



FEDERAL RESERVE BANK
OF DALLAS

WILLIAM H. WALLACE
FIRST VICE PRESIDENT

DALLAS, TEXAS 75222

April 5, 1985

Circular 85-39

TO: All direct sending depository
institutions in the Eleventh
Federal Reserve District

SUBJECT

Fractional Availability

DETAILS

In February 1983, depository institutions that send checks directly to their local Federal Reserve office were offered two crediting options, fixed availability and fractional availability, to recover Federal Reserve check float. Under fractional availability, a depositing institution receives partial credit for each deposit; that is, a fraction of each deposit is deferred an additional day.

Experience with the fractional availability credit option indicates that it has the potential for not fully recovering the costs of float from the institutions generating the float because the fractions reflect historical, rather than current, collection experience. As a result, in July 1984, the Board published for public comment a proposal to eliminate the fractional availability credit option. It also proposed to place a moratorium on permitting additional institutions to select the fractional program pending final Board action.

In view of the inability to modify fractional availability to preserve its benefits and eliminate the potential for under-recovery of float, and after reviewing comments received, the Board has taken the following action with regard to fractional availability:

- Discontinue the fractional availability credit option, effective September 1, 1986.
- Continue the current moratorium on new entrants into fractional availability option.
- Continue to provide, until September 1986, fractional schedules to institutions that request them.

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- ° Continue to pursue the development of alternative methods for the recovery or elimination of float.

ATTACHMENTS

Attached are the Board's press release and Federal Register documents.

MORE INFORMATION

For more information, please contact Robert L. Whitman, (214) 698-4357 at the Dallas Branch; 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.

Sincerely yours,

A handwritten signature in cursive script, reading "William H. Waller". The signature is written in black ink and is positioned below the typed name "William H. Waller".

FEDERAL RESERVE press release



For immediate release

March 21, 1985

The Federal Reserve Board has approved a proposal to eliminate the fractional availability crediting option offered to depository institutions for the recovery of Federal Reserve interterritory check float.

The Board's action will become effective September 1, 1986.

The Board took this action because experience with the fractional availability crediting option has indicated that the option would not provide for the full recovery of float from those institutions generating it.

The Board also approved a continuation of the current moratorium on permitting additional depository institutions to select this crediting option. Reserve Banks will continue to provide the fractions, on request, to depository institutions.

The Board's notice is attached.

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Attachment

[Docket No. R-0525]

Federal Reserve Services

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Termination of the fractional availability crediting option for interterritory check float recovery.

SUMMARY: The Board has approved the proposal to discontinue the fractional availability crediting procedures as an option for the recovery of Federal Reserve interterritory check float.

EFFECTIVE DATE: September 1, 1986.

FOR FURTHER INFORMATION CONTACT: Elliott C. McEntee, Associate Director (200/452-2231), or William Brown, Manager (202/452-3760), Division of Federal Reserve Bank Operations; Daniel L. Rhoads, Attorney (202/452-3711), Legal Division, Board of Governors of the Federal Reserve System, Washington, D.C. 20551.

SUPPLEMENTARY INFORMATION:

Background

In February 1983 the Board approved a program to reduce and price Federal Reserve interterritory check float. 48 FR 10753 (March 14, 1983). Under that program, depository institutions that send checks directly to the Federal Reserve office serving the paying institution were offered two credit options to recover Federal Reserve check float. With the first option, called fixed availability, a depository institution is given 100 percent credit for its check deposits. The amount of float is later determined by actual collection performance and recovered through "as-of" adjustments, clearing balance earnings credits, or explicit charges to the institution's account. Under the second option, called fractional availability, a depositing institution receives partial credit for each deposit, that is, a fraction of each deposit is deferred an additional day. Under this option, a separate fraction for each receiving Federal Reserve office is applied to all institutions that use the Federal Reserve transportation network to send checks directly to that Reserve office. Another set of fractions are computed when institutions use their own transportation to send deposits to other Federal Reserve offices. In all cases, the fractions are based on the

average collection experience over the prior four month period. Consequently, the fractional availability credit option results in an over or underrecovery at any given period that in theory should be offset by under or overrecoveries at other times.

Approximately 500 institutions currently are using the fixed availability option and 85 institutions currently are using the fractional availability option. These institutions are generally large commercial banks, including correspondents. The remaining 4,400 institutions using Federal Reserve check services deposit checks directly with their local Reserve Banks and do not have the option of choosing between the fixed and fractional availability float recovery options.

