

## **FEDERAL RESERVE SYSTEM**

**Docket No. OP-1182**

### **Policy Statement on Payments System Risk**

**AGENCY:** Board of Governors of the Federal Reserve System.

**ACTION:** Notice and request for comment.

**SUMMARY:** The Board is giving notice that it intends to adopt two changes to its Policy Statement on Payments System Risk (PSR policy). First, the Board intends to modify the daylight overdraft measurement rules (“posting rules”) for interest and redemption payments on securities issued by entities for which the Reserve Banks act as fiscal agents but whose securities are not obligations of, or guaranteed by, the United States—that is, securities issued by government-sponsored enterprises (GSEs) and certain international organizations. The planned modification would revise the Board’s PSR policy to specify that the Reserve Banks will release interest and redemption payments on the Fedwire®-eligible securities issued by a GSE or international organization only when the issuer’s Federal Reserve account contains funds equal to or in excess of the amount of the interest and redemption payments to be made.<sup>1</sup> The Board requests comment on how best to implement this policy change in order to promote a smooth market adjustment.

Second, the Board intends to align the PSR policy’s treatment of the general corporate account activity (activity other than interest and redemption payments) of GSEs and certain international organizations with the treatment of account activity of other account holders that do not have regular access to the Federal Reserve’s discount window. Such treatment includes strongly discouraging daylight overdrafts and applying a penalty fee to daylight overdrafts that nonetheless result from these entities’ general corporate payment activity.

**DATE:** Comments must be received by April 16, 2004.

**ADDRESSES:** Comments should refer to Docket No. OP-1182 and may be mailed to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20<sup>th</sup> Street and Constitution Avenue, N.W., Washington, DC 20551. Please consider submitting your comments through the Board’s web site at [www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm](http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm), by e-mail to [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov), or by fax to the Office of the Secretary at 202/452-3819 or 202/452-3102. Rules proposed by the Board and other federal agencies may also be viewed and commented on at [www.regulations.gov](http://www.regulations.gov). All public comments are available from the Board’s web site at [www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm](http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm) as submitted, except as necessary for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board’s Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

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<sup>1</sup> Fedwire is a registered servicemark of the Federal Reserve Banks.

**FOR FURTHER INFORMATION CONTACT:** Paul Bettge, Associate Director (202/452-3174), Stacy Coleman, Manager (202/452-2934), or Connie Horsley, Senior Financial Services Analyst (202/452-5239), Division of Reserve Bank Operations and Payment Systems; for the hearing impaired only: Telecommunications Device for the Deaf, Dorothea Thompson (202/452-3544).

## **SUPPLEMENTARY INFORMATION**

### **I. Background**

#### **A. Foundation of the PSR Policy**

In 1985, the Board adopted a policy to reduce the risks that payment systems present to the Federal Reserve Banks, to the banking system, and to other sectors of the economy (50 FR 21120, May 22, 1985). An integral component of this PSR policy is managing the Federal Reserve's direct credit risk by controlling institutions' use of Federal Reserve intraday credit, commonly referred to as "daylight credit" or "daylight overdrafts." A daylight overdraft occurs when an account holder's Federal Reserve account is in a negative position during the business day. The PSR policy requires all depository institutions incurring daylight overdrafts in their Federal Reserve accounts to establish a maximum limit, or net debit cap, on those overdrafts. In addition, a Reserve Bank may apply other risk controls to an account holder's payment activity if the account holder incurs daylight overdrafts in violation of the PSR policy or if the Reserve Bank believes that the account holder poses credit risk in excess of what the Reserve Bank determines to be prudent. Under these circumstances, a Reserve Bank may place real-time controls on the account holder's payment activity, so as to reject requested payments, or require the account holder to pledge collateral to cover its daylight overdrafts as a means of deterring further the use of Federal Reserve daylight credit.<sup>2</sup>

