



FEDERAL RESERVE BANK  
OF DALLAS

TONY J. SALVAGGIO  
FIRST VICE PRESIDENT

DALLAS, TEXAS  
75265-5906

September 8, 1995

**Notice 95-83**

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

**SUBJECT**

**Firm Closing Time for Fedwire Securities  
and Modifications to the Fedwire  
Third-party Access Policy**

**DETAILS**

The Board of Governors of the Federal Reserve System has approved a firm closing time of 3:15 p.m. Eastern Time (ET) for transfer originations and 3:30 p.m. ET for reversals for the Fedwire book-entry securities transfer system. The Board has also authorized the Reserve Banks to continue to close the Fedwire securities transfer service earlier than 3:15/3:30 p.m. ET on certain days when the U.S. government and mortgage securities markets observe partial-day or full-day holiday operations.

The Board believes that the new schedule will benefit market participants by reducing uncertainty about the final closing time of the system, thus enabling participants to manage resources more effectively and control costs with greater certainty. These changes become effective January 2, 1996.

In addition, the Board has approved certain modifications to its Fedwire third-party access policy to clarify its applicability and to reduce the administrative burden of several provisions. In particular, to reduce the costs imposed by the policy, the Board has limited several requirements to arrangements in which the service provider is not affiliated with the Fedwire participant. The policy's scope has also been clarified by the Board.

These changes became effective August 10, 1995. Existing Fedwire third-party access arrangements should comply with the revised policy by March 1, 1996.

**ATTACHMENTS**

Copies of the Board's notices as they appear on pages 42409-13 and 42418-23, Vol. 60, No. 157, of the *Federal Register* dated August 15, 1995, are attached.

**MORE INFORMATION**

For more information regarding Fedwire securities, please contact Nancy Barton at (214) 922-6746. For more information regarding Fedwire third-party access, please contact Jonnie Miller at (214) 922-6433.

For additional copies of this Bank's notice, please contact the Public Affairs Department at (214) 922-5254.

Sincerely,

A handwritten signature in cursive script, appearing to read "Tony J. Salysio".

# Federal Register

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Tuesday  
August 15, 1995

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Part VII

## Federal Reserve System

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Federal Reserve Bank Services; Notices

**FEDERAL RESERVE SYSTEM**

[Docket No. R-0866]

**Federal Reserve Bank Services****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Notice.

**SUMMARY:** The Board has approved a firm closing time of 3:15 p.m. Eastern Time (ET) for transfer originations and 3:30 p.m. ET for reversals for the Fedwire book-entry securities transfer system. Periodic extensions of this closing time may be granted only in response to significant operating problems at a major bank or dealer or to prevent market disruption. The Board also has authorized the Reserve Banks to continue to close the Fedwire securities transfer service earlier than the scheduled closing time on certain days when the U.S. government and mortgage securities markets observe partial-day or full-day holiday operations. The Board believes that the new schedule will benefit market participants by reducing uncertainty about the final closing time of the system, thus enabling participants to manage resources more effectively and control costs with greater certainty than today.

**EFFECTIVE DATE:** January 2, 1996.**FOR FURTHER INFORMATION CONTACT:**

Louise L. Roseman, Associate Director (202/452-2789), Gayle Brett, Manager (202/452-2934), or Lisa Hoskins, Project Leader (202/452-3437), Division of Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System. For the hearing impaired only: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

**SUPPLEMENTARY INFORMATION:****I. Background**

In January 1995, the Board issued for comment a proposal to establish a firm closing time of 3:00 p.m. ET<sup>1</sup> for Fedwire book-entry securities transfer originations and 3:30 p.m. ET for reversals, beginning in January 1996 (60 FR 123, January 3, 1995).<sup>2</sup> The Board also requested comments on the potential benefits, costs, and market implications of opening the on-line Fedwire book-entry securities transfer

<sup>1</sup> All times are Eastern Time. For ease of reference throughout this document, the closing time may be identified as 3:00/3:30 p.m., for example.

<sup>2</sup> Currently, the Fedwire book-entry securities transfer service has a published closing time of 2:30 p.m. for transfer originations and 3:00 p.m. for reversals. Some Reserve Banks permit the movement of securities within a participant's account (also called repositioning) after the close of the reversal period.

service earlier in the day and on new service capabilities that would give depository institutions the option of participating in the Fedwire securities transfer system during earlier hours. In addition, the Board requested comment on new service capabilities that would allow depository institutions to control their use of intraday credit during expanded and/or core business hours.

The Board's action at this time is limited to establishing a firm closing time for the Fedwire securities transfer service. The Board is continuing to evaluate comments received on the potential benefits, costs, and market implications of an earlier opening of the on-line securities transfer service and potential new service capabilities.

Thirty-six commenters responded to the Board's proposal. About 60 percent of the commenters were commercial banks or bank holding companies, including banks that provide government securities clearing and settlement services to dealers and other firms. The following table identifies the number of commenters by type of organization:

Commercial Banking Organizations <sup>3</sup>	21
Credit Unions	2
Broker/Dealers <sup>4</sup>	2
Clearing House Associations	2
Clearing Organization	1
Trade Associations	3
Federal Home Loan Banks	2
Federal Reserve Banks	2
State Government	1
Total public comments	36

Thirty-one commenters addressed the issue of a firm closing time for the book-entry securities service. The major topics discussed by these commenters include: (1) benefits of a firm closing time; (2) selection of an appropriate closing time; and (3) extensions of the scheduled closing time. The following discussion provides a summary of the comments received and the Board's analysis of the issues raised.

**II. Benefits of Firm Closing Time**

Thirty commenters supported the establishment of a firm closing time for the Fedwire book-entry securities transfer service. Almost half of these commenters stated specifically that a firm closing time would reduce uncertainty about the final close and allow them to better plan staffing and other resource needs, thus improving their ability to control costs. In addition, Aubrey Lanston & Co. noted that "a firm

<sup>3</sup> Banks, bank holding companies, and operating subsidiaries of banks or bank holding companies.

<sup>4</sup> Entities extensively involved in trading book-entry U.S. government or federal agency securities.

closing time would complement advances that have been made in the last year to reduce daylight overdraft charges, thus benefitting market participants with little additional costs."

Roughly one-third of the commenters addressing the concept of a firm closing time expressed support for the concept if the Federal Reserve Banks would exercise flexibility in granting "emergency" extensions. A few commenters believed that the current practice of granting frequent extensions is adequate for their processing and planning needs.

Market participants have made significant operational improvements over the last ten years, including increased reliability and processing capability of their automated systems, that have affected average daily volume patterns. In addition, a number of initiatives implemented by the Federal Reserve Banks and market participants have altered the intraday pattern of Fedwire securities transfers.<sup>5</sup> For example, prior to the implementation of daylight overdraft fees in April 1994, about 20 percent of the value of securities transfers on Fedwire was processed by 10:00 a.m., 40 percent by noon, and 75 percent by 2:00 p.m. Since January 1995, roughly 36 percent of the value of securities transfers on Fedwire was processed by 10:00 a.m., 65 percent by noon and 92 percent by 2:00 p.m. Over the last ten years, the average actual closing time of the Fedwire securities transfer system has moved from 5:30 p.m. to 3:15 p.m.