Experience with the fractional availability credit option indicates that it has the potential for not fully recovering the costs of float from the institutions generating this float because the fractions reflect historical, rather than current, collection experience. This means that in certain months the fractions must be less than actual collection experience in order to recover float incurred in prior months. For example, collection experience for the month of May is generally very good because of favorable weather conditions. However, the fractions applied to deposits during this month will be lower than actual collection experience because they reflect collection experience for December through March. Accordingly, a depository institution may improve its funds availability and thus avoid paying for float previously incurred by using alternate collection channels that reflect actual collection experience during May. An institution's average dollar sendings to a given point must remain relatively stable over time in order for float to be fully recovered by fractional availability. Accordingly, the cost of float will not be recovered from the institutions generating and benefiting from the float if the institution changes its collection patterns over time.

The Board published for public comment in July 1984 a proposal to eliminate the fractional availability credit option. 49 FR 29461 (July 20, 1984). The Board also placed a moratorium on permitting additional institutions to select the fractional program pending final Board action.

Discussion

The Board received 26 comments in response to its proposal to eliminate the fractional availability credit option. Seven of these commenters currently use the fractional availability credit

option. Thirteen commenters favored the elimination of fractional availability while 13 commenters preferred its retention. Of those in favor, three commenters stated that their support of the proposal to eliminate fractional availability was conditioned on the Federal Reserve changing the way it recovers float from depository institutions that deposit their checks directly with their local Federal Reserve office.

Those supporting the proposal regarded the elimination of the fractional option as appropriate in light of the Federal Reserve's concern with the potential for the underrecovery of float from the depository institutions generating and benefiting from the float. These commenters believed that eliminating the fractional option would remove the potential subsidization of depositors using the fractional availability option by the remaining Federal Reserve depositors. The concern was expressed that some of the institutions using fractional availability on a selective basis managed the option to their own advantage, but to the disadvantage of the industry at large.

Institutions opposing the elimination of fractional availability stated that this option provides institutions with predictability with regard to credit availability, a method for evaluating Federal Reserve check clearing performance. Several of these institutions also indicated that significant programming costs were incurred in order to participate in the fractional availability program and that they would incur additional programming costs if the this option were eliminated.

Comments was also requested on whether the fractional availability option could be modified to preserve its benefits while eliminating its potential to result in underrecovery of float from those institutions using it. Some commenters suggested modifying fractional availability to establish a periodic settlement period, at which time the cost of the underrecovered float would be charged directly to the institution that generated the float and would benefit from its underrecovery. However, if the fractional option were modified in this manner, institutions would not know in advance what their total float costs would be until the settlement period, thus losing the benefit of predictability. Further, this modification would make the fractional option very similar to the fixed availability option; if fractional availability were modified to incorporate a regular settlement period,

there would be no difference between the fractional and fixed availability options except for the timing of the settlement period. In addition, the Reserve Banks have indicated that they would incur significant one time implementation and ongoing costs if fractional availability were modified in this manner. Since this proposed modification would not retain the desired benefits of fractional availability and would increase costs, the Board believes that this modification should not be adopted.

Another modification suggested by the commenters was to change the method of calculating the fractions. Commenters suggested that instead of using a four month moving average for computing the applicable fraction, Reserve Banks use a monthly fraction based on the most recent month's collection experience or use a fraction that takes into account seasonal collection performance. Use of a one or two month moving average would, however, introduce further volatility into the fractions and would thus increase the incentives for institutions to use other collection channels when the fractions were low relative to actual collection experience. Further, it is not possible to establish fractions that will in most cases equal actual collection experience, regardless of the method of calculating the fractions. It will always be necessary to establish fractions in certain periods below actual collection experience to take account of previously unrecovered float. Accordingly, the Board believes it is not possible to eliminate the potential for float underrecovery from the institutions generating the float through modification of the methodology for calculating the fractions.

In view of the inability to modify fractional availability to preserve its benefits and eliminate the potential for underrecovery of float, the Board believes that the fractional availability option should be eliminated. The elimination of fractional availability will ensure that float is recovered from the institutions that benefited from the float, rather than from all depositors through per-item fees. Moreover, given the relatively few institutions that use fractional availability (85 of the approximately 600 that sent checks to the Reserve Bank office serving the paying institutions) and the numerous other adjustments that occur in Reserve and clearing accounts, elimination of the fractional option would not, as suggested by a few commenters, unduly complicate an institution's management of its reserve position.

The Board has approved the following steps to reduce the impact that elimination of the fractional availability option may have on depository institutions using the option. First, the Reserve Banks will continue, if requested, to provide fractions to depository institutions to enable them to continue using the fractions to allocate float to their customers. Provision of these fractions will also enable institutions to evaluate Reserve Bank check collection performance. Second, depository institutions currently using the fractional availability option will continue to be allowed to use the option until September 1, 1988. The delayed implementation date will provide institutions with sufficient lead time to make any necessary modification to their computer systems.

