMARY: The Board has approved an amendment to Subpart A of Regulation J, governing the collection of checks and other items by Reserve Banks, to permit a Reserve Bank to charge a paying bank for checks made available to it by a Reserve Bank on a weekday that is a banking day for the Reserve Bank but where the paying bank is regularly closed. A paying bank would not be required to open or begin processing the checks on such a midweek closing day because the time for return of the items would not begin to run until the paying bank's next banking day. The Board has also provided an alternative that enables paying banks to be charged for the value of the float created by their midweek closing. These actions will not apply to those instances where a paying bank is closed because of a state or local holiday but on which the Reserve Bank is open (nonstandard holidays). With regard to Federal Reserve check float arising from nonstandard holidays, the Board has decided to permit Reserve Banks to defer credit to depositing

institutions for checks drawn on institutions closed on nonstandard holidays where operationally feasible. The value of any remaining Federal Reserve check float generated by nonstandard holidays will be added to the cost base for the check collection service.

EFFECTIVE DATE: April 2, 1984.

FOR FURTHER INFORMATION CONTACT: John F. Sobala, Assistant Director (202/452-2739) or Morgan J. Hallmon, Program Manager, (202/452-3878), Division of Federal Reserve Bank Operations; Daniel L. Rhoads, Attorney (202/452-3711), or Joseph R. Alexander, Attorney (202/452-2489), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Background. Section 107 of the Monetary Control Act of 1980 (12 U.S.C. § 248a) ("MCA") requires that fees be established for Federal Reserve Bank services, including Federal Reserve float.

In April 1982, the Board requested public comment on a proposal to amend Regulation J to require a depository institution to pay for checks delivered or made available to it on days the institution is closed and on which the Reserve Bank is open. 47 F.R. 15349 (April 9, 1982). Such days consist of "midweek closing days" (regular weekdays on which a depository institution chooses to close as permitted by state law) and "nonstandard holidays" (days on which the paying institution is closed because of a state or local holiday). The proposal was intended to eliminate the float that results from these closings. A total of 150 comments were received on the issue of midweek closings: 59 commenters favored the proposal and 91 were opposed. There were 82 comments received on the issue of nonstandard holidays: 19 commenters favored the proposal and 63 were opposed.

After review of the comments received and the issues raised therein, the Board, in April 1983, decided not to adopt the proposed amendment; instead, the Board provided Reserve Banks with three options to eliminate or price float arising from midweek closings and nonstandard holidays. 48 F.R. 20802 (May 9, 1983). First, a Reserve Bank could modify its availability schedules for deposits of local depositors so that credit for checks drawn on closed institutions would be deferred one additional day. Second, a Reserve Bank could modify its current practice of posting funds received for the account of the institutions on the day the institution is closed. Third, a Reserve Bank could price all or any remaining float arising from midweek closings and nonstandard holidays by adding the value of this float to the cost base for the check collection service. These procedures were scheduled to become effective October 1, 1983.

As preparations were begun to implement these procedures, depository institutions requested reconsideration of the Board's action. Concerns were expressed about each of the alternatives. With regard to the alternative of modifying availability schedules for local depositors to delay credit for checks they deposit that are drawn on closed institutions, concerns were raised as to the inequitable treatment of local depositors relative to other depositors. Under this alternative, a local depositor would receive credit for its deposit of a check drawn on a closed institutions one day later than would a non-local depositor of a check drawn on the same institution. There was also some indication that this alternative could result in circuitous routing as checks drawn on closed banks are sent for collection through non-local depository institutions for whom credit would not be deferred.

Equity considerations also were raised concerning the alternative of adding the value of this float to the cost base of the check collection service. Concern was expressed that it was unfair for depository institutions that do not choose to close midweek to bear a substantial portion of the float cost of midweek closings simply because they are in a Reserve District with a disproportionately large number of institutions that voluntarily close midweek. For example, 40 percent of the depository institutions that close midweek are located in the Chicago Federal Reserve District, and 35 percent are located in the Atlanta Federal Reserve District. Local institutions would bear a disproportionate amount of the midweek closing float cost because most of the checks deposited with the Federal Reserve for collection are drawn on another institution located in the same Federal Reserve office territory.

With regard to the alternative of deferring credit received for the account of the institution on the day it is closed, it was suggested that closed institutions could easily avoid this deferral by directing their credits through correspondents.

