



FEDERAL RESERVE BANK OF DALLAS

Station K, Dallas, Texas 75222

Circular No. 84-55
April 23, 1984

TO: All depository institutions in the Eleventh Federal Reserve District

ATTENTION: Chief Executive Officer

SUBJECT: **Proposals to reduce risks on large dollar wire transfer systems**

SUMMARY: The Board of Governors of the Federal Reserve System has requested public comment on the proposals outlined in the attached press release regarding risks in large dollar wire transfer systems. The Board is concerned that developments could arise in connection with such systems that may destabilize financial markets and disrupt the nation's economy. Comments must be received by July 27, 1984. All correspondence should be addressed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, Washington, D.C., 20551 and should refer to Docket No. R-0515

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

MORE INFORMATION: Larry Ripley, Extension 6118 or Jonnie Miller, Extension 6290

ADDITIONAL COPIES: Public Affairs Department, Extension 6289

FEDERAL RESERVE press release



For immediate release

March 29, 1984

The Federal Reserve Board today announced two actions as part of its continuing effort to reduce risks involved in the electronic movement of hundreds of billions of dollars a day:

--The Board requested public comment on a wide variety of possible measures for reducing risk in the operations of large-dollar wire transfer systems.

--At the same time, the Board issued a policy statement designed to ensure that depository institutions do not use the Federal Reserve's wire transfer network to avoid the Federal Reserve or private sector risk reduction efforts that are under consideration.

There are at present four large-dollar electronic fund transfer systems that together handle more than \$500 billion dollars in wire transfers a day: Fedwire -- the Federal Reserve's wire transfer system; CHIPS (Clearing House Interbank Payments System) operated by the New York Clearing House; CashWire, operated by a consortium of banks and CHESS (Clearing House Electronic Settlement System) operated by the Chicago Clearing House. On Fedwire, average daily volume was about \$355 billion in 1983, involving some 150,000 transactions a day.

In taking its actions, the Board said, vis-a-vis the risks involved:

If a transfer is made over Fedwire [the Board's rules] provide that the transfer is final when the receiver's Reserve Bank credits the receiver's account or sends advice of credit; at that point the transfer is irrevocable. . . If the sender's Reserve Bank processes the transfer when the sender did not have sufficient funds in its account to cover the amount of the transfer, the sender incurs a "daylight overdraft" in its account with the Federal Reserve. The Federal Reserve bears the risk of loss if the sender is unable to cover the overdraft. The failure of an institution to cover overdrafts on Fedwire, therefore, would by itself have no effect on other institutions, including the receiver; all of the loss would be absorbed by the Federal Reserve.

Private wire networks (those other than Fedwire) however, are typically net settlement networks; that is, they operate by the

transmission of payment messages throughout the day, with settlement of net positions at the end of the day. The (time) gap between the sending of payment messages and their settlement gives rise to intra-day credit exposures among participants in private networks. These exposures are often quite large. Should a participant be unwilling or unable to settle a large net debit position (which could be due to its funds transfer activities, to other activities, or even to circumstances such as political developments, that are beyond its control) its corresponding net creditors could experience a sudden, rapid deterioration in their financial position. . .The failure of one participant to settle could affect not only other network participants, but also the full range of creditors of network participants, including bank and nonbank depositors. Sudden, large changes in the financial conditions of both network participants and their creditors could ultimately lead to serious disruptions in money and other financial markets, as well as to the disruption of trade and commercial activities.

The Board said that it is concerned with the possibility of developments that could destabilize financial markets, and noted that the Federal Reserve has already taken a number of actions designed to minimize risks associated with daylight overdrafts on Fedwire. These and a number of other actions by the Federal Reserve and in the private sector during the past several years, aimed at identifying and minimizing risks of this nature, are described in the attached notice requesting public comment. The Board said these developments show that there is a widespread recognition of risks that makes it appropriate for the Board to solicit comment on possible methods for reducing wire transfer risks.

In issuing its request for comment the Board stated four policy goals that it seeks to achieve. These are:

- Containment of the effects of settlement failure.
- Reduction of the volume of intra-day credit exposures.
- Control of remaining credit risk.
- Smooth operation of the payments system.

The request for comment

The Board identified three methods of reducing risks as deserving the most serious consideration and requested comment on them. These are:

Sender net debit caps. This would be a limit imposing a maximum ceiling or cap on the aggregate net debit position that an individual sending financial institution could incur during the day (this cap could be applied to the sender's payments made over a particular network or a single cap could be applied to all its transfer activities).

Bilateral net credit limits. Each receiving financial institution would determine the maximum amount it is willing to receive from any sender.

Finality of payments. Under this arrangement, the receiving financial institution would guarantee that it will promptly provide the beneficiaries of funds transfers with irrevocable credit for funds transfers.

The Board noted that each of these methods could be used singly or in concert with others, and requested commenters to suggest optimum combinations of risk reduction with respect to each of these three possible risk-reduction methods. The Board posed a series of questions in connection with each of these methods for the consideration and reaction of commenters. The Board also requested comment on certain specific issues, (such as how policies should apply to Edge Act and agreement corporations and U.S. branches and agencies of foreign banks), and invited commenters to suggest alternative methods for reducing risks, and to comment on any related topic.

The Board requested comment by July 27, 1984.

The policy statement:

The Board's policy statement is aimed at ensuring that institutions do not use Fedwire to avoid Federal Reserve or private sector risk reduction policies. The Board said that the most likely vehicle for such avoidance would be the use of

periodic settlement between depository institutions (probably at the end of the day) through the exchange of FedWire transfers.

The Board lifted a current moratorium on private network access to Federal Reserve net settlement facilities over the Fedwire, but established the following interim conditions for eligibility for such access:

1. All participants must set bilateral net credit limits.
2. Each network must adopt a sender cap of 50 percent of capital for each participant, applied to transfers sent over that network.
3. Each network must agree to provide the Federal Reserve with transactions data.

As the Board's requirements for access to net settlement services by large-dollar transfer networks evolve over time, such policies would apply to both existing networks and those given access under the interim requirements.

The statement sets forth measures to enforce the Board's view that it is inappropriate to use Fedwire to avoid Federal Reserve or other risk reduction measures. The enforcement measures include:

- Ex post monitoring of Fedwire transactions to detect patterns indicating inappropriate use of the Federal Reserve network.
- Counseling of institutions observed using Fedwire to avoid risk reduction measures.
- Removal of institutions from direct, on-line, access to Fedwire if they repeatedly abuse use of the wire, or, barring an offending institution from use of the Federal Reserve network.

The Board said it anticipates cooperation from financial institutions in achieving the objectives of this policy.

The Board's policy statement and its notice requesting comment are attached.

DATE: Comments must be received by July 27, 1984.

ADDRESS: Comments, which should refer to Docket No. R-0515, should be addressed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, D.C. 20551, or delivered to room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may be inspected in 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 availability of information, 12 CFR § 261.6(a).

