FEDERAL RESERVE SYSTEM

12 CFR Parts 210 and 229

[Regulations J and CC; Docket No. R-1009]

Collection of Checks and Other Items by Federal Reserve Banks and Availability of Funds and Collection of Checks

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Notice of proposed rulemaking; termination.

SUMMARY: In March 1998, the Board issued an advance notice of proposed rulemaking requesting comment on the benefits and drawbacks associated with its same-day settlement rule, which became effective in January 1994. The same-day settlement rule, which is part of Regulation CC, requires paying banks to settle in same-day funds for checks presented to them by private-sector banks by 8:00 a.m. local time at a location specified by the paying bank. The Board also requested comment on the implications of potential rule changes to reduce or eliminate the remaining legal disparities between Federal Reserve Banks and private-sector banks in the presentment and settlement of checks. The Board considered whether such changes would enhance the efficiency of the interbank check collection market, the check collection process, and the payments system as a whole. Based on its analysis of the comments received, the Board concluded that the costs associated with reducing the remaining legal disparities would outweigh any payments system efficiency gains. Therefore, the Board has decided not to propose any specific regulatory changes at this time to reduce these remaining legal disparities.

FOR FURTHER INFORMATION CONTACT: Louise L. Roseman, Associate Director (202/452-2789) or Jack K. Walton II, Manager, Check Payments Section (202/452-2660), Division of Reserve Bank Operations and Payment Systems; Oliver Ireland, Associate General Counsel (202/452-3625), or Stephanie Martin, Senior Counsel (202/452-3198), Legal Division. For the hearing impaired <u>only</u>, contact Diane Jenkins, Telecommunications Device for the Deaf (TDD) (202/452-3544).

SUPPLEMENTARY INFORMATION:

I. Background

In 1987 Congress passed the Expedited Funds Availability Act (EFAA). That act gave the Board the responsibility to regulate “any aspect of the payment system, including the receipt, payment, collection, or clearing of checks, and any related function of the payment system with respect to checks” to carry out provisions of the act. (12 U.S.C. 4008(c)(1)) The Board issued Regulation CC, Availability of Funds and Collection of Checks, to carry out its responsibilities under the EFAA. (12 CFR part 229) In October

1992, the Board amended Regulation CC by adopting the same-day settlement rule, effective January 1994. (57 FR 46956, October 14, 1992) The same-day settlement rule requires a paying bank to settle on the day of presentment by Fedwire for checks presented by a private-sector collecting bank, without the imposition of presentment fees, if the checks are presented at a location designated by the paying bank by 8:00 a.m. local time.[1] (12 CFR 229.36(f))

The same-day settlement rule was designed to improve payments system efficiency by 1) enhancing competition between private-sector banks and Reserve Banks in the provision of check collection services, 2) encouraging agreements between presenting banks and paying banks that would reduce the cost of the check collection system, 3) reducing inefficient intermediation in the check collection process, and 4) encouraging the migration from checks to more efficient payment mechanisms. At the same time, the rule was designed to address the concerns of large check drawers and banks that their controlled disbursement arrangements and paying bank operations would not be unduly disrupted.

In March 1998, the Board issued an advance notice of proposed rulemaking requesting comment on the effect that the same-day settlement rule has had on the interbank check collection market, on the check collection process, and, more broadly, on the payments system. (63 FR 12700, March 16, 1998) The notice also requested comment on the benefits and drawbacks of reducing legal disparities between Federal Reserve Banks and private-sector collecting banks. These legal disparities include the rules governing presentment deadlines, presentment locations, reasonable delivery requirements, the control and timing of settlement, and the obligation to settle on a non-banking day.

The Board undertook this evaluation to consider whether reducing these disparities would enhance the efficiency of the interbank check collection market, the check collection process, and the payments system as a whole either directly, by expediting the collection and return of checks, or indirectly, by fostering competition. Improved competition among collecting banks that would likely result from a reduction in legal disparities and the efficiency gains derived from this competition were weighed against any increased costs to paying banks and their check-writing customers that could

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[1] The term “bank” as used in this notice and in Regulation CC includes a commercial bank, savings bank, savings and loan association, credit union, and U.S. agency or branch of a foreign bank. (12 CFR 229.2(e)) A “collecting bank” is a bank handling a check for collection, except the paying bank. A “correspondent bank” is an intermediary collecting bank that provides check collection services to other banks. A “presenting bank” is the collecting bank that presents a check to the paying bank. A “paying bank” generally is the bank by, at, or through which a check is payable.

result from the changes. Consistent with its policy, the Board's evaluation of potential regulatory changes included an analysis of the competitive impact any changes might have on the ability of other service providers to compete with the Reserve Banks.[2] The following is a summary of the comments received and the Board's analysis of those comments.

