



July 26, 2004

*Via E-Mail*

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

Re: Policy Statement on Payments System Risk: Docket No. OP-1191

Dear Ms. Johnson:

Visa U.S.A. Inc.<sup>1</sup> very much appreciates this opportunity to comment on the proposal of the Federal Reserve Board (the "Board") to revise Part II of its Policy Statement on Payments System Risk ("Proposed Policy Statement").

The Visa Payment System, of which Visa U.S.A. is a part, is the largest consumer payment system and the leading consumer e-commerce payment system in the world, with more volume than all the other major payment cards combined. Visa plays a pivotal role in advancing new payment products and technologies, including technology initiatives for protecting personal information and preventing identity theft and other fraud, for the benefit of its over fourteen thousand U.S. member financial institutions ("Members") and their hundreds of millions of cardholders. Visa also considers itself an industry leader in addressing on behalf of its Members the risks identified in the Proposed Policy Statement.

Visa applauds the Federal Reserve for its worldwide leadership in addressing payment system risk. Particularly in light of the ever-increasing global nature of financial infrastructures, payments and payment systems, it is increasingly important that countries around the world address payment system risk in a consistent fashion. Failure to do so will result in inefficiencies for international payment systems such as the Visa Payment System and their users, and may increase the very payment system risk that each country's individual efforts are intended to reduce. Visa urges the Federal Reserve to continue to work through the Bank for

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<sup>1</sup> Visa U.S.A. is a membership organization comprised of U.S. financial institutions licensed to use the Visa service marks in connection with payment systems.

International Settlement, other multi-national organizations, and bilaterally with other countries toward a global approach to payment system risk consistent with the Board's Policy Statement on Payments System Risk.

Visa also strongly supports the flexible approach to risk-management embodied in the Proposed Policy Statement. Visa views a flexible approach to be critical, as the Visa Payment System and many of the other payment systems subject to the Proposed Policy Statement, do not fit neatly into a standard "one size fits all" model to which standard rules can be applied. Visa, for example, has worked extensively with its Members to establish and implement a comprehensive framework of risk management policies and procedures that address, in the unique context of the Visa Payment System, the commercial, legal and regulatory needs of Members. Visa views these risk control measures as central to its support of the Visa brand and the payment services it provides to its Members.

### SCOPE OF THE POLICY

The Board requests comment on whether the benefits of utilizing a bright line quantitative threshold for application of the Proposed Policy Statement based on a system's daily gross settlement value outweigh the costs of using more qualitative criteria and, if a quantitative threshold is appropriate, if settling an aggregate gross value of \$5 billion on any day during the next 12-month period continues to be a reasonable threshold.

Visa believes the current \$5 billion threshold excludes from the Payments System Risk Policy Statement several payment systems that should be covered under the Policy Statement. Visa is concerned about these payment systems for two reasons. First, through so-called "gateway arrangements," Visa sends payments transactions to and receives payments transactions from certain of these systems. As a result, as discussed below, any systemic risk not properly managed by these systems potentially could adversely impact Visa and its Members. Second, Visa has incurred and continues to incur substantial expense in addressing risk pursuant to the Payments System Risk Policy Statement. It is competitively unfair to Visa and its Members for other competing systems that pose these same risks to not also be addressing these risks.

There are a number of ways that the current Payments System Risk Policy Statement threshold could be revised to address these other payment systems. First, as suggested by the Board in the Proposed Policy Statement, a qualitative threshold taking into account the size and nature of the payment transactions being effected relative to the capital of the settling participants and other factors identifying systemic risk could more appropriately apply the Payments System Risk Policy Statement to payment systems that pose systemic risk than the current quantitative threshold.

Second, if the Board desires to continue to utilize a quantitative threshold, a quantitative threshold defined in terms of whether a specified percentage or number of settling participants' daily average net credit and/or debit positions through the system exceed a specified percentage of their capital and surplus would more appropriately correlate to systemic risk. The advantages of this approach are two-fold. First, such a threshold would be more consistent with

the approach Congress and the federal bank regulators utilize for bank lending limits, which address many of the same issues as the systemic risk threshold. Congress and the bank regulators have determined that a bank is permitted to lend any one borrower up to 15 percent of the bank's capital and surplus on an unsecured basis, plus an additional 10 percent on a secured basis. If the Payments System Risk Policy Statement further restricts a bank's exposure at a level that is lower than the lending limits, it would be not only inconsistent with the existing regulatory framework, but also would be illogical considering that payment systems have multiple participants that share the risk and considering the risk management measures required for those systems under the Policy Statement. Second, a threshold stated in these terms would more closely reflect the potential that failure of one settling participant may affect another participant.