FOR FURTHER INFORMATION CONTACT: Edward C. Ettin, Deputy Director, Division of Research and Statistics (202/452-3368); David B. Humphrey, Chief, Financial Studies Section, Division of Research and Statistics (202/452-2557); Elliott C. McEntee, Associate Director, Division of Federal Reserve Bank Operations (202/452-2231); Jeffrey C. Marquardt, Economist, Division of International Finance (202/452-2360); Gilbert T. Schwartz, Associate General Counsel, Legal Division (202/452-3625); or Joseph R. Alexander, Attorney, Legal Division (202/452-2489). Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION:

Background

Large-dollar electronic funds transfer systems¹ have become an integral part of both the domestic and international dollar payments mechanism, and play a crucial role in support of U.S. financial and real economic activity. The manner in which private systems generally are structured, however, creates significant risks for the institutions that participate in them and other sectors of the economy as well.

Any depository institution wishing to transfer funds ("the sender"), for its own account or for the account of a customer, to another depository institution ("the receiver"), for the

FEDERAL RESERVE SYSTEM

[Docket No. R-0515]

Proposals to Reduce Risk on Large-Dollar Transfer Systems

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comments.

SUMMARY: The Board of Governors is requesting public comment on proposals to reduce risks on large-dollar wire transfer systems. The Board is concerned that developments that could arise in connection with such systems may destabilize financial markets and disrupt the nation's economy.

¹ The term "large-dollar electronic funds transfer systems" (also referred to as "electronic payments systems" or "wire networks") refers here to networks composed of more than two participants transferring payment messages of both large average and large aggregate value, and providing for settlement, i.e. the actual transfer of funds. Such systems may involve a time lag between the transmission of the payment messages and settlement that gives rise to intra-day inter-bank credit exposures. Under these criteria, there are presently four large-dollar electronic funds transfer systems: Fedwire (the Federal Reserve's wire transfer system), CHIPS (Clearing House Interbank Payments System, operated by the New York Clearing House Association), CashWire (operated by a consortium of banks), and CHES (Clearing House Electronic Settlement System, operated by the Chicago Clearing House Association).

benefit of the receiver or a customer of the receiver, has several networks that it might use.² The choice of a network can involve several business and technical considerations.

If a transfer is made over Fedwire, § 210.36(a) of Regulation J, 12 CFR § 210.36(a), provides that the transfer is final when the receiver's Reserve Bank credits the receiver's account or sends the advice of credit; at that point the transfer is irrevocable, and the receiver has actually and finally collected funds. If the sender's Reserve Bank processes the transfer when the sender did not have sufficient funds in its account to cover the amount of the transfer, the sender incurs a "daylight overdraft" in its account with the Federal Reserve. The Federal Reserve bears the risk of loss if the sender is unable to cover this overdraft. The failure of an institution to cover daylight overdrafts on Fedwire, therefore, would by itself have no effect on other institutions, including the receiver; all of the loss would be absorbed by the Federal Reserve.

Private wire networks, however, are typically net settlement networks; that is, they operate by the transmission of payment messages throughout the day with settlement of net positions at the end of the day. The temporal gap between the sending of payment messages and their settlement gives rise to net intra-day credit exposures among participants in private networks. These exposures are often quite large. Should a participant be unwilling or unable to settle a large net debit position,³ its corresponding net creditors could experience a sudden, rapid deterioration in their financial positions. The term "systemic risk" refers to the possibility that the failure of one participant in a private network would so jeopardize the financial condition of its net creditors on that network, that its creditors, in turn, would also be unable to settle. The concept of systemic risk is also used to encompass the possible effects of settlement failure on the entire financial system. The failure of one participant to settle could affect not only other network participants, but also the full range of creditors of network participants, including bank and nonbank depositors. Sudden, large

changes in the financial condition of both network participants and their creditors could lead to serious disruptions in money and other financial markets, as well as to the disruption of trade and commercial activities.

Industry groups, as well as the Federal Reserve, have been concerned by these risks for some time. For example, in April, 1982, the Association of Reserve City Bankers ("ARCB") published a *Report on the Payments System*, which identified risk as one of the major issues facing participants in the nation's payments system. The ARCB's Payments System Committee subsequently established a task force to study the issue further. The Risk Task Force issued its report, *Risks in the Electronic Payments Systems*, in October, 1983, suggesting, *inter alia*, that certain types of voluntary credit limits be established to minimize the possibility that any participant would be unable to settle its end-of-day position on any network.

The Federal Reserve is particularly concerned about current payments system risks. First and foremost, the Federal Reserve is concerned about developments that may destabilize financial markets. Moreover, Congress has given the Federal Reserve a unique role in the nation's payments mechanism that justifies attention on the part of the System with the efficiency and safety of large-dollar payments systems. Indeed, the Federal Reserve's responsibility for the implementation of monetary policy, as well as its responsibility as a bank supervisor, requires the preservation of a safe and efficient payments mechanism. Further, to reduce systemic risk, the Federal Reserve may be called upon as lender of last resort to prevent one participant's settlement failure from spreading further through the banking system and into the rest of economy.

Initially, the Federal Reserve's concern with payments system risks was centered on the problems associated with daylight overdrafts on Fedwire. In September, 1981, the Board directed reserve Banks to discourage daylight overdrafts and to prevent institutions from incurring large daylight overdrafts on a regular basis. Subsequently, in May, 1982, the Board announced a three-part policy for dealing with these overdrafts. The components of this policy are: (1) Moving toward collateralization of daylight overdrafts arising out of wire transfers of book-entry U.S. government and federal agency securities; (2) *ex post* monitoring of daylight overdrafts resulting from Fedwire funds transfers

(those not arising out of book-entry securities transfers) and counseling those institutions incurring daylight overdrafts of inordinate frequency, duration, or size; and (3) full collateralization and real-time monitoring of Fedwire overdrafts of U.S. branches and agencies of foreign banks and Edge Act and agreement corporations.

The Board realized, however, that without a program to control risks across all wire transfer systems, reduction of Fedwire daylight overdrafts would not reduce systemic risks, because transfers (and overdrafts) on Fedwire would simply shift to other networks. To that end, the Board directed its staff to undertake a study of the risks associated with large-dollar wire transfer systems.

During the course of this study, there have been several other important developments:

- In October, 1982, the Board provided CashWire⁴ access to the Federal Reserve's net settlement service. This access was conditioned on CashWire's adoption of an aggregate intra-day net debit limit applicable to each CashWire sender ("sender net debit cap"). CashWire has also adopted requirements that each participant adopt an intra-day net credit limit *vis-a-vis* each other participant ("bilateral net credit limits"), and that each participant guarantee irrevocable availability of funds received over CashWire to its customers. Each of these measures reduces the effect that a CashWire participant's inability to settle would have upon other participants and their customers.

- Also in late 1982, the Board established the Federal Advisory Council/Thrift Institutions Advisory Council (FAC/TIAC) Payments System Committee to consider the issue of payment system risk. In November, 1983, the Committee issued a report containing several important proposals that are discussed more fully below.⁵

- In August, 1983, the Federal Financial Institutions Examination Council adopted a uniform manual of procedures for examination of funds transfer activities of depository institutions on large-dollar wire transfer networks, as well as nonsettling

² Transfers of funds involving traditional correspondent banking arrangements are also a possibility. Banks may also transmit payment messages over a nonsettling communications network and settle later over a settling network or through adjustment of correspondent balances.

³ The failure of an institution to settle may be related to its funds transfer activities, to other activities, or even to circumstances, such as political developments, that are beyond the institution's control.

