



# **SWIFT's response to the Federal Reserve System's request for comments on Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments**

**SWIFT**

**14 December 2018**

**Confidentiality: Public**

**IMPORTANT LEGAL NOTICES** – constituting part of SWIFT’s response to the Federal Reserve System’s request for comments on Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments.

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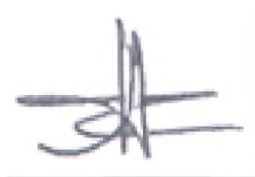
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SWIFT thanks the Federal Reserve System for the opportunity to provide comments on Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments.

SWIFT is a member-owned cooperative headquartered in Belgium. SWIFT is organised under Belgian law and is owned and controlled by its shareholders, comprising more than 2,000 financial institutions. We connect more than 11,000 institutions in more than 200 countries and territories.

SWIFT provides banking, securities, and other regulated financial organisations, as well as corporates, with a comprehensive suite of messaging products and services. We support a range of financial functions, including payments, securities settlement, reporting, and treasury operations. SWIFT also has a proven track record of bringing the financial community together to work collaboratively, to shape market practice, define formal standards and debate issues of mutual interest.

If you wish to discuss any aspect of our response, please do not hesitate to let us know.



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### **General SWIFT comments on the Federal Reserve System's proposal**

SWIFT welcomes the Faster Payments Task Force's convening and supports the Federal Reserve System's efforts to bring stakeholders together to improve the payments experience in the US.

We support the Federal Reserve System's efforts to engage with market participants as it considers its role and are grateful for the opportunity to contribute to making faster payments a reality.

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

#### **SWIFT response:**

SWIFT agrees that an RTGS, with supporting liquidity services, provides a strategic foundation for interbank settlement of faster payments. A settlement mechanism based on local central bank reserve balances provides participating institutions with the required guarantees. This means that participants do not have to fund a dedicated (and expensive) liquidity pool to cover counterparty risks.

The combination of 'settlement finality', accorded to the payment systems under local legislation, together with 'settlement in central bank money' provides the assurance and irrevocability that participants require.

Additionally, other settlement systems operating in a jurisdiction, such as Continuous Linked Settlement (CLS), will frequently settle across the same local central bank balances. These systems' settlement banks are often the same as those in the local payment systems and this centralisation of settlement across central bank balances can be extremely useful for market participants' treasury and liquidity management.

