Research Department
Federal Reserve
Bank of
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FRB SF Weekly Letter

Delayed Availability

Much controversy has been generated in legislative circles over bank and thrift policies of delaying withdrawal rights or interest credit on check deposits. In many cases, the institutions require that the deposit not be withdrawn for ten to fifteen business days (or longer) and in some cases interest is foregone over this period. The new interest-bearing money-market deposit accounts (MMDA's) and ceiling-free checking accounts (Super-NOW's) have brought the issue to the forefront.

Consumers commonly believe that delayed withdrawal rights and foregone interest (i.e., delayed accrual) have no logical basis other than as a means by which institutions somehow exploit their customers. This thesis is hard to defend, however, because these institutions compete with one another for deposits, and persistent exploitation would only result in a loss of business to more aggressive institutions.

In this *Letter*, we explain these bank and thrift policies in terms of the economic and technological constraints on clearing checks. Even in competitive markets, banks and thrifts might delay interest accrual for two or more business days beyond the date of deposit and require that funds not be withdrawn for ten to fifteen business days (or more). In fact, immediate interest and withdrawal rights normally would impose a cost on the institution that it somehow would have to recoup through a lower rate of interest or higher charges associated with the account.

Delayed interest

A bank may delay interest payments on deposits made by check for several days because it normally takes that long for the bank to clear the check and receive investable funds. When a bank accepts a check for deposit, it credits the depositor's account that night. However, to receive investable funds, the bank must clear the check in some combination of three possible avenues: directly with the other bank, through a correspondent bank or banks, or through the Federal Reserve System.

In the case of direct collection against a *local* bank, the collecting bank often receives investable funds in only one day. But "direct sends" to distant banks normally are too slow and costly to be practical. For distant banks, clearing may occur through a network of correspondent banks (i.e., banks that sell check-clearing services to other banks) and/or the Federal Reserve System. For example, the collecting bank may send the check to its local correspondent bank, which sends the check to the Federal Reserve for clearing. This process might take one to three or more days depending on the location of the collecting and ultimate payor banks.

Because of the time required to process paper checks, a bank does not receive compensation until one to three, or possibly more, days after the date of deposit. For this reason the bank may choose to delay accrual of interest on the deposit for a comparable period of time. However, as part of its checking account service policy, the bank may grant interest (and withdrawal rights) overnight, especially if the deposit is small and the account is longstanding. Such practice is commonplace, and amounts to a customer-initiated loan from the bank to the depositor.

Delayed withdrawal of funds

Throughout the clearing process, all interbank payments are "provisional," that is, conditional on the check ultimately being "good." Thus, the mere fact that the check clears in perhaps three days does not necessarily end the process: a check may be "bad." A check must be returned if it is incorrectly written, a forgery, written against

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insufficient funds, or somehow mutilated in the check-clearing process. If such a problem is discovered, which may occur *after* the check clears the interbank channels, the process must subsequently be "unwound." The check is returned, the interbank payment is reversed through the same channels, and the depositor's bank has its funds revoked. At present, this process can easily take ten to fifteen business days.

In the check-clearing process, therefore, only the passage of time beyond some norm for returned checks tells the collecting bank that a check is probably "good." If the bank allows the depositor to withdraw the funds (i.e., grants availability) soon after the date of deposit, the bank itself is at risk. Thus, delayed withdrawal protects the bank from the credit risk associated with checks. Again, as part of its normal checking account services, the bank may grant immediate funds availability, and this practice is commonplace for small checks and long-standing accounts.

Interest vs. withdrawal

Payment of interest and allowing withdrawal of funds each has economic value both to the depositor and the bank. Interest payments (or comparable in-kind services) are an *explicit* transfer of wealth, while assumption of credit risks is an *implicit* transfer of wealth. In assessing the terms of a deposit, the two issues of interest accrual and withdrawal of funds can be separated. When making deposits, consumers should ask when they will begin earning interest and when they can withdraw the funds. The customer to whom the terms are unsatisfactory can seek another bank (or thrift) that offers preferable terms, or can inquire about ways of depositing funds other than by paper check.

Some consumer groups have charged that banks enjoy fifteen days of "float" when withdrawal rights are delayed for that long, even though the bank may begin paying interest at market rates immediately. This interpretation of float is incorrect. "Bank float" arises because of a mismatch between the time at which a check is posted to a customer's account and the time at which the collecting bank or its correspondent receives investable funds through the clearing process. Float has a specific connotation that is not necessarily tied to withdrawal rights.

