



FEDERAL RESERVE BANK
OF DALLAS

TONY J. SALVAGGIO
FIRST VICE PRESIDENT

March 28, 1994

DALLAS, TEXAS
75265-5906

Notice 94-34

TO: The Chief Operating Officer of
each financial institution in the
Eleventh Federal Reserve District

SUBJECT

**Modification of the Payments
System Risk Policy**

DETAILS

The Board of Governors of the Federal Reserve System has modified its payments system risk policy by adopting a daylight overdraft penalty fee. The penalty fee will be assessed on the average daily daylight overdrafts in Federal Reserve accounts incurred by bankers' banks that do not maintain reserves, Edge and agreement corporations, and limited-purpose trust companies. The rate for the daylight overdraft penalty fee is equal to the regular daylight overdraft rate applicable to other institutions plus 100 basis points, quoted on a 24-hour basis, for a 360-day year, and adjusted for the length of the Fedwire operating day. The penalty fee should create an incentive for institutions that do not have regular discount window access to avoid incurring daylight overdrafts in Federal Reserve accounts.

The Board's policy statement becomes effective April 14, 1994.

ATTACHMENT

A copy of the Board's notice as it appears on pages 8977-81, Vol. 59, No. 37, of the Federal Register dated February 24, 1994, is attached.

MORE INFORMATION

For more information, please contact Donna Gonzales at (214) 922-5584 or James Smith at (214) 922-5585. For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely,

FEDERAL RESERVE SYSTEM**[Docket No. R-0693]****Modification of the Payments System Risk Policy; Bankers' Banks, Edge Corporations, and Limited-Purpose Trust Companies****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Policy statement.

SUMMARY: The Board has determined to assess a penalty fee on the average daily daylight overdrafts in Federal Reserve accounts incurred by bankers' banks that do not maintain reserves, Edge and agreement corporations, and limited-purpose trust companies. The rate for the daylight overdraft penalty fee is equal to the regular daylight overdraft rate applicable to other institutions plus 100 basis points, quoted on a 24-hour basis, for a 360-day year, and adjusted for the length of the Fedwire operating day. The penalty fee should create an incentive for institutions that do not have regular discount window access to avoid incurring daylight overdrafts in Federal Reserve accounts.

DATES: Effective April 14, 1994.

FOR FURTHER INFORMATION CONTACT: Oliver I. Ireland, Associate General Counsel (202/452-3625) or Stephanie Martin, Senior Attorney (202/452-3198), Legal Division; for the hearing impaired only: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

SUPPLEMENTARY INFORMATION: The Board has modified its payments system risk policy by adopting a daylight overdraft penalty fee. The penalty fee will be assessed on average daily daylight overdrafts in Federal Reserve accounts incurred by Edge and agreement corporations,¹ bankers' banks² that do not maintain reserves, and limited-purpose trust companies. These institutions do not have regular discount window access.

The Board anticipates that the penalty fee will provide an incentive for

¹ Edge corporations are organized under section 25A of the Federal Reserve Act (12 U.S.C. 611-631). Agreement corporations have an agreement or undertaking with the Board under section 25 of the Federal Reserve Act (12 U.S.C. 601-604a). For the purposes of this docket, the term "Edge corporation" includes both Edge and agreement corporations.

² A bankers' bank is a financial institution that is not required to maintain reserves under the Board's Regulation D (12 CFR part 204) because it is organized solely to do business with other financial institutions, is owned primarily by the financial institutions with which it does business, and does not do business with the general public. A bankers' bank is not a depository institution as defined in the Board's Regulation A (12 CFR 201.2(a)).

institutions without regular discount window access to refrain from incurring daylight overdrafts. This incentive will help a Reserve Bank to avoid a situation where it may be obliged to permit an overnight overdraft or to extend extraordinary discount window credit if an institution is unable to cover a daylight overdraft by the end of the business day. In addition, should daylight overdrafts be considered as Federal Reserve extensions of credit, the penalty fee for bankers' banks that do not maintain reserves would reflect the *quid pro quo* policy of reserves for discount window access embodied in the Monetary Control Act of 1980.