II. Summary of Comments

The Board received a total of eighty-one comment letters in response to the March 1998 advance notice of proposed rulemaking. The following table shows the number of comments received by category of commenter:

Category of Commenter	Number of Responses
Depository institutions, bank holding companies, and associations representing depository institutions	45
Corporations and associations representing corporations	15
Clearinghouses	7
Check processors	6
Federal Reserve Banks	4
Money order companies	2
Other organizations	2
Total	81

Sixty-one commenters recommended not changing the rule governing the same-day settlement presentment deadline or reducing other legal disparities. Eight commenters recommended limited expansion of the same-day settlement rule. Six commenters

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[2] The Board has established procedures for assessing the competitive impact of rule changes that may have a substantial impact on payments system participants. Under these procedures, the Board will assess whether a change would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve 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 differences. If no reasonable modifications would mitigate the adverse competitive effects, the Board will determine whether the anticipated benefits are significant enough to proceed with the change despite the adverse effects. These procedures are described in the Board's policy statement "The Federal Reserve in the Payments System," as revised in March 1990. (55 FR 11648, March 29, 1990; FRRS 7-145.2)

suggested rescinding the existing rule, and six did not offer a specific opinion. Thirteen commenters stated that if the Board were to make any regulatory changes, particularly those that would require operational or programming changes, the changes should not take effect prior to mid-2000. Several commenters raised other regulatory issues as well as issues related to specific Reserve Bank services or policies that were not germane to the Board's March 1998 advance notice of proposed rulemaking.

Based on its analysis of the comments received, the Board has decided not to propose specific amendments to the same-day settlement rule or Regulation J at this time. The following sections summarize the comments received regarding current market practices, the presentment deadline, the timing and control of settlement, and other legal disparities and review the Board's conclusions based on its analysis of the comments.

A. Current Practices

The March 1998 notice asked commenters to provide information on what effect, if any, the same-day settlement rule has had on their operations since it was implemented in January 1994. In addition, the Board requested information on current practices that it could use to assess the need to modify the same-day settlement rule further. In total, sixty-eight commenters provided information on the current practices of businesses and banks, including changes made since the implementation of the same-day settlement rule.

<u>Banks</u>

Twenty-three out of twenty-five comments on the effect of the same-day settlement rule on check collection costs and availability stated that the rule had resulted in lower costs for collecting banks. Ten of those commenters also stated that they had experienced an improvement in funds availability due to the implementation of the same-day settlement rule. Several large collecting banks reported that their check collection costs were reduced not only by the elimination of presentment fees, but by using lower-priced check clearing services offered by correspondent banks.

Smaller banks commented that the same-day settlement rule benefited only large collecting banks by shifting funds transfer, staff, and adjustment costs for same-day settlement presentments to small paying banks. Community banks stated that they have benefited, in some cases, from receiving same-day settlement presentments earlier in the day than they receive Reserve Bank presentments. Receiving presentments earlier in the day provides the paying bank with more time to process the presentments, which lowers their processing costs. Most of these banks, however, also cited the cost of funds transfers for settlement as particularly burdensome.
Old Kent Financial Corporation noted that the Grand Rapids, Michigan, Clearing House disbanded as a result of the same-day settlement rule because members were able to present items directly without incurring the administrative and organizational expenses of

maintaining a clearinghouse organization. Conversely, the five clearinghouses that provided information on their membership and clearing volume since 1993 stated that they had expanded their membership and clearing networks in response to the same-day settlement rule by providing transportation or settlement services.

Businesses

Of the thirty-eight commenters that commented on current business practices, none stated that the same-day settlement rule had influenced businesses' decisions to use controlled disbursement services. The Treasury Management Association (TMA) noted that 80 percent of businesses with annual sales over $100 million use controlled disbursement services. TMA as well as several businesses and banks noted that the primary benefit of controlled disbursement services was not the ability to generate float, but the ability to make investment and borrowing decisions early in the day based on knowledge of the value of that day's check presentments. Several large banks that provide cash management services as well as most businesses stated that they rely primarily or solely on the disbursement totals provided by their banks to determine their daily account balances because businesses tend to view internal forecasting as not sufficiently reliable. Three large cash management service providers and TMA reported that since the implementation of the same-day settlement rule, up to 55 percent of the value of their first presentment notification had shifted to their second presentment notification.[3] As a result, businesses that previously forecasted total daily presentments based on first presentment notifications have become more dependent on second presentment notifications to more accurately project daily presentments. Several banks and businesses indicated that maintaining an early morning presentment deadline also allows banks enough time to provide positive pay services, which help reduce losses from fraudulent check activity.[4]

