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

SUBJECT

Request for Comment on a Proposal to Expand the Operating Hours for the Fedwire Funds Service

DETAILS

The Federal Reserve Board has requested comment on a proposal to expand the operating hours for the Fedwire Funds Service. Under this proposal, Fedwire would open three and one-half hours earlier than the current opening time of 12:30 a.m. Eastern time, and depository institutions would participate in the earlier operating hours on a voluntary basis. The new opening time would be 9 p.m. for online funds transfers with a business date of the following calendar day.

An earlier Fedwire opening time would further the smooth functioning and continued development of the payments system, as well as improve efficiency and reduce risk in making payments and settlements. The closing time for the service would remain unchanged at 6:30 p.m., thereby expanding the service’s operating hours from eighteen hours to twenty-one and one-half hours each business day. The proposal would not affect the operating hours for the origination and telephone advice of credit for offline funds transfers and would not affect the operating hours for the Fedwire Securities Service.

The Board must receive comments by March 4, 2003. Please address comments to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551. Also, you may mail comments electronically to regs.comments@federalreserve.gov. All comments should refer to Docket No. R-1138.
ATTACHMENT

A copy of the Board’s notice as it appears on pages 77786–89, Vol. 67, No. 244 of the Federal Register dated December 19, 2002, is attached.

MORE INFORMATION

For more information, please contact Jack Walton II, Assistant Director, at (202) 452–2660, or Lorna Prosper–Harley, Senior Financial Services Analyst, at (202) 452–2690, Division of Reserve Bank Operations and Payment Systems, Board of Governors of the Federal Reserve System.

Paper copies of this notice or previous Federal Reserve Bank notices can be printed from our web site at http://www.dallasfed.org/banking/notices/index.html.

Sincerely,

Helen C. Holcomb
FEDERAL RESERVE SYSTEM
[Docket No. R–1138]

Proposal to Expand the Operating Hours for the On–Line Fedwire® Funds Service

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice; Request for comment.

SUMMARY: The Board requests comment on a proposal to expand the operating hours for the Fedwire Funds Service.1 Under this proposal, Fedwire would open three and one–half hours earlier than the current opening time of 12:30 a.m. eastern time, and depository institutions would participate in the earlier operating hours on a voluntary basis.2 The new opening time would be 9 p.m. for on–line funds transfers with a business date of the following calendar day.3 An earlier Fedwire opening time would further the smooth functioning and continued development of the payments system, as well as improve efficiency and reduce risk in making payments and settlements. The closing time for the service would remain unchanged at 6:30 p.m., thereby expanding the service’s operating hours from eighteen hours to twenty–one and one–half hours each business day. The proposal would not affect the operating hours for the origination and telephone advice of credit for off–line funds transfers and would not affect the operating hours for the Fedwire Securities Service.4

DATES: Comments must be submitted on or before March 4, 2003.

ADDRESSES: Comments should refer to Docket No. R–1138 and should be submitted to Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551, or mailed electronically to regs.comments@ federalreserve.gov. Comments addressed to Ms. Johnson may also be delivered to the Board’s visitors center in the east courtyard of the Eccles Building, located on 20th Street between Constitution Avenue and C Street, NW., between 8 a.m. and 5:30 p.m. Members of the public may inspect comments in room MP–500 of the Martin Building between 9 a.m. and 5 p.m. on weekdays, pursuant to §261.12, except as provided in §261.14 of the Board’s Rules Regarding Availability of Information, 12 CFR 261.12 and 261.14.


SUPPLEMENTARY INFORMATION:

1 All references to Fedwire apply to the on–line Fedwire Funds Service unless otherwise noted. Fedwire is a registered servicemark of the Federal Reserve Banks.

2 All references are to eastern time unless otherwise noted.

3 For example, if today were Thursday, November 14, 2002, Fedwire would open at 9 p.m., with the business (cycle) date of Friday, November 15, 2002.