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

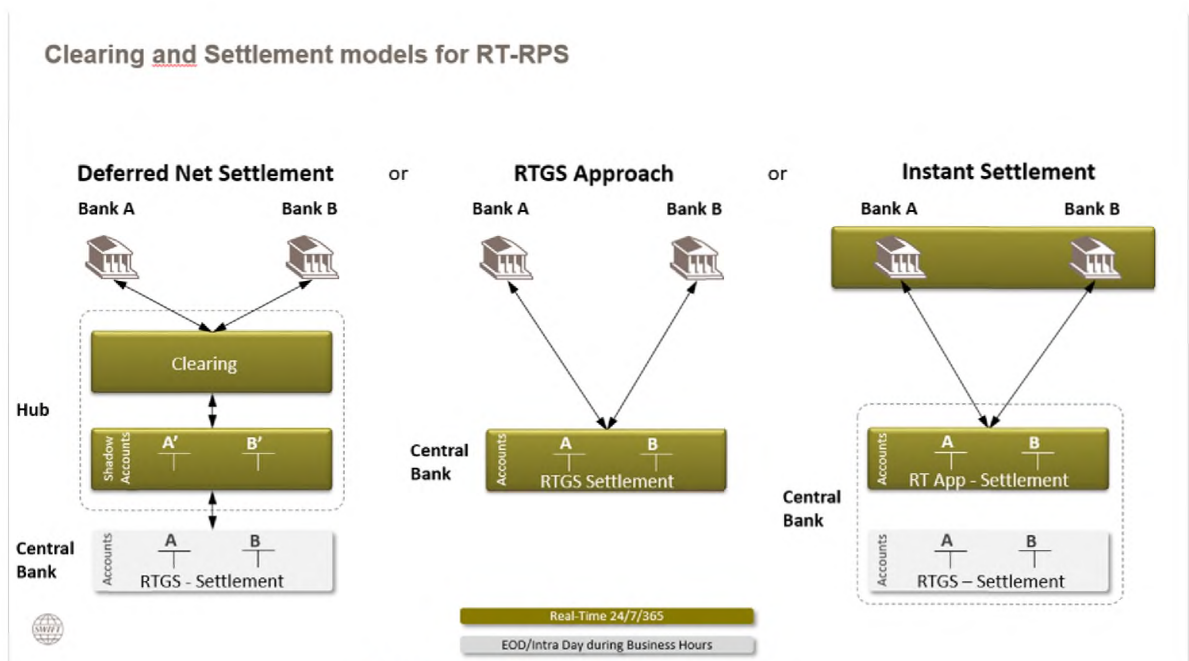
#### **SWIFT response:**

It is important to distinguish between the different models which the Reserve Banks could use to enable a 24x7x365 settlement service. We can consider three different arrangements (see Graph 1):

- 1) **Deferred Net Settlement (DNS):** In a DNS arrangement, a centralised entity collects and stores interbank settlement information, then offsets payment obligations owed by a bank with payment obligations due to that bank. First, it collects and nets settlement information related to groups of payments. Then, at regular intervals during the operating hours of the central bank's RTGS, the centralised entity submits the information on net obligations to the RTGS. Finally, it settles and adjusts the account balances of all participating banks on the central bank's books. DNS based payment systems would continue to operate (within pre-funded or other collateralised system limits) outside of RTGS operating hours with settlement across the RTGS then occurring when the system re-opens the following business day.
- 2) **RTGS:** In a pure RTGS arrangement, there is no middle step through clearing and netting via an intermediate facility. Rather, the funds are made available to the recipient after central bank settlement has occurred between, and confirmed to, the

banks party to the transaction. Payment occurs via the simultaneous debit and credit of balances held at the central bank. Unlike DNS systems, payments can only take place during the hours the RTGS is officially open.

- 3) **Instant settlement:** This involves the use of a separate real-time payment system at the central bank working 24x7x365. Unlike an RTGS, it uses sub-accounts. During RTGS operating hours, liquidity can easily be moved from one system to the other. Keeping an Instant Payments system separate from the RTGS allows both systems to retain (or develop) the appropriate and potentially different functionality, access models, opening hours and availability.



Graph 1: 3 different 24x7x365 models

Central banks following a pure RTGS approach (model 2) for a 24x7x365 settlement service are rare. Mexico has extended its RTGS operating hours to 23.5x7. A few countries, like Switzerland and the Czech Republic, handle both wholesale and retail transactions through their RTGS. However, in these markets, local commercial banks do not yet offer an instant overlay service on top of the local RTGS to their end-consumers.

Most central banks developing a 24x7x365 settlement service support their instant payments systems by using the instant settlement approach (model 3). These systems use sub-accounts that are automatically balanced during RTGS operating hours with the main RTGS account via pooling applications. Outside RTGS operating hours, either these sub-accounts carry sufficient central bank liquidity to cover the out-period of the RTGS or the accounts are pre-funded by commercial banks. This approach enables a central bank's RTGS application and services to continue to run on existing platforms, whilst the new 24x7x365 settlement service can be installed on new platforms better capable of handling 24x7 operations.

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?

**No response from SWIFT.**

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?

**SWIFT response:**

Following similar initiatives around the world, SWIFT has observed that the move to a full 24x7x365 settlement environment will have a substantial impact on market participants.

