FEDERAL RESERVE BANK OF DALLAS
Station K, Dallas, Texas 75222

Circular No. 84-83
July 31, 1984

TO: All depository institutions in the Eleventh Federal Reserve District

ATTENTION: Operations Officer

SUBJECT: **Request for public comment on a proposal to eliminate the "fractional availability crediting" option for the recovery of interterritory check float**

SUMMARY: The Board of Governors of the Federal Reserve System is requesting public comment on a proposal to eliminate one of the options that Federal Reserve Banks currently offer to depository institutions for the recovery of interterritory check float. Under the proposal, the "fractional availability crediting" option would be eliminated. No additional depository institutions will be permitted to begin using the fractional availability option, pending final Board action on this proposal.

Interested parties are invited to submit comments to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C., 20551. Comments must be received by September 7, 1984, and should refer to Docket No. R-0525.

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) 544-4730 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 July 17, 1984

The Federal Reserve Board today published for public comment a proposal to eliminate the "fractional availability crediting" option for the recovery of inter-territory check float. The Board requests comment by September 7.

The Board acted under the provisions of the Monetary Control Act of 1980 which provides that any Federal Reserve float that remains after operational improvements must be priced. Federal Reserve float is the value of checks for which the Federal Reserve has given credit to the institution that deposited the checks with the Federal Reserve for collection, but for which the Federal Reserve has not yet received payment.

Under the fractional crediting procedures, credit is given to depository institutions on the basis of an availability schedule[1]--based on past collection experience--unique to each institution that has opted to use this method of permitting the Federal Reserve to recover the value of float the institution's checks generate. Float is recovered on an average basis over time, resulting in an over- or underrecovery at any given period of time that should be offset by under- or overrecoveries in other periods. Experience suggests that a significant amount of float generated by depository institutions selecting this crediting option will not be recovered. Pending final Board action on this proposal, no additional depository institutions will be permitted to use the fractional availability option.

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1/ An availability schedule is a time schedule under which credit is given for checks deposited with the Federal Reserve based on average collection times.

Institutions depositing interterritory checks with the Federal Reserve may continue to use the "fixed availability" method for the recovery by the Federal Reserve of the value of interterritory check float they generate. Under this option, a depository is given credit on the basis of a fixed schedule for depositing its checks and the amount of float generated is determined based upon actual performance. This float is then recovered by the Federal Reserve through accounting adjustments, clearing balance earnings credits, or explicit charges.

The Board's notice is attached.

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Attachment

FEDERAL RESERVE SYSTEM

[Docket No. R-0525]

Federal Reserve Services

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Request for comment.

SUMMARY: The Board of Governors of the Federal Reserve System is requesting public comment on a proposal to eliminate one of the options that Federal Reserve Banks currently offer to depository institutions for the recovery of interterritory check float. Under the proposal, the "fractional availability crediting option" would be eliminated. No additional depository institutions will be permitted to begin using the fractional availability option, pending final Board action on this proposal.

DATE: Comments must be received by September 7, 1984.

ADDRESS: Comments, which should refer to Docket No. R-0525, may be mailed to Mr. William W. Wiles, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, D.C. 20551, or delivered to Room B-2223 between 8:45 a.m. and 5:15 p.m. Comments received may be inspected at Room B-1122 between 8:45 a.m. and 5:15 p.m., except as provided in § 261.6(a) of the Board's Rules Regarding Availability of Information, 12 C.F.R. § 261.6(a).

FOR FURTHER INFORMATION CONTACT: Elliott C. McEntee, Associate Director (202-452-2231), or William Brown, Manager (202-452-3760), Division of Federal Reserve Bank Operations; Gilbert T. Schwartz, Associate General Counsel (202-452-3625), Daniel L. Rhoads, Attorney (202-452-3711), or Robert G. Ballen, Attorney (202-452-3265), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION: Background. The Monetary Control Act of 1980 (Pub. L. 96-221) ("MCA") requires that fees be established for Reserve Bank services. The MCA also requires that the Reserve Banks price for Federal Reserve float that remains after operational means to reduce float are implemented.[1/]

In February 1983, the Board approved a program to eliminate or price Federal Reserve interterritory check float through changes in Reserve Bank crediting procedures for interterritory check deposits. Under the program, depository institutions that send interterritory checks directly to the Reserve Bank serving the paying institution were offered a choice between two crediting options: fixed availability or fractional availability. Under the fixed availability option, a depository institution is given credit on the basis of a "fixed" availability schedule. The amount of float generated

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1/ 126 Cong. Rec. S3167 (daily ed. March 27, 1980) (statement of Senator Proxmire).

under this option is then determined based upon actual delivery performance. The float is recovered through "as-of" adjustments, clearing balance earnings credits, or explicit charges to the institution's account for the value of the float. Under the fractional availability option, credit is given to depository institutions on the basis of an availability schedule unique to each institution, which is based on past collection experience. Consequently, under the fractional availability option float is recovered on an average basis over time, resulting in an over or underrecovery at any given period of time that should be offset by under or overrecoveries in other periods.

