MBA
MISSOURI BANKERS ASSOCIATION
Missouri Bankers Association

October 31, 2019

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

VIA: *regs.comments@federalreserve.gov*

Subject: Docket No. OP-1670

Dear Ms. Misback:

The Missouri Bankers Association is very pleased that the Board of Governors voted this past August to proceed with developing and offering a 24x7x365 "real-time gross settlement service" (RTGS) that the Board has branded as FedNOW Service. We offer this letter and two attachments as our position regarding the matters addressed under Docket No. OP-1670.

The MBA previously endorsed that the Federal Reserve take action to offer a real time payment (RTP) system in a letter dated July 22, 2019. We have attached this letter and respectfully request that you enter it in this Docket No. OP-1670 as it presents our position regarding FedNOW Service and addresses matters presented in this docket.

The MBA also supports the matters presented in the attached "talking points" dated October 28, 2019, and we ask that you also enter this document in the docket with this comment letter.

Briefly:

- MBA supports "interoperability" with other RTGS systems including The Clearing House system
- Access only to chartered financial institutions
- Accelerated implementation of the FedNOW Service and interoperability
- Enhanced Fedwire 24x7x365 and a Liquidity Management Tool – this effort should proceed in advance of the FedNOW Service
- FRB-NY joint account parity with Federal Reserve Bank master accounts – funds held in a joint account at the FRB-NY to support a RTP service should earn interest, count toward reserves, and be eligible for daylight overdrafts
- Close and timely coordination with all significant core providers for early access and testing
- Flat pricing for equitable access by all financial institutions

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- Commitment to Message Standard ISO 20022

The Missouri Bankers Association believes that the action by the Federal Reserve System in proceeding with the FedNOW Service promotes and preserves the five central functions of the System to: 1) conduct the nation's monetary policy; 2) promote the stability of the financial system; 3) promote the safety and soundness of individual financial institutions; 4) foster payment and settlement system safety and efficiency; and 5) promote consumer protection and community and economic development. The Federal Reserve System's status as a provider within the U.S. payment system promotes the security of the United States and fair access by all market participants to all payment systems by setting standards as a provider that favorably influences all providers while preserving competitive market functions that promote innovation.

The Missouri Bankers Association also believes that our recommendations and comments as reflected in this letter and our attachments will assist the Federal Reserve System in its competitive impact analysis for the FedNOW Service. For example, providing parity for FRB-NY joint accounts with Federal Reserve master accounts promotes the shared interests of all chartered financial institutions, assures liquidity, and provides parity to private sector payment system service providers that compete with Federal Reserve payment systems.

Thank you for consideration of our letter and attachments.

Sincerely,

Max Cook
President and CEO

Attachments: July 22, 2019 Letter
October 28, 2019 Talking Points

CC: Missouri Bankers Association Board of Directors
Esther George, President, Federal Reserve Bank of Kansas City
Rob Nichols, President and CEO, American Bankers Association

MBA
MISSOURI BANKERS ASSOCIATION
Missouri Bankers Association

July 22, 2019

Chairman Jerome H. Powell
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Powell,

On behalf of the Missouri Bankers Association, I would like to express our support that the Federal Reserve should proceed expeditiously to establish a Real Time Gross Settlement System (RTGS) to operate on a 24x7x365 basis. I further support the position that the RTGS system be interoperable with other payment systems.

Furthermore, I support the position that the Federal Reserve System should provide Liquidity Management Tools (LMTs) that would enable transfers between Federal Reserve accounts on a 24x7x365 basis.

I preface my comments by acknowledging that many banks support the efforts by The Clearing House (TCH) to establish a real-time payments system and some of these banks have expressed a concern that a dual effort by the Federal Reserve System could unduly delay implementation of the TCH system. The maximum value of any payments network is obtained by widespread adoption leading to ubiquitous use. Some participants in the TCH effort believe that if the Federal Reserve moves forward that potential users will delay adoption until the Federal Reserve implements its system, or alternatively, neither system will obtain ubiquitous use until the two systems attain interoperability so that payments initiated on one system can be completed on the other.