Under the PSR policy, an institution's eligibility to access daylight credit is contingent upon whether the institution is eligible for regular access to the Federal Reserve's discount window and whether it is in sound financial condition. By statute, regular access to the discount window generally is available to institutions that are subject to reserve requirements.<sup>3</sup> If such an institution fails to cover a daylight overdraft by the close of the business day, it either obtains a discount window loan or incurs an overnight overdraft. The Federal Reserve strongly

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<sup>2</sup> The Reserve Banks have the ability to monitor an entity's account for certain payment types in real time and reject those payments that would create, or increase, a daylight overdraft in the entity's account. These payment types include Fedwire funds transfers, National Settlement Service transactions, and certain automated clearing house transactions.

<sup>3</sup> Before the passage of the Monetary Control Act of 1980, only banks that were members of the Federal Reserve System enjoyed regular access to the discount window. The Monetary Control Act extended reserve requirements to nonmember institutions and provided that any institution holding deposits subject to reserve requirements (transaction accounts and nonpersonal time deposits) would have the same access to the discount window as member institutions (12 U.S.C. 461(b)(7)).

discourages institutions from incurring overnight overdrafts by charging a penalty rate, equal to the federal funds rate plus four percentage points, on the amount of the overnight overdraft.

The Federal Reserve has long been concerned that an institution that does not have regular access to the discount window may nevertheless incur a daylight overdraft, which could, in turn, become an overnight overdraft. To address the risks arising from such overdrafts and to avoid the extension of overnight credit to institutions that lack regular access to the discount window, the PSR policy does not permit such institutions to adopt a positive net debit cap and strongly discourages them from incurring any daylight overdrafts. The Board's policy is consistent with Congress's intent in the Federal Reserve Act to allow depository institutions access to Federal Reserve overnight credit as a quid pro quo for being subject to reserve requirements and to impose additional conditions on the Federal Reserve's provision of overnight credit to other entities.<sup>4</sup>

## **B. Introduction of Daylight Overdraft Fees**

Since the PSR policy was first adopted in 1985, the Board has modified and expanded it several times. Notably, in 1992, the Board approved a policy to charge institutions a fee for their use of Federal Reserve daylight credit, beginning in April 1994 (57 FR 47084, October 14, 1992). The Board's goal in adopting this policy was to induce behavior that would reduce risk and increase efficiency in the payment system. At that time, the Board also modified how it posted different types of transactions to institutions' Federal Reserve accounts to reflect more closely the time that transactions were processed (57 FR 47093, October 14, 1992).<sup>5</sup> The Board's objectives in designing these posting rules included minimizing intraday float, facilitating depository institutions' monitoring and control of their account balances during the

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<sup>4</sup> Section 13(3) of the Federal Reserve Act empowers the Board, by the affirmative vote of not less than five members (or, in certain cases, all available members), to authorize any Federal Reserve Bank to lend to individuals, partnerships, and corporations under "unusual and exigent circumstances" (12 U.S.C. 343 and 248(r)). Section 13(13) allows any Federal Reserve Bank to lend to any individual, partnership, or corporation when secured by U.S. government securities, subject to such limitations, restrictions, and regulations as the Board may prescribe (12 U.S.C. 347c). The Board's Regulation A applies the "unusual and exigent circumstances" requirement to discount window loans to any entity without regular discount window access, regardless of the type of collateral pledged. Regulation A also requires the Federal Reserve Banks to consult with the Board before lending to those entities. Lending under these provisions has been extremely rare, and such loans have not been extended since the 1930s.

<sup>5</sup> Prior to the 1992 posting rule modification, Fedwire funds and securities transfers were posted to institutions' Federal Reserve accounts as they were processed during the business day (as they still are today). The net of all automated clearing house transactions was posted as if the transactions occurred at the opening of business, regardless of whether the net was a debit or credit balance. All other, or "non-wire," activity was netted for a business day, and if the net balance was a credit, the credit amount was added to the opening balance. If the net balance was a debit, the debit amount was deducted from the closing balance. Under this method, an institution could use all of its non-wire net credits to offset any Fedwire funds or securities debits during the day but postpone the need to cover non-wire net debits until the close of the day.

day, and reflecting the legal rights and obligations of parties to payments. The Board's objective of minimizing intraday float is especially important in light of the daylight overdraft fee, which gives intraday credit an explicit value.