Background

Under the Board's current payments system risk policy, most depository institutions may incur daylight overdrafts in their Federal Reserve accounts up to a maximum, or cap, that is a multiple of their risk-based capital. Effective April 14, 1994, the Reserve Banks will assess a fee of 24 basis points (annual rate) on average daily daylight overdrafts. After full phase-in, expected in 1996, this fee will rise to 60 basis points (annual rate).

If an institution fails to cover a daylight overdraft by the close of the business day, it may either obtain a discount window loan (if it has access to the discount window) or carry the overdraft overnight (a practice that is discouraged by the Federal Reserve). The Reserve Banks charge a penalty fee on overnight overdrafts. Since 1981, the overnight penalty rate has equalled the higher of 10 percent or the federal funds rate plus 2 percent (annual rate). On February 16, 1994, the Board approved a new overnight overdraft penalty rate equal to the federal funds rate plus 4 percent, with no floor. When an institution incurs an overnight overdraft, it must make up for any reserve or clearing account deficiency by holding make-up balances on another night.

The Federal Reserve Act exempts bankers' banks from reserve requirements,³ and Regulation A explicitly excludes bankers' banks from regular discount window access.⁴ Nevertheless, the Board has permitted bankers' banks to have access to the discount window if they choose to maintain reserves voluntarily. Bankers' banks that maintain reserves may establish a cap and incur daylight overdrafts under the payments system risk policy to the same extent and subject to the same fees as depository

³ 12 U.S.C. 461(b)(9).

⁴ 12 CFR 201.2(a)(2).

institutions. To address the risks arising from daylight overdrafts and to avoid the extension of overnight credit to institutions with no discount window access, current policy provides that bankers' banks that do not maintain reserves should refrain from incurring daylight overdrafts. If such institutions do incur daylight overdrafts, however, they are required to post collateral to cover the overdrafts.

Edge corporations are subject to reserve requirements, but do not have access to the discount window on the same basis as depository institutions. Instead, Edge corporations generally are funded by their parent depository institutions, which have discount window access. Current policy permits Edge corporations to establish a cap and to incur overdrafts within that cap, provided that they post collateral to cover the overdrafts. Edge corporations also may incur book-entry securities overdrafts above their cap, provided the overdrafts are collateralized.

Limited-purpose trust companies may become members of the Federal Reserve, at the Board's discretion, subject to conditions the Board may prescribe pursuant to the Act. As a general matter, member limited-purpose trust companies do not accept reservable deposits, do not have regular discount window access, and may not incur daylight overdrafts.

Previous Board Actions

In May 1990, the Board proposed to levy a penalty fee, at a rate equal to the overnight overdraft penalty rate, on the maximum daily daylight overdrafts incurred by bankers' banks that do not maintain reserves and Edge corporations (55 FR 22086, May 31, 1990). In August 1993, the Board adopted a modified version of the 1990 proposal, but sought further comment on the rate at which the daylight overdraft penalty fee would be assessed (58 FR 44672, August 24, 1993). The policy adopted by the Board in 1993 provides that the daylight overdraft penalty fee will be levied on the daily average, rather than maximum, daylight overdraft of institutions that do not have regular discount window access. The Board also determined to apply the daylight overdraft penalty fee to limited-purpose trust companies as well as bankers' banks that do not maintain reserves and Edge corporations. The Board retained the requirement that, in the event a bankers' bank, Edge corporation, or limited-purpose trust company incurs a daylight overdraft, the overdraft should be

collateralized.⁵ Reserve Banks will have the ability to waive the penalty fee if, for example, the overdraft resulted from a Reserve Bank error.

The daylight penalty rate proposed in 1993 was equal to the overnight penalty rate plus the federal funds rate (e.g., given a 10 percent overnight penalty rate and a 3 percent federal funds rate, the daylight penalty rate would be 13 percent), adjusted for the length of the Fedwire operating day. The Board proposed the addition of the federal funds rate to make the daylight penalty rate more comparable to the overnight penalty rate. As noted above, institutions are required to make up any reserve or clearing account deficiency resulting from an overnight overdraft, thereby incurring a loss of interest earnings on the make-up funds. Rather than instituting a make-up requirement for daylight overdrafts subject to the penalty fee, the Board proposed that the daylight overdraft penalty rate include a factor to account for the cost of holding make-up funds.

