

VIA E-MAIL

July 26, 2004

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 -- OP-1191**

Dear Ms. Johnson:

On behalf of NACHA—The Electronic Payments Association¹, I respectfully submit this response to the Federal Reserve Board (“Board”) on its proposal to implement revisions to its Policy Statement on Payments System Risk (“PSR Policy”). Our response reflects the likely application of the revised policy on the ACH Network through the two ACH Operators: (1) the Electronic Payments Network (“EPN”) and (2) the Federal Reserve Banks (“FRB Operator”).

The Board seeks response to four specific questions regarding the proposed PSR Policy and its application. Our response addresses each of these questions below. We also believe the Board should address the longstanding issue of third party access to the ACH Network through sponsoring depository financial institutions (“DFIs”) by issuing a specific follow-up proposal and request for comment. Our views on this issue are presented after our responses to each of the Board’s four questions.

1. Do the benefits of a bright line quantitative threshold based on a system's daily gross settlement value outweigh the costs of using more complex factors to determine whether a system is covered by the policy? Should more qualitative or judgmental criteria be used instead? If a quantitative threshold is appropriate, does a threshold of \$5 billion a day continue to be reasonable? Should other quantitative criteria be considered?

Based on the proposed quantitative threshold, both ACH Operators – EPN and the Federal Reserve Operator -- will be well within the scope of the PSR Policy’s direct application based on their regular and expected daily clearing and settlement volumes.

We believe the proposed threshold is acceptable as it applies to clearing and settlement

¹ **About NACHA—The Electronic Payments Association:** NACHA is the leading organization in developing electronic solutions to improve the payments system. NACHA represents more than 12,000 financial institutions through direct memberships and a network of regional payments associations, and over 650 organizations through its industry councils. NACHA develops operating rules and business practices for the ACH Network and for electronic payments in the areas of Internet commerce, electronic bill payment and presentment (EBPP), financial electronic data interchange (EDI), international payments, electronic checks, and electronic benefits transfer (EBT). Visit NACHA on the Internet at: www.nacha.org.

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activities within the ACH Network. Currently, we do not recognize any other operators of ACH clearing and settlement systems as defined in the proposed PSR Policy that would approach the \$5 billion daily volume threshold. However, it will be helpful for any future entrants into the ACH Network as ACH Operators to know at which point they would be subject to direct application of the policy. Further, establishing a common U.S. dollar-denominated volume threshold across payment systems – both domestic and global, public and privately-owned or operated – will ensure a consistent regulatory approach.

2. Is the definition of what constitutes a system, and explicit exemptions from this definition, reasonable and appropriate?

We believe the proposed definition is reasonable and appropriate. By limiting the policy to systems with three or more participants (in addition to other provisions), bilateral clearing and settlement arrangements (such as correspondent banking relationships) would remain outside the direct application of the policy.

3. Do the general policy expectations of a sound risk-management framework, laid out in part B of the revised policy, give more structure and specific guidance to system operators and participants than the current policy's primary focus on types of risks and the general need to manage these risks?

We believe the proposed approach does provide more specific guidance.

4. In applying the Core Principles and the Recommendations, do the six criteria presented in the proposed policy appear reasonable for determining if a system is systemically important? Are there other factors that the Board should consider when determining whether a system is systemically important?

We believe the Board has captured the appropriate criteria in the proposal.

Additional NACHA Comment – Third-Party Access Settlement Risk

One issue we believe the current PSR Policy does not adequately clarify is the application of the Policy to direct access by third parties to multilateral clearing and settlement systems that permit such access. When a party other than the settling DFI is “sponsored” into a system – sending transactions directly to the system operator but settling through the sponsoring DFI’s account – significant risk can

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exist if the sponsoring DFI is not adequately monitoring its exposure and applying appropriate controls to what is originated on its behalf.

The risks associated with third-party ACH access have been thoroughly explored by NACHA and the Federal Reserve, but we remain concerned that policy guidance and related enforcement continue to lag what is needed to ensure the safety and soundness of the ACH Network. In 1993, NACHA's Board of Directors issued a resolution seeking a policy governing third party access and the issue was further explored and documented by the Settlement Risk Management Task Force in 1995-1996.² The recommendations of that Task Force were consistent with NACHA's 1993 resolution and supported in principle the Board's August 1995 proposal to govern third party access risk through its PSR Policy.³ Subsequently, NACHA commented in support of the August 1995 proposal, offering suggestions regarding the application of the policy and a willingness to work towards its implementation.⁴

Despite these reviews of third party access settlement risk by NACHA and the Board, our understanding is that, instead of becoming a specific feature within the PSR Policy, the Board's approach to the issue has been to lodge its enforcement with the Board's Division of Supervision & Regulation. While we can see some aspects of a policy along the lines of what was proposed by the Board in 1995 being enforced through that office, for reasons of clarity we believe the nature of the risks associated with third party access justify specific guidance through the PSR Policy. To this end, we believe the Board should again seek public comment on a specific proposal to address the management of third-party access settlement risk by payment system operators and their participants. In this regard, NACHA will again be reviewing the issue of ACH Network third party access risk to:

1. Identify current practices;
2. Quantify third party activity; and
3. Make recommendations regarding appropriate policy and ACH rules approaches.

We welcome and encourage Federal Reserve involvement in this effort (with representation from both Board staff and the FRB Operator) with the objective that the resulting policy recommendations assist the Board in its own review of the issue.

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NACHA appreciates the opportunity to comment on this proposal. If you have any questions

² "Report of the Settlement Risk Management Task Force," National Organization Of Clearing Houses and National Automated Clearing House Association (1996).

³ Federal Reserve Payment System Risk Policy, Docket R-0899, 60 *Fed. Reg.* 157 (August 15, 1995).

⁴ Response of William B. Nelson, NACHA, to Docket No. R-0889, Federal Reserve Payments System Risk Policy, November 15, 1995.

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regarding our comments, I may be reached at (703) 561-3929, or by e-mail at *imacoy@nacha.org*.

Sincerely,

Ian W. Macoy
Senior Director

NACHA – THE ELECTRONIC PAYMENTS ASSOCIATION
13665 Dulles Technology Drive; Suite 300
Herndon, VA 20171

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