The Board believes that a firm closing time for the Fedwire securities transfer service would allow market participants and the Federal Reserve Banks to manage resources more effectively and control costs with greater certainty than today. A firm closing time that accommodates the large majority of actual current closing times will reduce the frequency and duration of extensions and thus provide increased certainty with respect to the final closing time.

**III. Selection of Appropriate Closing Time**

Twenty-five commenters supported the proposed closing time of 3:00/3:30 p.m. Eleven commenters noted that establishing a closing time that is later

<sup>5</sup> Specific initiatives include: a \$50 million maximum transaction limit for Fedwire book-entry securities transfers; Public Securities Association's "good delivery guidelines" designed to encourage earlier-in-the-day settlement of large securities deliveries; and the assessment of fees for daylight overdrafts incurred in accounts held at the Federal Reserve.

than the current published closing time of 2:30/3:00 p.m. will provide extra processing time for securities transfers, which may be useful for some participants. Two commenters noted that the extra time would relieve some of the pressure of acting upon late instructions for outright sales and repo collateral activity and would facilitate a smooth daily transition from securities to cash processing. One commenter suggested that expanding the closing time in this manner would relieve industry bottlenecks on heavy settlement days and help prevent "fails"<sup>6</sup> on numerous occasions.

Seven commenters believed there would be no benefit to changing the current closing time of 2:30/3:00 p.m. These commenters stated that the current schedule is adequate for their processing needs and should not be changed. For example, the Public Securities Association (PSA) noted that the current closing time provides sufficient certainty to the market for participants to plan for staffing and other needs. In addition, while Chemical Bank stated that it did not oppose a 3:00/3:30 p.m. closing time, it indicated that it has been able to process successfully its two highest volume days on record within the current 2:30 p.m. closing time for securities transfer originations. Chemical Bank stated that there is no need to change the closing time, as long as the Federal Reserve Banks have the flexibility to extend the closing time when there are significant systems problems for a major participant.

Eight commenters believed that the Board should establish a firm closing time later than the proposed time of 3:00/3:30 p.m. While the American Bankers Association (ABA) expressed support for the proposed closing time; it noted that several of its members would support a 3:30/4:00 p.m. closing time to allow extra securities processing time. Harris Trust and Savings Bank stated that while its customers would benefit from the additional processing time associated with a 3:00/3:30 p.m. closing time, the bank prefers extending the closing time to 3:30/4:00 p.m. to facilitate its broker customers' needs arising from afternoon margin calls at the exchanges. The BOTCC argued that a 6:00 p.m. closing time would facilitate: (1) the afternoon settlement of futures transactions by permitting securities to be sold or pledged to meet related settlement obligations; (2) the collection of original margin deficits in

<sup>6</sup> A "fail" occurs when the securities and cash are not exchanged as agreed on the settlement date, usually because of technical problems.

the afternoon by permitting the transfer of securities to meet margin requirements; and (3) market participants' ability to adhere to firm closing times. In addition, the BOTCC suggested that a 6:00 p.m. closing time could benefit customers of clearing members by increasing the likelihood that they would receive the proceeds of payments from clearing members on a same-day basis.

Some commenters observed that a later close of the Fedwire book-entry securities transfer service will compress further the limited time available to complete overnight batch accounting cycles in anticipation of the 12:30 a.m. opening of the Fedwire funds transfer service, beginning in late 1997. Specifically, seven commenters indicated a fairly broad spectrum of end-of-day processing requirements and capabilities, ranging from 4–5 hour to 10–12 hour processing cycles. One commenter was unable to provide an estimate of the amount of time required for overnight batch processing because of systems changes it needed to make to accommodate interstate branch banking. In addition, one commenter noted that a later closing time could cause some participants to deliver securities "at the last minute" and another commenter argued that a later closing time would delay its funds settlement process.

The current published closing time has been in place since the system was implemented in the late 1960s. Historically, the service has routinely closed later than 2:30/3:00 p.m. to accommodate operating problems and volume backlogs incurred by major participants. Recent experience indicates that although market participants have made substantial improvements to their automated systems and internal operations, the increased efficiency has not enabled a stable closing time of 2:30/3:00 p.m. During the first half of 1995, the Fedwire securities transfer system was extended beyond the scheduled closing time on 61 out of 126 days, or 48 percent of the business days; most of these extensions were due to system/operating problems at a bank or major dealer. Extensions were granted on eight occasions to allow one of the clearing banks to complete its daily volume; generally, these volume backlogs were satisfied by 3:30 p.m.

In the context of reviewing changes to the final closing time, State Street Bank and Trust suggested that the Board also review the need for a dealer-turnaround deadline, which currently is 2:45 p.m. State Street suggested that the original reasons for granting broker/dealers additional delivery time to customers

are no longer valid in today's automated environment and stated that this intermediary deadline becomes more difficult to justify as operating hours are expanded. State Street indicated that there are no "class" distinctions within other depositories.

Dealer-turnaround time was established by the PSA as an industry guideline to promote the smooth functioning of the government securities market. Operationally, broker/dealers prioritize their work based on the PSA good delivery guidelines; processing transfers during the day first to other broker/dealers and later to their customers. The dealer-turnaround deadline has been reflected in the Federal Reserve Banks' operating circulars; however, the Reserve Banks do not police participant activity with respect to this time.

Whereas the Board's original proposal suggested a closing time of 3:00/3:30 p.m., the Board believes that establishing a firm closing time of 3:15 p.m. for transfer originations and 3:30 p.m. for reversals is consistent with current practice<sup>7</sup> and would enable an orderly close of the government securities market. The Board believes that these closing times will satisfy adequately the known processing needs of market participants with respect to interbank transfers. The Board believes that the new closing time provides sufficient opportunity for market participants to complete daily deliveries, absent unusual operating or computer problems.<sup>8</sup> In addition, the Board's action does not preclude the continuation of an industry standard for a dealer-turnaround time if the industry believes it is needed.<sup>9</sup> The Board also believes that this new closing time will not interfere with the normal end-of-day processing requirements of market participants and Federal Reserve Banks. The Board encourages market participants to continue efforts to improve the efficiency of back-office operations, especially as these may be necessary in anticipation of expanded Fedwire funds transfer service operating hours in late 1997.

The Board believes that establishing a closing time later than 3:15/3:30 p.m. for the Fedwire securities transfer service is not warranted at present. It is

<sup>7</sup> The existing 2:45 p.m. deadline for dealer-to-customer deliveries effectively results in a reversals-only period of 15 minutes.

<sup>8</sup> Those Reserve Banks that permit repositioning after the close of the reversal period may continue to do so.

