

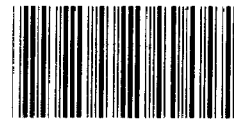
GAO

Briefing Report to the Chairman,
Subcommittee on Domestic Monetary
Policy, Committee on Banking, Finance
and Urban Affairs, House of
Representatives

October 1986

U.S. GOVERNMENT SECURITIES

Questions About the Federal Reserve's Securities Transfer System



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United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-221597

October 20, 1986

The Honorable Walter E. Fauntroy
Chairman, Subcommittee on Domestic
Monetary Policy
Committee on Banking, Finance and
Urban Affairs
House of Representatives

Dear Mr. Chairman:

At your request, we undertook an assignment regarding the Federal Reserve System's oversight of the U.S. government securities market. During work on your original request, several issues emerged concerning the way the Federal Reserve operates its book-entry securities transfer system.¹ From discussions with Federal Reserve System representatives and government securities dealers in different Federal Reserve Bank regions, we learned that the Federal Reserve's efforts to promote efficiency and to respond to the needs of agencies it serves as fiscal agent may have created advantages for securities dealers in some districts, causing disadvantages for dealers in others. Our subsequent work raised questions about the Federal Reserve System's policies, and we posed these questions to Federal Reserve System officials in July 1985 (see app. III).

The Federal Reserve responded in September 1985 that the differences we cited regarding operating capabilities and administrative practices raised some important concerns (see app. IV). Between February and May 1986 we contacted the Federal Reserve and three government securities dealers

¹Book entry is one form in which Treasury and certain government agency securities are held. Book-entry form consists of an entry on the records of the U.S. Treasury Department or a Federal Reserve Bank. The Federal Reserve maintains and operates the systems for electronically transferring government securities and funds to pay for securities.

to determine what subsequent actions the Federal Reserve has taken. As you requested, we are providing you with this briefing report showing the results of our work undertaken at your request. This letter summarizes our original concerns and the Federal Reserve's actions to date. We are issuing this report to you because your committee has expressed interest in the issues associated with assuring efficient national markets for government securities.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objective of our work was to assess the validity of comments we received from representatives of primary dealers² that variations between Federal Reserve districts' operation of the securities transfer network created disadvantages for dealers in certain districts. To fulfill this objective, we interviewed representatives from four Federal Reserve banks, three New York clearing banks, and 10 geographically dispersed primary dealers. We also reviewed Federal Reserve policies, procedures, and statistics regarding securities transfer system operations. Our work was performed in accordance with generally accepted government auditing standards.

GAO CONCERNS

In our earlier letter to the Chairman of the Board of Governors of the Federal Reserve System, we said that we were concerned about

- possible unfair advantages created by the Federal Reserve Bank of New York's (FRBNY) more advanced computer system;
- limited access to the book-entry system for certain types of securities by institutions not clearing through New York;
- frequency of improper reversals (i.e. improperly sending securities over the securities transfer network) coming from New York dealers;

²The Federal Reserve Bank of New York has designated a select group of government securities dealers as primary dealers based on their volume and reputation in the market. These dealers are the core group of market makers for government debt and are expected to actively participate in auctions of new government debt.

- apparent inequities in notification of securities transfer network extensions;
- possible disadvantages to West Coast dealers, who have less time to process security transfers; and
- possible inequities in districts' abilities to turn around securities after the normal transfer deadline.

ACTIONS TAKEN BY THE FEDERAL RESERVE SYSTEM
SINCE ITS RESPONSE TO GAO'S CONCERNS

In follow-up discussions, Federal Reserve officials told us that, since responding to our letter in September 1985, the Federal Reserve is better coordinating computer system enhancements among its districts, expanding access to the clearing system for certain securities, and more strictly enforcing its requirements for extending the securities transfer deadline. The following sections discuss the actions the Federal Reserve has taken to date.

Better coordination of computer enhancements

The Federal Reserve has separate securities transfer systems: the New York district's, the Philadelphia district's, the SHARE system,³ and the Chicago version of the SHARE system. We were concerned that the Federal Reserve Bank of New York's higher-capacity computer system might be giving competitive advantages to dealers clearing through that district. Also, certain districts, such as Chicago, had modified the SHARE system as a result of local demand so that their systems had features that were unavailable elsewhere.

There are still differences in Federal Reserve district computer systems for security transfers. However, according to Federal Reserve officials, as a result of our inquiry the Federal Reserve has given increased attention to depository institutions' needs for security transfer services. Also, a Federal Reserve system representative now reviews and coordinates all district changes to the SHARE system.

³SHARE is an acronym for "Security Handling Automation Resource Sharing Endeavor" which is a book-entry account maintenance and securities transfer system used by all districts except New York and Philadelphia.

Expanded access for certain securities

When we wrote the Federal Reserve in July 1985, only depository institutions within the New York district had the ability to transfer Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal National Mortgage Association (Fannie Mae) mortgage-backed securities, and they could transfer them only to other institutions within the New York district. In addition, the Federal Reserve initially restricted to the New York district the ability to transfer agency-discount notes and had expanded access to three other districts under an interim solution. Depository institutions in these three districts could transfer these securities to other depository institutions in their own territory and to depository institutions in New York. They could not transfer to depository institutions in the other districts.

Depository institutions in districts that could not access the book-entry system for mortgage-backed securities and discount notes could still trade them, but they had to accept delivery at a correspondent bank⁴ in the New York district--at significantly higher costs. Instead of paying the \$3 Federal Reserve transfer fee,⁵ institutions outside New York had to pay a correspondent bank from \$20 to \$60 per deposit or withdrawal.

We called attention to this issue in our July 1985 letter. The Federal Reserve said it had had to initially restrict access to the securities in order to satisfy its fiscal principals' need to convert them into book entry as quickly as possible and to manage the risk of implementation of a new product. Federal Reserve officials stated that, as a result of our work, the issue received higher priority, and the timetable for expanding access was accelerated. In February 1986, three districts implemented an interim system, which allowed their depository institutions to transfer mortgage-backed security and discount notes within their territories and with depository institutions in the

⁴A correspondent bank accepts deposits of and performs banking services for other depository institutions.

⁵The Federal Reserve transfer fee for book-entry non-Treasury securities is \$3 in all districts except New York. New York uses a sliding fee schedule based upon the time of day a transaction is originated.

New York district.⁶ In April 1986 access was extended to two more districts. The Federal Reserve implemented full nationwide transfers of mortgage-backed Freddie Macs and Fannie Maes and agency-discount notes on June 2, 1986.

