



September 4, 2018

*Via Electronic Submission*

Ann E. Misback  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue N.W.  
Washington, DC 20551

Re: **Docket No. OP-1613; New Message Format for the Fedwire® Funds Service**

Dear Ms. Misback,

The Clearing House Payments Company (**TCH**)<sup>1</sup> appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (**Board**) in response to its proposal to adopt ISO 20022 for the Fedwire Funds Service (**Fedwire**). As a core payment system infrastructure provider TCH encourages the evolution and improvement of the U.S. payment system. We believe adoption of ISO 20022 for the U.S. wire infrastructures – CHIPS and Fedwire – is important to the ongoing effectiveness and competitiveness of U.S. wire payments in the global market. Other high value systems around the world have adopted or are adopting ISO 20022, including systems that settle the British pound, the Japanese yen, the European Union euro, the Swiss franc, the Canadian dollar, and the Chinese renminbi. Given the strategic importance of ISO 20022 to U.S. wire payments, TCH strongly supports the Board’s proposal and is firmly committed to implementing ISO 20022 for CHIPS.

As further discussed below, TCH agrees with the proposed timeline and phases of ISO 20022 adoption for Fedwire though we believe that Phase 3 (fully-enhanced ISO 20022) should not precede SWIFT’s adoption of fully-enhanced ISO 20022 for its international (MT) payment messages. We also think that the Board and Federal Reserve Banks have a role to play in public-private sector efforts to (i) ensure the U.S. legal framework for wire payments is not negatively impacted by adoption of ISO 20022 and (ii) educate other U.S. agencies, the AML and OFAC compliance communities, and other stakeholders about the purpose of ISO 20022 and the implications of its richer and more structured data.

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<sup>1</sup> Since its founding in 1853, The Clearing House has delivered safe and reliable payments systems, facilitated bank-led payments innovation, and provided thought leadership on strategic payments issues. Today, The Clearing House is the only private-sector ACH and wire operator in the United States, clearing and settling nearly \$2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume. It continues to leverage its unique capabilities to support bank-led innovation, including launching RTP®, a real-time payment system that modernizes core payments capabilities for all U.S. financial institutions. As the country’s oldest banking trade association, The Clearing House also provides informed advocacy and thought leadership on critical payments-related issues facing financial institutions today. The Clearing House is owned by 26 financial institutions and supports hundreds of banks and credit unions through its core systems and related services.

## 1. Benefits of Adoption

### a. Interoperability

TCH agrees with the benefits of ISO 20022 adoption set forth in the Board's proposal. In particular, we emphasize the efficiencies and cost savings to banks likely to result from the existence of a common, international payment messaging format. Today banks must translate their international payments between multiple proprietary formats. While these formats are generally interoperable, meaning banks have "mapped" the data fields and codes used in one format to the fields and codes in another, translation between formats makes end-to-end payment processing less efficient. Translation also creates risk that data may be placed in an incorrect field. Or, if a bank must translate from a format with longer fields to shorter fields or with more fields to fewer fields, data may be split between different fields or into separate messages, truncated or dropped. Such reformulation of data is problematic from an AML and economic sanctions compliance perspective. To reduce these inefficiencies and risks, TCH supports adoption of ISO 20022 for U.S. wire transfers and the coordinated implementation of ISO 20022 with other high value system operators through the High Value Plus (HVPS+) task force.<sup>2</sup>

Given the interconnection of CHIPS and Fedwire and the importance of interoperability, TCH believes that it is crucial that Fedwire adopt ISO 20022. A decision not to complete Fedwire adoption would significantly undermine the value of ISO 20022 as a common domestic standard for U.S. wire and potentially impact the willingness of banks to adopt ISO 20022 for CHIPS. We note that TCH and many CHIPS participants have already made significant financial and human resource investments in ISO 20022 implementation based upon our understanding that Fedwire will also adopt the standard.

