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YOUR CORRESPONDENT BANK

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December 14, 2018

Ann E. Misback, Secretary
Board of Governors of the
Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551

VIA EMAIL: regs.comments@federalreserve.gov

RE: Docket No. OP – 1625
Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments
RESPONSE TO REQUEST FOR COMMENTS

Dear Secretary Misback:

This letter is co-submitted by The Bankers Bank (Oklahoma City, OK) and each of the smaller industry stakeholders identified below (collectively, "**Submitters**"), in response to the referenced Request for Comments ("**RFC**") issued September 28, 2018, by the Board of Governors of the Federal Reserve System (the "**Board**").

Submitters appreciate the Board's invitation to present their views. For the reasons stated in their responses to questions posed by the Board in its RFC, Submitters whole-heartedly endorse the Federal Reserve Banks' contemplated development of a 24x7x365 Real-Time Gross Settlement ("**RTGS**") system and clearing service, and request implementation of these faster payments offerings as quickly as feasible.

Respectfully submitted,

Mark P. Keeling

and

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[The Board's Questions and Submitters' Responses Follow]

THE BOARD'S QUESTIONS and SUBMITTERS' RESPONSES

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

Yes. The United States has been the spearhead for today's payments systems. A fully-interoperable RTGS backbone is essential for the U.S. to be a world-class leader in the faster payments systems of tomorrow. Without RTGS capability, credit and liquidity risks are heightened, resulting in additional friction, higher cost, and potential loss of static balances/reserves under the control of our financial institutions ("**FIs**").

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

Yes. From the time they were established, Federal Reserve Banks ("**FRBs**") have provided settlement and clearing services. No other instrumentalities, public or private, have the extraordinary level of public trust and confidence, or the breadth of collective reach to as many domestic FIs, that is necessary to assure ubiquitous access to these services. Submitters observe that 24x7x365 RTGS settlement and clearing service is the emerging standard for offerings by the central banks of other nations. That U.S. central banks must offer these services, and *soon*, is logically inescapable.

3. If the Reserve Banks do 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?

The demand for faster settlement and clearing is manifest today, and (as proven by industry developments in the wake of Check 21) will grow exponentially over the coming decade. To accelerate settlement within today's payments framework, the FRBs established dual custody accounts. While helpful, Submitters urge that this measure is simply not enough. Submitters support the FRBs' development of a rail that allows expedited settlement and clearing to the FI's master account, its correspondent's account, or a separate account such as an Excess Balance Account ("**EBA**"). The result would not only be faster, but offer more flexibility, as these accounts can be administered by the FI, or its endpoint or correspondent.

[Balance of Page Blank – Further Board Questions and Submitters' Responses Follow]

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?

This question suggests that the U.S. financial services industry and its customers have a practical choice to accept or reject operating in 24x7x365 settlement and clearing environment. In fact, they do not. Since the rest of the business world is moving there, the issue is not "if," but only "when," our industry and customers must go there too. Any change in the payments ecosystem requires adjustment and comes at a cost, though the degree of each will vary by stakeholder. For FIs, adjustment to a 24x7x365 settlement and clearing environment will require investments in their own futures, such as: new or upgraded software systems; additional training for FI personnel; renewed due diligence on potential service providers; revised hours of FI operations and rescheduling of associated personnel; enhanced customer help resources (at least temporarily); and the development of mobile and remote capabilities for business and retail customers. Some adjustments may be implemented incrementally, as the industry awaits the FRBs' roll-out of their new platform. However, the benefits will outweigh the cost and challenges to be overcome as our industry and customers step into this next "Brave New World." Submitters believe their optimism is entirely realistic. The transformation of payments from paper checks to image exchange took several years, significant infrastructure modification by industry stakeholders, and acclimatization by their customers. Despite the time, cost and learning curve for the millions affected by electronification, no segment is pressing for reinstitution of paper checks. Transaction speed and convenience, coupled with a "carrot-and-stick approach" to pricing and other efficiencies, helped bring the market to near 100% acceptance of electronified payments in a relatively short time. Now, we are poised at the threshold of a more comprehensive leap, for which the Board's hoped-for outcome is:

> "[to achieve] ubiquitous, safe, faster electronic solution(s) for making a broad variety of business and personal payments, supported by a flexible and cost-effective means for payment clearing and settlement groups to settle their positions rapidly and with finality."[1]

Submitters project that the substantive benefits inherent in the next-generation payments system envisioned by the Board, not to mention the ultimate economic benefits, will hasten a broad embracing of the new payments system.

