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Questions:

1. What intraday liquidity conservation strategies and technologies does your institution use (such as controlling the timing of payments and introducing queuing techniques to conserve on liquidity)?

   We have a system that throttles payments continuously throughout the day. Because the bank is so highly capitalized and utilizes only 24% of the cap, payments are not generally held in a liquidity queue due to the bank's intraday overdraft position at Fed.

   The Bank holds overnight borrowings for 23 hours based on the time received the previous day. We do not participate in "early" return trades unless the rate at which we borrow covers any daylight overdraft fees associated with the early release. We do not use any other measure to stop wires to lessen our daylight overdraft position; however, we may hold wires in accordance with credit policies as it relates to clients' accounts.

   It is important to note that most answers in the questionnaire are our company specific. While we are a top 10 U.S. bank, answers will vary from money center depository institutions. We are not a "clearing bank" for funds transfers and are not a CHIPS member.

2. How do these affect your institution's timing for sending payments?

   With the exception of maturing Fed funds and Eurodollar payments, most payments are sent once potential risk issues such as insufficient funds are resolved. However, most funds from overnight borrowings are traded and settled late in the day. As a result, the bank returns late in the day. It is important to note that if the bank receives funds at 10:00AM, we will return the proceeds at 9:00AM.

3. What, if any, changes are you planning with regard to intraday liquidity management?

   At this point, we do not anticipate making any changes as we are highly capitalized using approximately 24% of our net debit cap. Our daylight overdraft position is primarily a function of the size of the bank's overnight position.

4. How do the concentrated demands for intraday central bank money by private sector systems influence intraday liquidity management by depository institutions throughout the day?

During peak demand times, depository institutions (DIs) send payments from their accounts at the Federal Reserve to the private sector systems in order to make payments. This results in higher intraday overdrafts at the Fed in order to prevent gridlock in the private sector systems. It is important to recognize that the Fedwire funds transfer system is the backbone of the way payments are channeled through. If there is a disruption in the private sector systems, funds transfers is naturally the "back-up" method to those systems.

5. Are there significant concentrated sources of demand for intraday central bank money beyond those already mentioned in the text and how does this demand affect intraday liquidity management?

   The most common concentrated requests for early returns and intraday liquidity are GSEs as they struggle to meet new daylight overdraft requirements.

6. Is the concentration of payments late in the day a concern for your organizations?

   Yes

7. If so, what is the nature of your concern?

   It is easy to take this concentration issue for granted because most of the time problems are limited to a few payment fails. The bigger concern would be the trickle down effect during a contingency event. The industry as well as the Fed should look into taking precautions that can allow for "nimbleness" during times of stress. The PSR policy change affecting GSEs in July increases operational risk in that payments are delayed even further causing a larger gridlock.

8. Does it include operational risk from late-in-the-day payments, and has operational risk to your organization from such payments been increasing or decreasing?

   Please see above #7—we anticipate operational risk to increase for payment systems as a whole. The company's risks increase as a result of operational risk increasing across the banking sector. The company constantly evaluates the amount of increased risk with future business opportunities.

9. What are the key drivers of late-in-the-day payments?

   The key drivers result from DIs having to work within cap limits and trying to reduce the amount of daylight overdraft fees. It is important to *note that this behavior affects clients as well. Most client accounts need to be funded in full or within a pre-approved daylight overdraft limit. If payments are owed to clients from another bank with daylight overdraft issues, the client's wire is held until funds become available. When funds become available, the wire transfer will be released but it can have a domino effect as the "next receiver" may have payments held up as well.*

10. How has your organization responded to the late-in-the-day concentration of payments?

    We request information on wire transfers from areas within the bank that send/receive high dollar volumes. Our system is automated so we have a view of what is keyed into the system to send out and we see wire transfers reflected in our totals as they come in. The Treasury Division monitors this activity. If transfers are sent after 5:30PM, Treasury has to be notified and approve the transfer. We have processes and procedures in place as well as adequate staffing in Treasury and the Wire Facility to handle the concentration.

