



July 15, 2019

*Via Electronic Delivery*

Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20551

Re: Docket No. OP-1664; Potential Modifications to the Federal Reserve Banks' National Settlement Service and Fedwire Funds Service to Support Enhancements to the Same-Day ACH Service and Corresponding Changes to the Federal Reserve Policy on Payment System Risk, Request for Comments

Dear Ms. Misback:

The Clearing House Payments Company, L.L.C.<sup>1</sup> respectfully submits this comment letter to the Federal Reserve Board ("Board") in response to the Board's request for comment on potential changes to the National Settlement Service (NSS) and Fedwire Funds Service (Fedwire) operating hours ("Request for Comment").<sup>2</sup> These changes are needed to support a third same-day ACH processing and settlement window that was approved by the NACHA voting membership in September 2018.

## **I. Introduction**

### **A. Overview of the Proposal**

In September 2018, the NACHA voting membership approved an additional same-day ACH processing and settlement window at the end of the day. This new window would have an afternoon submission deadline of 4:45 p.m. (ET), with settlement occurring at 6:00 pm (ET). These NACHA rule changes are contingent on the Federal Reserve Banks ("Reserve Banks") making the changes to NSS and Fedwire operating hours described below.

To facilitate the 6:00 p.m. settlement of ACH transactions processed during this new window, the Board has proposed to extend NSS operating hours by moving the closing from 5:30 to 6:30 p.m. (ET). In addition, the Board proposed to extend Fedwire closing by 30 minutes from 6:30 p.m. to 7:00

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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 the RTP® network. 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 24 financial institutions and supports hundreds of banks and credit unions through its core systems and related services.

<sup>2</sup> Potential Modifications to the Federal Reserve Banks' National Settlement Service and Fedwire Funds Service to Support Enhancements to the Same-Day ACH Service and Corresponding Changes to the Federal Reserve Policy on Payment System Risk, Request for Comments, 84 Fed. Reg. 22132 (May 16, 2019).

p.m. (ET).<sup>3</sup> The Board would also extend the cutoff time for Reserve Bank accountholders to initiate transfers on behalf of third parties via Fedwire (the “third-party cutoff”) by 45 minutes, from 6:00 p.m. (ET) to 6:45 p.m. (ET).<sup>4</sup>

The Board emphasizes that it is not addressing the comments received in response to its October 2018 request for comment on Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments.<sup>5</sup> The Board states that it “continues to evaluate, and will separately respond to, comments on the 2018 notice.” Similarly, the views of The Clearing House expressed in this letter address only the expansion of NSS and Fedwire operating hours set forth in this Request for Comment and no other potential Federal Reserve settlement services.

## **B. Overview of The Clearing House’s Comments**

The Clearing House strongly supports the proposed changes to NSS and Fedwire to allow for the implementation of a new, third same-day ACH window.<sup>6</sup> The banking industry approved the change to the NACHA Operating Rules to create the third same-day ACH window by a wide margin through the NACHA rulemaking process, and desires to meet the demand from consumers and businesses for faster interbank electronic transfers. Although we generally agree with the Board’s view of the second and third criteria for approving a major service enhancement, we note that this Request for Comment provides limited analysis to support the Board’s position that the criteria will be met.

In addition, The Clearing House:

- recognizes that the proposed changes and related end-of-day compression risk may pose challenges for some financial institutions, and carry some risks, but believes that financial institutions will be able to make appropriate changes to account for these changes;
- supports reducing the two hour window between the closing and reopening of Fedwire as a means to address the risk of more frequent delays to Fedwire reopening; and
- encourages the Board to closely monitor the frequency of Fedwire reopening delays, consider additional policy changes if there is a notable increase in reopening delays, and take into account the disruption such delays have when determining whether to grant Fedwire extensions.

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<sup>3</sup> The Board explains that it “has long provided at least 30 minutes between the last NSS settlement and the closing of the Fedwire Funds Service, recognizing that ‘the Fedwire funds transfer service is the primary alternative for orderly and efficient settlement of bilateral obligations in case a settlement arrangement is unable to complete its multilateral settlement through NSS.’”

<sup>4</sup> The Board states that “[t]he Fedwire Funds third-party cutoff was established to stop the flow of customer transactions and allow financial institutions a settlement period to conduct bank-to-bank transfers to adjust master account positions before the closing of the Fedwire Funds Service.”

<sup>5</sup> Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments 83 Fed. Reg. 57351 (Nov. 15, 2018).

