



May 19, 2011

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th and C Streets, N.W.
Washington, DC 20551

Re: Docket No. R-1412: Financial Markets Utilities

Ladies and Gentlemen:

The Electronic Check Clearing House Organization ("ECCHO")¹ is submitting this comment letter to the Federal Reserve Board in response to its request for comment on its proposed rule (the "Proposed Rule") for the establishment of risk management standards for financial market utilities ("FMUs") designated as systemically important by the Financial Stability Oversight Council ("FSOC"). FMUs designated as systemically important by the FSOC are referred to herein as "designated FMUs".

1. ECCHO Supports An Exemption For Retail Payments

ECCHO does not believe an entity that facilitates the exchange and settlement of paper or check images should, by virtue of that activity, be a designated FMU. There are a number of policy and operational factors that support the conclusion that the retail payment systems in general, and the paper and check image systems in particular, are not appropriate for supervision under the systemically important FMU structure established under the Dodd-Frank Act. The check image system and the other retail payment systems process payment transactions that are relatively low in individual average dollar amount, compared to transaction amounts in the wholesale payment systems and other investment trading systems. These retail payment systems were not in any manner the source of any of the risk concerns that were identified during the recent financial crisis. In addition, there are alternative processors and settlement organizations for check image and the other retail payments (including the Federal Reserve Banks in the context of check image and ACH payments) that mitigate the risks associated with any one participant in the retail payments process. For example, the 2010 Federal Reserve Payments Study estimated the value and volume of checks paid in 2009. Using these values and volumes as a starting point, the

¹ECCHO is a not-for-profit national check clearinghouse owned by its over 3,000 member financial institutions dedicated to promoting electronic check collection and related payment system improvements. ECCHO is recognized across the U.S. as the national provider of private sector check image exchange rules. During 2010, ECCHO member financial institutions used check images to exchange under the ECCHO check clearinghouse rules approximately 7.9 billion transactions totaling \$9.9 trillion. The views expressed in this letter do not necessarily reflect the views of each ECCHO member financial institution.

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CheckImage Collaborative² data for 2009 showed that the largest single reporting entity was the Federal Reserve with 25% of the value and 30% of the transit check volume. The next largest entities individually reported values and volumes of approximately only one half of the Federal Reserve's values and volumes or approximately 12.5% to 12% respectively.

However, in the recent FSOC proposed rule, issued on March 17, 2011, the FSOC expressly declined to commit to exempting the retail payment systems providers from potential designation as designated FMUs in the future. As a provider of check image rules that are used by a range of image networks and other inter-bank exchanges in the United States, ECCHO is concerned that the designation of one or more FMUs that uses the ECCHO Rules as a designated FMU would impact the ECCHO rules drafting and amendment process. Accordingly, ECCHO believes it is necessary to set forth its concerns and comments now in the context of the Federal Reserve's proposed rulemaking as to the appropriate supervision of a designated FMU engaged in check image exchange, if that were to occur in the future. ECCHO's comments are focused on the provisions of the Proposed Rule that relate to the advanced notice to the Federal Reserve of changes to the operating rules used by designated FMUs in support of their payments and other financial transactions.

2. Advance Notice Requirement In Situation Where Reserve Banks Offer A Competing Payment Service

For check image services, the Reserve Banks provide depository institutions with check image payment services that compete with private sector correspondent banks, check clearinghouses and image exchange networks. A Reserve Bank's provision of check image services is governed by Operating Circular #3 and Regulation J of the Federal Reserve Board. Assuming that the Reserve Banks would not be deemed to be designated FMUs, the Reserve Banks would not be required to obtain prior approval of changes to their check image rules under the proposed new 12 CFR Part 234. Accordingly, if private sector check image exchange rules were subject to this prior approval process, the Reserve Banks would enjoy a significant competitive advantage vis-à-vis their private sector check image competitors. That is, the Reserve Banks would be able change their check image rules without being subject to the same delay and uncertainty to which the competing FMU would be subject under the 12 CFR Part 234 advanced notice and review process.

For example, the Reserve Banks, without prior notice to and approval of the Federal Reserve Board under the Proposed Rule, could change their item eligibility requirements under Operating Circular #3 to permit the exchange of a new type of check image payment, such as a missing check image file, that is not currently permitted under Operating Circular

² The CheckImage Collaborative is co-sponsored by the Federal Reserve Retail Products Office and ECCHO. The CheckImage Collaborative Communication Work Group collects and reports check image volumes from various sources across the U.S. including the Federal Reserve, The Clearing House, Viewpointe, and various local and regional exchanges. The value and volume of check images reported by the CheckImage Collaborative for 2009 represented 69% and 75% respectively of the transit check value and volume included in The 2010 Federal Reserve Payments Study.

