Rodman K. Reef
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Ms. Ann 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

Dear Ms. Misback:

The following are my comments about the “Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments”.

Please remove the personally identifiable contact information at the top of this letter before making the comments publically available at the Board’s web site or in paper form at the Board’s offices.

The Federal Reserve should provide a real-time gross settlement system (“RTGS”) much as described, but not as completely described, in the paper requesting public comments. The goal should be to develop infrastructure to support U.S. payment systems, especially faster payment systems, on which the private sector can build innovative services to serve broad markets and the public interest.

The “Potential Federal Reserve Actions” paper correctly states that a RTGS system is preferred over a differed net settlement system (“DNS”). This is especially true when there is one message and one path for both clearing and settlement. RTGS eliminates the time difference between the end user recipients receiving funds and the receiving bank receiving funds. This eliminates counterparty risk and eliminates many of the reconciliation steps inherent in current systems and even in some of the DNS-based systems. It is, therefore, more efficient. This is, as the paper suggests, slightly offset by the need for immediate funds availability for every transaction. However, this supports the counterparty risk reduction benefit mentioned above and is worth the extra effort.

RTGS with one message and one path for both clearing and settlement supports the banking industry’s “straight through processing” goal that emerged several years ago. RTGS, with separate paths for clearing and settlement messages, and DNS do not support this goal as well.

The Federal Reserve should be able to do build the RTGS and meet its statutory obligations. It is uniquely positioned to build an RTGS system. Every depository institution in the U.S. either has or has access to an account at the Reserve Banks. The depository institutions do not have similar account access in any other U.S. organization and access to an account of all depository institutions is key to building a RTGS. In addition, depository institutions have an incentive to keep funds at Federal Reserve Banks. The funds are included in their regulatory required reserves and they earn interest on the money. No other organization can provide these services and benefits in a reasonable timeframe.

Given there is no other organization where all depository institutions have an account or have access to an account, it is in the public's interest and a public benefit for the Federal Reserve to provide access to these accounts for a RTGS.

It is generally understood, and supported by the GAO study cited in the request for comments, that the Federal Reserve meets the statutorily required full cost recovery for its existing payment systems. It is reasonable to assume the Federal Reserve would similarly meet the requirement for a RTGS. The statutes require the Federal Reserve to report regularly how it meets this requirement. Any deviation from the requirement would be visible in these reports or follow-on analyses.

It is likely no one faster payment system can provide ubiquitous access nationwide to all deposit accounts. Interoperability between systems is needed. RTGS, because of its simplicity and lack of counterparty risk, can reduce the complexity of exchanging transactions between faster payment systems. It is therefore a key ingredient to achieving "ubiquitous, nationwide access to" and usage of "safe and efficient faster payments".

A Federal Reserve provided RTGS may encourage some non-U.S. central banks, who might otherwise be concerned about settling with a private sector organization, to connect to one or more of the U.S.' faster payment systems.

In the short-run, having more than one faster payment settlement system in the market may confuse participants and may delay participation decisions. However, this is outweighed by the opportunity for competition and by the efficiencies provided by a RTGS, including the lack of counterparty risk. From a competition perspective, there are potential faster payment participants who are not currently comfortable with the current faster payment providers. These participants feel, because some of the current providers are owned and dominated by large institutions, they will not have any influence in the rules about or in the cost of the services. They feel this repeats a problem they have with some of the existing payment system. They want an organization to provide the services that has a mandate to service everyone in the same manner. They believe the Federal Reserve meets this criteria and will provide the competition needed in the market.

The Federal Reserve's implementation of RTGS should be focused, with one exception, on the message movement and money movement functions. It should leave all other value added services, e.g. directory services, to the private sector. The only exception should be the encouragement of fraud data sharing, a fraud database and the provision of fraud tools the private sector cannot easily provide. The private sector, for various reasons, does not share fraud data well. The Federal Reserve can provide the confidentiality and other legal and regulatory structures necessary to make financial institutions comfortable with sharing fraud information.

There is much experience in the market in building 24x7x365 real time financial systems. This includes the credit card networks, the ATM networks and many of the on-line banking systems for both retail and corporate customers. The same is true for other industries such as the airlines, car rental businesses, process control environments, etc. The need for 24x7x365 availability should not be a stumbling block for the development of a RTGS.

Depository institutions currently process many 24x7x365 services. These include debit and credit card transactions, ATM transactions, on-line business transactions, etc. While there will be some impact when 24x7x365 faster payments are added to the mix, it will not be a completely new phenomenon. There will be, similar to other new services, concerns and problems but none of them should be completely unfamiliar given the experience with other 24x7x365 services.

The Federal Reserve should offer both RTGS for faster payments through the existing reserve accounts and through separate accounts. It should let the RTGS participants decide which approach is best for them. It is likely the bigger institutions will decide to use a separate account, assuming the same level of interest is paid on the balance as is paid on reserve account balances, and smaller institutions will choose to use their existing reserve account. The difference is likely to be the ability to manage the balances in the accounts given the number of faster payment and other transactions.

It is important to think about RTGS as the settlement system of the future. There may be other settlement approaches in the market when RTGS arrives. It is likely, due to RTGS's benefits, most implementations will migrate to RTGS over time.

Similarly, RTGS, as the industry gains experience with it, may have other uses besides faster payments. For example, it could be used for debit card settlement, P2P transaction settlement, prepaid card settlement, and certain cross-border transaction settlements.

The liquidity tool mentioned in the Federal Reserve's request for comment paper is a good idea and should be developed no matter the approach decided for faster payment settlement. The 24x7x365 ability to move funds from an institution's reserve account to another account inside or outside a Federal Reserve Bank will be useful no matter where the receiving account is housed. It can reduce customer service issues in the unlikely circumstance when the account supporting an institution's faster payment product runs out of funds. It can be valuable when, in a faster payment DNS environment, an institution does not have sufficient funds in its account to pay the net amount due even though the end users have the funds.

Given its value no matter the settlement process, the decision about the liquidity management tool should be made independent of the settlement system decision and it should be developed independent of the settlement system.

It would be valuable for the Federal Reserve to have separate industry advisory councils for the development of an RTGS settlement system and for the development of the liquidity management tool. At a minimum, this will give the process transparency and build trust between the service provider, the Federal Reserve, and the services' potential users.

Thank you for the opportunity to comment on these potential proposals.

Please let me know if you have any questions.

Sincerely,

Rodman K. Reef

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