

January 20, 2010

Submitted via the Federal eRulemaking Portal, <http://www.regulations.gov>

Financial Stability Oversight Council  
United States Department of the Treasury  
Office of Domestic Finance  
1500 Pennsylvania, Avenue, N.W.  
Washington, DC 20220

Re: Advance Notice of Proposed Rulemaking: Authority to Designate Financial Market Utilities as Systemically Important

Dear Sir or Madam:

The American Bankers Association (ABA)<sup>1</sup> appreciates the opportunity to comment on the Financial Stability Oversight Council (FSOC) Advance Notice of Proposed Rulemaking<sup>2</sup> regarding the identification and designation of systemically important financial market utilities (FMUs). Safeguarding the payments system is essential to a productive economy and to ensure confident participation of both commercial customers and consumers. The ABA recognizes the need to protect these payment systems in a prudent and effective fashion. Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) grants the FSOC broad powers to identify, designate, and regulate FMUs. It is essential that the FSOC regulate to effectively mitigate risk where needed without overburdening the payment systems to an extent that they become inefficient.

FMUs are defined generally in the DFA as any person that manages or operates a multilateral payments system for the purpose of transferring, clearing, settling payments, securities or other financial transactions among financial institutions or between financial institutions and that person. FMUs reduce costs for market participants by providing centralized payment services and reducing the need for each market participant to have an individual relationship in order to effect a transaction. Some examples of FMUs facilitate bank wire transfers, paper check clearing, Automated Clearing House transfers, and credit and debit card networks.

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<sup>1</sup> The American Bankers Association 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](http://www.aba.com).

<sup>2</sup> Federal Register Vol.75 No. 244, December 21, 2010, <http://edocket.access.gpo.gov/2010/pdf/2010-32005.pdf>

In this universe, ABA believes only the two major wire systems, CHIPS and Fedwire, achieve the status of systemically important FMU (SIFMU)<sup>3</sup>.

## **Background**

DFA Title VIII authorizes the FSOC to review the status of FMUs to determine if they are systemically important. To be designated as systemically important, the FSOC must determine if the failure or disruption to the functioning of an FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States. DFA enumerates the following factors to be taken into consideration when making this determination:

1. The aggregate monetary value of transactions processed by the FMU;
2. The aggregate exposure of the FMU to its counterparties;
3. The relationship, interdependencies, or other interactions of the FMU with other FMUs or payment, clearing or settlement activities;
4. The effect that the failure of or a disruption to the FMU would have on critical markets, financial institutions, or the broader financial system; and
5. Any other factors the FSOC deems appropriate.

The process for designating a SIFMU from among all FMUs is dictated by DFA and involves advance notice and an opportunity for hearing.

The ANPR requests input on what quantitative and qualitative information should be used to measure the factors in DFA Section 804(a)(2) in arriving at a determination of SIFMU status.

## **ABA Comments**

### *Applying the Factors*

The measures and thresholds by which FSOC will apply the statutory list of factors in determining a SIFMU are best articulated by identifying the characteristics that describe the few FMUs that display the definitional hazard of spreading significant liquidity or credit risk among financial institutions or markets that thereby destabilizes the financial system of the United States. This is a substantial threshold that few FMUs will meet-- which is as it should be. ABA does not believe that the SIFMU designation was intended to create a redundant supervisory regime for the diversity of competitive FMUs, but rather is intended to establish standards for the uniquely critical FMUs that can spread significant risk across the broad financial system in a de-stabilizing manner.

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<sup>3</sup> CHIPS and Fedwire are the two wire system operators in the United States. The Clearing House Interbank Payments Company L.L.C. (CHIP Co.) manages the Clearing House Interbank Payments System (CHIPS) and the Federal Reserve Banks operate Fedwire.

Consequently, if an FMU processes a dominant market presence characterized by a major dollar volume relative to the marketplace for participants who rely on quick and final settlement and there are no effective parallel substitutes to effect the payments, then it may well be systemically important and its failure may spread disruption across the financial system. The order of magnitude of the measures of such factors should be set at the level displayed by those FMUs which the market participants readily and by consensus recognize as having the necessary critical adverse systemic effect. On the other hand, if the dollar amounts are percentage-wise relatively small, the payment and settlement process is not time critical and there are alternative payment methods available, then those FMUs would not meet the standard of being systemically important.

### *Wires*

In general, wire systems process the largest volumes of any payment system in terms of dollar amount and amount per transaction. These are known as wholesale payments. There are two predominate FMUs engaged in the wire system space: CHIPS and Fedwire. In evaluating the characteristics of these two systems against the statutory factors, the magnitude of their footprint identifies them as uniquely critical FMUs. Consequently, the measures of volume of transactions, aggregate exposure to counterparty risk, interdependence of the market on their operations and the impact of the disruption of their respective operations yield the appropriate types of information and level of threshold that constitute a SIFMU.

It is important to note that wire systems are very different from other types of payment systems and provide benefits to its users that other payment systems are not able to provide. The most important is that these payments are made in real time and are final. Other payment types may be reversed after they are made and do not provide funds immediate funds availability. The combination of the dollar volume involved in these transactions, the special characteristics regarding real and final settlement of funds, and the reality that there is no easily found substitute for wire transactions if the system fails or is disrupted would indicate that these two FMUs are systemically important.