After the Board approved its policy of charging fees for daylight overdrafts and its revised posting rules, it adopted a penalty fee (the regular daylight overdraft fee, currently 36 basis points, plus 100 basis points) for daylight overdrafts incurred by certain institutions that, by statute, do not have regular discount window access (59 FR 8977, February 24, 1994). Because of concerns that a daylight overdraft could become an overnight overdraft, the Board determined that such account holders should not be permitted the same access to intraday credit as depository institutions and should be prohibited from incurring daylight overdrafts. Recognizing, however, that these account holders may, nonetheless, incur daylight overdrafts, the Board believed a penalty fee should be applied to these account holders' daylight overdrafts to provide such account holders a strong incentive to avoid incurring any, including inadvertent, daylight overdrafts. The Board's policy explicitly addressed the account holders that would be subject to the penalty fee, which included Edge and agreement corporations, limited purpose trust companies, and bankers' banks that do not waive their exemption from reserve requirements. At the time, however, the Board did not explicitly address whether certain aspects of the policy would be applied to GSEs and international organizations for which the Reserve Banks act as fiscal agents.<sup>6,7</sup>

In 1994, the Board issued an interpretation of the PSR policy that stated GSEs should not incur daylight overdrafts in their accounts and would not be allowed to adopt positive net debit caps because they do not have regular access to the discount window (59 FR 25060, May 13, 1994). In its interpretation, the Board granted a temporary exemption from fees on daylight overdrafts resulting from the Reserve Banks' release of interest and redemption payments on Fedwire-eligible securities issued by GSEs prior to the issuers' full funding of such payments.<sup>8</sup> The Board granted this temporary exemption because it was uncertain of the effect

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<sup>6</sup> In their role as fiscal agents, the Reserve Banks maintain securities issued by GSEs and international organizations on the Fedwire Securities Service and make interest and redemption payments to depository institutions on each issuer's behalf, in addition to providing other payment services generally related to these fiscal agency services.

<sup>7</sup> These entities include the following GSEs: the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), entities of the Federal Home Loan Bank System (FHLBS), the Farm Credit System, the Federal Agricultural Mortgage Corporation (Farmer Mac), and the Student Loan Marketing Association (Sallie Mae). They also include the following international organizations: the International Bank for Reconstruction and Development (World Bank), the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank. The Student Loan Marketing Association Reorganization Act of 1996 requires Sallie Mae to be completely privatized by 2008; however, Sallie Mae plans to complete privatization by September 2006. Upon privatization, Sallie Mae will no longer be considered a GSE, and the Reserve Banks will no longer add new issuances of Sallie Mae securities to the Fedwire Securities Service.

<sup>8</sup> The term "interest and redemption payments" refers to payments of principal and interest on securities maintained on the Fedwire Securities Service.

that daylight overdraft fees would have on securities markets and did not want to introduce too much change at one time. The Board indicated that it would revisit the temporary exemption after market participants adjusted to the effects of daylight overdraft fees. In addition, the Board applied the regular daylight overdraft fee to the daylight overdrafts arising from the GSEs' general corporate funding activity, but did not apply the penalty fee that applies to other institutions that lack regular discount window access.<sup>9</sup> The Board stated it was not, however, ruling out the future application of the penalty fee.