Third, in the event the Board decides to retain the current daily gross settlement value threshold, Visa suggests that this threshold be decreased substantially, for example to \$1 billion. Visa recognizes the Board's longstanding concern that smaller payment systems not be burdened by the Payments System Risk Policy Statement's requirements.<sup>2</sup> However, in light of the consolidation of payment systems and the banking industry generally and the growth in electronic payment volume since the Board initially promulgated the \$5 billion threshold in 1999,<sup>3</sup> the exempted payment systems are by no means the same small systems they were in 1999. By decreasing the daily gross settlement value threshold to \$1 billion, the Board would ensure that those payment systems which raise the risks identified in the Payments System Risk Policy Statement would be covered under the Policy Statement.

Regardless of the threshold the Board adopts for purposes of determining the payment systems subject to the Payments System Risk Policy Statement, it is important that it be transparent which payment systems are subject to the Policy Statement. Depository institutions need to know which payment systems are subject to the Payments System Risk Policy Statement in order to assess a payment system's compliance with the Policy Statement when evaluating whether to participate (or continue to participate) in a particular payment system. In addition, it must be apparent which payment systems are subject to the Payments System Risk Policy Statement if payment systems are to comply with the requirement discussed below that they analyze the cross-system risks resulting from other payment systems with which they have inter-relationships or dependencies.

## **DEFINITION OF "SYSTEM"**

The Board proposes to clarify the definition of a "system" to identify three key characteristics of systems that would be used individually or in combination to determine if an arrangement qualifies as a system for purposes of the Payments System Risk Policy Statement.<sup>4</sup> Visa suggests that the proposed definition be revised to clarify the relationship between the general definition and the three characteristics. For example, is a payment system that meets the

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<sup>2</sup> Policy Statement on Privately Operated Multilateral Settlement Systems, 63 Fed. Reg. 34888, 34890 (June 26, 1998).

<sup>3</sup> 90th Ann. Rep., Board of Governors of the Federal Reserve System 116-117 (2003) (noting the trend away from using checks and towards greater use of electronic payment methods).

<sup>4</sup> 69 Fed. Reg. 22512, 22513 (Apr. 26, 2004).

general definition, but does not include each of the three characteristics covered under the policy! Does it matter how many or which of the three characteristics the payment system encompasses?

## KEY ELEMENTS OF A SOUND RISK-MANAGEMENT FRAMEWORK

As discussed above, Visa agrees that flexibility in risk-management for multilateral settlement systems covered under the Payments System Risk Policy Statement is critical. Given the differences in the systems that would be covered under the Payments System Risk Policy Statement, it would be impossible to attempt to define one standard set of risk management measures for all payment systems. The differences between systems covered under the Payments System Risk Policy Statement, including differences involving the nature of the participants, the number of the participants, transaction velocity, settlement credits and debits relative to participant capital and surplus, the size of transactions, and the number and nature of transactions processed and settled, mandate differences in how these systems each approach risk management. For example, the average size of a Visa transaction is approximately \$60, while the average size of a CHIPS transaction is \$5.1 million;<sup>5</sup> the average size of a Fedwire transaction is \$3.5 million;<sup>6</sup> the average size of an ACH transaction varies from \$70 to \$1,234, depending on the type of ACH transaction;<sup>7</sup> and the average size of a check transaction is \$925.<sup>8</sup> The CHIPS system settles on average a greater dollar value of payments in one day (\$1.4 trillion)<sup>9</sup> than the Visa system in one year (\$1.1 trillion).<sup>10</sup> Risk management measures appropriate for small dollar retail Visa card transactions may not make sense for large dollar wholesale wire transfers, and vice versa.

Regarding the four key elements of a sound risk-management framework and the detailed descriptions of each provided by the Board in the Proposed Policy Statement, Visa believes the detailed descriptions are helpful and further the Board's goal of providing flexibility in implementing the risk-management principles. However, Visa would ask the Board to clarify the following two points in these descriptions.

First, the Board states in footnote 20 that where systems have inter-relationships with or dependencies on other systems, system operators should analyze whether and to what extent cross-system risks arise and who bears them.<sup>11</sup> As indicated above, the Visa Payments System receives transactions from Members to be cleared and settled through other payment systems, which Visa passes through to those other systems through pre-established gateway arrangements with those other systems. Similarly, the Visa Payments System and Members

<sup>5</sup> CHIPS Annual Stats for 2003, [http://www.chips.org/annual\\_stats.php](http://www.chips.org/annual_stats.php) (June 2004).

<sup>6</sup> Federal Reserve Board, Fedwire Funds Annual Data for 2003, <http://www.federalreserve.gov/PaymentSystems/FedWire/fedwirefundstrfann.pdf> (2003).

<sup>7</sup> Press Release, NACHA, Ten Billion ACH Payments in 2003 (Mar. 22, 2004).

