HSBC

December 14, 2018

Via Electronic Submission

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,

HSBC Bank USA, National Association ("HSBC Bank USA, N.A.") appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System ("Board") in response to its request for comment ("FR Notice") about potential actions that the Federal Reserve could take to promote ubiquitous, safe, fast and efficient payments in the United States. At the outset, we support the Board's objective to promote faster, safe, ubiquitous payments that can be made 24/7 anywhere in the United States. We also believe the Board appropriately used its convening power in bringing together the Faster Payments Task Force, which was a moving force behind the progress made to date by the private sector.

In the FR Notice, the Board requested input on two specific ideas. One relates to the development of a 24/7 Reserve Bank service for faster payments, and the other a liquidity management tool that would enable the movement of funds 24/7 among Federal Reserve accounts. The first idea involves a principal public sector role, with the Reserve Banks entering the faster payments playing field with their own proposed payments product. The second idea, relating to a liquidity management tool, is independent of the first idea and would have the Federal Reserve play a supporting and facilitating role, by acting as a liquidity source supporting private sector faster payments systems.

For the reasons described below, we believe that the Reserve Bank development of a competing public sector 24/7 faster payment service would actually hinder, rather than promote, faster real-time payments in the United States. Indeed, we submit that the publication of a FR Notice describing the potential of such a Federal Reserve service offering could have an untoward effect. With respect to the proposed liquidity management tool, we believe that such a tool might be useful, but only if it provides liquidity during weekends and holidays, when it is most needed. During other times, there are many alternative sources for liquidity and it is less necessary.

HSBC Bank USA, N.A. is a significant participant in U.S. payment systems, including the Clearing House Interbank Payment System (CHIPS), the Electronic Payments Network (EPN), and the Fedwire Funds Service (Fedwire Funds). We also participated actively in the Faster Payments Task Force, and have worked collaboratively with the payment industry and the Board in the collective effort to develop a ubiquitous, nationwide payment system that would provide faster payments on a 24/7 basis.

The FR Notice makes only a brief and anonymized reference to the crucial fact that there is currently a system for making faster payments in the United States. It was launched in late 2017, and is designed and actually makes payments on a 24/7 basis within the United States. The Network is called the RTP Network, and it is owned and operated by The Clearing House Payments Company ("TCH"). HSBC Bank USA, N.A. is one of the Class A owners of TCH, and, as both an owner and a U.S. financial institution dedicated to its customers, has a direct interest in the success of the RTP Network.

The RTP Network is now operating but it is still in a "start-up phase", with plans to grow significantly over the course of the coming 12 months. As the Board knows, because it regulates the RTP Network as a bank service corporation, the RTP Network was in the planning stage in 2014, and arose from an effort by TCH and its owners to be payment system innovators, with the shared and clear intention to create a ubiquitous and safe real time payment system. As the necessary criteria for such a system emerged from the deliberations of the Faster Payments Task Force, the design of the RTP Network adapted so that there would be alignment with the principles and criteria produced through that collaborative effort. As a result, the RTP Network has been built, with Federal Reserve encouragement, in accordance with the 36 criteria set forth by the Faster Payments Task Force and the guiding principles of the Consumer Financial Protection Bureau.

The owners of TCH have collectively committed over $130,000,000 so that this new payments network could operate in the best interests of bank customers and the financial industry more generally, and in a safe and sound manner. The Board actively encouraged TCH's owners at each material step, and stated on several occasions in their public releases that it would not enter the field as a competitor unless there was convincing evidence that the private sector would not deliver on the vision of faster payments by 2020. TCH and its owners relied on the Board's statement. As one of TCH's owners, HSBC Bank USA, N.A. has invested more than $8,000,000.00 to support the RTP Network, money put toward research, development, and implementation, as well as devoting key personnel. But our monetary contribution is just one component of what we have done to make the RTP Network operational. We have also taken action to adapt our delivery channels and to incent our customers to do so as well. These required changes were necessary to ensure that the infrastructure in our institution and used by our customers would have the operational capability to integrate with the RTP Network.

We do not want to suggest here that all of the work on the RTP Network is done. TCH, in our view, has a viable plan to reach full ubiquity, but the plan is dependent on the execution of banks and customers throughout the country. The magnitude and dimension of this work are significant, and present a challenge to the achievement of the objective, whether the challenge is faced by the RTP Network or by a public sector effort.