***ABA does not believe that other payment FMUs possess the magnitude of size, counterparty risk, interdependence or systemic impact displayed by the identified wire systems and therefore they do not warrant a designation of being systemically important.*** We illustrate these distinctions below:

### *Retail Payment Systems*

In general, when reviewing retail payment systems, the dollar volumes are lower, there is not a real time settlement requirement and there are many types of payments systems that may be substituted if one type fails.

Consider an operator of a check clearinghouse, an ACH operator, or a debit or credit card network. If there were a significant disruption or failure to that clearinghouse the core principles correctly would suggest that it is not systemically important because the dollar volume is relatively low, the FMU would have limited exposure to its

counterparties, participants in the system could use alternative payment systems including cash, ACH, or debit and credit cards to make payments. It is also important to note that participants paying by check are not relying on immediate funding and final settlement that is a benefit of wire transactions.

### *Checks*

If the check system fails or is disrupted, most retail transactions could be conducted with cash or a debit or credit card transaction with little risk of the disruption overwhelming the other payment systems. Given the shrinking check volume as confirmed in the most recent Federal Reserve Payments Study, checks will become less significant with each passing year.<sup>4</sup> For the rare check transaction that needs a faster credit and final settlement, the parties may opt to substitute it with a wire transfer.

### *Cards*

If there were a significant disruption of the debit or credit card networks or if they actually failed, the result would be similar to a check system event. If one network failed, other networks would receive more business and there may be an increase in check and cash transactions. Many consumers would be able to substitute one card for another. If no card transactions were possible, payments would shift to checks and cash. Online commerce may suffer a decrease on volume, but that alone does not pose a systemic risk.

### *ACH*

ACH operators acting as FMUs facilitate debit and credit transactions. Debit transactions occur when a party has granted authorization to a second party to remove funds from their account. This is a common practice for payees of regular bills such as mortgage payments and car loans. It is important to note that ACH debits do not provide a certain settlement because the payers are allowed to reverse these transactions.

Credit transactions occur when a party moves funds out of their own account to the account of the receiver. The most common applications using ACH credits are payroll and benefit payments. These may be important payments to the individuals whose transaction is disrupted, but they do not indicate a systemic risk. ACH credits are relatively low in dollar value and if the credit is not generated the FMU risk exposure is limited.

There are substitute payment systems available, including using another ACH operator to process the transactions. If the other ACH operator is not available, payments may be made by check. This is not as fast using ACH credits, but it is an acceptable substitute until the system is repaired. Interestingly, the U.S. Department of the

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<sup>4</sup> The 2010 Federal Reserve Payments Study indicates that the check volume has shrunk dramatically in recent years. From 2006 to 2009 the number of checks processed has dropped from 30.5 billion to 24.4 billion, a drop of over 7% each year. The dollar volume of those checks dropped from \$41.6 billion to \$31.6 billion over the same time period.

[http://www.frbservices.org/files/communications/pdf/press/2010\\_payments\\_study.pdf](http://www.frbservices.org/files/communications/pdf/press/2010_payments_study.pdf)

Treasury issues prepaid debit cards to emergency federal benefit recipients in disaster zones on the basis that a debit card can be used by someone without a bank account and there may be difficulty in getting a check cashed.

Retail payment systems are effective substitutes because they provide the similar benefits to the payer and most payees will accept more than one type of payment. If one retail payment type fails the volume will move to the other systems reducing the possibility of an increase in systemic risk.

### *Existing Oversight*

The Federal Reserve System Policy on Payments Systems Risk, Docket No. OP-1191, amended in 2005, sets forth key risk management expectations in the design and operation of payment and settlement systems for those with a gross volume of more than \$5 billion per day. Those entities must implement a risk management framework that is appropriate for their risk level. Payment and settlement operators that are systemically important must meet even higher standards. Payment system operators that are required to implement these risk management policies are examined by their regulator for compliance.

ABA believes that the FSOC should include among its explicit considerations for determining what constitutes a SIFMU, the strength of the existing supervisory regime to which the FMU is subject as reflected in the oversight of risk management practices of the constituent members of the FMU or the FMU itself. The adequacy of the existing risk management practices required by the Federal Reserve, for instance, militates against designating most FMUs as systemically important.

### *Future Oversight*

The FSOC has the authority to identify and designate FMUs as systemically important and therefore subject to additional regulation. However, the type and extent of the additional regulation is unknown at this time making it difficult to gauge the administrative burden of being designated as systemically important FMU will be on an entity. FMUs designated as systemically important should be subject to fair and effective oversight that does not create an undue burden whose cost outweighs its benefits.

## **Conclusion**

The core principles outlined by the FSOC are appropriate for determining whether an FMU represents a systemic risk. The principles provide an effective tool to evaluate the characteristics that contribute most to payment system risk, large dollar volume, finality of settlement, and the lack of any comparable substitute system. Correctly, these principles indicate that wholesale wire systems (such as CHIPS and Fedwire) pose a systemic risk while retail payment systems including checks, ACH, and debit and credit cards, do not because of the smaller dollar volume, the lack of an expectation of finality at settlement, and that if one of them fails, transactions can be conducted with similar standards of convenience and settlement expectations.

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](mailto:skenneally@aba.com).

Sincerely,

A handwritten signature in cursive script that reads "Stephen K. Kenneally".

Stephen K. Kenneally  
Vice President  
Center for Regulatory Compliance