Data on the impact of nationwide transfer is not yet available. However, depository institutions in districts operating under the interim solution have been quick to utilize access to transferring these securities. On May 20, 1986, the five districts operating under the interim solution were holding \$32 billion of the \$200 billion in book-entry accounts of these securities at Federal Reserve banks. Representatives of several depository institutions in Chicago told us that they will save substantial custodial fees and that they planned to transfer all book-entry securities of this type out of their New York correspondent banks and into their accounts at the Chicago Federal Reserve Bank.

More prompt closing of the securities transfer network

The deadline for depository institutions to originate on-line securities transfer transactions is 2:30 p.m. Eastern time. However, because of volume or technical problems, this deadline is usually extended each day. In our letter we said that New York dealers are notified of extensions in the securities transfer deadline more quickly than dealers outside New York. More timely notification allows dealers to plan more effective settlement strategies.

During our initial review in 1985, the Federal Reserve was considering modifying the SHARE system to reduce delays in notification of extensions. We stated, and the Federal Reserve agreed, that if the SHARE system was modified delays in notifying financial institutions outside the New York district would be reduced but not eliminated. As of April 1986 this modification had not been implemented. However, other positive developments have occurred.

In January 1986 the Federal Reserve began stricter enforcement of its requirements for granting extensions

⁶The Chicago, Boston, and Philadelphia districts implemented the interim solution in February 1986. In April 1986, access was extended to Kansas City and San Francisco as they began interdistrict trading of mortgage-backed securities and discount notes using the interim solution.

requested by depository institutions. Prior to this, the Federal Reserve Bank of New York, which is responsible for coordinating with other Federal Reserve bank regions and announcing when extensions will be granted, would poll major clearing banks to determine their volume of uncleared securities. If at least two banks had a high uncleared volume the FRBNY would grant an extension based on "market backlog." No specific clearing bank would be held accountable for the extension. In 1985, 19 percent of the network extensions were of this type. The Federal Reserve now grants this kind of extension only on predictably high volume days such as quarterly refinancings or mortgage-backed securities settlement days. Instead of the Federal Reserve Bank of New York canvassing the clearing banks, a specific depository institution or a Federal Reserve bank must request the extension. If the extension is granted, the extension broadcast identifies the requester as the cause.

The system is also closing more promptly. According to Federal Reserve Bank of New York officials, in the first 6 months of 1986 the book-entry security transfer system closed, on the average, about 45 minutes earlier than it had during 1985, despite a growth in transfer volume. The Federal Reserve believes these improvements reflect a positive trend.

Additionally, the Federal Reserve Bank of Chicago and its depository institutions have recently taken steps to improve communication when extensions are necessary. Six depository institutions have installed direct phone lines to the Federal Reserve Bank of Chicago. The Chicago Federal Reserve staff calls these institutions directly when the securities transfer deadline is extended in addition to sending its depository institutions a printed message over the SHARE system.

OTHER ISSUES

As a result of our initial letter of inquiry and in addition to taking the specific actions noted above, the Federal Reserve is in the process of studying two issues that we addressed in our earlier work, and has decided not to take action on a third issue. The status of these issues is described below.

- Improper reversals - In our letter we indicated that the New York district seemed to generate most of the system's improper reversals. In an improper reversal, a dealer completes an original transaction during a period of time after the deadline for original transactions

which is set aside for correcting erroneous transactions--a practice which can unfairly shift overnight financing costs from the seller to the buyer because the buyer is not able to resell the security to the intended customer. In responding to our report, the Federal Reserve stated that the Federal Reserve Bank of New York imposes a penalty on its depository institutions for such transfers and the Federal Reserve is now considering applying this penalty systemwide.

- Dealer turnaround time - In our letter we also asked why some dealers in some districts apparently had extra time at the end of the day in which to deliver securities to their ultimate customers. The Federal Reserve's Subcommittee on Securities and Fiscal Services was studying the use of the dealer turnaround period. The Federal Reserve Bank of New York had discussed various options with its depository institutions and the Public Securities Association; the Boston and Chicago Reserve banks had also discussed this issue with their depository institutions. Based on these discussions, the system is considering implementing dealer turnaround nationwide. The Federal Reserve noted that if this is done, however, the market will be expected to self-regulate its usage, as is currently the case.

- Simultaneous system opening - We noted in our initial letter that, because of national time differences, West Coast dealers have 2-1/2 fewer hours to process transactions than East Coast dealers. We asked whether the Federal Reserve had considered opening the system simultaneously nationwide. The Federal Reserve responded that it is not considering the issue of a standard opening time. According to Federal Reserve officials the San Francisco and Chicago Reserve banks will open the transfer system earlier when requested to do so or on an expected heavy-volume day; however, the Federal Reserve had not received any indication from depository institutions that a standard opening time is a desirable or needed feature.

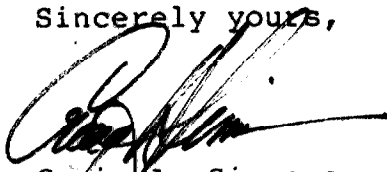
In addition to the issues discussed above, we asked the Federal Reserve to respond to some broader questions regarding greater centralization of the book-entry securities transfer system. The Federal Reserve responded that concerns regarding centralization will begin to be explored by the Federal Reserve System during 1986.

AGENCY COMMENTS

We provided copies of this briefing report to the Federal Reserve System and the Department of the Treasury for comment and received comments from them which have been included in this report (see apps. I and II). The Federal Reserve said the report fairly represents their responses to the issues we raised in July 1985 and subsequent actions. Their response provides further clarification of the Federal Reserve Board's position on selected issues and, in certain instances, indicates progress of ongoing efforts since their September 1985 response. For example, the Federal Reserve noted in its letter that it has designated a Federal Reserve System representative to review and coordinate district-level changes to automated securities transfer systems. By this means, it is attempting to insure that local modifications do not unknowingly create unfair competitive advantages for depository institutions clearing through a particular Federal Reserve Bank. The Department of the Treasury noted in its response that it acknowledges the excellent efforts of the Federal Reserve in the development and operation of the book-entry system. The Treasury noted that it supports improvements to standardize the level and availability of book-entry services system-wide. Treasury officials also noted in their response that the broader issue of centralizing book-entry operations is an issue of great interest to them and that they expect to participate with the Federal Reserve in the evaluation of this concept.

As arranged with your office, copies of this report are being sent to the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury. We will also make copies available to other interested parties upon request. If you need additional information about this report, you may call me on 275-8678.