The Board also proposed to adjust the manner in which the penalty fee is calculated to make it similar to the calculation of the "regular" daylight overdraft fee. The regular daylight overdraft fee is quoted on a 24-hour basis, for a 360-day year, and adjusted for the length of the Fedwire operating day. This adjustment maintains a constant per-minute charge in the event that Fedwire hours change. The Board proposed that the daylight penalty rate be quoted on a similar basis. Under the 1993 proposal, assuming an overnight overdraft rate of 10 percent and a federal funds rate of 3 percent, the annual 24-hour daylight penalty rate would be 22.3 percent, adjusted to 9.3 percent for a 10-hour Fedwire operating day.

Daylight Overdraft Penalty Rate Adopted by the Board

The Board believes that it is appropriate to retain a relatively high overnight penalty rate (i.e., greater than the federal funds rate) to provide a strong incentive for all depository institutions to avoid overnight overdrafts. However, a daylight penalty rate tied to the overnight rate would also be relatively high, perhaps higher than necessary to provide an incentive for institutions to avoid daylight overdrafts. Therefore, the daylight overdraft penalty

⁵ As these institutions do not normally maintain collateral pledged to the Federal Reserve on an ongoing basis, if a bankers' bank, Edge corporation, or limited-purpose trust company incurs a daylight overdraft, the Reserve Bank generally requests a pledge of collateral (that would be eligible collateral for a discount window loan) for an appropriate period.

rate adopted by the Board is tied to the regular daylight overdraft rate, rather than the overnight penalty rate.

The daylight overdraft penalty rate adopted by the Board is equal to the regular Federal Reserve daylight overdraft rate plus 100 basis points. The annual daylight penalty rate will equal 124 basis points as of April 14, 1994, rising to 160 basis points when the regular daylight overdraft fee is fully phased in. The daylight penalty rate, like the regular daylight rate, will be adjusted to take account of the length of the Fedwire operating day, yielding a rate of 52 basis points as of April 14, 1994 (given a 10-hour Fedwire day), and rising to 67 basis points after full phase-in of the regular daylight fee. There is no deductible associated with the daylight overdraft penalty fee. In addition, the Board has set a minimum fee of \$25 for any two-week period in which a penalty fee is assessed (i.e., any fee greater than zero and less than \$25 over a two-week period would be rounded up to \$25).

Summary of and Responses to Comments on 1993 Proposal

The Board received 28 comments on the proposed penalty fee calculation. The comments were distributed as follows:

Type of commenter	No. of responses
Corporate credit union	18
Commercial bank	2
Federal Reserve Bank	2
Credit union	1
Commercial bankers' bank	1
Trade association	1
Bank holding company	1
Edge corporation	1
Federal agency	1
Total	28

The corporate credit union commenters generally expressed similar views regarding the proposal. They opposed both the concept of the daylight overdraft penalty and the size of the proposed rate. These commenters contended that the Board did not present a legally sustainable case as to why the same daylight overdraft rate should not be imposed on all institutions. They also asserted that the Federal Reserve Act does not authorize a penalty fee for corporate credit unions.

The corporate credit union commenters, as well as the National Credit Union Administration, maintained that one of the purposes of the proposed penalty fee appeared to be to penalize those bankers' banks that do not maintain reserves. They argued that it is unwarranted and contrary to the

letter and spirit of the Monetary Control Act (MCA) for the Board to attempt to reduce the equality of treatment among users of Federal Reserve services by assessing corporate credit unions a penalty fee for daylight overdrafts.

Five commenters, including a bank trade association, a bank holding company, and a commercial bankers' bank, agreed that the MCA does not require the Federal Reserve to treat daylight credit as a service to which depository institutions should have equal access. Two of these commenters stated that charging the same rate for all daylight overdrafts would give an unfair competitive advantage to those institutions that do not maintain reserves.