<sup>9</sup> The Federal Reserve Banks' book-entry securities operating circulars will be modified to eliminate reference to a separate deadline for dealer-to-customer deliveries.



not clear that the potential benefits of closing later than 3:15/3:30 p.m. are sufficient to outweigh the costs of a later close. The existing characteristics of the Fedwire securities transfer service, especially the inability to control the receipt of securities transfers delivered against payment, compel on-line participants to actively monitor their accounts throughout the operating day. It is difficult to justify requiring participants to incur the additional expense associated with monitoring their Fedwire securities activity when there is relatively little volume to be processed later in the day.<sup>10</sup> While the BOTCC pointed out that a significantly later close of 6:00 p.m. would facilitate the afternoon settlement of futures transactions and permit the transfer of securities to meet margin requirement, there are significant costs associated with delaying the back-end processing that takes place at depository institutions after the close of the Fedwire book-entry securities transfer service. In addition, a 6:00 p.m. closing time for the Fedwire securities service may require a later third-party deadline and final close for the Fedwire funds transfer service. Also, decreasing the time between the close of the Fedwire book-entry securities transfer service and the close of the Fedwire funds transfer service allows less time to accommodate securities-related extensions without resulting in Fedwire funds transfer extensions. The Board is concerned about the possibility of securities-related extensions affecting the ability of the funds transfer service to close timely in light of its decision to open the Fedwire funds transfer service at 12:30 a.m. ET, beginning late 1997. Despite these concerns, the Board is willing to consider later closing times for the book-entry securities transfer service in the future and will continue to assess changes in market behavior and intraday volume patterns, as well as improvements in the efficiency of back office operations, that may call for such modifications.

#### IV. Extensions of the Scheduled Closing Time

Nine commenters emphasized the need for Federal Reserve flexibility in granting extensions for unusual circumstances. In addition, five commenters encouraged the Board to provide guidance as to what circumstances would warrant extension of the scheduled closing time.

<sup>10</sup>Recent data indicate that, on average, less than one percent of the aggregate value of securities transfers processed over Fedwire remains to be processed after 3:00 p.m.

Specifically, some commenters argued that extensions should be granted only to accommodate significant operating or computer problems at a depository institution or major dealer or to prevent market disruption. PSA suggested that extensions also should be granted to accommodate the processing volume of large market participants. Two commenters stated that the Board should develop more "equitable" guidelines for granting extensions, arguing that the criteria should be more relevant to the industry as a whole. For example, State Street Bank and Trust observed that the "current extension guidelines (\$500 million or more in straight sells) favor the few banks which process the majority of securities transfers."

Although market participants have improved significantly their automated systems over time, operational problems occasionally arise that interfere with the timely settlement of a participant's Fedwire securities transfers. An operating problem at a participant that originates and/or receives a significant volume of daily Fedwire securities transfers could affect the government securities market broadly by contributing to settlement gridlock. Settlement gridlock, if prolonged, could lead to systemic liquidity problems among dealers and other financial institutions, which could contribute to increased credit risks.

The Board believes that it is essential for the Federal Reserve Banks to have the flexibility to extend the closing time of the Fedwire book-entry securities transfer system on an as-needed basis to facilitate the smooth functioning of the government securities market and to minimize the systemic risks that may arise due to significant operating problems at one or more depository institutions or major dealers. The Board believes that granting extensions in such circumstances provides for the orderly functioning of the government securities market and minimizes the number of failed trades. Because the Board expects all on-line participants to invest in the necessary automation resources to process peak volumes as well as normal volumes, the Federal Reserve Banks generally will not grant extensions based on circumstances arising from volume backlogs at a participant.

#### V. Other Issues

Commenters raised several other issues relating to the closing time for the Fedwire book-entry securities transfer service. Specifically, these suggestions include implementing a free delivery period, considering an earlier close on certain days, and monitoring/

disciplining participants for improper actions during the reversal processing period.

##### A. Free Delivery Period

Bank of America suggested that in conjunction with implementing a firm closing time of 3:00/3:30 p.m., the Board should consider allowing depository institutions to make bank-to-bank transfers free-of-payment (also called "free deliveries") for an hour after the close of the reversal period. Bank of America noted that depository institutions and their customers could use this processing window (i.e., from 3:31 p.m. to 4:30 p.m.) to resolve major difficulties, such as correcting any operational errors or financing securities that inadvertently remained in the dealer's account. The bank stated that if payment were required for a securities transfer to be delivered during this period, the buyer could send the payment via the Fedwire funds transfer system. Bank of America believes that this new service should be implemented in January 1996.

At present, the Federal Reserve Banks' Fedwire book-entry securities transfer applications are unable to establish different closing times for interbank transfers that are "free" versus those that are against payment. The Federal Reserve Banks plan to implement new software for the book-entry securities transfer service, called the National Book-Entry System (NBES), beginning in 1996. NBES will have the capability to differentiate certain types of transactions by time-of-day, which would enable the Reserve Banks to establish a special period for free deliveries of securities, for example. The functionality for processing "free" bank-to-bank transfers after the close of the period for delivery-versus-payment transfers may be made operational in the future pending additional analysis.

##### B. Earlier Close on Certain Market Holidays

Crestar Financial Corporation suggested that the Board should consider closing the Fedwire book-entry securities transfer service earlier on days when the government securities market is closed and/or closes early. Crestar stated that "typically these are days when staff schedules vacations and there might be significant system wide savings if coverage did not have to be provided."

Each year, PSA announces a holiday schedule recommending full-day and partial-day closings of markets for U.S. government and mortgage securities and money market instruments. Typically, there is little Fedwire securities transfer volume to be processed on such days. As a result, the Federal Reserve Banks

generally have been able to close the Fedwire securities transfer system earlier than 2:30/3:00 p.m. on certain days designated in the PSA holiday schedule, such as Good Friday. For example, on April 14, 1995 (Good Friday), depository institutions in the Second Federal Reserve District originated a combined total of about 650 securities transfers, which were all completed by noon, compared with average volume of over 38,000 securities transfers originated per day during March 1995. Thus, the Federal Reserve Banks were able to close the system at 1:30 p.m. on that day.

As noted earlier, the characteristics of the Fedwire securities transfer service, especially the inability to control the receipt of securities transfer delivered against payment, compel on-line participants to actively monitor their accounts throughout the operating day. It is difficult to justify requiring participants to incur the additional expense associated with monitoring their Fedwire securities activity on those days when no volume is processed later in the day.

The Board believes that it is appropriate for the Federal Reserve Banks to continue to close the Fedwire securities transfer service earlier than the published closing time on all or some days designated by the PSA as full or partial market holidays, when there is relatively little volume to be processed. Shortly after the PSA publishes its annual holiday schedule, the Federal Reserve Banks will issue a notice identifying the days on which it plans to close the securities transfer service earlier than 3:15/3:30 p.m. In addition, the Federal Reserve Banks will notify participants of the scheduled early close approximately two weeks in advance of the particular date that Fedwire will be closed early, coincident with PSA's reminder notices for the recommended market holiday.

