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May 18, 2011

Via Electronic Submission

Board of Governors of the Federal Reserve System
Attention: Jennifer J. Johnson, Secretary
20th Street and Constitution Avenue, NW.
Washington, D.C. 20551

Re: Docket No. R-1412 and RIN No. AD-7100-AD71 – Financial Market Utilities

Dear Sirs and Madams:

The Board of Governors of the Federal Reserve System (“Board”) recently published a proposed rulemaking (“Proposed Rule”) pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act (the “DFA”) regarding:

(1) risk-management standards governing the payment, clearing and settlement activities of financial market utilities (each, an “FMU”) designated by the Financial Stability Oversight Council (the “Council”) as systemically important (each, a “DFMU”) (Section 805(a)(1)(A) of the DFA); and

(2) the process to implement the DFA requirement that a DFMU provide its supervisory agency with 60 days advance notice of certain proposed changes (Section 806(e)(1)(B) of the DFA).

As discussed in its response to the Council’s Advance Notice of Proposed Rulemaking on the topic of designating FMUs as systemically important, NACHA - The Electronic Payments Association (“NACHA”) believes that designating the entities that manage or operate low value payment systems, like the Automated Clearing House (“ACH”) Network, as “systemically important” is unwarranted under the DFA. However, since the Council indicated that it does not intend to categorically exclude any type of payment system from the scope of its regulation, NACHA is providing comments on the Proposed Rule in the event that the Council designates NACHA or the operators of the ACH Network as systemically important. NACHA appreciates the opportunity to respond to the Proposed Rule.

I. Background: The ACH Network – Who We Are

The ACH Network is a batch processing payment system. The beginnings of the ACH Network date to the early 1970s as banks sought a method to use technology to replace paper check processing. Today, the ACH Network is a hub for the electronic movement of money and other related data, providing a safe, secure, reliable network for direct consumer, business and government payments. It is a fully electronic payment system that enables movement of money between accounts held at virtually all of the nation's financial institutions.

The general public is most familiar with the ACH Network through various "direct deposit" programs, which are widely used for payroll, tax refunds and government benefit payments, including Social Security. Automated and online bill payments are other common and growing uses of the ACH Network by individual customers. Businesses use the ACH Network for similar purposes, as well as to convert payment made by check into electronic debits. The single largest user of the ACH Network is the Federal government, which uses the ACH Network for employee payroll and retirement distributions, benefit payments, tax collections and refunds, vendor payments and collections of other payments from individuals and businesses. With the Federal Reserve Banks serving as fiscal agents and depositories to the Federal government, these transactions generally flow through the Fed Operator.

In 2009 and 2010, respectively, the total number of interbank ACH entries processed and settled through the ACH Operators was 15.26 billion and 15.62 billion. In 2010, the average daily volume of interbank ACH entries was approximately 59.8 million, and the average dollar value of these entries was \$2,032 (\$3,022 for credits and \$1,353 for debits).

The ACH Network is managed by NACHA, and interbank clearing is conducted through the ACH Operators. Currently, there are two ACH Operators in the ACH Network: The Clearing House ("TCH"), a private organization owned by major financial institutions, and the Federal Reserve Banks (the "Fed Operator"). Each ACH Operator serves as an intermediary among participating financial institutions holding the accounts from which ACH transactions (both debit and credit) are initiated and the financial institutions to which such ACH transactions are destined. The financial institutions that conduct the vast majority of ACH transaction volume have relationships with both ACH Operators.¹ The ACH Operators sort the transactions initiated in the ACH Network by destination and make files available to each receiving financial institution. In each case, interbank positions are then netted and settled by the Operator via transfers among the settlement accounts of the participating financial institutions or their correspondents (generally the institution's reserve or clearing account held with a Federal Reserve Bank – "fed account"). With respect to TCH, this interbank settlement is effected through the Federal Reserve's Net Settlement Service (NSS).