Although the concept of bank float is widely accepted, it has little economic relevance to today's interest-bearing checking accounts. The key dimension in determining an *economic value* associated with "float" is the time difference between when a depositor has access to the valued attributes of the account and when the bank receives investable funds. If deposits pay no explicit interest (e.g., traditional demand deposits), then withdrawal rights are the key attribute because the account is valued largely for funds availability. In this case, an economic value associated with "float" would be marked by the time difference between when the bank grants withdrawal rights and when it receives investable funds.

But if deposits pay market rates (e.g., the new MMDA's), the date of interest accrual marks commencement of the depositor's access to the account's economic value because the account is valued primarily for its interest payments. If the bank grants overnight interest accrual at market rates but does not receive investable interbank funds for three days, three days of economic return have been granted the depositor despite

when the account was posted or withdrawal rights were made available. For interest-bearing accounts, the accepted concept of "float" has little economic relevance.

Electronic payments

Deferred interest and availability arise from the fact that funds transfers and supporting information flows are slow in a paper-check payments system. While this system presently is economic for small-dollar payments, both the funds and confirmations need to move faster for large-dollar payments.

For payments that are readily automated, such as recurring social security and salary payments, computerized transfers through the automated clearinghouse (ACH) essentially eliminate the problem of slow paper checks. For large-dollar payments the "wire" provides an alternative to paper checks. The depositor can request the paying bank to "wire" funds to the collecting bank, thereby eliminating the paper check. Electronic notification is sent from the paying to the collecting bank and interbank funds are transferred that day. The collecting bank receives "good" *(investable and irrevocable)* funds immediately. Moreover, given the legal nature of wire transfers, the collecting bank faces almost no credit risk. Consequently, the norm is for banks to grant depositors overnight interest and immediate availability on such deposits.

Legislative debate

Delayed credit has been debated in Federal and state legislative circles and several possible legislative avenues have been considered. Proposals have been put forth to require that institutions inform depositors as to delayed interest accrual and withdrawal on check deposits and of the option of wire transfers. Another direction would require that institutions not delay interest accrual beyond the time that it takes for the bank to collect the funds. Still another direction would require further standardization of interbank check processing and expedited interbank acknowledgment of a check's being returned.

At face value, all of these proposals have merit. But the legislative/regulatory approach seems unnecessarily cumbersome or possibly perverse as a solution to delayed interest and availability. For example, it is possible that creating legislative/regulatory standards for interest accrual might actually work against many consumers because banks and thrifts might delay interest credits even on small deposits for which they now typically grant overnight interest. Moreover, does the consumer wish to be barraged with information regarding delayed interest, delayed withdrawal, and access to the wire on *every* deposit?

Although legislative and regulatory developments may be a partial solution to the problem, competition among institutions to provide more attractive services, including faster interest and withdrawal credits, is the solution that the marketplace already provides. Competition for deposits will force banks and thrifts to offer attractive combinations of interest accrual policies, withdrawal rights, and yields. But since all three attributes impose a cost on the institution, depositors should expect more favorable terms in one area to be traded off against less favorable terms elsewhere. For this reason, the shift to deregulate market yields on accounts has resulted in somewhat tighter policies on overnight interest and funds availability.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 2/23/83	Change from 2/16/83	Change from year ago Dollar	 Percent
Loans (gross, adjusted) and investments*	163,045	– 296	4,640	2.9
Loans (gross, adjusted) — total#	141,657	– 419	4,704	3.4
Commercial and industrial	44,927	– 83	2,668	6.3
Real estate	57,368	49	664	1.2
Loans to individuals	23,586	– 85	265	1.1
Securities loans	2,250	– 115	– 148	– 6.2
U.S. Treasury securities*	7,602	32	1,263	19.9
Other securities*	13,786	92	– 1,326	– 8.8
Demand deposits — total#	39,449	– 593	1,817	4.8
Demand deposits — adjusted	26,291	–1,128	222	0.9
Savings deposits — total	62,826	656	32,639	108.1
Time deposits — total#	71,518	– 963	– 20,933	– 22.6
Individuals, part. & corp.	63,186	– 851	– 19,460	– 23.5
(Large negotiable CD's)	23,728	– 535	– 12,520	– 34.5

Weekly Averages of Daily Figures	Week ended 2/23/83	Week ended 2/16/83	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	20	95	73
Borrowings	3	73	155
Net free reserves (+)/Net borrowed(–)	17	22	– 82

* Excludes trading account securities.
# Includes items not shown separately.

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