#### *C. Monitoring Improper Actions During Reversal Period*

Two commenters expressed concern about the practices of some institutions that send securities transfer originations during the reversals-only period. One of these commenters inquired about the Federal Reserve's ability to monitor and/or report such practices, indicating that the Federal Reserve should penalize institutions for improper use of the transfer reversal code.

The Federal Reserve Banks' book-entry securities services uniform operating circular sets forth the terms and conditions governing access to the Fedwire book-entry securities transfer service. In particular, paragraph 21 of this circular indicates that a participant

should not send a transfer message for the first time during the reversals-only period by using a reversal code and provides the receiver of such a transfer with the ability to request an as-of adjustment for improper use of the reversal code. The circular notes that use of the reversal code to resend a transfer initially sent during the origination period and improperly reversed is not a misuse of the reversal code. The Board believes that this provision provides sufficient protection to receivers of improper transfer messages and, as a result, it is not necessary to institute additional measures at this time.

#### **VI. Effective Date of Proposed Changes**

Almost all of the commenters responding to the proposal believed that January 1996 is a reasonable effective date for establishing a firm closing time for the Fedwire book-entry securities transfer service. One commenter, however, suggested that it would be more prudent to establish an effective date that is after the implementation of the National Book-Entry System.

The Board believes that the benefits associated with establishing a firm closing time of 3:15/3:30 p.m. for the Fedwire securities transfer service justify a near-term effective date that permits institutions to make any necessary internal operational/procedural changes. The Board believes that an effective date of January 2, 1996 is reasonable because the new closing time does not represent a material change from average actual experience.

#### **VII. Competitive Impact Analysis**

The Board assesses the competitive impact of changes that may have a substantial effect on payment system participants. In particular, the Board assesses whether a proposed change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve Banks in providing similar services and whether such effects are due to legal differences or due to a dominant market position deriving from such legal differences.

Other providers of securities transfer services do not provide services that are directly comparable to the Fedwire book-entry securities transfer service, because only the Federal Reserve Banks can provide final delivery-versus-payment of securities settled in central bank money. There are other private-sector systems, however, such as the Government Securities Clearing Corporation and the Participants Trust Company, that facilitate primary and secondary market trades of U.S.

Treasury and/or agency securities. Other transactions involving U.S. government securities may be cleared and settled on the books of depository institutions to the extent that the counterparties are customers of the same depository institution.

The Board does not believe that the establishment of a firm closing time for the Fedwire securities transfer system would have a direct and material adverse effect on the ability of other service providers to offer similar services. The Federal Reserve Banks, however, would maintain their unique position of providing risk-free central bank settlement.

By order of the Board of Governors of the Federal Reserve System, August 9, 1995.

**William W. Wiles,**

*Secretary of the Board.*

[FR Doc. 95-20127 Filed 8-14-95; 8:45 am]

BILLING CODE 6210-01-P



**FEDERAL RESERVE SYSTEM****[Docket No. R-0890]****Federal Reserve Payment System Risk Policy****AGENCY:** Board of Governors of the Federal Reserve System.**ACTION:** Policy statement.

**SUMMARY:** The Board has approved certain modifications to its Fedwire third-party access policy to clarify its applicability and to reduce the administrative burden of several provisions. Some depository institutions have entered into arrangements under which a third party provides operating facilities for their Fedwire services; under such arrangements, the third party's actions may result in a debit to the institution's reserve or clearing account at a Federal Reserve Bank. The policy provides important safeguards to both depository institutions participating in third-party access arrangements and to the Reserve Banks. Among other things, the policy requires depository institutions to impose prudent controls over Fedwire funds transfers and book-entry securities transfers initiated, received, or otherwise processed on their behalf by a third-party service provider. These policy modifications are interim modifications, pending the completion of a broader review of supervisory policies that should be applicable to outsourcing arrangements. The review may result in further modifications to the policy; however, the Board believes that any further modifications will be in the same general direction as those made today. The Federal Reserve Banks will not approve any new third-party access arrangements involving a foreign service provider, pending further analysis of issues associated with such arrangements.

**EFFECTIVE DATE:** August 10, 1995.

**FOR FURTHER INFORMATION CONTACT:** Gayle Brett, Manager (202/452-2934) or Lisa K. Hoskins, Project Leader (202/452-3437), Fedwire Payments, Division of Reserve Bank Operations and Payment Systems; for the hearing impaired *only*: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

**SUPPLEMENTARY INFORMATION:****I. Background**

Fedwire is the large-value payment mechanism owned and operated by the Federal Reserve Banks. Fedwire provides depository institutions with real-time gross settlement in central bank money of funds transfers and

book-entry securities transfers made for their own account or on behalf of their customers. Typically, each depository institution that holds an account at the Federal Reserve processes its own transfers and accesses Fedwire directly. In some cases, however, a depository institution accesses Fedwire through a third-party access arrangement in which a service provider, acting as agent for a depository institution, initiates payments that are posted to the institution's account at the Federal Reserve. Third-party access arrangements are a form of outsourcing. Depository institutions use service providers to perform a number of functions, including customer accounting, check and automated clearing house (ACH) processing, and the processing and/or transmission of large-value funds and securities transfers. Depository institutions have increasingly viewed outsourcing arrangements as one way to reduce operating costs.

During the mid-1980s, the Board and Reserve Banks became concerned about the credit exposure faced by depository institutions that contracted with a third-party service provider to process Fedwire funds transfers on their behalf. Due to the concerns raised about the legal, supervisory, and payments system risk implications of such arrangements, a moratorium on approving additional arrangements was imposed in 1985 until these issues could be reviewed and guidelines established.

In July 1987, the Board approved a set of conditions under which Fedwire third-party access arrangements could be established, as part of its payment system risk reduction policy (52 FR 29255, August 6, 1987). Specifically, the Board adopted a policy placing certain conditions on the ability of a service provider to initiate Fedwire transfers from a participant's reserve or clearing account held at the Federal Reserve.<sup>1</sup> The Board's original policy addressed two types of arrangements. Where the service provider and the participant are not affiliated, the participant must authorize each individual transfer before it is sent to a Reserve Bank. Where the service provider and the participant are affiliated, the participant may establish limits within which the

service provider is authorized to act. For purposes of the policy, an affiliated service provider is defined as an organization that has at least 80 percent common ownership with the participant.

Since the third-party access policy went into effect, the Federal Reserve Banks have approved approximately 500 third-party service arrangements.<sup>2</sup> During this time a number of issues and requests for clarification have been raised with respect to the policy. These questions relate to: (1) the circumstances under which line-of-credit arrangements can be used; (2) the responsibility of a participant to monitor its reserve or clearing account in line-of-credit arrangements; (3) the need for a participant to have backup capabilities in the event the Federal Reserve Bank terminates the arrangement; and (4) the duties that may be assigned to personnel employed by the parties to the arrangement.