In March 1995, the Board decided to raise the rate charged on daylight overdrafts to 36 basis points (60 FR 12559, March 7, 1995). At the time, the Board stated that it would evaluate further fee increases in a few years. When the Board began its evaluation of the effectiveness of the daylight overdraft fee in 2000, it recognized that significant changes had occurred in the banking, payments, and regulatory environment since the fee was introduced and, as a result, decided to broaden its review to include all aspects of the Federal Reserve's daylight credit policies. Based on its review, the Board determined that the PSR policy appears to be generally effective in controlling risk to the Federal Reserve and creating incentives for depository institutions to manage their intraday credit exposures (66 FR 64419, December 13, 2001).<sup>10</sup>

During its review, the Board also determined that market participants appear to have adjusted to daylight overdraft fees, which prompted an assessment of the temporary exemption granted to GSEs under the Board's 1994 interpretation of the PSR policy. In conducting this assessment, the Board evaluated the treatment of interest and redemption payments on Fedwire-eligible securities issued by GSEs and certain international organizations as well as the treatment of other payment services these entities use for their general corporate payment activity. As a result of this evaluation, the Board plans to implement two modifications to its PSR policy as described below.

## **II. Discussion of Planned Policy Changes**

### **A. Modification of Posting Rules for Interest and Redemption Payments**

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<sup>9</sup> To facilitate measurement of overdrafts arising from the different activity, the Board required the GSEs and Reserve Banks to establish separate GSE accounts for principal and interest activity (P&I account) and for general corporate payment activity (general account).

<sup>10</sup> Through its analysis, the Board identified growing liquidity pressures among certain payments system participants and, as a result, revised the policy to modify the net debit cap calculation for U.S. branches and agencies of foreign banks, to modify the time electronic check presentments are posted to depository institutions' Federal Reserve accounts for purposes of measuring daylight overdrafts, and to allow certain depository institutions to pledge collateral to the Federal Reserve in order to access additional daylight overdraft capacity above their net debit caps, subject to Reserve Bank approval. These changes to the policy were intended to benefit the few financially healthy institutions that had been constrained by their net debit caps by increasing their daylight overdraft capacity and to remove a potential impediment to the use of electronic check presentment.

In the course of the Board's assessment of its 1994 interpretation of the PSR policy, the Board found that the dollar volume of interest and redemption payments on Fedwire-eligible securities issued by GSEs and international organizations that are credited to the receiving depository institutions' Federal Reserve accounts prior to such payments being fully funded by the issuer has grown significantly over the past ten years. In large part this increase owes to the rapid growth in Fedwire-eligible securities issued by GSEs. In addition, for some issuers, the lag between the time the Reserve Banks credit depository institutions' accounts for the interest and redemption payments and the time the issuer covers the payments extends, at times, until shortly before the close of the Fedwire Funds Service.<sup>11</sup>

The Board's current daylight overdraft measurement rules specify that U.S. Treasury and government agency interest and redemption payments are posted, that is, debited from the issuers' accounts and credited to the receivers' accounts, by 9:15 a.m. Eastern Time (ET) and that original issues of securities are posted on a flow basis, as they are issued, but no earlier than 9:15 a.m. ET.<sup>12</sup> These posting rules were designed primarily to grant depository institutions the benefit of receiving interest and redemption payments on U.S. Treasury or government agency securities prior to debits being made to their accounts for the purchase of new issues.

For operational ease, the Reserve Banks have applied the same posting rules to interest and redemption payments on Fedwire-eligible securities issued by GSEs and international organizations. However, the practice of releasing such payments before they are fully funded by the issuer is neither necessary to achieve the Federal Reserve's statutory mission nor appropriate risk management policy for the central bank. Furthermore, this practice is inconsistent with that of private issuing and paying agents for their customers' securities. In general, these issuing and paying agents do not allow payments to be made for a securities issuer before the issuer has fully funded its payments. The Board, therefore, intends to revise its policy to specify that the Reserve Banks will release interest and redemption payments on Fedwire-eligible securities issued by a GSE or an international organization only when the issuer's Federal Reserve account contains funds equal to or in excess of the amount of the issuer's interest and redemption payments to be made.