<sup>8</sup> Geoffrey R. Gerdes and Jack K. Walton, II, Use of Checks and Other Noncash Payment Instruments in the United States, Federal Reserve Bulletin 360 (Aug. 2002).

<sup>9</sup> CHIPS, About Us, <http://www.chips.org/about.php> (last visited July 14, 2004).

<sup>10</sup> Press Release, Visa USA, Visa USA Posts 11.6 Percent Growth in 2003, [http://usa.visa.com/personal/newsroom/press\\_releases/nr197.html](http://usa.visa.com/personal/newsroom/press_releases/nr197.html) (Feb. 9, 2004).

<sup>11</sup> 69 Fed. Reg. at 22517, n. 20.

receive transactions to be processed and settled through the Visa Payment System from these other systems through these gateway arrangements.

Failure of these other systems to appropriately manage their risks under the Payments System Risk Policy Statement could adversely impact Visa and its Members. For example, failure of one of those other systems to settle on a given day could result in the failure of Visa or a Member to receive settlement for a transaction sent to or from that other system through a gateway arrangement. In this way, the settlement failure of the other system potentially could cascade through the gateway to the Visa Payment System and its Members.

Visa believes this is precisely the type of situation the Board envisions when it states in footnote 20 that system operators should analyze whether and to what extent any cross-system risks arise and who bears them. Assuming Visa is interpreting footnote 20 correctly, Visa requests that the Board revise footnote 20 to clarify that gateway arrangements of the type described above are included within the scope of footnote 20, in order to make Visa's basis for assessing the risk of these other systems clear to Members and these other systems.

Further, as indicated above, it must be transparent which payment systems are subject to the Payments System Risk Policy Statement if payment systems are to analyze the cross-system risks resulting from other payment systems with which they have inter-relationships or dependencies.

Second, the Board states it will seek to understand how a system achieves the four elements of a sound risk-management framework, and it may be necessary for the Board to obtain information from system operators or to obtain data or statistics on system activity on an ad-hoc or ongoing basis.<sup>12</sup> Visa urges the Board to indicate in the Payments System Risk Policy Statement that it will obtain whatever data it needs in this regard from those payment systems subject to the Federal Financial Institutions Examination Council (FFIEC) examination process through that FFIEC process. Visa believes that the current FFIEC examination process is the appropriate process through which the Board should obtain any information it needs in connection with the Payments System Risk Policy. Since Visa provides services to Members that are regulated or supervised by all of the constituent regulatory agencies of the FFIEC, any consideration of Visa's efforts in connection with the Payments System Risk Policy Statement would appropriately be the concern of all of those regulatory agencies. In addition, a separate Board examination or other process in addition to the existing FFIEC examination would be unnecessarily burdensome on Visa.

## **THE BIS CORE PRINCIPLES FOR SYSTEMICALLY IMPORTANT PAYMENT SYSTEMS**

Visa strongly supports the Board's implementation of the BIS Core Principles as the standards for systemically important payment systems. As indicated above, consistent central bank and country payment systems regulation is imperative. Otherwise, inefficiencies and increased payment system costs will result for providers and users of international payment systems; unique local country requirements at the extreme could balkanize international payment

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<sup>12</sup> 69 Fed. Reg. at 22517

systems and thereby disrupt international payment transactions and international business dealings.

Consistent with the BIS Core Principles, Visa recommends that the Board provide additional guidance in the Payments System Risk Policy Statement about the systems that are, and are not, systemically important payment systems. Given the significant additional requirements imposed under the Payments System Risk Policy Statement on systemically important payment systems, it is important for all payment systems to know with certainty whether they are, or are not, systemically important payment systems.

Specifically, while the BIS Core Principles define what is a “systemically important payment system,” they do not discuss what is not a systemically important system. Visa recommends that the Payments System Risk Policy Statement, to assist systems in determining whether or not they are systemically important, should define characteristics of payment systems that are not systemically important, for example where the payment system settles small dollar retail transactions for a large number of financial institution participants such that *each* participant’s credit position in that settlement is not significant relative to its capital, and where there is no velocity or same-day turnover of settlement funds. Visa also recommends that the Proposed Policy Statement specifically state that those systems that do not meet the prescribed criteria for a systemically important payment system are not subject to the BIS Core Principles.

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Visa again thanks the Board for this opportunity to comment on the Proposed Policy Statement. Visa looks forward to working with the Board in connection with the implementation of Payments System Risk Policy Statement as it relates to the Visa Payment System. Please contact me, at (415)932-2178, if you have any questions about this letter or we can otherwise be of further assistance as the Board further considers the Proposed Policy Statement.

Sincerely,  
  
Russell W. Schrader  
Senior Vice President and  
Assistant General Counsel

