



**Via FedEx and Electronic Delivery**

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Robert deV. Frierson, Esq.  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

**Re: Policy Statement - Federal Reserve Policy on Payment System Risk; Procedures for Measuring Daylight Overdrafts**

**File Number: Docket No. OP-1472**

Dear Mr. Frierson:

The Clearing House Association L.L.C. and The Clearing House Payments Company L.L.C., (together, “**The Clearing House**”)<sup>1</sup> welcomes the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the “**Board**”) regarding (i) the proposed changes to part II of the Federal Reserve Policy on Payment System Risk (the “**PSR Policy**”) related to the procedures for measuring intraday balances in institutions’ accounts at the Federal Reserve Banks (the “**Reserve Banks**”), which specifically provides for a change in the posting time for FedACH debit transactions from 11:00 a.m. (ET) to 8:30 a.m. (ET); (ii) the proposed changes to the Board’s Regulation J regarding the timing of when paying banks settle for check transactions presented to them by the Reserve Banks; and (iii) the proposed principles for establishing future posting rules for the Reserve Banks’ same-day ACH service and any future same-day ACH service to be provided by private sector ACH operators (collectively, the “**Proposed Rules**”).<sup>2,3</sup>

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<sup>1</sup> Established in 1853, The Clearing House is the oldest banking association and payments company in the U.S. It is owned by the world’s largest commercial banks, which collectively employ over 2 million people and holds more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated-clearing house, funds-transfer, and check-image payments made in the U.S. See The Clearing House’s web page at [www.theclearinghouse.org](http://www.theclearinghouse.org).

<sup>2</sup> 78 Fed. Reg. 74,130 (Dec. 10, 2014).

<sup>3</sup> We note that the Board is also contemplating a change to section II.G.3 of the PSR Policy, which is intended to clarify that U.S. branches and agencies of the same foreign bank are expected to manage their accounts so that the

### *Executive Summary*

The Clearing House supports the Board's efforts to ensure a safe, efficient and accessible payment system and to align Federal Reserve posting rules with private sector practices. We are concerned, however, that the Board's proposals do not consider the possible risks to the current EPN settlement process and potentially causes competitive disparity in the services offered by the Reserve Banks and private sector payment operators. Hence, we offer the following comments and suggestions, which are further explained in the body of this letter.

- Posting rules must not hinder private sector operators from competing effectively with the Reserve Banks.
- In the long term, the Board needs to develop a comprehensive approach to settlement and posting across all Federal Reserve products and private sector competitors to ensure that processes and rules regarding posting order, precedence, overdrafts and rejected settlements do not give the financial services offered by the Reserve Banks an advantage over private sector operators.
- In the short term, to avoid potential disruption to EPN settlement, the proposed simultaneous posting of FedACH debits and credits should occur after 8:30 a.m. (ET).
- National Settlement Service ("**NSS**") operating hours should be extended in order to address the gap between the close of NSS at 5:00 p.m. (ET) and the proposed cut-off timing for same-day ACH posting. Extending NSS hours would also further support the progression towards "ubiquitous near-real-time retail payment systems" which the Reserve Banks have called for in their public consultation paper<sup>4</sup> as this would allow financial institutions to settle among themselves on a more frequent basis.
- Reserve Banks and private sector operators should allow at least a 30 minute period between settlement for payment transactions and the close of Fedwire as financial institutions need time to settle other positions among themselves.
- The industry should have the ability to comment on future posting rules that would conform to the proposed same-day ACH posting principles.

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<sup>4</sup> See Board of Governors of the Federal Reserve System, "Payment System Improvement – Public Consultation Paper" (September 10, 2013).



### ***Discussion***

The Clearing House supports the Board's efforts to align and modernize the procedures for measuring account balances associated with ACH and check transactions. As noted in the Board's proposal, The Clearing House has had a long-standing practice to settle both debit and credit transactions at 8:30 a.m. (ET). We have previously supported efforts by the Board to align FedACH posting times with private sector operators<sup>5</sup> in order to promote parity between the services offered by the Reserve Banks and private sector operators and to reduce overall risk to the payment system.

While we generally support the changes contemplated in the Proposed Rules, The Clearing House has concerns regarding the effect the Proposed Rules will have on the timing and sequence of the overall settlement process currently in place, the competitive disparity issues inherent in these proposed changes and the potential for operational and settlement risk to current private sector settlement procedures.

