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

Docket No. OP-1625, Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments

Dear Ms. Misback:

Please consider our comments on this critical proposal.

Reinvestment Partners is a non-profit 501 c 3 organization, operating from North Carolina, which works to enhance economic justice through an intersectional strategy across "people, places, and policy." We provide direct services to low-income consumers as they seek to buy a home, avoid foreclosure, or prepare their taxes. We have developed models to encourage individuals who receive food stamps to buy more fresh fruits and vegetables. We build and rehabilitate housing for rental and homeownership. Lastly, we pursue policy agendas to increase access for underserved consumers to safe and affordable banking products.

Reinvestment Partners participated in the Faster Payments Task Force and the Governance Foundational Formation Team.

The ideal faster payments solution should provide an environment where consumers can transact using reasonably-priced products that do not compromise the safety of their funds or the security of their personally-sensitive information. We believe that a real-time gross settlement system, based on good funds, could also expand access to the banking system for traditionally underserved consumers.

We believe that the Federal Reserve's participation as an operator will benefit consumers.

A second operator should create a competitive marketplace. At the moment, startup costs for implement existing solutions are expensive for smaller depositories. With the Federal Reserve as an operator, more financial institutions will be able to build faster payments platforms.

Additionally, we believe that the Federal Reserve will create a stronger ecosystem for consumer protections. The Faster Payments Council, as currently envisioned, will not have rulemaking or enforcement authority.

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

Response: Yes, it is a foundational element. Payments cannot be immediate unless there is a real-time gross settlement service available in such a way that it allows anyone to pay anyone else, at any time, and with any device.

A net settlement approach creates a credit risk for financial institutions. For consumers, net settlement leads to batch processing of debits and credits. Were net settlement to be deployed, it would be important to establish rules for the ordering of payments.

Real-time gross settlement eliminates these problems.

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

Response: Yes, the Federal Reserve should become the operator of a 24x7x365 RTGS service.

We agree with the Federal Reserve's conception of how it fulfills its payments mission: "The Federal Reserve…has 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."

We support the idea that the Federal Reserve intervene in a market that would otherwise only be populated by private enterprises. At the moment, there is for better or worse just one large B2B provider, and it serves only a finite number our nation's largest banks. There are a handful of P2P services, but each has its limitations, and many have instituted high fees for his or her services. Only two of those P2P services have begun to reach scale.

A market-driven economy does not function when a large portion of end-users cannot access a solution through their financial institution. Legitimate real-time payments exist in a market-driven economy when multiple providers can compete. The Federal Reserve, acting in the role of an operator, will contribute to the proper functioning of the private marketplace, at least concerning the benefits experienced by end-users.

Currently, the only way to have a cross-solution interoperable payment is to accept settlement risk. Solutions already exist that mitigate risk by pre-funding accounts inside a single standard solution. The shortcoming is for a system that can link different solutions.

To overcome real-time settlement risk across solutions, providers need the ability to access a pre-funded account held at a single location.

Aspect of concern	Common provider	Multiple providers (fractured market)
Legal relationships	Unilateral agreements	Bi-lateral agreements
Security	Common security standards	Different security standards
Speed	Immediate	Slower
Consumer Protections	Known, standard	Opaque, different across solutions
Interoperability	Yes	Only within solutions
Directory	Universal	Depends
Ubiquitous receipt	Except for unbanked	Except for unbanked and others

If we had a system where different solutions could draw from a pre-funded escrow account held at the Federal Reserve, then we could create a market where new entrants would be able to establish new products without having to create "one-off" bi-lateral agreements. New entrants could operate safely even with smaller capital structures.

Without such accounts, we have concerns that a system would develop where end-users become tethered to a single solution, or instead where they would need to open multiple accounts that enable them to transmit payments through a broader group of banks. With current card networks, such a need does not exist. Payment networks can transfer funds unilaterally through different providers and among all financial institutions. In countries where providers make bilateral agreements with each other, end-user retailers have to have multiple point-of-sale systems in place.