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1 Federal Reserve System: "*Strategies for Improving the U.S. Payment System: Federal Reserve Next Steps in the Payments Improvement Journey,*" September 6, 2017, at 4. Full text at https://fedpaymentsimprovement.org/federal-reserve-next-steps-payments-improvement-journey-available/

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.

Since the *ideal* timeline for the FRBs to implement 24x7x365 RTGS settlement and clearing services has passed, **now** will have to do. Any further delay will be to the detriment of the stakeholder segments comprised of smaller FIs and new industry innovators. The only RTGS settlement services marketed at this time are offered by private sector entities owned and controlled by big bank interests. So far, this clique has shown little interest in promoting interoperability, less interest in having others participate in the development of rules for faster payments processes, and no interest whatsoever in transparent self-governance. However, once the FRBs enter the market as providers of 24x7x365 RTGS settlement and clearing services, their presence will have the salutary effect of encouraging all other providers to refocus their efforts toward achieving efficiency, interoperability, ubiquity, fairness and transparency. The FRBs' active presence will also remove obstacles to diverse innovation. If the faster payments services market is not entirely dominated by big-bank interests, new and different innovators will have incentive to enter that space.

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 nonbusiness 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?

Liquidity and credit management will be enhanced by the presence of an FRB-offered RTGS settlement and clearing system. Some FIs may request an option enabling them to defer receipt of information from nonbusiness days to the next business day. However, automations already in place at some FIs, and at most correspondents, can be augmented to monitor and react to payments movements occurring on nights, weekends, and holidays. While they acknowledge the possibility that other challenges may emerge once the FRBs' service is implemented, Submitters do not presently foresee significant stumbling blocks to the adoption of a seven-day accounting regime.

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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?

At this juncture, Submitters reasonably assume that the FRBs' settlement and clearing services would have sufficient flexibility to interact with small FIs' master accounts, or with their preferred correspondent's settlement accounts, or with their separately held accounts (such as EBAs). The specific features and functionality of the service(s) to be offered by the FRBs, and the ability to treat funds in these accounts as interest-earning balances or reserves, will be of primary importance to smaller FIs. The operational burden on smaller FIs would be minimal if correspondents will have the capability to access reporting, and to monitor and transact in these accounts, on behalf of the small FIs.

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?

Submitters suggest that the FRBs are uniquely well-positioned to operate a federated directory service. This offering, too, will accelerate interoperability and ubiquity.

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

Interoperability between the RTGS settlement and clearing services of <u>all</u> providers, whether public- or private-sector, is key to achieving ubiquity. The public will not accept a faster payments system unless each user knows that all payments sent will swiftly and safely reach the intended payees. The public cannot rest so assured if these services do not smoothly interface with each other. Again, the FRBs are inimitably situated to promote interoperable communication of faster payments data.

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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?

