



November 6, 2019

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

Regarding: Notice and Request for Comments – Federal Reserve Actions to Support Interbank Settlement of Faster Payments; Docket No. 1670

Dear Ms. Misback:

The Community Bankers Association of Illinois (“CBAI”), which proudly represents 310 Illinois community banks, is pleased to provide our observations and recommendations in response to the Federal Reserve System’s (“Federal Reserve” or “Fed”) Notice and Request for Comments (“Notice”) regarding Federal Reserve Actions to Support Interbank Settlement of Faster Payments (“Proposal”). CBAI congratulates the Federal Reserve Board (“Board”) on its decision to develop a real-time gross settlement service (“RTGS”) which affirms the important role the Fed has and must continue to play in the nation’s payments system (“Payments System”) and which supports the nation’s community banks, consumers and small business. This historic decision will protect and benefit community banks, as well as our financial system as a whole, our economy and American taxpayers.

CBAI is dedicated to exclusively representing the interests of Illinois community banks and thrifts through effective advocacy, outstanding education, and high quality products. CBAI’s members hold more than \$70 billion in assets, operate 860 locations statewide, and lend to consumers, small businesses, and agriculture. For more information, please visit www.cbai.com.

Observations

CBAI and its community bank members have long supported the Federal Reserve's role in faster (real-time) payments through the formation of our Payments Task Force and Committee; meetings with the Federal Reserve Banks in Chicago and St. Louis; participating in Town Hall meetings in Chicago, St. Louis, Cedar Rapids, and Washington, D.C.; submitting thoughtful comment letters to Fed, becoming founding members of the Faster Payments Council, hosting education sessions, writing informative articles, and encouraging member engagement in payments system improvements.

CBAI agrees with the following Federal Reserve assessments and statements in the Notice.

“The United States payments system faces a critical juncture in its evolution.”;

“Advances in technology have created an opportunity for significant improvements in the way individuals and businesses make payments in today's economy.”;

“[T]oday's technology presents a pivotal opportunity for the Federal Reserve and the payment industry to modernize the nation's payment system to establish a safe and efficient foundation for the future.”;

“Since its founding, the Federal Reserve has played a key operational role in the nation's payments system by providing such infrastructure.”;

“Throughout its history, the Federal Reserve has provided [payment] services alongside, and in support of, similar services offered by the private sector.”;

“The potential exists today to once again achieve such improvements through upgrades to the payment capabilities of both the Federal Reserve and the private sector.”

“The private sector alone may face significant challenges in providing equitable access to an RTGS”;

“The Board expects that a single private sector provider of such services is unlikely to connect the thousands of small and midsize banks necessary to yield nationwide reach, even in the long-term.”;

“[A] single provider of RTGS services for faster payments without competition is likely to create undesirable outcomes for pricing, innovation, service quality, and reach.”;

“Indeed, Federal Reserve and private-sector payments services operating alongside one another would be consistent with the other existing payment systems.”;

“An additional RTGS service for faster payments would promote resiliency through redundancy”;

“Serving an operational role in the payment system allows the Federal Reserve to provide stability and support the banking system and the broader economy in normal times and times of stress.”; and,

“Therefore, as has been the case with other retail payments systems, the Federal Reserve’s operational role as a provider of interbank settlement is the most effective approach to improve the prospects of ubiquitous, safe, and efficient faster payments in the United States.”

CBAI appreciates the thoughtful and inclusive approach the Fed has taken in its decision making regarding faster payments. In its 2018 comment letter, CBAI provided observations and recommendations which supported the Fed’s development of a faster payments system and cautioned about payments system improvements that are dominated by The Clearing House (“TCH”), which is owned by 25 of the largest banks. The mega banks endangered our financial system and the entire economy during the financial crisis and cannot now be given monopoly power over real-time payments.

CBAI also stressed that while it is not only not too late for the Fed to fulfill its important mission in developing a RTGS service, NOW is the time for the Fed to move forward in implementing its real-time payments system. CBAI firmly believes that the Fed’s operational role in real-time payments will assure open access and fair treatment to all community banks regardless of size, charter type and location as it already does for checks, ACH payments and wire transfers to nearly 11,000 financial institutions across the country.

