very limited incentives for additional reductions in daylight overdrafts and credit risk. Furthermore, the Board was concerned that the momentum in the financial markets for the serious review and improvement of payment and settlement conventions might be lost if the fee were not increased.

Increase the Fee to 15 Basis Points for at Least Two Years

The Board's decision to increase the fee to 15 rather than 20 basis points was based on three primary considerations. First, as noted above, the response by depository institutions and securities dealers to the 10-basis-point fee has improved RP settlement practices and has reduced significantly the use of Federal Reserve securities-related daylight credit, which before implementation of daylight overdraft fees constituted a large and growing portion of total daylight credit. The strong response in securities markets eases the need for sizeable increases in daylight overdraft fees over the next two years. Instead, a more limited increase to 15 basis points would provide incentives for additional improvements in securities settlements, while limiting increases in daylight overdraft charges borne by securities market participants. The improvements in settlement practices might include the use of timespecific deliveries of RP securities and the greater use of netting contracts between counterparties, where appropriate. Allowing two years before considering additional fee increases will permit sufficient time for the study of other potential changes in market conventions that could help reduce securities-related daylight overdrafts.

Second, the Board believes that an increase in the daylight overdraft fee to 15 basis points will provide additional incentives for participants in funds markets to evaluate and modify payment practices that create daylight overdrafts. As discussed earlier, the responses in funds markets that the Board anticipated when it originally adopted the fee policy have not occurred to a significant degree. The uncertainty about the strength of the market response to daylight overdraft fees at various fee levels was one of the reasons that the Board announced that fees would be phased-in beginning at 10 basis points. The lack of significant response in the funds markets suggests that there is still room for improvements in funding and settlement practices and reductions in daylight overdrafts.

Improvements in funding practices might include the greater use of "rollovers," "continuing contracts," or "term contracts" for federal funds transactions, where appropriate. Further, the Payments Risk Committee, a committee of representatives from a selection of large U.S. depository institutions, has suggested that a higher fee may prompt the market to study changes in federal funds and other settlement timing conventions that contribute to a large portion of the aggregate level of daylight overdrafts. Also, a higher fee may prompt institutions to take measures to reduce daylight overdrafts related to customer payment activity.

Third, the Board believes that concerns about systemic risk argue for a more gradual approach to raising daylight overdraft fees. It is important to note that the Board has taken a number of steps to limit systemic risks in the payments system, including adopting policies that apply to private-sector payment networks.³ Most recently, the Board adopted a revised policy statement on risks in large-dollar multilateral netting systems (59 FR 67534, December 29, 1994). This policy statement applied the Lamfalussy minimum standards for netting arrangements to domestic as well as offshore multilateral netting systems that clear U.S. dollar payments. At the same time, the Board announced that the staff would continue to study systemic risks in small-dollar payment systems, such as check and ACH clearing systems, as well as the need for any public policy changes in this area.

Thus, at this time, a limited increase in the daylight overdraft fee, particularly an increase to 15 basis points instead of 20 basis points, is likely to create very little incremental systemic risk in private-sector payment systems. In case greater concerns develop regarding systemic risks, the Board retains the option of reducing daylight overdraft fees and taking other appropriate measures to help limit such risks.

The Board believes that the daylight overdraft fee program has been an important part of efforts by both the Board and the private sector over a number of years to reduce risk in the payments system. The fundamental theory of charging fees has been that cost-effective behavioral changes to reduce risks would be taken by depository institutions and their customers if modest fees were charged for daylight credit. Some changes in payment practices have already taken place, and additional changes appear to be possible. Thus, the Board believes a modest increase in the daylight overdraft fee at this time will continue to encourage private-sector efforts to reduce risks and to improve efficiency in the nation's payment and settlement systems.

V. Competitive Impact Analysis

The Board has established procedures for assessing the competitive impact of rule or policy changes that have a substantial impact on payments system participants.4 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 efficiently 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.

As noted in the Board's 1992 announcement of the daylight overdraft fee policy, the Board does not believe that imposition of daylight overdraft fees adversely affects the ability of private-sector payments system participants to compete with the **Reserve Banks in providing payments** services. Private-sector correspondent banks have the ability to charge for intraday credit extended to their customers, either explicitly (as do the Reserve Banks) or implicitly as part of overall service fees. The Board stated in 1992 that private-sector payment systems might benefit from daylight overdraft fees, if the fee caused institutions to shift payments from the Federal Reserve to private systems in order to avoid daylight overdraft fees. Although the shift to private systems might not be as large under a 15-basispoint fee as under a 20-basis-point fee, the Board believes that the lower fee might still produce payment shifts, as discussed in the supplementary information above, as well as a reduced cost burden for private-sector payments system participants.

VI. Administrative Procedure Act

The notice and comment requirements of the Administrative

³These policies include those for private largedollar multilateral netting systems and private delivery-against-payment securities systems (54 FR 26092, 26104, June 21, 1989). In addition, in 1991, the New York Clearing House adopted changes to the CHIPS rules designed to enhance the assurances of settlement through the use of loss sharing and collateral requirements.

⁴These 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).