THE BANK OF NEW YORK MELLON

Donald R. Monks Vice Chairman

June 4, 2008

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

Re: Docket No. OP-1309

Dear Ms. Johnson:

Thank you for the opportunity for the Bank of New York Mellon to comment on the proposed rule changes to the intraday overdraft charging rules of the Federal Reserve.

Summary

We are generally supportive of the proposed rule changes and, echoing comments provided in the joint response letter of the Payments Risk Committee (PRC) and Wholesale Client Advisory Group (WCAG), we believe that the proposed rule changes should lead to an earlier release of payments with the concomitant benefit of greater market liquidity. However, specific to our processing environment and our core businesses, there are a number of areas where we would like further clarification and guidance.

Given the scope and significance of The Payment Systems Risk (PSR) Policy, although we have encouraged the behavior intended by the Federal Reserve, we believe that the behavior of Fedwire banks in managing intraday liquidity and collateral is likely to vary and that the elimination of daylight overdraft (DOD) charging could have some unintended consequences, including increasing daylight overdraft usage, particularly earlier in the day. Our comments below also reflect some areas where further clarification by the Federal Reserve is needed, particularly in relation to collateral management and measurement, all of which will be discussed in greater detail below.

Charging Impact on Third Parties:

Most of the discussion on the topic of eliminating DOD charges has been around the negative impact of charges on the repositioning of funds late in the day. The proposal as written, may have unintended impact on the orderly opening of the government securities market (particularly the early day unwind of the repo market). In the mid-1990s the Federal Reserve began charging for DODs, driven by large daylight overdrafts that were being incurred by the tri-party repo business between 9:00 a.m.-12:00 p.m. We are concerned that this practice will resume if pricing is eliminated when collateral is available to off-set DOD positions, especially earlier in the day. As such, the implementation of this new policy could cause the industry to revert back to pre-DOD charging practices, thereby increasing risk to the system. Furthermore, while it would seem that this practice would help banks manage their respective DOD expenses, the potential resulting daylight overdraft positions could be of longer duration.

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Collective Behavior

Changes in collective behavior will be required to realize the shared benefits associated with the proposed PSR changes. The shared benefits will be exponentially higher if all banks act for the collective good rather than to minimize their own individual expense. Although we believe that most banks will typically act appropriately, the behavior of a small number of banks could have an adverse impact on achieving the benefits that the PSR changes are intended to realize. For example, as in today's environment, a participant might choose to decline to either post collateral or go into an overdraft position, instead waiting for others who have posted collateral to provide liquidity to the market.

However, if institutions are collateral-constrained and find it more costly to pledge collateral for PSR purposes, they may continue to hold back payments until late in the day. In this scenario, an imbalance in banks' ability or willingness to pledge collateral could lead to certain banks acting as 'liquidity traps.' This may negate the Policy's intent of remedying the current situation in which payments are increasingly being delayed until later in the day. Consequently, banks may need to make behavioral changes and/or monitor bilateral flows to maximize payment flows earlier in the day.

Impact on CHIPS Payment Flow

We believe the proposed PSR changes will have a positive impact on improving throughput times on CHIPS payments, which are normally large-dollar Treasury-type payments. Currently there is an imbalance between the large processing banks' positions between CHIPS and Fedwire. The new PSR policy will allow the large processing banks to use collateral availability to move funds from Fedwire to supplement their debit positions on CHIPS, so that payments can be released on CHIPS well before the system closes. This will allow for the reduction of late-day payments on Fedwire after CHIPS closes.

Implementation Timeframe

As referenced in the joint industry comment letter provided from the PRC and WCAG, and given the potential benefits to the industry, The Bank of New York Mellon agrees that accelerating the proposed two-year implementation timeframe would be beneficial. Barring major technological constraints, it appears feasible to adopt a one-year timeframe from the date on which the final policy is publicly announced, and we would ask the Federal Reserve to work with the industry to implement the proposed changes within that period.

Conclusion

The Bank of New York Mellon views the proposed rule changes as one of several enhancements to address the issues of systemic liquidity and late-day release. We encourage the Federal Reserve to support the work of industry participants who continue working on important efforts to identify and eliminate liquidity inefficiencies in existing clearing and settlement processes.

Finally, given the complex environment, as well as the nuances to the different approaches that might be used to managing positions, The Bank of New York Mellon would benefit from a discussion in person with the Federal Reserve.

Sincerely yours,

Don Monke