The Board therefore determined to republish for comment the proposed amendment to Regulation J to permit a Reserve Bank to charge a depository institution for checks delivered or made available to it on days the institution is closed and on which the Reserve Bank is open. 48 F.R. 41776 (September 19, 1983). The Board noted that there had been a substantial reduction in the amount of Federal Reserve check float arising from midweek closings and nonstandard holidays.[1/] The Board believed that the concerns expressed with the three options approved by the Board for the treatment of this float and the significant decline in the levels of this float warranted re-publication of the proposed amendment to Regulation J to permit depository institutions the opportunity to reassess the impact of the proposed amendment. The Board also decided to solicit comment on the option of

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1/ In 1982, daily average float arising from midweek closings was estimated to be $160 million, while daily average float from nonstandard holidays was estimated to be $110 million. By the third quarter of 1983, float resulting from midweek closings had declined to an estimated daily average of $110 million and float resulting from nonstandard holidays had declined to an estimated daily average of $10 million.

permitting paying institutions to defer the charge an additional day for checks made available to them on days they are closed where the Reserve Bank is open and compensate the Federal Reserve for the float caused by the deferral. Paying institutions would be charged for this float in the same manner as is done currently for interterritory check float.[2/]

Analysis of Comments. The Board received 100 comment letters on its midweek closing and nonstandard holiday proposal. Comments favoring the proposal were also received from ten Federal Reserve Banks. (These comments are not included in the following analysis.) The majority (87 percent) of commenters were banks and bank holding companies, with more than 40 percent of the comments from institutions with deposits of less than $200 million and 31 percent from institutions with deposits of $1 billion or more. The majority of comments from depository institutions were received from institutions located in the Federal Reserve Districts of Atlanta and Chicago.[3/]

A. Midweek Closings. Of the 91 commenters discussing midweek closings, 53 (approximately 58 percent) favored the proposal to charge paying institutions for checks made

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2/ Charges could be made by an "as of" adjustment to the institutions' reserve or clearing account, or by explicit charge.

3/ Seventy-five percent of the institutions that regularly close midweek are located in these two Districts and generate almost 90 percent of the $110 million daily average float attributable to midweek closings.

available to them on the days that they are closed.[4/] Three of these commenters conditioned their support on receiving same-day credit for Saturday deposits, and one commenter supported the proposal on the condition that the Federal Reserve authorize all collecting institutions to charge closed institutions on days they are closed. Commenters in favor of the proposal generally indicated that the cost of float should be borne by those institutions responsible for creating it, and that the proposal was equitable since it was unfair for open institutions to be required to pay for float generated by institutions which close midweek voluntarily. These commenters indicated further that the proposal was feasible, easy to implement, and that the float payment option would minimize the operational impact of the proposal on closed institutions. These comments were similar to those presented when the Board previously requested comment in April 1982.

Thirty-eight commenters (approximately 42 percent) were opposed to the proposal. These commenters generally stated that it was unfair to charge institutions when they are closed and that institutions would experience account management problems under the proposal. Two commenters argued

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4/ When the Board previously published this proposal in April 1982, 59 (39%) of 150 comments received favored the proposal and 91 (61%) were opposed.

that the proposal would give the Federal Reserve an unfair competitive advantage. Seven commenters suggested alternatives to the proposal.

Twenty-six commenters stated that the proposal was unfair and that it would affect disproportionately the earnings of small institutions. These commenters stated that small institutions closed midweek in order to open on Saturdays and provide full banking services to their communities, and that being charged for checks made available to them on days they are closed midweek would increase their costs. Eight commenters stated that they would have to absorb the cost of float or incur additional operating costs to process the checks on the days they are closed. As a result, some indicated they might reduce the level of service they provide on Saturday. Six commenters stated that management of their money position would be more difficult and expensive under the midweek proposal. These commenters argued that because they could not forecast accurately the dollar value of checks expected from the Federal Reserve, they would have to maintain excess balances to avoid account overdrafts or, alternatively, incur additional expense in having employees at the institution on the closed day to manage their money position. Two commenters also stated that the increased costs may disadvantage them competitively relative to institutions in neighboring communities. Three commenters also believed that this could adversely affect the economies of the small and rural communities in which these institutions are located. Five commenters stated that the cost of the proposal to small institutions outweighed any possible benefits, and two commenters stated that the Federal Reserve should recover the cost of this float by including it in the costs of the check collection service.