Issues also were raised about the scope of the policy. Questions of scope include: (1) whether the policy applies to arrangements for book-entry securities transfers as well as funds transfers; (2) whether the policy applies to arrangements in which a service provider serves as a communications link but does not process the transfers; (3) whether the policy applies when an institution contracts with a third party to process transfers that subsequently are routed through the participant to the Reserve Bank; and (4) whether the policy applies to arrangements in which the service provider is located outside the United States.

In considering modifications to the Fedwire third-party access policy, the Board has determined that it would be useful to undertake a broader review of supervisory policies that should be applicable to a larger range of outsourcing arrangements. The staff has begun to review broader issues relating to outsourcing generally, including, for example, the extent to which termination backup requirements should apply to other critical functions outsourced by banks and whether foreign service provider arrangements should be subject to special conditions. It is possible that the Board will modify further the Fedwire third-party access policy following completion of the

<sup>1</sup> The original issues surrounding third-party access arrangements arose in the context of funds transfer arrangements, and the language of the original policy reflected this orientation. Board staff subsequently interpreted the policy to include Fedwire book-entry securities transfer arrangements within its scope. Board staff also interpreted the policy to cover all situations where transfer instructions are not communicated directly to the Reserve Bank by the sending bank, but rather are transmitted indirectly through another entity.

<sup>2</sup> The number of current arrangements is less than the number approved because of mergers and changes in relationships between participants and service providers. Because some of the approved arrangements involved multiple participants using the same service provider, however, there may be more than 500 Fedwire participants currently using third-party service providers for Fedwire processing.



study. The Board believes, however, that any additional modifications to this policy are likely to be consistent with the changes made today to reduce further the costs imposed by the policy.

## II. Provision-by-Provision Analysis

The following identifies each provision of the revised Fedwire third-party access policy and discusses how and why it differs from the original policy provision.

### A. Scope

#### Revised Provision

The Board will allow third-party access arrangements whereby a sending or receiving institution ("the participant") designates another depository institution or other entity ("the service provider") to initiate, receive, and/or otherwise process Fedwire funds transfers or book-entry securities transfers that are posted to the participant's reserve or clearing account held at the Federal Reserve, provided the following conditions are met:<sup>3</sup>

#### Original Provision

The Board will allow, under certain conditions, arrangements by which a depository institution or other entity ("the service provider") could initiate Fedwire transfers from the Federal Reserve account of another depository institution ("the participant"). Such arrangements will be permitted provided:

The original policy applied to arrangements where funds transfers or book-entry securities transfers were charged or credited to a depository institution's reserve or clearing account held at the Federal Reserve and for which the depository institution did not provide its transfer instructions directly to the Federal Reserve, but rather transmitted its instructions indirectly through another entity. The revised policy applies to the arrangements described above, as well as arrangements where an institution contracts with a third party to process transfers that subsequently are routed through the participant to the Reserve Bank. The Board believes that, whenever a service provider plays a role in processing Fedwire funds transfers or book-entry securities transfers that affect the participant's reserve or clearing account, the arrangement should be subject to the third-party access policy. The revised policy governs all

<sup>3</sup> This policy applies to third-party access arrangements in which an office of the participant located outside the U.S. acts as service provider by initiating, receiving, or otherwise processing Fedwire transfers on behalf of the U.S. participant.

arrangements in which a service provider has the operational ability to add or modify transfer instructions that will be posted to the participant's reserve or clearing account held at the Federal Reserve. As a result, communications carriers whose sole job is to transmit transfer instructions between entities are excluded from this policy.

The original policy is silent on whether the service provider can be located outside the United States. The Reserve Banks have not approved any such arrangements; however, several inquiries have been received during the last few years. Such arrangements raise a number of supervisory issues. In addition, because the original third-party access policy applies only to arrangements where the service provider is a separate legal entity from the participant, a Fedwire participant could designate an office of its bank located outside the U.S. to process Fedwire transfers on its behalf without obtaining prior approval from the Reserve Bank. The Reserve Bank and the primary regulator may be unaware of such an arrangement until discovered in the course of an examination. The Board believes that many of the issues that arise with respect to foreign service providers also arise when a foreign office of a Fedwire participant processes that participant's Fedwire transfers. Consequently, the Board has broadened the scope of the policy to include such arrangements. Any existing arrangements involving a foreign service provider must be reported promptly to the participant's Reserve Bank. The Reserve Bank will work with the participant and its primary supervisor to determine the extent to which the arrangement complies with the policy and the appropriateness of the arrangement. No new arrangements involving the outsourcing of Fedwire processing to a foreign service provider will be approved by the Reserve Banks pending the completion of the Board's analysis of issues associated with foreign service provider arrangements.

### B. Control of Credit-Granting Process

#### Revised Condition (#1)

The participant retains operational control of the credit-granting process by (1) individually authorizing each funds or securities transfer, or (2) establishing individual customer transfer limits and a transfer limit for the participant's own activity, within which the service provider can act. The transfer limit could be a combination of the account balance and established credit limits. For the purposes of this policy, these arrangements are called "line-of-credit arrangements."

#### Original Condition (#1)

The institution whose account is being charged (the "institution") retains control of the credit-granting process by individually approving each transfer or establishing credit limits within which the service provider can act.

#### Original Condition (#12)

No individual with decision-making responsibilities relating to the funds-transfer area may hold such a position in more than one affiliated institution participating in an approved arrangement.

The Board believes that it is important for the participant to retain operational control of the credit-granting process under a third-party access arrangement. The revised language (1) clarifies that this condition applies to both funds transfer and book-entry securities transfer arrangements; (2) removes the restriction that line-of-credit arrangements are permissible only where the service provider and participant are affiliated organizations;<sup>4</sup> and (3) deletes the condition in the original policy that no individual with decision-making responsibilities related to Fedwire may hold such a position in multiple institutions participating in the arrangement.

The Board believes that the participant can retain operational control of the credit-granting process either by individually authorizing each transfer based on specific parameters (e.g., customer account balance and/or available credit line) or by permitting the service provider to make the same decisions the participant would have made based on the specific parameters established by the participant. Therefore, the Board does not believe it is necessary to limit the circumstances in which line-of-credit arrangements can be used. The revised policy clarifies further that the transfer limits in line-of-credit arrangements must be established by the participant for individual customer activity and for the participant's own activity. Some participants may prefer to establish lines of credit for certain categories of transfers (e.g., customer activity), but to authorize individual transfers for other categories (e.g., the participant's own activity).

The original provision prohibiting an individual with Fedwire-related responsibilities from holding such a position in multiple institutions participating in the arrangement was intended to ensure that a participant retains control of its reserve account and of its credit-granting function and does

<sup>4</sup> In original condition 2, line-of-credit arrangements were limited to participants that used affiliated service providers.

not effectively relinquish control of these functions to the service provider. The Board believes that this condition has posed problems in cases where an individual with Fedwire-related responsibilities is an officer of multiple holding company affiliates that wished to establish Fedwire third-party access arrangements. The Board has deleted this specific provision from the revised policy, but continues to believe that it is important that the participant retain operational control of the establishment of criteria for approving Fedwire transfers handled by the service provider.

