JPMorganChase

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Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
Attention: Jennifer J. Johnson, Esq.,
Secretary

Re: Docket No. OP-1257
Consultation Paper on Intraday Liquidity
Management and Payment System Risk

Governors:

JPMorgan Chase Bank, N.A. ("JPMorgan") is pleased to submit these comments in connection with the Board of Governors of the Federal Reserve System's (the "Board's") "Consultation Paper on Intraday Liquidity Management and Payment System Risk Policy" (the "Consultation Paper"). JPMorgan, as the nation's largest U.S. dollar clearer of cash and book entry securities, has a keen interest in working with the Federal Reserve to reduce the risks in, and improve the efficiency of, the payments system. JPMorgan is very supportive of the goals of the Federal Reserve in this regard and has been actively participating in the Payments Risk Committee and Wholesale Customer Advisory Group (PRC/WCAG) task force established to gather data on the factors contributing to late day payments, to assess such data and to recommend solutions.

Late day payments over Fedwire, i.e., payments effected between the hours of 3:00P.M. to 6:00P.M. ET, have grown significantly over the years due to multiple factors, including natural growth in the size and volume of transactions, the impact of funds transfer daylight overdraft ("DOD") charges and bank credit and liquidity management practices. Some of the drivers leading to payments compression are structural in nature and may be difficult to change in any meaningful way, such as the operation of the tri-party repo market, the commercial paper market and the end-of-day securities settlement market. But where there are opportunities to improve efficiency, lower costs and reduce risk, they should be thoroughly explored. Our comments address the prospects of achieving these goals via: (1) the establishment of an intraday funds market; (2) DOD charges and collateralization; and (3) operational changes impacting payments and settlement systems.

While JPMorgan is supportive of the notion of creating an intraday funds market, it is the case only to the extent the economics of such a market can be proven, i.e., that the infrastructural and operational costs and expenses make sense in light of anticipated returns. Banks will be unlikely to make the initial and on-going investments to support such a market unless the business case can be made. To the extent DOD charges are reduced to incent early in the day release of payments, however, we think there is little likelihood that an intraday liquidity market will be needed.

JPMorgan believes that the reduction of DOD charges in connection with funds transfer activity clearly would be a factor in the reduction of late day payments. In this regard, a combination of a partial collateralization approach as described below, coupled with only a slight adjustment to DOD pricing, could prove very effective. The adjustment we recommend is a zero DOD charge zone during designated early morning hours, for example between the hours of 8:00AM to 10:00AM ET. We envision that at the end of the zero DOD charge zone period, any bank net overdraft incurred during such period would remain free of DOD charges for the entire day. With our proposed approach, banks will not need to manage their liquidity positions in the fashion they do today, and payments will be released into the system earlier in the day. In order to determine the optimal zero DOD charge zone period and to assess the impact on Fedwire throughput and DOD charges, the Federal Reserve System should conduct such modeling and testing as may be appropriate. While the risk to Reserve Banks in the incurrence of larger DODs, as the result of earlier in the day release of payments, may increase somewhat, the risk will be mitigated to the extent a portion of an institution's DODs can be collateralized. Moreover, the Federal Reserve System can always determine to cap the maximum overdraft eligible to be incurred during a zero DOD charge zone period, perhaps as a percentage of a bank's DODs or as a percentage of a bank's pledged collateral.

We have in the past been, and currently are, supportive of the collateralization of daylight overdrafts by means of pledging discount window collateral, a practice which has been adopted by most central banks worldwide. Many institutions today make little or no use of discount window collateral so that a DOD collateralization regime would create a productive use for such assets and an incentive for banks to increase such assets, ultimately leading to improved payments system efficiency and reduced costs.

Assuming that some portion of an institution's DODs will be uncollateralized and will bear DOD charges, banks should be given the ability, or option, to utilize their collateralized DOD position first, before going against their uncollateralized position. We recommend a partial collateralization approach because it would have a lesser impact on the self-assessment process, a process which we believe to be a key underpinning of the safety and soundness of the U.S. payments system in that it promotes discipline and includes board level and senior management scrutiny of an institution's payments operations and policies. There would be no need to conduct a self-assessment if an institution could simply send payments throughout the day up to the value of its collateral. JPMorgan believes, then, that the amount of intraday liquidity available from collateralized overdrafts should be limited to some percentage, to be determined after further analysis, of an institution's net sender debit cap established through the payments self-assessment process. This would likely have the beneficial effect of incenting early release of payments and reducing costs while at the same time preserving the risk controls inherent in the self-assessment process. If the Board chooses to lower the cost of Fedwire funds daylight overdrafts through some form of collateralization, we recommend that the Board also consider lowering the cost of Fedwire securities overdrafts, which are in effect collateralized by the underlying securities which are sent.

The level and extent of collateralization that would be permitted, the types of eligible collateral, the mandatory or voluntary nature of collateralization, the differential in pricing between collateralized and uncollateralized overdrafts and other issues germane to the implementation of a collateralized DOD regime will require further collaboration and input from the industry.

The Consultation Paper sets forth some possible operational changes to private settlement systems such as CHIPS and DTC as well as to the Fedwire funds transfer system. The Clearing House, of which JPMorgan is a member, will be responding directly on the Board's proposals. We also note that the PRC/WCAG task force has recommended feasibility studies on potential changes to DTC as well as collaboration with CHIPS to identify ways to release payments from the CHIPS queue earlier in the day. We support these initiatives.

Other operational changes discussed are queuing and netting of payments over Fedwire and establishment of throughput requirements. Our positions on these potential changes follow.

We think that a centralized queuing and release of netted payments over Fedwire is not a good idea in that it would undermine the value of Fedwire as an RTGS system.

Throughput requirements, as observed by the Board, may be difficult for some institutions to achieve and for the Federal Reserve System to enforce. Conceptually, such requirements are a good idea. CHIPS, for example, has operated with voluntary throughput requirements which although not enforced are adhered to on an aggregated basis. We think voluntary throughput requirements, encouraged by the Fedwire Reserve and other bank examiners, should be implemented. It should be kept in mind, however, that Fedwire, unlike CHIPS, does not process substantial international transactions; and, unlike CHIPS, there is no significant queue of payments awaiting release upon opening of business. Consequently, while improvements in Fedwire throughput can and should be made, there should be no expectation that throughput results achieved by CHIPS can ever be matched. Finally, the zero DOD charge zone we recommend, from 8:00AM to 10:00AM ET, would also have a positive effect upon throughput.

We thank the Board for the opportunity to comment upon to the Consultation Paper and hope our comments have been helpful.

Very truly yours,

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