UBS AG
Stamford Branch
677 Washington Blvd
Stamford, CT 06901
Tel: +1-203-719-3000

Barry Tebbutt
677 Washington Boulevard
Stamford, CT 06901
Internal: +19 337 0590
Tel: +1-203-719-0590
Fax: +1-203-719-0443
barry.tebbutt@ubs.com

Anneliese Schwyter
677 Washington Boulevard
Stamford, CT 06901
Internal: +19 337 7349
Tel: +1-203-719-7349
Fax: +1-203-719-0280
anneliese.schwyter@ubs.com

www.ubs.com

Federal Reserve System
Board of Governors
Ms. Jennifer J. Johnson
Secretary
20th Street & Constitution Avenue, NW
Washington, DC 20051

March 13, 2007

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

Dear Ms. Johnson:

Thank you for the opportunity to participate in the Federal Reserve System's Board of Governors *Consultation Paper on Intraday Liquidity Management and Payment System Risk ("PSR") Policy*. We are pleased to provide our experience in managing intraday liquidity, credit, and operational risks related to Fedwire funds transfers and associated transactions.

Of particular importance and concern to our organization is the focus on the current formula used for calculating permissible caps and deductibles for daylight overdrafts under the existing PSR Policy. This formula derives the cap for each institution based on its allowable capital, but recognizes an unequal percentage of capital for international banks in comparison to domestic bank's thereby creating a significant difference in determining deductible calculation of overdraft fees for international banks.

We echo the Institute of International Bankers' (IIB) recent comment letter voicing serious concern regarding inequitable treatment of foreign banks. As you know, the IIB's concern is supported by data collected from member banks, including UBS, by the Federal Reserve's Payments Risk Committee and Wholesale Customer Advisory Group which was used to analyze late day Fedwire Funds transfers and liquidity queue management. We agree with the IIB that the disparity in the treatment of international banks results in adverse cost differences and introduces risk elements that are competitively significant, consequently generating a markedly unequal playing field for international banks as compared to domestic banks that are major participants in the U.S. dollar clearing business.

While the Consultation Paper raises a number of complex issues, we respectfully request that this critical and increasing competitive disparity be reviewed first and independently to achieve uniformity and equitable treatment for all institutions (domestic and international).

UBS would like to offer our time and participation to meet and work with the Board staff and/or FRBNY to continue discussions as a large user of intra-day credit. It is our hope that the Federal Reserve will maintain its long-standing practice of working with financial institutions to address pertinent payments system risk issues such as the above, and continue to provide a framework for discussion around the short and long-term evolution of the PSR Policy.

Yours sincerely,

UBS AG

Barry Tebbutt,

Executive Director

U.S. Head of Foreign Exchange, Cash Collateral Trading, and Payments & Cash Management Operations

UBS AG

Anneliese Schwyter

Managing Director

Head of Group Treasury North Americas

Enclosure

FEDERAL RESERVE SYSTEM

Docket No. OP 1257

UBS AG (ABA #: 026007993)

Consultation Paper on Intraday Liquidity Management and Payment System Risk Policy

1. ***What intraday liquidity conservation strategies and technologies does your institution use (such as controlling the timing of payments and introducing queuing techniques to conserve on liquidity)?***

   Our intraday liquidity conservation strategy is to manage our daylight overdraft (DLOD) cost as close to the deductible amount while maintaining sufficient liquidity to meet our intraday obligations. Specific settlements such as CLS, Code 15, and DTC intraday progress payments are monitored and factored into our daily liquidity strategy. In situations where we are overdrawn beyond our target balance we throttle our money market payments until the CHIPS finality settlement.

   From a technology perspective, in December 2006 we introduced a new system with more advanced capabilities to better manage our queuing process. This new system allows us to prioritize payments based on account or payment type. The system also provides the liquidity manager the flexibility to set thresholds for the manual release of payments or the prioritization by account type. If necessary, the liquidity manager can also withhold payments to specific settlement members or convert the method of payment for a single or set payments from CHIPS to Fed or vice versa. These features allow our firm to control the flow of payments to the market based on a number of factors or payment attributes.