Sincerely yours,



Craig A. Simmons
Senior Associate Director

C O N T E N T S

APPENDIX

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

July 25, 1986

Mr. Craig A. Simmons
Associate Director
United States General
Accounting Office
Washington, D.C. 20548

Dear Mr. Simmons:

We have reviewed the final draft of your report entitled "Government Securities: Questions About the Federal Reserve's Securities Transfer System." Your original letter last year on these issues raised some important questions, several of which were already under consideration by the Federal Reserve System. Overall, this last report fairly represents the Federal Reserve's responses and subsequent actions. The following comments are provided as further clarification of the Federal Reserve Board's position on selected issues and, in certain instances, to indicate the progress of ongoing efforts since our mid-1985 response.

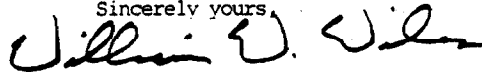
- It is the policy of the Federal Reserve System to provide services to depository institutions in an equitable manner. In keeping with that policy and as your report recognizes, we have designated a Federal Reserve System representative to review and coordinate district-level changes to our automated securities transfer systems. We are thus attempting to insure that local modifications do not unknowingly create unfair competitive advantages for depository institutions clearing through a particular Federal Reserve Bank. However, some differences in automated systems, occurring in response to strictly local demand, will remain.
- Your report included a concern that the higher computer capacity at the Federal Reserve Bank of New York might provide advantages to depository institutions clearing through that Federal Reserve Bank. The New York system was necessary to support the high degree of automation in the New York clearing banks that enables them to process and send large numbers of transfers.
- Regarding the introduction of book-entry discount notes and mortgage-backed securities, as of June 30, 1986, 20 percent (approximately \$51 billion) of the total outstanding of such securities in book-entry form was held outside the New York District.
- Most improper reversals (that is, new securities transfers sent during the period designated for reversals) do originate in the New York District where 75 percent of all book-entry securities transfer volume also originates. These reversals are not considered to be a major problem (during one representative three month period, from a volume of

1.3 million transfers, 232 improper reversals were reported). The Federal Reserve Bank of New York has for some time, however, imposed a penalty on its depository institutions for such transfers. The Federal Reserve System is now considering applying this penalty Systemwide.

- Regarding timely notification of extensions, a change to the SHARF system now enables those Federal Reserve Banks to extend the operating time of their automated systems and simultaneously notify customers of the extension. This modification has reduced the amount of time needed to notify institutions located outside the New York District.
- The Federal Reserve System has still received no indication from depository institutions that a standard, nationwide opening time for the securities transfer system is desirable. We will continue, however, to open the system earlier when requested to do so and on expected heavy volume days.
- With respect to dealer turnaround (that is, that period at the close of business when dealers may make securities deliveries to their final customers), the System is considering implementing this provision nationwide. If this is done, however, the market will be expected to self-regulate its usage, as is currently the case.

Thank you for providing us a further opportunity to comment on this review. Again, we believe that your report raised some important questions and fairly represents our responses and subsequent actions.

Sincerely yours,



William W. Wiles
Secretary of the Board

cc: Mr. William Gregg
Commissioner of the Public Debt



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON

JUL 25 1986

Dear Mr. Simmons:

This is in response to your request for a review of the draft report entitled, "Government Securities: Questions About the Federal Reserve's Securities Transfer System".

It is our understanding that the Board of Governors of the Federal Reserve System is providing some recommended changes to the report for clarification and updating, so we have limited our comments to the concerns cited in your report. Our specific comments on each of the concerns pertinent to Treasury are provided in the enclosure.

The efficient and equitable operation of the book-entry securities transfer system is essential to the marketability of Treasury securities. As a general comment, Treasury supports improvements that can be made to standardize the level and availability of book-entry services system-wide. At the same time, we wish to acknowledge the excellent efforts of the Federal Reserve in the development and operation of the book-entry system.

We appreciate your providing us with the opportunity to comment on the issues raised in your draft report.

Sincerely,

A handwritten signature in cursive script that reads "Gerald Murphy".

Gerald Murphy
Fiscal Assistant Secretary

Mr. Craig A. Simmons
Associate Director
General Government Division
General Accounting Office
Washington, D. C. 20548

Enclosure

TREASURY'S COMMENTS ON GAO'S REPORT ENTITLED
"GOVERNMENT SECURITIES: QUESTIONS ABOUT THE
FEDERAL RESERVE'S SECURITIES TRANSFER SYSTEM"

Note: The concerns listed are those cited by GAO in its report.

Concern: "...possible unfair advantages created by the Federal Reserve Bank of New York's more advanced computer system..."

Comment: As expressed in the SHARE report, this concern refers not only to differences between SHARE and non-SHARE Districts, but to differences among the SHARE Districts as well. The Treasury's primary concerns are that (1) a consistent, basic level of service be made available to all users of the securities systems, (2) an individual District's customizing not provide its financial institutions with significant competitive advantages over other Districts' institutions, and (3) individual customizing efforts do not negate the cost effectiveness and efficiencies to be gained from standardized systems.

Concern: "...frequency of improper reversals (i.e., improperly sending securities over the securities transfer network) coming from New York dealers..."

Comment: The Treasury has reviewed and indicated its support of a Federal Reserve proposal to apply a penalty for improper reversals uniformly in all Districts. We are in agreement with the Federal Reserve that the penalty should be applied only to improper reversals reported to the Federal Reserve Banks and that the penalty rate should be reviewed periodically to ensure its effectiveness.

Concern: "...apparent inequities in notification of securities transfer network extensions..."

Comment: The Treasury supports system and procedural changes that have been taken to reduce timing differences in the notification of extensions to the entire system. We also concur with the Federal Reserve's efforts to eliminate the need for routinely extending the system. Significant progress has already been made toward this goal. We feel that further improvements are possible, not only through the Federal Reserve's actions, but also those of major network participants.

Concern: "...possible disadvantages to West Coast dealers, who have less time to process security transfers..."

Comment: As a general rule, Treasury feels that all participants in the securities transfer network should have the opportunity for equal access. However, we concur with the Federal Reserve's conclusion that there is no justification for a standard earlier opening of the system in the absence of any expressed need from West Coast and Midwestern institutions, or of any measurable benefits to the overall operation of the system.

Concern: "...possible inequities in districts' abilities to turn around securities after the normal transfer deadline..."

Comment: The Treasury has reviewed and indicated its support of a Federal Reserve proposal to provide the capability for "dealer turnaround time" in all Districts.