⁴ CashWire is a service offered by the Payment and Administrative Communication Corporation (PAC), which is owned by a consortium of 180 U.S. banks. PAC also offers a nonsettling communication service (BankWire II). The 17 banks using the CasWire service exchange about 350 messages per day, with an average value of \$700,000 per transfer.

⁵ Copies of this report are available from the Secretary of the Board at the address listed above.

costs and other constraints may provide incentives for participants to find ways of avoiding risk reduction policies adopted by the Federal Reserve and privately-owned wire networks. The most likely vehicle for such avoidance would be the use of periodic settlement between depository institutions (most likely at the end of the day) through the exchange of Fedwire transfers. It is clear that the widespread use of these kinds of settlement arrangements by wire network participants could undermine the effectiveness of any risk reduction measures. In order to assure that this result does not occur, the Board is issuing this policy statement to define more clearly the parameters of appropriate Fedwire use.

II. The Board's Authority Over Fedwire

Fedwire operates through the transmission of payment messages between Federal Reserve Banks and the debiting and crediting of accounts at Reserve Banks. The Federal Reserve Act gives the Board explicit, plenary authority to regulate all aspects of a Fedwire transfer. This includes the authority to regulate the withdrawal of funds from reserve accounts, 12 U.S.C. 464, and the authority to regulate the transfer of funds among Reserve Banks, 12 U.S.C. 248(o). The Board also possesses authority to promulgate all rules and regulations necessary to carry out its functions, duties, and services. 12 U.S.C. 248(i).

III. Interim Policy

During the pendency of the Board's consideration of the issue of wire transfer risk, Reserve Banks were instructed not to provide net settlement services to wire transfer networks that had not previously obtained Board approval. The purpose of this moratorium was to maintain the *status quo* to ensure that sufficient options remained open to the Board while it considered various approaches to the issue of risk on large-dollar transfer systems.

Today, the Board is requesting public comment on several proposals for dealing with the risk issue. Concurrently, the Board is lifting the moratorium, and Reserve Banks will now be able to offer net settlement services on an interim basis to large-dollar wire transfer networks that had not previously obtained Board approval. To be eligible for net settlement services, such networks and their

participants must agree to the following conditions:

1. All participants must set bilateral credit limits.
2. The network must adopt a sender debit cap of 50 per cent of capital for each participant to be applied to transfers sent over that network.
3. The network must agree to provide *ex post* transaction data to the Federal Reserve.

When the Board adopts a final policy for large-dollar transfer networks such policy would apply to both existing networks and those given access under the interim policy.

The purpose of these requirements is to ensure that risks are not increased while the Board considers public comments and decides on its ultimate risk reduction policies. It is important, therefore, that networks and their participants do not seek to use Fedwire to avoid these conditions or the more permanent policies that may eventually be adopted.

IV. Inappropriate Uses of Fedwire

It is the Board's policy that use of Fedwire for the avoidance of Federal Reserve or private sector risk reduction measures is not appropriate. To achieve the objectives of this policy, the Reserve Banks will conduct *ex post* monitoring of Fedwire transactions for the purpose of detecting patterns indicating that institutions are using Fedwire for inappropriate purposes. Institutions that use Fedwire to avoid risk reduction measures will be counseled. Repeated abuse of Fedwire may result in an institution being removed from on-line access to Fedwire so that its Fedwire transactions may be individually screened, or an offending institution may be barred from using the Federal Reserve's wire transfer service.

The Board believes that depository institutions perceive the seriousness of the wire transfer risk issue. Accordingly, the Board anticipates that institutions will cooperate with this policy as the Board and the banking industry pursue appropriate measures to reduce these risks.

By order of the Board of Governors of the Federal Reserve System, March 29, 1984.

William W. Wiles,
Secretary of the Board.

[FR Doc. 84-8797 Filed 4-2-84; 8:45 am]

BILLING CODE 6210-01-M

permissible for bank holding companies. Unless otherwise noted, such activities will be conducted throughout the United States.

Each application is available for immediate inspection at the Federal Reserve Bank indicated. Once the application has been accepted for processing, it will also be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing on the question whether consummation of the proposal can "reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." Any request for a hearing on this question must be accompanied by a statement of the reasons a written presentation would not suffice in lieu of a hearing, identifying specifically any questions of fact that are in dispute, summarizing the evidence that would be presented at a hearing, and indicating how the party commenting would be aggrieved by approval of the proposal.

Unless otherwise noted, comments regarding the application must be received at the Reserve Bank indicated or the offices of the Board of Governors not later than April 23, 1984.

A. Federal Reserve Bank of Atlanta (Robert E. Heck, Vice President) 104 Marietta Street, NW., Atlanta, Georgia 30303:

1. *First Continental Bancshares, Inc.*, Gretna, Louisiana; to engage *de novo* through its subsidiary Liberty Heritage Life Insurance Company, Shreveport, Louisiana, in the sale of life, accident and health insurance, and disability insurance directly related to its extensions of credit. These activities will be provided in the State of Louisiana.

B. Federal Reserve Bank of Chicago (Franklin D. Dreyer, Vice President) 230 South LaSalle Street, Chicago, Illinois 60690:

1. *Firsnabanco, Inc.*, Viroqua, Wisconsin; to engage *de novo* in making or acquiring loans and other extensions of credit secured by a borrower's inventory, accounts receivable or other assets. These activities will be provided in the State of Wisconsin.

2. *First of America Bank Corporation*, Kalamazoo, Michigan; to engage *de novo* through its subsidiary First of America Insurance Company, Phoenix, Arizona, in the activity of underwriting, as reinsurer, credit life and credit disability insurance. The activities are directly

related to the extension of credit by the credit-extending affiliates of First of America Bank Corporation. These activities will be provided in the State of Michigan. Comments on this application must be received not later than April 20, 1984.

3. *Midwest Financial Group, Inc.*, Peoria, Illinois; to engage *de novo* through its subsidiary Midwest Financial Data Corp., Peoria, Illinois, in providing data processing services to its affiliated banks and to customers of its affiliated banks, such data processing facilities being designed, marketed and operated for the transmission of financial, banking or economic data. These activities will be provided in the State of Illinois and states contiguous to Illinois.

C. Federal Reserve Bank of San Francisco (Harry W. Green, Vice President) 101 Market Street, San Francisco, California 94105:

1. *Fresno Bancorp*, Fresno, California; to engage *de novo* through Fresno Bansystem, Inc., Fresno, California, in providing to others data processing and data transmission services, facilities (including data processing and data transmission hardware, software, documentation, or operating personnel), data bases on access to such services, facilities or data bases. Comments on this application must be received not later than April 17, 1984.

2. *Security Pacific Corporation*, Los Angeles, California; to engage *de novo* through its subsidiary Security Pacific Mortgage Corporation, Los Angeles, California, in the origination and acquisition of mortgage loans, including residential mortgage loans, development and construction loans on multi-family and commercial properties for its own account or for sale to others and the servicing, including the purchase and sale of such loans for others.

Board of Governors of the Federal Reserve System, March 28, 1984.

James McAfee,
Associate Secretary of the Board.

[FR Doc. 84-8799 Filed 4-2-84; 8:45 am]

BILLING CODE 6210-01-M

[Docket No. R-0516]

Policy Statement on Use of the Federal Reserve's Wire Transfer Network

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Policy statement.