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#3 or the ECCHO Rules today. A designated FMU that uses the ECCHO Rules to provide rules support for its check image processing could conclude that the FMU must subject an identical change to the ECCHO Rules to the Federal Reserve Board's advance notice and review process under Section 234.5 of the Propose Rule. This advance notice requirement would delay the designated FMU in offering a competing check image processing service to its financial institution clients for at least 60 days and maybe longer if the Federal Reserve Board staff requests additional information regarding the proposed ECCHO Rule change.

In light of these competitive concerns, ECCHO requests that the Federal Reserve Board consider the potential that delays in rule implementation by designated FMUs caused by the Section 234.5 advanced notice and review process may negatively impact competition between the Reserve Banks and the designated FMUs. As appropriate, the Federal Reserve Board should include within the final rule one or more provisions that seek to mitigate the potential for a negative impact on competition that may arise from the advanced notice process for the designated FMUs.

For example, we believe that this potential competitive concern could be mitigated if the Federal Reserve Board more narrowly defined the scope of designated FMU operating rule changes in the context of retail payments that would be subject to Section 234.5 review process. As described in greater detail below, we believe that designated FMUs operating in the retail payment context should have a more extensive range of operating rules that do not require advance notice to the Federal Reserve. Alternatively or in addition, the Federal Reserve Board could establish in the final rule a shorter notice period and a more rapid review process for any designated FMU operating rule change that is being made by the designated FMU in response to a similar rule change made by the Reserve Banks for their retail payment services. Finally, the Federal Reserve Board could consider applying the advance notice requirement and approval requirements of Section 234.5 of the Proposed Rule to the Reserve Banks for rule changes for their retail payment products.

3. Advanced Notice Requirement Should Apply Only To A Narrower Range of FMU Operating Rules

We believe that, in the context of the retail payments systems, the requirement that a designated FMU file advanced notice of proposed operating rule changes with the Federal Reserve would delay the implementation of the FMU's operating rules to the detriment of the FMU and its participant financial institutions, without a corresponding reduction of risk or improved supervision by the Federal Reserve. Accordingly, we request that the Federal Reserve Board provide in the final rule a greater range of operating rule changes for designated FMUs participating in the retail payment systems that would come within the safe harbor under Section 234.5(c)(3) of the final rule and therefore would not require advance notice to the Federal Reserve. In this regard, we recommend the below changes with respect to the safe harbor for operating rule changes under Section 234.5(c)(3) of the final rule.

A. Establish Wider Range of Categories of Rules under Section 234.5(c)(3) For Retail Payment System Designated FMUs

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In light of the lower systemic risk posed by designated FMUs in the context of the retail payment systems, and the competitive concerns with the Reserve Banks as noted above, we request that the Federal Reserve Board consider establishing in the final rule broader categories of designated FMU operating rules that would not be subject to the advanced notice requirement for those FMUs that process retail payments, such as check image, ACH, and card payments. There is nothing in Sections 805, 806 or 810 of the Dodd Frank Act that suggests that the Federal Reserve Board is limited to having a single set of categories of rules that do not present material risk to different types of FMUs. Indeed, a "one size fits all approach" to the categories of operating rules that are subject to the advanced notice requirement is inconsistent with the fact that the retail payment systems differ from the wholesale systems or the systems that settle derivatives trades and other esoteric financial instruments. The financial services industry has decades of experience with the retail payment systems, and the operating rules associated with the retail payment systems are well understood by the financial institution participants, the FMUs that operate the systems, and the bank regulators. It seems heavy-handed and unnecessary to apply the same risk matrix of operating rules changes to FMUs in the retail payment context as would apply to FMUs that process newly developed financial instruments with complicated structures with which participants, the FMUs or the regulators may have limited experience or direct knowledge.

B. Rules Governing Adjustments and Chargebacks of Individual Transactions

We recommend that the final rule include within the safe harbor under Section 234.5(c)(3) any operating rule of a designated FMU that relates to the adjustment or chargeback of an individual payment transaction.

In the retail payments environment, a very small percentage of transactions are subsequently subject to chargeback or adjustment from the paying bank to the presenting/originating bank after settlement of the particular payment transaction. The relative dollar amount and number of these chargebacks or adjusted transactions are small relative to the total dollar amount and number of the daily forward payments that settle without chargeback/adjustment. Accordingly, we would not view changes to a designated FMU's operating rules relating to these adjustment/chargeback transactions as subjecting the FMU or the financial institution participants in an FMU to material risk. By comparison, it is possible that operating rules of a designated FMU that relate to the rejection of entire files of payment transactions could be viewed as impacting the material risk to the FMU or its participants.

