

What does CHIPS have to do with Banking? Provided by Julie Hayre, Senior VP/Manager City National Bank

The Clearing House Interbank Payments System (CHIPS) is the main privately held clearing house for large-value transactions in the United States, settling well over US\$1 trillion a day in around 250,000 interbank payments. Together with the Fedwire Funds Service (which is operated by the Federal Reserve Banks), CHIPS forms the primary U.S. network for large-value domestic and international USD payments (where it has a market share of around 96%). CHIPS transfers are governed by Article 4A of Uniform Commercial Code.

CHIPS is owned by financial institutions. According to the Federal Financial Institutions Examination Council (FFIEC), an interagency office of the United States government, "any banking organization with a regulated U.S. presence may become an owner and participate in the network." CHIPS participants may be commercial banks, Edge Act corporations or investment companies. Until 1998, to be a CHIPS participant, a financial institution was required to maintain a branch or an agency in New York City. A non-participant wishing to make international payments using CHIPS was required to employ one of the CHIPS participants to act as its correspondent or agent.

Banks typically prefer to make payments of higher value and of a less time-sensitive nature by CHIPS instead of Fedwire, as CHIPS is less expensive (both by charges and by funds required).

CHIPS differs from the Fedwire payment system in three key ways. First, it is privately owned, whereas the Fed is part of a regulatory body. Second, it has 47 member participants (with some merged banks constituting separate participants), compared with 9,289 banking institutions (as of March 19, 2009)[2] eligible to make and receive funds via Fedwire. Third, it is a netting engine (and hence, not real-time).

A netting engine consolidates all of the pending payments into fewer single transactions. For example, if Bank of America is to pay American Express US\$1.2 million, and American Express is to pay Bank of America \$800,000, the CHIPS system aggregates this to a single payment of \$400,000 from Bank of America to American Express – only 20% of the \$2 million to be transferred actually changes hands. The Fedwire system would require two separate payments for the full amounts (\$1.2 million to American Express and \$800,000 to Bank of America).

Only the largest banks dealing in U.S. dollars participate in CHIPS; about 70% of these are non-U.S. banks. Smaller banks have not found it cost effective to participate in CHIPS, but many have accounts at CHIPS-participating banks to send and receive payments.