SUMMARY: In recent years, the Board has become concerned with the increasing

risk associated with large-dollar wire transfer systems. In a related action, the Board issued for public comment proposals to reduce those risks and interim policies regarding the provision of Reserve Bank net settlement services to wire transfer networks. To ensure that institutions do not use the Federal Reserve's wire transfer network (Fedwire) to avoid Federal Reserve or private sector risk reduction policies, the Board is issuing a policy statement indicating that use of Fedwire to avoid risk reduction measures is inappropriate.

EFFECTIVE DATE: April 30, 1984.

FOR FURTHER INFORMATION CONTACT: Edward C. Ettin, Deputy Director, (202/452-3368), or David B. Humphrey, Chief, Financial Studies Section, Division of Research and Statistics (202/452-2557); Elliott C. McEntee, Associate Director, Division of Federal Reserve Bank Operations (202/452-2231); Jeffrey C. Marquardt, Economist, Division of International Finance (202/452-2360); or Gilbert T. Schwartz, Associate General Counsel (202/452-3625), or Joseph R. Alexander, Attorney, Legal Division (202/452-2489), Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION:

I. Introduction

The Board has been increasingly concerned with the risks associated with participation on large-dollar wire transfer networks.¹ The Board has been considering several methods of reducing wire transfer risk, and has today requested public comment on several of these methods.

As the Board indicated in its request for comment, an effective program for reducing wire transfer risks may involve certain costs and constraints. These will likely include a reduction in the amount of intra-day credit exposure associated with wire transfers and an increase in the costs of effectively managing an institution's position. The increased

¹ The term "large-dollar wire networks" refers to networks composed of more than two participants transferring payment messages of both large average and large aggregate value, and providing for settlement, i.e. the actual transfer of funds. Such networks may involve a time lag between the transmission of the payment messages and settlement that gives rise to intra-day inter-bank credit exposures. Under these criteria, there are presently four large-dollar networks: Fedwire (the Federal Reserve's wire transfer system), CHIPS (Clearing House Interbank Payments System, operated by the New York Clearing House Association), CashWire (operated by a consortium of banks), and CHES (Clearing House Electronic Settlement System, operated by the Chicago Clearing House Association).

and summarizing the evidence that would be presented at a hearing.

Unless otherwise noted, comments regarding each of these applications must be received not later than April 23, 1984.

A. Federal Reserve Bank of Richmond (Lloyd W. Bostian, Jr., Vice President) 701 East Byrd Street, Richmond, Virginia 23261:

1. Guyan Bankshares, Inc., Gilbert, West Virginia; to become a bank holding company by acquiring 100 percent of the voting shares of Gilbert Bank & Trust Company, Gilbert, West Virginia.

B. Federal Reserve Bank of Atlanta (Robert E. Heck, Vice President) 104 Marietta Street, N.W., Atlanta, Georgia 30303:

1. *Bank South Corporation*, Atlanta, Georgia, to merge with Cumming Bancshares, Inc., Cumming, Georgia, and thereby indirectly acquire Bank of Cumming, Cumming, Georgia.

C. Federal Reserve Bank of Chicago (Franklin D. Dreyer, Vice President) 230 South LaSalle Street, Chicago, Illinois 60690:

1. *Citizens Bancorporation*, Sheboygan, Wisconsin; to acquire the assets and liabilities of Bancorporation of Wisconsin, Inc., West Allis, Wisconsin, and thereby indirectly acquire Southwest Bank, New Berlin, Wisconsin, and West Allis State Bank, West Allis, Wisconsin. Comments on this application must be received not later than April 17, 1984.

2. *Citizens Banking Corporation*, Flint, Michigan; to acquire 100 percent of the voting shares of Grayling State Bank, Grayling, Michigan. Comments on this application must be received not later than April 20, 1984.

4. *Northern Trust Corporation*, Chicago, Illinois; to acquire 100 percent of the voting shares of Northern Trust of Florida Corporation, Miami, Florida, and thereby indirectly acquire Northern Trust Bank of Florida, N.A., Miami, Florida; Northern Trust Bank of Florida/Naples, N.A., Naples, Florida; Northern Trust Bank of Florida/Palm Beach, N.A., Palm Beach, Florida; and Northern Trust Bank of Florida/Sarasota, N.A., Sarasota, Florida.

4. *Northern Trust of Florida Corporation*, Miami, Florida; to become a bank holding company by acquiring 99 percent of the voting shares of each of the following banks: Northern Trust Bank of Florida, N.A., Miami, Florida; Northern Trust Bank of Florida/Naples, N.A., Naples, Florida; Northern Trust Bank of Florida/Palm Beach, N.A., Palm Beach, Florida; and Northern Trust Bank of Florida/Sarasota, N.A., Sarasota, Florida.

D. Federal Reserve Bank of Dallas (Anthony J. Montelaro, Vice President) 400 South Akard Street, Dallas, Texas 75222:

1. *Oak Ridge Bancshares, Inc.*, Oak Ridge, Louisiana; to become a bank holding company by acquiring 80 percent of the voting shares of Bank of Oak Ridge, Oak Ridge, Louisiana. Comments on this application must be received not later than April 25, 1984.

Board of Governors of the Federal Reserve System, March 27, 1984.

James McAfee,

Associate Secretary of the Board.

[FR Doc. 84-8671 Filed 4-2-84; 8:45 am]

BILLING CODE 6210-01-M

First Community Bancshares, Inc., et al.; Formations of; Acquisitions by; and Mergers of Bank Holding Companies

The companies listed in this notice have applied for the Board's approval under section 3 of the Bank Holding Company Act (12 U.S.C. 1842) and § 225.14 of the Board's Regulation Y (49 FR 794) to become a bank holding company or to acquire a bank or bank holding company. The factors that are considered in acting on the applications are set forth in section 3(c) of the Act (12 U.S.C. 1842(c)).

Each application is available for immediate inspection at the Federal Reserve Bank indicated. Once the application has been accepted for processing, it will also be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing to the Reserve Bank or to the offices of the Board of Governors. Any comment on an application that requests a hearing must include a statement of why a written presentation would not suffice in lieu of a hearing, identifying specifically any questions of fact that are in dispute and summarizing the evidence that would be presented at a hearing.

Unless otherwise noted, comments regarding each of these applications must be received not later than April 26, 1984.

A. Federal Reserve Bank of Richmond (Lloyd W. Bostian, Jr., Vice President) 701 East Byrd Street, Richmond, Virginia 23261:

1. *First Community Bancshares, Inc.*, Princeton, West Virginia, to acquire 100 percent of the voting shares of Oceana National Bank, Oceana, West Virginia.

B. Federal Reserve Bank of Atlanta (Robert E. Heck, Vice President) 104 Marietta Street, N.W., Atlanta, Georgia 30303:

1. *First National Bancshares of West Alabama, Inc.*, Aliceville, Alabama; to become a bank holding company by acquiring 80 percent of the voting shares of First National Bank of Aliceville, Aliceville, Alabama, and Bank of Gordo, Gordo, Alabama. Comments on this application must be received not later than April 25, 1984.

