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4 June 2008

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

Re: Docket Number OP-1309; Policy on Payments System Risk; 73 Federal Register 12417; March 7, 2008

Docket Number OP-1310; Policy on Payments System Risk; Daylight Overdraft Posting Rules; 73 Federal Register 12443; March 7, 2008

Dear Ms. Johnson:

The American Bankers Association[1] appreciates the opportunity to submit comments on the recently proposed revisions on policies to mitigate payment system risk. The proposals are intended to increase intraday liquidity by encouraging banks to provide collateral to secure daylight overdrafts and amending the ACH posting rules.[2] The companion proposals are part of the Board of Governors' (Board) strategy to improve risk management in the payments system.

Summary of Comment

The ABA supports the Board's efforts regarding these two proposals and recommends some clarifications to assist in their implementation.

The ABA recognizes the intent of the Board to improve intraday liquidity by adjusting its fees downward for banks that incur collateralized daylight overdrafts, and the ABA supports the proposal. This change should have the desired effect to reduce the number of banks that currently believe that

[1] The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95% of the industry's $12.7 trillion in assets and employ over 2 million men and women.
[2] 73 *Fed. Reg*. 12417, (March 7, 2008) and 73 Fed. Reg., 12443, (March 7, 2008)

they need to wait until late in the day to make funds transfers hoping to avoid daylight overdrafts and their associated fees.

The ABA recognizes the benefits of aligning the posting of FedACH debits and credits simultaneously at 8:30 a.m. and supports the Board's proposal to implement this change to replace the current practice of posting credits at 8:30 a.m. and debits at 11:00 a.m. This change will allow banks to know their net balance earlier in the day, and this will help them to manage their funds balances and reduce late day wire transfers to balance their accounts.

The ABA recommends that the implementation date of these proposals be made flexible. The proposal to change the ACH posting times was set for six months from the date of the final rule while the daylight overdraft changes had a two year timeline. The ABA recommends that banks that wish to implement the overdraft proposal's terms earlier be allowed to do so at the time the ACH posting change becomes effective. Banks that would rather operate under the existing overdraft policy should be allowed to do so until a formal implementation date two years after the publication of the final rule.

Daylight Overdrafts

The Board proposes to loosen intraday liquidity restraints and reduce operational risk by encouraging banks to collateralize daylight overdrafts voluntarily. The Board intends to ease the burden on banks incurring daylight overdrafts by eliminating the fee when they have voluntarily pledged collateral with the Board. Additionally, the Board would increase the biweekly fee waiver to $150 from $25 for banks that use small amounts of daylight overdrafts. To encourage banks to pledge collateral voluntarily, the Board proposes to increase the fees associated with uncollateralized daylight overdrafts.

The Board recognizes that this represents a policy shift from one that discouraged daylight overdrafts to one that recognizes that, when collateralized, daylight overdrafts can be an effective tool that prevents other disruptive or negative events. Some of these negative events can occur when banks delay making funds transfers out of their accounts until late in the afternoon with the hope that incoming funds transfers will be greater than the outgoing amount that threatens to create a daylight overdraft.

The Board estimates that 96.4% of the banks affected would pay lower fees under this proposal, based on fourth quarter 2007 figures. It is important to note that the size and overdraft history of the other 3.6% of the individual banks would be affected differently. The Board indicated that some 35 out of 4,100 small banks would incur higher fees of $500-$1,000 per year. These increased fees would be eliminated, in the Board's estimation, if the affected banks pledged, on average, $8,000,000 in additional collateral.

In general, the proposed change would affect only the banks that use daylight overdrafts to cover their positions. Banks that do not incur daylight overdrafts would not be directly affected. In addition, banks that incur small daylight overdrafts, below the newly proposed $150 biweekly minimum, would not be affected either. In general, banks that do incur daylight overdrafts can benefit from collateralizing these transactions and incurring lower fees.