Description of the FedNow Service

The Fed’s real-time payments solution (“FedNow Service” or “FedNow” or “Service”) will support interbank settlement of end-to-end faster payment services by financial institutions and, in combination with private sector real-time payment services, provide infrastructure to promote ubiquitous, safe and efficient faster payments in the United States.

The proposed features of the FedNow Service include:

- Real-time processing of individual credit transfers on a 24x7x365 basis;
- Final and irrevocable settlement of payments in financial institutions’ master accounts at the Federal Reserve Banks;
- Integrated clearing functionality with messages based on the ISO 20022 standard;
- Transaction value limits of \$25,000 (initially, but CBAI believes this amount needs to mirror competitors’ minimums to avoid the Service and community banks being put at a disadvantage);
- Access to intraday credit on a 24x7x365 basis consistent with the Federal Reserve’s Policy on Payment System Risk;
- End-of-day balances calculated each day of the week with reports to support transaction monitoring, reporting, and reconciliation;
- Payment messages containing descriptive information related to payments, such as remittances or invoices;
- Access through FedLine Solutions, which will be enhanced to support 24x7x365 access; and,
- Support for indirect access through agents and correspondent banks.

Recommendations

Implementation Timeframe

The spurious arguments against the Fed developing its own real-time payments service is that the Fed's efforts are unnecessary and duplicative because TCH has already developed its own real-time payments system ("RTP Network" or "RTP"), and the Fed's decision will fragment the market and slow the adoption of faster payments. These arguments ignore the fact that for a decision of such incredible magnitude it is more important to "get it right" than to "do it fast," particularly when the delay is not expected to be significant. Decisions made and implemented now will impact community banks, the payments system, financial services and the economy for decades to come. The correct decision is for the Fed and TCH to operate alongside one another in real-time payments, which is completely consistent with past precedent.

That does not in any way minimize the necessity for the Fed to move quickly to implement the FedNow Service. The United States lags the world in payments system improvements. The Fed's competitor in real-time payments, TCH, has already developed its own proprietary network. The large bank owners of TCH control the vast majority of the country's banking assets, and can already provide access to their RTP Network to approximately 50% of demand deposit accounts. The Fed's slow implementation will result in TCH gaining market share and will extend the period needed for the Fed to recover the costs for developing its Service. Also, community banks will be disadvantaged by not being able to access a fair and equitable payments system to offer real-time payments to their customers.

A delay in the implementation of FedNow also gives those who oppose the Fed more time to organize opposition which could damage the credibility of the new Service and slow its implementation and adoption. We have already seen evidence of this in the run-up to the Fed's decision to develop FedNow, and since its announcement, articles have been written, hearings held, and legislation proposed questioning and challenging the Fed's decision. Nothing will quiet the opposition more than a well-designed, promptly implemented Service, that fully realizing all of the expected and desired successes.

CBAI realizes that the earlier proposed 2020 date for faster payments was likely aspirational. Now, after a thoughtful process leading to the decision to launch the FedNow Service, there is a revised implementation timeframe of 2023/24. We sincerely hope that this estimate is overly cautious and the Fed is simply not wanting to disappoint. Honestly, this timeframe needs to be shortened significantly and on day-one the Service needs to have many desirable features to encourage adoption. We are confident of a shorter timeframe because there are other real-time payment systems operating successfully in the world and the multi-year process leading up to the Fed's decision to implement the Service has already identified most of the questions and concerns that need to be answered and resolved. **CBAI urges the Fed to implement a feature-rich FedNow Service as quickly as possible – definitely earlier than 2023/24.**

Interoperability to Achieve Ubiquity

CBAI appreciates the thoughtful approach the Fed has taken in its decision making process to develop its real-time payments system and its desire to move carefully in launching its FedNow Service. CBAI agrees with the Fed that “nationwide reach is a key objective,” and believes that the best way to achieve this nationwide reach (ubiquity) is with the Fed as an operator in real-time payments along with TCH just as other parts of the payments system operates today.

Ideally, when the new FedNow Service launches there will be complete interoperability in real-time payments, but this goal is dependent on many factors including the cooperation of others. There must be a reasonable balance struck between an earlier launch and there being sufficient functionality for community banks to provide their customers with access to a real-time payments system that is competitive with TCH’s RTP. However, achieving complete interoperability cannot delay the launch of the Service. **CBAI urges the Fed to make interoperability a high priority but to not delay implementation, and that an earlier launch of the FedNow Service will quicken the pace of early adoption, promote interoperability and achieve ubiquity.**

Guard Against TCH and the Largest Banks from Undermining the Fed’s Development and Implementation of the FedNow Service.

