

May 19, 2011

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

**Re: Docket No. R-1312, RIN No. 7100-AD71
Notice of Proposed Rulemaking Regarding Financial Market Utilities**

Dear Ms. Johnson:

The American Bankers Association (ABA)¹ welcomes the opportunity to provide comments on the Board of Governors of the Federal Reserve (Board) proposed rule² regarding risk management standards governing the operations related to the payment, clearing, and settlement activities of certain financial market utilities (FMUs) as required by section 805 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act, or DFA). FMUs designated as systemically important by the Financial Stability Oversight Council (FSOC) would be subject to these enhanced standards. In addition, the proposed rule prescribes standards for determining when advance notice is needed to be provided to the Board by a designated FMU (DFMU) when the FMU is considering changes to its rules, procedures, or operations that could have a material effect on the level of that entity's risk.

ABA represents the banking industry whose members are active and essential participants in the payment system and will feel the effects of the proposed rule, because any FMUs with whom they transact business that are subject to the rule will likely pass on the costs and constraints of enhanced supervisory oversight to our members. Consequently, ABA urges the Board to assure that the benefits of enhanced risk management standards exceed the cost of implementing these changes on banks and their customers when establishing standards for, and conducting supervision of, designated FMUs.

Overview

As originator of the bank routing number system, ABA plays a pivotal and enduring role in the history and ongoing vitality of private sector facilitated payment transaction solutions. This is just one illustration of how the American payment system is a market driven integration of private and public sector arrangements whose record of soundness and efficiency is a model for any successful economy. In pursuing the mandate of Title

¹ The ABA represents banks of all sizes and charters and is the voice for the nation's \$13 trillion banking industry and its 2 million employees. The majority of ABA's members are banks with less than \$165 million in assets. Learn more at www.aba.com.

² 76 Federal Register 18445, April 4, 2011

VIII of the Dodd-Frank Act to mitigate systemic risk in the payments system, ABA urges the Board to recognize the success of the range of financial market utilities, to focus on gaps in the identification and mitigation of system-wide risks, and to avoid unnecessarily encumbering the operational efficiencies of payment systems that do not display truly systemic impacts. In ABA's comment³ in response to the FSOC's Advance Notice of Proposed Rulemaking on determining how to designate FMUs as systemically important, we noted that enhanced standards were warranted for the truly systemically important FMUs, but that adding these burdens to other payments systems that were not large or did not pose the same risk would be bad public policy.

The Dodd-Frank Act provides the FSOC with five factors to consider when determining if an FMU is systemically important. These factors include the aggregate monetary value of transactions processed, the exposure of the FMU to its counterparties, the relationship or interactions of the FMU with other FMUs, the effect that a failure or disruption of an FMU would have on other markets or the broader financial system, or any other factors that the FSOC deems appropriate.

ABA's comment letter to FSOC reviewed these factors and recommended that if they are properly applied, wire systems would be designated as systemically important. However, we articulated why retail systems, including the Automated Clearing House (ACH), credit and debit cards, and paper checks should not be considered systemically important. Unfortunately, in FSOC's Notice of Proposed Rulemaking, they decline to exclude retail payment systems from consideration as being systemically important. This is significant, because increased burden placed on these entities during the review process, whether they are designated as systemically important or not, will add to their expenses, and those expenses will be passed to financial institutions that use their services. If these entities are designated as systemically important, then the proposed risk management standards will permanently increase those costs.

Seeking to improve risk management while incurring commensurate costs is reasonable, and it is a policy that should be pursued. Establishing risk management standards without considering the effect on FMUs and their financial institution partners is imprudent.

