December 14, 2018

Via Electronic Submission

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

Re: Docket No. OP-1625; Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments

Dear Ms. Misback:

BAFT (the Bankers Association for Finance and Trade)[1] respectfully submits the following letter in response to the request for comments by the Board of Governors of the Federal Reserve System ("the Board") on *Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments* ("the Notice").[2] BAFT shares the Board's goal of a payments infrastructure that is safe, reliable, efficient, and ubiquitous. These comments are offered to support the development of a modern payments system on which the private sector can build innovative and competitive products that meet the needs of end users.

The Board seeks comment on two potential Federal Reserve Bank services to support faster payments: (1) a liquidity management tool ("LMT") and (2) a real-time gross settlement service ("RTGS Service"). Given its global membership and mission, BAFT is uniquely situated to provide feedback on these potential services. Many of our members have witnessed first-hand the modernization of the payment system within their own jurisdiction, including the establishment of a real-time retail payments infrastructure/capability. This experience has enabled BAFT to evaluate and compare systems and to identify the characteristics critical for inclusion in any potential solution.

Below, BAFT explores the need for and the benefits and drawbacks of the potential development in the near-term of a LTM and RTGS Service by the Federal Reserve ("the Fed"). We also discuss the characteristics that would be essential in the Fed's provision of such solutions, should it decide to

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[1] BAFT is an international financial services trade association whose membership includes large global and important regional banks headquartered in roughly 50 countries around the world, financial services providers, and a growing number of non-bank and financial technology companies. BAFT provides advocacy, thought leadership, education and training, and a global forum for its members in the areas of transaction banking, including cross-border payments, international trade finance, and compliance. For nearly a century, BAFT has played a special role in expanding markets, shaping legislative and regulatory policy, developing business solutions, and preserving the safety and soundness of the global financial system.

[2] https://www.govinfo.gov/content/pkg/FR-2018-11-15/pdf/2018-24667.pdf

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move forward with the development of either or both solutions in the near- or the long-term. BAFT concludes that the industry needs and would benefit greatly from the Fed's immediate development of a LMT. In contrast, BAFT believes that the Fed should forego the development of a RTGS Service at this time because it would duplicate an existing private sector service and might thereby impede the adoption of faster payments in the US.[3]

The Fed's Role

As Central Bank

BAFT notes that both the potential LTM and RTGS Service for faster payments fall within the traditional functions performed by central banks for commercial banks: namely, the provision of liquidity and interbank settlement to reduce risk in the payments system. The Fed has successfully provided these services in support of other bank activities for years. For instance, the Fed offers discount window credit to meet liquidity needs of banks with respect to their master accounts held with the Fed. The Fed also facilitates interbank settlement between master accounts through the Fedwire Funds Service ("Fedwire") and the National Settlement Service ("NSS").

Congress with the *Monetary Control Act of 1980* ("MCA") and the Board with its own long-standing policies, however, have placed limits on the Federal Reserve Banks' introduction of new and major enhancements to existing payment services – even those falling within a central bank's traditional remit. The Board explains in the Notice that, when introducing a new service, the Federal Reserve Banks must adhere to the following requirements under the MCA:

> (i) the Federal Reserve will achieve full cost recovery over the long run, (ii) the service will yield a clear public benefit, and (iii) the service is one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity.[4]

The Board also has a policy to conduct an analysis of any service that would have a substantial impact on payment system participants. Under the policy, the Board would assess the proposed service to determine whether it would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Fed in providing similar services due to differing legal powers or constraints, or due to a dominant market position of the Fed deriving from such differences. If no reasonable modifications to the proposed service would mitigate the adverse competitive effects, the Board would then determine whether the anticipated benefits are significant enough for the Federal Reserve Banks to proceed with the introduction of the service despite the adverse effects.[5]

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[3] BAFT's large bank members headquartered in the US are opposed to the Fed's development of a RTGS Service. Although BAFT has not received feedback from any of its US regional bank members, we assume that some of these members support and expect the Fed to offer a service that competes with the Real Time Payments ("RTP") solution of The Clearing House ("TCH") like the Fed current does for check, ACH, and wire payments. BAFT's other members are generally indifferent with regard to the Fed's decision whether or not to offer a RTGS Service.