### b. Other Benefits

The benefits of ISO 20022 will extend beyond banks to their customers, the end-users of wire systems. This is because ISO provides a common message format not just for bank-to-bank messages but also customer-to-bank and bank-to-customer messages. For example, a customer can instruct a wire payment using an ISO 20022 payment initiation message and a bank can provide account reports to its customers using a cash management message. Customers that adopt these messages will benefit from straight through processing and reconciliation of their payments. Banks in turn will be able to offer new services to their customers that support and incorporate these new messages.

Another benefit of ISO 20022, in its fully-enhanced implementation,<sup>3</sup> is that it enables more information in a more structured format to be included in payment messages than current CHIPS and

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<sup>2</sup> "New high value payments systems task force is a key enabler of ISO 2022 harmonisation," *available at* <https://www.swift.com/insights/press-releases/new-high-value-payments-systems-task-force-is-a-key-enabler-of-iso-20022-harmonisation>.

<sup>3</sup> As explained in the Board's proposal, Fedwire's initial implementation of ISO 20022 (Phase 2) is a "like-for-like" version of ISO 20022 which is limited to the current fields, field lengths and codes used in Fedwire messages as of 2020 (after the Phase 1 "preparation" phase). TCH is taking the same approach for its CHIPS implementation.

Fedwire messages. For example, the fully-enhanced version of ISO 20022 will enable identification of an initiating party and more intermediary banks (in addition to other entities), contact information for various persons identified in the payment, more structured address information and more remittance information. Such additional information and structure will be useful for both business and compliance purposes. For example, we expect higher straight through processing rates for ISO formatted wire payments. Further, the additional information carried in the payment messages should also enable intermediary and beneficiary banks to determine with more specificity the persons involved in a payment, thereby reducing inquiries and their associated costs and delays. And the highly structured nature of the information should enable banks to be more targeted in the fields they screen and monitor, thereby improving the effectiveness of their compliance systems. However, as discussed in section 3 below, the richer data may also create regulatory challenges for banks if public and private sector stakeholders are not educated about ISO 20022 and its U.S. adoption.

## 2. Timeline and Phases

The Board has proposed to adopt ISO 20022 in three phases, beginning with Phase 1, a preparation stage, targeted for November 2020, in which certain updates would be made to the Fedwire proprietary format to support an easier transition to ISO 20022. Phase 2, targeted for August 2023, would be a “like-for-like” implementation of ISO 20022 in which messages have elements and character lengths that are comparable to the current Fedwire proprietary messages (as updated in Phase 1). Fedwire participants would implement like-for-like ISO 20022 in “waves,” meaning that not all participants would implement at the same time. Consequently, the Federal Reserve Banks will translate messages from the proprietary Fedwire format to like-for-like ISO 20022 and vice versa until all participants have implemented it. During this phase, participants will also test to ensure that they can receive fully-enhanced ISO 20022 in preparation for Phase 3. The Board currently plans to move to Phase 3 in November 2023 at which time Fedwire participants would be able, but not required, to send fully-enhanced ISO 20022 messages. Phase 3 will not be done in waves because all participants would have tested and confirmed their ability to receive fully-enhanced ISO 20022 in Phase 2.

TCH plans to adopt ISO 20022 for CHIPS in the same phases as Fedwire and the same timeframes for Phases 1 and 2. However, TCH will not implement Phase 3 (fully-enhanced ISO 20022) until SWIFT has also adopted fully-enhanced ISO for its MT messages. Ninety five percent of CHIPS volume begins or ends in another country so it is critical that CHIPS messaging be interoperable with SWIFT messaging. We believe it is best for the industry for Fedwire to also ensure that its implementation of Phase 3 does not precede SWIFT’s adoption of fully-enhanced ISO.

