FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. 9494
May 12, 1983]

Final Phase of Program To Reduce and Price Federal Reserve Float

*To All Depository Institutions in the Second
Federal Reserve District, and Others Concerned:*

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

The Federal Reserve Board has approved procedures to eliminate or price the remaining categories of Federal Reserve check float. This type of float is the value of checks for which the Federal Reserve has given credit to the institution that deposited the checks for collection, but for which the Federal Reserve has not yet received payment.

The Board acted under the Monetary Control Act of 1980, which requires the System to reduce and price remaining Federal Reserve float. The Board's approval of these procedures is the latest in a series of actions to fulfill these requirements.

In November 1982, the Board requested public comment on a proposal to charge depository institutions for large ($50,000 or more) interterritory returned checks as a result of a wire notification from the returning Federal Reserve office. Interterritory returned checks cause Federal Reserve float because Reserve Banks are unable to debit immediately the original depositing institution's account for the returned checks.

After reviewing comment received, the Board decided not to adopt the proposal. As suggested by commenters, the Board voted to defer credit for interterritory returned items for one day. This one-day deferral of credit will eliminate $130 million of interterritory return-item float. This procedure will be implemented in August 1983 to provide Reserve Banks and depository institutions sufficient time to make necessary operational changes.

In April 1982, the Board proposed an amendment to Regulation J to require paying banks to pay for checks delivered or made available to them on days the paying banks are closed and on which the Reserve Bank is open. Such days consist of ''midweek closing days'' — regular weekdays on which a depository institution is closed as permitted by state law — and ''nonstandard holidays'' — days on which the paying bank is closed because of a state or local holiday.

In response to comment received, the Board did not adopt the proposed amendment at this time. As an alternative, the Board decided to eliminate or price float arising from midweek closings and nonstandard holidays, beginning in October 1983, by giving Reserve Banks three options to deal with such float. The three options are:

— a Reserve Bank could modify its availability schedule for local depositors so that credit for checks drawn on closed institutions would be deferred an additional day.

— a Reserve Bank could modify its current practice of posting funds received for the account of the institution on the day the institution is closed.

— Reserve Banks could price all or any remaining float arising from midweek closings or nonstandard holidays by including the value of such float in the cost of the Federal Reserve's check collection service.

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The Board also had requested comment in November 1982 on proposals to price intraterritory transportation float and the other remaining categories of check float. The Board has approved the proposals to price these categories of check float by adding the cost of such float to the cost of the check collection service. The addition of these costs to the costs of the check collection service will begin in October 1983.

With the implementation of these procedures, all Federal Reserve check float arising from the provision of check collection services to depository institutions will be eliminated or priced.

Enclosed, for depository institutions in this District, is a copy of the Board's official notice in this matter; it will be published in the *Federal Register*, and additional copies may be obtained from our Circulars Division (Tel. No. 212-791-5216).

Questions on check float should be directed, if you are in this Bank's Head Office territory, to James O. Aston, Vice President (Tel. No. 212-791-6334) or John F. Sobala, Assistant Vice President (Tel. No. 212-791-5997). In the Buffalo Branch territory, such questions should be directed to Peter D. Luce, Assistant Vice President (Tel. No. 716-849-5013) or Robert J. McDonnell, Operations Officer (Tel. No. 716-849-5022).

ANTHONY M. SOLOMON,
President.

FEDERAL RESERVE SYSTEM

[Docket Nos. R-0392, 0433]

Reduction and Pricing of Federal Reserve Float

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Approval of proposals to reduce and price Federal Reserve check float.

SUMMARY: The Board of Governors has approved procedures to eliminate and price Federal Reserve check float. A substantial portion of float arising from interterritory returned checks will be eliminated by deferring credit for these returned checks by one day. Other check float will be eliminated or priced. With the implementation of these procedures, all Federal Reserve float arising from the provision of check collection services to depository institutions will be eliminated or priced.

EFFECTIVE DATE: August 1, 1983. On that date, Reserve Banks will change availability schedules for interterritory returned checks. The other procedures will be implemented on October 1, 1983.