#### C. Transfers That Would Exceed the Established Transfer Limit

##### Revised Condition (#2)

In funds transfer line-of-credit arrangements, the service provider must have procedures in place and the operational ability to ensure that a funds transfer that would exceed the established transfer limit is not permitted without first obtaining the participant's approval. In book-entry securities transfer line-of-credit arrangements, the service provider must have procedures in place and the operational ability to provide the participant with timely notification of an incoming transfer that exceeds the applicable limit and must act upon the participant's instructions to accept or reverse the transfer accordingly.

##### Original Condition (#3)

The service provider must not permit or initiate transfers that would exceed individual credit limits without first obtaining the institution's permission.

The Board believes that it is important to retain the condition that customer credit limits are operationally binding on the service provider and that the service provider may not exceed those limits without the participant's permission. The language of this condition has been revised to distinguish between arrangements involving Fedwire funds transfers and book-entry securities transfers. In a funds transfer, the participant's reserve or clearing account held at the Reserve Bank is debited when the transfer is processed; therefore, transfer limits or controls must be in place before the transfer is made. In a book-entry securities transfer, however, the participant's reserve/clearing account is debited for each incoming transfer; therefore, transfer limits can only be monitored in an *ex post* fashion. As a result, the service provider must be able to notify the participant in a timely manner about incoming transfers that exceed the applicable limit so that the participant can instruct the service provider to accept or reverse the transfer accordingly.

#### D. Posting Transfers and Responsibility for Account Management

##### Revised Condition (#3)

Transfers will be posted to the participant's reserve or clearing account held at the Federal Reserve, and the participant will remain responsible for managing its Federal Reserve account, with respect to both its intraday and overnight positions. The participant must be able to monitor transfer activity conducted on its behalf.

##### Original Condition (#5)

All funds-transfer activity must be posted to the institution's account, and the institution will remain responsible for its account.

##### Original Condition (#9)

The institution must have the ability to monitor transfers being made on its behalf.

The revised condition (1) eliminates the language that limits the condition to funds-transfer activity; (2) clarifies that responsibility for management of the participant's reserve or clearing account, including control over daylight overdrafts, remains with the participant; and (3) incorporates the requirement that the participant be able to monitor its transfer activity.

#### E. Board of Directors' Approval

##### Revised Condition (#4)

The participant's board of directors must approve the role and responsibilities of a service provider(s) that is not affiliated with the participant through at least 80 percent common ownership. In line-of-credit arrangements, the participant's board of directors must approve the intraday overdraft limit for the activity to be processed by the service provider and the credit limits for any inter-affiliate funds transfers.<sup>5</sup>

##### Original Condition (#4)

The service provider must have the operational ability to ensure that the aggregate funds-transfer activity of the institution does not result in daylight overdrafts in excess of the institution's cap.

##### Original Condition (#6)

The institution's board of directors must approve the specifics of the arrangement, including (a) the operational transfer of its funds-transfer activity to the service provider, (b) the net debit cap for the activity to be processed by the service provider, and (c) the credit limits for any inter-affiliate funds transfers.

The Board has modified this condition to: (1) Limit the participant's board of directors' review of the roles

<sup>5</sup> In cases where a U.S. branch of a foreign bank wishes to be a participant in an arrangement subject to this policy, and its board of directors has a more limited role in the bank's management than a U.S. board, the role and responsibilities of the service provider should be reviewed by senior management at the foreign bank's head office that exercises authority over the foreign bank equivalent to the authority exercised by a board of directors over a U.S. depository institution.

and responsibilities of the service provider to arrangements where the service provider is not affiliated with the participant; (2) eliminate the language that limits the condition to funds-transfer arrangements; (3) clarify that certain issues to be considered by the board of directors are pertinent only to line-of-credit arrangements; and (4) encompass arrangements where more than one service provider handles a participant's transfer activity. The Board also acknowledges that the board of directors of a foreign bank might have more limited responsibilities than those typical of a U.S. board and has indicated that whatever body exercises similar authority in these situations would be the appropriate decision-maker with respect to the provisions of this policy that fall within the purview of a participant's board of directors.

#### F. Backup

##### Revised Condition (#5)

The Board expects all participants to ensure that their Fedwire operations could be resumed in a reasonable period of time in the event of an operating outage, consistent with the requirement to maintain adequate contingency backup capabilities as set forth in the interagency policy (FFIEC SP-5, July 1989). A participant is not relieved of such responsibility because it contracts with a service provider.

##### Revised Condition (#6)

In cases where the service provider is not affiliated with the participant through at least 80 percent common ownership, the participant must be able to continue Fedwire operations if the participant is unable to continue its service provider arrangement (e.g., in the event the Reserve Bank or the participant's primary supervisor terminates the service provider arrangement).

##### Original Condition (#8)

The institution must have adequate backup procedures and facilities to cover equipment failure or other developments affecting the adequacy of the service being provided. This backup must provide the Reserve Bank with the ability to terminate a service-provider arrangement.

The original backup requirement had two facets: (1) contingency backup to enable recovery in the event of an operating outage and (2) the ability of the participant to continue transfer activity in the event the arrangement with the service provider is terminated. The Board expects all Fedwire participants to maintain adequate contingency backup capabilities in accordance with the policy adopted by the federal banking regulatory agencies; a participant is not relieved of such responsibility because it contracts with a service provider. Revised condition #5 references explicitly the interagency policy that requires a depository



institution to have contingency backup capabilities more broadly than for Fedwire processing.

The original "termination backup" requirement provided the participant's Reserve Bank with the flexibility to terminate an arrangement if it determined that the service provider was in a precarious financial condition, was performing its responsibilities in an unsafe and unsound manner, or was otherwise jeopardizing the condition of the participant. The termination backup requirement can be satisfied either by (1) retaining the capability to perform the functions internally that have been delegated to the service provider; or (2) making arrangements with an alternate service provider to take over these functions in the event that the arrangement must be terminated.

The Board recognizes that the termination backup requirement may have made third-party access arrangements impractical for some large institutions, due to the expense required either to have the internal capability to take over the functions of the service provider or to arrange with a backup service provider that has the capability and necessary software to assume these functions on short notice. This condition could prevent some institutions from benefiting from the cost savings that could be derived from a third-party access arrangement.

The Board has limited the termination backup requirement to arrangements in which the service provider is not affiliated with the participant. Most of the arrangements that have been approved to date involve affiliated parties. In arrangements where the service provider is affiliated with the participant, the participant is likely to have information about the service provider that would enable the participant to take actions to foster improvements in the financial condition and/or operating controls of the service provider before the situation deteriorates to the point that the Reserve Bank or the participant's primary supervisor would be likely to terminate the arrangement. The Board believes it is necessary at this time to retain the termination backup requirement for unaffiliated service provider arrangements in order to provide the Reserve Bank or the participant's primary supervisor with a higher level of supervisory control over such arrangements.