   How do these affect your institution's timing for sending payments?

   As indicated in the recent analysis of the PRC/WCAG, high value payments (usually money market repayments) are generally released in the last few hours of the day. The primary drivers for this behavior are the management of our DLOD cost and the limitation of our debit cap as a foreign bank.

   What, if any, changes are you planning with regard to intraday liquidity management?

   As a result of our recent system implementation mentioned above, we are currently in the process of evaluating the current liquidity thresholds as well as the prioritization of our payments by account type. These are minor changes that will allow us to maintain the optimal mix of criteria that will ensure the uninterrupted flow of payments to market without compromising our liquidity conservation strategy.

2. ***How do the concentrated demands for intraday central bank money by private sector systems influence intraday liquidity management by depository institutions throughout the day?***

We would like to refer to our participation in recent data collection by the PRC/WCAG which provides analysis of late day Fedwire Funds transfers and liquidity queue management. Data collected from thirteen banks for ten business days beginning on September 18, 2006, and ending on September 29, 2006 showed sharp increases in payment activity particularly after 3:00PM EST. This data is consistent with the increase in our late day payment activities. Our intraday liquidity management is influenced in the following ways:

a. Fed wire payments could be held back if we anticipate a large CHIP settlement;
b. We may go "long" across Fed Accounts in anticipation of a large CHIP settlement; and
c. Anticipation/existence of DTC intraday exposures that will require settlement.

A number of high value payments are held within our internal queue pending the settlement of:

- Federal Book Entry (FBE) system;
- DTCC;
- CHIPS; and
- Money Market Repayments.

Are there significant concentrated sources of demand for intraday central bank money beyond those already mentioned in the text and how does this demand affect intraday liquidity management?

As an institution that offers clearing services to both our affiliates and other clients, it is necessary for us to provide early settlement of funds to meet FRB deadlines for settlement of payments to central bank. We also witness demand for early repayment of funds to GSE's.

3. *Is the concentration of payments late in the day a concern for your organization?*

Yes.

If so, what is the nature of your concern?

Our concern centers on the significant values of payments late in the day overlaid by multiple settlements across a number of critical markets occurring late in the day.

This exposes our institution to risk, in the event of possible system wide disruptions while concurrently forcing a need to hold back our final funding activities until all late day settlements are finalized.

Does it include operational risk from late-in-the-day payments, and has operational risk to your organization from such payments been increasing or decreasing?

Yes it does but less within the institution and more so with external market factors.

Late in the day (defined by us as after 3:30PM), our projected funding positions are relatively flat vis-à-vis our closing the U.S. dollar position. However, a number of high value payments are held within our internal queue pending the settlement of:

- Federal Book Entry (FBE) system;
- DTCC;
- CHIPS; and
- Money Market Repayments.

Operational risk in late-in-the-day payments has risen within the marketplace and specifically is a concern for us. An example of this risk can be seen when comparing the situation the marketplace faced on September 11, 2001. The payment system was stressed early in the day and was able to ultimately settle and reopen on the following day. If a 9/11type event were to occur late in the day, it is our opinion that the market disruption could be catastrophic with the potential of an orderly settlement severely impeded.

A late in the day disruption to participants' ability to settle FBE, DTCC, CHIPS and ultimately accounts maintained within the Federal Reserve System could be avoided by an earlier cycling of liquidity across the various critical markets.

What are the key drivers of late-in-the-day payments?

Participants are:

1. monitoring their internal credit exposures;
2. minimizing their market risk;
3. planning for settlements at clearing agents/central depositories/private payment networks;
4. endeavoring to minimize their exposure to daylight overdraft expense; and
5. some market participants must be holding large credit positions.

How has your organization responded to the late-in-the-day concentration of payments?

Foreign Banking Organizations in general are concerned with the key drivers identified above and in particular, for the last, face a hurdle that disadvantages FBO's when compared to U.S. domestic institutions. This is important to note when considering how our institution addresses the late-in-the-day concentration of payments.