FOR FURTHER INFORMATION CONTACT: Elliott C. McEntee, Assistant Director (202/452-2231) or Morgan J. Hallmon, Program Manager, Payments Mechanism Planning (202/452-3878), Division of Federal Reserve Bank Operations; Gilbert T. Schwartz, Associate General Counsel (202/452-3625), Daniel L. Rhoads, Attorney (202/452-3711), or Robert G. Ballen, Attorney, (202/452-3265), Legal Division, Board of Governors of the Federal Reserve System, Washington, D. C. 20551.

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

On December 31, 1980, the Board determined, in response to comments received on the Board's proposals to reduce and price float (45 F.R. 58689), to proceed with internal operational improvements to reduce float.

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

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As a method of eliminating a portion of Federal Reserve check float, the Board requested comment in April 1982 on a proposed amendment to Regulation J to require a depository institution to pay for checks made available to it by a Reserve Bank on a weekday that is a banking day for the Reserve Bank even if the institution is closed on a regular basis during the business week ("midweek closings"). Comment was also requested on whether this procedure should apply to checks made available to institutions that are closed on state or local holidays by Reserve Banks that are open on such days ("non-standard holidays"). 47 F.R. 15349, (April 9, 1982).

The Board also requested comment in November 1982 on a proposal to charge a depository institution that deposits an interterritory check of $50,000 or more based on a wire notification by the Reserve Bank when that check is returned. Comment was also requested on proposals to price holdover check float, intraterritory check transportation float, and other categories of check float as well as interterritory check float. 47 F.R. 50342 (November 5, 1982).

On March 8, 1983, the Board announced a program to reduce and/or price interterritory check float and check holdover float. 48 F.R. 10753 (March 14, 1983). Under this program, depository institutions would be offered two crediting options to reduce interterritory check float and three methods for paying for remaining interterritory check float. Additionally, the Board approved pricing of check holdover float over a six month period by incorporating the value of this float in the cost of check services to be recovered in 1983. The Board has now adopted procedures to reduce and/or price the remaining categories of Federal Reserve float arising from the provision of check collection services to depository institutions.

Return Item Float

Float associated with interterritory returned items amounted to $150 million on a daily average basis in 1982. This float arises because current System procedures specify that payor institutions receive immediate credit for returned items. Reserve Banks, however, are operationally unable to debit immediately the original depositing institution's account for returned items drawn on an institution located in another Federal Reserve territory.

In order to reduce the float associated with such interterritory returned items, the Board requested public comment in November 1982 on a proposal to charge the depositing institution's account for large interterritory returned items ($50,000 or more) based on receipt of a wire notification from the returning Federal Reserve office. As an alternative to having the institution's account debited immediately, the Board proposed that a depository institution could compensate for such return item float through an "as of" adjustment to its account.

The Board received 144 comments on the return item float proposal. A substantial number of commenters (68) expressed support for the proposal. However, a number of commenters, including many who supported the proposal, raised legal concerns regarding the proposal. These concerns included: (1) the impact of the proposal on the midnight deadline for returned items; (2) whether a Reserve Bank has authority to charge an institution's account based upon a wire notification; (3) the authority of a depository institution to charge its customer's account prior to receipt of the physical item; (4) the depository institution's liability for errors in account entries, including the possibility of charging an account twice for the same return or charging an account improperly, which may result in subsequent wrongful dishonors; and (5) the Federal Reserve's lack of liability for transmission of erroneous payment data. In addition, a large number of commenters also cited considerable operational difficulties such as reconciling the wire notification with the paper return.

Many commenters suggested that the Federal Reserve consider alternative methods of recovering return item float. Twenty commenters suggested that return item float be handled through a modification to the Federal Reserve's availability schedules. Commenters suggesting this deferred availability approach generally stated their belief that such an approach would more equitably assign float costs associated with returned items by placing the burden of this cost on the institutions that are returning the items and their customers. Some commenters suggested that the Federal Reserve impose an explicit fee for returned items, which would also cover the float costs.