If Fedwire or CHIPS were to enable fully-enhanced ISO 20022 prior to SWIFT, banks would need to truncate or drop data if converting from fully-enhanced ISO 20022 to current MT formats and having to do so would present unacceptable regulatory risk. Consequently, even if Fedwire implemented fully-enhanced ISO 20022 prior to SWIFT’s adoption of it, few banks are likely to Fedwire messages in the send fully-enhanced ISO format until SWIFT’s adoption of it.

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Hence, the information available in “like-for-like” version of ISO will be the same as the information available in the 2020 versions of the proprietary Fedwire and CHIPS formats.

It should be noted that there is a possibility that SWIFT will support fully enhanced ISO prior to November 2023. If this happens, we think the Federal Reserve Banks and TCH should consider the implications this would have on their implementations and adjust them accordingly, if feasible. The optimal outcome will be for all three financial market infrastructures to synchronize their implementations of fully-enhanced ISO 20022.

### 3. Legal, Regulatory and Compliance Issues

While TCH supports adoption of ISO 20022 for CHIPS and Fedwire, we note that there are legal, regulatory and compliance issues that the format presents and which the U.S. public and private sector will need to address together.

#### a. Legal Issues

ISO 20022 uses terminology, which is captured in the message format itself, which has specific meaning under U.S. law, such as reference to an originator as a “debtor” and a beneficiary as a “creditor” despite the fact that the originator may owe no debt the beneficiary. ISO 20022 also refers to banks as “agents” while U.S. funds transfer law provides that a receiving bank in a funds transfer is not the agent of any other party to the funds transfer, unless that bank expressly agrees to be an agent.<sup>4</sup> Additionally, ISO 20022 messages also identify, among other new entities, an “ultimate debtor” and “ultimate creditor” which are persons that have some relationship to the “debtor” and/or “creditor,” respectively, but are not direct parties to the payment. However, U.S. funds transfer law applies to payments that begin with an originator’s (“debtor’s”) payment order to its bank and end with acceptance of a payment order by the beneficiary’s (“creditor’s”) bank (and its obligation to pay the beneficiary).<sup>5</sup> U.S. funds transfer law does not contemplate further persons beyond the originator and beneficiary and identification of these “ultimate” persons in a wire may call into question the application of U.S. funds transfer law. Such an outcome may undermine the legal basis for wire systems, contrary to the principle that systemically important financial market infrastructures should have a well-founded, clear, transparent, and enforceable legal basis.<sup>6</sup>

We note that the Board has recognized the potential legal issues created by ISO 20022 implementation. Earlier this year the Board proposed a change to Subpart B of its Regulation J, which governs Fedwire. The proposed change (i) clarifies that financial messaging standards (e.g., ISO 20022), including the financial messaging components, elements, technical documentation, tags, and terminology used to implement those standards, do not confer or connote legal status or responsibilities and (ii) specifies that Regulation J, Article 4A of the Uniform Commercial Code, and the operating circulars of the Reserve Banks govern the rights and obligations of parties to a Fedwire payment and supersede any inconsistency between a financial messaging standard adopted for Fedwire.<sup>7</sup> TCH supported this amendment to Regulation J in its comments to the proposal and plans to include a similar provision in the CHIPS Rules.

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<sup>4</sup> Uniform Commercial Code Article 4A-212.

<sup>5</sup> Uniform Commercial Code Article 4A-104(a).

<sup>6</sup> Principle 1 (Legal Basis), Committee for Payments and Market Infrastructures, Principles for Financial Market Infrastructures (2012).

<sup>7</sup> Federal Reserve System, Docket No. R-1599, “Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire” (March 15, 2018).

