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By electronic delivery to:
www.federalreserve.gov

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

RE: Consumers' Research Comment on Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments - Docket No. OP-1625

Consumers' Research appreciates the opportunity to respond to the Federal Reserve Board's request for comments on potential Federal Reserve actions to support a faster interbank payment settlement system. Consumers' Research[1] is a 501(c)(3) organization established to educate consumers and advocate for their general interests. This comment does not represent the views of any particular affected party or special interest group. It is intended to assist the Federal Reserve Board in evaluating the possible advantages of a faster payment settlement system, including 24x7x365 real-time payment, from a consumer and public interest perspective.

Introduction

In the past, interbank settlement and the processing of payments have been sluggish, especially for deposit availability and for payments by check. This time lag has progressively decreased over time. Long holds on consumer deposits used to be common but are now much less so, except in cases where a bank does not have full confidence in the validity of a check or other non-cash payment instrument. Faster interbank payment settlements might reduce the time lag on the availability of consumer deposits, but its main effects would be on the broader banking system.

Despite the increase in the speed of bank transactions, the Proposed Rule[2] notes that non-bank payment services have emerged that provide for faster receipt and payment of funds for consumers.[3] These faster transactions make it possible for consumers to receive funds and make payments with ease. Faster transactions could help consumers avoid late payments of bills and other obligations without the necessity of paying well in advance to ensure the payment clears in time.

Faster interbank payment settlement would increase efficiency throughout the banking system and is desirable — provided that it can be accomplished safely in terms of systemic risk and that the system is

[1] Founded in 1929, Consumers' Research is the nation's oldest consumer affairs organization. Consumers' Research aims to increase the knowledge and understanding of issues, policies, products, and services of concern to consumers and to promote the freedom to act on that knowledge and understanding.

[2] While the Federal Reserve calls this a Proposed Rule, it is actually a presentation of a proposed framework and contains no actual regulatory language; nevertheless, it will be referred to as the Proposed Rule in this comment.

[3] See Proposed Rule https://www.federalregister.gov/documents/2018/11/15/2018-24667/potential-federal-reserve-actions-to-support-interbank-settlement-of-faster-payments-request-for#h-21 at , Page 57,352.

not overly expensive.[4,5] The Federal Reserve is proposing a 24x7x365 settlement system that banks can use for all their settlements of payment.[6] The Proposed Rule aims to complete interbank settlements within 30 minutes.[7]

The Proposed Rule contemplates clearing end-user transactions within one minute. Unless significantly more advanced technologies are proven to operate effectively, consistently, and reliably, this objective may be risky without allotting enough time for a human to review a transaction flagged as potentially fraudulent. Until such time, the Federal Reserve should consider a five-minute objective. Any transaction that is found to be potentially fraudulent would be delayed, which is currently the practice.

The Federal Reserve suggests two possible mechanisms for a 24x7x365 payment settlement — deferred net settlement (DNS) and real-time gross settlement (RTGS). The Proposed Rule favors RTGS, and its logic for this preference is good, as discussed below in response to Question 1.

Responses to specific questions asked

Question 1 -- Is RTGS the appropriate strategic foundation for interbank settlement of faster payments? Why or why not?

While DNS is more like current clearing arrangements than is RTGS, RTGS, once established, would be smoother and easier to administer than DNS. It avoids the possible accumulation of settlement risk in a DNS system where banks front the funds for a transaction and all transactions between banks are netted out at the end of a cycle. Even if it takes somewhat longer to set up an RTGS system, its greater ease of administration and safety for participating banks make it the better choice. In an RTGS system, each transaction is still completed before funds become available, but the system would provide for clearing the transactions quickly (possibly every 30 minutes) so transaction risk cannot accumulate over a whole night or weekend. Coupled with the transaction limits discussed in the answer to Question 7 below, this structure should keep risk very low both for individual banks and for the overall system.

Question 2 -- Should the Reserve Banks develop a 24x7x365 RTGS settlement service? Why or why not?

Yes, the Federal Reserve Banks should develop a 24x7x365 RTGS settlement service. There is clearly a trend, both in the United States and abroad, toward carrying out many transactions on an expedited basis at all times.[8] The logical end point of this trend is 24x7x365 settlement of transactions. It will make the overall financial system more efficient and keep it up-to-date in the future. RTGS also prevents banks from being in a position where transaction settlements are held up overnight and over weekends. The faster payments system should be developed so as to aid smaller banks and other banking institutions by

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[4] See response to question 7.

