The Clearing House
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November 1, 2019

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System

Via Electronic Submission (regs.comments@federalreserve.gov)

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

Dear Ms. Misback,

The Clearing House Payments Company, LLC (**TCH**)[1] appreciates the opportunity to comment on the Federal Reserve's plan to offer the FedNow service in competition with the RTP®[2] system, a private sector, real time gross settlement service for faster payments launched in 2017 that already reaches over 50% of the transaction accounts in the United States.

TCH remains resolute in its ongoing efforts to expand real-time payments in the United States and is confident in the value and integrity of the RTP system, as fully confirmed by the strong ratings it received from the Federal Reserve's own Faster Payments Task Force. We are committed to achieving ubiquity and working closely with every federally insured depository institution that is interested in participating in the RTP system so that each institution's customers can obtain the benefits of real-time payments. To help TCH achieve this objective, we believe there are two critical actions the Board of Governors of the Federal Reserve System (the **Board**) can take now, before the Reserve Banks launch the FedNow service, to enable the RTP system to evolve for the benefit of the industry. These actions will also help to create competitive equality between the private sector and the government and thereby mitigate the risk that a depository institution is disadvantaged if it wants to use the RTP system.

- First, in the near term, the Board should treat the balance in the RTP joint account as reserves and should authorize the Federal Reserve Bank of New York to pay interest on such reserves.[3] A depository institution should not be penalized by the Federal Reserve with respect to the receipt of interest simply

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[1] Since its founding in 1853, The Clearing House has delivered safe and reliable payments systems, facilitated bank-led payments innovation, and provided thought leadership on strategic payments issues. Today, The Clearing House is the only private-sector ACH and wire operator in the United States, clearing and settling nearly $2 trillion in U.S. dollar payments each day, representing half of all commercial ACH and wire volume. It continues to leverage its unique capabilities to support bank-led innovation. As the country's oldest banking trade association, The Clearing House also provides informed advocacy and thought leadership on critical payments-related issues facing financial institutions today.
[2] RTP® is a registered service mark of The Clearing House Payments Company L.L.C.
[3] We believe paying interest will be relatively simple given that TCH currently provides the Federal Reserve with the RTP position of each RTP participant at the close of the Fedwire Funds Service, the precise point in time when the Federal Reserve calculates reserves in its other accounts.

because the depository institution is holding part of its balance at the Federal Reserve in a joint account.

- Second, the Federal Reserve should move quickly to enable more equivalent liquidity management between the RTP system and the FedNow service by expanding Fedwire Funds operating hours. This expansion can be done incrementally over time but should be implemented to some extent before the FedNow service goes live to better ensure that a depository institution is able to use its master account balance on weekends and holidays to support not only FedNow payments but also RTP payments.

TCH has included an appendix to this letter that further discusses these actions in the context of the Board's competitive impact analysis.

In addition to the desire for competitive equality between FedNow and the RTP system, TCH is aware that there is strong industry interest in the interoperability of the FedNow service with the RTP system. The Federal Reserve has indicated that interoperability is not an immediate objective for its service and further observed that interoperability "may be difficult to achieve."[4] While TCH believes that interoperability of real-time gross settlement systems is highly unlikely, the Federal Reserve may be able to reduce the impact of introducing a second system by aligning the FedNow service as much as possible to the RTP message specifications and operating rules, both of which are public. Further, as it designs its system, if the Federal Reserve identifies potential ways that the government service may be made interoperable with the private sector service, TCH is willing to engage in direct discussions to explore those ideas for the benefit of the United States.

Very Truly Yours,

JD Aramanda

James D. Aramanda
President and Chief Executive Officer
The Clearing House Payments Company

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[4] 84 Fed. Reg. 39297 at 39311.

Appendix
Competitive Impact Analysis

The Board conducted an initial competitive impact analysis of the FedNow service and identified certain aspects of its service that may have a direct and material adverse effect on the ability of the RTP system to compete effectively and invited comments on its analysis. TCH strongly believes that the proposed FedNow service has a direct and material adverse effect on the ability of TCH's RTP system to compete effectively with the Federal Reserve in providing similar services and that such effect is due to legal differences.[5] TCH also believes that there are steps that the Board could take to mitigate these differences that would not call into question any of the benefits identified by the Board of the FedNow service.

A. Differences between the RTP System and Central Bank Service

In its competitive impact analysis the Board identified two differences between its service and the RTP system that it stated may have a direct and material adverse effect on the ability of the RTP system to effectively compete. As further discussed below, TCH believes these two differences, as well as other differences that the Board did not identify, will have a direct and material adverse effect on the RTP system's ability to compete effectively with the central bank service and stem from legal differences.

