



November 20, 2018

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

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

Dear Ms. Misback,

Southern Financial Exchange, a regional payments association with financial institution members in Alabama, Arkansas, Louisiana, Mississippi and Tennessee, strongly supports the leadership role taken by the Federal Reserve to improve the speed and security of payments, shaping the future payment system and appreciates the opportunity to respond to the Federal Register Notice regarding Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments. Our members are cautiously supportive of moving payments faster. Most smaller organizations do not have this built into their strategic plans and are taking a “wait and see” approach. Larger institutions are more interested, but also cautious due to the significant costs of moving to faster payments.

The Request for Comment (RFC) seeks input on capabilities that the Federal Reserve (Fed) could support, “including a settlement infrastructure on which the private sector can provide innovative faster payment services that serve the broad public interest”. Southern Financial Exchange is providing feedback on whether the Fed should offer the following capabilities:

- 24x7x365 real-time interbank settlement of faster payments
- Other supporting features of an “RTGS settlement system”
- A liquidity management tool that would enable transfers between accounts held at the Federal Reserve Bank

This response letter addresses each of the aforementioned capabilities starting with responses to several of the questions asked in the RFC and providing additional observations and recommendations.

Responses to RFC Questions

Is development of a real-time settlement service the appropriate strategic foundation for interbank settlement?

As discussed in the RFC, technology has rapidly advanced in the past two decades, which has created a gap between the capabilities of traditional payment methods and end-user expectations for speed, convenience, accessibility and security. As the central bank for the U.S., the Fed has responsibility to close that gap and provide a payment network that is vital to the growth of the economy. Development of a real-time settlement service that is free of counterparty risk and provides finality of payment is one component of a solution to lead the payment system into the future.

Will there be sufficient demand for faster payments to support the development of the services?

Demand for a real-time process already exists; however, financial institutions have limited options available to tap into the demand. In Q3 2018, Zelle (an open network with capability of reaching financial institutions throughout the U.S.) reported that activity increased 16% quarter-over-quarter to 116 million transactions for a total of \$32 billion in payments. Year over year growth was 83%. Venmo (a closed network that has the capability to reach accounts held by Venmo or PayPal) is also reporting a strong growth rate of 78%. While volumes processed by these systems are small when compared to traditional payment methods, growth rates indicate strong demand for real-time payments.

What types of transactions are most likely to generate demand for faster payments?

Fintech providers of faster payment solutions have focused on person-to-person payments. However, demand for business-to-business payments are likely a source of demand for the ability to move robust payment messages (detailed information relevant to the payment) and provide confirmation of receipt instantaneously with the payment transaction. Consumers could utilize real-time payments for bill payment.

Would Fed action in faster payment settlement hasten or inhibit financial services industry adoption of faster payment services?

At the town hall meeting sponsored by the Fed in St. Louis, participants (community banks and credit unions) indicated they are reluctant to use a product developed by the twenty-six (26) largest U.S. banks and strongly support the Fed's proposed actions. These financial institutions are likely to delay a decision to join other faster payment initiatives, pending the Fed's decision on this issue.

What is the ideal "time to market" for this service?

Time to market is critical and our organization encourages the Fed to move rapidly. While our members don't believe it's necessary for the Fed to have a solution by 2020, introducing a solution by 2023 (scheduled date for adoption of ISO 20022 by FedWire) would help motivate conversion to the international standard. PayPal's Venmo is a non-bank competitor to financial institutions with a head start on faster payments. The longer it takes for the Fed to enter this market, the more likely it becomes for other non-bank competitors to emerge. Additional closed loop systems would further fragment the market and make it less like to achieve ubiquity.

What adjustments would the industry and customers need to make to operate in a 24x7x365 environment?

U.S. financial institutions will need time to adapt to a 24x7x365 environment. Financial institutions (and their software and service providers) will need to develop solutions that facilitate the origination and receipt to the end user. The Fed, with as much clarity as possible, should communicate to financial institutions the need to work with processors and correspondents to facilitate real-time payments in a 24x7x365 environment. In addition, adjustments will be required to update balance information to endpoints within their networks; including ATMs, online banking and other systems. Our organization assumes that after-hour payments from real-time and same-day payment networks in a 24x7x365 environment would be treated in a similar manner to how ATMs and debit cards are treated today. Proactive steps should be taken as soon as possible to accommodate this environment to prevent continued loss of market share to non-bank competitors.

Are auxiliary services, such as a payments directory or fraud prevention services, needed for this service?

Payment Directory Services have been proposed multiple times as a significant tool for the industry, both for consumer and business transactions and are necessary. Our organization believes directories could solve multiple issues. A directory developed by the Fed could link to financial institutions, as well as other private sector directories. For example, allowing an alias such as an email address or cell number to cross reference to routing and account number information. A directory may also serve as a tool to validate account ownership and mitigate fraud. The directory service should be channel agnostic, supporting more than just real-time payments.

The U.S. lacks an effective process to monitor actual fraud across the various payment channels so fraud prevention tools are needed. Routine surveys help bridge that gap; however, accuracy of survey information cannot be verified. Additional information would be useful regarding how the Fed proposes to operate an effective fraud prevention service.

How critical is interoperability between payment systems to achieve ubiquity?

The Fed's proposal discussed interoperability capabilities between payment networks. This would be a valuable tool to achieving ubiquity across the U.S. However, variability parameters such as settlement, security, and functionality within message sets may limit feasibility of interoperability between payment systems.