Under the revised policy, a cut-off hour by which the issuers must fund their respective interest and redemption payments would be established on the Fedwire Securities Service in order to avoid disruptions to end-of-day processing for this and related systems. The

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<sup>11</sup> Fedwire Funds messages other than settlement payment orders may be sent until 6:00 p.m. ET (settlement payment orders may be sent until 6:30 p.m. ET). Under the Reserve Banks' Operating Circular 6, a settlement payment order is a payment order in which the originator and the beneficiary are each either (i) a bank subject to reserve requirements (whether or not it actually maintains reserves), or (ii) a participant in a net settlement arrangement approved by a Reserve Bank as an eligible originator or beneficiary of a settlement payment order sent during the settlement period.

<sup>12</sup> While transactions for various payment types are processed throughout the business day, daylight overdrafts in an entity's Federal Reserve account are calculated on an ex post basis according to the daylight overdraft posting rules.

latest this cut-off hour could be is 4:00 p.m. ET in order to allow the Reserve Banks to close other elements of the Fedwire Securities and Funds Services on time.<sup>13,14</sup> In the event that an issuer did not fund its interest and redemption payments by the established cut-off hour, its payments would not be processed on that day. Requests by an issuer for extensions of the 4:00 p.m. ET funding deadline would not be granted.

The planned posting rule modification is intended to address the intraday credit that results from the current manner in which the Reserve Banks process and post interest and redemption payments on securities issued by GSEs and international organizations to the receiving depository institutions' Federal Reserve accounts prior to such payments being fully funded by the issuer. The Board recognizes that the removal of Federal Reserve intraday credit that is currently extended between the time the Reserve Banks disburse interest and redemption payments and the time the Reserve Banks receive funding for such payments may require alternate sources of private funding. This is similar to the hour-by-hour funding that depository institutions arrange in the ordinary course of business for other types of transactions. When depository institutions have difficulty with intraday funding sources, they may be required to obtain alternative financing in the money and capital markets to facilitate their intraday operations. The Board is confident that payment practices and markets will adjust to the planned policy changes, and, in an effort to promote a smooth market adjustment and minimize market participants' adjustment costs, the Board requests comment on whether to implement the policy change through full implementation on a specified date or through a phased approach.

If implementing the planned policy change without a phase-in period would better promote a smooth market adjustment, the Reserve Banks would, beginning in July 2006, release interest and redemption payments on Fedwire-eligible securities issued by a GSE or an international organization only when the issuer's Federal Reserve account contains funds equal to or in excess of the amount of the issuer's interest and redemption payments to be made. Alternatively, if market participants believe that a phased approach would better facilitate implementation of the planned change, the Board requests comment on the specific structure and objectives of any suggested phased approach and the rationale for why such an approach is

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<sup>13</sup> Participants on the Fedwire Securities Service can reposition securities held in their own accounts against payment until 4:30 p.m. ET (repositioning securities without payment is permitted until 7:00 p.m. ET). Because interest and redemption payments on Fedwire-eligible securities are processed through the Fedwire Securities Service as funds-only transactions, they cannot be processed after 4:30 p.m. ET. A cut-off hour of 4:00 p.m. ET for issuers to fund these interest and redemption payments would provide the Reserve Banks a 30-minute window in which to complete the requisite processing for funds-related transactions in order to close the Fedwire Securities Service on time.

<sup>14</sup> The 4:00 p.m. ET cut-off hour would apply specifically to the interest and redemption on Fedwire-eligible securities issued by GSEs and international organizations and would be independent of any other established operating hours of the Fedwire Securities Service as published in the Reserve Banks' Operating Circular 7.

considered preferable to one of full implementation in terms of promoting a smooth market adjustment.<sup>15</sup>

## **B. Uniform Policy Treatment of Account Holders that Lack Regular Access to the Discount Window**

As part of the Board's assessment of its 1994 interpretation of the PSR policy, the Board also evaluated the treatment of other payment services used by GSEs and international organizations for their general corporate payment activity, that is, payment activity unrelated to interest and redemption payments. While most of these entities only infrequently incur daylight overdrafts as a result of their general corporate payment activity, a few of these entities incur such daylight overdrafts on an almost daily basis.