[5] See pricing discussion at the end of this comment.

[6] Note 3 to the proposed Rule states: Throughout this notice, the term *"bank"* will be used to refer to any type of depository institution. Depository institutions include commercial banks, savings banks, savings and loan associations, and credit unions. In this comment, the term "bank' will be used the same way.

[7] Proposed Rule Page 57,354.

[8] A Financial System That Creates Economic Opportunities Nonbank Financials, Fintech, and Innovation, U.S. Treasury Report July 2018, Pages 144-45 https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf and Bank for International Settlements Fast payments – Enhancing the speed and availability of retail payments, November 2016 https://www.bis.org/cpmi/publ/d154.pdf

making such a service available to them on equal terms as recommended in a recent U.S. Treasury report.[9] Such an RTGS settlement system would actually improve smaller banking institutions' competitive position, as they, unlike the larger banks, would have great difficulty accessing on their own any system that might become available in the private sector.

The Federal Reserve is uniquely positioned to support the development of a 24x7x365 banking settlement system by virtue of its extensive role in bank settlements and its already-existing role in ensuring the safety and stability of interbank transactions. A Federal Reserve-backed 24x7x365 interbank transaction system is a natural extension of the current role of the Federal Reserve, which already has all the tools needed to keep such a system safe and make it effective. To clarify, this is not to suggest that the Federal Reserve should make participation in such a 24x7x365 system mandatory, but only that the Federal Reserve is best placed to develop it, support it, encourage its adoption, and make it available to all interested banks. As stated in the Proposed Rule, the Federal Reserve would seek to make its 24x7x365 system easily interoperable with any private system for rapid payments, provided such a system met the necessary technical and safety guidelines. The Federal Reserve should not seek to monopolize rapid payments, but only to do what it is best situated to accomplish — provide a safe and efficient system for 24x7x365 interbank settlements. One major advantage of a Federal Reserve 24x7x365 system is that its users would have great confidence in it due to its backing by the Federal Reserve. Furthermore, the Federal Reserve is uniquely able to take action should any systemic difficulties occur, despite all the precautions discussed in this comment.

Question 3 --If the Reserve Banks develop a 24x7x365 RTGS settlement service,

a. **Will there be sufficient demand for faster payments in the United States in the next ten years to support the development of a 24x7x365 RTGS settlement service? What will be the sources of demand? What types of transactions are most likely to generate demand for faster payments?**

There is already a consumer demand for faster payments[10], and that demand is likely to accelerate over the next decade. Many Americans have become used to the speed and convenience of mobile financial technologies, paying for goods and services with the click of a button online or in a mobile application. Initially, consumers who expect real-time financial updates on their banking accounts will be the driving force for the expanded demand, but retailers will gain efficiency benefits from an RTGS system, as well.

b. **What adjustments would the financial services industry and its customers be required to make to operate in a 24x7x365 settlement environment? Are these adjustments incremental or substantial? What would be the time frame required to make these adjustments? Are the costs of adjustment and potential disruption outweighed by the benefits of creating a 24x7x365 RTGS settlement service? Why or why not?**

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9 Ibid, Payments Page 13.
10 Governor Lael Brainard (October 03, 2018). "Supporting Fast Payments for All," https://www.federalreserve.gov/newsevents/speech/brainard20181003a.htm

This question is best addressed by a collaborative working group of banking, payment, and other financial experts can answer. As the 24x7x365 system is not intended to be mandatory, institutions that find the burden too great need not participate, though competitive pressures may require them to do so eventually. As discussed in answers to Questions 2, 4, and 7, every effort should be taken to make the adoption of the 24x7x365 system as inexpensive and easy as possible.

c. **What is the ideal timeline for implementing a 24x7x365 RTGS settlement service? Would any potential timeline be too late from an industry adoption perspective? Would Federal Reserve action in faster payment settlement hasten or inhibit financial services industry adoption of faster payment services? Please explain.**

Again, this question is best addressed by a working group or a joint Federal Reserve-industry task force — though any such task force should be given a tight deadline to report so as not to unduly delay the adoption process. Any reasonable timeline would likely accelerate the ubiquitous adoption of faster payment services because the Federal Reserve has great advantages both in initiating a 24x7x365 system and in creating and maintaining confidence in its operation.

d. What adjustments (for example, accounting, operations, and agreements) would banks and bank customers be required to make under a seven-day accounting regime where Reserve Banks record and report end-of-day balances for each calendar day during which payment activity occurs, including weekends and holidays? What time frame would be required to these changes? Would banks want the option to defer receipt of such information for nonbusiness days to the next business day? If necessary changes by banks represent a significant constraint to timely adoption of seven-day accounting for a 24x7x365 RTGS settlement service, are there alternative accounting or operational solutions that banks could implement?