[4] *Id.*, page 8.

[5] These procedures are described in the Board's policy statement *The Federal Reserve in the Payments System*, as revised in March 1990. 55 FR 11648 (March 29, 1990).

The MCA's requirements assist the Fed in avoiding conflicts of interest as it performs different roles in the financial system. The Board's policy ensures the Fed does not unfairly leverage its differing legal powers (as an US government/quasi-government agency and the US central bank) or dominant market position derived from those differences (such as its position as the only entity with direct access to the master accounts of almost all US depository institutions held at the central bank) when competing against other payment system participants.

In the SIPS Initiative

BAFT and its members have been strong advocates of the Fed's Strategies for Improving the US Payment System ("SIPS") initiative from its inception. Individually, BAFT and many of its members joined and actively participated in the Fed's subsequently organized Faster Payments Task Force ("FPTF"). As the Fed now contemplates the development of a LMT and RTGS Service, it should remain mindful of its role and the broad strategies as described in the SIPS paper with respect to the development of a faster payments service capability in the US.

In the January 2015 paper, the Fed officially declared its role as "leader, convener, and catalyst" of the industry and called upon all stakeholders "to seize this opportunity and join together to improve the payment system."[6] The Fed further communicated that it "would not consider an operational role in providing [a] faster payments capability unless it determines, not only that the new service would be expected to yield clear public benefits, but also that other providers alone could not be expected to provide this capability with reasonable effectiveness, scope and equity and following public comment."[7] In May 2015, the Fed convened a wide array of stakeholders to establish the FPTF. The Fed proceeded to lead the FPTF in its mission to identify and assess alternative approaches for implementing safe, ubiquitous, faster payments capabilities in the US until publication of the FPTF's *Final Report: Part Two* in July 2017. Given the Fed's role in the SIPS initiative and its leadership of the FPTF in particular, the industry expects the Fed to evaluate the potential RTGS Service against the effectiveness criteria and targets (especially near ubiquity by end 2020) established by the FPTF.

If the Fed develops the LMT, RTGS Service, or both, it should do so in furtherance of a wider, long-term plan to modernize the US payments system and in a manner that facilitates cross-border faster payments with other jurisdictions. Incremental modifications, like the addition of features or extension of operating hours, to existing systems may acceptable in the short-term. But, the Board and the Federal Reserve Banks should come together to build new and flexible services as part of a holistic plan to modernize and integrate the payment rails that the Federal Reserve Banks currently operate. Any long-term tool or service introduced by the Fed should enhance the resiliency, safety, and soundness of the entire US payment system by, for instance, serving as a contingency to an ACH or wire system or as the technical foundation for a next generation ACH or wire system. The Fed should align the design with the principles applied to systemically important infrastructures. In addition, given the rapid pace of technology innovation, a new tool or rail must be enabled for multiple technology refresh cycles through its operating life. Even if the Fed forgoes the development of a RTGS Service, it

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[6] https://fedpaymentsimprovement.org/wp-content/uploads/strategies-improving-us-payment-system.pdf, page 1.
[7] *Id.*, page 18. BAFT thanks the Board for soliciting public comment on the Fed's potential assumption of such an operational role with its Notice.

should still initiate discussions with the operators of national faster payments systems in other jurisdictions about moving faster payments across the US border.

LMT

The Fed should develop a LMT that would enable transfers between all the accounts that commercial banks hold at the Fed on a 24x7x365 basis to support RTGS solutions for faster payments. The Federal Reserve Banks' introduction of a LMT would meet the requirements of the MCA and would not trigger a competitive impact analysis by the Board.