The Board has determined that GSEs and international organizations for which the Reserve Banks act as fiscal agents should not be permitted the same access to intraday credit as depository institutions because, by statute, they do not have regular access to the discount window. Therefore, to provide uniform treatment of account holders that do not have regular access to the discount window, the Board intends to apply the penalty fee to daylight overdrafts that result from GSEs' and international organizations' general corporate payment activity. The Board plans to implement the penalty fee concurrent with the posting rule change for interest and redemption payments, either upon full implementation of that policy change or at the start of a phased implementation. This planned policy change would supersede the Board's 1994 temporary exemption pertaining to government-sponsored enterprises. As a result, the Board would rescind its 1994 interpretation upon implementation of the planned policy change.

## **III. Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. ch. 3506; 5 CFR 1320 Appendix A.1), the Board has reviewed the policy statement under the authority delegated to the Board by the Office of Management and Budget. No collections of information pursuant to the Paperwork Reduction Act are contained in the policy statement.

## **IV. Federal Reserve Policy Statement on Payments System Risk**

The Board plans to amend the "Federal Reserve Policy Statement on Payments System Risk." Section I.A., under the heading "Daylight overdraft definition and measurement" would be amended as follows with changes identified in *italics*:

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<sup>15</sup> Under any phased approach, each issuer would be required to fund the amount of its interest and redemption payments to be made on a given day by the close of business, as is the case today. Regardless of the approach the Board ultimately adopts, at full implementation, each issuer would be required to fund the amount of its interest and redemption payments to be made on a given day by the established cut-off hour before the Reserve Bank would release the issuer's interest and redemption payments.

## Procedures for Measuring Daylight Overdrafts<sup>2</sup>

### Opening Balance (Previous Day's Closing Balance)

Post Throughout Business Day:

+/-Fedwire funds transfers

+/-Fedwire book-entry securities transfers

+ Fedwire book-entry interest and redemption payments on securities that are not obligations of, or guaranteed by, the United States<sup>3,4</sup>

+/-Net settlement entries.

Post by 9:15 a.m. Eastern Time:

+ U.S. Treasury and government agency book-entry interest and redemption payments<sup>5</sup>

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<sup>2</sup> This schedule of posting rules does not affect the overdraft restrictions and overdraft-measurement provisions for nonbank banks established by the Competitive Equality Banking Act of 1987 and the Board's Regulation Y (12 CFR 225.52).

<sup>3</sup> The Reserve Banks act as fiscal agents for certain entities, such as government-sponsored enterprises (GSEs) and international organizations, whose securities are Fedwire-eligible but are not obligations of, or guaranteed by, the United States. These entities include the following GSEs: the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), entities of the Federal Home Loan Bank System (FHLBS), the Farm Credit System, the Federal Agricultural Mortgage Corporation (Farmer Mac), and the Student Loan Marketing Association (Sallie Mae). These entities also include the following international organizations: the International Bank for Reconstruction and Development (World Bank), the Inter-American Development Bank, the Asian Development Bank, and the African Development Bank. The Student Loan Marketing Association Reorganization Act of 1996 requires Sallie Mae to be completely privatized by 2008; however, Sallie Mae plans to complete privatization by September 2006. Upon privatization, Sallie Mae will no longer be considered a GSE, and the Reserve Banks will no longer add new issuances of Sallie Mae securities to the Fedwire Securities Service.

<sup>4</sup> The Reserve Banks will post these transactions, as directed by the issuer, provided that the issuer's Federal Reserve account contains funds equal to or in excess of the amount of the interest and redemption payments to be made. If a Reserve Bank does not receive funding from an issuer for the issuer's interest and redemption payments by the established cut-off hour of 4:00 p.m. ET, the issuer's payments will not be processed on that day.

<sup>5</sup> For purposes of this policy, government agencies are those entities (other than the U.S. Treasury) for which the Reserve Banks act as fiscal agents and whose securities are obligations of, or guaranteed by, the United States.