The legislative history of the MCA indicates that Congress intended bankers' banks to have access to Federal Reserve payment services despite the fact that they do not maintain reserves, but also indicates that the access to Federal Reserve services was opened up to depository institutions in general because they all were to be subject to reserve requirements.⁶ The Board believes that, when implementing a fee for daylight overdrafts incurred through use of Federal Reserve payments services, it is reasonable to establish different rates for institutions that maintain reserves and those that do not. The language of the MCA supports this distinction, by explicitly providing that the Board may impose balances "sufficient for clearing purposes" as a requirement for access to Federal Reserve services. By including this provision, Congress recognized that certain institutions with access to Federal Reserve services may not hold reserves at the Reserve Bank and may be subject to terms that would account for that fact.

The corporate credit union commenters also stated that the Board has not shown how daylight overdrafts incurred by corporate credit unions differ from those incurred by commercial banks and other depository institutions. Many of these commenters cited the Board's 1989 overdraft survey, which showed that corporate credit unions incurred only 0.18 percent of the total amount of daylight overdrafts incurred. The corporate credit unions, as well as an Edge corporation, stated that a penalty incentive is not necessary, as these institutions rarely incur daylight overdrafts. The commenters also stated that corporate credit unions

do not incur overnight overdrafts, and therefore there is no evidence that a daylight penalty fee is necessary to prevent overnight overdrafts.

The Board believes there is a fundamental difference between overdrafts incurred by institutions that have access to Federal Reserve credit and those that do not. Even though corporate credit union overdrafts constitute only a small percentage of the total daylight overdrafts in Federal Reserve accounts, the Board believes that these institutions should not receive any daylight credit from the Federal Reserve. On the other hand, the Board allows depository institutions with discount window access to incur limited daylight overdrafts. The daylight overdraft penalty fee reflects this difference.

The corporate credit unions and the National Credit Union Administration argued that the proposed penalty fee is excessive for the purposes of discouraging daylight overdrafts. These commenters also noted that the Board has stated that even the regular daylight overdraft fee of 60 basis points (adjusted to 25 basis points given a 10-hour Fedwire day) will provide an incentive for depository institutions to reduce daylight overdrafts. The corporate credit union commenters, as well as a bank trade association, also noted that the 10 percent floor in the current overnight penalty rate, to which the proposed daylight penalty rate was tied, yields an anomalous result as the federal funds rate declines. One commenter suggested that a daylight penalty rate 100 basis points above the federal funds rate should provide more than sufficient incentive for corporate credit unions to avoid daylight overdrafts. Four commenters, including a bank holding company and a commercial bankers' bank, supported the Board's proposed penalty fee calculation as equitable and sufficient to deter daylight overdrafts.

As noted above, the daylight overdraft penalty rate adopted by the Board will not be linked to the overnight penalty rate, but rather to the regular daylight rate applicable to depository institutions. The daylight penalty rate will be computed using the regular daylight rate plus a penalty add-on of 100 basis points, which is more proportional to the regular daylight rate. This policy will allow the Board to maintain a relatively high overnight rate that will provide a strong incentive to avoid overnight overdrafts, while maintaining a relatively low daylight penalty rate that will be less of a cost burden on affected institutions yet high enough to effect behavioral changes by institutions to avoid daylight overdrafts

altogether. The Board may consider raising the penalty rate if such behavioral changes do not occur. Also, if an intraday market rate were to develop in the future, the Board may base the daylight penalty on that rate. The daylight penalty rate will be adjusted to account for the length of the Fedwire operating day (multiplied by 10/24, given the current 10-hour Fedwire day), as is the regular daylight overdraft rate.

A bank trade association recognized the Board's intent to prevent institutions that do not have regular discount window access from obtaining credit from the Federal Reserve, but stated that a penalty-oriented approach could result in risk-shifting from the Federal Reserve to the private sector, rather than reducing overall payment system risk.