The Board believes that the commenters raised legal and operational issues with respect to the proposal that cannot be resolved in a cost effective manner. Further, since the proposal would have applied only to large dollar returned items, procedures for pricing remaining return item float would still have to be developed. The Board has therefore decided not to adopt the proposal regarding interterritory return item float. Further, the Board does not believe that adoption of an explicit fee for returned items as suggested in some of the comments is appropriate at this time since the System is conducting pilot programs in the Dallas and Kansas City Districts to determine the effectiveness of return item pricing.

After consideration of the comments received and further analysis, the Board has decided to adopt an alternative suggested by the commenters. Under this approach, credit for interterritory returned items would be deferred one day. This deferral of credit on interterritory returned items would eliminate $130 million of return item float.[2/][3/] Deferring credit by one day for interterritory returned items will be implemented in August 1983 in order to provide Reserve Banks and depository institutions sufficient time to make operational changes.[4/] Since this procedure may affect local clearinghouses that require immediate credit for returned items, Reserve Banks will consult with local clearinghouses to assure orderly implementation of the procedures.

Midweek Closings and Nonstandard Holidays

In April 1982, the Board requested public comment on a proposal to amend Regulation J to require a depository institution to pay for checks delivered or made available to it on days the institution is closed and on which the Reserve Bank is open. Such days consist of "midweek closing days"--regular weekdays on which a depository institution closes as permitted by state law and "nonstandard holidays"--days on which the paying institution is closed because of a state or local holiday. The proposal was intended to eliminate the float that results from granting credit to the depositor for checks that could not be charged to the closed paying institution. Float resulting from midweek closings was approximately $160 million, and float resulting from nonstandard holidays was approximately $100 million on a daily average basis in 1982.

A total of 150 comments were received on the issue of midweek closings; 59 commenters favored the proposal, and 91 were opposed. Most of those opposed were small institutions and their trade associations. These commenters opposed the proposal because they believed that it was unfair to

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[2/] Some commenters suggested that credit for interterritory returned items be provided based upon a fixed availability schedule depending upon the location of the depositing bank. The Board does not believe that such a schedule is necessary or appropriate since most returned items are delivered to the depositing bank's Federal Reserve office within one day.

[3/] The remaining $20 million of return item float arises from a variety of other reasons, including when a Reserve Bank is unable to return the item to the depositing institution on a timely basis or when it has sent the item to the wrong payor. This "holdover" float will be priced in the same manner as other holdover float, that is, the value is to be added to the cost of the check collection service.

[4/] This one-day deferral generally would apply to interterritory and intraterritory returned items that are commingled. However, if intraterritory returned items are separated by the paying bank, credit for such items would not be deferred since the items can be returned to the depositing bank the same day and no Federal Reserve float would be created. Reserve Banks that are able to process commingled returns in a timely fashion could give immediate credit for such intraterritory returned items when no Federal Reserve float would arise from such a practice.

require depository institutions to pay for checks when they are closed as permitted by state law. The commenters also stated that the proposal would make it difficult and more expensive for them to manage their cash positions.

Those in favor of the proposal generally indicated that it is an equitable way of eliminating float. Institutions that are the source of the float would be most immediately affected by the proposal. These commenters also indicated that the proposal would eliminate the advantages these closed institutions may have in not having to bear the cost of such float directly.

A total of 82 comments were received on the issue of nonstandard holidays. Of these, 19 were in favor of the proposal, and 63 were opposed. Those opposed indicated that bank holidays are mandated by state law and it would be unfair to penalize banks for acting in accordance with state law; it is inequitable to charge banks that are closed on nonstandard holidays when Reserve Banks themselves do not follow a uniform holiday schedule; and the proposal would make it more difficult and expensive for depository institutions to manage their cash positions.

The Board believes the comments on both midweek closings and nonstandard holidays raise significant issues. The major impact of the midweek closing proposal would be on small institutions in small communities that are closed during the week. In some areas the practice has been widespread for many years. For example, it is reported that over 70 percent of the banks in western Tennessee close during the week. Such institutions typically prefer to open on Saturdays as a convenience to customers that are unable to do their banking business during the week. Adoption of the proposal could also have a significant effect upon the operations of some small institutions, particularly since they would be unable to debit their customers accounts until the following day. In addition, there is little evidence to suggest that the bulk of these institutions are closed in order to avoid paying for checks or to create Federal Reserve float. Further, depository institutions closed on nonstandard holidays generally do not have the opportunity to remain open. Therefore, the Board has determined not to adopt the proposed amendment to Regulation J at this time.