A LMT will yield a clear public benefit and is a tool that the private sector cannot provide with reasonable effectiveness and scope. Banks could use the LMT to effectively administer funds dedicated to faster payments, whether those funds are located in a master account or separate faster payments liquidity account, and held at the Fed. Banks could use a LMT at any time to withdraw excess funds and put them to better use. Banks also could supplement low balances to avoid the rejection of their customers' faster payment orders when Fedwire is closed on nights, weekends, and holidays. By enabling the banks to add liquidity needed to reliably effectuate payments during off-hours, a LMT would indirectly increase the public's confidence in and adoption of faster payments. Furthermore, a LMT would help banks to meet the challenge of determining the appropriate balance to maintain in any prefunded account that is segregated for faster payments, like the joint Real Time Payments ("RTP") account held on the books of the Fed by The Clearing House ("TCH"). A LMT offered by the Fed is likely to be more effective and broad in scope than any private-sector solution because nearly all banks hold master accounts at the Fed, the Fed has direct access to those master accounts, and the Fed serves as the banks' "lender of last resort." Unsurprisingly, the private sector has not introduced a LMT similar to that described in the Notice and, therefore, a competitive impact analysis by the Board would be unnecessary.

The Fed should offer a LMT as soon as practicable and independently of its decision whether or not to develop a RTGS Service. If necessary, the Fed could initially expand the operating hours of Fedwire or the NSS to something less than 24x7x365 availability to allow banks to manage liquidity. Ideally, the Fed would expeditiously build and launch a separate LMT that would serve as one facet of its holistic, long-term plan to modernize the US payments system. If the Fed does decide to develop a RTGS Service, the long-term LMT should be developed in tandem with the RTGS Service to properly align the design and to facilitate the testing and implementation of both services.

A solution that offers a combination of the functionalities mentioned in the Notice would be most preferable for the long-term LMT; it should allow a bank to originate a transfer from one account to another, an agent to originate a transfer on behalf of one or more banks, and the automatic transfer of balances (or "sweep") based on pre-established thresholds and limits. To the extent possible, the LMT must work in harmony with banks' existing liquidity applications and meet the current and foreseeable future needs of banks. At a minimum, the long-term LMT must:

- Operate 24x7x365;
- Permit a bank to monitor and manage, and thereby maintain, its liquidity positions;
- Allow a bank to set up alarms and alerts should its position fall below a configurable threshold;

- Alert a bank when its liquidity position exceeds its balance or any other defined parameter such as a debit cap;
- If the Fed implements a faster payments liquidity account, enable a bank to move funds between this faster payments liquidity account and other accounts (for example, its master account) in order to ensure adequate liquidity in all accounts at the Fed; and
- Ensure that a bank's reserve requirements can be met by aggregating the balances in all of its accounts.[8]

RTGS Service

For several reasons, the Fed should forego the development of a RTGS Service at this time. Instead, the Fed should carefully monitor the faster payments ecosystem over the near-term to identify any emergent market failure (in this case, the inefficient distribution of faster payment services in the free market). If a market failure materializes despite more modest actions taken by the Fed, it could build and implement a RTGS Service then.

Only one solution for interbank RTGS of faster payments currently exists in the US marketplace: TCH's RTP. TCH had nearly completed its design of and already committed to build RTP in 2014 – a year before the Fed established the FPTF. Yet, TCH openly engaged with the FPTF to ensure that RTP would meet all the needs of the faster payments ecosystem. The FPTF ultimately deemed RTP "very effective" with respect to 31 criteria and "effective" with respect to the remaining 5 criteria. TCH members made significant investments in building RTP. The solution was launched in November 2017 and reaches almost 50% of demand deposit accounts in the US today. Given TCH's willingness to accept the call to improve the US payment system by introducing an accessible, reliable, safe, and effective faster payments solution, the Fed should allow TCH to pursue RTP ubiquity without Fed interference until at least end of year 2020.

The Federal Reserve Banks should not expend significant time and resources to design and build an RTGS Service when their inability to meet the MCA's requirements will prevent the service offering. As a second comer to the market with a RTGS Service (assumedly) similar in effectiveness, functionality, and expense to RTP, the Fed will have difficulty achieving cost recovery. The public benefit of the introduction of a RTGS Service is unclear, given RTP's launch last year and current ability to reach 50% of demand deposit accounts in the US. Some believe that, by issuing the Notice almost a year after the introduction of RTP, the Fed has impeded the industry's efforts to reach the target date for ubiquity at the end of 2020. They argue that smaller banks will defer participation in faster payments until the Fed decides against a RTGS Service offering or stands up the service. Moreover, the characteristics and current rate of adoption of RTP refutes any claim that the private sector is unable to deliver its own service with reasonable effectiveness, scope, and equity.