1. **Use of master accounts and interest on reserves.** Both the FedNow service and the RTP service rely on balances at a Reserve Bank. However, the balances that are used for the FedNow service are counted towards reserve requirements and earn interest. In contrast, the balance in the Federal Reserve joint account that supports the RTP system does not count as reserves and does not earn interest. The decision not to treat the joint account balance as reserves, which was made by the Board when granting the use of the joint account for the RTP system, has significant consequences for depository institutions deciding between use of FedNow and use of the RTP system, especially smaller depository institutions. TCH believes this will have a direct and material adverse effect on the RTP system for the reasons the Federal Reserve suggests in its analysis. Moreover, TCH cannot realistically mitigate this difference by moving the joint account to a commercial bank. As the Federal Reserve observed in its proposal, "the inherently risk-free nature of deposits at a central bank relative to deposits at a commercial bank"[6] is a significant legal difference.

2. **Ability to overdraw master accounts during non-Fedwire Funds operating hours.** TCH is concerned that the ability for FedNow participants to overdraw master accounts during non-Fedwire Funds operating hours puts the RTP system at a material disadvantage. This is because FedNow participants will be able to overdraw their accounts and make payments at times when RTP participants under similar circumstances (i.e., a system position that is less than the value of a payment) will not be able to

[5] The Board limited its analysis to the RTP system and excluded "indirect competitors". 84 Fed. Reg. 39297 at 39321, footnote 125. TCH suggests that the government's entrance into a robust and varied private sector faster payments market segment should require a broader impact analysis. For example, TCH suggests that the Board consider other private sector service providers of interbank faster payments, such as card networks that offer push payment services and services that enable directory-based, faster payments.

[6] 84 Fed. Reg. 39297 at 39322.

increase their system position through Fedwire Funds payments to the joint account and, thus, will not be able to make payments.

This disadvantage cannot be entirely overcome as the Board suggests by liquidity arrangements between RTP system participants as such arrangements are limited by the liquidity that a "lending" participant would have available in the RTP system at the time that a "borrowing" participant needs it (and of course requires finding a willing RTP participant to lend).

3. **The Federal Reserve's use of the RTP joint account agreement to limit RTP system growth and mandate costly and burdensome reporting for research and monetary policy purposes, which is not required for any other private sector retail system.** The joint account is central to the RTP system's prefunded settlement model and, thus, a critical dependency for the system itself. As discussed above, TCH does not believe that a commercial bank account is a viable option for the RTP joint account, and, thus, is limited in its ability to negotiate conditions that the Federal Reserve has placed upon the account. Under the joint account agreement, TCH's ability to add new participants to the RTP system and continued use of the joint account is conditioned on automated and ongoing reporting of data, some of which has no relevance to the operation of the joint account but is for Federal Reserve payments policy or monetary policy purposes. We note that no other private sector retail system is required to provide such reporting to the Federal Reserve and that the requirement to provide this data adds costs to the on-going operation of the system and could be a deterrent to a depository institution's decision to use the system.

4. **The Federal Reserve is not subject to anti-trust laws.** Unlike The Clearing House as a private sector operator, the Reserve Banks and the Board are not subject to antitrust law and the private sector has no remedy if the Reserve Banks or the Board were to engage in monopolistic or anticompetitive activity. *Jet Courier Services, Inc. v. Federal Reserve Bank,* 713 F. 2d 1221 (6th Cir. 1983).

B. Actions the Federal Reserve Should Take

Where, as here, the material adverse effects are the result of legal differences, the Board must evaluate the potential public benefits of the new service in order to determine whether those benefits could be reasonably achieved with a lesser or no adverse competitive impact. TCH believes that all of the benefits of the proposed FedNow service can be achieved with a lesser competitive impact if the Board were to take the following actions[7]:

1. **Pay interest on funds in the RTP joint account.** For the reasons discussed in section A.1. above, TCH believes that the central bank service will have a direct and material adverse effect on the ability of the

[7] The Board suggests in the Federal Register notice that TCH might be able to mitigate the legal differences by changing the way that it operates the RTP system. Specifically, the Board suggests that TCH could use a commercial bank to hold the joint account and thereby have access to interest and 24/7 liquidity. TCH does not believe this line of analysis is appropriate for the competitive impact analysis especially given the significant impact such a change would have on the risk profile of the RTP system.

RTP system to effectively compete if RTP participants do not have the same ability to receive interest on the balances they hold at the Reserve Banks for purposes of the RTP system as FedNow participants will have to receive interest on balances in their master accounts held for purposes of FedNow. This legal difference can be eliminated by the Board without calling into question the benefits of the FedNow service. TCH defers to the Board as to whether it could do this by interpretation or whether a change to Regulation D would be required. TCH believes, however, that the Board has the authority to reach this outcome through either one of these paths. As a condition to using the joint account, TCH already is required to provide the information that the Reserve Banks would need to calculate interest on reserves for RTP participants.