The Board notes that federal banking regulators currently do not require depository institutions to provide equivalent termination backup capabilities for other critical functions, such as customer deposit accounting

(e.g., demand deposit accounting, or DDA) and loan processing, which provide management with information that may be necessary to approve Fedwire funds transfers and securities transfers. The Board plans to evaluate, as part of its broader review of outsourcing generally, the extent to which the "termination backup" requirement should apply to other business applications/functions that are outsourced to a third-party service provider, especially where there are dependencies between such functions and the Fedwire funds transfer and securities transfer services.

#### *G. Consistency With Corporate Separateness and Branching Restrictions*

##### Revised Condition (#7)

The participant must certify that the arrangement is consistent with corporate separateness and does not violate branching restrictions.

##### Original Condition (#10)

The institution must provide an opinion of counsel that the arrangement is consistent with corporate separateness and does not violate branching restrictions.

The third-party access policy raises potential concerns regarding maintenance of separate corporate identities between the service provider and the participant. Moreover, given the definition of "branch" as a location at which deposits are received, checks paid, or money lent, certain third-party access arrangements may raise questions regarding whether the location of the service provider is deemed a branch of the participant. The Board believes that the participant should carefully review the arrangement for consistency with corporate separateness and state branching restrictions. Although the participant may desire an opinion of counsel to make this certification, the Board believes that the participant's certification that the arrangement is consistent with corporate separateness and branching restrictions is sufficient and that the Reserve Bank need not require a copy of an opinion of counsel addressing these issues.

#### *H. Compliance With Applicable Laws and Regulations*

##### Revised Condition (#8)

The participant must certify that the specifics of the arrangement will allow the participant to comply with all applicable state and federal laws and regulations governing the participant, including, for example, retaining and making accessible records in accordance with the regulations adopted under the Bank Secrecy Act.

##### Original Condition

None.

In clarifying the scope of the policy, the Board believes it is important that the participant in a third-party access arrangement certify that the arrangement will be established in such a way to allow the participant to comply with all applicable state and federal laws and regulations, particularly those associated with record retention and availability of records, as required under the Bank Secrecy Act regulations (31 CFR Part 103). If, subsequent to establishing an arrangement, the Reserve Bank receives information that the operations or activities of the participant or its service provider do not comply with applicable state and federal laws and regulations, the Reserve Bank may terminate the third-party access arrangement.

#### *I. Primary Supervisor*

##### Revised Condition (#9)

The participant's primary supervisor(s) must affirmatively state in writing that it does not object to the arrangement.

##### Original Condition (#11)

The primary supervisor must not object to the arrangement.

The Board believes that it is important for the participant's primary supervisor(s) to review, and affirmatively not object to, each proposed third-party access arrangement. The provision has been modified further to recognize that some state-chartered institutions must inform both state and federal supervisors.

#### *J. Audit Program*

##### Revised Condition (#10)

The participant must have in place an adequate audit program to review the arrangement at least annually to confirm that these requirements are being met.

##### Original Condition (#13)

The institution must have in place an adequate audit program to review the arrangements at least annually to confirm that these requirements are being met.

The Board continues to believe that, because an agent is effecting transfers to and from the participant's reserve or clearing account held at the Federal Reserve and because the arrangement originally approved may change over time, it is in the interest of the participant to have its auditors confirm compliance with proper procedures.

**K. Service Provider Examination****Revised Condition (#11)**

The service provider must be subject to examination by the appropriate federal depository institution regulatory agency(ies).<sup>6</sup>

**Original Condition (#2)<sup>7</sup>**

The service provider must be an affiliate of the institution, or, if the institution approves each individual transaction, an unaffiliated company. All service providers must be subject to examination.

Depository institution service providers are subject to examination by the institution's primary supervisor. Service providers that are nonbank subsidiaries of a bank holding company are subject to examination by the Federal Reserve. Service providers that are not depository institutions or affiliates of bank holding companies may be subject to examination pursuant to the Bank Services Corporation Act.<sup>8</sup> Service providers that are subsidiaries of banks are subject to examination by the parent bank's primary supervisor(s). The Board believes that the service provider must acknowledge that it is subject to examination by the appropriate federal depository institution regulatory agency(ies). The requirement that the service provider be subject to examination also applies to arrangements where the participant's service provider arranges for a separate service provider to handle the participant's Fedwire transfers.

**L. Agreements****Revised Condition (#12)**

The participant and the service provider(s) must execute an agreement with the relevant Reserve Bank(s) incorporating these conditions.

**Original Condition (#7)**

The institution and the service provider must execute an agreement with the relevant Reserve Banks delineating the terms of the agreement.

This condition was revised to reflect the possibility that a participant's transfer activity may be handled operationally by more than one service

provider in a given third-party access arrangement. The Reserve Banks have indicated that the conditions under which these arrangements could be established will be set forth in uniform appendices to the Fedwire funds transfer and book-entry securities transfer operating circulars. The uniform operating circular appendices would replace the individual comprehensive legal agreements that are currently used in most districts; would be easier to modify; and would govern arrangements of which the Reserve Bank otherwise may not be aware (for example, arrangements where transfers are processed by a service provider but transmitted to the Reserve Bank by the participant). The appendices to the operating circulars will include a model letter certifying compliance with circular requirements that would be signed by the participant and the service provider(s). Such a letter could be useful in the event that a service provider, especially a non-depository institution, may not have agreed to abide by the terms of the Reserve Bank operating circular through the general agreement. The Board believes that it is not necessary for Reserve Banks to obtain new agreements for existing arrangements because the revised policy is less restrictive than the original policy.

**M. Review and Approval of Proposed Arrangements****Revised Condition (Closing Paragraph)**

The Federal Reserve Bank is responsible for approving each proposed Fedwire third-party access arrangement. In a proposed arrangement in which the participant is not affiliated through at least 80 percent common ownership with the service provider and where the participant is owned by one of the 50 largest bank holding companies (based on consolidated assets), the Directors of the Division of Reserve Bank Operations and Payment Systems and the Division of Banking Supervision and Regulation must concur with the arrangement.

**Original Condition (Closing paragraph)**

In order to ensure consistency with the Board's policy, each new arrangement should be reviewed by the Director of the Division of Federal Reserve Bank Operations prior to approval by the Reserve Bank.

The Reserve Banks are responsible for approving proposed Fedwire third-party access arrangements before they become operational. Under the original policy, approval of all proposed arrangements was subject to review by Board staff. The Board believes that, given the number of existing third-party access arrangements, establishment of such arrangements has become more routine. Therefore, the Board has eliminated the

requirement for Board staff review of most third-party access arrangements. The Board has retained, however, the requirement that Board staff review arrangements where the service provider is unaffiliated with the participant, and the participant is owned by one of the 50 largest bank holding companies (based on consolidated assets) before Reserve Bank approval. The Board believes that greater scrutiny of this subset of arrangements is warranted due to the significant value of the Fedwire transfers that would be handled by a service provider that is not affiliated with the participant.