None of the cash management service providers or businesses reported any plans to shift from checks to electronic payments as their primary method for disbursements, but a few noted that some businesses would consider expanding their use of electronic

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[3] Cash management banks typically provide corporations with a preliminary initial notification of the day's clearing totals by around 8:00 a.m. local time, which includes early direct presentments, on-us items, and the first Reserve Bank presentments. The second notification is typically made between 9:30 and 11:00 a.m. eastern time and includes the second Reserve Bank presentment from the high dollar group sort program and most same-day settlement presentments.

[4] Companies using positive pay services generally provide the paying bank with an electronic file containing information on all checks disbursed. The paying bank compares data on the file with data captured from the presented checks to identify exceptions that are examined for potential fraudulent check activity.

payments as services become more widely accepted and affordable. Technological investment and other startup costs were mentioned most often as the primary barriers to expanded use of electronic forms of payment.

B. Presentment Deadline Disparity

Under Regulation J, Reserve Banks can obtain same-day settlement for checks presented to a paying bank before its cut-off hour, generally 2:00 p.m. or later. (12 CFR 210.9(b)(1)) The same-day settlement rule for private-sector banks, however, requires that they make their presentments by 8:00 a.m. to ensure that they receive same-day settlement by Fedwire without being assessed presentment fees. The Board requested comment on the effect of the difference in presentment deadlines for Reserve Banks and private-sector collecting banks. The Board also requested comment on an extension of the presentment deadline if the presenting bank transmits the information contained in the magnetic ink character recognition (MICR) line of each check by some earlier time. Further, the Board requested comment on the Reserve Banks' noon presentment policy and the effect of allowing interest payments on demand deposit accounts.

<u>Presentment Deadline</u>

Most commenters did not believe that the six-hour difference in presentment deadlines was a significant impediment to the ability of private-sector collecting banks to compete with the Reserve Banks. Several banks and processors noted that Reserve Banks typically make their check presentments to paying banks much earlier than the 2:00 p.m. cut-off hour. In addition, most large correspondent banks indicated that they are able to compete effectively with Reserve Banks by offering lower prices and, in some cases, better availability of funds.

Ten banks, two check processors, and one Federal Reserve Bank noted that a later same-day settlement presentment deadline would require paying banks to process incoming presentments during the time they currently use to process internal documents and outgoing checks. For example, commenters noted that shifting same-day settlement check volumes into a shorter processing window would cause paying banks to incur significant additional costs, including the cost of acquiring additional sorter capacity and increased staffing expense. Commenters also indicated that the shorter processing windows would likely result in higher check-fraud losses because paying banks would have less time to inspect presented checks properly and make return decisions regarding those checks. In addition, banks and processors that provide cash management services stated that later presentments would reduce their revenue from cash management services because daily clearing totals would be reported later in the day to businesses and, therefore, businesses would be less willing to pay for those services. All of the comments received from businesses stated that a later presentment deadline would severely diminish their ability to manage account balances efficiently because presentment totals would be reported to them later in the day.

Seventy-five percent of all commenters favored not changing the 8:00 a.m. same-day settlement presentment deadline primarily because the additional costs incurred by paying banks and businesses would outweigh benefits gained by collecting banks. Six commenters recommended that the same-day settlement rule be rescinded to allow paying banks to discourage private-sector presentments, regardless of the presentment deadline. Seven commenters favored expanding the same-day settlement rules by moving the deadline for private-sector presentments later in the day, with the recommended new deadline ranging from 9:00 a.m. to 2:00 p.m. First Union Bank and Firstar Bank conditioned their recommendation on preserving an 8:00 deadline for controlled disbursement checks, while First Tennessee Bank recommended the deadline only be extended if the presenting bank provided a MICR information transmission by 8:00 a.m. Several banks both for and against extending the same-day settlement presentment deadline suggested that a later deadline would improve funds availability by increasing the amount of processing time available to private-sector collecting banks, particularly for West Coast banks collecting checks drawn on East Coast banks. Those opposed to extending the deadline, however, believed that the availability improvements would not likely be of sufficient magnitude to justify additional transportation expenses for collecting banks or the increased operational costs to paying banks.