#### ***I. Settlement Procedures Should Meet Objective Criteria***

As the Board has stated, "the role of the Federal Reserve in providing payment services is to promote the integrity and efficiency of the payments mechanism and to ensure the provision of payment services to all depository institutions on an equitable basis, and to do so in an atmosphere of competitive fairness" (emphasis added).<sup>6</sup> We believe that certain elements of the Proposed Rules do not promote this atmosphere of competitive fairness. As we discuss further below, if the Proposed Rules were implemented, Reserve Banks would potentially gain advantages that are not otherwise available to private sector operators due to the functional differences between NSS and Reserve account posting as a settlement mechanism and the limitations imposed by the current operating hours of NSS.

The Federal Reserve needs to separate its role as a central bank from its role as a financial services provider. Settlement procedures should not form the basis for competition between payment services provided the Reserve Banks and private sector operators and any changes to the manner in which the Reserve Banks settle must be implemented in a way that also ensures that private sector operators can effectively compete. Further, Reserve Banks, in their role as financial services providers to the private sector, should not have priority over private sector competitors or special access to Federal Reserve accounts. Hence, settlement for Federal Reserve services should be functionally equivalent to NSS settlement, which private sector providers use.

Ultimately, The Clearing House strongly believes that the Board needs to develop a comprehensive approach to settlement and posting across all Federal Reserve products and private sector competitors (i.e. collecting and correspondent banks, check clearinghouses, and ACH operators) that meets objective criteria. The Board should ensure that processes and rules regarding posting order, precedence,

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<sup>5</sup> See letter to Board of Governors of the Federal Reserve System, dated June 11, 2008, submitted by The Clearing House Association L.L.C. and The Clearing House Payments Company L.L.C.

<sup>6</sup> See Board of Governors of the Federal Reserve System, "The Federal Reserve in the Payments System", 76 Fed. Res. Bull. 293 (May 1990).

overdrafts and rejected settlement do not give Federal Reserve financial services an advantage over private sector competitors. This could be accomplished by separate but equivalent settlement for Reserve Bank services and private sector services (i.e., same function, timing, and access to amounts in Reserve Bank accounts). This would mean, for example, that in the event a FedACH participant had insufficient funds or intra-day credit to fund its net FedACH debit position at settlement time, it would have an effect on FedACH posting that is functionally equivalent to a recast settlement for EPN. Further, if a financial institution is both a FedACH and EPN participant and does not have sufficient funds or intra-day credit to fund its net debit positions with both ACH operators that are due to be settled at the same time, neither operator would have precedence over the other.

## ***II. Posting Time for FedACH Debit Transactions***

### ***a. EPN Settlement Risk***

EPN, The Clearing House's ACH network, and other private sector payment systems settle using the NSS. At settlement time EPN determines the net debit or credit position of each EPN participant for all the intra-EPN ACH entries the participant has sent and received during the applicable settlement period. EPN then sends a settlement file to NSS that instructs the Reserve Banks to debit or credit the Federal Reserve accounts of each EPN participant (or its settler) according to its net position.

The Reserve Banks first post (or attempt to post) debits entries from the NSS file to the Reserve accounts of EPN participants that are in a net debit position as these debits will fund the credit entries in the NSS file. If all the NSS debits successfully post, the Reserve Banks will then post NSS credit entries to the Reserve accounts of EPN participants that are in a net credit position. If all the debits entries in the NSS file do not successfully post, the NSS file will be rejected. In this event, EPN will recast its settlement by re-calculating the net positions of EPN participants by removing from the calculation the entries of the EPN participant(s) whose prior net debit position could not be posted to their (or their settler's) Reserve account.

The Clearing House is concerned that the new proposed timing to post both FedACH debit and credit transactions at 8:30 a.m. (ET) would have the potential to cause lower or negative balances in the accounts of EPN customers at 8:30 a.m. (ET), which in turn could cause the NSS file for EPN to be rejected, thereby affecting settlement for EPN participants. This is not a risk consideration for FedACH settlement, because the Reserve Banks have visibility into account balances and have the discretion to cease processing and refuse to settle before settlement time if a Federal Reserve account is deemed likely to have insufficient funds at settlement time.<sup>7</sup>

With respect to EPN participants that have insufficient funds in their Reserve accounts to cover an NSS debit entry, we understand that banks generally have daylight overdraft capacity that the Reserve Banks

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<sup>7</sup> See section 10 of the "Federal Reserve Banks Operating Circular No. 4: Automated Clearing House Items" effective as of November 4, 2013.