After full consideration of these comments, the Board has determined that the burden of imposing the cost of this float on depositing institutions outweighs the impact of charging the paying institution for checks made available to it. As indicated previously, if the Reserve Banks added the value of this float to the check cost base, check costs would be impacted disproportionately because of the disproportionate concentration in two Reserve Districts of institutions that close midweek. Local institutions would bear a disproportionate amount of the float cost because most of the checks deposited by a depository institution with the Federal Reserve for collection are drawn on other institutions within the same Federal Reserve office territory. Further, recovering this float through per item check fees would be inequitable to other institutions and would represent a subsidy to institutions which close voluntarily since they would not bear the full burden of float generated by their voluntary closing. By placing the float burden upon those institutions that can be easily identified as responsible for generating the float, the Board also believes that the amendment improves the efficiency of the payments mechanism since payment for checks is enhanced. While the amendment may increase costs somewhat for these closed institutions, the Board believes that institutions that regularly close midweek are the appropriate parties to incur the cost. Further, the option of deferring the charge to closed institutions for one day with the institutions and being charged for the float incurred should minimize the operational burdens on these closed institutions. The Board believes that this option also addresses the money management concerns expressed by commenters. In addition, these institutions can call their local Federal Reserve office to determine the value of checks that will be charged to their accounts. With regard to the concern about the adverse impact of the proposal on the economies of small and rural communities, there is no indication that the large majority of institutions in these communities will not continue to provide full banking services on Saturday.

Two commenters believed that the proposal represented an unfair use of Federal Reserve regulatory authority to enhance funds availability for institutions using Federal Reserve services. These commenters argued that correspondent institutions would be disadvantaged in offering competitive services, since, unlike Federal Reserve Banks, they would not be able to charge closed institutions. The Board does not believe that the amendment would have a material effect upon the competitive balance between the Federal Reserve and correspondents. First, the Reserve Banks will not change their availability schedules as a result of this amendment. Thus, the amendment will not affect the availability of funds to depositors from current levels. Additionally, the Board notes that the percentage of checks drawn upon institutions that are closed midweek is quite small relative to total clearings. Further, some correspondent banks already charge their respondents for such checks on a day the respondent chooses to close.

Commenters suggested several alternatives to the proposed amendment of Regulation J. One commenter suggested that the Federal Reserve not recover float attributable to midweek closings since it is incidental to the provision of banking services to small and rural communities and should be considered a social cost of maintaining the nation's payments mechanism. Five commenters also stated that the decline in the level of midweek closing float makes the need for the Board to take action at this time less urgent. However, the Federal Reserve is required to eliminate or price all Federal Reserve float.

One commenter suggested that the Reserve Banks should obtain voluntary agreements from closed institutions authorizing the Federal Reserve to charge for checks made available on closed days. The Board does not, however, believe that voluntary agreements between the Reserve Banks and depository institutions would eliminate most or all midweek closing floats. Since Federal Reserve Banks are only collecting agents there is little likelihood that paying institutions would authorize Reserve Banks to charge their accounts. Another commenter suggested that the Federal Reserve authorize all collecting institutions to charge paying institutions on closed days. However, there is a substantial question as to whether the Board is empowered to authorize all collecting institutions to charge paying institutions for checks presented on midweek closing days. Another commenter suggested that the Federal Reserve and depository institutions work jointly toward developing uniform presentment rules for all institutions. Such efforts would not enable the Federal Reserve to move expeditiously to recover fully the cost of this float.

One commenter suggested that the Federal Reserve defer credit one day to all depositors of checks drawn on closed institutions, arguing that this alternative would be consistent with the practice of the private sector. The Board believes that deferring credit to depositors for checks drawn on closed institutions would result in more complex Federal Reserve availability schedules. Implementation of these schedules would be extremely burdensome for the Reserve Banks and depository institutions since every institution depositing checks with the Federal Reserve, as well as the Reserve Banks, would have to keep track of virtually every institution that is closed midweek. Moreover, in order to delay making credit available to their customers, depository institutions would likely separately sort checks drawn on closed institutions, requiring substantial and expensive modifications to existing check sorting patterns.