CBAI is aware that TCH, the largest banks, and their supporters in government, financial services, and the many associations they control oppose the Fed’s development of the FedNow Service. It is clearly not in their best interests to have the Fed as a competitor in real-time payments. A review of the comments received by the Fed leading up to its decision clearly shows that virtually all community financial institutions (banks AND credit unions), small business and consumers urged the Fed forward in faster [real-time] payments. Also, the Fed’s decision to proceed is only the first of many battles, and victories that need to be won, and there will be many opportunities for opponents to undermine the Fed in developing a successful FedNow Service.

One need to look no further than the financial crisis, which was caused by the Wall Street banks and financial firms, in the relentless pursuit of their own best interests, to draw into suspect the TCH’s and its large bank owners’ intentions with their RTP Network – which are likewise self-serving. Also, their messaging about real-time payments often fails to explain the issues correctly or completely because it is not in their best interests to do so.

We find the TCH's intentions revealed when, before the Fed's decision was released, it offered a set of Business Principals for their RTP. The document included a final bullet point that stated, "These principals apply so long as the RTP is the only provider of faster real-time clearing and interbank settlement." In plain English, these principles would only apply if TCH is given monopoly power over real-time payments. How preposterous! TCH has since removed that bullet point from its statement of Business Principles.

One of the least credible arguments against the Fed's real-time payments proposal was that TCH and its large bank owners have invested over a billion dollars in the development of their RTP and that this investment may be in jeopardy if the Fed develops a competing system. This argument strains credibility and should garner no sympathy, considering that many of these banks' misdeeds before and after the financial crisis resulted in hundreds of billions of dollars in fines and penalties being imposed on them by regulators and other authorities.

TCH touts reaching 80% of households, and having 50% of all demand deposits accounts accessible to their RTP and therefore there is no need for the Fed to implement its Service. What these percentages do not reveal is that TCH provides direct access through approximately 500 (or less than 5%) of the nation's financial institutions. The Fed, on the other hand, provides access to all 11,000 financial institutions and will similarly do so with real-time payments. Any claim by TCH about providing this reach is something it has not come close to achieving and there should be no reasonable expectation for TCH to accomplish this now or in the future. Only the Fed can provide truly nation-wide reach in payments services including their FedNow Service.

Attempts to undermine the Fed's development and implementation of its FedNow Service will undoubtedly continue, but these objections cannot be deemed credible nor can they be allowed to hinder the Fed's development and implementation of FedNow. **CBAI urges the Fed to be continually on guard to prevent TCH, its large bank owners and supporters from undermining the Fed's efforts to quickly and successfully develop its FedNow Service.**

Service Access Limited Only to Regulated Financial Institutions

CBAI notes that during the previous comment period several tech giants/large commercial firms were supportive of the Fed's role in faster payments – likely for their own benefit because they want direct access to the real-time payment system. A consistent theme in all of CBAI's comments about others who want the benefits of being a bank, is that those benefits come with

regulatory requirements, responsibilities and costs. CBAI commends the Fed for highlighting the clear statutory requirements to access Fed Reserve services and how only Congress has the authority to change that requirement. **CBAI urges the Fed to continue to allow only chartered and insured, federal and state regulated, financial institutions with Fed master settlement accounts (either directly or through a correspondent bank) to have access to the FedNow Service.**

The Fed's Role as Payments System Regulator

The Fed is not plenary regulator of the Payments System and this limitation will extend to the faster payments. However, the Fed does regulate (directly, indirectly, or as an influencer) all 25 owners of TCH and every federally supervised depository institution which has access to the payments system. The Fed's responsibility regarding these institutions includes ensuring that they are operating in a safe and sound manner and complying with all applicable laws and regulations. The safety and soundness of all banks and the financial system is supported by a properly functioning faster payments system. **CBAI urges the Fed to continue to exercise influence over the payments system through the Reserve Bank's provision of payment and settlement services to banks.**

Service Pricing

The Fed operates a payment services which by its own policy provides universal access (all providers everywhere and at all times) and fair pricing. **CBAI agrees with the Fed's position on pricing the FedNow Service, and that until it reaches maturity and relatively stable costs and revenues, and a critical mass of bank participants, the fees should be based on the costs associated with mature volume estimates. CBAI also urges the Fed to price the services in a transparent manner, fairly and equitably to all participants.**