Six banks and one check processor with operations in the Midwest or West noted that moving the presentment deadline as little as thirty minutes later would result in a further shift of controlled disbursement accounts to banks in the eastern time zone. Being located in the eastern time zone gives controlled disbursement service providers an advantage in reporting disbursement totals to customers earlier in the day because it offers them time to make investment and funding decisions prior to the close of the European and U.S. financial markets. First Interstate Bank (Montana) and Bank of America proposed establishing a presentment deadline based on eastern time, rather than local time, to allow banks in the western part of the country to compete more effectively with banks in the eastern time zone in providing cash management services. In addition, four commenters recommended creating a special class of controlled disbursement routing numbers with an 8:00 a.m. presentment deadline and extending the presentment deadline for all other types of checks.

Because some collecting banks have been slow to take advantage of the same-day settlement rule, several commenters noted that they would prefer to leave the current same-day settlement rule unchanged. Maintaining the rule would allow the private sector to continue promoting other initiatives, such as the expansion of direct presentments through existing clearinghouses. A few commenters recommended moving the Reserve Banks' presentment deadline earlier, to match the private-sector same-day settlement presentment deadline, but several others noted that this would most likely force Reserve Banks to move deposit deadlines earlier, slowing the check collection process.

Later Presentment Deadline Conditioned on Earlier Transmission of MICR Information

Forty-seven commenters commented on conditioning the extension of the same-day settlement presentment deadline for paper checks on the transmission of check MICR information earlier in the day. Twenty-nine of those commenters opposed conditioning the extension of the presentment deadline on an earlier MICR transmission. Twelve commenters stated that the presentment deadline under the same-day settlement rule could be extended by the earlier provision of MICR information only if the rule contained detailed standards regarding the MICR transmission. Six commenters favored using MICR files to extend the presentment deadline as long as the private sector is allowed to set MICR transmission standards. The primary concern of those opposed to conditioning the extension of the presentment deadline on the earlier transmission of MICR information was the accuracy of the data contained in the MICR files. Three banks stated that they currently receive MICR files from presenting banks and noted that they occasionally find discrepancies between data contained in the electronic files and the associated checks. Other concerns included the investment required to send, receive, and process MICR files; potential communication network capacity issues at peak transmission times; and the need for additional warranties.

The commenters that currently receive MICR file transmissions under bilateral agreements stated that their existing agreements adequately cover relevant MICR file transmission issues and that regulation of these issues would likely be too general to address operational issues effectively. Several paying banks noted that if they wanted to maintain their current cash management reporting deadlines, they would be required to process MICR files from presenting banks that take advantage of the later deadline, even if paying banks determined that the investment required to process MICR information could not be recouped by efficiency gains. Several commenters suggested that it would be better to let market forces determine the acceptance of MICR files than to incorporate the use of MICR files in the same-day settlement rule as a condition for a later presentment deadline.

Noon Presentment Policy

Of the twenty-three comments received on the Reserve Banks' current noon presentment policy for city-zone endpoints, seventeen commenters stated that the policy does not need to be changed.[5] They said that the current policy adequately balances the

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[5] The Board adopted a policy in 1982 under which the Reserve Banks generally must present checks to paying banks located in Federal Reserve city availability zones by noon
(continued...)

Reserve Banks' ability to expedite the collection of city-zone checks with the desire of paying banks to receive their presentments earlier in the day. Four commenters suggested that the Reserve Banks make presentments earlier in the day and two suggested that the Reserve Banks could make their presentments later in the day.

Interest on Demand Deposits

Most banks that provide cash management services stated that controlled disbursement accounts would still be needed even if banks were permitted to pay interest on corporate demand deposits. Several banks indicated that they already compensate businesses through earnings credits and that they would not be able to pay rates high enough to keep larger businesses from seeking higher returns through alternative investments, although paying interest might help smaller businesses. TMA and Bank of America stated, however, that if banks paid market rates of interest on corporate demand deposits, the demand for controlled disbursement services would be significantly reduced, thus mitigating concerns about a later same-day settlement presentment deadline.