2. **Expand Fedwire Funds operating hours.** The only aspect of the Federal Reserve's 2018 proposal that received nearly unanimous support was the provision of a liquidity management tool through expanded Fedwire Funds Service hours. For the reasons discussed in section A.2 above, TCH believes that the central bank service will have a direct and material adverse effect on the ability of the RTP system to effectively compete, if RTP participants do not have the same ability to manage their RTP liquidity through 24x7 Fedwire Funds transfers to and from the RTP joint account as participants in the central bank service will have to send and receive payments to and from Federal Reserve master accounts. This difference, which TCH believes is based on the Board's legal view of Reserve Banks' as a provider of intraday liquidity and of their lending authority, can be mitigated (though not eliminated) without calling into question the benefits of the FedNow service by committing to a plan that will expand Fedwire Funds operating hours by the time the FedNow service launches. Such an expansion can be done incrementally but should be designed so that the Fedwire Funds Service is eventually 24x7.[8]

3. **Hold the central bank service to the same standards that the RTP System is held to as a result of its use of the joint account and its status as a private sector service.** Because of the risk free nature of an account at a Reserve Bank, the Federal Reserve has significant leverage over a private sector competitor – such as TCH – that desires to operate a payment system using a Federal Reserve account. In this regard, the Board issued a set of guidelines for approving a request to open a joint account in support of operating a payment system.[9] These guidelines apply certain risk management expectations from the Board's Payment System Risk Policy in addition to any other supervisory obligations a private sector arrangement may be subject to and regardless of whether the private sector arrangement would otherwise by subject to the policy. Specifically, a private sector arrangement is expected to have a general risk management framework appropriate for the risks the payment system poses to the operator, the participants, and other relevant parties and payment systems.[10] The result is a set of requirements that address concerns that go well beyond the risks to a Reserve Bank in maintaining a joint account and with

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[8] TCH is supportive of expanding NSS operating hours in addition to expanding Fedwire Funds operating hours. While the RTP system currently uses the Fedwire Funds service for liquidity management, TCH may be able to make technical changes that would enable the RTP system to use the NSS service also.

[9] "Guidelines for Evaluating Joint Account Requests," *available at* https://www.federalreserve.gov/paymentsystems/joint_requests.htm.

[10] Guideline 3, Guidelines for Evaluating Joint Account Requests.

which an operator like TCH must comply in order to continue its operations. We therefore believe that, to ensure competitive fairness, the Board's Guidelines (and how they have been addressed in the RTP Joint Account Agreement) should be applied to the FedNow service as they clearly express the Board's views on the monetary policy and payments system risks associated with retail faster payment systems generally. Applying the Guidelines (and any associated reporting requirements) will not affect any of the perceived benefits of the FedNow service and will help to mitigate competitive advantages of the FedNow service.

Similarly, the Board's legal interpretation of the Reserve Banks' lending authority and its Payment System Risk Policy in connection with the proposed FedNow service creates additional concerns about an un-level playing field between the proposed FedNow service and the RTP system on weekends and holidays, if the discount window is closed. TCH is concerned that the Board may be treating the weekends and holidays for lending purposes differently from how it is treating those days for accounting purposes, which we think is inconsistent with the risk management standards imposed on the private sector. We suggest two ways that the Board could mitigate this difference. The first is to keep the discount window open 7 days a week so that Reserve Bank intraday liquidity and overnight lending polices do not change depending on whether it is a holiday or weekend. Making this change would have no impact on the benefits of the FedNow proposal. Alternatively, the Board could require that the FedNow service be designed so that FedNow transfers are rejected in real time if they would create an overdraft in an account at a time when such overdraft cannot be converted at the end of the day to a discount window loan (or at least limit such overdrafts to a FedNow participant's net debit cap). While this would have some impact on the benefits of the FedNow service, establishing a real time gross settlement system without real time controls on credit is inconsistent with the design standards placed on private sector competitors like TCH.[11]

In closing, even though the Federal Reserve is immune from anti-trust laws, it should commit to act in the public interest by (i) taking action in the near term to enable the RTP system to evolve for the benefit of the industry by paying interest on funds in the joint account and to begin work to expand Fedwire Funds operating hours and (ii) affirmatively accepting its ongoing responsibility to ensure strong competition in the faster payments market segment.

[11] TCH notes that while the central bank service is described as 24x7 and RTGS, the Federal Reserve appears to have determined not to monitor its central bank service payments against a sending bank's account balance and any applicable debit cap in real time. Lack of real-time monitoring seems incongruous with risk management for a real-time system and we believe this has a competitive effect on the RTP system as it enables the Federal Reserve to implement its service with less cost and more quickly than it otherwise could. We note that the Federal Reserve has previously proposed to monitor all Fedwire Funds payments in real-time. "Policy on Payment System Risk and Expanded Real-time Monitoring," Docket No. OP-1607 (2018).