The intent of the penalty fee is to induce institutions to manage their accounts so as to avoid overdrafts, this reducing overall risk. The Board recognizes, however, that some risk-shifting would occur if institutions affected by the penalty fee move their payments business from the Federal Reserve to the private sector. Presumably, however, the risk would be shifted to depository institutions that have discount window access and thus could obtain Federal Reserve credit to cover daylight or overnight overdrafts in their Federal Reserve accounts.

Several corporate credit union commenters stated that the proposed penalty fee formula unfairly penalizes corporate credit unions by not allowing a deductible. The commenters noted that the Board's stated purpose of the deductible for depository institutions was to refrain from charging a large number of institutions who present small amount of risk and that this reasoning should also apply to corporate credit unions. One commenter suggested that, as an alternative to a deductible, the Board allow a one-hour grace period before assessing a penalty fee.

The Board established a deductible for the regular daylight overdraft fee to account for Reserve Bank error and computer downtime. The deductible also provides a minimal amount of free intraday credit to depository institutions. The Board does not believe that it is appropriate to supply free intraday credit to institutions that do not have discount window access, and thus has not provided a deductible or grace period for the daylight penalty fee. Reserve Banks will be able to waive penalty fees that result from Reserve Bank error or computer malfunction.

Two commenters suggested that no penalty fee be imposed until the Federal

⁶Colloquy between Mr. Wirth and Mr. Reuss, 126 Cong. Rec. H 2291, daily ed. March 27, 1980, and remarks of Sen. Proxmire, 126 Cong. Rec. S 3167, daily ed. March 27, 1980.

Reserve's book-entry securities system is redesigned to allow receiver control of securities deliveries. These commenters stated that the current system's design forces unanticipated daylight overdrafts and that the penalty fee punishes certain institutions for a shortfall in the Federal Reserve's book-entry securities transfer system.

Although institutions that receive securities versus payment over Fedwire do not have operational control over the timing of the transaction, they often know the approximate size and time of incoming securities deliveries. The Board believes it is appropriate to require institutions without access to Federal Reserve credit to manage their account so as to avoid securities-related overdrafts. The Federal Reserve is currently studying new service capabilities that would permit receivers of securities to control the use of securities-related intraday Federal Reserve credit.

An Edge corporation requested that, if a penalty fee is imposed, the Board clarify that an Edge corporation could pledge collateral to support regular discount window borrowing similar to the policy allowing bankers' banks to voluntarily maintain reserves, thereby allowing such Edge corporations to pay only the regular daylight overdraft fee rather than the penalty fee. This commenter also suggested that the Board should allow a parent bank to guarantee the daylight overdraft position of, or substitute itself for, an Edge corporation, similar to practice under CHIPS rules. This practice would allow a Reserve Bank to combine the daylight position of an Edge corporation and its parent.

The Board believes that collateral and pricing serve two related but separate purposes. Although collateral limits Reserve Bank risk, its purpose is to make discount window loans to book-entry securities overdrafters feasible during periods of operational difficulty. The daylight overdraft penalty fee is designed to create economic incentives to eliminate the use of daylight credit by institutions without regular discount window access. Their lack of access to the discount window suggests that Edge corporations should be subject to the same policy as bankers' banks that do not maintain reserves. The policy statement notes that the parent of an Edge or agreement corporation could fund its subsidiary during the day over Fedwire and/or the parent could substitute itself for its subsidiary on private networks. Such an approach by the parent could both reduce systemic risk exposure and permit the Edge or

agreement corporation to continue to service its customers.

Competitive Impact Analysis

The Board assesses the competitive impact of changes that have a substantial effect on payments system participants.⁷ Under this analysis, the Board determines whether the change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing similar services.

Many corporate credit unions have argued that the daylight overdraft penalty fee would put them at a competitive disadvantage vis-a-vis other payments system participants, particularly in book-entry security settlement and safekeeping services. These commenters asserted that daylight overdraft penalty fees would drive corporate credit unions out of the securities services and would force credit unions to do business with other service providers. Such other service providers could be private institutions, such as commercial banks, or credit unions could choose to establish accounts directly with a Federal Reserve Bank.