A final item mentioned in the draft report is the broader issue of centralizing the book-entry operations. This is an issue of great interest to the Treasury. To provide the critical foundation for Treasury securities marketability, the book-entry system must be reliable, predictable, and accessible. The Treasury feels that the concept of a centralized system that can combine these features with a consistent level of services to all users warrants full exploration as part of any planning to replace or redesign existing securities systems. The Treasury expects to participate with the Federal Reserve in the evaluation of this concept.

Treasury Department
BPD/OFAS
July 1986



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT
DIVISION

23 JUL 1965

The Honorable Paul A. Volcker
Chairman, Board of Governors
Of the Federal Reserve System

Dear Mr. Volcker:

The U.S. General Accounting Office is currently studying the U.S. government securities market. During this study, several issues emerged concerning the way the Federal Reserve operates its book entry securities transfer system. Since February 1985 we have been separately studying these issues primarily through interviews with Federal Reserve officials and system users. In brief, our concerns are that the Federal Reserve may be creating unintentional advantages for securities dealers in certain districts to the disadvantage of dealers in others. This concerns us because we believe the market for U.S. government securities is a national market, and as such there should not be competitive advantages or disadvantages for market participants because of the capabilities or practices of the Federal Reserve district in which they are geographically situated. In this letter, we would like to outline for you our specific concerns and request your comments on these concerns.

Our interviews with representatives from four Federal Reserve banks, three New York clearing banks, and 10 primary dealers, as well as our review of Federal Reserve policies, procedures, and statistics, have led us to believe that certain Federal Reserve operations may favor dealers who clear securities through the New York District. As discussed in more detail in this letter, our concerns are that

- The Federal Reserve Bank of New York's (FRBNY) more advanced computer system may lead to competitive advantages to dealers clearing through that district.
- Depository institutions clearing their securities transactions in New York have access to the book entry system for mortgage backed and agency discount securities that depository institutions clearing in other districts do not.
- Most improper reversals seem to come from dealers within the New York district and go to dealers outside it.
- Major clearing banks in the New York district are notified of extensions in the securities transfer deadline before member institutions in other districts.

--Dealers clearing on the West Coast have less time to process securities transfers than dealers clearing in the rest of the country.

--Only dealers in certain districts can turn around securities to customers after the normal transfer deadline.

We are aware that the Federal Reserve has already taken actions to remedy some of the above problems. After we describe these problems in further detail, we will summarize what the Federal Reserve's actions, as we understand them, have been to date. We invite you to comment on our concerns and request that you clarify and update any actions that the Federal Reserve plans to take regarding these issues.

The New York district's superior computer system may lead to advantages to dealers clearing through that district

According to Federal Reserve officials, during the 1970s each district bank developed its own securities transfer system. In general though, there were three major systems--the New York district's, the Chicago district's, and a system for all other districts. Because coordinating systemwide changes and improvements among the different systems was problematic, the San Francisco, St. Louis, Dallas, and Kansas City Federal Reserve Banks began a joint effort to develop a standardized securities transfer system in 1979 and 1980. Out of this effort came the Security Handling Automation Resource Sharing Endeavor (SHARE) system. This system is currently on line in many districts and, according to a San Francisco Federal Reserve official, is expected to be fully operational in all districts, except New York, by 1986.

Because it handles such high volume, the New York district has its own system, and has no plans to implement SHARE. The Chicago district has implemented SHARE but with such extensive modifications that it is now essentially a different system. The end result is that in spite of the efforts toward standardization, there are still essentially three Federal Reserve securities transfer systems.

The three systems are not equal. According to Federal Reserve officials and dealers, the New York system can process transfers faster, can handle more volume, and is automated to a greater extent than the systems used elsewhere. Chicago dealers and representatives of New York clearing banks have stated that

because dealers outside New York can not turn around securities as quickly as their New York counterparts, they are more vulnerable to fails.¹

Federal Reserve officials point out that the major New York clearing banks have more sophisticated internal computer systems than most banks clearing outside New York. Because of these systems, they feel that the New York banks will be able to turn securities around faster than banks elsewhere. In light of this, in your opinion would a dealer outside New York who had or who developed a system as sophisticated as the New York clearing banks be disadvantaged by interfacing with a Federal Reserve district bank that utilizes the SHARE system rather than the New York system?

Also, the Chicago version of SHARE, although it has a history of slow response times, offers features unavailable under the nationwide SHARE system. These features include standardized formats for transfers to regular customers (known as recurring transfers), activity reports at the close of business each day, and easier intrabank transfers. What would be the desirability of extending these enhancements to the nationwide SHARE system?

Depository institutions clearing in the New York district have access to the book entry system for certain securities that depository institutions in other districts do not

Not all institutions have access to the book entry system for all types of securities. Only depository institutions within New York currently have access to clear Federal Home Loan Mortgage Corporation (Freddie Mac) and Federal National Mortgage Association (Fannie Mae) mortgage-backed securities. In addition, the book entry system for agency discount securities was initially restricted to the New York district and is only gradually becoming accessible to other districts. Depository institutions in districts that cannot access the book entry system for these securities can still trade them, but they must settle

¹In the government securities market, the same security can be sold many times a day. Before dealers even receive the securities they have bought, they sometimes have resold them. This is called turning around securities. There is a risk to this practice, however. Buyers do not have to pay for securities until they are delivered, but they begin collecting interest on the day that the securities are supposed to be delivered. Thus, if sellers do not deliver securities, (referred to as failing to deliver) they not only do not get paid, but they give up the interest on the securities as well.

their trades through a correspondent bank in the New York district at significantly higher costs. As a result, instead of paying the \$3 Federal Reserve transaction fee,² institutions outside New York must pay at least \$20 and, in one case, as high as \$60 per deposit or withdrawal to a correspondent bank.

As we understand it, the status of access to these securities through the book entry system is as follows:

Mortgage-backed Freddie Macs and Fannie Maes

Mortgage-backed Freddie Macs began to be traded under the book entry system in January 1985, and original issue Fannie Maes in May 1985. Access to these securities through the book entry system is currently available only to financial institutions in the New York district.

The Chicago and Boston districts are working with the FRBNY to develop an interim solution that would allow those districts to settle trades in these securities with New York financial institutions. As of May 1985, no implementation date for the interim solution had been established. The FRBNY and SHARE programming staff are also working on a long-term solution. However, both the long- and short-term solutions still have unresolved technical problems. According to Federal Reserve officials, the bookkeeping for these securities is quite complicated and accounts are reconciled manually. They feel that expanding access would disrupt the reconciling process.