The FR Notice is ambiguous as to the Federal Reserve's future plans to enter the faster payments playing field. In our view, this ambiguity is not constructive. It is not constructive because we believe that it may well incite passivity in banks that otherwise would be moving assiduously to participate in the RTP Network. Some financial institutions will speculate that there is a probability that the Federal Reserve will move forward with the development of its own competing system for faster payments. It would then be not unreasonable that these institutions, which may have been contemplating the speedy adoption of the RTP Network, to put their plans to move forward with the RTP Network "on pause". They would do this, in our view, so that they could make later an informed decision whether to continue devoting substantial internal resources (including the involvement of customers) to the RTP Network, with all that this entails, or, instead, to wait for the Federal Reserve's central-bank-provided faster payment system. In this regard, the proposal strongly implies that the Federal Reserve's faster payment system is something worth waiting for.

The proposal explicitly suggests that the central bank's faster payment system would be better than the private sector RTP Network because it would settle in "central bank money" rather than on a "private ledger". A Federal Reserve 24/7 real time gross settlement Network is not better than the RTP Network because it settles in "central bank money". It is just different. From an end-user perspective, the nature of the two systems would be identical; both would begin and end with an account at an insured depository institution. Further, as the FR Notice itself recognizes, interbank settlement on the RTP Network "is performed using a private sector-owned settlement ledger that is backed by funds in a 'joint account'." As the FR Notice recognizes, this joint account is on the books of a Federal Reserve Bank, making RTP Network settlements similar to settlement in central bank money.

Because of this explicit statement, the FR Notice might have a discouraging effect on banks contemplating the use of the RTP Network because of what they will perceive to be negative comments by the Board. We observe that a negative perception can easily become a reality, especially when the negative comment is coming from the Board, the RTP Network's regulator (as well as the regulator of the many banking organizations that are TCH's owners).

Most importantly, the simple suggestion by the Federal Reserve of a coming competing system, and one that might even be superior, does the damage. Merely raising the prospect is sufficient to cause some banks to wait for it. Just "around the corner" there will be a public sector alternative to the RTP Network, so why should any bank proceed into private sector faster payments now. The unintended consequence of this is that the Board, through publication of the FR Notice, could have set back the effort to move toward faster payments in the United States.

The timing of the FR Notice comes at a very sensitive moment for the RTP Network. Had the Board put the Notice out several years ago, when the Faster Payments Task Force began its work, there would not have been such concerns. Alternatively, had the Board postponed publication of the FR Notice until some future date (assuming for the sake of argument only that the RTP Network encountered some type of future technological or business failure that caused the Board to determine, which it has not done, that "the actions of the private sector alone will likely not achieve the desired outcomes for speed, efficiency and safety in a "timely manner")[1], then there would not be such concerns. But the Board published the FR Notice at a very delicate point in time when the RTP Network was in a vulnerable state - just when it has started operating and attracted such energy and momentum. If those considering the RTP Network now decide on a "holding" response, this energy and momentum might be lost.

The best path toward faster payments in the United States is not to abandon the Board's encouragement of the RTP Network and offer a competing product. Describing the potential for a competing Federal Reserve payment Network, suggesting explicitly that the competing Federal Reserve Network will be better, and intimating that the Federal Reserve could swiftly move from a generalized idea to a secure and efficient network connecting at least 11,000 depository institutions, is, of course, not supportive. It is actually counterproductive.

One lesson that the RTP Network has learned through its experience is the difficult challenge of integrating bank and customers facing systems, so that the benefits of the RTP Network are realized by both banks and their customers. This challenge will face the Federal Reserve just as it faces TCH, with one very salient difference. TCH is already addressing the challenge, and the Federal Reserve has not yet started.

The implicit suggestion that the FedLine connections in place today between the Federal Reserve and its customers will support a faster payment system and provide a swift way for the Federal Reserve to enter the market is not supported by our implementation experience with banks, core processors and end users. FedLine network connections are not typically sized or configured with the capacity and low latency needed to handle retail real-time payment traffic. Financial institutions hoping to use the FedLine channel would likely need to upgrade or replace their Fedline network connections, and would also need to do work on their backend systems that connect to the FedLine channel to address the need to access DDA account on a 24/7 basis.

We also see interoperability of the proposed 24/7 service as an extremely challenging issue for any faster payment system. Full interoperability would be critical to the public benefit of the 24/7 service. This would require in the first instance that somehow the Federal Reserve's settlement service and the RTP Network, in which settlement and clearing are simultaneous and functionally inseparable, be able to exchange payments without settling the payments twice. It would also require establishing and maintaining on-going functional parity as both systems evolve

[1] We quote the Board's formulation. See Federal Reserve System, "Strategies for Improving the U.S. Payments System" at 5 (Jan. 26, 2015)(hereafter cited as "Strategies White Paper").

and innovate over time, which can be especially challenging when interoperability is between a private sector entity and a public entity. The benefits of interoperability and its impact on access, cost, and risk will depend on the degree to which full interoperability is attainable.