While small in relative dollar amount, because the adjustment and chargeback operating rules address a payment that is subject to a potential dispute, these rules typically include a high degree of detail and documentation elements. Therefore, these rules tend to be somewhat lengthy and detailed, and subject to frequent changes as the processor or the participants fine tune the chargeback/adjustment process. For example, a payment processor may change operating rules governing required documentation for a valid adjustment, the time period within which adjustment claims can be made or response to claims must be settled, and/or the evidentiary burden of proof between the two banks.

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These rules may vary for different types of chargebacks/adjustments within the same rules set.

C. Rules Relating to Time Schedules, Delivery Locations, File Records and Similar Operational Details

We recommend that the final rule include within the safe harbor under Section 234.5(c)(3) any operating rule of a designated FMU in the retail payment systems that relates to operational details for timing, delivery locations, file records and similar matters. The fundamental rights and liabilities of participants in the retail payment system are well understood by participants and established under the operating rules of the FMU or in certain cases applicable law. These fundamental rights with respect to retail payments and the participants exchanging such payments are rarely the subject of rules changes. In contrast, there are frequently FMU operating rule changes that relate to operational aspects of how the FMU participants transmit payment instructions to and from the FMU and each other. For example, there may be rule changes that require payments files be dispatched or received by a particular time, include certain record information or formatting, or establish locations for the delivery of payment files. In the context of retail payment systems, these operational rules should not be viewed as increasing or affecting the material risk to the FMU or its participants.

D. Non-Settlement Rules

In addition to the specific rule types designated in the Section 234.5(c)(3) safe harbor, the safe harbor also should include a catch all for other non-settlement related rules of those designated FMUs processing retail payments. The purpose of Title VIII of Dodd-Frank and the designated FMU is to address systemic risk. Systemic risk results from the failure of the designated FMU to settle its obligations in a timely manner. Rules of the designated FMU that do not relate to settlement are not relevant to systemic risk, and should not be subject to the advance notice and approval requirements of Section 234.5 of the Proposed Rule.

4. Establish Formal Process for Designated FMU to Obtain Guidance on Whether a Rule Change Impacts Material Risk or Not

The adopting release to the Proposed Rule states that the Federal Reserve Board expects that communications between the designated FMU and the staff of the Federal Reserve will assist the FMU in determining if a particular proposed rule change impacts material risk or not.

We believe that as a practical matter there will be a significant number of potential rule changes that will fall within the grey area between the lists of safe harbor non-material risk rule changes under Section 234.5(c)(3) and those rule changes that require advanced notice to the Federal Reserve under Section 234.5(c)(2). Accordingly, we recommend that the Federal Reserve Board in the final rule provide a more formalized process for a designated FMU to obtain guidance from the Federal Reserve staff as to whether or not a

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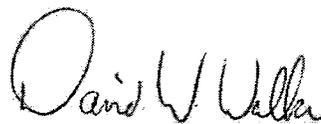
particular proposed rule change would present material risk to the FMU or its participants. The Federal Reserve Board's final rule could, for example, establish informational requirements and a format for the designated FMU to submit its request to the Federal Reserve staff for this guidance, and a time period within which the Federal Reserve staff must respond to an inquiry from the FMU regarding whether the proposed rule change is material or not.

5. Role of Rules Organization in Review and Approval of Designated FMU Rule

As discussed above, multiple potential FMUs utilize the ECCHO Rules. There also are other retail payment systems, such as the ACH, where the rules of a rulemaking organization are used by more than one FMU. ECCHO requests that the Federal Reserve Board address in the final rule the role of these rule organizations in the review and approval of designated FMU use of their rules. It would be more efficient, for example, for the Federal Reserve Board to review an ECCHO rule one time, upon its adoption by ECCHO, rather than for the Federal Reserve Board to review that same rule multiple times in the context of each designated FMU using that rule. Also, the rulemaking organization generally will have more information about the background, rationale and operation of the rule. ECCHO recommends that the Federal Reserve Board consider including in its final rules some type of pre-clearance process that could be utilized by the rulemaking organizations on behalf of the designated FMUs which will be using the rule in question.

Thank you for this opportunity to provide to you the views of ECCHO regarding the Proposed Rule. If you have any questions regarding this letter, please do not hesitate to contact me, at 214-273-3201.

Sincerely,



David Walker
President & CEO

cc: Thomas A. Fox, Schwartz & Ballen LLP