



BNY MELLON

May 19, 2011

Jennifer J. Johnson, Secretary  
Board of Governors of the  
Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, DC 20551

RE: Notice of Proposed Rulemaking; Docket No. R-1412; RIN No. AD-7100-AD71

Dear Ms. Johnson:

The Bank of New York Mellon Corporation (“BNYM”), a bank holding company with its headquarters in New York, New York, appreciates the opportunity to comment on the Notice of Proposed Rulemaking of the Federal Reserve Board (the “Board”) that appeared in the March 16, 2011 issue of the *Federal Register* (the “NPR”) regarding risk-management standards governing the operations related to the payment, clearing, and settlement activities of certain financial market utilities (“FMUs”) that are designated systemically important by the Financial Stability Oversight Council. Our comments address two elements of the NPR: (1) the proposed risk management standards would exceed statutory objectives, and (2) the definition of ‘materiality’ with respect to changes to risk management standards should be more narrowly drawn.

1. The Proposed Risk Management Standards Would Exceed the Statutory Objectives of the Dodd Frank Act

In response to the Board’s request for comment on whether the proposed standards achieve the statutory objective of the Dodd Frank Act (“DFA”), BNYM believes that certain of the proposed standards would go beyond such objectives.<sup>1</sup> In particular, we believe it is clear that three of the proposed Payment System standards and parts of two of the proposed standards for central securities depositories and central counterparties do not advance the statutory objectives.

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<sup>1</sup> Those objectives are: (1) to produce robust risk management; (2) to promote safety and soundness; (3) to reduce systemic risk; and (4) to support the stability of the broad financial system. See, 12 U.S.C. § 5464(b)

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The following three payment system standards address operating system issues and not risk matters.<sup>2</sup>

- The payment system should provide a means of making payments that is practical for its users and efficient for the economy.
- The payment system should have objective and publicly disclosed criteria for participation, which permit fair and open access.
- The payment system's governance arrangements should be effective, accountable, and transparent.

In like manner, the corresponding standards for central securities depositories and central counterparties address operating issues instead of risk mitigation (BNYM does not argue that these two standards in their entirety do not further statutory objectives; only the portions in italics can be so described):<sup>3</sup>

- The central securities depository or central counterparty should require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the central securities depository or central counterparty. The central securities depository or central counterparty should have procedures in place to monitor that participation requirements are met on an ongoing basis. *The central securities depository's or central counterparty's participation requirements should be objective and publicly disclosed, and permit fair and open access.*
- The central securities depository or central counterparty should have governance arrangements that *are clear and transparent and fulfill public interest requirements and to support objectives of owners and participants and should* promote the effectiveness of a central securities depository's or central counterparty's risk-management procedures.

It is fair to conclude that these standards are worthy elements for any payment system, central securities depository or central counterparty arrangement. On the other hand, they do not actually address risks contemplated by DFA. For example, criteria for access to a

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<sup>2</sup> These three standards are found, respectively, at proposed sections 12 C.F.R. 234.3(a)(8-10).

<sup>3</sup> These standards are found, respectively, at proposed sections 12 C.F.R. 234.4(a)(2) and (8).

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payment system, central securities depository or central counterparty do not relate to any of the risks contemplated by Title VIII of DFA. Participation criteria may be relevant to other matters but they do not have an impact on financial system risks. Rather, it is the actions taken by the payment system, depository or counterparty – not the rules governing who can participate in them – that create or mitigate risk.

Similarly, system governance structure does not have an impact on financial system risks. There can be no doubt that the actual decisions made by a system's governing body can and do have consequences for financial risk. It should be equally clear, however, that the governance structure selected and employed by that system is of little consequence when risk is concerned. The risk created by any entity is a function of the decisions it makes and actions it takes – not the structure employed by its governing body. Each payment system, central securities depository, and central counterparty should not be restrained in its selection of governance structure; rather, each such entity should be free to choose the governance structure that it and, where applicable, its members believe will best serve their purposes. Operating efficiency of a payment system, central securities depository or central counterparty will be enhanced by the ability to select and promptly adjust a governance structure in response to market and industry developments or other circumstances.

Any payment system will be naturally motivated to establish a practical means of making a payment that is also efficient for the economy. Whether such means are in fact practical or efficient is largely a matter of judgment, particularly at the time they are implemented. Even when such means have been in operation for some time, there can always be debate over whether a modification or alternate means would be more practical or efficient. Judgments of this nature are better left to the market and its participants whose business choices and actions will constitute the ultimate conclusion on practicality or efficiency.

## 2. The Definition of Materiality Should be More Narrowly Drawn

In accordance with Title VIII of DFA, the NPR provides for 60 days' advance notice to the applicable regulatory agency of proposed changes to rules, procedures or operations of a payment system, central securities depository, or central counterparty that could materially affect the nature or level of risks presented by a designated FMU.<sup>4</sup> BNYM shares the concern expressed by other industry members that such a requirement can hinder the ability of the FMU to operate effectively and efficiently and to promptly and in a reasonable manner respond to changing circumstances and market conditions.

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<sup>4</sup> See, proposed section 12 C.F.R. 234.5.

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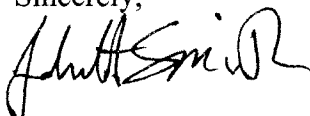
Accordingly, we urge that the prior notice requirement be applied narrowly and only to situations that actually impact the FMU's risk. Failure to narrowly construe this notice requirement can lead to constant or at least frequent submissions of change requests that will tax regulatory staff and reduce the efficiency of an FMU and impair its ability to promptly and effectively react to industry changes and risks. In this respect, we believe that at least three notice triggers specified in the NPR do not warrant a prior review and approval by regulators:

- Participant eligibility or access (see discussion above in part 1);
- Scope of services (such changes are typically unrelated to risk, but are instead made to improve competitive position);
- Governance (see discussion above in part 1).

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We greatly appreciate your consideration of our comments. If you have any questions or wish to discuss our comments, please contact me at 412-234-3887 or by email at [john.h.smith@bnymellon.com](mailto:john.h.smith@bnymellon.com).

Sincerely,



John H. Smith  
Managing Director and Senior Counsel