2. *NBC Bancshares of DeRidder, Inc.*, DeRidder, Louisiana, to become a bank holding company by acquiring 100 percent of the voting shares of National Bank of Commerce of DeRidder, DeRidder, Louisiana. Comments on this application must be received not later than April 25, 1984.

C. Federal Reserve Bank of Chicago (Franklin D. Dreyer, Vice President) 230 South LaSalle Street, Chicago, Illinois 60690:

1. *Evergreen of Wisconsin, Inc.*, Poy Sippi, Wisconsin, to become a bank holding company by acquiring 100 percent of the voting shares of Farmers State Bank, Poy Sippi, Wisconsin. Comments on this application must be received not later than April 25, 1984.

2. *Rockford City Bancorp, Inc.*, Rockford, Illinois, to merge with Boone Bancorp, Inc., Belvidere, Illinois and thereby indirectly acquire Boone State Bank, Belvidere, Illinois. Comments on this application must be received not later than April 25, 1984.

D. Federal Reserve Bank of Dallas (Anthony J. Montelaro, Vice President) 400 South Akard Street, Dallas, Texas 75222:

1. *Amarillo Western Bancshares, Inc.*, Amarillo, Texas, to acquire 100 percent of the voting shares of City National Bank, Amarillo, Texas.

Board of Governors of the Federal Reserve System, March 28, 1984.

James McAfee,

Associate Secretary of the Board.

[FR Doc. 84-8798 Filed 4-2-84; 8:45 am]

BILLING CODE 6210-01-M

First Continental Bancshares, Inc. et al.; Notice of Applications To Engage de Novo in Permissible Nonbanking Activities

The companies listed in this notice have filed an application under § 225.23(a)(1) of the Board's Regulation Y (49 FR 794) for the Board's approval under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) and § 225.21(a) of Regulation Y (49 FR 794) to commence or to engage *de novo*, either directly or through a subsidiary, in a nonbanking activity that is listed in § 225.25 of Regulation Y as closely related to banking and

under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) and section 225.21(a) of Regulation Y (49 FR 794) to commence or to engage *de novo*, either directly or through a subsidiary, in a nonbanking activity that is listed in section 225.25 of Regulation Y as closely related to banking and permissible for bank holding companies. Unless otherwise noted, such activities will be conducted throughout the United States.

Each application is available for immediate inspection at the Federal Reserve Bank indicated. Once the application has been accepted for processing, it will also be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing on the question whether consummation of the proposal can "reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices." Any request for a hearing on this question must be accompanied by a statement of the reasons a written presentation would not suffice in lieu of a hearing, identifying specifically any questions of fact that are in dispute, summarizing the evidence that would be presented at a hearing, and indicating how the party commenting would be aggrieved by approval of the proposal.

Unless otherwise noted, comments regarding the applications must be received at the Reserve Bank indicated or the offices of the Board of Governors not later than April 20, 1984.

A. *Federal Reserve Bank of Richmond* (Lloyd W. Bostian, Jr., Vice President) 701 East Byrd Street, Richmond, Virginia 23261:

1. *First Maryland Bancorp*, Baltimore, Maryland and *Allied Irish Banks Limited*, Dublin, Ireland; to engage *de novo* through a subsidiary, First Maryland Mortgage Corporation, in commercial and industrial real estate equity financing.

B. *Federal Reserve Bank of Atlanta* (Robert E. Heck, Vice President 104 Marietta Street, N.W., Atlanta, Georgia 30303:

1. *Citizens and Southern Georgia Corporation*, Atlanta Georgia; to engage *de novo* in the activity of management consulting to nonaffiliated bank and nonbank depository institutions and their subsidiaries.

C. *Federal Reserve Bank of San Francisco*, (Harry W. Green, Vice President) 101 Market Street, San Francisco, California 94105:

1. *New City Bancorp*, Orange, California; to engage *de novo* through its subsidiary, *New City Leasing*, Orange, California in leasing of personal property, especially motor vehicles; insurance sales as an agent or broker with respect to any insurance directly related to an extension of credit by a bank or bank related firm, or any insurance directly related to the provision of other financial services by a bank or bank related firm, serving the state of California. Comments on this application must be received not later than April 23, 1984.

Board of Governors of the Federal Reserve System, March 27, 1984.

James McAfee,

Association Secretary of the Board.

[FR Doc. 8669 Filed 4-2-84; 8:45 am]

BILLING CODE 6210-01-M

Acquisition of Company Engaged in Permissible Nonbanking Activities; First Security Corporation

The organization listed in this notice has applied under section 225.23(a)(2) or (f) of the Board's Regulation Y (49 FR 794) for the Board's approval under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) and section 225.21(a) of Regulation Y (49 FR 794) to acquire or control voting securities or assets of a company engaged in a nonbanking activity that is listed in section 225.25 of Regulation Y as closely related to banking and permissible for bank holding companies. Unless otherwise noted, such activities will be conducted throughout the United States.

The application is available for immediate inspection at the Federal Reserve Bank. Once the application has been accepted for processing, it will also be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing on the question whether consummation of the proposal can "reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." Any request for a hearing on this question must be accompanied by a statement of the reasons a written presentation would not suffice in lieu of a hearing, identifying specifically any questions of fact that are in dispute, summarizing the evidence that would be presented at a hearing, and indicating how the party

commenting would be aggrieved by approval of the proposal.

Comments regarding the application must be received at the Reserve Bank or the offices of the Board of Governors not later than April 25, 1984.

A. *Federal Reserve Bank of San Francisco* (Harry W. Green, Vice President) 101 Market Street, San Francisco, California 94105:

1. *First Security Corporation*, Salt Lake City, Utah; to acquire Mission Bay Mortgage Company, San Diego, California, and thereby engage in making or acquiring loans and other extensions of credit such as would be made by a mortgage financing company, including making both residential and commercial mortgage loans for its own portfolio and for sale to others; the purchase of such loans from affiliated banks and other entities and from others; the assembly of loans into blocks for investors; servicing of such loans for others, and all activities incident thereto; limited insurance agency activities directly, through an affiliate, or through other insurance companies covering insurance related to the extension of credit.

Board of Governors of the Federal Reserve System, March 27, 1984.

James McAfee,

Associate Secretary of the Board.

[FR Doc. 84-8670 Filed 4-2-84; 8:45 am]

BILLING CODE 6210-01-M

Formations of; Acquisitions by; and Mergers of Bank Holding Companies; Guyan Bankshares, Inc., et al.

The companies listed in this notice have applied for the Board's approval under section 3 of the Bank Holding Company Act (12 U.S.C. 1842) and section 225.14 of the Board's Regulation Y (49 FR 794) to become a bank holding company or to acquire a bank or bank holding company. The factors that are considered in acting on the applications are set forth in section 3(c) of the Act (12 U.S.C. 1842(c)).

Each application is available for immediate inspection at the Federal Reserve Bank indicated. Once the application has been accepted for processing, it will also be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing to the Reserve Bank or to the offices of the Board of Governors. Any comment on an application that requests a hearing must include a statement of why a written presentation would not suffice in lieu of a hearing, identifying specifically any questions of fact that are in dispute

foreign banks continue to be fully collateralized?

- If caps are established, how should Edge Act and agreement corporations be treated?

- As separate entities, with a cap determined by reference their own capital?

- As part their parent institutions with one overall cap for the parent and all of its subsidiaries?

