American Bankers Association
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Ann E. Misback
Secretary, Board of Governors of the Federal Reserve System
Eccles Board Building
20th and C Street, N.W.
Washington, DC 20219

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

Dear Ms. Misback,

The American Bankers Association[1] appreciates the opportunity to comment on the Notice of the Board of Governors of the Federal Reserve System (Federal Reserve) regarding the creation of a new payments network to support faster payments in the United States, FedNow. ABA supports the adoption of faster payments to meet the needs of consumers and commercial entities throughout the United States. ABA's members have a long association with technologies that have increased the speed of payments, from wires to card networks and recently-launched real-time payment systems. ABA continues to support the advancement of payment technologies, including accelerating payments in use cases where rapid settlement would benefit bank customers. We believe that a well-executed bank-centric model is essential to provide a valuable and safe payment system for all participants in a transaction. FedNow has the opportunity to encourage the adoption of faster payments across the country.

The Federal Reserve has been active in working with the industry to improve the payment system since 2013. The white papers and the creation of the Faster Payments Task Force by the Federal Reserve have helped to focus industry attention on the need for speedy, yet safe, payment products. One of the results of these efforts has been the creation of the Real Time Payments Network (RTP) by The Clearing House. RTP is a private sector solution that is already processing live transactions. We hope that RTP and FedNow will leverage each other's solutions to extend faster payments services across the nation with the benefits to be shared by all.

The ABA believes that FedNow can contribute to a better, faster, and safer payment system if implemented correctly. The Notice has identified several areas where comment is sought, and this letter addresses the issues that have been declared the most important by our membership to optimize the payments products and services available to depository institutions and their customers. In general, faster payments products that promote safety, interoperability, and speed to market are encouraged by the ABA membership.

[1] The American Bankers Association is the voice of the nation's $18 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard nearly $14 trillion in deposits, and extend more than $10 trillion in loans.

In addition to the specific FedNow related issues called out in the Notice, ABA is providing comments on a separate issue, the Federal Reserve's stated goal of exploring expanded hours for Fedwire and the National Settlement Service (NSS). Enhancements to these services, including aspiring to 24/7/365 operating hours, would benefit not only faster payments initiatives, but the entire industry.

Overview

This comment provides analysis and recommendations on several issues that are material to the development of FedNow and the faster payments ecosystem in general.

ABA's comments can be summarized as follows. The Federal Reserve should:

- **Interoperability.** Make the pursuit of interoperability with similar private-sector solutions its highest priority for the benefit of the entire payments ecosystem.
- **Chartered depository institution Access to FedNow.** Ensure only chartered, regulated, and examined depository institutions have direct access to FedNow.
- **Nonbank Access to FedNow.** Ensure that nonbanks with access to FedNow through partnerships with depository institutions be subject to stringent regulatory oversight given the immediacy and finality of these payments.
- **Implementation Timeline.** Recognize that the long lead time before the first live transactions may harm the faster payments market and reduce the chances of success for FedNow.
- **Disparity Between FedNow and Private Sector Solutions and the Benefits of Creating a 24/7/365 Liquidity Management Tool**. Amend its policies to allow funds held at the pooled Federal Reserve-New York account to earn interest and count towards reserve requirements consistent with funds held in Federal Reserve master accounts and pursue extending Fedwire and National Settlement Service operating hours towards a 24/7/365 environment.
- **Role of Core Service Providers.** Work actively with core service providers to ensure they have all of the needed product requirements far in advance to enable them to meet implementation deadlines. This will ensure all entities have access to FedNow at the same time regardless of the provider.
- **Equitable Pricing.** Set pricing so all banks, regardless of size or transaction volume, are subject to the same per-item pricing schedule.
- **ISO 20022 Message Formats.** Establish ISO 20022 Real-Time Payment usage guidelines for FedNow.
- **Request for Payment.** Offer this functionality, although it is not essential immediately.
- **Fraud Prevention Services**. Leverage the Federal Reserve's position as network operator and work with the industry to offer enhanced transaction fraud prevention tools.
- **Seven-Day Accounting Regime.** Allow depository institutions to adopt the accounting policy of their choice.
- **Business Day.** Allow depository institutions to adopt the business day policy of their choice.