<sup>6</sup> Although not discussed in the Request for Comment, we note that the Reserve Banks’ Discount Window hours generally align with Fedwire operating hours. The Clearing House’s support for expanded Fedwire operating hours is contingent on similar expansions to the hours the Discount Window will be available.

## II. Discussion

### A. Federal Reserve Criteria

The Board views the proposed changes to both NSS and Fedwire as major service enhancements, which are required to meet certain criteria.<sup>7</sup> Specifically, for any major enhancement to an existing service, or any potential new payment service, (i) the Federal Reserve must expect to achieve full recovery of costs over the long run; (ii) the Federal Reserve must expect that its providing the service will yield a clear public benefit; and (iii) the service “should be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity.” With respect to the changes proposed in the Request for Comment, the Board expects each of these required criteria to be satisfied.

The Clearing House does not take a view on the first criterion regarding cost recovery. However, as further discussed herein, we believe that the proposed changes will yield a clear public benefit; and that other providers alone could not provide the enhanced services with reasonable effectiveness, scope, and equity, without fundamentally altering The Clearing House’s approach for ACH settlement.

The Clearing House agrees that the proposed changes to existing Federal Reserve services set forth in the Request for Comment would yield a clear public benefit, as they would expand access to and adoption of same-day ACH, which would benefit both consumers and businesses that need to send and receive same-day payments. The third same-day ACH window would be especially beneficial for west coast financial institutions and their customers, which currently can only make use of same-day ACH until the existing 2:45 p.m. (ET) / 11:45 a.m. (PT) processing deadline. The current timing makes it impractical for many customers of west coast financial institutions to utilize same-day ACH given the deadlines banks set for their customers, which are generally earlier than ACH Operators’ processing cutoffs.

The changes to NSS and Fedwire to support the third same-day ACH window would provide customers of all financial institutions, and west coast based institutions in particular, new options for utilizing same-day ACH capabilities later in the day. While many financial institutions are likely to utilize the third window for all eligible transactions; urgent bill payment, emergency payroll, business to business transactions, account-to-account transfers, and person-to-person payments are specific use cases that will benefit from the expansion. Among other things, the third window will further enable consumers and businesses to make time sensitive payments, and receive faster crediting of such payments. The expansion is also likely to contribute to further growth of same-day ACH volumes and the reliable and ubiquitous ACH network,<sup>8</sup> and as discussed below, is a modest yet achievable step towards expanding Fedwire operating hours so that financial institutions have a greater ability to transfer liquidity between Federal Reserve accounts.

As the Board states, The Clearing House utilizes NSS to settle intra-EPN ACH transactions and EPN would be unable to offer a third same-day ACH window with settlement at 6:00 p.m. ET using its current settlement approach, unless the Reserve Banks extend the closing time of NSS. While it may be theoretically possible for The Clearing House to implement an alternative settlement model for the third

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<sup>7</sup> “Federal Reserve in the Payment System,” *available at* [http://www.federalreserve.gov/paymentsystems/pfs\\_frpaysys.htm](http://www.federalreserve.gov/paymentsystems/pfs_frpaysys.htm).

<sup>8</sup> In 2018, nearly 178 million same-day ACH payments were made, which was a 137 percent increase over the prior year.

Same Day ACH window, any such alternative would be more complex than NSS, introduce potential risks that NSS mitigates, and require significant changes to the EPN Operating Rules and The Clearing House's operational practices.<sup>9</sup> We also note that there is no private sector provider of multilateral settlement services of the type offered by the Reserve Banks. For these reason, we agree with the Board's view that other providers alone could not provide the enhanced services<sup>10</sup> with reasonable effectiveness, scope, and equity.

Although The Clearing House generally agrees with the Board's view of the second and third criteria, we note that the Request for Comment provides limited analysis to support the Board's position. On this point, we believe that the extent of the requisite analysis regarding the criteria should be commensurate with the scale of the service enhancement or the introduction of the new service. In particular, the introduction of an entirely new service to a market that is currently being served by the private sector should require a more exhaustive and detailed analysis supported by data and evidence, to determine whether the criteria will be met, than modifications to existing Federal Reserve services such as those proposed in this Request for Comment.

Because the Board has not treated the third same-day ACH settlement window for FedACH as a major service enhancement in this Request for Comment, it only indirectly addresses the competitive harm that would result if the Reserve Banks were to go forward with the third window for FedACH (something they can do without expanding NSS or Fedwire operating hours), without expanding NSS and Fedwire operating hours.<sup>11</sup> While we agree that the expansion of the NSS and Fedwire Funds operating hours would promote competitive fairness between the two ACH operators, we think the required analysis about competitive impact requires the Board to expand the NSS and Fedwire Funds operating hours if the Reserve Banks intend to implement the third same-day settlement window for FedACH.