Seven commenters suggested that the Federal Reserve pass credit to depositors on a six day basis, and one commenter suggested that all depository institutions be required to clear checks on Saturdays. In their opinion, this would increase the efficiency of the payments mechanism. To implement either of these suggestions, it would be necessary for the Federal Reserve and perhaps the entire banking system to remain open on Saturdays. Such an alternative is well beyond the scope of the midweek closing proposal and would require extensive consideration and analysis.

One trade association suggested that small institutions should be exempted from the proposal. However, since most float from midweek closings is attributable to small institutions, such an exemption would not accomplish the objective of eliminating this float.

B. Nonstandard holidays. Of the 65 commenters discussing nonstandard holidays, 41 (63 percent) favored charging for checks made available to institutions closed on nonstandard holidays. Of these commenters, five conditioned their support on the Federal Reserve differentiating between mandatory and voluntary nonstandard holidays, and three conditionally supported the proposal if the Reserve Banks provided credit on days the Reserve Banks are closed and depository institutions are open. Commenters favoring the proposal generally based their support on equity considerations, observing that closing was optional for many nonstandard holidays.

Twenty-four commenters (37 percent) opposed the proposal. Eight commenters stated their belief that it is unfair to charge institutions for mandatory or uniformly observed nonstandard holidays. Twelve commenters stated that the proposal would have a negative impact on their earnings, and 11 commenters suggested alternatives to the proposal.

Seven commenters stated that it was unfair to charge for nonstandard holidays when depository institutions are required by state or local law to be closed. The Board agrees that a distinction should be made in the treatment of float arising from mandatory closings. However, for many nonstandard holidays, it is unclear as to whether an institution is require or merely permitted to be closed. In view of the complexity and burden in making this distinction for all state and local holidays, the Board believes that, at this time, it is appropriate to treat all nonstandard holidays as if they were mandatory.

Twelve commenters indicated that the proposal would be operationally burdensome or costly to implement since a closed institution would have to have staff present on closed days or maintain excess balances to avoid account overdrafts. As indicated in the discussion of midweek closings, institutions would have had the option of having their Federal Reserve offices defer for one day charges to their accounts, with the institutions compensating the Federal Reserve for the float incurred.

Two commenters stated that it is unfair for the Federal Reserve to charge for nonstandard holidays when Federal Reserve Banks themselves do not observe holidays uniformly. Ten commenters suggested that the Federal Reserve should standardize holiday schedules. One commenter suggested that the Reserve Banks should credit the accounts of institutions that are open on nonstandard holidays on which their Reserve Banks are closed. One commenter suggested that the Federal Reserve should work with the industry to develop a universal holiday schedule. The Board agrees that uniform holiday schedules could contribute substantially to a further reduction in nonstandard holiday float. However, this would require extensive analysis by the Federal Reserve System and is beyond the scope of the proposed amendment.

Three commenters stated their belief that the proposal would provide a competitive advantage to some institutions located in the same state as their Federal Reserve office. These commenters argued that those institutions would be charged for fewer nonstandard holidays than other institutions within the same territory because their Federal Reserve office also observes most of these holidays. The Board believes, however, that there is no competitive advantage with respect to being charged on nonstandard holidays since all institutions would be charged when their Reserve Banks are open and would not be charged when their Reserve Banks are closed.

Two commenters stated that the Board's proposal would provide an unfair competitive advantage to Reserve Banks since correspondent institutions could not make similar charges. Another commenter stated that the Federal Reserve would achieve a competitive advantage because the cost to the Federal Reserve to implement the proposal is small relative to the costs for private sector competitors. One commenter suggested that the Federal Reserve should work with the private sector to develop uniform presentment rules for all institutions and another commenter suggested voluntary presentment agreements. Given the small amount of float involved in nonstandard holidays ($10 million), even if the proposal were adopted it is unlikely that there will be a material impact on the competitive balance between Reserve Banks and correspondents.

Citing the decline in nonstandard holiday float, two commenters suggested that the amount of this float was small and that it therefore should be excluded from pricing. However, this alternative is impractical since the Federal Reserve is required to eliminate or price Federal Reserve float.

It was suggested by three commenters that the Federal Reserve should defer credit to collecting institutions for nonstandard holidays. Since institutions in the same state often observe nonstandard holidays uniformly, it may be possible to identify readily such institutions and defer credit to depositors for checks drawn on these institutions. Thus, where operationally feasible, Reserve Banks will be provided the option of deferring credit in such instances.