Comments

The proposal establishes standards (essentially supervisory expectations) for designated financial market utilities (by adopting the Committee on Payment and Settlement Systems Core Principles, CPSS Publications 43, (Core Principles) from 2001. While DFA authorized Board consideration of international standards, Congress did not compel or endorse the wholesale adoption of such sources as the sole basis for guarding against system-wide risks that materially threaten broader financial stability. Despite being labeled by the CPSS as "Core Principles for Systemically Important Payment Systems", in reality, the driving force of the Core Principle exercise launched in 1998 was "to consider what principles should govern the design and operation of

³ ABA Letter dated January 20, 2011, <http://www.aba.com/NR/rdonlyres/DC65CE12-B1C7-11D4-AB4A-00508B95258D/70488/FSOCFMUANPRFinal.pdf>

payment systems in all countries.” The consensus sought was to encompass developed and developing countries in the establishment of sound foundations for payment systems. The initiative was not directed at solving supervisory management of critical systemic risk vulnerabilities. Closer inspection of the Core Principles demonstrates that they have significant shortcomings as supervisory standards for achieving the true mandate of DFA Title VIII of mitigating systemic risk in the financial system and promoting financial stability.

First, standard 4, requiring payment finality on day of value, is not a universally applicable aspiration for retail payment systems. The proposed rule would enact standards that would not allow transactions to be unwound or reversed, requiring final settlement. Retail payment networks, including ACH network, paper checks, and credit and debit card networks all allow transactions to be reversed, returned, or charged back under certain circumstances. While finality of payment is very important when sending a wire for \$100 million dollars, it is not practical when 100 million payments of \$20 apiece are made. The volume of retail transactions mandates a streamlined system to correct errors and enhance customer service. ABA recommends that the Board exempt retail payment systems from the risk management standards mandating finality of settlement.

Second, standard 8, while enunciating a general principle of practicality and efficiency appropriate for any FMU (designated or not), does not address the kind of critical issues that are the focus of material system failure. Soundness and efficiency may be the bedrock of a well functioning payment system, but as DFA notes, the danger to be guarded against by Title VIII is not a lack of efficiency in mitigating risk successfully managed by multi-lateral arrangements, but rather the creation of risks elsewhere in the payment system or beyond whose propagation materially threaten American financial stability. Such material risk externalities of a DFMU are the rightful focus of supervisory standards that the Board should be proposing. The Board is not charged by DFA with micro-managing “efficiency” or intervening in the market to impose its interpretation of such a state among competing systems and participants. ABA recommends that this standard be removed from the final rule.

Similarly, standard 9’s aspiration for fair and open access may be an admirable goal of any FMU, but is not a primary source of the type of activity likely to compromise financial stability that relates to the reason d’être for designating systemically important FMUs or enhancing supervision of them.

ABA members believe that the remaining Core Principles can be applied appropriately to the supervisory challenge at hand, at least of immediate purposes. Although we note with some caution that the proposal’s introduction of the principles as standards that a DFMU “should meet or exceed” appears to invite a supervisory application that is boundless. We trust that the supervisory latitude implied will be exercised with adequate advance notice of the agency’s expectations that exceed current practices.

ABA further believes that there is a greater relationship between the elements for what merits designation as a systemically important FMU and the appropriate supervisory expectations and processes to be applied to such DFMUs than is evident from the parallel rule-makings the Board and the FSOC are conducting.

Because we believe that the relevant parties have predominantly common interests in fulfilling the DFA mandate, we urge the Board and the FSOC to give serious consideration to sponsoring more open discussion by all interested parties about a truly fitted and focused supervisory regime necessary to achieve the underlying concerns and any future mandates intended to protect the financial system's stability. from systemically important payment system vulnerabilities as we work to understand more about them. ABA considers the recent work of the Cleveland Federal Reserve Bank staff in the paper, "On Systemically Important Financial Institutions and Progressive Systemic Management", as representing some constructive thinking and affording some useful vocabulary for discussing and framing future debate about the challenges of identifying systemically important risks and supervising them.

Thank you for the opportunity to comment. If you have any questions or need additional information, please contact the undersigned at 202.663.5147 or via email at skenneally@aba.com.

Sincerely,



Stephen K. Kenneally
Vice President
Center for Regulatory Compliance