11. For the market, operational, and PSR Policy changes discussed in this document and listed as follows, how might the timing of payments and the demand for daylight overdrafts be affected?

    The demand for early return money will be more commonplace than it is now. Creating price differences and the overnight market will need to adapt to the changes. Systems will need to be adjusted for netting arrangements. Some DIs may have the ability to "net" Fed funds and Eurodollar trades but others may not. Although the company has the capability to net, implementing this will greatly affect our normal process and procedures. Adjustments will need to be made to accommodate this workflow. If netting arrangements are expanded to be broader in scope, say all payments between another DI & the company were to be netted, system changes, management and streamlined processes will be a major issue for the industry.

12. What advantages or disadvantages do you see for these changes?

    ◊ An intraday market to exchange liquidity between institutions that hold positive balances at the Reserve Banks and those that run negative balances

    The advantages may not outweigh the disadvantages. Having intraday liquidity would help for a very short period of time during the day but this could also exacerbate the current amount of risk in the payment systems as this liquidity is "exchanged" back. Systems are not generally set up for intraday exchanges. There will be a need for *major technological advances in this area. To some extent, smaller DIs may draw funds from correspondent banks early in the day to cover their payments and send funds back later in the day. (This type of behavior was prevalent when daylight overdraft fees were implemented and continues among smaller institutions.) The company has put procedures in place so we do not bear greater exposure, however, this kind of behavior is difficult to monitor. Large DIs may simply try to do this as well.*

◊ A market for the early return of federal funds or other money market investments

Currently, there are requests for early return money. This will just evolve and probably some consistent pricing will be established for this. The borrowing DI will either pay a lower rate to compensate for the increased overdraft expense they will incur while selling DIs will receive a lower yield but will have the liquidity. For highly capitalized DIs, the benefits will need to be evaluated. DIs that are not well capitalized or the GSEs will have to be big players because they need the liquidity. We want to be a corporate citizen and a market participant but we also make sure we offset our daylight overdraft changes with a lower interest rate.

◊ Enhancements by private settlement systems that further economize on the use of central bank money, for example multiple settlement periods to release liquidity earlier in the day

A potential issue would be that a depository institution might be forced to settle though the private sector by "funding" the private sector but causing a stoppage of activity on the central bank because funds aren't available there either. This concept is similar to consumers using various credit credits to continue spending above their means.

◊ Liquidity saving mechanisms for the Fedwire funds transfer system

Most large DIs have a liquidity savings mechanism internally that can designate payments and settle according to incoming payments. The true advantage would be seen by the large money center banks for daily clearings. A big challenge will be technological enhancements that allow payments to be paired up. It is possible that this "pairing" consider type of wire, ABA, and possible originator and/or beneficiary information to facilitate payments being made in this fashion.

◊ Throughout requirements for the Fedwire funds transfer system

Throughput requirements would be extremely difficult to monitor just as monitoring third party wires after 6:00 PM is today. Throughput requirements would need to be "synched" up with Federal Reserve postings so as to prevent additional daylight overdrafts. Throughput requirements would also be difficult for the GSEs to adhere to since they are not able to incur daylight overdrafts.

◊ Greater use of voluntary or required collateral to cover partially or fully daylight overdrafts in depository institution accounts at the Reserve Banks

Accepting the use of collateral for daylight overdrafts can provide the mechanism for those DIs that need additional capacity to make payments. It is important to note that the change for daylight overdrafts and the management policies/views at smaller DIs sometimes prohibit these institutions from using daylight overdraft credit. The mid to large sized institutions view daylight overdrafts as a cost associated with doing business, making timely commitments, and meeting clients' needs. By having a voluntary method for collateral, the Fed would actually encourage DIs to use this opportunity as more of a collateral management tool. Just for further clarification, the same collateral should be pledged to both the discount window and daylight overdrafts allowing for a more efficient to use of collateral from the DI's perspective while still offering protection for the Fed. Somewhat related to this issue, the Board should consider any overnight overdrafts as an automatic discount window borrowing if collateral is available from the individual depository institution. Controls could be put in place to limit potential misuse.