Agency discount notes

In December 1983, the FRBNY converted agency discount notes to the book entry format. Access was initially restricted to financial institutions in the New York district. In July 1984, the FRBNY offered an interim system designed to allow other districts access to these securities. Financial institutions in districts that implement this interim system can settle discount note trades with other financial institutions in their territory and with financial institutions in New York. They cannot settle

²Three dollars is the current transaction fee in all districts except New York, which varies fees depending on the time of day. On October 1, 1985, the fee will drop to \$2.25 nationwide.

trades with financial institutions in the 10 other districts. The Boston, Philadelphia, and Chicago districts are currently operating under this system; financial institutions in other areas of the country cannot yet gain access to agency discount notes through the book entry system. According to officials of the Federal Reserve Bank of San Francisco that bank is working on a long-term solution to allow nationwide discount note trading over the SHARE system. The programming package for this solution is currently being tested at the Federal Reserve Bank of Kansas City.

Although the Federal Reserve is working to allow nationwide access to mortgage-backed Freddie Macs and Fannie Maes (currently available for settlement under the book entry system only in New York) and to agency discount notes (currently available for settlement only between New York and three other districts), we are concerned about the amount of time it will take for such access to become available. Over a year and a half has passed since discount notes became accessible under the book entry system in New York, yet access to nationwide settlement is still in a test phase. Furthermore, there are still unresolved technical problems with expanding access to nationwide trading in mortgage-backed securities. While we understand that there are difficulties involved in converting new types of securities to book entry, and that the Federal Reserve has had competing resource demands, long periods in which access is available only to the New York district may give financial institutions in that district competitive advantages.

So that we may better understand how the Federal Reserve anticipates dealing with this problem, we would appreciate your outlining the plans to make the book entry system for all securities accessible nationwide.

Most improper reversals seem to come from dealers within the New York district and go to dealers outside it

For 30 minutes after the deadline for original transactions,³ securities transfer network users can send back, or reverse, securities and funds they have received erroneously. Sometimes, however, when sellers of securities miss the deadline for sending original transactions, they will send securities out

³Dealers in four districts can turn around or redeliver securities to customers during the first 15 minutes of this period, see p. 9.

during the reversal period anyway rather than financing them overnight. These improper reversals⁴ can create problems for buyers if they intended to resell the securities rather than keeping them overnight. If buyers receive securities during the reversal period and cannot send them to their customers or back to the seller before the network closes, the overnight financing costs shift to them. Recognizing this problem, the Federal Reserve has set up a procedure under which it can penalize network users that send improper reversals.⁵

Comments from Federal Reserve officials indicate that most improper reversals about which the Federal Reserve is notified are sent by network users in New York to users in the rest of the country. We are unsure of the cause of this pattern. According to a San Francisco Federal Reserve official, when a SHARE user sends an improper reversal, the system generates an automatic report to the user's Federal Reserve bank. The New York system does not generate similar reports. However, New York dealers may be able to initiate these transactions without their district Federal Reserve bank's knowledge, whereas dealers elsewhere cannot.

To assist us in determining the causes and significance of the improper reversal problem, we would appreciate your providing us with the following:

- Statistics, by district, on the number of improper reversals reported to the Federal Reserve, the districts in which these reversals originated, and data on the resolution of these reversal cases. If it appears that more improper reversals come from some districts than others, please explain why.
- Comments on the appropriateness of the 5 percent penalty.

⁴Referred to as illegal reversals by network participants.

⁵If an institution receives an improper reversal and cannot send it back before the securities transfer network closes, the receiver can contact its Federal Reserve bank, which can either arrange to have the network reopened to process the transaction or arrange for a debit reserve adjustment. The sender can be penalized at the annual rate of 5 percent of the par value of the securities for 1 day. Some dealers have suggested to us that since improper reversals continue to grow, the penalty may be too low.

New York dealers are notified of extensions more quickly than others

The deadline for financial institutions to originate on-line transactions in book entry securities is 2:30 p.m. eastern time. However, because individual financial institutions and the securities transfer network itself experience frequent technical problems, this deadline is usually extended each day. The FRBNY is responsible for coordinating and announcing whether or not the deadline will be extended and normally extends the deadline in half-hour increments. This prevents market participants from using the extension period to generate new trades and transactions. As a result, beginning a few minutes before 2:30 p.m. eastern time and continuing every half hour thereafter until the network closes, dealers nationwide wait to learn if the deadline has been extended. This process normally goes on for several hours. For example, from January through March 1985 the average closing time for the securities transfer network was 5:00 p.m. Occasionally the network is open much later. For example, on May 20, 1985 the network was open until almost midnight.

Not all dealers are notified of extensions at the same time or in the same manner. The FRBNY notifies its major clearing banks directly, first by direct-line telephone, then by printed message. It notifies other district banks, except Chicago,⁶ by printed message only. The district banks also notify their member institutions and branches by printed message, but they must wait for the FRBNY to notify them before they can notify their institutions. As a result of this multi-stage notification process, financial institutions outside New York are sometimes notified after the deadline passes or extensions begin.

Some Chicago and California primary dealers stated that, as a result of the slow Federal Reserve notification, they rely on contacts with New York dealers to learn of extensions. Some dealers also stated that because of slow notification they were

⁶The FRBNY notifies the Chicago District by phone as well as by printed message. In May 1985 the Federal Reserve Bank of Chicago installed a separate phone exclusively for communication of extension notices by the FRBNY.

forced to deliver securities "blind" (i.e. not knowing if the network was open or closed) and are therefore put at a disadvantage.

According to an official from the Federal Reserve Bank of San Francisco, there are plans to modify the SHARE system so that extension notifications will go directly from the FRBNY to all on-line institutions, eliminating the need for each district to notify its own member institutions. If implemented, this change should reduce but not eliminate delays. Extension notifications are recorded on the same printer as all other securities messages, and therefore sometimes get delayed. Representatives of New York clearing banks told us that it is precisely for this reason that the FRBNY phones them in addition to sending the printed message. Also, if the New York clearing banks will continue to receive both phone and printed notification, they probably will continue to learn of extensions first.

We would appreciate your comments on the differences in notification processes between New York and the rest of the country. Please tell us whether dealers outside New York are notified of extensions significantly later than New York dealers, and if so, will the modifications to the SHARE system correct this situation?