Before discussing the second idea raised in the FR Notice, we believe it appropriate to raise one final procedural point – the Federal Reserve has not considered its own longstanding policy regarding payment systems.[2] In this policy, the Board sets forth three conditions that must all be present before the Federal Reserve may propose a new service or service enhancement. Although there are questions whether either of the first two conditions have been satisfied, we believe that the third condition, in particular, is not satisfied. The third condition makes clear that the Federal Reserve will not offer a new payments product unless the private sector "cannot be expected to provide [the product] with reasonable effectiveness, scope, and equity."[3] As the discussion set forth above shows, the RTP Network is a private sector Network for effecting faster payments anywhere in the United States on a 24/7 basis. There is no suggestion, by the Board or any other public body or agency, that it does not have the required effectiveness or scope, or that it fails to offer equitable terms. The RTP Network has a flat pricing schedule that is the same for all participants, regardless of the participant's size, and there are no discounts for volume commitments, or monthly minimum transfers for participating institutions. From our perspective, the private sector has done what the Federal Reserve anticipated it would do in 2015 when it published the Strategies White Paper, and under the Board's own policy, we do not see any basis for the Federal Reserve to offer a competing public sector product, at least at this time.

In the FR Notice, the Board (without ever actually naming the RTP Network), explains one of its distinguishing features. "Each participant in this arrangement relies on the presence of balances stored in a single joint account at a Reserve Bank that is held for the benefit of the joint account-holding banks as a method of backing the private-sector service." There is, however, an important nuance. The RTP Network operates 24/7 and effects faster payments at any time of the day or night on each and every day of the year. Account services at the Federal Reserve, and the joint account referenced in the Board notice, are not available on weekends or holidays throughout the year.

It is foreseeable that, assuming that the RTP Network develops and grows, there could be a situation where liquidity becomes "trapped" in an account at the Federal Reserve, and that liquidity cannot be put to a needed use. Currently, the Federal Reserve has no mechanism to provide access to a balance in a Federal Reserve account on a weekend or a holiday, because of the longstanding tradition that banking services are rendered only during "banking hours" and on a "banking day". This conception of banking hours and banking days has changed, and the change in thinking about when a critical banking service like payments should be operational is one of the driving forces behind the RTP Network. Because this fundamental assumption of when banking services should be available has changed, we believe it is also appropriate to reconsider the Federal Reserve's role in freeing up "trapped liquidity" so that it can be used in a way that has not been available in the past. In our view, it is this quintessential central bank function – being the liquidity provider to the banking system when liquidity is needed – that should be the focus, rather than the Federal Reserve as a competitor to a private sector transfer Network that it regulates.

In our view, the Federal Reserve could be very helpful in freeing the trapped liquidity in a Federal Reserve account, such that the trapped liquidity could be used by bank participants in a faster payment network during a weekend or a public holiday. One might envision this as an extension of the historic role played by the central bank

[2] Board of Governors of the Federal Reserve Network, "The Federal Reserve in the Payments Network."Issued 1984; revised 1990(hereafter "Payment Network Policy"). Available at https://www.federalreserve.gov/payment Networks/pfs_frpaysys.htm.

[3] Payments Network Policy, supra n.4, at 5.

as a liquidity provider. The extension, however, would be modest – it would only be to "free up" trapped liquidity in Federal Reserve accounts so that the "freed up" liquidity could be used to facilitate a 24/7 faster payment Network. It calls for a simple functionality: a means to move a balance in a Federal Reserve account during a weekend or a holiday so that the balance could be used for a specific purpose i.e., effecting payments.

With respect to the RTP Network, the Federal Reserve insisted that the RTP Network develop a means of transferring available liquidity on the RTP ledger during off hours and encourage RTP participants to make liquidity arrangements that could be triggered if such a need arose through the use of the mechanism developed. Although this approach to managing liquidity on the RTP Network may suffice, it still relies on the existence of some level of excess liquidity on the RTP Network and a willingness to lend such liquidity. But on weekends and public holidays, the back-up lines could be unnecessary if trapped liquidity in a Federal Reserve account could be "freed up" so that the balances could fund payment activities. This kind of access to liquidity that would otherwise be "trapped" could be of great utility in all sorts of situations, such as an operational problem, a storm (e.g., Super Storm Sandy), or a terrorist attack (e.g., September 11th). In this regard, we note that performing this kind of traditional central banking function would also help the United States to achieve a 24/7 faster payments system in the short term. Fedwire is clearly fit for this purpose, but it may not be necessary to keep all the functionality of the Fedwire service open on weekends and holidays.

We appreciate the opportunity to comment on the FR Notice. If you have any questions, or wish to discuss this letter, please do not hesitate to contact the undersigned.

Respectfully submitted,

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