Most organisations' core payment back-office environments are not geared up to work on non-business banking days and systems are set up to process bulk payments in batches and at regular time periods. Furthermore, the supporting processes (such as screening, fraud detection, core ledger, reconciliation, acquisition verifications) are not built to process individual transactions instantly. Neither are they built to be maintained and upgraded in run-time to guarantee full 24x7 availability. The hardware and software maintenance required, as well as the supporting processes and staff operations, would have a significant effect on participants.

The advantage of a pre-funded DNS approach (model 1) is that each participant would, under normal conditions, operate with an overall 'net cap' (limit). Typically mirroring the pre-funded amount in central bank money, this is fixed at a level to take account of weekend and market holiday flows. Also often a maximum transaction limit is in place. These systems can operate in a near automated fashion as the netting effect between participants would rarely cause these 'net cap' limits to be breached.

A 24x7x365 RTGS settlement environment (model 2 and 3) is likely to require more hands-on liquidity management – including functions needing to transition to a more 'business as usual' approach outside of normal banking hours. If this is not managed appropriately, it introduces settlement risk.

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.

**No response from SWIFT.**

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 non-business 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?

**No response from SWIFT.**

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?

**No response from SWIFT.**

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 e-mail 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?

**SWIFT response:**

We believe we should differentiate between value added service (or auxiliary services) – such as a proxy database, fraud detection and screening applications – and overlay services – such as services linking payments securely to documents (e.g. a remittance advice or tax statement) and request for money from others. Value added services support the participating community in processing the transactions more effectively and efficiently through the system. Overlay services are community services that participants agree to offer jointly to their customer base.

In similar projects around the world, we have observed that a proxy database is a significant driver for the adoption of an instant payment system. When countries start a domestic instant payments service with a convenient overlay service and a widely adopted proxy database, the early success rates are much higher. The most straightforward proxy services rely on a central domestic database. However, such services cover a significantly smaller population than the US domestic market. In the case of larger countries, and supra-national solutions, multiple Instant Payment (IP) operators and varying

proxy database services are typically used. To be successful in larger countries, the IP operators have to be interoperable for both the basic payment flows and for the supporting proxy database interactions. API frameworks have been designed to support this proxy database interoperability. Furthermore, it is envisaged that standalone domestic proxy databases might have to support interoperability, particularly when instant payment schemes start considering cross-border, cross-currency services.

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?

**SWIFT response:**

Real-time payments present the opportunity for real-time fraud and we believe that having the right tools in place to prevent it is becoming increasingly necessary. Each financial institution must have its own fraud detection systems in place – however collective industry data can prevent fraud prior to reaching settlement in the payment chain. A combination of centrally coordinated detection mechanisms and enhanced monitoring tools (e.g. SWIFT's Payment Controls service) are effective in addressing these continually evolving risks.

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?

**SWIFT response:**

Transaction limits are linked to different types of overlay services that could be built on top of a 24x7x365 settlement service. This kind of settlement service should, ideally, not have restrictions – such as transaction limits. It should allow for different, competitive, innovative and selective overlay services agreed by payment communities. However, the settlement service should be complemented with the presence of appropriate liquidity management mechanisms to ensure that banks can react promptly to significant one-way transaction flows affecting their settlement accounts. Transaction limits, set at the overlay service level, can differ based on acquisition channels, the community that is serviced and the risk that needs to be covered. For example, mobile-to-mobile instant payments would require lower limits than a B2B overlay service used to handle the domestic leg of large value cross-border payments entered outside RTGS opening hours.



Value added services facilitate a more efficient, convenient and effective operation of the central platform and of the supported overlay services. We have seen that the launch of a new domestic 24x7x365 settlement service in combination with a convenient overlay service and a mobile proxy database has a significant impact on the success of the launch. High early growth figures are much more common when overlay services support the launch of a new platform. An absence of this overlay service may require additional measures to artificially increase the traffic growth (e.g. an obligation for the participants to process standing orders through the 24x7x365 settlement service).

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

**SWIFT response:**

Depending on the interpretation of ‘interoperability’ there are different ways to consider this question.