The Board does not believe that its policy adversely affects the ability of corporate credit unions to compete with the Reserve Banks in providing payments services. The policy places controls on the use of the Federal Reserve Banks' funds and book-entry transfer services, which are consistent with controls used in private clearing and settlement systems. Corporate credit unions have the ability to establish caps and collateralize book-entry securities overdrafts if they voluntarily maintain reserves, as commercial banks are required to do. By voluntarily maintaining reserves, the corporate credit unions would avoid the penalty fees that, according to their comments, would cause their customer credit unions to go to the Reserve Banks or elsewhere for payments services. In addition, the penalty rate adopted by the Board is significantly lower than the rates proposed in 1990 and 1993 and will result in a lower cost burden on corporate credit unions vis-a-vis their competitors.

Policy Statement

The Board has adopted the following to replace part (I)(D)(4) of its "Federal Reserve System Policy Statement on Payments System Risk" under the

⁷ These assessment procedures are described in the Board's policy statement entitled "The Federal Reserve in the Payments System" (55 FR 11648, March 29, 1990).

headings "I. Federal Reserve Policy", "D. Net Debit Caps", and "4. Special Situations," effective April 14, 1994:

4. *Special Situations.* Special risks are presented by the participation on Fedwire of Edge and agreement corporations, bankers' banks that are not subject to reserve requirements, limited-purpose trust companies, and institutions that have been assigned a cap of zero by their Reserve Banks. Most of these institutions lack regular discount window access. In developing its policy for these institutions, the Board has sought to balance the goal of reducing and managing risk in the payments system, including risk to the Federal Reserve, with that of minimizing the adverse effects on the payments operations of these institutions.

Regular access to the Federal Reserve discount window generally is available to institutions that are subject to reserve requirements. If an institution that is not subject to reserve requirements and thus does not have regular discount window access were to incur a daylight overdraft, the Federal Reserve may face the necessity of extending overnight credit to that institution if the daylight overdraft is not covered by the end of the business day. This credit would be contrary to the *quid pro quo* of reserves for discount window access established in the Federal Reserve Act and Board regulations. In addition, the Board expects that assessing a fee for daylight overdrafts could lead to an intraday funds market, similar to the current overnight funds market. As daylight credit begins to have significant value, daylight overdrafts in accounts at the Federal Reserve will begin to appear more and more like overnight extensions of credit by Reserve Banks. Thus, institutions that do not have regular access to the discount window should not incur either overnight overdrafts or daylight overdrafts in their Federal Reserve accounts.

As set out below, Edge and agreement corporations, bankers' banks that are not subject to reserve requirements, and limited-purpose trust companies are subject to a daylight overdraft penalty fee levied against the average daily daylight overdraft incurred by the institution. The annual rate for the daylight overdraft penalty fee is equal to the annual rate applicable to the daylight overdrafts of other depository institutions (i.e., the rate set forth in section (I)(B)) plus 100 basis points, adjusted to take account of the Fedwire operating day (multiplied by the fraction of the day Fedwire is scheduled to operate). The daily daylight penalty

rate is calculated by dividing the annual penalty rate by 360.

The penalty fee applies to the institution's average daily daylight overdraft in accounts at the Federal Reserve. The average daily overdraft is calculated by dividing the sum of the negative Federal Reserve account balances at the end of each minute of the scheduled Fedwire operating day (with positive balances set to zero) by the total number of minutes in the scheduled Fedwire operating day. The penalty fee is charged in lieu of, not in addition to, the daylight overdraft fee described in section (I)(B) and is effective April 14, 1994.

Overnight overdrafts for these institutions are treated similarly to overnight overdrafts of other depository institutions.

*a. Edge and agreement corporations.*⁹ Edge and agreement corporations should refrain from incurring daylight overdrafts in their reserve or clearing accounts. In the event that any daylight overdrafts occur, the Edge or agreement corporation must post collateral to cover the overdrafts. In addition to posting collateral, the Edge or agreement corporation would be subject to a daylight overdraft penalty fee levied against the average daily daylight overdrafts incurred by the institution, as described above.