monitor on an ex post basis and that this overdraft capacity typically allows the Reserve Banks to process an NSS debit entry. However, private sector operators like The Clearing House do not have knowledge of (or the ability to verify) which of their participants have daylight overdraft capacity sufficient to cover their NSS debits or which of their participants have been placed on the real-time monitor.<sup>8</sup> A single rejected NSS debit will cause the entire settlement for a private sector operator to be recast if the institution that has insufficient funds or intra-day credit to cover their NSS debit does not fund shortly within settlement time.<sup>9</sup>

The Clearing House believes that the potential for a rejected or delayed private sector settlement will have negative cascading effects on multiple financial institutions and create disadvantages for EPN participants. Accordingly, the Board should address this operational and settlement risk given its potential adverse impact to financial institutions and private sector payments operators. Ideally, next-day FedACH settlement and private sector settlement should occur simultaneously at 8:30 a.m. (ET) under functionally equivalent settlement schemes that do not advantage one ACH operator over another. If this is not possible, in the short term, the Board should provide that next day FedACH settlement occurs shortly after settlement by private sector operators so as to ensure that FedACH settlement does not disrupt settlement by private sector operators. For example, FedACH debit and credit settlement could occur fifteen or thirty minutes after the private sector operator has completed settlement rather than the proposed timing of 8:30 a.m. (ET).

In connection with these concerns, The Clearing House would like to request additional information from the Board as to what types of analysis and modeling (including stress scenarios) have been undertaken to factor in the effects of these proposed changes to NSS settlement and whether such findings and conclusions may be shared with private sector operators.

***b. Clarification of “simultaneous”***

As posting order of debit and credit transactions is a key component in considering these proposals, one area of clarification that The Clearing House requests is regarding the “simultaneous” posting of FedACH debit and credit transactions. The Proposed Rules state that the “ACH credit and debit transactions are posted ‘simultaneously’ so that balances would increase or decrease by only the net amount of funds from daily ACH settlements and that debits associated with the receipt of ACH debit transactions could be simultaneously offset by credits from the receipt of ACH credit transactions, and vice versa.” However, there is still some uncertainty as to the implications of “simultaneous” posting of FedACH

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<sup>8</sup> “A Reserve Bank will apply real-time monitoring to an individual institution’s position when the Reserve Bank believes that it faces excessive risk exposure, for example from problem banks or institutions with chronic overdrafts in excess of what the Reserve Bank determines is prudent. In such a case, the Reserve Bank will control its risk exposure by monitoring the institution’s position in real time, rejecting or delaying certain transactions that would exceed the institution’s maximum daylight overdraft capacity or net debit cap, and taking other prudential actions . . . .” Federal Reserve Policy on Payment System Risk, § II(G)(2).

<sup>9</sup> Typically, The Clearing House will wait approximately 20-40 minutes for an institution to fund their Federal Reserve Account prior to recasting the settlement.

debit and credit transactions. We ask that the Board clarify that there will be only one posting of an institution's net FedACH position rather than a debit posting immediately followed by a credit posting or vice versa.

***c. West coast institutions***

The Clearing House also notes with respect to this proposal and the changes being made to the posting times for check debits and credits and large value check adjustments and corrections that, notwithstanding certain changes implemented to the PSR Policy since 2008 to provide for interest on Federal Reserve accounts to certain eligible institutions and to allow certain eligible institutions to collateralize daylight overdraft to reduce or eliminate daylight overdraft fees, the proposed change in timing to 8:30 am (ET) for posting of FedACH debit transactions would still adversely affect certain west coast institutions (albeit, such burdens are somewhat alleviated due to the changes in the PSR Policy since 2008) and could require these institutions to incur additional costs associated with funding accounts earlier in the day and also incur additional staffing costs.