However, as Regulation J only governs Fedwire payments and the CHIPS Rules only govern CHIPS payments, funds transfers that are conducted outside of CHIPS and Fedwire will not have the benefit of these clarifications. While we do not believe that ISO terminology changes the U.S. legal framework for funds transfers, given their high value, funds transfers are frequently the subject of litigation. Not all courts are adept at understanding and applying Article 4A to cases involving funds transfers and it is a common practice for plaintiffs in such cases to argue that the article does not apply or that rights and obligations from other areas of law should apply. For these reasons, we are concerned that ISO terminology may provide additional arguments for litigants seeking to bypass Article 4A's liability framework and confuse courts. To mitigate the likelihood of such outcomes, we believe clarification regarding the relationship of ISO 20022 to funds transfer law, beyond provisions in Regulation J and the CHIPS Rules, is warranted. As the Board is the primary federal agency with responsibility for the U.S. payment system, we believe the Board should assist efforts to address the legal implications of ISO 20022 for private sector funds transfers. For example, we ask that the Board encourage the Permanent Editorial Board of the Uniform Commercial Code to address legal ISO issues in commentary to appropriate provisions of Article 4A.

b. AML, Economic Sanctions and Privacy Issues

As previously noted, the fully-enhanced version of ISO 20022 provides for richer and more structured data in wires. In particular, fully-enhanced Fedwire and CHIPS messages will identify, in specific structured fields, more persons who may be involved in a funds transfer in some way than current CHIPS and Fedwire formats and their like-for-like ISO implementations. While there are benefits to this additional information being included in wires, there is an inherent tension between additional data and the regulatory and compliance implications of the data. Not all data may or should be relevant for AML monitoring or economic sanctions screening and not all data will be available or appropriate for every payment. Hence, it will be important that the regulatory and compliance communities develop an understanding of ISO 20022 so that monitoring and screening practices and data expectations are appropriately tailored and do not undermine the ability to use ISO 20022's structured data to target screening and monitoring to relevant fields. Otherwise banks may encounter significantly more alerts in their monitoring and screening of payments, which could potentially adversely impact the overall efficiency of wire systems using ISO 20022.

Additionally, we believe the regulatory and compliance communities need to understand that under the Board's proposal, two versions of ISO 20022, (i.e., "like-for-like" and "fully-enhanced"), will be permitted for Fedwire. We expect that large, global banks will send fully-enhanced ISO 20022 messages once SWIFT has converted to that format. However, smaller banks that are not as internationally active may choose to continue sending like-for-like ISO 20022 messages. We are concerned that the co-existence of these two versions of the ISO 20022 format, one of which is more data rich than the other, may be the source of regulatory criticism for banks that choose to stay with the like-for-like version (which may be appropriate for the kinds of payments they make) or for correspondent banks that accept payments from their respondent customers in like-for-like format. Again, education will be important to prevent misunderstandings about why different banks may use different versions of ISO 20022.

Lastly, we note that ISO 20022 is being adopted at a time when concerns about data privacy and public interest in controlling personal and other data has become more pronounced. Hence, the additional persons and the additional information about those persons that are included in the fully-enhanced version of ISO 20022 may create data privacy and other data management challenges for banks.

Given the regulatory and compliance implications of Fedwire's adoption of ISO 20022 adoption, we believe the Board and the Federal Reserve Banks should assist in efforts to educate the regulatory and compliance communities about ISO 20022 and participate in public-private sector efforts to address AML, economic sanctions and privacy issues that are identified as the industry implements the format.

#### 4. Competitive Impact

The Federal Reserve Banks' Wholesale Product Office has engaged in a collaborative and transparent process with TCH and the CHIPS and Fedwire communities in its preparation for ISO 20022 adoption. Our expectation is that CHIPS and Fedwire payments will remain inter-operable during and after ISO 20022 implementation. Assuming that there are no significant differences in how the applicable legal frameworks for CHIPS and Fedwire address the legal issues created by ISO 20022 and no significant differences in the regulatory and compliance expectations for CHIPS and Fedwire payments, TCH agrees that Fedwire's adoption of ISO 20022 will not negatively impact TCH's ability to compete with the Fedwire service.

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Thank you for your consideration of these comments. If you have any questions or wish to discuss this letter, please do not hesitate to contact me.

Yours very truly,



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