West Coast dealers have less time
to process securities transfers than
dealers in the rest of the country

West Coast financial institutions have 2-1/2 fewer hours to process transactions than their East Coast counterparts because of national time differences. When the network opens in New York at 8:00 a.m., it is only 5:00 a.m. in San Francisco. However, the San Francisco Network does not open until 7:30 pacific time, which is 10:30 a.m. eastern time. Also, this situation may contribute to the almost daily extensions of the securities transfer deadline. Securities transfer volume peaks

⁷Dealers that are notified of extensions promptly can plan more effective settlement strategies. Dealers normally try to settle their large sales first, to reduce the costs of potential fails. Dealers often buy securities in several small lots to package together for delivery in a large sale. A dealer's operations staff should ideally know, in the final minutes before the deadline, whether or not the network is going to be extended. It can then decide whether to deliver on several small sales, or hold back until it receives enough securities to deliver on a major sale. Dealers that are notified of extensions late must make these decisions based on incomplete information, and are therefore at a disadvantage.

at the end of the day. Because West Coast dealers cannot begin sending or receiving securities until mid-morning arrives in the rest of the country, the late opening of the West Coast network may contribute to the extension problem. We understand that at the request of West Coast dealers the Federal Reserve is currently studying its district bank operating hours. In conjunction with this, we would like you to consider if it would be feasible to open the entire system simultaneously.

Only dealers in certain districts can
turnaround securities to customers after
the normal transfer deadline

During the first 15 minutes after the securities transfer network closes, dealers in New York, San Francisco, Los Angeles, and Chicago can redeliver, or turnaround, securities to their ultimate customers. Dealers outside these four areas, however, do not have this added time. It is unclear to us why this situation occurs only in certain districts, and whether it is restricted only to primary dealers. According to an FRBNY official, the market may have interpreted the additional turnaround time as being available only to primary dealers, but the Federal Reserve has not. Also, the Federal Reserve does not police additional turnaround time usage to determine if only primary dealers are taking advantage of it. Yet, according to an official of the Federal Reserve Bank of Boston, that bank has denied the financial institutions within its district access to turnaround time because they are not primary dealers. A non-primary dealer in that district cited the use of turnaround time as an advantage of being a primary dealer.

To clarify this matter, we would appreciate an explanation of the Federal Reserve's turnaround time policies.

- What is turnaround time's purpose?
- Why is it only available in certain districts?
- Is it only available to primary dealers? If so, why?
- Should the Federal Reserve police its use?

In your response to this letter, we would appreciate any supplemental discussion of these six issues, as well as your answers to the specific questions raised within each issue. We would also appreciate your responding to some broader questions about the operation of the book entry securities transfer system.

- Given the state of current technology, does it make sense for the Federal Reserve to have different capabilities in different districts, especially since the U.S. government securities market is national in scope?
- Why not have one centralized system and uniform policies instead of distinctions by district?
- What are the options and current plans for future development of the book entry securities transfer system?

We would like to thank you and your staff for the cooperation we received while we were studying the issues raised in this letter. If you have any questions, or would like to discuss this matter, please contact Stephen Swaim at 452-2409.

Sincerely yours,



William J. Anderson
Director



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

September 5, 1985

Mr. William J. Anderson, Director
General Government Division
General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Anderson:

As promised on July 25th, in our acknowledgement of your July 23rd letter regarding the Federal Reserve's book-entry system, we are enclosing a detailed response which addresses our responsibilities as fiscal agents of the United States for the U.S. Treasury Department and for other government agencies. It is the responsibility of the Federal Reserve Banks as fiscal agents to offer efficient and equitable book-entry securities services to all depository institutions. It is our commitment to provide a consistent, core level of service nationwide while balancing, in a cost-effective manner, the needs of market participants -- which can vary among Districts -- the requirements of our fiscal principals, and the resources available to the Federal Reserve Banks.

The differences you cited regarding operating capabilities and administrative practices raised some important concerns. These concerns relate to apparent service level inequities which stem primarily from three sources. First, as fiscal agents, the Federal Reserve Banks give highest priority to implementing new Treasury initiatives, such as the introduction of Treasury STRIPS. Given available resources, this has sometimes delayed the scheduled expansion of other automation enhancements at the System level. Second, in responding to the needs of our other fiscal principals, short-term inequities in service levels have developed between Districts. Finally, our practice of providing a core level of uniform automation capabilities nationwide and supplementing it with local enhancements, in response to local needs, has created some differences in District capabilities. We believe, however, that this approach has provided an appropriate balance between cost containment and service to depository institutions.

Mr. William J. Anderson
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In general, we believe that any disadvantages resulting from local differences in the book-entry securities service have been minimal, of the shortest duration possible under the circumstances, and, for the most part, unavoidable. Improvements to the book-entry service are under constant consideration and, as indicated in our responses, a number of the enhancements currently underway will eliminate many of the inequities.

Your letter identified some important issues with which the Board too is concerned. The document that accompanies this letter addresses in detail each of the specific issues which you raised.

Very truly yours,



James McAfee
Associate Secretary
of the Board

Enclosure

cc: Mr. W.M. Gregg
Commissioner of the Public Debt

FEDERAL RESERVE RESPONSE TO BOOK-ENTRY/SECURITIES TRANSFER ISSUES
RAISED BY THE GENERAL ACCOUNTING OFFICE

Note: GAO comments appear at the end of this appendix.

Issue: "The New York District's superior computer system may lead to advantages to dealers clearing through that District.in your opinion would a dealer outside New York who had or who developed a system as sophisticated as the New York clearing banks be disadvantaged by interfacing with a Federal Reserve district bank that utilizes the SHARE system rather than the New York district system?"

Response: Given the volumes processed in other Districts, a depository institution which develops a highly automated securities clearing system should not be disadvantaged by interfacing with a SHARE District. 1/ If the New York clearing banks appear to have an advantage, it would be as a result of their highly automated back office operations. Other depository institutions, both inside and outside of the New York District, generally do not have the same degree of automation in their operations. However, any depository institution, for example a large clearing bank outside of New York, can elect to interface with a Federal Reserve office via a computer link, incorporating any desired level of back office automation.

Issue: "The Chicago version of SHARE... offers features unavailable under the nationwide SHARE system. What would be the desirability of extending these enhancements to the nationwide SHARE system?"

Response: The Federal Reserve provides a core level of service to all its on-line depository institutions. In addition, other Districts have written local programs to address specific local needs. While nationwide expansion of local SHARE enhancements is possible, it would not be cost effective where insufficient local demand exists. Therefore, we do not automatically schedule inclusion of local enhancements in the core SHARE system. However, the Federal Reserve regularly reevaluates the desirability of extending local enhancements. All local SHARE enhancements, including those developed in-house are available to every other SHARE District.