- If caps are established, how should U.S. agencies and branches of foreign banks be treated?

- as separate entities, with a cap determined by reference to branch or agency assets, or some form of capital equivalent?

- as consolidated entities, with a cap determined by reference to the consolidated U.S. branch and agency assets of each foreign bank, or some form of capital equivalent based on a consolidated U.S. balance sheet?

- as part of their parent institutions with one overall cap for the parent, hence for all of its branches and agencies, determined by reference to the parent's worldwide capital stated in U.S. dollars?

- Should monitoring of these entities be on a real-time or *ex post* basis?

5. *Enhanced Examination Procedures.* As noted previously, the Federal Financial Institutions Examination Council ("FFIEC") has adopted a uniform manual of procedures for examining funds transfer activities on large-dollar wire transfer networks and nonsettling communications networks. These procedures have been designed to disclose deficiencies in the internal credit and operational controls of institutions participating in large-dollar networks, and to assess the adequacy of the senior management's supervision of these activities.

With the FFIEC's approval, the role of the examination process could be expanded further. Federal examiners could review and comment on the bilateral net credit limits and sender net debit caps voluntarily established by each institution. This review might include analysis of the procedures used by each institution to establish and periodically review its limits and caps, comparison of the size of an institution's limits and caps with those established by per group institutions, consideration of whether the limits and caps have ever been exceeded, and review of procedures used when limits or caps are exceeded.

The Board requests comment on whether it should seek FFIEC concurrence for expanded examination of wire transfer activities, and, if so,

what this expanded examination should entail.

6. *Monitoring.* The FAC/TIAC Payment Systems Committee recommended that "[t]he Federal Reserve continue to collect and review information on daylight credit exposures on Fedwire and private wire systems." This monitoring may be done in a variety of ways. For example, the Federal Reserve requires, as a condition to access to Federal Reserve net settlement services, access to transaction data on an *ex post* basis, and the Board may collect similar information from all other networks.

The Board requests comment on this issue, specifically on the appropriate uses for transaction data from wire networks, and the type of analysis that would be necessary for continued monitoring of wire transfer activities.

7. *Book-Entry U.S. Government Securities Transfers.* When the Board announced its policy for dealing with Fedwire daylight overdrafts, it directed the Reserve Banks to develop, if legally and operationally possible, a plan for collateralizing, with the underlying securities being transferred, daylight overdrafts arising out of book-entry transfers of U.S. government and federal agency securities. This decision reflected the Board's concern that subjecting these overdrafts to overall controls could disrupt the government securities market and, hence, the conduct of monetary policy through open market operations. Technical difficulties have made it impossible so far to implement the Board's policy, and, pending development of an operationally feasible collateralization plan, Reserve Banks have been exempting overdrafts arising from the transfer of book-entry U.S. government and federal agency securities from the counseling guidelines the Board also adopted.

The Board will continue, for the time being, to exempt daylight overdrafts arising from book-entry government securities transfers from the limitations of the proposal. Procedures are being developed that will permit at least partial collateralization of such overdrafts by pools of pledgeable book-entry U.S. Treasury and agency securities, which the Board hopes to adopt by mid-1985.

Limiting Avoidance Techniques

The adoption of voluntary or regulatory risk reduction measures may induce some depository institutions to attempt to avoid the costs and restraints such measures may entail. The most probable vehicle for such avoidance would be the use of new or existing

communications networks that send payments messages during the day, coupled with periodic bilateral settlement through the exchange of individual Fedwire transfers. The use of such arrangements would circumvent risk reduction policies, and could seriously jeopardize the success of any Federal Reserve or private sector risk reduction program. To deter such a possibility, the Board has adopted a general policy statement declaring that the use of Fedwire to avoid risk reduction measures is an unacceptable use of Fedwire.

Interim Measures

In conjunction with seeking public comment on these proposals, the Board is lifting the System's moratorium on the provision of net settlement services for any wire networks that had not previously been specifically approved for net settlement services by the Board. This moratorium was established pending further Board consideration of the issue of risk on large-dollar transfer systems. During the period before the adoption of a final risk reduction program, Reserve Banks may, upon application, provide interim net settlement services to large-dollar transfer networks that had not previously received authorization from the Board. To be eligible for net settlement services, such networks and their participants must agree to the following conditions:

1. All participants must set bilateral net credit limits.

2. The network must adopt a sender debit cap of 50 percent of capital for each participant to be applied to transfers sent over that network.

3. The network must agree to provide *ex post* transaction data to the Federal Reserve.

When the Board adopts a final policy for large-dollar transfer networks, such policy will apply to both existing networks and those given access under the interim policy.

By order of the Board of Governors of the Federal Reserve System, March 29, 1984.

William W. Wiles,
Secretary of the Board.

[FR Doc. 84-8796 Filed 4-2-84; 8:45 am]

BILLING CODE 6210-01-M

Applications to Engage de novo in Permissible Nonbanking Activities; First Maryland Bancorp, et al.

The companies listed in this notice have filed an application under section 225.23(a)(1) of the Board's Regulation Y (49 FR 794) for the Board's approval

As with sender net debit caps, bilateral credit limits have support among private sector participants. Both the FAC/TIAC Payment System Committee and the ARCB Risk Task Force have recommended that receiving banks adopt bilateral credit limits. CashWire requires each of its participants to set bilateral net credit limits *vis-a-vis* other participants on that network, which CashWire monitors on a real-time basis. CHIPS has begun experimenting with bilateral credit limits for members of its network, and expects to have its program fully in effect by October, 1984. As with the CashWire sender net debit caps, any payment message which causes a CHIPS sender to exceed the credit limit established by its receiver will be rejected unless the receiver increases the limit.

The Board requests comment on whether bilateral net credit limits would be useful in reducing payment system risk. Specifically, the Board requests comments on the following questions:

- Would bilateral net credit limits be effective in reducing risks?
- What criteria should institutions use in establishing these limits?
- Would finality of payments (see below) be necessary or desirable to provide receivers of payments with appropriate incentives to establish bilateral credit limits that will lead to effective risk management?
- Should examiners review and comment on bilateral credit limits?
- If sender net debit caps are used, is there a need to have bilateral net credit limits?

3. *Finality of Payments.* As noted previously, transfers of funds made over Fedwire are final when the receiver's Reserve Bank credits the receiver's account or sends the advice of credit. The credit to the receiver is irrevocable (although subject to the Reserve Bank's right of setoff against the receiver), and the receiver agrees, under Regulation J, to make the amount of the transfer available to the beneficiary promptly. 12 CFR §§ 210.36, 210.30(b). In other words, the Federal Reserve guarantees "good funds" to the receiver.

CashWire also provides finality of payments, by providing that receivers of transfers over that network agree to provide final credit to the beneficiaries. If the sender does not settle its net position at the end of the day, receivers of the failed sender's transfers do not have recourse to the funds that have been made available to the beneficiaries. CHIPS and CHES, on the other hand, do not provide for finality in

this sense.⁹ Rather, finality is conditional upon settlement, and if settlement does not occur, the receiver has recourse to any funds provisionally credited to its customer's account.