CBAI is concerned about pricing, in a more global sense, when core processors are included in the equation along with the Fed, TCH, and other payment service participants. The specific concerns are with highly favorable exclusive routing agreements perhaps in exchange for long-term commitments, large upfront payments and attractive transaction volumes that may favor TCH versus FedNow real-time payments. **CBAI urges the Fed to review these agreements for any unreasonable restraint on community banks ability to adopt the FedNow Service**

which would impact their safety and soundness. (See the section on Core Processors for additional concerns about service pricing)

Rules and Standards

CBAI urges that rules and standards for real-time payments be centralized, independently controlled, and consistent within the entire payments industry. Incorporating these essential features will not favor one provider over another, and will promote interoperability which is required for ubiquity. CBAI encourages the Fed to look to the Faster Payments Council to create rules and standards for real-time payments similar to how the National Automated Clearing House Association (NACHA) operates for the Automated Clearing House.

Payments Directory

A payments directory enables a payer to transfer funds to a payee (recipient) without knowing the details of the payee's account information by providing an alias or public identifier, such as an email address or a phone number. There are merits to arguments for either a centralized directory (fewer points of failure) or a federated directory (no single point of failure). CBAI is concerned with a federated directory knowing that other entities will be looking to insert themselves into the payment process for their own selfish benefit and at the expense of everyone else (i.e., as toll-takers). These entities must not prevail. **CBAI supports the Fed, as the trusted service provider with the broadest reach to play an integral role in the ownership and operation of the payments directory.**

Fraud Prevention Services

The Fed must be an essential soldier on the front-line of fraud preventions and be an ally of community banks in their efforts to mitigating fraud risks and preventing losses. The Fed should gather and be a repository of information about fraudulent activity, in much the same way as the Treasury's OFAC - Specially Designated Nationals and Blocked Persons List and the private sector ChexSystems operates today. This effort must include a robust liability shield for banks in making good faith efforts to share information with the Fed and among other financial institutions. **CBAI strongly encourages the Fed to develop and implement fraud mitigation standards, including a searchable database to provide community banks with "robust" capabilities to support their own significant efforts to defeat fraudulent activity and losses.**

Modernized Regulations

The implementation of the FedNow Service will require modernizing many banking and consumer regulations to conform with the way the Service is developed and implemented, how interoperability is achieved, and incorporating the reasonable needs of others who may qualify to participate in real-time payments. As the Service is currently proposed, consumers and businesses must know, and the regulations must support the reality of faster payments, which is that when a payment is processed it is the equivalent of exchanging cash, it cannot be cancelled or revoked (i.e., the receiver has irrevocable access to the funds without risk of being recalled) and banks cannot be held responsible for customers' mistakes or changes of mind. However, there are some legitimate reasons for flexibility for banks to recall payments and for resolution of errors. To the extent, and when these features are incorporated into the Service, the regulations must simultaneously reflect these changes.

The implementation of FedNow (together with recall and error resolution enhancements) cannot place any additional regulatory burden on community banks. Community banks are already suffering from excessive regulatory burdens in payments and many other areas of regulation. The Fed should also work closely with the state regulators and the Conference of State Bank Supervisors so there are no conflicts between the federal and state rules and regulations which may inhibit the adoption of real-time payments and ubiquity. **CBAI recommends the Fed develop the required regulatory revisions in parallel with the development of the FedNow Service because they must be effective simultaneously with, and cannot delay the timely launch of, the Fed's Service.**

Core Processors and Other Service Providers

Unlike the largest banks which have the resources to develop/maintain/upgrade their own processing systems, community banks are reliant on outside data processors ("Cores") to support their critical operations. This dependence on Cores will likely continue and will be an important element of community banks' participation in real-time payments.

Currently, community banks experience significant delays and costs with the largest Cores in implementing even simple requests for new services. Also, several of the largest Cores are internally distracted in dealing with the post-acquisition consolidation of their operations. CBAI is concerned about the potential for community banks suffering high costs and long delays by the Cores in accessing the FedNow Service.