See comment 1.

See comment 1.

1/

SHARE is an acronym for a book-entry account maintenance and securities transfer system scheduled for use in, or already being utilized by, all Districts except New York and Philadelphia.

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Issue: "Depository institutions clearing in the New York District have access to the book-entry system for certain securities that depository institutions in other Districts do not. Long periods in which access is available only to the New York District's depository institutions may give those institutions competitive advantages. Over a year and a half has passed since book-entry discount notes became accessible in New York, yet access to nationwide settlement is still in a test phase. So that we may better understand how the Federal Reserve anticipates dealing with this problem, we would appreciate your outlining plans to make the book-entry system for all securities accessible nationwide."

Response: Initially implementing new securities services in fewer than all Districts simultaneously is a source of ongoing concern to us since it is our policy to provide all depository institutions with equal access to services. In the case of discount notes and mortgage-backed securities, our fiscal principals expressed a strong desire to bring the benefits of book entry ^{3/} to these securities. The Federal Reserve System decided that the Federal Reserve Bank of New

See comment 1.

3/ A book-entry security generally is not available in definitive (physical) form. Rather, it exists as an entry on the books of the obligor or its agent. A Federal Reserve Bank, as fiscal agent, records these securities on its books on behalf of depository institutions which, in turn, maintain detailed records of ownership. Securities are transferred between depository institutions for their own accounts or on behalf of customers utilizing the Fedwire network. The institution initiating a transfer (seller) transmits a message of instruction to the Reserve Bank which charges its securities account and simultaneously (1) credits its funds account with the proceeds of the sale; (2) notifies another Reserve Bank to credit the receiving institution (buyer) with the security; and (3) charges the receiver's cash account. Prior to book entry, such trades were completed only when definitive securities were delivered from the seller to the buyer and payment, usually by check, was made.

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York, which already handles approximately 75 percent of the System's securities transfer volume because of its location in the principal market, could handle the approximately 1,300 additional issues of discount notes and over 25,000 issues of mortgage-backed securities. It was further determined, however, that these securities could not be transferred to or held in other Districts unless the agencies were either willing to perform the traditional accounting functions that they performed for their other obligations, or were willing to wait until the Federal Reserve Banks could develop an automated interdistrict reconciliation system to account for the debt. ^{4/}

The agencies responded that they could not assume the reconciliation function, but they also did not wish to wait for the Reserve Banks to develop the necessary system and encouraged implementation within the New York District. In view of the principal-agency relationship and since New York is the center of the market, it was considered appropriate to phase in these securities beginning with the Federal Reserve Bank of New York. However because the System was concerned with the question of equal access to all book-entry securities, it developed interim procedures to permit limited interdistrict transfers of discount notes until the automated nationwide reconciliation system could be developed. The interim procedures were made available to all Reserve Banks in July 1984, six months after the introduction of book-entry discount notes in New York. Currently, three Districts are using the interim procedures -- Boston, Chicago, and Philadelphia. It appears that sufficient demand does not exist in the other Districts. Consideration is also being given to developing interim procedures to permit limited interdistrict transfers of mortgage-backed securities provided that such efforts would not seriously delay implementation of the automated reconciliation system.

^{4/} The purpose of debt accounting is to ensure that the daily transfers have not changed the amount of debt outstanding. This could happen, for example, if District A sends a message to District B, but District B never receives it. At the end of the day, the amount of debt recorded as outstanding nationwide would be less than it should be. A reconciliation system would catch that and an adjustment would be made. Because the potential exists for discount notes to mature daily and because of the similarly unique characteristics of mortgage-backed securities, unlimited nationwide transfers of these instruments without a sophisticated reconciliation system to assist in the daily nationwide balancing was deemed unacceptable.

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The Reserve Banks had planned to develop and introduce the automated reconciliation system in 1984-85, but the Banks' limited securities automation resources had to be shifted to unplanned Treasury-mandated changes such as (i) the introduction of Treasury STRIPS, (ii) the introduction of foreign-targeted securities, and (iii) the repricing of the Treasury book-entry service effective October 1, 1985.

Implementation of the nationwide book-entry securities transfer service for discount notes and mortgage-backed securities is now slated for the second quarter of 1986. However, given the level of concern about equal access, we are reviewing our plans and commitments to ensure the earliest possible implementation.

Issue: "Most improper reversals seem to come from dealers within the New York District and go to dealers outside it....We are unsure of the cause of this pattern....However, New York dealers may be able to initiate these transactions without their District Federal Reserve Banks' knowledge, whereas dealers elsewhere cannot.... To assist us in determining the causes and significance of the improper reversal problem, please provide statistics on the number of improper reversals, their origination and their resolution, and comment on the appropriateness of the 5 percent penalty."

Response: The New York District processes approximately 75 percent of all book-entry transfer transactions nationwide. This proportion should also be generally reflective of the ratio of improper reversals emanating from the New York District. Over a recent three-month period, 232 such transactions were reported to the New York Reserve Bank out of a total volume of 1.3 million transfers. Of the 232 improper reversals reported, 185 were sent from a New York depository institution to another New York depository institution; 25 were sent by New York institutions to out-of-District institutions; and 22 were sent by depository institutions outside the District to New York. Statistics on reported improper reversals either within or between other Federal Reserve Districts are not available but based on our discussions with selected Reserve Districts indications are that the number of reported improper reversals appears minimal.

System staff believes, from conversations with participants in the marketplace, that there are many additional "improper" reversals daily, perhaps hundreds, but that these are transfers that have been agreed upon by both parties and

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are therefore not reported to any Reserve Bank. Often, a seller cannot send the security to the buyer until late in the day because it does not yet have it. By the time the seller receives the security, the only way the security can be sent to the buyer, who is expecting it, is to send it under the reversal code because the deadline for regular transfers has passed. We understand that, in many cases, these transfers are made to complete repurchase transactions.

Although the Federal Reserve Banks with SHARE, unlike the New York Reserve Bank, receive an end-of-day listing of "improper" reversals, this report does not serve as a Federal Reserve monitoring mechanism for "improper" reversals because (1) the report will also reflect reversals of the previous day's wires, which are, in fact, proper reversals; and (2) it will also reflect reversal wires which are "improper", in the sense that there was no original incoming wire to be reversed, but which are being sent at the mutual agreement of the sending and receiving parties. Therefore, in both SHARE and non-SHARE Districts, the only reliable determiner of the propriety of a reversal must be the receiving institution; a Federal Reserve Bank can only penalize the sender and compensate the receiver of improper reversals if it is notified by the receiving institution. We believe to do otherwise would constitute inappropriate interference with market activity.

