

FEDERAL RESERVE BANK  
OF CHICAGO

MICHAEL H. MOSKOW  
President and Chief Executive Officer

August 1, 2001

Ms. 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

By e-mail to: [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Re: **Policy Statement on Payments System Risk (Docket No. R-1107)**

Dear Ms. Johnson:

The Board of Governors of the Federal Reserve System recently adopted an interim policy statement permitting depository institutions with self-assessed net debit caps to incur daylight overdrafts in excess of their net debit cap levels by pledging collateral to the Federal Reserve. The Board has requested comment upon all aspects of the interim policy statement. On behalf of the Federal Reserve Bank of Chicago (the “Bank”), I am pleased to have this opportunity to comment on the following specific questions raised by the Board:

- What are the benefits and drawbacks of allowing depository institutions with self-assessed net debit caps to pledge collateral for additional daylight overdraft capacity?
- Would the interim policy cause institutions to pledge additional collateral to the Federal Reserve or would they primarily use collateral already pledged to a Reserve Bank?

Consistent with longstanding Federal Reserve policy, the release accompanying adoption of the interim policy statement indicates that “. . . some intraday credit may be necessary to keep the payments system running smoothly and efficiently.” Similar concerns were expressed in the report of the Payments Risk Committee, entitled *Intraday Liquidity Management in the Evolving Payment System: A Study of the Impact of the Euro, CLS Bank and CHIPS Finality* (April 2000)(the “Liquidity Management Report”), to which the Board’s release refers.

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It is in the context of the reported needs of certain depository institutions for additional daylight overdraft capacity that the Bank has evaluated the Board's interim policy statement. Therefore, for purposes of this comment, the Bank has not undertaken to reexamine the longstanding policy of the Federal Reserve System that daylight overdraft facilities are necessary and desirable to maintain the smooth and efficient operation of the payment system. The Bank's comments should be understood, therefore, as addressing only questions relating to the implementation of the interim policy statement.

### **Benefits and Drawbacks of Interim Policy Statement**

The Bank believes that the principal benefit of the interim policy statement will be to make expanded daylight overdraft capacity available for institutions that process critical payments, including the U.S. dollar leg of international payments, and payments associated with new payments developments. Furthermore, the Bank believes that it is reasonable to make additional intraday credit available only to institutions that pledge collateral in support of credit capacity exceeding the amount of their net debit caps. As further discussed below, however (see next section), the Bank anticipates that few institutions in the Seventh District will take advantage of expanded overdraft capacity under the interim policy statement.

The Bank believes that the principal drawback of the interim policy statement is that it may be interpreted to suggest that Federal Reserve banks can be insulated from excessive risk exposure by requiring depository institutions to collateralize intraday credit capacity exceeding the amount of their net debit caps. The Bank believes that collateralization is only one part of an effective risk management program and cannot, by itself, assure that excessive risk will not be incurred.

### **Likely Effect of Interim Policy Statement Upon Levels of Collateral**

As of the date of this comment, no depository institution in the Seventh District has requested daylight overdraft capacity above its net debit cap level pursuant to the interim policy statement for institutions with self-assessed net debit caps. Nevertheless, the Bank anticipates that a small number of institutions, possibly including a handful of institutions operating in the Seventh District, may in the future take advantage of the expanded daylight overdraft capacity available pursuant to the interim policy statement. Overall, however, the Bank's experience is broadly consistent with the Board's observation that ". . . approximately 97 percent of all account holders [institutions with self-assessed net debit caps] use less than 50 percent of their net debit caps for their average peak overdrafts."

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I hope that the Board will find our comments useful. If you have any questions, I invite you to contact Richard Lamm at (312) 322-6807 or Robert Steigerwald at (312) 322-2414.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael H. Moskow". The signature is fluid and cursive, with the first name "Michael" and last name "Moskow" clearly distinguishable.

Michael H. Moskow