4 The operating hours for off–line funds transfers and securities transfers are outlined in the Federal Reserve Banks’ Operating Circulars 6 and 7, respectively.
I. Background

In December 1997, the Federal Reserve Banks (Reserve Banks) expanded the operating day for on-line Fedwire funds transfers from ten hours to eighteen opening weekdays at 12:30 a.m. and closing at 6:30 p.m. (61 FR 216, November 6, 1996). The Board believed that, over the long term, expanded Fedwire hours would enable individual depository institutions and clearing organizations to (1) reduce foreign exchange settlement risk through innovations in payment and settlement practices, and (2) use Fedwire to manage settlement risk early in the day during times of financial stress. The Board also believed that an expansion of Fedwire hours would respond to the payment and settlement needs of both existing and emerging financial markets, including overseas markets that depend on the U.S. dollar.

In 2001, the members of the Wholesale Customer Advisory Group (WCAG) of the Reserve Banks’ Wholesale Product Office (WPO) approached the WPO about further expanding the hours for Fedwire.5 The WCAG believes that, given the continuing globalization of business and payment activity, current Fedwire hours may constrain the ability of U.S. depository institutions that operate in multiple markets and time zones to meet the payment and settlement needs of some current and potential customers. The WCAG also believes that the current Fedwire operating hours may constrain the ability of U.S. depository institutions to manage settlement and operational risks cost effectively. In particular, the WCAG highlighted the need to achieve greater overlap of U.S. wholesale payments systems operating hours with those of the Asia–Pacific markets, including Australia, Hong Kong, Japan, and New Zealand. Finally, the WCAG noted that the recent movement of some U.S. dollar clearing and settlement activity offshore has underscored the need for expanded Fedwire operating hours.

The Clearing House Inter–Bank Payments System (CHIPS) also has asked the WPO to consider expanding the on–line Fedwire hours to support longer CHIPS operating hours because of a growing demand in Asia for real–time, final U.S. dollar payments processed during the Asian business day. CHIPS and its participants rely on Fedwire to conduct certain daily funding and settlement activities. Both the CHIPS and WCAG requests are consistent with long–term business and technological developments in wholesale payments markets.

The Board believes that further expansion of Fedwire funds transfer operating hours would support the smooth functioning and continued development of the payments system, and improve efficiency and reduce risk in conducting existing U.S. dollar payments and settlements. Furthermore, an earlier opening of Fedwire may facilitate innovations in payment and settlement services provided by individual institutions and clearing organizations, thereby making a broader and more robust array of payment options generally available in the financial markets.

II. Issues Associated With the Proposed Expanded Fedwire Operating Hours

International Markets. Generally, the Fedwire operating hours fully overlap the operating hours of large–value payment systems in the Americas and Europe.6 In contrast, the Fedwire operating hours overlap the operating hours of major Asia–Pacific large–value payments systems by only two and one–half to five hours. Some depository institutions believe that substantially expanding the amount of overlap in the operating hours of Fedwire and the Asia–Pacific markets will help to support the development of enhanced and more competitive dollar–based payment and settlement services in the international marketplace. Also, some depository institutions that are active in international markets maintain local money–desk and money–transfer operations in the regions in which they operate. Expanding Fedwire operating hours may provide opportunities for these institutions to consolidate some of their local activities, which could improve their ability to manage globally their dollar funding and related liquidity risks, as well as to reduce costs and increase operational efficiencies.

Domestic Markets. Neither the Board nor the organizations that advocated further expansion of Fedwire operating hours anticipated that an earlier opening of Fedwire would adversely affect domestic markets. Indeed, there may be beneficial effects from enhancements to payment and settlement services offered by financial institutions to the extent that current Fedwire hours act as a barrier to developing these enhancements.

Costs of and Participation in the Expanded Fedwire Hours. The estimated costs for Reserve Banks to open Fedwire three and one–half hours earlier are expected to be negligible and should not affect funds transfer fees paid by depository institutions. While the operational costs incurred by depository institutions that participate in the earlier hours are difficult to estimate, such costs would be incurred voluntarily. In particular, if a depository institution believed that the potential costs of participating in the expanded operating period outweighed the potential benefits, it could choose to remain closed during this period and would therefore not incur additional operating costs.7 Similarly, potential costs and benefits stemming from streamlining operational, funding, and risk management functions are difficult to estimate. Again, however, depository institutions would only incur costs during the expanded operating period if they voluntarily chose to do so. While depository institutions would not be required to participate in the earlier operating hours, they would still receive funds transfers sent from participating institutions during these hours.