At least initially, allowing banks to defer receipt and processing of such information to the next business day should be an option. The limitation on the size of transactions cleared under 24x7x365 settlement proposed in the response to Question 7 would make it safer to defer such accounting to the next business day.

e. What incremental operational burden would banks face if a 24x7x365 RTGS settlement service were designed using accounts separate from banks' master accounts? How would the treatment of balances in separate accounts (for example, ability to earn interest and satisfy reserve balance requirements) affect demand for faster payment settlement?

A significant operational burden an RTGS account may impose on banks would be a constant need to move money from the master account to the RTGS account to complete settlements stemming from an incentive to maximize deposits in the master account until required for RTGS settlement. Allowing an RTGS account to count as part of the bank's required Federal Reserve balance and earn interest at the Federal Reserve interest rate would minimize any operational burden and reduce a bank's incentive to keep a minimum balance in the RTGS account.

f. Regarding auxiliary services or other service options,

i. Is a proxy database or directory that allows faster payment services to route end-user payments using the recipient's alias, such as email address or phone number, rather than their bank routing and account information, needed for a 24x7x365 RTGS settlement service? How should such a database be provided to best facilitate nationwide adoption? Who should provide this service?

In the short-run, existing computer programs could easily rely on bank routing and account information to make the RTGS operational and effective. However, as financial technologies progress and new business models come online in the financial services industry, the need for proxy databases or directories will become more apparent and compelling. Financial technology companies are increasingly offering services that do not require users to have or link a bank account. For example, certain credit card issuers market and grant cards to consumers without bank accounts and no credit history (i.e. consumers new to the credit market). A payment platform such as Venmo only requires U.S. residence and a U.S. telephone number to create and use an account. Likewise, cryptocurrency wallets do not require bank accounts. Consumers and vendors transferring money between credit cards, Venmo accounts, or cryptocurrency wallets not linked with a bank account cannot be identified by bank routing and account information and are therefore unrecognizable by payment processing platforms and software that rely on such information. An RTGS that relied on bank routing and account numbers would limit the interoperability of non-traditional payment systems and would curb transfers between certain products and platforms with traditional financial services institutions using such a system. As more currency flows through or sits within non-bank entities, the more imperative it becomes to accommodate non-traditional financial institutions, transaction mechanisms, and payment platforms.

ii. Are fraud prevention services that provide tools to detect fraudulent transfers needed for a 24x7x365 RTGS settlement service? How should such tools be provided? Who should provide them?

Consultation with the banking industry on the best way to provide such tools would be desirable. Possibly, a master contract could be competed and awarded. Its cost could be allocated to participating banks in proportion to their exposure. The proposed rule suggests tying the size of the Federal Reserve account balances to transaction limits. Federal Reserve account balances might also be a good measure for allocating costs.[11]

iii. How important are these auxiliary services for adoption of faster payment settlement services by the financial services industry? How important are other service options such as transaction limits for risk management and offsetting mechanisms to conserve liquidity? Are there other auxiliary services or service options that are needed for the settlement service to be adopted?

Security is critical to widespread adoption of faster payment services. Thus, both transaction limits, as discussed in Question 7, and fraud protection services are important for the rapid and widespread adoption of 24x7x365 systems. Mechanisms to conserve liquidity are also likely to make the difference between adoption and non-adoption for many banks. Thus, banks' ability to use their Federal Reserve account balances in the 24x7x365 settlements process is extremely valuable.

[11] See answer to Question 7.

g. How critical is interoperability between RTGS services for faster payments to achieving ubiquity?

Interoperability with other RTGS services clearly fosters ubiquity. Existing RTGS service providers, and companies considering developing an RTGS platform, should be consulted in the development of the system. These companies have the expertise necessary to ensure the Federal Reserve RTGS system has maximum interoperability with other RTGS services. They may also have additional knowledge in how to integrate third-party RTGS systems without compromising the safety and efficiency of the Federal Reserve system.

h. Could a 24x7x365 RTGS settlement service be used for purposes other than interbank settlement of retail faster payments? If so, for what other purposes could the service be used? Should its use be restricted and, if so, how?