## **B. Other Uses of Expanded NSS and Fedwire Operating Hours**

If the Board extends Fedwire operating hours as proposed, The Clearing House expects to consider extending the operating hours for CHIPS, the largest private sector USD clearing system in the world. Among other things, this would expand CHIPS availability for west coast financial institutions and provide additional opportunities for financial institutions to make large value payments later in the day.<sup>12</sup>

Further, The Clearing House expects that RTP Participants would use expanded Fedwire hours under this or other proposals to support RTP network funding. We remind the Board that The Clearing House previously supported expanded NSS and Fedwire operating hours in response to the Board's request for comment on Potential Federal Reserve Actions to Support Interbank Settlement of Faster

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<sup>9</sup> NSS allows an agent to authorize direct debits and credits to financial institutions' Federal Reserve accounts; and has built in risk controls, including that debits and credits on a settlement file must net to zero and that credits are not processed unless and until all debits are successfully processed.

<sup>10</sup> We note that the Board's analysis of this criteria is somewhat confusing as it defines the enhanced services as expanded NSS and Fedwire Funds operating hours but its analysis of the criteria focuses on EPN's ability to support expanded ACH same day settlement.

<sup>11</sup> The Board states that "the changes to NSS and the Fedwire Funds Service would allow TCH, the private-sector ACH operator, to implement the third same-day ACH window" and "would promote competitive fairness between the two ACH operators."

<sup>12</sup> Currently, CHIPS has a 20 hour operating day that begins at 9:00pm the preceding calendar day, and concludes at 5:00pm.

Payments.<sup>13</sup> Specifically, we stated that “expanded National Settlement Service hours may be useful to faster payments services provided via ACH or other future private sector arrangements involving settlement groups.”<sup>14</sup> The Clearing House also views the expansion of Fedwire operating hours as the most useful means of providing a new liquidity management tool to transfer liquidity between Federal Reserve accounts outside of current standard business hours, and encouraged the Board to seek further industry input on a 24x7 Fedwire service. We encourage the Board to continue its efforts towards that goal. While the move to a 24x7 Fedwire service will require a longer implementation timeline, a modest expansion of Fedwire hours to support the third same day ACH window is a tangible step that can be achieved in the near term.

In addition, The Clearing House operates the Image Exchange Network, a private sector check image exchange service. Currently, Image Exchange Network settles check image transactions daily at 12:00 and 4:00pm (ET). The Clearing House expects to consider adding a later Image Exchange Network settlement if NSS operating hours are expanded as proposed.

### **C. Risk Considerations**

The Clearing House recognizes that the proposed changes to Fedwire may pose challenges for some financial institutions, and carry some risks. However, as discussed herein, we believe that there are steps the Board can take to successfully manage these risks; that financial institutions will be able to make appropriate changes to account for the end-of-day compression between NSS closing, the third-party cutoff, and Fedwire closing; and that the changes to NSS and Fedwire operating hours to support the third same-day ACH window are in the best interest of the continued evolution of the U.S. payment system.

#### **1. End-of-Day Compression**

The Clearing House agrees that banks will need to make changes to accommodate the proposed end-of-day timeline. The risks associated with such end-of-day compression were well-articulated and understood by the industry as part of the NACHA rulemaking process. The Clearing House believes that the strong support for the third same-day ACH window from financial institutions of all sizes demonstrates that, on balance, the industry considers the end-of-day compression risk small in comparison to the benefits of expanded same-day ACH hours. We also believe that banks can appropriately manage and mitigate the risks, though we encourage the Board to continue to monitor these risks in the context of the evolving U.S. payment system, and in the context of potential market disruptions or events that could cause the volume of Fedwire transactions to rapidly increase.

The Clearing House’s member banks will be able to accommodate the modified NSS and Fedwire operating hours described in the Request for Comment, and expect to be able to do so in advance of March 2021, when the third same-day ACH window is scheduled to take effect.

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<sup>13</sup> 83 Fed. Reg. 57351. Specifically, The Clearing House stated that “[s]ubject to further industry consideration and in addition to expanded hours for the Fedwire Funds Service, we think expanded National Settlement Service hours may be useful to faster payments services provided via ACH or other future private sector arrangements involving settlement groups.”