Finally, the policy change will have a positive effect on market liquidity when combined with the Board's companion proposal to change the ACH posting rules. Some banks that are large originators of debits will benefit from receiving those funds earlier in the day, reducing the exposure of daylight overdrafts. We do note that banks that do not originate large volumes of debits may lose the "float" associated with a delay in debits being withdrawn from their account two and one half hours after the credits are deposited.

The collateralization of overdrafts will allow banks to manage their funds better, with lowered risk to themselves and to the market. This change removes the stigma of the daylight overdraft. Requiring it to be collateralized mitigates borrowing risks. This will help to reduce the number of late day funds transfers that can be so disruptive to fund balances.

ACH Posting Changes

Currently, the FedACH service posts ACH credits at 8:30 a.m. and debits at 11:00 a.m. This proposal would call for ACH credits and debits to be made at the same time each day so that banks would know their net position earlier in the day and would not have to wait until after the 11:30 a.m. debit posting to begin to bring their accounts into balance. For the same reason, the Board is proposing the post Treasury Tax and Loan (TT&L) and Electronic Federal Tax Payment Service (EFTPS) ACH debit transfers at 8:30 a.m., instead of the current 11:30 am posting time.

This proposed change would bring the FedACH service into alignment with its private sector competitor, the Electronic Payments Network (EPN). This proposed change would result in all ACH credits and debits being settled at the same time, regardless of the ACH operator driving the transaction.

The majority of banks would not be affected significantly by this change. Banks that originate large volumes of ACH debits will benefit from receiving those funds earlier in the day.

Currently, the U.S. Department of the Treasury (Treasury) uses TT&L to collect taxes via ACH credits and debits as well as to invest excess balances with certain banks. The present system allows for Treasury to collect tax payment credits at 8:30 a.m. The same process is repeated at 11:00 a.m. when Treasury collects the debit transfers. The proposed change would have the TT&L debits and credits processed at 8:00 a.m. to allow for one cycle of tax collection and investment of excess funds.

The ACH posting time change could affect some banks' fund balances by making the debit and credit settlement simultaneously. Although this is not expected to be a material issue, some banks will be affected. Banks that are large originators of debits will be credited with those funds two and one half hours. Other banks will lose the benefit of receiving credits two and one half hours before the debits reduce the value of their account.

Comments

We support adoption of the proposed changes regarding daylight overdrafts and ACH posting times. The ABA has additional comments on the implementation date of the two proposals, the frequency of collateral reporting, and individual bank liquidity.

The proposal suggests that the daylight overdraft changes be implemented two years after the change is finalized. The Board's related proposal regarding ACH posting times (OP-1309) would be implemented within six months of its publication in the Federal Register, according to the proposal. While the change in ACH posting times will not affect the banking system significantly, it may contribute to increased daylight overdraft positions being created by some banks. These banks will not be able to take advantage of the "new" collateralized daylight overdraft policy for 18 months after the ACH posting rule is put into place. We believe that banks that wish to implement the proposed policies related to daylight overdrafts be allowed the flexibility to do so at the same time the ACH posting rule changes are effective. Implementing any posting rule change in conjunction with the broader Payment System Risk policy will provide institutions an opportunity to pledge (additional) collateral to manage a possible increase in fees. Banks that wish to delay implementation of the daylight overdraft changes for the two years proposed in the rule change should be allowed to wait if they so choose.

Currently, the Federal Reserve's Collateral Management System (CMS) records collateral held outside of the NBES system. It documents deposits of collateral held in Reserve Bank vaults or by third party custodians. This verification is completed on a monthly basis under the current regulations, and that frequency should remain the same under the proposed changes.

Banks that choose to participate in providing collateral to offset overdrafts will make the decision that those funds are better used for that purpose than for other investing or bank operational activities. We urge the Board to facilitate a smooth and efficient process for banks to withdraw funds If a bank decided that a better use of its funds could be found outside of the overdraft collateral arrangement.

We appreciate the opportunity to share these comments with you and would be pleased to discuss them with you at your convenience should you find that helpful. If you have any questions about these comments, please contact the undersigned at (202) 663-5147 or via email at skenneally@aba.com.

Sincerely,

Stephen K. Kenneally

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Center for Regulatory Compliance