



December 3, 2018

Ann Misback
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 201551
Re: Docket No. OP-1625

The purpose of this letter is to provide comment to the Board of Governors on potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments. We have attempted to answer the questions posed in the Federal Register (Docket No. OP – 1625) regarding the Federal Reserve potentially designing and operating a Real-Time Gross Settlement (RTGS) service, and a liquidity management tool, as noted below. However, some introductory comments immediately follow.

Introductory Comments

While the Register provides a description of the settlement service being considered, and of the liquidity management tool that would support it, we are left to surmise what “rails” such payments would ride between banks as to the posting of the transactions. Absent this specificity it is difficult to comment on the questions posed with complete clarity. For example, the Register discusses the settlement process, but seems to be silent on the debiting/crediting of transactions to be settled. It is difficult to provide comment on one (settlement) without understanding the other (transaction processing). Specific examples of this confusion include: “Would the settlement process take place concurrent with corresponding transactions?”, or “Would the timing of settlement and transaction posting differ?” And, “Would posting of transactions be expected to occur 24/7/365?” If so, this has significant operational, staffing and systems implications, particularly for smaller banks. It appears to be virtually impossible to separate the settlement system from the faster payments process, in responding to the Federal Register questions. It would be beneficial to have better understanding of these points to provide more clarity in responses to the questions posed in the Register.

While slightly off-topic, we believe that the faster payments environment (and supporting systems, such as the RTGS) should be designed and constructed to handle virtually all use cases, including all retail payments, and as many commercial payments as possible, subject to any risk-based large-dollar limits that might be imposed.

With these points in mind, our responses to the questions posed in the Federal Register (Docket No. OP – 1625) are as follows (responses shown in *italics*). Please note that our comments are offered primarily from the perspective of a small-to-medium-size community bank.

Questions

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

We believe that the RTGS is the appropriate foundation for faster payments, assuming that, as described above, the “rail” to be used, will in fact be new to the payments system. As such, it is appropriate that a new and special-use interbank settlement process be developed that will support the volume, timing, and use-cases of a “faster payments” process. As noted above, any such design should include accommodation of commercial payments.

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

We feel that it would be appropriate for the Federal Reserve to design a 24x7x365 RTGS. Historically, roles for the Fed have been limited to those that include 1) the FRB achieving full cost recovery over the long run, 2) the service yielding a clear public benefit, and 3) the service being one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity. Development of the RTGS clearly meets these criteria. This case is similar to the FRB’s current settlement service. Development and offering of such a service seems well-suited to the FRB as a “trusted intermediary” in banking transactions. Such a role would be consistent with the Federal Reserve’s central mission, which includes a “fundamental responsibility to ensure that there is a flexible and robust infrastructure supporting the U.S. payment system on which the private sector can develop innovative payment services that serve the broadest public interest”. It seems clear that this is a role that fits well with 1) current operations of the FRB in providing other, related settlement services; 2) capabilities of the FRB to develop such a utility; and 3) the needs of the marketplace to provide the fundamental basis of a new payments system that otherwise would (likely) not be available to all financial institutions.

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?

We believe that there will be sufficient demand in the next ten years to support development of an RTGS- assuming that the Federal Reserve’s target of a faster payments system by 2020 occurs. Sources of the demand would likely include person-to-person payments; business to consumer payments (e.g. insurance claims payouts); business to business payments; and potentially government benefits payments. Another way to consider the potential for use is to view existing, remaining check payments as potential users of a faster payments system.

- 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?

From a smaller community bank perspective, the adjustments necessary are difficult to know with certainty at this time, as noted in our introductory comments. However, it would seem

likely that adjustments would be more significant to smaller financial institutions that do not maintain off-shift or weekend staff. It would seem that a process would be needed to accommodate after-hours and weekend/holiday funding, which may be accommodated by the proposed liquidity management tool. As noted in our introductory comments, more information about the posting requirements for a new, “faster payments process, which would likely be a 24X7X365 system” would help us to understand the corresponding impact of an RTGS. However, it would appear that the adjustments to accommodate likely posting requirements would require funding, staff and systems. The required changes to systems would, in many cases have to be provided by banks’ core systems providers (e.g., Fiserv, FIS, Jack Henry). It is unclear at this point what the cost/benefit case would be of not just the RTGS settlement system, but of the faster payments process, as well.

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.

The timeline for implementing the RTGS settlement service should be coordinated to support availability of a “faster payments” system. We believe that a reasoned, phased approach of a “faster payments system” may be appropriate, to minimize risk and fraud. The timeline for the RTGS system should be timed accordingly.

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?

It would seem that financial institutions may need to disclose to customers that immediate posting of debits and credits would be likely, in a “faster payments” scenario. For example, customers need to understand that if they initiate a “faster” payment, that the charge to their account will take place (almost?) instantly, thus possibly requiring different account management on the part of the accountholder. An open question is “how frequently will posting of transactions to customer accounts take place, in this “faster payments” environment?” For example, will financial institutions be expected to create the ability to post transactions on an ongoing basis throughout the day? Or on scheduled “batch” times? And what about off-hours and weekends/holidays? Will such transactions instead be allowed to “queue” for Monday morning posting? If not, systems will need to be adjusted to allow for real-time, ongoing posting of transactions, which would appear to increase risks and operating costs significantly. While large financial institutions would require time to develop such capability, medium and smaller institutions would generally rely on their core software providers to create that capability. And, such terms and conditions would need to be included in account agreements with account holders and disclosed, as noted above.

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?