To resolve this concern, I urge the Federal Reserve to make and announce its decision post haste to develop a RTGS system. Further, the Federal Reserve should designate a highly capable and accountable project manager and provide all necessary financial and team resources to implement an RTGS system. The goal should be to have an operable system within the next two years. Finally, the Federal Reserve RTGS system should be interoperable with other systems.

Why RTGS?

The United States requires RTGS systems in order to be competitive with other countries that have or are moving forward with RTGS systems. The RTGS system reduces counter party risks compared to other non-cash payment systems (checks, debit, credit) because payments are settled directly rather than netted one or more times a day. Also, because the RTGS system reduces the window of time that sensitive information is exposed to cyber threats (checks, debit, credit and wire) potential fraud opportunities are reduced. A robust and ubiquitous RTGS system will also lower unit transaction costs for business and consumers. Consumers primarily value convenience and merchants primarily value the lower unit costs and immediate access to funds. RTGS will also appeal to users who execute large

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transactions. Finally RTGS could significantly lower costs for international remittances. And, while the speed and efficiencies of legacy payment systems have increased dramatically, RTGS presents a paradigm shift where technology establishes a completely new payment channel as compared to technology being applied to improve legacy payment channels. RTGS is truly a next generation payments system.

Presently, multiple non-cash payment systems co-exist and have interoperability between the Federal Reserve and the TCH systems. These systems will continue even as RTGS is introduced and gains market share. And, like the legacy systems, a Federal Reserve RTGS system can co-exist with a private option. The Federal Reserve and TCH systems should be interoperable so that our industry and customers gain the benefits of competitive selection and competitive improvement as well as systems redundancy that reduce risks for service disruptions. The additional capacity of dual channels will also contribute to the stability of the payments network in the event there are volatile increases in transaction volumes.

Why the Federal Reserve?

The Federal Reserve System performs five central functions. The Federal Reserve: 1) conducts the nation's monetary policy; 2) promotes the stability of the financial system; 3) promotes safety and soundness of individual financial institutions; 4) fosters payment and settlement system safety and efficiency; and 5) promotes consumer protection and community development. Setting up and maintaining an RTGS system is specifically within the fourth function. The operation of a RTGS system facilitates and enhances the execution of all five of the Federal Reserves' central functions. Assuming the TCH effort continues, the Federal Reserve's participation to implement a RTGS system creates competition on price, service and innovation. The redundancies of a Federal Reserve System RTGS and a TCH RTGS plus the legacy non-cash payment systems protect against system failures and promote the national and economic security of the United States. Because the Federal Reserve already has connections with more than 11,000 banks and credit unions, the Federal Reserve's participation should decrease the time to reach end-user ubiquity to reap the full benefits of the new payment system networks.

The United States has a long history of choice in banking via our unique dual banking system that allows for both state and nationally chartered banks. Choice has contributed to assuring our banking system is diversified and stable yet also innovative. The founding of the United States and our Constitution reflects a fundamental desire for de-centralized power. We are a government and a nation of checks and balances intended to ensure that power is not concentrated in the hands of a few. And, even the structure of Federal Reserve System with twelve Federal Reserve Banks and the internal structures for the Federal Reserve Board and Federal Open Market Committee demonstrate a design that promotes diverse inputs and perspectives and a careful balancing of interests. Banks and their directors and officers operate within a system of checks and balances, both in corporate governance and as a regulated industry, where counterbalancing influences have served our industry well. Our communities and our national economic security interests will be best served by the Federal Reserve System's direct operation of a RTGS system in tandem and in competition with the TCH.

Liquidity Management Tool (LMT)

LMTs will facilitate payments under an RTGS system as well as under our legacy payment systems. LMTs lower counter party risks across all payment systems and the Federal Reserve System is in a unique position to serve this function. With the Federal Reserve's involvement, the costs for LMTs can be spread in a manner that is equitable to banks of all sizes as well resulting in pricing to reflect specific and systemic risks presented by participants. LMTs can also provide options for financial institutions participating in the RTGS system. With LMTs, some banks could set operational hours while allowing settlements to occur on a 24x7x365 basis by drawing on one or more of the liquidity tools made available, including tools that work automatically. Other banks will find that setting internal operations to a 24x7x365 basis is more advantageous, even after accounting for costs, and will see reduced reliance on LMTs.