C. Timing and Control of Settlement

Under Regulation J, Reserve Banks have the right to settle for check presentments by debiting the Federal Reserve account of the paying bank or its correspondent settlement agent, a process often referred to as autocharge. (12 CFR 210.9(b)) The debit is posted during the day based on the time of presentment, as provided in the Reserve Banks' operating circulars. Under the same-day settlement rule in Regulation CC, however, the paying bank maintains control of the settlement through the initiation of a Fedwire funds transfer that does not have to be made until the close of Fedwire (6:30 p.m. eastern time). (12 CFR 229.36(f)(2)) Most commenters acknowledge that the regulations governing the timing and control of settlement favor Reserve Banks over private-sector collecting banks. None of the commenters, however, suggested an alternative that eliminated the disparity while maintaining a balance between the needs of both the paying and collecting banks to control some portion of the settlement process.

None of the commenters recommended changing the control of settlement. The primary concern with eliminating the Reserve Banks' ability to autocharge accounts was that paying banks would incur additional costs to transfer funds daily to the Reserve Banks. In addition, none of the paying banks indicated problems with the Reserve Banks' autocharge process. Moreover, most banks opposed giving private-sector presenting

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local time. (48 FR 79, January 3, 1983) This noon presentment policy, which provided for later presentments to city banks than was previously the case, was part of a broader program to expedite the collection of checks by establishing significantly later deposit deadlines and associated later presentment times for checks drawn on city banks.

banks the ability to debit their Federal Reserve accounts directly. Smaller paying banks, in particular, stated that their ability to adjust the amount of their funds transfers for settlement was often their most effective method of resolving discrepancies in the presentment totals, even though funds transfers were also cited as a significant cost to paying banks under the same-day settlement rule.

While seven commenters suggested moving the settlement deadline under the same-day settlement rule for private-sector banks to earlier in the day, most commenters stated that the current timing of Reserve Bank settlements was appropriate. Several banks expressed concern that if Reserve Banks obtained settlement for their presentments later in the day, Reserve Banks would post credits to depositors' accounts later, thus increasing the likelihood of daylight overdrafts. Another concern cited by several collecting banks was that under the current same-day settlement rule, most funds transfers settling for same-day settlement presentments are received late in the day, making it difficult for collecting banks to manage account balances and reserve requirements. A few paying banks, however, noted that the later settlement deadline for private-sector banks provided paying banks time to process and reconcile presentments before settling. To help resolve issues regarding the timing and control of settlement, the regional check clearinghouses noted that they have incorporated same-day settlement presentments into their clearinghouse settlements.

D. Other Legal Disparities

In its March 1998 notice, the Board also requested comment on other legal disparities that exist between Reserve Banks and private-sector collecting banks. Specifically, the Board wanted to know if the difference in presentment location, reasonable delivery requirements, and the obligation to settle on a non-banking day hindered competition and innovation in the payments system. The Board also asked for comment on any other legal differences between Reserve Banks and private-sector collecting banks that limit the ability of private-sector banks and Reserve Banks to compete in the interbank check collection market.

Under the same-day settlement rule, paying banks have the right to designate the presentment location, with certain restrictions, and to impose reasonable delivery requirements for presentments received from private-sector presenting banks. (12 CFR 229.36(f)(1)) Regulation J, however, allows Reserve Banks to present checks at certain locations that may not be the same as the location designated by the paying bank under the same-day settlement rule. (12 CFR 210.7(b)) In addition, Regulation J does not give paying banks the right to impose delivery requirements on Reserve Banks. In practice, however, the Reserve Banks generally present checks at a location designated by the paying bank and generally comply with the paying bank's delivery requirements.

Most of the thirty-one commenters on the issues of presentment location and reasonable delivery requirements noted that Reserve Banks already generally comply with private-sector practices. Fourteen commenters noted that the current disparity in presentment location and delivery requirements does not result in any material competitive advantage. Further, they noted that if the Board were to make changes in this area, the Board should modify Regulation J to allow paying banks to designate the presentment location and reasonable delivery requirements for presentments by Reserve Banks. None of the commenters suggested eliminating the reasonable delivery requirements for private-sector presentments. Only four commenters noted that the current rules provide a material competitive advantage for the Reserve Banks and suggested that collecting banks be given the same legal rights for presentment location as Reserve Banks.

The settlement obligation of a paying bank that closes voluntarily on a business day differs based on whether the presenting bank is a Reserve Bank or a private-sector bank. Under Regulation J, the paying bank's obligation to settle with a Reserve Bank is triggered if the Reserve Bank "makes a cash item available to the paying bank on that day." (12 CFR 210.9(b)(3)) Under the same-day settlement rule, the paying bank's obligation to settle with a private-sector collecting bank is triggered only if the paying bank "receives presentment of a check" on a business day on which it is open. (12 CFR 229.36(f)(3)) Of the seventeen commenters that commented on this issue, none of the commenters believed that the difference between the rules for private-sector banks and Federal Reserve Banks had a material competitive effect.