NACHA is the not-for-profit organization that, through its board of directors, staff and various committees helps manage the ACH Network. NACHA develops and maintains standards for electronic fund transfers using the ACH Network, authors the *NACHA Operating*

¹ This goes to the issue of availability of substitutes in the event of the failure or disruption of a single ACH Operator. Additional information can be found in NACHA's January 2011 comment letter to the Council's Advance Notice of Proposed Rulemaking.

Rules, and enforces the *NACHA Operating Rules* through its National System of Fines. The *NACHA Operating Rules* govern the exchange of ACH payments, establish transaction formats and authorization requirements, and define the roles and responsibilities of ACH Network participants. These participants include:

- Originators (account holders that initiate credit or debit entries into the ACH Network);
- Receivers (account holders that have authorized receipt of a credit or debit entry by their financial institutions);
- ODFIs (depository financial institutions that hold the accounts of Originators, originate entries on behalf of their account-holding Originators and debit or credit such entries to the accounts of their Originators), and
- RDFIs (depository financial institutions that hold the accounts of Receivers, receive ACH entries through the ACH Network and debit or credit such entries to the accounts of their Receivers).

Since 1974, NACHA has successfully administered these private-sector operating rules governing the exchange of ACH payments, and defining the roles and responsibilities of financial institutions and other participants in the ACH Network. In its role as the standards organization for payments through the ACH Network and author of the *NACHA Operating Rules*, NACHA represents and brings together approximately 11,000 member financial institutions of all sizes and types throughout the United States, both directly and through 18 Regional Payments Associations. NACHA also brings together more than 450 other companies and organizations through our industry councils and Affiliate Membership program.

The *NACHA Operating Rules* are amended through a deliberative and inclusive process similar to that used by Federal agencies under the Administrative Procedures Act. This allows participants in the ACH Network - commercial banks, community banks, credit unions, the ACH Operators, large corporation, small businesses, consumer advocates, and industry vendors - the opportunity to comment on proposed rule changes. Through this inclusive process, NACHA is able to maintain a fair and equitable set of rules that create certainty for all parties using in the ACH Network. The *NACHA Operating Rules* work in concert with applicable laws and regulations to provide a legal and business foundation for the use of ACH payments.

Private-sector rulemaking provides the flexibility to promptly identify and respond to participant requirements and new technologies, and to define in sufficient detail the roles and responsibilities of participants in the ACH Network. From this foundation, the *NACHA Operating Rules* promote innovation and efficiency, and provide security and certainty regarding ACH payments.

II. The standards for payment systems should be limited to those intended to mitigate systemic risk and promote financial stability.

Among the stated purposes of Title VIII of the DFA is to “mitigate systemic risk in the financial system and promote financial stability by ... authorizing the Board of Governors to promote uniform standards for the ... management of risks by systemically important financial market utilities...” Section 802(b)(1)(A) of the DFA. Certain standards included in Section 234.3 of the Proposed Rule, however, appear to be aimed more at improving and maximizing efficiency and/or user satisfaction rather than at mitigating or minimizing payment system risk.

In particular proposed Section 234.3(a)(8) states that “the payment system should provide a means of making payments that is practical for its users and efficient for the economy.” While payment systems, including the ACH Network, have a vested interest in maximizing efficiency and customer satisfaction, such goals are outside the scope of systemic risk issues intended to be covered by the DFA and should be driven by market forces, not regulatory oversight. An entity that is designated as a DFMU would be hard pressed to respond to a risk management standard that indicates the entity should be “efficient,” particularly in the context of a regulatory mandate fully enforceable through the sanctions available under section 8 of the Federal Deposit Insurance Act. This is particularly true when competing concerns other than efficiency, such as security of the network or openness of a rule-setting process may counterbalance the commercial imperative towards more efficient operations. Both NACHA and TCH operate lean and efficient organizations, but NACHA suggests that our respective efficiencies are more a measure of our commercial competitiveness than of the risks posed by the ACH Network. Accordingly, NACHA respectfully requests that this standard be excluded from the final rule.