Finality is achieved primarily through a receiver "guarantee" that irrevocable credit will promptly be given to the accounts of customers receiving payments. Such guarantees are likely to induce receiving banks to reduce their risk exposure by establishing lower bilateral net credit limits for each sender than they would without them. Indeed, if receiver guarantees were required, there would be little need to require bilateral credit limits, because such limits would naturally evolve as the method of managing receiver risk exposure.

An important advantage of finality is that it tends to insulate the nonbank sector from the effects of a settlement failure, thus protecting financial markets and the general economy. Moreover, because finality is achieved through receiver guarantees, receivers are induced to make more prudent credit evaluations of their senders and modify such evaluations promptly as new information becomes available, reducing risk to the banking system in the process.

Unlike bilateral credit limits and sender net debit caps, the concept of finality does not yet appear to have wide-spread support in the private sector. The FAC/TIAC Payment Systems Committee concluded that, while finality of payments is a worthwhile goal, its achievement through receiver guarantees is premature and should not now be required. That committee believes that the costs of receiver guarantees (reduction in volume of transfers and increased payment system cost to compensate the receivers for bearing the increased risk) cannot be justified at this time, and that other measures (such as bilateral credit limits and sender caps) can control risks significantly. The ARCB Risk Task force did not reach a consensus on the issue of finality, although its report noted that a minority of its credit risk working group believed that finality would be necessary for a network to compete effectively with CashWire and Fedwire, which do

⁹ CHIPS and CHES transfers are final in the sense that in releasing a payment message, the sender becomes obligated to pay the amount of the transfer and, hence, to settle its net position. CHIPS rule 13a; CHES rule 5.1.4; see also *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*, 609 F.2d 1047, 1051 (2d Cir. 1979). CHIPS and CHES transfers are not completely "final," however, because credits made to beneficiaries are in fact provisional until settlement, and receiving institutions have recourse to amounts credited to beneficiaries in the event a sender fails to settle.

provide for finality. Although CHIPS currently does not provide for finality, its committee working on sender net debit caps is studying this issue.

The Board request comments on the following points:

- Should all private wire transfer systems provide for finality of payments?
- Should finality be achieved by receiver guarantees?
- If finality is desirable, would Federal or uniform state legislation or regulation on this topic be desirable?
- In lieu of finality by receiver guarantees, what methods of risk sharing designed to assure settlement (e.g., insurance, indemnity agreements, or collateralization) might be useful or appropriate?

4. *Edge Act and Agreement Corporations and U.S. Agencies and Branches of Foreign Banks.* There are special risks associated with the participation in large-dollar transfer systems of Edge Act and agreement corporations and U.S. agencies and branches of foreign banks. These institutions are often major participants in such networks, often making and receiving large volumes of payments on behalf of themselves, their parent organizations, and others. The size of their payment activities is generally quite large relative to their U.S. capital or U.S. assets.

Under current policy, the Board requires full collateralization of daylight overdrafts on Fedwire by all Edge Act and agreement corporations and by U.S. agencies and branches of foreign banks. In the case of agencies and branches, this collateralization requirement reflects the concern that the system does not have sufficient timely information on the financial condition of foreign banks to warrant Reserve Bank extension of uncollateralized daylight credit. The Board applied similar constraints to Edge and agreement corporations because of their small capital base relative to potential Fedwire payments. The Board will continue this policy during the period comments are being received and studied, and pending adoption of a more permanent policy regarding Edge Act and agreement corporations and U.S. branches and agencies of foreign banks.

The Board requests comment on what policies should be adopted with respect to these institutions. Commenters are asked to respond specifically to the following questions:

- Should Fedwire daylight overdrafts of Edge Act and agreement corporations and U.S. branches and agencies of

cap is monitored on an *ex post* basis. When funds transfers cause daylight overdrafts to exceed the cap, the overdrafting institution is counseled; individual transfers are not rejected.

The purpose of sender net debit caps is to reduce the size of intra-day credit exposure. Some have argued that to be effective and equitable, the cap must apply to a sender's total net debit position across all large-dollar transfer systems; otherwise, volume (and risk) would be shifted from networks which imposed caps to those that did not, or, if caps were imposed on each network, volume (and risk) would shift to networks with "unused" caps. New networks might also proliferate. Others have argued that caps on each network would be effective because a large number of networks would not develop.

While debit caps would reduce risks, one effect of such caps is the possibility that senders would be so severely constrained by these limits as to be unable to make the volume of payments requested by their customers.⁸ Alternatively, individual senders may delay making payments in order to minimize the risk of being bound by their debit cap. This might shift the burden of the cap to other banks and generally slow the process of making payments.

Some have also argued that sender caps, if based on a percentage of capital and applied uniformly, would be unfair to banks located in unit banking states, because banks in those states fund a larger proportion of their assets through overnight federal funds borrowings. Thus, daylight overdrafts on Fedwire from the morning repayment of federal funds borrowed the previous day may be significantly larger for banks operating in unit banking states than for banks operating in states that permit branching.

There are several steps that could be taken to alleviate these concerns. One would be to set caps initially at higher than optimal levels, lowering them in stages over time. A second procedure which might be helpful would involve the adoption by individual networks of general "rules" which seek to minimize the extent to which one sender could purposely and consistently delay payments until later in the day in order to shift its daylight exposure problem to others who continue to send payments early in the day. With any form of binding net debit cap, it is likely that an

intra-day funds market would develop and/or institutional changes would occur in the overnight funds markets (e.g., earlier transfer of the proceeds of borrowing, later repayments of borrowings, increased reliance on term funds, etc.) that would ease the burden of constraints on sender net debit positions. Such market developments would, however, involve adaptations that require lenders and borrowers to share explicitly risks and costs in a market-determined way, and should, as a result, reduce risk but increase participant costs.

Several private sector study groups support sender net debit caps. For example, the FAC/TIAC Payment Systems Committee recommended "[t]he prompt establishment of caps by each sending institution on its overall net debit position across all payments systems, including Fedwire * * *." The ARCB Task Force also recommended that caps be established, and the ARCB has formed a working group to develop guidelines and procedures to be used to aid depository institutions in setting their own sender net debit caps across all networks. The New York Clearing House Association has also adopted the principle of sender net debit caps for CHIPS participants, and has appointed a committee to study the implementation of these caps on CHIPS. The Board welcomes these and other efforts, believing that they are indications of the seriousness with which the private sector is approaching the issue of payments systems risk.

The Board seeks comment on whether sender net debit caps are a useful and appropriate method of reducing wire transfer risk. The Board especially desires comments on the following questions:

- Should institutions be encouraged to establish sender net debit caps?
- Should the caps be established across all networks, or be established separately for each network?
- Should each institution establish its own caps, or should each network, or the Federal Reserve, establish caps for participants based on objective criteria?
- Should examiners review the caps that are set?
- If caps are set individually or by private networks, how should Fedwire daylight overdrafts be treated?
- If caps are to be established on the basis of objective criteria, what should those criteria be?

—percentage of capital;

—other factors, such as an institution's internal controls, type of business, quality of management;

—a combination of percentage of capital and other factors?

- If caps are to be based on capital, what should the percentage be? Should this percentage be lowered over time to reduce risks further?

- How much lead-time is desirable between the adoption of a policy of caps and the date on which such caps become effective?

- Will the market respond to caps with developments, such as an intra-day federal funds market or institutional modifications in the overnight federal funds and other markets, that will reduce the possibility of payments mechanism disruptions?