**III. Effective Date**

The revised Fedwire third-party access policy becomes effective immediately. Existing Fedwire arrangements must comply by March 1, 1996. All arrangements established after the effective date must comply with the policy when established.

**IV. Competitive Impact Analysis**

The Board assesses the competitive impact of changes that may have a substantial effect on payment system participants. In particular, the Board assesses whether a proposed change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve Banks in providing similar services and whether such effects are due to legal differences or due to a dominant market position deriving from such legal differences.

The Federal Reserve Banks' Fedwire funds transfer and book-entry securities transfer services provide real-time gross settlement in central bank money. While these services cannot be duplicated by private-sector service providers, banks can make large-dollar funds transfers through other systems, such as CHIPS, or through correspondent book transfers, although these transactions have attributes that differ from Fedwire transfers. Similarly, there are private-sector securities clearing and/or settlement systems, such as the Government Securities Clearing Corporation and the Participants Trust Company, that facilitate primary and secondary market trades of U.S. Treasury and agency securities. Other transactions involving U.S. government securities may be cleared and settled on the books of banks to the extent that the counterparties are customers of the same bank.

The Board's third-party access policy places conditions on arrangements in which a Fedwire participant may contract with another organization to

<sup>6</sup>The U.S. federal depository institution regulatory agency(ies) must be able to examine any aspects of the service provider as may be necessary to assess the adequacy of the operations and financial condition of the service provider.

<sup>7</sup>The "affiliation" requirement for line-of-credit arrangements is discussed in the context of revised condition 1.

<sup>8</sup>Section 7(c) of the Bank Services Corporation Act provides that " \* \* \* whenever a bank that is regularly examined by an appropriate Federal banking agency \* \* \* causes to be performed for itself, by contract or otherwise, any services authorized under this Act, whether on or off its premises \* \* \* such performance shall be subject to regulation and examination by such agency to the same extent as if such services were being performed by the bank itself on its own premises."



initiate, receive, or otherwise process Fedwire transfers. The Board has revised the policy to clarify its scope and reduce its administrative and operational burden. Neither the original nor the revised policy adversely affects the ability of other service providers to compete with the Federal Reserve Banks to provide funds transfer or securities transfer services.

#### V. Policy Statement

The Board has amended its "Federal Reserve System Policy Statement on Payments System Risk" under the heading "I. Federal Reserve Policy" by replacing "G. Third-party access arrangements" with the following:

##### G. Fedwire Third-Party Access Policy

The Board will allow third-party access arrangements whereby a sending or receiving institution ("the participant") designates another depository institution or other entity ("the service provider") to initiate, receive, and/or otherwise process Fedwire funds transfers or book-entry securities transfers that are posted to the participant's reserve or clearing account held at the Federal Reserve, provided the following conditions are met:<sup>1</sup>

1. The participant retains operational control of the credit-granting process by (1) individually authorizing each funds or securities transfer, or (2) establishing individual customer transfer limits and a transfer limit for the participant's own activity, within which the service provider can act. The transfer limit could be a combination of the account balance and established credit limits. For the purposes of this policy, these arrangements are called "line-of-credit arrangements."

2. In funds transfer line-of-credit arrangements, the service provider must have procedures in place and the operational ability to ensure that a funds transfer that would exceed the established transfer limit is not permitted without first obtaining the participant's approval. In book-entry securities transfer line-of-credit

<sup>1</sup> This policy applies to third-party access arrangements in which an office of the participant located outside the United States acts as service provider by initiating, receiving, or otherwise processing Fedwire transfers on behalf of the U.S. participant.

arrangements, the service provider must have procedures in place and the operational ability to provide the participant with timely notification of an incoming transfer that exceeds the applicable limit and must act upon the participant's instructions to accept or reverse the transfer accordingly.

3. Transfers will be posted to the participant's reserve or clearing account held at the Federal Reserve, and the participant will remain responsible for managing its Federal Reserve account, with respect to both its intraday and overnight positions. The participant must be able to monitor transfer activity conducted on its behalf.

4. The participant's board of directors must approve the role and responsibilities of a service provider(s) that is not affiliated with the participant through at least 80 percent common ownership. In line-of-credit arrangements, the participant's board of directors must approve the intraday overdraft limit for the activity to be processed by the service provider and the credit limits for any inter-affiliate funds transfers.<sup>2</sup>

5. The Board expects all participants to ensure that their Fedwire operations could be resumed in a reasonable period of time in the event of an operating outage, consistent with the requirement to maintain adequate contingency backup capabilities as set forth in the interagency policy (FFIEC SP-5, July 1989). A participant is not relieved of such responsibility because it contracts with a service provider.

6. In cases where the service provider is not affiliated with the participant through at least 80 percent common ownership, the participant must be able to continue Fedwire operations if the participant is unable to continue its service provider arrangement (e.g., in the event the Reserve Bank or the participant's primary supervisor

<sup>2</sup> In cases where a U.S. branch of a foreign bank wishes to be a participant in an arrangement subject to this policy, and its board of directors has a more limited role in the bank's management than a U.S. board, the role and responsibilities of the service provider should be reviewed by senior management at the foreign bank's head office that exercises authority over the foreign bank equivalent to the authority exercised by a board of directors over a U.S. depository institution.

terminates the service provider arrangement).

7. The participant must certify that the arrangement is consistent with corporate separateness and does not violate branching restrictions.

8. The participant must certify that the specifics of the arrangement will allow the participant to comply with all applicable state and federal laws and regulations governing the participant, including, for example, retaining and making accessible records in accordance with the regulations adopted under the Bank Secrecy Act.

9. The participant's primary supervisor(s) must affirmatively state in writing that it does not object to the arrangement.

10. The participant must have in place an adequate audit program to review the arrangement at least annually to confirm that these requirements are being met.

11. The service provider must be subject to examination by the appropriate federal depository institution regulatory agency(ies).<sup>3</sup>

12. The participant and the service provider(s) must execute an agreement with the relevant Reserve Bank(s) incorporating these conditions.

The Federal Reserve Bank is responsible for approving each proposed Fedwire third-party access arrangement. In a proposed arrangement in which the participant is not affiliated through at least 80 percent common ownership with the service provider and where the participant is owned by one of the 50 largest bank holding companies (based on consolidated assets), the Directors of the Division of Reserve Bank Operations and Payment Systems and the Division of Banking Supervision and Regulation must concur with the arrangement.

By order of the Board of Governors of the Federal Reserve System, August 9, 1995.

**William W. Wiles,**

*Secretary of the Board.*

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<sup>3</sup> The U.S. federal depository institution regulatory agency(ies) must be able to examine any aspects of the service provider as may be necessary to assess the adequacy of the operations and financial condition of the service provider.