Extensions to the Scheduled Fedwire Closing Time. Today, the Reserve Banks extend the scheduled Fedwire closing time primarily to prevent major market disruptions. If the Board approved an earlier Fedwire opening time, extensions of the scheduled Fedwire closing time could result in greater operating difficulties for some depository institutions, such as the need to compress end–of–day account posting activities. Furthermore, extensions of the closing time beyond a certain point might adversely affect the ability of the Reserve Banks or depository institutions to open Fedwire services for the next business day as scheduled. Such extensions could have significant effects on business during

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5 The WCAG was established by the WPO to provide a mechanism for ongoing communication and collaboration between the WPO and a representative sample of U.S. depository institutions that are major users of wholesale payment services. The WPO and WCAG work together on a variety of initiatives, which include identifying trends in domestic and international banking and financial services that will affect wholesale payment services, and emerging regulatory and policy issues that may affect delivery or use of such services.

6 The Fedwire operating hours do not overlap the operating hours of the large–value payment system in Switzerland, Swiss Interbank Clearing (SIC) for five and one–half hours.

7 Nonparticipating institutions may need to review their internal systems and procedures, however, to ensure that they accurately recognize payments sent to them during the early Fedwire operating hours. Fedwire funds transfers contain two dates: (1) a cycle date that represents the date of a specific operational business day within the Fedwire application, and (2) a system date that represents the day the transfer is processed by the Fedwire application. With early Fedwire operating hours, between 9 p.m. and 11:59 p.m., the cycle date will differ from the system date. This situation already exists for depository institutions outside the eastern time zone in today’s eighteen–hour Fedwire business day.
the earlier operating hours, particularly if the use of the earlier operating hours were to become significant.\textsuperscript{8} In the near term, the Reserve Banks could continue to allow infrequent extensions of the scheduled closing times to preserve orderly market closings. In the long term, the Reserve Banks may have to reevaluate the extension policy to sustain the ability to open Fedwire timely.

Access to Depository Institutions’ Account Balances. Under the expanded Fedwire operating hours, depository institutions’ Federal Reserve account balances may not reflect all of the previous day’s payment activity because certain activity that is processed and posted later in the day may be posted to accounts by 9 p.m., the start of the next Fedwire operating day.\textsuperscript{9} Generally, account balances would reflect all of a business day’s activity by about 11 p.m. The Reserve Banks would also notify depository institutions when the day’s payment activity has been processed and is reflected fully in their account balances.

Currently, depository institutions can access their account balance information through the Reserve Banks’ Account Balance Monitoring System (ABMS) until 10 p.m. on each business day. Under the expanded Fedwire operating hours, ABMS would be available until 7:15 p.m. to access information for the current business day. ABMS would reopen at 8 p.m. for the next business day, and account balances would be considered provisional until all of the previous day’s payment activity is processed and posted.

The Reserve Banks also monitor depository institutions’ accounts for daylight overdraft purposes on an ex post basis. Under the expanded Fedwire operating hours, depository institutions’ reported ex post opening account balances would reflect all of the previous day’s payment activity. As a consequence, the reported ex post opening account balance may differ from the ABMS opening account balance because of transactions that are processed late in the day. While account balance differences may exist between ABMS and ex post reports, the Federal Reserve continues to expect depository institutions to manage their accounts according to the daylight overdraft posting rules set forth in the Board’s payments system risk policy.\textsuperscript{10}

Federal Reserve Intraday Credit and Fees. Under the expanded Fedwire operating hours, the Reserve Banks will continue to provide intraday credit to eligible depository institutions on the same basis as they do today according to the provisions of the Board’s payments system risk policy. While the calculation of the daylight overdraft fee will be adjusted under the proposal to reflect the expanded Fedwire operating hours, the fee assessed for the use of intraday credit will not change for an overdraft of a given size and duration.\textsuperscript{11}

Monetary Control and Reserve Management. The Board believes that an expansion of Fedwire operating hours will not affect the current process of reserve management for depository institutions. Because there is a sufficient break in time between Fedwire operating days, the Board will continue to measure reserve holdings, monetary measurement and control issues do not arise for the Federal Reserve.