- Would some institutions—such as those from unit banking states, Edge Act and agreement corporations, or U.S. branches and agencies of foreign banks—face special problems in the implementation of caps?

- How should caps be enforced? By voluntary compliance, network rules, examiner review?

- What policy should the Federal Reserve adopt if caps set by each bank for itself or by networks for their participants are either extremely high or frequently breached?

- Will caps increase costs significantly or otherwise reduce the efficiency of the payments mechanism? Will this be a temporary or long-run development? Are the higher costs or reduced efficiency worthwhile to achieve (or a necessary by-product of) risk reduction? If so, what alternatives should be used to reduce risks?

- Should Reserve Banks permit institutions to exceed their caps on Fedwire occasionally (if such caps are established) in order to provide some flexibility in the administration of caps? Should such "excess" overdrafts or "overline" credits be negotiated in advance, be collateralized, or be subject to penalty rates?

- If bilateral credit limits (see below) are established, are sender net debit caps necessary?

2. *Bilateral net credit limits.* Under this method, each receiver would itself determine the maximum amount of net transfers (i.e., value of receives in excess of the value of sends) that it is willing to receive from each sender either across all networks other than Fedwire or from each sender on a particular private network. The purpose of this limit is to reduce risk by limiting the exposure of receivers of payments in the event that a sender fails to settle. Presumably, the net credit limit would be based on the receiver's credit analysis of the sending bank.

⁸The FAC/TIAC Payment Systems Committee pointed out in its report that bilateral net credit limits, especially if coupled with receiver guarantees (discussed below), could have the same effect of restraining the volume of payments senders are able to make.

communications networks. The new procedures have been designed to disclose deficiencies in the internal credit and operational controls of those institutions participating on these networks, and to assess the adequacy of senior management's supervision of such activities.

- In March, 1984, CHIPS⁶ began testing bilateral net credit limits. Under this test, each participant sets the maximum amount of net payments it will accept from each of the other participants over CHIPS. CHIPS intends to have these credit limits fully implemented by October, 1984. When these limits are effective, however, receivers will not, as on CashWire, be required to provide the beneficiaries with irrevocable access to payments received over CHIPS prior to settlement. CHIPS has also decided in principle to adopt sender net debit caps, and has formed a task force to study the implementation of these caps. This task force will also explore ways of making CHIPS payments final. This task force is to report by year-end 1984.

- The ARCB has also formed a task force to develop guidelines and procedures for the establishment by each institution of voluntary sender net debit caps as recommended by its Risk Task Force and the FAC/TIAC Committee.

These developments demonstrate that participants in the large-dollar payments systems (the private sector as well as the Federal Reserve) are increasingly aware of the risks such systems entail and are beginning to take steps to control them. At this point, the Board believes that it is appropriate to solicit public comment on several methods that could be used, individually or in concert, by the banking industry, the Federal Reserve, or both to achieve these goals.

Objectives of a Risk Reduction Policy

The Board believes that there are several important goals that any policy to reduce risks on large-dollar transfer systems must seek. These goals are not mutually exclusive, although in some cases, attainment of one of the goals may, in the short-run, work against the attainment of one or more of the other goals. The Board realizes, therefore, the necessity of some short-run trade-offs among these goals.

1. *Contain the effects of a settlement failure.* Potential settlement failures pose the threat that their effects could spread beyond the participants to the

banking system as a whole, to other financial markets, and to the rest of the economy. An important goal of a risk reduction policy is, therefore, to contain the effects of a settlement failure.

2. *Reduce the volume of intra-day credit exposures.* As noted above, the principal source of risk in wire networks is the amount of intra-day credit exposure incurred by senders and receivers in connection with wire transfers. Reduction of the aggregate volume of daylight credit exposure is, therefore, a primary goal of a risk reduction program.

3. *Control remaining credit risk.* Some extensions of credit are, perhaps, inescapable if large-dollar networks are to run smoothly. Another goal of a risk reduction policy is, accordingly, to encourage institutions participating on such networks to exercise prudent judgment in extending and managing such credit.

4. *Smooth operation of the payments system.* As was noted at the outset, large-dollar electronic funds transfer systems are an integral part of the payments mechanism. Any risk reduction program must, therefore, seek its objectives without causing undue operational disruptions to the payments mechanism.

The public may wish to comment on these goals and provide its views on whether there are other goals that should be sought.

Methods of Reducing Risks

In the course of its study of payment system risk, the Federal Reserve considered and discussed with the FAC/TIAC Committee and private sector participants numerous proposals for reducing risks. The methods discussed below, on which the Board is explicitly requesting comment, are those that appear to be best suited to attaining the goals discussed above. Each of these methods may be used singly or in concert, and the Board asks commenters for their views on whether a particular combination of these methods would be best. Commenters are, of course, free to suggest alternative methods which might be used, singly or in combination with other methods, to reduce payment systems risk.

The Board also considered several other risk reduction options, including collateralization of sender net debit positions, charging a fee for extending intra-day credit, and methods to assure settlement (such as settlement insurance or agreements among participants on a network to cover a failed sender's settlement obligations on that network). Each of these options poses difficulties that, in the Board's view, make them

undesirable. For example, collateralization would appear merely to shift risks from those holding collateral to the deposit insurance funds, and available collateral is not likely to provide the liquidity necessary to assure settlement.⁷ Any pricing proposal would have to overcome the exceedingly difficult problem of determining an appropriate price for the intra-day extension of credit. While settlement insurance and other methods of assuring settlement would tend to minimize the disruptions that a settlement failure would cause, they may tend to reduce the degree of prudence exercised by individual participants, who would look to others for the protection of their positions. Commenters may wish to provide their views on how these difficulties might be overcome.

While the Board requests specific comments on the issues presented below, it also requests comments on the degree to which the intensely competitive atmosphere in which payment services are offered may act as a constraint on some of the risk reduction options. For example, in the current environment, would completely voluntary measures be adequate, should examiner review of risk reduction measures be an essential part of a risk reduction program, or should the Federal Reserve and the other regulators of financial institutions take a more active role in designing and enforcing risk reduction measures?

1. *Sender net debit caps.* These limits would impose a maximum ceiling or "cap" on the aggregate net debit position (i.e., the value of all sends in excess of the value of all receives) that an individual sender could incur on any one network or across all networks during a day. A sender net debit cap applied across all networks would permit net debits on one network to be offset by net credits on another, and would impose a maximum intra-day debit exposure on each sending institution. CashWire, as previously noted, imposes a net debit cap of 50 percent of the sender's capital for net positions on that one network. This cap is applied on a real-time basis; any payment message that would bring the sender in excess of its cap is rejected. The Fedwire daylight overdraft policy, in principle, imposes a sender cap equal to 50 per cent of capital as well, but this

⁶ CHIPS (Clearing House Interbank Payments System) is owned and operated by the New York Clearing House Association. This network processes about 75,000 transactions per day, each having an average size of about 3 million.

⁷ As discussed below, collateralization may be useful in securing Fedwire daylight overdrafts of Edge Act and agreement corporations and U.S. branches and agencies of foreign banks, and for daylight overdrafts arising out of the transfers of book-entry U.S. Treasury and federal agency securities.