The 24x7x365 system should initially be limited to interbank settlements. Some experience should be accumulated before expanding the 24x7x365 system beyond its initial purpose. However, once the system is proven to be safe and secure, the Federal Reserve should move quickly to expand the system to include person-to-person (P2P) settlements and business-to-business (B2B) settlements. Financial technology companies are already serving the P2P and B2B markets, and many would make use of the Federal Reserve's 24x365x7 payment system if permitted. Such additional bank and non-bank uses should be reviewed and implemented over time if they satisfy requirements of safety and do not overburden the system.

i. Are there specific areas, such as liquidity management, interoperability, accounting processes, or payment routing, for which stakeholders believe the Board should establish joint Federal Reserve and industry teams to identify approaches for implementation of a 24x7x365 RTGS settlement service?

Each of these areas are vital to insure the widespread adoption of a Federal Reserve 24x7x365 RTGS settlement service. The board should establish committees on each to ensure proper implementation and rapid adoption. However, committee participants should not be limited to the Federal Reserve staff and industry representatives. The consumer perspective must also be included to ensure that the payment needs of consumers are represented in the final Federal Reserve 24x7x365 system.

Question 4 -- Should the Federal Reserve develop a liquidity management tool that would enable transfers between Federal Reserve accounts on a 24x7x365 basis to support services for real-time interbank settlement of faster payments, whether those services are provided by the private sector or the Reserve Banks? Why or why not?

Yes, the Federal Reserve should develop a liquidity management tool that allows banks' Federal Reserve accounts to be used on a 24x7x365 basis to support the system for faster interbank settlements. This liquidity management tool would facilitate the adoption of 24x7x365 interbank settlements. Banks would be able to use the Federal Reserve's liquidity management tool rather than develop proprietary accounts to use the Federal Reserve's RTGS system. Subject to safety measures to be discussed below, the use of Federal Reserve accounts should not have any adverse effects on the safety of the banking system. Allowing this use of Federal reserve accounts makes them more useful to the banks, all of which are required to hold substantial funds in these accounts.

Question 5 -- If the Reserve Banks develop a liquidity management tool,

a. What type of tool would be preferable and why?

For banks, proposed alternative iii, a tool that allows an automatic transfer of balances (or “sweep”) based on pre-established thresholds and limits, would be preferable as it would allow for the smoothest operation of the liquidity management system and would need the least out-of-business-hours management by participating banks. The pre-established limits would ensure each bank’s comfort with the possible drawdowns under the system. However, financial technology companies may be better served under other models, and those should also be considered.

b. Would a liquidity management tool need to be available 24x7x365, or alternatively, during certain defined hours on weekends and holidays? During what hours should a liquidity management tool be available?

Once a liquidity management tool is developed, it should initially be used on nights, weekends, and holidays. Once experience has been accumulated and effectiveness has been demonstrated, expansion to 24x7x365 may well be safe and useful.

c. Could a liquidity management tool be used for purposes other than to support real-time settlement of retail faster payments? If so, for what other purposes could the tool be used? Should its use be restricted and, if so, how?

Initially the system should be developed and experience with it accumulated before other uses are considered. However, if the Federal Reserve intends full interoperability with private networks, the liquidity management tool will need to quickly support other types of payments. Like the RTGS system, financial technology companies operating in the P2P and B2B markets, or even the Automatic Clearing House network, might make use of the liquidity management tool. The Federal Reserve should design the liquidity management tool to be settlement-system agnostic once safety and soundness are confirmed.

Question 6 -- Should a 24x7x365 RTGS settlement service and liquidity management tool be developed in tandem or should the Federal Reserve pursue only one, or neither, of these initiatives? Why?

Both of these initiatives are complementary and should be developed in tandem. The liquidity management tool strengthens 24x7x365 RTGS and makes it possible for banks to participate in it without incurring additional costs. As discussed above in Question 2, 24x7x365 bank settlement services are likely to be ever more in demand and will enhance the efficiency of the financial system for the banks that are its immediate customers. Businesses and consumers will benefit indirectly from this change, as banks will have the ability to offer their customers faster clearing and settlement services.