Nine commenters raised as another legal disparity the way paying banks and private-sector presenting banks resolve discrepancies in the settlement amount for presentments. The Reserve Banks' Operating Circular 3, Collection of Cash Items and Returned Checks (paragraphs 12, 18, and 19), sets forth the terms under which Reserve Banks handle corrections, adjustments, and warranty claims. Although paying banks and private-sector presenting banks can establish bilateral or multilateral agreements addressing adjustment standards, the same-day settlement rule does not provide standards for private-sector banks lacking such agreements. Several commenters noted that the lack of detailed adjustment standards had occasionally made it difficult to resolve differences between collecting and paying banks in a timely manner. While a few commenters asked the Board to incorporate detailed standards in Regulation CC, several others recommended that industry groups continue to set these standards.

E. Analysis and Conclusions

The Board recognizes that certain legal disparities between Reserve Banks and private-sector collecting banks may affect the competitive position of participants in the check collection system. In evaluating potential reductions in the legal disparities between Reserve Banks and private-sector collecting banks, the Board recognizes that even removing the disparities discussed in its advance notice of proposed rulemaking would not result in a completely level playing field in the interbank check collection market. For example, the Reserve Banks enjoy an unsurpassable credit rating that makes them an attractive service provider in times of financial stress.[6]

Based on the comments received, the Board believes that regulatory changes to reduce legal disparities between Reserve Banks and private-sector collecting banks would yield only marginal benefits in terms of directly expediting the collection and return of checks. While the removal of these disparities may foster competition between Reserve Banks and private-sector collecting banks in the check collection market, neither the direct nor indirect benefits appear to be sufficient to offset the significant additional costs that such regulatory changes would impose on paying banks and their customers. Specifically, the Board has concluded that moving the presentment deadline later in the day for private-sector banks would impose significant costs on paying bank operations and those businesses that use controlled disbursement services. In addition, moving the Reserve Banks' presentment deadline earlier in the day would delay the collection of some checks, which would be inconsistent with one purpose of EFAA: to expedite the check collection and return system.

Further, the Board believes that eliminating the disparities between the Reserve Banks and private-sector banks as to the control and timing of settlement would also likely increase costs and reduce the efficiency in the check system. The Board notes that private-sector initiatives, such as the expansion of clearinghouse settlement services, have been able to mitigate the settlement disparities to some extent.

With respect to the control of settlement, the Board believes that the autocharge system used by the Reserve Banks provides an efficient settlement mechanism that has not created problems for paying banks and therefore should be retained. The Board recognizes that while banks generally are not concerned with the ability of Reserve Banks to charge paying banks' Federal Reserve accounts, banks are very concerned about the risks associated with extending this capability to private-sector banks.

With respect to the timing of settlement, providing for a later settlement of Reserve Bank presentments would similarly delay the ability of Reserve Banks to post credits for check deposits, thereby making intraday account management more difficult for many banks and potentially increasing their daylight overdraft charges. In addition, providing for an earlier settlement deadline for presentments by private-sector banks could materially increase the costs and risks to paying banks by reducing the time that they have to process and reconcile presentments before settling.

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[6] Reserve Banks also labor, however, under constraints not imposed on their private-sector competitors, such as central bank concerns regarding the adequacy of payment services in the markets and cost recovery by major service category, as well as a level of public scrutiny of price and service level determinations not shared by the private sector.

The Board has also concluded that the legal disparities in control of presentment location, delivery requirements, and settlement on a non-banking day do not materially affect the efficiency of or competition in the check collection system.

The implementation of the same-day settlement rule in 1994 has significantly reduced the legal disparities between private-sector collecting banks and Reserve Banks, thereby improving the competitive position of private-sector collecting banks. While some legal disparities related to the presentment and settlement of checks still exist, they are not as significant as those that existed prior to 1994. The Board believes that the costs associated with reducing the remaining legal disparities would outweigh any payments system efficiency gains. Therefore, based on its analysis of the comments received, the Board believes that changes to further reduce the legal disparities should not be made at this time.

By order of the Board of Governors of the Federal Reserve System, December 8,

1998.

(Signed) Jennifer J. Johnson

Jennifer J. Johnson,
Secretary of the Board.