As previously noted, Submitters support the FRBs' development of a feature- and functionality-rich RTGS settlement and clearing service offering. Submitters are confident that the base features of the service will be fully explored with the large FI's/processors. However, Submitters implore the Board to make room at the planning table for smaller FIs, and their associated bankers banks and corporate credit unions, to fully consider the tools that are meaningful to the business needs of smaller FIs. These FIs serve a crucial function, and they should not be treated as afterthoughts. The American Banker put it succinctly:

> "Small, independent, geographically limited banks lie at the heart of the great American experiment in democratic self-governance and enterprise. No country does banking like the United States, with thousands of independently chartered financial institutions, many of which chartered in small, agricultural towns. Banks like these, and countless more, were born of a proud belief that neighborhoods and towns needed to gather their resources to provide for their own economic well-being. It is this hyperlocal culture and mission — not the hyperglobal — that provide the lifeline to small businesses upon which American community and progress fundamentally depends."[2]

<…>

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

Submitters urge that all of the functionalities identified above be included in the FRBs' liquidity management tool. Although many banks and agents transact business for their own accounts, some banks (notably, the smaller FIs) may prefer or need to have another FI act on their behalf. It therefore inexorably follows that some FIs have the

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[2] May 6, 2017, The American Banker, *"People Still Don't Get Community Banks. Let's Help Them Understand."* See, https://www.americanbanker.com/opinion/people-still-dont-get-community-banks-lets-help-them-understand.

need to act for multiple, other FIs. Automation of liquidity management functions is necessary, of course; but the availability of automated functionality should not preclude the FI from performing manual operations. Now, while the FRBs are designing their faster payments tools, is the best time to provide for that flexibility.

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?

Submitters favor the eventual roll-out of full 24x7x365 availability, understanding that staged deployments may be necessary to get there.

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?

Submitters urge that the FRBs' settlement and clearing services, including any contemplated liquidity management tool(s), be made available to all federally-regulated FIs for RTGS settlement and clearing of retail faster payments, or any other purpose that promotes the business of banking. However, Submitters respectfully oppose any use by "non-banks." While these businesses do contribute value to the industry, non-banks are not subject to the same regulatory oversight; they are not FDIC-insured; non-banks' direct use of these services will inject confusion into the negotiation/settlement/clearing process because the law doesn't recognize them as parties to that process; and, not to belabor the obvious, non-banks simply do not "settle" payments. They serve only as information conduits in the settlement and clearing process, and their "settlement" activities are in fact conducted by/through client FIs.

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?

Submitters encourage the simultaneous development and deployment of the FRBs' contemplated RTGS settlement service, and a liquidity management tool. Both are appropriate at this time.

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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?

Submitters are confident that the FRBs' simultaneous pursuit of both of actions will assist in achieving ubiquity, by providing fair access and transparency to all FIs and their customers. Furthermore, history teaches that no other organization, public or private, can match the FRBs as service providers in terms of adding much needed resiliency and redundancy to the payments system. Especially during times of crisis and stress, it is imperative to maintain the public's trust and confidence in our financial system. When the United States was attacked on September 11, 2001, the private sector's check system was stopped dead in its tracks, even at our nation's mightiest financial institutions. Had the FRBs not quickly and smoothly stepped up with liquidity and transaction operator assistance, commerce would have ground to a halt. It must be remembered that the 9/11 attacks were crude by current standards, as was our then-paper check payments system. That was yesterday. Today and into the foreseeable future, the most potent attacks on our financial system have and will come via cyberspace, originated by foreign state and non-state hostiles, and other criminals of any or no ideological stripe. Now more than ever, the public's trust and confidence in any payments system depends on the FRBs presence as active service providers.

8. What other approaches, not explicitly considered in this notice, might help achieve the broader goals of ubiquitous, nationwide access to faster payments in the United States?

The addition of fraud-related services, and BSA/AML monitoring by the central banks for items moving on their payments rails, would be an enormous assistance to the payments industry as a whole. These services are performed today on a decentralized basis, which inestimably multiplies the cost, and is wide open to potentially conflicting results. Anti-fraud and BSA/AML are logically-related concerns, and fairly beg to be consolidated for efficiency into a new, unified subscription service offered by the FRBs. As noted above, Submitters also urge the FRBs to provide a centralized, federated directory structure for use by all payments systems. These suggested approaches would combine to increase efficiency, reduce the incidence of errors, diminish industry confusion, and ultimately promote ubiquitously available access to faster payments.

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[End]