III. The proposed finality of settlement standard is inappropriate for retail payment systems like the ACH.

Section 234.3(a)(4) of the Proposed Rule would require a payment system that is a DFMU to provide “prompt final settlement on the day of value.” To the extent this reference is intended to preclude returns, reversals or other unwinding of previous settled payments, the standard would be fundamentally in conflict with longstanding practices in most retail payment systems, including the well-established right of return for ACH debit transactions provided in the *NACHA Operating Rules*. The *NACHA Operating Rules* permit ACH debits to be returned for any reason on the banking day after the settlement day, and disputed consumer debit transactions can be returned for an extended period. These rights are well known and understood by ACH Network participants and accordingly ACH Network participants manage the liquidity risks associated with such returns in their day-to-day operations. Other retail networks make similar provision for reversals of payment, driven in large part by the impact of federal consumer protection statutes such as the Electronic Funds Transfer Act. These types of returns do not affect the liquidity risk of the DFMU (NACHA or TCH) or the payment system as a whole (the ACH Network) or even of any individual institution since they are driven by individual transaction issues. Accordingly, NACHA respectfully requests that a standard for final settlement on the day of value should not apply to retail payment systems.

IV. The changes for which advance notice is required should be clearly defined.

Section 234.5 of the Proposed Rule would implement Section 806(e)(1)(A) of the DFA, which requires a DFMU to provide at least 60-days advance notice to its supervisory agency of any proposed change to its rules, procedures or operations that could, as defined by the

supervisory agency, materially affect the nature or level of risks presented by the DFMU. In Section 234.5(c)(1) of the Proposed Rule, the Board has proposed to define “materially affect the nature or level of risks presented” as “matters as to which there is a reasonable possibility that the change could materially affect the performance of clearing settlement or payment functions or the overall nature or level of risk presented by the [DFMU]”. NACHA appreciates the Board’s effort to limit the required notice beyond situations where there simply “could” be a material impact to DFMU risk. However, even “reasonable possibility” still sets a threshold that we believe would be overly burdensome both to the industry and the Board. DFMUs faced with the question whether a change involves a “possibility” of material impact to risk, albeit a “reasonable” one, are highly likely to err in favor of significantly over-disclosing changes to their rules, procedures and operations. Instead, we respectfully suggest that the standard should be “matters as to which it is reasonably likely that a change could materially affect the performance of clearing settlement or payment functions or the overall nature or level of risk presented by the [DFMU].” This standard still would require notice of the types of changes that have a real potential to increase risk within the system without creating a process that likely would end up unnecessarily involving the Board in a myriad of DFMU decisions.

In an attempt to provide clarity around this expansive definition of “materiality,” Section 234.5(c)(2) of the Proposed Rules sets forth a non-exhaustive list of changes that “would materially affect the nature or level of risks” and therefore would require at least 60-days advance notice to the Board. Although it could be helpful to clarify the difference between changes that would be material and those that would not by providing examples of each, the examples provided by the Board do not appropriately draw this dividing line.

Most items included in the Board’s proposed list of “material” changes are described in a manner that would require DFMUs to provide the Board notice of changes that would not necessarily affect the nature or level of risk in any manner. Indeed, because no element on the list is modified by any quantitative or qualitative measure, in some ways the list is inconsistent with the general standard that there be some reasonable prospect of a material impact on DFMU risk. For example, subclause (v) – “financial resources” would require a DFMU to provide advance notice of any change in the DFMU’s financial resources. Thus, while many changes to finances are not material, the example could be read to require repeated notices of a DFMU’s financial budgeting processes that in any way affect capital, access to credit or liquidity. The statutory language of Article VIII may be broadly written, but it is not that broad.