This policy reflects the lack of access of these institutions to the discount window and the possibility that the parent of an Edge or agreement corporation may be unable or unwilling to cover its subsidiary's overdraft on a timely basis. The Board notes that the parent of an Edge or agreement corporation could fund its subsidiary during the day over Fedwire and/or the parent could substitute itself for its subsidiary on private networks. Such an approach by the parent could both reduce systemic risk exposure and permit the Edge or agreement corporation to continue to service its customers. Edge and agreement corporation subsidiaries of foreign banks are treated in the same manner as their domestically-owned counterparts.

*b. Bankers' banks.*¹⁰ Bankers' banks are exempt from reserve requirements

and do not have regular access to the discount window. They do, however, have access to Federal Reserve payments services. The Board's policy provides that bankers' banks should refrain from incurring overdrafts and post collateral to cover any overdrafts they do incur. In addition to posting collateral, a bankers' bank would be subject to a daylight overdraft penalty fee levied against the average daily daylight overdrafts incurred by the institution, as described above.

The Board's policy for bankers' banks reflects the need to protect Reserve Banks from potential losses resulting from daylight overdrafts incurred by bankers' banks. The policy also reflects the fact that some bankers' banks do not incur the costs of maintaining reserves as do other depository institutions and do not have regular access to the discount window and the similarity between overdrafts and discount window credit.

Bankers' banks may voluntarily waive their exemption from reserve requirements, thus gaining access to the discount window. Such bankers' banks would be free to establish caps and would be subject to the same policy as other depository institutions. The policy set out in this section applies only to those bankers' banks that have not waived their exemption from reserve requirements.

c. Limited-purpose trust companies.^{10A} The Federal Reserve Act permits the Board to grant Federal Reserve membership to limited-purpose trust companies subject to conditions the Board may prescribe pursuant to the Act. As a general matter, member limited-purpose trust companies do not accept reservable deposits, do not have regular discount window access, and may not incur daylight overdrafts.

Limited-purpose trust companies are subject to the same daylight overdraft penalty fees as other institutions that do not maintain reserves and do not have regular discount window access. Limited-purpose trust companies should refrain from incurring overdrafts and should post collateral to cover any overdrafts they do incur. In addition to posting collateral, a limited-purpose trust company would be subject to a daylight overdraft penalty fee levied against the average daily daylight

overdrafts incurred by the institution, as described above.

d. Zero-cap depository institutions. Some depository institutions have caps of zero that are imposed by Reserve Banks because of the institutions' financially troubled status or failure to comply with the Board's payments system risk policy or because the institution itself requested a zero cap. Regardless of whether it has access to the discount window, if a depository institution on which a Reserve Bank has imposed, or that has adopted, a zero cap incurs a funds-transfer-related overdraft, the Reserve Bank would counsel the institution and may monitor the institution's activity in real-time and reject or pend any Fedwire funds transfer instruction that would cause an overdraft. Because the timing of book-entry securities transfers are not fully within the control of the receiving depository institution, the Board will allow depository institutions with caps of zero that have access to the discount window to continue to incur book-entry overdrafts, but will require that such overdrafts be collateralized even if they are infrequent and modest.

By order of the Board of Governors of the Federal Reserve System, February 17, 1994.

Jennifer J. Johnson,

Associate Secretary of the Board.

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BILLING CODE 6210-01-P

⁹ These institutions are organized under section 25A of the Federal Reserve Act (12 U.S.C. 611-631) or have an agreement or undertaking with the Board under section 25 of the Federal Reserve Act (12 U.S.C. 601-604a).

¹⁰ For the purposes of this policy statement, a bankers' bank is a financial institution that is not required to maintain reserves under the Board's Regulation D (12 CFR part 204) because it is organized solely to do business with other financial institutions, is owned primarily by the financial institutions with which it does business, and does not do business with the general public and is not

a depository institution as defined in the Board's Regulation A (12 CFR 201.2(a)).

^{10A} For the purposes of this policy statement, a limited-purpose trust company is a trust company that is a member of the Federal Reserve System but that does not meet the definition of "depository institution" in section 19(b)(1)(A) of the Federal Reserve Act (12 U.S.C. 461(b)(1)(A)).