As to the penalty itself, we are currently reevaluating not only the size of the penalty, but also the circumstances under which it is assessed.

Issue: "New York dealers are notified of extensions more quickly than others.Not all dealers are notified of extensions at the same time or in the same manner....We would appreciate your comments on the differences in notification processes between New York and the rest of the country. Please tell us whether dealers outside New York are notified of extensions significantly later than New York dealers and, if so, will the modification of the SHARE system correct this situation?"

Response: The Federal Reserve Bank of New York coordinates the process of extending the wire and notifying the rest of the System. This process begins with a priority broadcast message from the Federal Reserve Bank of New York to all other Federal Reserve Districts and to New York's on-line depository institutions. Once New York's wire notification is received

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by the other eleven Reserve Banks, there is only a momentary lag while the information is manually entered into each Reserve Bank's local communication network. A SHARE enhancement will further reduce this lag but will not eliminate it.

In addition to this standard process, two supplemental notification mechanisms have been added in New York: one at the expense of certain major New York depository institutions and one at the request and expense of the Federal Reserve Bank of Chicago. At the New York institutions, direct communication lines to the New York Reserve Bank were installed originally so that these institutions and the New York Reserve Bank could advise each other promptly of system malfunctions. Since these malfunctions sometimes impeded the Reserve Banks's ability to notify the large volume clearing institutions by wire of extensions, the Reserve Bank later began using the direct telephone lines as a second means of notifying them. At the Chicago Reserve Bank, a special-purpose telephone extension was installed for the sole use of the New York Reserve Bank when communicating priority messages such as extension notifications. As a result, Chicago may be able to notify its on-line institutions faster.

Hence, all on-line depository institutions nationwide are notified of extensions in the same manner -- by wire message. In addition, certain New York institutions are notified a second time by telephone.

Issue: "West Coast dealers have less time to process securities transfers than dealers in the rest of the country.the late opening of the West Coast network may contribute to the extension problem. We understand that... the Federal Reserve is currently studying its District bank operating hours. In conjunction with this, we would like you to consider if it would be feasible to open the entire system simultaneously."

R_ponse: West Coast depository institutions do have less time to send and receive securities transfers than institutions in other time zones, since the San Francisco District opens its securities transfer system at 10:30 a.m. Eastern Time (7:30 a.m. Pacific Time). Despite the shorter transfer hours, however, only one percent of the total extension hours in the first six months of 1985 was due to problems or volumes emanating from the San Francisco District.

Other than additional staff costs, there is no constraint on our ability to simultaneously open the securities transfer network nationwide, i.e., at 8:00 a.m.

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Eastern Time. In fact, the Chicago District, in special circumstances, has opened its system in conjunction with the East Coast. Similarly, at the request of a depository institution, the San Francisco District recently began opening its system an hour earlier each morning, but only one depository institution has taken advantage of the expanded hours. No demand has been expressed in the San Francisco District to open the securities transfer system any earlier.

Regarding the study mentioned in the letter, that at the request of West Coast dealers we were currently studying Reserve Bank operating hours, we know of no such study. We believe the letter refers to a study of the operating hours for the funds transfer system not the securities transfer system. However, the closing hour for the securities transfer system is currently under review.

Issue: "Only dealers in certain districts can turnaround securities to customers after the normal transfer deadline.What is turnaround time's purpose? Why is it only available in certain Districts? Is it only available to primary dealers? If so, why? Should the Federal Reserve police its use?"

Response: The purpose of the turnaround time is to allow securities dealers a short period after the normal transfer deadline to make final delivery of securities to their customers. This period permits the completion of most purchase, or repurchase collateral, transactions the same day and avoids costly fails. This parallels the historical practice in the definitive securities market of allowing dealers some time, after the usual delivery deadlines, for their deliveries of definitive securities by messenger within New York City.

It was originally the Association of Primary Dealers which, via the New York Clearing House Association, expressed a need on the part of its members for this book-entry turnaround time. As a result, in 1974 when the Federal Reserve System permitted the book-entry turnaround arrangement, the list of primary dealers served as the market's starting point for identifying the dealer group to which turnaround time would initially apply. Since these initial participants were located in four Federal Reserve offices, edits were established in the New York Reserve Bank's securities transfer system to restrict turnaround activity to those four offices. In addition, in two of the four offices, availability of the turnaround period has since been further restricted to the bank primary dealers via software edits. Hence, although the original intent of

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the Federal Reserve System was to expand this capability to all Federal Reserve offices later, this has not occurred. We agree that more uniformity in this area would be preferable especially since secondary market participants can use this time to deliver and receive repurchase agreement collateral.

We will reevaluate turnaround policy and practices and will make changes where appropriate. But it remains our policy that market participants must themselves monitor the use of the turnaround period. Although various software edits installed in certain Districts have, in effect, assisted market participants by restricting access to the turnaround period, the responsibility remains with the market participants.

Issue: "Given the state of current technology, does it make sense for the Federal Reserve to have different capabilities in different districts, especially since the U.S. government securities market is national in scope? Why not have one centralized system and uniform policies instead of distinctions by districts? What are the options and current plans for future development of the book-entry securities transfer system?"

Response: The Federal Reserve System's book-entry policy is uniform and all Districts offer a core level of uniform capabilities. Beyond this, regional differences have brought about regional enhancements. We believe that the current practice of providing certain uniform capabilities nationwide and then offering regional enhancements in response to regional needs creates an appropriate balance between cost containment and service to depository institutions.

As to centralization and the future automation plans for the securities transfer system, centralization could be a logical step since so much volume is already concentrated in one District. However, although volume is concentrated, users are not, as over 3,200 depository institutions throughout the country currently access the book-entry system for securities transfers. Reserve accounts and clearing accounts, which provide the integral funds settlement for securities transfers, are maintained in each of the twelve Reserve Districts. In addition, a centralized system would have to provide a range of different services to depository institutions with varying capabilities. It would also require a backup system. These concerns and others regarding centralization will be explored by the Federal Reserve System, working with the Treasury and various government agencies for which the Reserve Banks act as fiscal agents, during 1986.

The following are GAO's comments on the Board of Governors of the Federal Reserve System's letter dated September 5, 1985.

GAO Comment: 1. Material has been deleted at the request of the Federal Reserve.

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