Moreover, if the Federal Reserve Banks seek to introduce a RTGS Service before the end of 2020, the solution is unlikely to survive the Board's competitive impact analysis. The RTGS Service would have a direct and material adverse effect on the ability of one existing service provider (TCH) to compete effectively with the Fed in providing similar services (RTP) due to: (1) differing legal constraints and (2)

[8] The bank should also earn interest on the funds in all of the accounts held at the Fed.

differing legal powers and the dominant market position of the Fed deriving from those differences. For example:

- To participate in the Fed's FPTF, TCH agreed to contractual terms the provided Fed personnel with access to sensitive information regarding RTP and other proposed solutions. Anti-trust and IP laws would have constrained TCH from convening a task force like the FPTF and obtaining access to details about the potential future products of its competitors. The Fed could now use the knowledge it gained from its organization and leadership of the FPTF to design a RTGS Service that directly competes with RTP.
- By law, commercial banks are required to hold reserves in master accounts at the Fed, which is the US central bank. Because of these differing legal powers, the Fed has attained a dominant market position as the only entity with a direct connection to most banks through their master accounts.

We believe that the Federal Reserve Banks would be unable to modify the RTGS Service to negate the adverse effect to TCH and the Board would conclude that the anticipated benefits of a RTGS Service were not significant enough for the Federal Reserve Banks to proceed.

Finally, the possibility that the Fed is able to design, build, and launch a RTGS Service that is comparable to RTP in effectiveness and functionality and to achieve ubiquity by the end of 2020 is extremely remote. The FPTF judged RTP as an overall "very effective" faster payments service. TCH expects to expand the reach of RTP to approximately 65% of all demand deposit accounts in the US by the end of 2019 and has developed a sound plan to reach near ubiquity by the end of 2020. In the Notice, the Fed itself acknowledges that its development and implementation of a RTGS Service could take many years to achieve.

If the Fed decides to move forward with a RTGS Service, interoperability with existing (currently, only RTP) and future services of a similar nature is imperative. If the RTGS Service is not interoperable with other comparable solutions like RTP,[9] banks will have to participate in two or more duplicative and expensive systems or in a single system with the knowledge that a customer's order will fail when the recipient's bank participates in an alternative system. Both options will significantly impede the adoption of faster payments in the US through the introduction of significant cost to and fragmentation of the market. Thus, a RTGS Service must be able to communicate with other services, use a modern messaging format (such as ISO 20022) consistent with other services, and leverage common industry standards and practices. If necessary, a standard for message conversion between the Fed's RTGS Service and other comparable solutions should be developed.

A RTGS Service ideally should be one part of a greater, long-term plan to modernize all the payment services currently offered by the Federal Reserve Banks. The Fed should design any future faster payments service with other domestic payment systems in mind so that the faster payments service does not become a "single point of failure." The Fed should learn from and, as appropriate, emulate the best aspects of the payment system modernization initiatives currently underway in Australia, Canada, the European Union, and the United Kingdom. The Fed should facilitate the possible delivery of cross-border faster payments by operating a RTGS Service with 24x7x365 availability to

[9] TCH notes that achieving interoperability between RTP and any other service will be difficult, if not impossible. This is because RTGS settlement solutions for faster payments, such as RTP, are designed to clear and settle simultaneously on the platform.

accommodate originator and beneficiary banks located in different jurisdictions and time zones. Lastly, the Fed should confer with the operators of national faster payment systems in other jurisdictions and incorporate common attributes as it builds out its own service.

Thank you for the opportunity to provide comments in response to the Notice. We appreciate the Board's leadership in soliciting industry input on potential actions the Fed could take to promote the development of an efficient, safe, reliable, and ubiquitous faster payments capability in the US. We look forward to our continued work with you in further improving the US payment system.

Should you have any questions regarding BAFT's response to the Notice, please contact the undersigned at spelosi@baft.org or (202) 663-5537.

Sincerely,

/s/

Samantha J. Pelosi
Senior Vice President, Payments & Innovation