Zelle's payment solution offers consumers the impression of "near real-time payments" but creates counter-party risk through delayed settlement processes that occur outside the view of the user. While the proposed action would offer an alternative without this risk, interoperability between Zelle (as settlement works today) and a real-time network may not be achievable.

The RFC contemplates using ISO 20022 formats. This format has been implemented by RTP and is used internationally. Furthermore, the Fed has announced that ISO 20022 is planned to be used by the FedWire system. Consistency in formats will help with interoperability. To establish ISO 20022 as the new standard for payments, it is important to rollout both the Fed's real-time payment clearing and settlement system at the same time the changes are being rolled out for FedWire.

Will there be sufficient demand for a liquidity management tool?

The RTP solution from The Clearing House requires the financial institution to prefund a private sector-owned settlement ledger backed by funds in a joint account at the Fed. Only if sufficient funds are available in the settlement ledger will RTP allow funds to be sent by the financial institution. This would disrupt the flow of payments outside normal banking hours when funding is inadequate. The proposed liquidity tool allows a possible resolution to this issue. In addition to the liquidity management tool, the Fed should consider the following:

- Include automatic sweep functionality with the capability to move funds to or from the faster payment settlement account based on pre-established balances. This would allow financial institutions sending payments to retain funds in the master account as long as possible, earning interest and meeting reserve requirements. Financial institutions receiving funds would also benefit.
- Allow access to the liquidity management tool on a 24x7x365 basis.
- Allow access to the discount window on a 24x7x365 basis. Access to discount window even as a temporary measure should help minimize disruption.
- As discussed in the RFC, consider allowing a designated agent, such as a Correspondent Bank or a Corporate Credit Union, access to the accounts maintained by their correspondents. Allow designated agent(s) to transfer funds between master accounts, which could lead to the development of innovative solutions to help small community bank and credit unions participate in real-time payments by consolidating management of these accounts.
- The Fed should support financial institutions' management of liquidity through expanding the operating hours of the Fedwire Funds service. At a minimum, Fedwire should have operating windows on weekends and holidays and allow financial institutions to add or remove liquidity as needed to support a 24x7x365 banking environment.

Additional Observations and Recommendations

24x7x365 Settlement. The Fed is signaling the advent of 24x7x365 payment systems and banking. The development of the internet has ignited an expansion of services that are provided on a 24x7x365 basis. The U.S. marketplace operates across time zones and facilitates sales of goods and services at any time of the day, any day of the year. Banking services entered into this same 24x7x365 environment. Consumers can access funds through ATMs and debit cards, access financial information, pay bills, complete loan applications and transfer funds between accounts all on a 24x7x365 basis. Development of real-time clearing and settlement systems to support this environment is a necessary solution.

Counterparty Risk. Several of the “faster payment” processes currently in use today create counterparty risk through deferred settlement processes. The Fed’s proposal may spur innovation to eliminate or reduce this risk.

Our organization strongly urges the Fed to expand the scope of the proposal. As the Fed states in the introduction to the RFC, part of the mission of the central bank is to provide a settlement infrastructure on which the private sector can provide payment services that serve the broad public interest. In the proposal, the Fed narrows this mission statement to supporting only faster payment services (meaning

real-time in the RFC). The scope of the effort to modernize the payments industry should be expanded to include the following:

- The Fed should expand the capabilities and operating hours of the existing National Settlement Service (NSS) to support a 24x7x365 environment. NSS is the critical link that provides ACH settlement for transactions that flow between the two ACH Operators (Fed and The Clearing House). Today's policy of reopening NSS after 9:00 pm on tomorrow's banking date is not responsive to the needs of the industry to settle later in the same business calendar day. For many years NACHA has requested the Fed to update NSS to improve capabilities within the ACH Network for faster payments.
- Updates to the regulatory environment are needed to support a real-time payment system and a 24x7x365 environment. While a group organized under the Faster Payments Council is working on identification of potential changes, the Fed should encourage this process to move forward as quickly as possible to meet the changing environment of the U.S. payment system.
- Development of Rules and enforcement actions for non-compliance are necessary. Our organization recommends a rule making body that is independent of governmental legislation and regulation. This provides greater flexibility to adapt to changes in technology which can happen overnight and threaten the security of the payments system.
- Experience with real-time payment systems in other countries should be considered as a guide to U.S. initiatives. The United Kingdom has had a real-time process in place for 10 years and 3% - 5% of payment transactions are flowing through this system. If this is an indicator of the U.S. market, the Fed needs to take a broad approach, helping to raise the speed of clearing and settlement across all components of the payments ecosystem.
- Financial institutions in a real-time payments environment are facilitating the transfer of funds based on the instructions provided by the user. Education is required to communicate who is responsible when errors or fraud occurs in a real-time environment.

Faster interbank settlement. While clearing and settlement in a real-time environment is necessary, the future of banking should include more than a focus on real-time systems. Other countries around the world are committed to expanding the capabilities of their batch networks – knowing that end users demand both single entry and efficient batch payments. This proposal should not be limited to only supporting real-time payments, but should also include expanding the capabilities of batch networks to serve broader public interest.

On behalf of Southern Financial Exchange and our members, thank you for this opportunity to respond and for the consideration of these comments.

Respectfully submitted,

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