Proposed Expanded Fedwire Hours Implementation Timeframe. If the Board were to adopt a 9 p.m. Fedwire opening time, depository institutions would be given the opportunity to test their systems for the expanded Fedwire hours with the Reserve Banks beginning in the third quarter 2003. Full implementation of the expanded Fedwire operating day from 9 p.m. to 6:30 p.m. would begin in the second quarter of 2004.

III. Request for Comment

The Board requests comments on its proposal to expand the on-line Fedwire operating hours. Specifically, the Board requests comments on whether the opening time for Fedwire should be moved to 9 p.m. or whether a different opening time would be preferable. In addition, the Board is interested in commenters’ views regarding the business, market, risk management, and operational issues that should be considered in evaluating the benefits and drawbacks of a 9 p.m. to 6:30 p.m. Fedwire business day. For example, what are the business needs that would warrant an earlier Fedwire opening time? Would the availability of provisional rather than final account balance information in ABMS for the first two hours of the expanded Fedwire day adversely affect the risk management of depository institutions that choose to participate during the early hours? Should the Reserve Banks continue to grant significant extensions to the Fedwire closing time to help mitigate substantial market disruptions (such as those granted during the week of September 11, 2001) even if they result in a significant delay in the Fedwire opening for the next business day?

IV. Competitive Impact Analysis

All operational and legal changes considered by the Board that have a substantial effect on payments system participants are subject to the competitive impact analysis described in the March 1990 policy statement “The Federal Reserve in the Payments System.”\textsuperscript{12} Under this policy, the Board assesses whether the proposed change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Reserve Banks in providing similar services, due to differing legal powers or constraints or due to a dominant market position of the Federal Reserve deriving from such legal differences. If the expansion of the on-line Fedwire operating hours creates such an effect, the Board must further evaluate the proposed expansion of hours to assess whether its benefits can be retained while reducing the restrictions on competition.

The Reserve Banks are the only providers of real-time gross settlement of funds transfers in central bank money in the United States. The main alternative provider of funds transfer services and a number of depository institutions have indicated that the expansion of the Fedwire operating hours would make it possible for them to enhance the finality of their U.S. dollar payment and settlement services. As a result, the expansion of Fedwire operating hours would not have a direct and material adverse effect on their ability to compete effectively with the Reserve Banks.

\textsuperscript{8} An extension beyond a certain point to the Fedwire Services Security Operating hours could also result in the Fedwire Funds Service and, consequently, affect the timely opening of Fedwire for the next business day.

\textsuperscript{9} The transactions that are processed late in the day include discount window loans and a small percentage of payments associated with check activity, currency and coin shipments, and other activity, such as food coupon deposits. Generally, the dollar amounts and volumes associated with these transactions are not significant.

\textsuperscript{10} Depository institutions may also obtain account information using Fedline’s web-based Account Management Information (AMI) application or by accessing the Federal Reserve’s Integrated Accounting System (IAS). Fedline is a registered trademark of the Federal Reserve Banks.

\textsuperscript{11} While the effective annual rate charged on daylight overdrafts would change from 27 basis points under an 18-hour Fedwire operating day to 32.25 basis points under a 21.5-hour Fedwire operating day, the annual rate charged on daylight overdrafts would remain at 36 basis points under a 21.5-hour Fedwire operating day.

\textsuperscript{12} Federal Reserve Regulatory Service 7–145.2.
By order of the Board of Governors of
the Federal Reserve System, December
16, 2002.

Jennifer J. Johnson,
Secretary of the Board
[FR Doc. 02–31930 Filed 12–18–02; 8:45 am]
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