We understand interoperability refers to RTGS operators and solutions within a single currency zone, which could specifically be the case in larger communities such as the US and the Eurozone. To achieve critical mass, linking the existing instant payment (IP) systems together is absolutely necessary.

An absence of interoperability between IP operators will mean the overall solution will lack ubiquity and result in low take-up or failure. We believe that this type of interoperability is an absolute necessity to achieve a successful IP service. One of the main drivers for the ECB’s decision to build Target Instant Payment Settlement (TIPS) was that the EACHA (European ACH Association) framework, connecting multiple solutions together, was not working.

To achieve such interoperability, the US financial community will need to agree on a market practice for instant payments, describe it in a single scheme, preferably based on a single message standard with commonly agreed implementation guidelines and on interoperable network protocols in case multiple networks are being used.

In addition, interoperability can also assist at an operational resilience level with the potential for redirection of payment traffic from one system to another.

An important ingredient to interoperability between systems is the use of common standards. This was illustrated by the Bank of England’s recent work:

- Late in 2017, the Bank published a number of principles to further define what good interoperability could look like. The principles focussed on the alignment of high value payment system messages with those of retail payment systems – with the minimum of implementation differences. They also focussed on sound change management and the need to restrict implementation to a subset of the overall ISO 20022 superset.

- In June 2018, this work was extended with the publication of a joint consultation between the Bank and the UK's New Payment System Operator (now Pay.UK) on the shape and form of the ISO 20022 implementation. This consultation also looked at the introduction of a Common Credit Message (CCM) format that would be used by both the new retail payment system and the renewed RTGS system. Along with other industry stakeholders, SWIFT responded positively to this consultation.

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?

**SWIFT response:**

SWIFT believes such a service could indeed be used for other purposes. In theory, once the mechanism is in place, other payment or settlement systems that would normally just settle on 'normal' business days could extend their operation to other days. This could be of considerable value at the time of stressed market conditions even if normal business practices are not extended.

Moreover, it could support a 24x7 economy with secure, fast and reliable information exchanges beyond the pure financial transaction (e.g. notary documents, insurance documentation, billing and invoicing remittance information).

Also, such a 24x7 platform developed to handle peak traffic for instant payments, would, by design, have sufficient capacity to be able to handle less urgent, standing orders and batch transactions during idle time, thus reducing cost. It supports the consolidation of different platforms and reduction of institutions' total cost of ownership.

Lastly, IP systems are increasingly being viewed as an extension of cross-border correspondent banking transactions. A pilot conducted by SWIFT and banks from China, Thailand, Singapore and Australia, linking gpi correspondent banking transactions with AU-NPP transactions, has demonstrated the central contribution domestic real-time systems can have to faster cross-border payments.

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?

**SWIFT response:**

In line with the approach being adopted in other countries, we believe that considerable benefit accrues from the establishment of these teams.

Some examples:

- The Bank of England established an interoperability working group which SWIFT, FMIs and banks participated in.
- The Australian NPP was designed and developed in close collaboration with industry working groups – including the Reserve Bank of Australia, participating banks, the Australian Payments Clearing Association, SWIFT as the solution provider and the project management team.
- The scheme and solutions in Europe were driven by the ECB’s Euro Retail Payments Board (ERPB), including representation from buy and supply side.

Where interoperability discussions are required to enable a countrywide ubiquitous solution to be successful, industry-wide teams are indispensable. Some areas where teams are particularly valuable include liquidity provisioning agreements, message routing and market practice support.

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?

**No response from SWIFT.**

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

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

- i. A tool that requires a bank to originate a transfer from one account to another
- ii. A tool that allows an agent to originate a transfer on behalf of one or more banks
- iii. A tool that allows an automatic transfer of balances (or “sweep”) based on pre-established thresholds and limits
- iv. A combination of the above
- v. An alternative approach

**No response from SWIFT.**

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?

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?

**No response from SWIFT.**

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?

**No response from SWIFT.**

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?

**No response from SWIFT.**

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