The Board believes, however, that it is necessary to adopt procedures to eliminate or price this float as required by the MCA. Therefore, Reserve Banks will have three options to deal with float arising from midweek closings and nonstandard holidays. First, a Reserve Bank could modify its availability schedule for local depositors so that credit for checks drawn on closed institutions would be deferred one additional day.[5] Second, a Reserve Bank could modify its current practice of posting funds received for the account of the institution on the day the

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[5] It would be operationally infeasible for Reserve Banks to delay credit on interterritory checks drawn on closed banks because each Reserve Bank would be required to keep track of every bank in the country that is closed.

institution is closed. A one day deferral of credits received on the day the institution is closed would offset some of the float arising from midweek closings and nonstandard holidays. Finally, Reserve Banks could price all or any remaining float arising from midweek closings or nonstandard holidays in the same manner as holdover float. The value of this float would be added to the cost of the check collection service.

The Board intends to monitor float associated with midweek closings to determine whether it is increasing to any significant extent. If a pattern develops, the Board may reconsider the proposed amendment to Regulation J.

Intraterritory Transportation Float

In November 1982, it was proposed that intraterritory transportation float be priced in the same manner as holdover float. Intraterritory transportation float results primarily from the inability of a Federal Reserve office to make presentment of checks to payor institutions as a result of transportation delays. The few commenters expressing views specifically on this proposal generally were opposed to charging at all for float that arises from conditions beyond the control of depository institutions. Other commenters argued that pricing of intraterritory transportation float in this manner would not provide Reserve Banks with an incentive to operate efficiently.

The MCA requires that all Federal Reserve float arising from the provision of priced services to depository institutions be priced. Because of the operational difficulty of allocating intraterritory transportation float back to specific depository institutions and in view of the small amount of float involved ($110 million), it would also be inefficient to attempt to trace the float to individual depositors. Accordingly, the Board believes that the value of such float should be added to the cost of the check collection service. Reserve Bank performance will continue to be monitored to ensure that intraterritory transportation float is kept to a minimum and that Reserve Banks continue to operate efficiently.

All Other Check Float

Only a small amount ($40 million) of check float will remain after implementation of the above procedures. This remaining check float arises primarily from adjustments to the accounts of depository institutions because of Federal Reserve accounting errors and from the handling of government agency deposits at Reserve Banks. The amount of float arising from adjustments is relatively small ($30 million) and it would not be cost effective to charge the float to particular depository institutions. The Board therefore believes it appropriate to add the value of this float to the cost of the check collection service.

The Board also believes that it is inappropriate to charge depository institutions for float arising from deposits by government agencies ($10 million) since such float does not arise from the provision of priced services to depository institutions. Indeed, since such float arises from the provision of services to government agencies, it is not necessary to price such float under the Monetary Control Act. Accordingly, the value of this float will be attributed to such government agencies.

Implementation Schedule

The one day deferral of credit for interterritory returned items will be implemented on August 1, 1983, in order to provide Reserve Banks and depository institutions sufficient time to make the appropriate operational adjustments.

Virtually all other categories of check float will be priced by adding the value of the float to the cost of the check collection service. Any necessary adjustments to fee schedules will be implemented beginning in October, 1983, thus providing Reserve Banks with an opportunity to implement operational adjustments designed to reduce float further and to put into place and test the systems necessary to implement the adopted procedures. An October 1983 implementation date also will enable Reserve Banks to coordinate these change with modifications to fees that may result from the comprehensive review of their fee schedules planned for this summer. The Board believes that piecemeal adjustments to fee schedules at an earlier time could be disruptive to depository institutions that take Federal Reserve fee schedules into account in their planning and operations. After implementation of these procedures, all Federal Reserve float arising from the provision of check collection services to depository institutions will have been eliminated or priced in accordance with the Monetary Control Act of 1980.

By order of the Board of Governors of the Federal Reserve System, May 3, 1983.

(signed) James McAfee

James McAfee
Associate Secretary of the Board