<sup>14</sup> The Clearing House comments on Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, *available at* [https://www.theclearinghouse.org/-/media/new/tch/documents/advocacy/fed\\_actions\\_to\\_support\\_faster\\_payments\\_12-14-2018.pdf](https://www.theclearinghouse.org/-/media/new/tch/documents/advocacy/fed_actions_to_support_faster_payments_12-14-2018.pdf).

## 2. Potential Fedwire Reopening Delays

The Board also asks for comment on “potential options to mitigate the risk of more-frequent delays to the reopening” of Fedwire. The Clearing House supports changes to Fedwire policies and practices that would reduce the risk of frequent delays to Fedwire reopening. Delayed reopening of Fedwire would disrupt the flow of large value payments supporting activity in international markets, and adversely impact the ability of U.S. depository institutions operating in those markets to meet their customers’ payment needs.

Delayed Fedwire reopening would also impact CHIPS. CHIPS starts its operating day at 9:00pm and CHIPS Participants use Fedwire to prefund their CHIPS ledger positions. Fedwire reopening delays would, thus, postpone the opening of CHIPS as CHIPS Participants cannot send payments until they have prefunded their ledger positions. Given the international nature of funds transfers that involve CHIPS, we note that roughly 12% of daily CHIPS transaction volume and 5% of daily transaction value are sent to CHIPS during the first hour of CHIPS processing (9:00 p.m. to 10:00 p.m. (ET)). Delayed Fedwire reopening would negatively impact CHIPS Participants active in Asian Pacific financial markets that need to make high value U.S. dollar payments, and rely on the overlap between CHIPS and Asian Pacific market operating hours to do so.

The Board offers three options to reduce the risk of frequent delays to the reopening of Fedwire: (i) increasing the current \$1 billion value threshold for providing Fedwire extensions to the third-party cutoff or Fedwire closing time (e.g., to \$5 billion),<sup>15</sup>(ii) changing the practice of maintaining a 2-hour window between the closing and reopening of Fedwire, and (iii) implementing a \$5 billion threshold for extensions and reducing the two-hour window between the closing and reopening of the Fedwire from 2 hours to ninety minutes.

The Clearing House supports reducing the two hour window between the closing and reopening of Fedwire as a control to reduce the risk of frequent delays to Fedwire reopening. The question of raising the dollar threshold for Fedwire extensions is, however, more complex. Some of our owner banks expressed concern that increasing the dollar threshold may adversely impact some financial institutions’ ability to receive Fedwire extensions when needed. At the same time, some of our owner banks were concerned that failing to raise the dollar threshold could lead to an increase in Fedwire reopening delays if the Board changes Fedwire operating hours as proposed. Because our owners do not hold a consensus view on whether the Board should raise the dollar threshold for Fedwire extensions, The Clearing House does not take a position on this particular issue. Regardless, if the Board approves the proposed changes to Fedwire operating hours, we encourage the Board to closely monitor the frequency of Fedwire reopening delays that occur after the new timing takes effect, and consider additional policy and practice changes if there is a notable increase. We also encourage the Reserve Banks to take into account the disruption Fedwire reopening delays have when determining whether to grant Fedwire extensions.

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<sup>15</sup> The Reserve Banks may grant an extension of the Fedwire closing time “only if (a) there is a failure of Reserve Bank network equipment and/or the Fedwire Funds Service network equipment; or (b) there is a significant operating problem at a bank or major dealer; and, as a result, (c) the extension is deemed necessary, in the Federal Reserve Bank of New York’s (or its designee’s) view, to prevent a significant market disruption (i.e., the dollar value of delayed transfers exceeds \$1 billion).” Operating Circular 6, Paragraph 10.3.

#### **D. Changes to the Payment System Risk Policy**

The Board would also make changes to the Federal Reserve's Payment System Risk Policy to account for the third same-day ACH settlement at 6:00 p.m., and adjust the approach for calculating fees for daylight overdrafts, which is based on the length of the Fedwire operating day. In particular, the daylight overdraft fee rate is calculated using an annual rate of 50 basis points that is prorated to the length of the Fedwire operating day. The Board explains that "If the operating hours of the Fedwire day increase by 30 minutes, the effective annual rate would be  $(22/24)$  multiplied by 50 basis points, or approximately 0.004583, and the effective daily rate would increase by about 2.4 percent to 0.0000127."

The Clearing House supports these proposed corresponding changes to the Payment System Risk Policy.

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Thank you for your consideration and review of these comments. If you have any questions or wish to discuss this letter, please do not hesitate to contact me using the contact information provided below.

Yours very truly,

/s/

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