Post Beginning at 9:15 a.m. Eastern Time:

- Original issues of Treasury securities.<sup>6</sup>

Section I.E. under the heading “Special situations,” would be amended as follows with changes identified in *italics*:

#### E. Special Situations

*Under the Board’s policy, certain account holders warrant special treatment primarily because of their charter types. As mentioned previously, an institution must have regular access to the discount window and be in sound financial condition in order to adopt a net debit cap greater than zero. Account holders that do not have regular access to the discount window include Edge and agreement corporations, bankers’ banks that are not subject to reserve requirements, limited-purpose trust companies, government-sponsored enterprises (GSEs), and international organizations. Depository institutions that have been assigned a zero cap by their Reserve Banks are also subject to special considerations under this policy based on the risks they pose.* In developing its policy for these *account holders*, the Board has sought to balance the goal of reducing and managing risk in the payments system, including risk to the Federal Reserve, with that of minimizing the adverse effects on the payments operations of these *account holders*.

Regular access to the Federal Reserve discount window generally is available to institutions that are subject to reserve requirements. If an *account holder* that is not subject to reserve requirements and thus does not have regular discount-window access were to incur a daylight overdraft, the Federal Reserve might end up extending overnight credit to that *account holder* if the daylight overdraft were not covered by the end of the business day. Such a credit extension would be contrary to the quid pro quo of reserves for regular discount-window access as reflected in the Federal Reserve Act and in Board regulations. Thus, *account holders* that do not have regular access to the discount window should not incur daylight overdrafts in their Federal Reserve accounts.

Certain *account holders* are subject to a daylight-overdraft penalty fee levied against the average daily daylight overdraft incurred by the *account holder*. These include Edge and agreement corporations, bankers’ banks that are not subject to reserve requirements, limited-purpose trust companies, *GSEs, and international organizations*. The annual rate used to determine the daylight-overdraft penalty fee is equal to the annual rate applicable to the daylight overdrafts of other depository institutions (36 basis points) plus 100 basis points multiplied by the fraction of a 24-hour day during which Fedwire is scheduled to operate (*currently* 18/24). The daily daylight overdraft penalty rate is calculated by dividing the annual penalty rate by 360.

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<sup>6</sup> Original issues of government agency, *GSE, or international organization* securities are delivered as book-entry securities transfers and will be posted when the securities are delivered to the purchasing institutions.

The daylight-overdraft penalty rate applies to the account holder's average daily daylight overdraft in its Federal Reserve account. The daylight-overdraft penalty rate is charged in lieu of, not in addition to, the rate used to calculate daylight overdraft fees for depository institutions described in section I.B. While daylight overdraft fees are calculated differently for these account holders than for depository institutions, overnight overdrafts at Edge and agreement corporations, bankers' banks that are not subject to reserve requirements, limited-purpose trust companies, GSEs, and international organizations are priced the same as overnight overdrafts at depository institutions that have regular access to the discount window.

A new heading "Government-sponsored enterprises and international organizations" and text would be added to read as follows in Section I.E.4.:

4. Government-sponsored enterprises and international organizations

The Reserve Banks act as fiscal agents for certain GSEs and international organizations in accordance with federal statutes. These entities generally have Federal Reserve accounts and issue securities over the Fedwire Securities Service. The securities of these account holders are not obligations of, or guaranteed by, the United States. Furthermore, these account holders are not subject to reserve requirements, do not have regular discount-window access, and should refrain from incurring daylight overdrafts and post collateral to cover any daylight overdrafts they do incur. GSEs and international organizations are subject to the same daylight-overdraft penalty rate as other entities that do not maintain reserves and do not have regular discount-window access.

Section I.E.4., under the heading "Problem institutions," would be renumbered as "I.E.5."

By order of the Board of Governors of the Federal Reserve System, February 4, 2004.

Jennifer J. Johnson (Signed)

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Jennifer J. Johnson,

Secretary of the Board.