Five commenters suggested that the value of nonstandard holiday float should be recovered through per item fees, since the amount of this float is small. Ideally the burden of float should be placed on the institution responsible for generating it. However, given the issues raised by the nonstandard holiday proposal, the Board believes it is appropriate that the value of nonstandard holiday float remaining after operational changes are made be added to the check collection cost base.

C. Float Payment Option. Seventeen commenters specifically discussed the option of permitting paying institutions to compensate the Federal Reserve for the value of midweek closings and nonstandard holiday float rather than being charged for their checks when they are closed. These commenters generally stated that it would minimize the difficulties faced by an institution in managing its money position, e.g., avoiding the expense of having an employee present on the closed day. One of these commenters conditionally supported the float payment option, provided the Reserve Banks pass credit when they are closed and depository institutions are open. The Board agrees that the float payment option would make the midweek closing amendment to Regulation J less burdensome operationally, and therefore this option will be available at all Reserve Banks.

Board Action.

After review of the comments and analysis of the issues raised therein, the Board has determined to approve the amendment to Regulation J to give the Reserve Banks the ability to charge institutions regularly closed midweek for checks made available to them by the Reserve Banks on the days they are closed, effective April 2, 1984. Such days include days on which the institution regularly closes midweek even if these closings are characterized as "holidays" under State law since such closings are clearly voluntary in all cases. The Board has also approved the option of permitting closed institutions to be charged for the value of the float created by their midweek closing in the same manner as is currently done for interterritory check float. In accordance with the provisions of the Regulatory Flexibility Act, 5 U.S.C. §§ 601-612, the Board considered the alternatives outlined above to minimize the impact of the amendment on small institutions. However, it is appropriate that the institution that is closed midweek bear the cost of the float that is created as a result of its closing. The Board believes that the option to allow institutions to be charged for the value of float will minimize the impact of the amendment on small institutions by permitting banks regularly closed midweek to avoid the operational costs that might otherwise be incurred. It is the Board's opinion that the amendment is the most effective and equitable manner with which to eliminate or price Federal Reserve float created by midweek closings.

The Board has also determined that the amendment to Regulation J should not apply at this time to those nonstandard holidays where a depository institution is closed but its Reserve Bank is open. The Board has decided therefore to permit Reserve Banks to defer credit to depositing institutions for checks drawn on institutions closed on nonstandard holidays where operationally feasible. The value of any remaining float arising from nonstandard holidays will be added to the cost base for the check collection service.

<u>List of Subjects in 12 C.F.R. Part 210</u>

Banks, banking; Federal Reserve System.

Effective April 2, 1984, pursuant to the Board's authority under section 13 of the Federal Reserve Act (12 U.S.C. § 342), section 16 of the Federal Reserve Act (12 U.S.C. §§ 248(o), 360), and section 11(i) of the Federal Reserve Act (12 U.S.C. § 248(i)), paragraph (a) in § 210.9 of Regulation J (12 C.F.R. Part 210) is amended by inserting "(1)" after "(a) Cash items.", redesignating subparagraphs (1), (2) and (3) as (i), (ii) and (iii) respectively, designating the undesignated paragraph following subparagraph (iii) as "(2)" and revising paragraph (2) of section 210.9 to read as follows:

SECTION 210.9 -- PAYMENT

(a) Cash items. (1) * * *

(i) * * *

(ii) * * *

(iii) * * *

(2) The proceeds of any payment shall be available to the Reserve Bank by the close of the Reserve Bank's banking day on the banking day of receipt of the item by the paying bank. If the banking day of receipt is not a banking day for the Reserve Bank, payment shall be made on the next day that is a banking day for the Reserve Bank by the close of the Reserve Bank's banking day. A paying bank that closes regularly on a weekday which is a banking day for the Reserve Bank shall either pay on that day by the close of the Reserve Bank's banking day for cash items that the Reserve Bank makes available to the paying bank on that day, or compensate the Reserve Bank for the value of the float associated with the items in accordance with procedures provided in its Reserve Bank's operating circular; in such circumstances, the paying bank is not considered to receive the item until its next banking day.

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By Order of the Board of Governors, January 30, 1984.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board