THE BANK OF NEW YORK MELLON

Donald R. Monks Vice Chairman

May 21, 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:

The banks comprising the Payments Risk Committee (PRC)[1] and the Wholesale Customer Advisory Group (WCAG)[2] are pleased to provide joint comments to the Board of Governors of the Federal Reserve on the proposed rule changes under Docket No. OP-1309. The committees are private sector advisory boards composed of major users of Federal Reserve payment services who meet regularly with the Federal Reserve Bank of New York and Board payments staff to foster collaborative improvements in the use and provision of payment services.

Summary

All institutions on the PRC and WCAG are generally very supportive of the proposed rule changes.

- We uniformly agree that the increasing concentration of late-day payments is an important issue for the banking industry, and we welcome the Federal Reserve's initiative in addressing the issue.
- We also recognize the importance of intraday liquidity and collateral management in the operation of the nation's various payments systems.
- Furthermore, we agree that the concentration of late-day payments is due in part to the charging environment; therefore, eliminating or reducing the costs of overdrafts is expected to lead to increased Fedwire funds transfer activity earlier in the day, though it is difficult to quantify the full effect.

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[1] The PRC identifies and analyzes issues of mutual interest related to risk in payments and settlement systems. Where appropriate, it seeks to foster broader industry awareness and discussion, and to develop input on public and private sector initiatives. The institutions represented on the PRC include Bank of America, Bank of New York Mellon, Bank of Tokyo-Mitsubishi UFJ, Citibank, Deutsche Bank, HSBC, JPMorgan Chase, State Street, UBS, Wachovia, and Wells Fargo.

[2] The WCAG is represented by depository institutions that are major users of the Federal Reserve's Fedwire Funds Transfer Service. WCAG members alert the Federal Reserve when they have business suggestions related to their use of the Fedwire Funds Transfer Service, and advise the Federal Reserve on how various initiatives and service/policy changes to the Fedwire services will impact banks' operations and customers. Institutions currently represented on this group are Bank of America, Bank of New York Mellon, Citibank, Deutsche Bank, HSBC, JPMorgan Chase, Key Bank, State Street, Sun Trust, UBS, US Bank, US Central Federal Credit Union, Wachovia, and Wells Fargo.

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Consequently, this proposed change should have a positive impact on the industry.

Given the scope and significance, the members of the PRC and WCAG agree that the behavior of Fedwire banks in managing intraday liquidity and collateral may vary and that the new collateral rules could lead to some unanticipated consequences. Finally, banks think some additional further analysis by the banks and clarification by the Federal Reserve are needed, particularly around collateral management and measurement, all of which will be discussed in greater detail below.

A. Collective Benefits

All banks agree that the proposed changes to the PSR policy are likely to lead to payments being processed earlier in the day, assuming all banks have adequate collateral, even if, as expected, banks continue to occasionally hold payments in queues to avoid overdraft charges. Furthermore, depending on the cost of collateral, the proposed changes are likely to lead to an increased amount of collateral pledged in the aggregate and thus, more daylight credit used earlier in the day because of the zero fee associated with collateralized overdrafts.

Additionally, the proposed changes could help to level the playing field between foreign and domestic institutions by increasing net debit cap flexibility. Foreign banking organization (FBO) members of the group noted that the incremental flexibility that the proposed streamlined max cap program provides them is a very positive development. The ability of highly-rated FBOs and financial holding companies to increase intraday overdraft capacity through the use of collateral up to their worldwide capital greatly increases the available capacity to those institutions. This increased flexibility should be beneficial in reducing the volume of payments held by these institutions to limit cost and stay within their respective net debit caps. Individual FBOs may express their desire to have the Federal Reserve recognize a greater percentage of their worldwide capital in the determination of both uncollateralized and collateralized debit caps in their individual responses.

And finally, there is potential to leverage benefits in other payments systems. For example, in CHIPS, the changes could lead to the availability of liquidity for use toward supplemental funding in CHIPS and the release of unresolved payments or for final settlement. The earlier release of these payments will have a positive impact on late-day payments.

B. Collective Behavior

Changes in collective behavior will be required to realize the collective benefits associated with the proposed PSR changes. The collective benefit would be exponentially higher if all banks acted for the collective good rather than to minimize their own individual cost. Although we believe that most banks will typically act for the collective good, the behavior of a small number of banks could have an adverse impact. For example, as in today's environment, a participant might choose to keep zero collateral and never go into an overdrawn position, awaiting others to fund first, while others post collateral to get payments out earlier in the day.

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' which may not improve upon the late-day problem. In these examples, banks may need to make behavioral changes and/or monitor bi-lateral flows to maximize greater payment flows earlier in the day.

C. Collateral Management Process

As noted above, we all agree conceptually that eliminating the charge for daylight overdrafts for collateralized overdrafts is largely beneficial. However, further detail is needed on the capabilities of both institutions and the Federal Reserve to manage collateral, including movement, monitoring and measuring collateral value at a given time. To balance the opportunity cost of collateral and the cost of daylight credit, institutions require a high degree of flexibility with regard to collateral movement and, potentially, posting. All institutions have a potential interest to move collateral into the Federal Reserve intraday. The industry needs to understand the mechanics of how that will occur.

Finally, to evaluate the full effects to liquidity and the extensions of intraday credit to clients given the proposed changes, banks will need a thorough understanding of the mechanics of collateral measurement and the subsequent benefits to costs and will be undertaking those analyses individually.

D. Implementation Timeframe

As a final, but important component to the proposal, we all believe, there may be a desire to implement the proposed changes sooner than the suggested two-year timeframe. The majority of the banks have concluded that a one-year time frame from the point that the final policy is publicly announced appears feasible and ask the Federal Reserve to work with the industry to implement the proposed changes within that period.

Conclusion

All banks are supportive of the proposed change in PSR policy, and we think it an important step in resolving late-day payment concentrations. In addition, the Federal Reserve and industry participants should not de-emphasize the focus and effort on the other work streams addressing the late day concentration of payments, namely DTC, CHIPS, and particularly liquidity savings mechanisms being contemplated by the Federal Reserve.

While the letter highlights questions and issues which need to be addressed, we think that the industry will work diligently towards the adoption of the proposed PSR changes.

Sincerely yours,

Donald R. Monks
Chair, Payments Risk Committee