The Payments Systems are Core Banking Functions

The payments access that banks provide for individual customers, businesses and merchants is a core banking function. Many "value added" and profitable services can be linked to payments services. Consumers, merchants and businesses in general all benefit from competition in the banking sector to provide payments and related services. A Real Time Gross Settlement System presents a paradigm shift compared to legacy payment systems and this payment channel must be available for all banks.

Banks should remain gatekeepers to the payment systems because this central role contributes to the strength of the banking system which is foundational to our economy. The regulatory regime that banks operate under serves to strengthen our payment systems and to assure that they remain the public highways of commerce. Banks must also be innovators for value added payments services to avoid seeing our payment channel systems reduced to the status of a commodity service. The importance of the Federal Reserve System for RTGS is that a Federal Reserve System option assures equitable access for all banks and assures that banks preserve payments access as a core banking function.

Many bankers might assume that banks will always be integral to the payments systems. This status is not a given because technology may move faster than the government, a regulatory agency, or industry anticipates. Banks risk the loss of new generations of customers if non-bank payment facilitators gain a significant presence in banking services. Loss of gatekeeper status in payment systems would be detrimental to the safety and soundness of banks. Without a robust dual banking system and a mix of global, regional and community banks, many communities will be left behind as economic power and benefits become concentrated.

I respectfully ask that the Federal Reserve System move forward as expeditiously as possible to create and implement a RTGS system, provide for its interoperability with other payment systems and also proceed to implement liquidity management tools to reduce counter party risks, operating costs and to provide operational choices for banks regarding the RTGS system.

Sincerely,

Max Cook
President and CEO

CC: Federal Reserve Board of Governors

Vice Chair Richard H. Clarida
Vice Chair for Supervision Randal K. Quarles
Governor Michelle W. Bowman
Governor Lael Brainard

Esther George, Kansas City Federal Reserve Bank
Rob Nichols, American Bankers Association
MBA Executive Committee
Missouri Senators Blunt and Hawley

Notice: Federal Reserve Actions to Support Interbank Settlement of Faster Payments Docket No. OP-1670

The Federal Reserve Notice announced their intention to become an operator of a new, faster payments network to facilitate interbank funds settlement. The FedNow service will allow consumers and commercial customer to make payments in real time where funds will leave the payer's account and be credited to the receiver's account immediately. The Federal Reserve estimates the first FedNow transactions will take place in 2023 or 2024.

Comments due on November 7, 2019

Interoperability

Interoperability is the ability for a transaction to be originated on one payment rail and have it completed on another. The most relevant example is the ACH system where a transaction can be originated using FedACH and it can be received by the private sector's Electronic Payment Network (EPN). The Federal Reserve has indicated that interoperability is a goal, but that the difficulty in achieving this state due to technical requirements and governance issues makes it unlikely to happen on Day One of FedNow operations.

- The Clearing House operates a private sector faster payments solution. Real Time Payments Network (RTP), that reaches more than 50% of deposit accounts in the U.S. right now.
- The Federal Reserve has indicated that interoperability is desirable, it is not likely to occur before 2024.
- If interoperability is not achieved, there will be two parallel systems that cannot exchange transactions.
- Financial institutions will have the choice between offering one solution that cannot reach all end users, or, absorbing the costs and inefficiencies of operating both services.
- Recommendation
    - The Federal Reserve should make all efforts to become interoperable with private sector solutions offering similar services on its first day of operations.
        - This will increase the attractiveness of both networks to end users, improve the efficiency of the payments system, and ultimately bolster the chances of success of FedNow.

  - This will result in seamless internetwork payments contributing to a better customer experience.

Chartered FI Access to FedNow
Financial institutions are chartered by state and federal authorities that must comply with regulations covering capital requirements, deposit insurance, data privacy and other important safeguards for consumers. Because of this, financial institutions are the only entities allowed to access Federal Reserve Payment Systems as determined by Federal statute.

- Allowing entities other than financial institutions direct access to FedNow will introduce risks that are not acceptable.
- The Federal statutes in place are effective in protecting the payment system.
- Recommendation
  - The Federal Reserve should continue to offer access to the all payment systems, including FedNow, <u>only to qualified financial institutions</u>.