By way of further example, the requirement to provide notice of changes in “the scope of services, including the addition of a new service or discontinuation of an existing service” in subclause (viii) would require a DFMU to provide the Board notice of the addition of a new service that has no impact on clearing, settlement or payment functions other than to enable additional transaction growth within parameters already accepted and understood by the DFMU and the Board. The inability to roll out products and services that do not materially change a DFMU’s risk profile without following a time consuming regulatory review process would put well-managed and already highly regulated entities like NACHA at a substantial competitive disadvantage with respect to start-up retail payment systems that do not operate under such constraints, effectively increasing risk by pushing transactions toward these less regulated

competitors who can be more nimble without the overly intrusive aspects of proposed Regulation HH.

In much the same way, some of the exclusions proposed by the Board are so narrowly drawn as to be affirmatively unhelpful in marking a reasonable line between circumstances that may compel notice and those that may not. For example, the Board proposes to exempt “[a] change that does not modify the contractual rights or obligations of the [DFMU] or persons using its payment, clearing, or settlement services.” See Proposed Section 234.5(c)(3)(i). In the case of the ACH Network, and of all other payments systems with which we are familiar, the network rules by definition establish the contractual rights and obligations of the participants in the network. However, not all such changes affect the risk profile of the designated DFMU, the payment system itself or the participants in the payment system. By way of example, in response to a staff commentary to Regulation E regarding stop payment orders issued by the Board in 2007, NACHA implemented changes to the *NACHA Operating Rules* to align the ACH stop payment rules with the Board’s guidance. While these changes certainly affected the contractual rights and obligations of participants in the ACH Network, they did not have a material impact on the affected parties’ risk profile. We would not in this example have considered the mere adjustment of stop payment processes to be material as to risk in the system, and the Board’s guidance would govern the parties’ respective rights and obligations even in the absence of the change to the *NACHA Operating Rules*. However, because this change affected ACH participant’s contractual rights or obligations, it would have been subject to the advance notice requirement of the Proposed Rule thereby delaying implementation of a change made to eliminate conflicts between the *NACHA Operating Rules* and applicable law. In essence, the only types of changes to payment system rules that clearly do not modify contractual rights or obligations would be the types of clerical, non-substantive amendments separately identified by the Board as exempt at clause (v). While we agree that that such changes should not require prior notice and approval, the stark contrast of these exceedingly narrow exemptions to the broad swath of changes that are covered (e.g., any change to governance) creates a concern whether the Board has unintentionally narrowed the scope of what might otherwise be considered “material.”

Indeed, unless changes are made to both the descriptive standard and the examples in the proposed rule, DFMUs likely will provide the Board notice of an unnecessarily broad scope of proposed changes, regardless of the true likelihood of the impact to the risk of the payment system. This will require the Board to review changes for which there is a low probability of any significant impact on payment system risk, thereby reducing the Board’s ability to focus its limited resources on providing strategic and efficient review of more significant changes. It also will inhibit the effective management of core payments systems and negatively impact their ability to compete with their less regulated competitors. Accordingly, NACHA believes that in order to provide useful and effective guidance to DFMUs and to prevent “over-compliance” by DFMUs, the examples – both for changes that are material and those that are not - should be substantially re-written to produce a more targeted list of things that truly are material as listed. Alternatively, the Board could qualify the list by materiality, although this is a second-best solution since a simple materiality qualifier would not provide little additional guidance to DFMUs.

In addition, the examples provided by the Board should be further qualified to indicate which examples apply to DFMUs that “operate” systemically important payment systems versus those that merely “manage” such a system. For example, as a rules-setting and enforcement body, NACHA’s finances are not all that relevant to the risks involved in ACH processing. Similarly, participant access criteria to NACHA as a trade association are much less relevant than the criteria for access to the ACH Network itself.