◊ Tow-tiered pricing for collateralized daylight overdrafts, with a fee charged for collateralized daylight overdrafts set lower than the rate for uncollateralized overdrafts

This concept is related to the previous assumption that collateral would be interchangeable between the discount window and daylight overdrafts. The two tiered pricing approach would reduce charges that DIs incur while protecting the Fed interest. The Fed must understand the behavior that will follow this proposal. For institutions that are highly capitalized and have available collateral, this can actually incent DIs to have a larger daylight overdraft position and except the cost of daylight overdraft charges to expand current business that extensively use payment systems especially funds transfers. This would allow smaller DIs to re-evaluate collateral management practices and add *some incentive for them to incur daylight overdrafts while being collateralized at a cheaper cost.*

◊ Time-of-day pricing of daylight overdrafts
Most banks do not manage collateral by the hour but by the day so any changes probably would only affect the largest banks. However, for those banks that need to use collateral to make payments, it would expedite timing in payments.

Behavior may change if overdrafts in the morning are cheaper to incur than late in the evening; however the largest banks accept daylight overdrafts costs and exposure as a cost of doing business. The amount of late day daylight overdrafts may lessen somewhat; however, it will still to bump up in the late afternoon as trade settlements don't take place until later in the day.

13. What are other possible approaches to consider to reduce delays in payments and to manage efficiently and effectively the Federal Reserve's exposure to increasing daylight overdrafts as well as depository institutions' exposure to intraday liquidity and credit risks?

Technological advances could be made so that netted debit/credit items post through to the Fed account on a daily basis. For example, ACH credit files (debits) post as early as 8:30 AM whereas debit files (credits) do not post until 10:00 AM. Depository institutions would only have to fund the incremental net outflow if applicable.

14. Are there other market or operational changes in the private sector that could help reduce intraday liquidity and credit risks?

DTC-

DTC currently charges depository institutions' Fed account for funds owed to DTC. When DTC owes payments to depository institutions, a funds transfer is sent. Although DTC is planning to make payment methods consistent, a date has not been determined for this effort. If DTC would post credits through Federal Reserve accounts in the same time frame as the debits post, the reliance on funds transfers would be eliminated and depository institutions would receive payments in a more timely fashion.

CHIPS-

It is important to note that CHIPS settlement deadline has been extended to 5:00 PM from 4:30 PM, causing final payments from CHIPS to be released at 5:15 PM. This later cutoff time contributes to added payment systems risk late in the afternoon as CHIPS members receive settlements due to them at 5:15. Any extension related to CHIPS exacerbates the problem and/or any fails associated with CHIPS payments are handled through Fedwire payments. (See response to question 4 above.)

Congress is currently considering legislation that would allow the Federal Reserve to pay interest on reserve balances held by depository institutions at the Reserve Banks.

15. How would the payment of interest on reserves affect depository institutions' intraday liquidity management, including the demand for daylight overdrafts at the Reserve Banks?

    DIs would hold more balances overnight and by holding higher balances, daylight overdrafts may diminish a bit but the largest DIs will have payments to make so it will not significantly change the largest exposures to the system.

16. Could the payment of interest on reserves be utilized to reduce the value or timing of daylight overdrafts?

    If the rate structure was such that the interest is similar to Fed funds, the market would have somewhat of a floor most of the time. DIs that have excess funds would limit what they sell in the market and hold more in balances at Fed. While this may reduce the amount of the overdraft, the amount of balances held at Fed would not greatly affect the massive amount of payments as DIs would continue to look for higher yielding assets to invest in. (It is important to note that setting the discount rate at 100 basis points over the target was thought to have placed a ceiling on the market; however there are still instances in which the market will trade higher than the discount rate.)

    Small DIs who traditionally depend on correspondent banking services may hold funds at Fed utilizing those services instead of correspondent bank services as a result of this proposed legislation.