Association for
Financial Professionals®

March 14, 2007

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Docket No. OP-1257
Consultation Paper on Intraday Liquidity Management
and Payment System Risk Policy

Dear Ms. Johnson:

The Association for Financial Professionals (AFP) welcomes the opportunity to comment on the experience of its members in managing intraday liquidity, credit and operational risks associated with Fedwire funds transfers. The Federal Reserve Board has requested the views of the financial industry and other interested parties on potential changes in market practices, operations, and the Board's Payments System Risk Policy that could reduce one or more of these risks, while maintaining or improving the efficiency of the payments system.

AFP represents approximately 14,000 finance and treasury professionals who, on behalf of over 5,000 corporations and other organizations, are significant participants in the payments system. Organizations represented by its members are drawn generally from the Fortune 1,000 and the largest of the middle market companies. Many of AFP's members are responsible for managing incoming and outgoing wire transfers, for investment and borrowing decisions, and for the settlement of financial transactions. They thus have a sizeable stake in ensuring the efficiency of the wire transfer system.

The Federal Reserve has indicated that changes to U.S. payments and settlement systems and growth in the value and volume of Fedwire funds transfers have increased the demand for intraday liquidity and caused a steady rise in daylight overdrafts at the Reserve Banks. In recent years, as a result of financial institutions' intraday liquidity management strategies and other factors, the volume and value of large Fedwire payments made late in the day has grown, increasing the risk to financial markets that payments will not be settled in a timely manner if significant operational disruptions were to occur later in the day.

Corporations use wire transfers to settle mergers and acquisitions, for real estate settlements, investments, borrowing, debt repayments and other time-critical business transactions. The increase in late-in-the-day wire transfers has created inefficiencies in corporate financial transactions, added costs for U.S. businesses without economic benefit, and introduced new uncertainties in financial markets. The experience of AFP's corporate members underscores the urgency of Federal Reserve action to reduce the incidence of late-day wires and restore the efficiency of the Fedwire funds transfer system.

Inefficiencies in Financial Transactions
Wire transfer delays caused by financial institutions managing their daylight overdraft positions have a cascading, negative effect on the settlement of financial transactions. When a corporation borrows on a line of credit or sells commercial paper, the wire with incoming funds often does not arrive until late in the day. Because this places the company in a daylight overdraft position, its outbound wires to a third party are delayed.

An AFP member reports this example of the chain reaction caused by late-day wires: A company must make a $20 million wire payment to a third party. In the morning, it sells commercial paper through its dealer and receives confirmation of the sale. It then wires the funds to the third party. If the dealer does not wire the $20 million to the company's bank account until late in the day, the bank may not release the company's wire to the third party until late in the day, when it confirms that funds have been received in the account.

Cost of Delayed Wire Transfers
Companies incur actual costs and opportunity costs because of delayed wire transfers. When incoming wire transfers are received late in the day, companies miss investment opportunities that would otherwise have been available. Or they may receive lower rates on investments that could not be made in the morning. A real estate closing may be cancelled if a wire transfer is not received on a timely basis. Funding for controlled disbursement checks, both payroll and accounts payable, is delayed.

To ensure that wire transfers are made without delay, companies sometimes draw on their intraday credit lines. Attorneys' fees escalate if a real estate settlement or merger is delayed and all parties must await confirmation of wire transfer receipt. Staff is assigned to remain in close contact with their bank's wire room to monitor the status of wires. Manual communication with the bank can sometimes mitigate the delay, but not always.

An AFP member reported this example of the cost of delayed wires. A company sends a quarterly wire transfer to the third party that processes and mails its dividend checks. The wire transfer is submitted to the bank the day before the due date with a next-day effective date in order to meet the 10:00 am deadline of the third party. One morning, when the relationship officers at the bank were not available to approve the company's intraday overdraft, the wire missed the deadline. The company was assessed a penalty of over $5,000 for a 2 ½ hour delay, an effective interest rate of 3,000%.

AFP Recommendation

Businesses use wire transfers because they are secure, same-day and final. They expect that their large-value payments will also be made on a timely, efficient basis. But companies now pay a heavy price because of the cascading uncertainties and increasing costs of the Fedwire funds transfer system. In contrast, one AFP member pointed out that their company uses the ACH to make a multi-million dollar payment to the Depository Trust Company each quarter to pay a common stock dividend and the payment is settled on time.

AFP recommends that the Federal Reserve assign a high priority to the evaluation and implementation of measures to reduce the intraday liquidity, credit and operational risks associated with Fedwire Funds transfers in order to improve the efficiency of the Fedwire funds transfer system.

AFP thanks the Federal Reserve for the opportunity to comment on the management of risks associated with the Fedwire funds transfer system. Should you have questions about the Association's position, please call Arlene Chapman of AFP at 301-907-2862.

Sincerely,

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