Finally, the Proposed Rule - read literally - would require DFMUs to obtain Board approval of changes that are designed to improve, mitigate and/or minimize the nature or level of risks faced by the DFMU. Although we understand that the Board would like notice of changes that materially transfer or transform risk, as well as those that materially increase risk, the Proposed Rule remains overbroad in failing to exclude rule changes that do none of these. For example, NACHA has proposed to lower the threshold for certain actions related to the reporting and curtailing of unauthorized transactions within the ACH Network. Requiring Board approval for such changes would delay the implementation of positive changes with a corresponding negative impact on risk mitigation. Accordingly, NACHA encourages the Board to exclude such changes from the 60-day advance notice requirement.

V. The process for Board approval of proposed changes should provide for preliminary Board review and definitive periods for Board requests for additional information.

The proposed process for DFMUs to provide the Board notice of, and the Board to respond to, proposed changes to rules, procedures or operations lacks efficiency and could lead to indefinite review by the Board thus preventing DFMUs from providing clear guidance to their participants. Accordingly, NACHA requests that the Board incorporate the following elements into its approval process, which would satisfy the Board’s need to review changes that would have a material impact on payment system risk, while also providing definitive time frames on which DFMUs can rely for purposes of managing their core business.

Preliminary Determination

NACHA is concerned that the Proposed Rule lacks a time frame for the Board to provide a DFMU a preliminary determination of whether a proposed change is “material” and requires advance notice. As discussed above, in light of the expansive definition of “materiality,” DFMUs are likely to provide notice to the Board of changes that have a remote chance of affecting payment system risk. As a result, DFMUs may need to wait to the end of the 60-day period to implement a change that the Board may ultimately determine is not a “material” change or a change that would reduce or mitigate payment system risk. Accordingly, to prevent such results and to encourage efficient system management, NACHA encourages the Board to include a preliminary determination process within its Proposed Rule. NACHA proposes the following framework for the preliminary determination process

- A DFMU would provide advance notice of a change in writing to the Board, including sufficient information for the Board to make a judgment as to whether the proposed change would meet the regulation’s materiality standard. Within 10 days of receipt of the advance notice, the Board would notify the DFMU whether the change is matter for which advance notice is required.

- If the Board indicates that notice is required, the Board would continue to evaluate the proposed change to determine whether it objects to the change, and the DFMU would have 10 business days to complete its application. If the DFMU provides a complete package within that timeframe, the 10-day period would count toward the aggregate 60-day review period.
- If the Board notifies the DFMU that advance notice is not required or does not notify the DFMU that advance notice and approval is required for the proposed change within the 10-day period, the matter shall be deemed one for which advance notice is not required and the DFMU may implement the proposed change.

Limits on the Board's Right to Request Additional Information:

NACHA is also concerned that the Proposed Rule could lead to indefinite and extended Board reviews of proposed changes. Under the Proposed Rule, the Board may request additional information reasonably required for it to evaluate the impact of the proposed change for which advance notice is required on the nature or level of risk, which extends the review period until such time as the Board ceases to request additional information. NACHA recognizes that the Board's ability to request additional information is critical to enable the Board to make a well-informed determination regarding the impact of proposed changes. However, as currently drafted, the Board is permitted an open-ended time frame to continue to request such additional information. This indefinite review process would hinder DFMUs' ability to manage their businesses. Moreover, although the Supplementary Information suggests that the Board anticipates an information consultative process to address questions from DFMUs, such a process is unlikely to work for either the Board staff or DFMUs, given the volume of questions that are likely to arise and the need for a prompt and definitive response. Accordingly, NACHA proposes the following limitations that would continue to provide the Board the ability to request and obtain the information it needs to evaluate the impact of a proposed change, while at the same time giving DFMUs more certainty regarding the duration of the Board's review.

- The Board should make any affirmative request for additional information within 30 days of a DFMU's original submission of an advance notice.
- A request for review of a change for which advance notice is required shall be deemed complete as of the date of original submission if the Board does not ask for additional information within the 30-day period following the original submission, or as of the date on which the DFMU submits all additional information requested by the Board and following which submission the Board does not request additional information within 15 days following such subsequent submission.