In the FPTF solution showcase, one company submitted a plan that would have allowed end-users to establish their own "Fednote" accounts. This approach would have enabled anyone to transform cash to electronic value through an exchange of value with any other entity holding its Fednote account. This solution depended on action by the Federal Reserve. It also would have created an opportunity to allow all end-users to engage in real-time electronic payments.

Question: If the Reserve Banks develop a 24x7x365 RTGS settlement service, 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?

Response: Many use cases would benefit from 24-7-365 real-time gross settlement. Funds availability is critical, but so is the ability to have real-time confirmation that a payment was sent and that is has been received.

The market has p2p solutions in place, but unfortunately, they are expensive. For example, consider the consumer experience with Venmo. Venmo works across the ACH rails. In the last few months, Venmo rolled out a same-day payment. However, last month they applied a 1 percent fee (minimum 25 cents, maximum $10) for a payment that settles in 30 minutes.

P2B: Consumers using "bill-pay" typically wait between three and five days to see their push payment credited to their vendor's account. Empirical evidence suggests that consumers have been willing to pay a fee for an immediate payment of credit card bills.

Other use cases: payment of rent to "mom-and-pop" landlords.

P2P: Services are accessible, but not 24-7-365. Currently, across-solution providers charge high fees.

The utilization of services such as Venmo Instant Transfer (30 minutes, 1 percent) and Ingo Instant Payment (30 minutes, minimum $5 up to 2 percent of face amount) suggests that consumers will pay for faster payments. Ingo Money, a white label remote deposit service

If this is correct, it means that most consumers want immediate confirmation of payment receipt on a 24-7-365 basis. Intuitively, this makes sense.

B2P: Many consumers have “more month than paycheck.” Under these constraints, they make suboptimal choices. Many consumers bypass banks in favor of alternative financial service providers when they need immediate access to their money. Every weekend, hundreds of thousands of consumers use a check casher instead of a bank to access the funds in their paycheck. Even though market prices (which usually clear at the maximum amount allowed by state law) are high – between 1 and 10 percent depending on the state and the type of check – they consent. When “vote with their feet,” they underscore the value of immediate funds availability.

Only a fraction of workers will want to use a faster payment to receive wages. In most cases, direct deposit meets their needs. However, gig workers and financially distressed workers are expressing an interest in being paid sooner. With services such as SimplyPaid, many workers receive pay every day. Services like SimplyPaid only work with larger businesses, as it takes a substantial amount of time to integrate advance payment of wages inside the employer’s payroll systems. To meet the needs of workers who want to be paid at the end of their shift, most small employers still disburse funds by paper check. In the opinion of Reinvestment Partners, small employers would utilize a faster payment product if certain technological barriers inside payroll processing were reduced.

Question: 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? 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.

Response: The ideal time ended years ago. The United States payments system is falling behind those of other countries.

Currently, millions of consumers experience significant challenges to their household financial liquidity, as indicated by the Federal Reserve’s 2017 report that found that 41 percent of US households would not be able to draw on enough cash to pay for a $400 emergency[1]. Often, they have accrued earnings that they cannot access. Real-time payments could alleviate their liquidity challenge in several ways:

[1] “Report on the Economic Well-Being of U.S. Households in 2017.” Board of Governors of the Federal Reserve System. May 2017. Resourced on December 12, 2018 at https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf

To facilitate the daily payment of wages. While it is true that the marketplace is already providing wage advances, the integration of those services is complicated. The service providers must integrate within the payroll software of the partner employer. As a result, use of these services is limited mainly to workers at large companies. A RTGS service that could distribute wages (or payments to 1099 workers) would hold value for a significant number of workers and freelancers who receive pay from small businesses.