Designing and implementing a set of accounts that are separate from banks' master accounts would require that banks set up and manage a similar reconciliation process to that which currently exists. This would involve reconciliation throughout the day, at a minimum of the new settlement account for faster payments, and it would require the ability to fund such an account. Funding of the new account would presumably be required for weekends and holidays, though not likely at night. Would the FRB's discount window be available for such off-hours funding? Would FHLB funding be available?

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?

As noted in the introductory comments above, it is virtually impossible to separate and comment on the various components of a faster payments process. Accordingly we believe it to be preferred that the FRB provide the proxy database or directory, to achieve the objectives of security, ubiquity, and to facilitate progress in one of the components of a faster payments project list. As noted above, "Development and offering of such a service seems well-suited to the FRB as a "trusted intermediary" in banking transactions. Such a role would be consistent with the Federal Reserve's central mission, which includes a "fundamental responsibility to ensure that there is a flexible and robust infrastructure supporting the U.S. payment system on which the private sector can develop innovative payment services that serve the broadest public interest". This notation applies to development and operation of the proxy database as it does to the development and offering of an RTGS system.

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?

Presumably, tools to detect fraudulent transfers for the RTGS settlement service would be similar to those in place for the current settlement service offered by the FRB. It would seem that more robust fraud prevention techniques would be required the closer to faster payments network that this work results in. For example, if the FRB designs and operates the proxy database or directory noted above, then that will require significantly more fraud prevention than a bank-to-FRB- to-bank settlement service.

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?

As noted previously, the answer to this question depends on how closely tied the settlement process is to the actual, individual posting transactions. Ultimately, auxiliary services such as fraud detection and risk management should be tied to the process responsible for processing of individual posting transactions. Transaction dollar limits would likely be effective in avoiding the risks encountered by the Funds/Wire Transfer system.

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

Interoperability of the RTGS is critical for faster payments to achieve ubiquity, which serves as reinforcement of the case for the Federal Reserve to develop and manage the RTGS. This represents the best conditions for all U.S financial institutions to be able to have access to faster payment services. Leaving this to the private sector would be unlikely to have these desired results.

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?

An obvious consideration would be to enhance the FRB's current settlement system to accommodate faster payments. This would offer possible advantages – reconciliation of a single FRB account; funding of a single account, and use of a single master account. Challenges of this approach would include complexity of reconciliation of the account due to additional, frequent entries resulting from faster payment transactions; more frequent monitoring and funding of this “general use” account; and the need to fund such an account during off-hours of the bank. And, this would result in comingling of faster payments transactions with a bank's current transactions. Finally, there would need to be a logical “cut-off” time late in the day to allow for adequate reconciliation of related accounts.

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 noted previously, the RTGS needs to be in sync with the above noted items, such as interoperability, accounting processes, and payment routing. Development of joint FR and industry teams to identify approaches is strongly advised (especially given the success achieved by the FR's collaborative work for faster payments work to-date).

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?

Yes, the FR should develop a liquidity management tool to facilitate transfers, whether those services are provided by the FR or by the private sector. The FR's involvement in this process is critical to ensuring the desired outcomes (ubiquity, etc). Absent the FR's involvement, the private sector would lack the reach, level of trust, and resources, all of which would be required to achieve this step.

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

Our preference would be to have a system that would not require a pool of “contingency funding” in the event additional funds are required during off-hours, to fund the RTGS account. We would prefer a process to identify an “overdraft”, and then a process by which to fund the “overdraft”. Our preferred method would be to utilize a “sweep” approach, whereby funds would automatically be swept to the RTGS from another, pre-arranged funding source. Could this include the FRB's discount window?

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?

We believe that such a system would need to be available during certain defined hours on weekends and holidays – and probably less likely at night, though we would prefer that some type of “daylight/nighttime” overdraft system be in place to address overnight overdrafts.

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?

Consideration should be given to the possible use of the liquidity management tool by banks to help to facilitate management, reconciliation and funding of current settlement accounts as well as the RTGS. Funding of banks' master accounts and any other special accounts should be made possible via a new liquidity management tool.

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?

The FR should pursue both the RTGS and the liquidity management tool, in tandem. This will provide the most seamless and effective implementation in support of a faster payments system.

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?

As noted previously, we feel strongly that the FR should pursue development and ongoing operation of both. This action will provide the industry with the best opportunity of achieving ubiquitous, nationwide access to safe and efficient faster payments in the long run, due to the FR presence, reach, and level of trust.

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?

As noted previously, more clarity with regard to how a settlement service will work relative to the faster payments system, including posting of debits and credits at banks would be helpful. This clarity would assist in understanding better how overall development of a faster payments environment might play out. The suggestion above for development of joint FR and industry teams to identify approaches is strongly advised (especially given the success achieved by the FR's collaborative work for faster payments work to-date).

9. Beyond the provision of payment and settlement services, are there other actions, under its existing authority, the Federal Reserve should consider that might help its broader goals with respect to the U.S. payment system?

In Question 3.F.i. above, the question is asked "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?". This question appears to raise the possibility that the Federal Reserve might provide a data base or directory service, as opposed to the free market doing so. We suggest that the Board of Governors of the Federal Reserve System seek input on this potential action. We feel that it would be appropriate for the Federal Reserve to provide such a service, for the reasons noted above with respect to proving the RTGS and liquidity management tool, and that this would presumably require this step.

Sincerely,
(Via E-mail)
Steve Whitney
Executive Vice President
Norway Savings Bank
Norway, Maine 04268