VI. The Proposed Rule should account for DFMUs that allocate responsibility for Rule-making functions and operations functions between separate entities.

As described above, NACHA is the not-for-profit entity responsible for developing and enforcing the *NACHA Operating Rules* for the ACH Network. The ACH Operators are responsible for conducting the transactions and associated settlement in the ACH Network in accordance with the *NACHA Operating Rules*. As we have suggested in our comment to the Council, although we believe that neither TCH nor NACHA should be designated as DFMUs, if TCH is so designated in connection with its role as an ACH Operator, NACHA also would need to be so designated in its capacity as a manager of the ACH Network through its rule writing and enforcement authorities. In this capacity, NACHA, as the Rules administrator, would submit proposed changes to the *NACHA Operating Rules* for Board review when required. For consistent application of the Rules throughout the ACH Network and to avoid unnecessary and burdensome duplication of effort, it would be critical that the Board review and treat such rules changes consistently across all constituent FMUs comprising the ACH Network and that the single submission of the proposed rules change by NACHA satisfy the obligation to provide notice for the entire ACH Network and all of its constituent DFMUs.

VII. The Proposed Rule should reserve the ability of the Board to tailor a specific review process as part of the DFMU designation.

Finally, notwithstanding the general process comments above, the unique role of the Board in the ACH Network would warrant separate and more efficient oversight of the ACH rulemaking process if NACHA were deemed to be a DFMU. Specifically, NACHA proposes that the Board reserve the right to designate a more streamlined rule review process in connection with the Council's order designating a DFMU. This would enable the Board to take advantage of its existing integral involvement in the ACH rulemaking process by, for example, starting the 60 day review period of a proposed change the *NACHA Operating Rules* as part of NACHA's publication of a Request for Comment ("RFC") on a proposed rule. As the Board staff is aware, RFCs are published only after an extensive effort at gathering and synthesizing industry input, including input from the Board staff and the Board's Retail Payments Office. In a typical rulemaking effort, NACHA will consult informally with the Board and RPO staff, RPO staff may have participated in a work group that helped develop the rule (including the standing Risk Management work group), Board and RPO staff will have observed all of the discussion regarding the proposal at the Operating and Rules Committees, and the RPO staff would have sat through the presentation regarding the rules proposal to the NACHA Board. In many ways, an additional 60 day review would be redundant at that point, but at least if the period runs concurrent with the RFC process, it would help avoid further delaying an already extensive rulemaking process. Further, to the extent that NACHA makes material changes to the final *NACHA Operating Rules* from those proposed in an RFC in response to industry comments received during the RFC process, NACHA respectfully requests that the Board's review of such changes be limited to a 10 business day period since the Board would have previously undertaken a detailed review of the initial proposal. It also is worth noting in this regard that for a significant portion of the ACH Network, i.e., depository institutions that participate through the Fed Operator, the final determination whether an ACH rule change will actually apply is made the Board through its Operating Circular No. 4. That Operating Circular adopts the *NACHA Operating Rules* for transactions processed by the Fed Operator, but reserves the Board's right to reject rules on a case by case basis. With so much existing involvement in the ACH rulemaking processes, we respectfully suggest that, if NACHA is designated as a DFMU, the Board should

work with NACHA and TCH to minimize the impact to the ACH Network of any such designation.

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NACHA appreciates the opportunity to provide comments on the Proposed Rule. If you have any questions regarding our comments, please do not hesitate to call me at (703) 561-3927, or our counsel at Sidley Austin LLP in this matter, David E. Teitelbaum, at (202) 736-8683.

Sincerely,

/s/ Jane Larimer

Jane Larimer
EVP ACH Network Administration
General Counsel

cc: David E. Teitelbaum, Esq.