These potential challenges with the Cores are additionally concerning because TCH already has a head-start with its RTP Network. The Cores and any other groups or entities must not put community banks at a competitive disadvantage when they are ready to participate in the FedNow Service. The Fed should be mindful of these challenges for community banks.

CBAI encourages the Fed to use its regulatory authority to ensure the Cores and other service providers do not disadvantage community banks in faster payments, but rather help maintain a level competitive playing field, which will encourage competition between banks regardless of their size, and will discourage further financial services industry consolidation. This use of the Fed’s authority is completely within its responsibility as a regulator to ensure the safety and soundness of the banks that it regulates. (See the section on Service Pricing for additional concerns regarding the Cores)

Requests for Payments

A request for payments feature is a desirable enhancement in real-time payments. Properly constructed, this feature should help eliminate uncertainty by allowing both parties to identify each other prior to irrevocably sending funds. An important element of this feature should include direct connections to financial institutions or by the financial institutions directly. Similar to our comments made in the Payments Directory section of this comment letter, CBAI is concerned about entities inserting themselves into the payment process for their own benefit. These entities must not prevail. **CBAI urges the Fed to include a carefully constructed request for payments feature in the initial implementation of the FedNow Service.**

Competitive Impact Analysis

CBAI acknowledges that “The Board conducts a competitive impact analysis when considering operational or legal change to a new or existing service, such as the FedNow Service [to determine if the Service] would have a direct and material adverse effect on the ability of other service providers to compete effectively with the Federal Reserve in providing a similar service due to differing legal powers or constraints or due to the dominant market position of the Federal Reserve deriving from such differences.”

CBAI agrees with the Fed in its assessment that there is currently only one private-sector RTGS service for payments in the United States (i.e., TCH) and this situation is expected to continue. Currently, TCH processes 50% of the real-time payments derived mostly from its large bank

owners, and its owners are highly unlikely to shift their real-time payments activity to the FedNow Service. Due to the anticipated lack of other competitors, effective competition by others is not and will not be an issue in faster payments for the foreseeable future.

CBAI also agrees with the Fed's identification of the differences between the FedNow Service and TCH, particularly concerning eligible funds held in master accounts that earn interest and count towards reserve requirements, and the ability to manage account positions in different ways. These differences, however, are insufficient to reach the "material adverse effect" threshold so as to present a problem or preventing the Fed from moving forward with its FedNow Service.

The Fed and TCH successfully operate now side-by-side in other forms of payments and have done so for decades. The effect of the Fed in payments has been positive in ensuring bank choice, increased competition, encouraging the widespread adoption, lower costs, essential checks and balances, beneficial and creative innovation, reduced concentrations in financial services, and crucial redundancy (no single point of failure) in times of crisis. We are not aware of any logical reasons to suggest that these same positive outcomes for community banks, consumers, small businesses, the financial system, the economy and American taxpayers will be achievable without the Fed's operation of its real-time payments service.

CBAI believes that these facts should make any challenge, based on legal powers or constraints or due to a dominant market position, ring hollow. Also, there is no credible reason that the Fed and TCH cannot successfully exist side-by-side in real-time payments as they do today in other forms of payment in a cooperative relationship for the benefit of all.

Conclusion

CBAI applauds the Federal Reserve on its decision to develop and implement a real-time payments system called the FedNow Service. The Service will provide universal access to faster (real-time) payments on a fair and equitable basis to nearly 11,000 financial institutions on a 24x7x365 basis across the country.

CBAI has provided a number of observations and recommendations in this comment letter which the Federal Reserve should consider in the design and implementation of its FedNow Service. The Fed must also be mindful of its impact on the nation's community banks which rely on the Fed to provide a real-time payment alternative to TCH's RTP fairly and without discrimination.

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The implementation of the FedNow Service must not create unintended consequences which will negatively impact community banks or favor the nonbank financial service providers or large retailers and commercial firms which currently utilize the payments system through financial institutions. This is indeed a large undertaking with enormous consequences for community banks, their customers and communities, our financial system, the economy and American taxpayers. CBAI is confident the Fed is up to this task.

CBAI thanks the Fed for the opportunity to respond to this Notice and Request for Comment and looks forward to its continued engagement with the Fed on this important issue. If you have any questions or need additional information please do not hesitate to contact me at (847) 909-8341 or davids@cbai.com.

Sincerely,

/s/

David G. Schroeder
Senior Vice President
Federal Governmental Relations