Implementation Timeline
The FedNow notice projects that the first live transaction will take place in 2023 or 2024. This means it could be as long as <u>four to five years</u> after the current comment period ends before the first transaction is processed.

- The FedNow effort does not have a set budget, project plan, final technical requirements, or any contracted vendors suggesting that the 2023-2024 deadline could even be at risk.
- Some banks may wait for the FedNow solution to go live before offering the service, effectively freezing a portion of the market until 2024 or beyond.
- Banks that want to offer faster payment solutions to their customers sooner will opt for private sector solutions before FedNow goes live.
- Recommendation
  - The Federal Reserve must do all it can to implement a faster payments solution in a shorter period of time.
  - The sooner the launch, the more attractive FedNow becomes.

Enhanced Fedwire 24/7/365 and a Liquidity Management Tool
The Notice states that the Federal Reserve will consider enhancements to Fedwire and the National Settlement Service (NSS) to allow it to operate 24/7/365 as part of a separate initiative. This will enable financial institutions to effectively manage the balances held in prefunded accounts allowing larger balances to remain in master accounts where they will accrue interest, count towards reserve requirements, and be eligible for daylight overdraft services.

- Extending these hours could enable a Liquidity Management Toll (LMT) that would make managing prefunded accounts, like the TCH RTP Network, much easier for financial institutions.
- It would also allow financial institutions to offer extended hours for wire services as well as allowing the ACH network to settle more often.
- Recommendation
  - The Federal Reserve should pursue improvements to Fedwire and the NSS by extending the hours of operation towards 24/7/365 as soon as possible for the improvement of the payments industry.
  - This effort should begin immediately and not be tied to FedNow development.

Master Accounts vs. FRB-NY Accounts

FedNow transactions will be drawn directly from financial institution master accounts at the Federal Reserve. These balances will earn interest, count towards reserve requirements and are eligible for daylight overdraft services. In comparison, funds held in the RTP Network pooled account at the FRB-NY are not eligible for those benefits.

- These funds intended for the same purpose and both present comparable levels of risk.
- The disparate treatment creates a significant advantage for FedNow, especially if the Liquidity Management Tool is not in place to make managing funds held in the RTP Network more efficient.
- Recommendation
  - The Federal Reserve should change its policy to allow funds held in the FRB-NY pooled account to fund real time payments to earn interest, count towards reserve requirements, and be eligible for daylight overdrafts.

Managing Core Service Providers

Most banks in the U.S. rely on core service providers to process essential transactions like accepting deposits, making loans, and initiating payments. The reliance on core service providers can be problematic when their performance suffers and implementation deadline are missed.

- Creating a new payment platform like FedNow will require significant commitments from the core service providers.
- Large technology projects can become delayed when not enough time is allowed between providing requirements to core service providers and financial institutions to allow adequate time for testing and implementation.
- Recommendation
  - Federal Reserve should make a commitment to providing all system requirements and technical specifications far in advance of the implementation deadlines to allow for the core service providers to bring all of their customers online by the due date.

FedNow Equitable Pricing Model

The Federal Reserve offers a tiered pricing mode for its FedACH services. This means that financial institutions with higher volumes pay less per item. The Notice provides little clarity into how FedNow will be priced except to note that more information will be available closer to the implementation date.

- Tiered pricing models provide advantages to financial institutions that can generate the largest numbers of transactions.
- Recommendation
  - The Federal Reserve should commit to a flat pricing model offering the same per item fees to financial institutions of all sizes.

Message Standard ISO 20022

The ISO 20022 Message Standard is being adopted by payment platforms all over the world, including Fedwire and, according to the notice, FedNow. This recognizes the benefits and efficiencies gained by having common message formats regardless of the payment type. The message format, ISO 20022 Real-Time Payments Group (RTPG) usage guidelines has been developed to increase uniformity for interoperability.

- The ISO 20022 format is becoming the industry standard and is in use by the TCH RTP Network.
- The use of ISO 20022 Real-Time Payments Group usage guidelines is essential for interoperability between systems, including future cross border transactions.
- Recommendation
  - The Federal Reserve should commit to consistency with the ISO 20022 Real-Time Payments Group usage guidelines.