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Statement of the Shadow Financial Regulatory Committee

on

Federal Reserve Proposal for Pricing Daylight Overdrafts

May 22, 1995

On March 2, 1995, the Federal Reserve Board announced that it was cutting in half a long-scheduled increase in the fee Reserve Banks charge for granting intraday (i.e., "daylight") credit to banks that clear transactions through the Fed's payment network. On an annualized basis, the Fed calculates the value of its revised fee at a mere 36 basis points. This tiny charge lies well below the current 600 basis-point interest rate on federal funds that banks lend each other overnight.

As does any private bank in clearing its own trades and in paying and receiving funds on behalf of its customers, the Fed opens temporary credit positions with other parties. Until a bank's clearings positions with customers and other institutions are settled, these positions impose a time cost of money and a risk of noncollection.

In producing clearing and settlement services, the Fed's transactions and communications networks compete directly with private suppliers. The Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA) requires the Fed to set explicit cost-based fees for eight classes of service, including daylight overdraft, that the Fed had previously performed for member banks without charge.

In contravention of DIDMCA, the Fed's overdraft fee prices only a small fraction of the opportunity costs of intraday clearings overdrafts. The Fed's March 2, 1995 policy statement expresses the belief that concerns about systemic risk argue for a "gradual approach to raising daylight overdraft fees[1]." The Shadow Financial Regulatory Committee notes that increasing the fee by 12 basis points every 30 months would take 120 years for the Fed overdraft fee to reach the current 600 basis-point interest rate of federal funds.

To justify what amounts to a permanent pricing subsidy, Federal Reserve officials resort to scare tactics. Without quantifying the costs, benefits, or probabilities that characterize taxpayers' stake in the fee charged, Fed spokespersons claim that the odds of a payment-system gridlock or meltdown would increase dangerously if the Fed were to set a competitive price that might divert a major portion of its still-subsidized clearing business to private networks such as CHIPS.

Principles of good government demand that the Fed face strict accountability for any decision that an outsider may reasonably construe as promoting its bureaucratic interests at taxpayer and competitor expense. The Shadow Financial Regulatory Committee urges Congress to require the Fed, except in extraordinary circumstances, to charge an intraday overdraft fee that is equivalent each day at least to the average federal funds rate. Every departure from this policy should be carefully documented and subjected to detailed Congressional review.

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[1] Docket No R – 0806, P.16