Workers demonstrate a significant willingness-to-pay for the ability to make up for slow payments. According to the Financial Service Centers of America ("FiSCA"), 30 million Americans uses their member's storefront financial centers to cash checks in any given year. Moreover, they attribute the ability to access funds around work schedules – "seven days a week, even 24 hours a day" as a prime reason to explain why their customers are willing to pay between 1 and 10 percent of the face value of the check to have it converted to cash[2].

Question: Regarding auxiliary services or other service options, is a proxy database or directory that allows faster payment services to route end-user payments using the recipient's alias, such as email address or phone number, rather than their bank routing and account information, needed for a 24x7x365 RTGS settlement service?

Yes, the use of a directory with aliases is essential as it allows immediate payments to occur without the need for the sender and receiver to exchange private bank account details. Any system that requires this will be less safe and much slower.

Question: How should such a database be provided to best facilitate nationwide adoption? Who should provide this service? 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? 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?

Response: The system would benefit from a universal directory but doing so would trigger the need to develop strong protections for end-user information. The administrators of the directory should ensure that there is no more than one entry in a directory per account. End-users should have the ability to review how their information is kept in the directory. End-users should have the right to remove their information from the directory. If an end-user closes a bank account, the directory should remove their information from the directory.

Faster payments will create new opportunities for victim-assisted fraud. It will be important to provide real-time warnings to senders of payments.

Moreover, a safe system will provide end-users with the right to revoke a transaction.

[2] "Fact Sheet: The Unbanked & Underbanked Consumer in America." Financial Service Centers of America." 2013. Accessed on December 12, 2018 at https://www.fisca.org/FISCA/Content/FiSCA-Facts.aspx

Question: How critical is interoperability between RTGS services for faster payments to achieving ubiquity?

Response: We cannot have ubiquity without smoothing out technical issues (security, directory, rules) across different solutions. Currently, we have a fractured marketplace in faster payments, in contrast to the status quo in traditional ACH and card network payments.

All networks benefit from scale, and all users receive the downstream benefits of participating in a more extensive network. If more financial institutions can offer a faster payments service if the Fed becomes an operator, then there will be a corresponding aid to end-users. However, the gains only occur when one network grows larger. There are two ways to realize these gains. Market solutions can make agreements that allow for seamless cross-solution transactions or end-users must be able to use a single service that has nodes with all other end-users. If the Federal Reserve becomes an operator, the second path becomes a reality for US consumers. Without intervention by the Federal Reserve, the prospect for true interoperability dims.

Question: 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?

Response: Reinvestment Partners believes that smaller banks and credit unions would benefit from this tool. Our second-hand understanding is that many have liquidity constraints over the weekend.

Question: If the Reserve Banks develop a liquidity management tool, would a liquidity management tool need to be available 24x7x365, or during certain defined hours on weekends and holidays? During what hours should a liquidity management tool be available?

Response: The tool must be available over the weekend.

Question: 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?

Response: The liquidity management tool will help some financial institutions to offer "24-7-365" service.

In particular smaller banks and those where demand deposits make up a higher-than-normal share of their assets would benefit from this tool.

Question: 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?

Response: Both proposed actions by the Federal Reserve would advance the utilization of faster payments.

However, it remains to be seen if unbanked consumers will be able to take advantage of these services. If the only means of accessing the system is through a bank account, then we can expect to see little or no utilization by those individuals. In our opinion, we risk losing an opportunity.

Conclusion

Consumers demonstrate their need for faster payments when they bypass traditional banks and use check cashers. In the current banking system, slow pull payments create hurdles to the expansion of access to banking services. Banks are rightfully hesitant to give checkbooks to consumer who pose a credit risk. In turn, many consumers shy away from using a bank because they need immediate availability to all of their funds. We believe a good funds RTGS model could remove one of the barriers to the expansion of access to basic banking services.

We strongly urge the Federal Reserve to operate a 24-7-365 real-time gross settlement service. We believe that it will increase completion in the marketplace. We respectfully submit that we believe the Federal Reserve will apply strong consumer protections within its solution.

Thank you for your concern.

Sincerely,

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