UBS responds to this concentration risk by ensuring:

1. a dedicated staff to monitor internal queues and expected funds from other institutions;
2. a supervisory infrastructure which oversees the use of our intraday daylight overdraft limit;
3. a dynamic system interface with Fedwire to check positions;
4. a consolidated methodology to understand our intraday exposure for settlements;
5. meeting with CHIPS/DTCC and clearing agents to endeavor to minimize high value settlement payments; and
6. participating in the FRB NY sponsored Payments Risk Committee work in this area.

Additionally, we consistently pledge collateral with the Federal Reserve at levels in line with our DLOD usage.

4. *For the market, operational, and PSR Policy changes discussed in this document and listed as follows, how might the timing of payments and the demand for daylight overdrafts be affected? What advantages or disadvantages do you see for these changes?*

An intraday market and early return market are not likely to be effective without all participants being on a level playing field with regard to the deductible calculation. Foreign banks would not have any incentive to participate in such an initiative.

- ***An intraday market to exchange liquidity between institutions that hold positive balances at the Reserve Banks and those that run negative balances.***

  The development of the tools necessary to process this activity and manage associated risk would be complex.

- ***A market for the early return of federal funds or other money market investments: Early returns are being tested now by the GSE's now.***

  We believe that the market for early day returns for GSE's is being provided by many of the institutions that already incur daylight overdrafts. We would encourage the FRB to continue to examine why some institutions hold long daylight positions and how they might be encouraged to make these funds available to the market earlier.

- ***Enhancements by private settlement systems that further economize on the use of central bank money, for example multiple settlement periods to release liquidity earlier in the day.***

  We would like to again, refer to recent data collection by the PRC/WCAG and subsequent analysis which suggested that there are potential benefits from modifying settlement processes at CHIPS and the DTCC.

- ***Liquidity saving mechanisms for the Fedwire funds transfer system:***

  We believe there would be benefits for the Fedwire system to utilize liquidity saving mechanisms to store and match payments, utilizing central algorithms that are similar to CHIPS.

- ***Throughput requirements for the Fedwire funds transfer system:***

  We believe this idea has merit, but believe it will be difficult to enforce. Additionally, if throughput requirements risk our internal bank controls, it is unlikely that we would be able to support this.

  Our recommendation is that any throughput requirements should also include Value and not just Volume to be effective.

- ***Greater use of voluntary or required collateral to cover partially or fully daylight overdrafts in depository institution accounts at the Reserve Banks***

  We support the greater use of voluntary or required collateral, as increased limits allow efficient same day movements of intraday systems. However, we strongly emphasize the need for equal collateral limits to all participants both foreign and domestic.

- ***Two-tiered pricing for collateralized daylight overdrafts, with a fee charged for collateralized daylight overdrafts set lower than the rate for uncollateralized overdrafts.***

  The above suggestion has merit, but would be difficult to implement technologically and may not be cost-effective. We are unsure of its benefits until further in-depth analysis and research based on demand and need at the end of the day.

- ***Time-of-day pricing of daylight overdrafts.***

  We do not believe that it would have significant benefits.

5. ***What are other possible approaches to consider to reduce delays in payments and to manage efficiently and effectively the Federal Reserve's exposure to increasing daylight overdrafts as well as depository institutions' exposure to intraday liquidity and credit risks? Are there other market or operational changes in the private sector that could help reduce intraday liquidity and credit risks?***

   As noted previously, we encourage the FRB to examine why some institutions hold long daylight positions and how they might be encouraged to make these funds available to the market earlier.

6. ***Congress is currently considering legislation that would allow the Federal Reserve to pay interest on reserve balances held by depository institutions at the Reserve Banks. How would the payment of interest on reserves affect depository institutions' intraday liquidity management, including the demand for daylight overdrafts at the Reserve Banks? Could the payment of interest on reserves be utilized to reduce the value or timing of daylight overdrafts?***

   Although we support this initiative, we believe payment of interest on the reserve balance which is held overnight has no direct correlation to the daily payment volume and the respective intra-day liquidity management.