Question 7 --If the Federal Reserve pursues one or both of these actions, do they help achieve ubiquitous, nationwide access to safe and efficient faster payments in the long run? If so, which of the potential actions, or both, and in what ways?

A 24x7x365 RTGS bank settlement system in tandem with a Federal Reserve-linked liquidity management tool would be a major step in developing ubiquitous, nationwide access to faster, more efficient payments, as it would make such a system available to all federally-chartered banks on favorable and equal terms. Therefore, both should be pursued in tandem.

Safety

Great care must be taken to assure the safety and stability of this new system. As the system matures, new technological solutions, particularly those developing out of the field of machine learning, may address certain system vulnerabilities. Until those solutions are technologically feasible, there should be a limitation on the amount of night or weekend transactions that can be processed for any one bank. Such a limit would prevent a weekend run on a bank and large-scale financial transactions that could escape the level of review given during normal business hours. To prevent these risks, limits on the size of any individual transaction and on the sum of out-of-business hours transactions should be adopted. These limits should be set as a percentage in relation to the size of a bank's Federal Reserve account balances, as that is a measure of the bank's ability to absorb any loss or legitimate outflow of funds that might occur during these hours.[12]

The exact percentages should be determined by consultation between the Federal Reserve and banking representatives, but the limit should not be set too high, at least until significant experience has been accumulated with the workings of the system. When such a limit is reached, all that bank's further transactions would be postponed until normal business hours to be processed as usual at that time. Such a limit would prevent very large transactions from being processed 24x7x365 at smaller banks and would protect banks from a spate of transactions that might be part of a run. A standard notice should go out to a party concerned in case any transaction reaches such a limit. Such notices should be held secret under bank secrecy regulations so as to prevent unwarranted speculation against a bank that would not have occurred without the 24x7x365 system. Thus, a bank would have time to take measures to protect itself, including asking for Federal Reserve assistance. Of course, if a bank's underlying soundness came into question, normal FDIC procedures would take effect.

However, it may be prudent to reevaluate the "normal business hours" paradigm. In the Federal Reserve's 2015 Strategies for Improving the U.S. Payment System report, Strategy Five called for expanding the hours of operation of the National Settlement Service. As recently as three years ago, the Federal Reserve recognized the expanding need for faster settlement. At this point, the Federal Reserve has only expanded its hours from 5:00 p.m. to 5:30 p.m. EST which is 2:30 p.m. PST. San Francisco is a

[12] It might seem as if it would be difficult to track the more than 11,000 Federal banks' account balances in the Federal Reserve system accurately, but modern computer programs have far more capacity than is needed to accomplish this task.

worldwide leader in financial technology, but West Coast companies wishing to use the Federal Reserve's current settlement system are unable to do so after 2:30 p.m. EST, well before most businesses close for the day. Because financial companies are able to process payments worldwide in seconds at any time of day, normal Federal Reserve business hours should also be 24x7x365.

Questions 8 and 9 – no comments.

Suggested Pricing for 24x7x365 services to banks

Although the questions at the end of the Proposed Rule do not include a question as to pricing for 24x7x365 services, this is a point worthy of comment. Pricing should be set so as to recover all Federal Reserve costs of providing these 24x7x365 services in the long run. It would be reasonable to plan for cost recovery (including interest at a standard federal rate, such as the 10-year Treasury bond) over a period of ten years from the initiation of services. However, it may well make sense to offer a price that scales up over time. It ought to be below cost for the first two or three years to incentivize adoption, equal to cost for the following two or three years, and slightly above cost over a five-year period thereafter to recover costs lost during the initial period. This kind of cost structure would promote early adoption of the 24x7x365 system and is similar to the strategy of a competitor opening up a new market. The difference would be that the Federal Reserve would intend to break even in the long term, not to make profits from this service.

Whatever pricing is adopted should encourage smaller banks to join so as to promote the objective of ubiquity of the 24x7x365 system. An initial pricing system could use a very small percentage of each bank's Federal Reserve Balance to calculate a base fee for participating. Then usage charges could be proportionate to some combination of the number of transactions processed and the size of these transactions. Consultation with the banking industry as to a fair way to calculate fees and charges would be in order, but care should be taken to assure the smaller banks a strong voice in the pricing structure.

Sincerely,

John C. Meyer

John C. Meyer, Senior Researcher