Six commenters indicated that if the fractional availability option is eliminated, the Federal Reserve should not allow depositors depositing checks with their local Federal Reserve office for collection to use the fractional availability option. The Federal Reserve currently sorts such checks by endpoint and provides the depositing institutions availability based upon the anticipated collection of the checks. While the Federal Reserve provides a form of fractional availability to recover float from these depositors, it is administered differently and does not provide the benefits of the fractional availability option that is the subject of this action. Because the institutions depositing checks with their local Federal Reserve office are typically small institutions that do not sort their checks before depositing them with the Federal Reserve, they generally do not know the mix of checks they have deposited. Accordingly, unlike the fractional availability option, the depository institution typically does not know with certainty in advance the availability it will receive from the Federal Reserve.

Moreover, it is unlikely that this procedure will result in an underrecovery of float from the institutions that benefit from the float because such institutions, given their smaller size, generally do not shift their collection patterns in response to short term changes in availability.

Finally, it simply is not operationally feasible to extend fixed availability to depository institutions depositing checks with their local Federal Reserve office. When an institution deposits its checks with its local Federal Reserve office, the checks are sorted by receiving Federal Reserve office and commingled with items from other depositors destined for that same Reserve office.

Unlike the checks deposited by institutions that send checks directly to other Federal Reserve offices, the float associated with the deposits made by the individual depositor depositing checks with its local Federal Reserve office cannot be determined. For these reasons, the Board does not believe that it is appropriate to change the manner in which float is recovered from institutions depositing checks with their local Federal Reserve office.

In view of the inability to modify the fractional availability credit option to preserve its benefits and eliminate the potential for underrecovery of float, the Board has determined to discontinue this crediting option effective September 1, 1988. The Board has also decided to continue the moratorium on permitting additional depository institutions to select the fractional availability option. To reduce the impact of its decision to eliminate the fractional availability option, the Board has instructed Reserve Banks to continue providing the fractions, on request.

The Board has also approved several modifications to the procedures for accounting for Federal Reserve check float. Three of the commenters responding to the proposal to eliminate the fractional availability credit option commented that the remaining fixed availability crediting procedures do not take into consideration the effect of float recovery on required reserves, resulting in overcharging for float.

Depository institutions are permitted to deduct the amount of their cash items in the process of collection ("CIPC") from the amount of gross transaction accounts in computing required reserves. 12 CFR 204.3(f)(1). When a depository institution deposits a check with the Federal Reserve for collection, the amount of the check is included in the institution's gross transaction accounts subject to reserve requirements, and is offset by a corresponding CIPC deduction. The CIPC deduction is provided in recognition of the fact that the depository institution has not yet been given credit by the Federal Reserve for the check. When credit for the check is given, the institution loses the CIPC deduction and its reserve requirements increase. If credit is given before the check is collected by the Federal Reserve, float is generated. When the institution is later charged by the Federal Reserve for the float, no adjustment is made for the cost of the increased reserve requirement, with the result that the float charge exceeds the benefit to the institution of the float.

In response to the concerns expressed by depository institutions, the Board has determined to modify the System's accounting procedures to take into account the effect of float on the reserve requirements to which Reserve Banks would be subject if they were required to hold reserves. Net check float will be deducted from the amount of clearing balances maintained with the Federal Reserve before the imputed required reserves are determined.

This procedure will result in the Federal Reserve accounting for float in a manner conforming more closely to the accounting practices of correspondent banks. The effect of this modification will be to reduce the Reserve Bank's imputed reserve requirement and increase their earning assets.¹ The interest on these additional earning assets will then offset part of the cost of float that is to be charged back to depository institutions.

The Board wishes to emphasize that the Federal Reserve's accounting procedures as modified will continue to recognize as a cost to the Federal Reserve the full value of float at the federal funds rates, as required by the MCA. The accounting change approved by the Board will reduce explicit float charges to direct and consolidated sending institutions by 12 percent. Further, the float component of per-item fees will also be lowered by 12 percent. The modifications are expected to have a minimal impact on the Federal Reserve's per-item fees since the float component of the base used to calculate per-item fees is less than 3 percent of the total. A 12 percent reduction in this component will reduce the total to be recovered by only 0.25 percent. Federal Reserve income statements will be amended to reflect these accounting changes.

By order of the Board of Governors of the Federal Reserve System, March 20, 1985.

William W. Wiles,

Secretary of the Board.

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