Discussion.

A. Experience with fractional availability. The Federal Reserve's experience to date suggests that a significant amount of the float generated by depository institutions selecting the fractional availability crediting option will not be recovered. This underrecovery is due to the fact that the fractions do not precisely match actual collection experience and collection patterns change. The fractions for each institution are based on historical collection experience, using a four month moving average. For example, fractions effective in January are based on collection experience from August to November. The January fractions will likely be more favorable than the actual experience in January because of the increased likelihood for poorer weather

conditions in January. However, the collection experience in January will be reflected in fractions in effect in March, April, May and June. Since the likelihood is for better collection experience in the spring than in January, the underrecovery experienced in January would ordinarily be expected to be offset in the spring months. However, this underrecovery will not be offset if the value of checks sent for collection does not remain fairly constant over time. When the fractions used are less favorable than actual collection experience, depository institutions have economic incentives to shift to other collection options that enable them to obtain better availability.

The underrecovery of interterritory check float from institutions using fractional availability is inequitable to other institutions depositing checks with the Federal Reserve because the value of this underrecovered float must be incorporated into the cost base that is used to determine check collection fees.[2/] This situation is inconsistent with the Board's float recovery principle that, to the extent practicable, the cost of float should be recovered from the institution that benefits from the float.

2/ The fractional availability method creates an additional inequity because the same fraction applies to all depository institutions using any given route of the ITS network. Accordingly, if a depository institution with large dollar volumes uses the ITS network only during bad weather, this would have a significant negative impact upon the fractions applicable to the other depository institutions that routinely use the ITS network.

B. Modification of current fractional availability methodology. The Board recognizes that there are some advantages to fractional availability. Fractional availability assists depository institutions in allocating float costs back to their own depositors and it provides depository institutions with predictability with respect to the cost of float they will incur.

In view of these advantages, the Board analyzed whether it is possible to revise fractional availability to eliminate the inequities associated with the current methodology. Specifically, the Board considered shorter time periods to calculate the fractions (i.e., calculate fractions based upon the prior month's experience), separate fractions for each user of ITS, and a requirement that depository institutions pay for the value of unrecovered float at regularly scheduled intervals, such as quarterly. The first modification would not eliminate the incentive for institutions to change their collection patterns depending upon the fraction in effect; the second modification would resolve the problem only for those institutions that use the ITS network and would have no effect upon institutions that arrange their own transportation. The only modification that would eliminate all of the inequities associated with fractional availability would require each depository institution to pay at regularly scheduled intervals for the value of unrecovered float resulting from the checks it deposited. However, this pay-up

provision would make fractional availability in practice the functional equivalent of fixed availability because depository institutions would not know at the time they deposit checks what their float costs would be. In addition, modifying fractional availability would result in increased operational costs to depository institutions and the Federal Reserve.

It does not appear that the fractional availability option can be modified to ensure that depository institutions using this option bear the full costs of their interterritory check float while at the same time preserve the benefits of fractional availability. Nevertheless, the Board requests public comment on whether the fractional availability option could be modified.

C. Board proposal. The Board proposes to eliminate the fractional availability crediting option currently offered to depository institutions for the recovery of interterritory check float. In order to avoid additional inequities, the Board has also determined not to permit additional depository institutions to begin to use fractional availability until a final determination is made on this proposal.

The Board anticipates that the impact on the banking industry of eliminating fractional availability will be minimal. As of June 22, 1984, only 85 of the 5,000 depository institutions depositing checks with the Federal Reserve used fractional availability. To minimize the impact on the

institutions currently using fractional availability, the Reserve Banks would, if requested, continue to calculate and provide fractions to depository institutions to enable them to continue using the fractions to allocate float to their depositors. Further, under the proposal, these institutions could continue to pay for float through fractional availability until December 1984.

With regard to depository institutions that deposit interterritory checks directly with their local Reserve Banks, credit is currently provided on a calculated availability basis. Under this approach, credit is provided on the basis of the historical collection experience of the ITS network. The inequities discussed above have not arisen with regard to these checks because the collection patterns of the depository institutions that use this option are generally constant over time and the dollar value of these deposits is relatively small. (Approximately 10 percent of the dollar amount of total interterritory checks collected by the Federal Reserve are deposited by institutions with their local Reserve Banks.) Moreover, it would be operationally cumbersome at this time to extend the fixed availability float recovery option to such checks. However, to ensure that inequities do not arise, the Board proposes that any underrecovery of float costs arising from such checks be recovered from the depository institutions specifically using this service.

The impact of this proposal on small entities has been considered in accordance with the Regulatory Flexibility Act (Pub. L. 96-354; 5 U.S.C. § 603). Small depository institutions typically deposit interterritory checks directly with their local Reserve Banks and accordingly would not be affected by this proposal. Finally, the proposal imposes no new reporting or recordkeeping requirements on depository institutions.

By order of the Board of Governors, July 16, 1984.

(signed) William W. Wiles

William W. Wiles
Secretary of the Board