***III. Posting Principles Applicable to Same-Day FedACH and Any Future Same-Day ACH Service***

***a. Competitive Disparity***

The proposed posting principles for same-day ACH service provides in part that Reserve Banks will not post settlement for same-day ACH transactions between 6:30 p.m. (ET) and 8:30 a.m. (ET). If the principles were to be adopted, private sector payment operators who engage in same-day ACH transactions in the future would be strictly limited in their posting and settlement activity to the hours of NSS, which are 8:30 a.m. (ET) to 5:00 p.m. (ET) as opposed to the Reserve Banks, which would have up to an additional hour and a half to post settlement beyond NSS hours. This is a clear competitive disadvantage and is not consistent with the Board's statements regarding the provision of payment services in an atmosphere of competitive fairness.<sup>10</sup>

While we note the Board's comments with respect to "operational limitations and account management" issues regarding its inability to extend NSS hours to 6:30 p.m. (ET)<sup>11</sup>, we believe that the competitive disadvantage resulting from this proposal warrants further review. The Clearing House respectfully requests that the Board address this competitive disparity by ensuring that FedACH operating hours are consistent with NSS operating hours. This can be achieved by extending NSS hours to 6:00 p.m. (ET) (with the effect that the Reserve Banks post settlement of same-day ACH at the same time as private sector payment operators). Alternatively, if a 6:00 p.m. (ET) close is not feasible, NSS could continue its existing closing hour of 5:00 p.m. (ET) and reopen at 9:00 p.m. (ET) that same day, when Fedwire Service operating hours commence, which would benefit west coast financial institutions and the movement towards near-real time ACH payment systems by allowing financial institutions as

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<sup>10</sup> See footnote 4 above.

<sup>11</sup> See footnote 38 of the Board of Governors of the Federal Reserve System's, "Federal Reserve Policy on Payment System Risk; Procedures for Measuring Daylight Overdrafts" (Docket No. OP-1472).



much time and opportunity to settle among themselves. Indeed, any enhancements to NSS should address the expansion of current operating hours, which we believe is a significant obstacle in the progression towards near “ubiquitous near-real-time retail payment systems,” which the Reserve Banks have called for in their public consultation paper.<sup>12</sup>

***b. Settlement Period Solely Among Financial Institutions***

The Clearing House is also concerned that settlement of same-day ACH transactions potentially as late as 6:29 p.m. (ET), whether for FedACH or any other future same-day ACH service, would not give financial institutions sufficient time to settle other positions prior to the Fedwire Funds 6:30 p.m. close. We would propose that there always be at least a 30-minute period between settlement for ACH and check transactions and the close of Fedwire so as to reserve time for financial institutions to clear amongst themselves other positions they may have relative to one another.

***c. Comments on Future Posting Rules***

Separately, as financial institutions and payment systems operators endeavor to work towards faster ACH clearing and settlement, we note that the process and the environment in which ACH clearing and settlement operates continues to evolve at a rapid pace. In light of this, The Clearing House is concerned with the Board’s statement that it does not anticipate seeking public comment again on future same-day ACH posting rules that would conform to the proposed same-day ACH posting rule principles.<sup>13</sup> While, except for the NSS operating hours disparity noted above, the Board’s proposed same-day ACH service principles are compatible with our expectations today regarding how future same-day ACH services might operate, these proposed principles may not reflect material considerations that could arise in the future on the issue. Accordingly, The Clearing House respectfully requests that, in the event the Board considers implementing future rules in accordance with the proposed principles on same-day ACH in the Proposed Rules, the Board would first seek public comment prior to implementation of any such rules so as to allow public discourse on the particular issue.

***IV. Posting Times for Credits and Debits for Check Transactions and Large Value Adjustments and Corrections***

While The Clearing House is generally supportive of the proposed changes to the posting times for credits and debits for check transactions and large value adjustments and corrections, we reiterate our concerns outlined above with respect to posting times that extend outside the current operating hours

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<sup>12</sup> See Board of Governors of the Federal Reserve, “Payment System Improvement – Public Consultation Paper” (September 10, 2013).

<sup>13</sup> See section III of the Board of Governors of the Federal Reserve System’s, “Federal Reserve Policy on Payment System Risk; Procedures for Measuring Daylight Overdrafts” (Docket No. OP-1472), stating, “That the Board does not contemplate that it would ordinarily request comment on changes to the posting rules that conform to such principles, but would request comment should it consider implementing posting rules that deviate from the principles.”

of NSS. In order to promote a level playing field between the financial services offered by the Reserve Banks and private sector clearinghouses and collecting banks and to also further promote the progression of near real time payment systems, we believe that NSS hours should be extended to be on par with the posting and settlement times available to the Reserve Banks.

The Clearing House also requests clarification from the Board as to whether the proposed 5:30 p.m. (ET) posting time for check credits and debits would be solely in connection with paper presentments to paying banks who do not receive check images.

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We greatly appreciate your consideration of our comments and would welcome the opportunity to discuss them further with you. If you have any questions or are in need of any further information, please do not hesitate to contact me.

Respectfully submitted,



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