Issue Analysis and Recommendations

Interoperability

For the purposes of this comment, we believe interoperability is achieved if a transaction can be originated on one faster payment solution and received by a payee using another payment solution in a seamless manner. We understand that there are many underlying challenges to interoperability, including technical challenges and differing rules. For example, parties would have to agree on how they will treat a transaction that cannot be processed and must be returned to the originator.

The benefits of interoperability are clear. It would allow different solutions to compete with one another, benefitting end users with improved pricing, more seamless transactions, and better service. Transactions that can seamlessly connect customers will improve the value of both networks.

It is important to note that FedNow is scheduled to start live transactions in 2023 or 2024, which is six to seven years after TCH RTP's first payment. FedNow would benefit from having instant access to an established network of endpoints for its payment system. In a similar manner, TCH RTP would benefit if FedNow was able to onboard depository institutions that had been on the sideline. Interoperability provides the opportunity for each solution to benefit.

Interoperability is not without its challenges. Even so, it is troubling to hear the Federal Reserve has accepted it likely will not be interoperable on day- one but will aspire to become interoperable eventually. TCH has also stated publicly that it is doubtful that interoperability can be achieved. It is time for the parties to recognize that the cost of not becoming interoperable hurts the payment system overall as well as their own networks.

A faster payments ecosystem that does not provide interoperability between systems with similar levels of service and security will fragment the market. It will also result in excessive costs and inefficiencies for banks, increase costs, and produce inferior customer experiences. If FedNow is not interoperable with existing faster payment services, depository institutions will be forced to make one of two choices. Depository institutions will need to decide which service it will offer to their customers, while recognizing that they will be unable to send or receive payments to users of the other service. Being forced to choose a system that does not work with other systems will create a poor customer experience and customer frustration. The alternative solution would be for depository institutions to offer both services to ensure broader coverage. The expense of managing parallel systems is not the optimal economic solution and will harm the entities that have to implement and maintain two services that perform the same function. This unnecessary burden on depository institutions will be unworkable and fail to help their customers.

It is critical that any interoperable systems meet minimal, agreed-upon security requirements. This will allow parties to rely on the actions of their counterparts to mitigate security risk. The adage that "A chain is only as strong as its weakest link" is very appropriate in these circumstances. We urge the payment systems to use the Faster Payments Task Force

Effectiveness Criteria[2] as a resource. The report describes 11 general criteria that payment solution providers should meet or exceed to keep the faster payments ecosystem safe for its users.

On day one, the Federal Reserve should make every effort to become interoperable with existing private-sector solutions that provide similar features and meet agreed-upon security requirements. Interoperability will make each solution more attractive and increase their chances of long-term viability. We acknowledge that interoperability requires the collaboration of multiple parties, but that does not mean it should not be the highest priority. The negative consequences if payment systems are not interoperable will detrimentally impact the market, consumers, and each payment system.

Chartered Depository Institution Direct Access to FedNow
Depository institutions and member banks are regularly examined for compliance with regulations and are permitted to access to existing Federal Reserve's payment systems by statute. Access by heavily regulated entities is appropriate due to the importance of protecting customer (both consumer and commercial) funds, data, and privacy and preserving the reliability of and confidence in the payments system. Depository institutions are held to high standards when it comes to protecting customer information and privacy. Additionally, they also must meet liquidity and other prudential regulatory requirements to demonstrate that they have the ability to meet their financial obligations, including payment transactions.

The Federal Reserve and Congress should protect customers, depository institutions, and the payment system by strengthening the current laws and policies that protect consumers and the payments system by restricting direct access to the Federal Reserve payment services solely to regulated depository institutions.

Nonbank Indirect Access to FedNow
The proposal contemplates that nonbank companies could access the FedNow system indirectly through a participating bank. Indirect access by nonbanks could raise significant consumer protection, fraud, cybersecurity, and anti-money laundering risks. Unlike the current environment that allows non-banks to access the ACH system through agent banks, FedNow transactions are irrevocable and immediate. The ACH network moves slower and has Operating Rules in place to reverse transactions, which would not be possible with FedNow.
Chartered depository institutions that are regularly examined for compliance and have strict oversight are best positioned to minimize these significant risks. Nonbank agents, however, are not as heavily scrutinized and, as a practical matter, are not generally subject to regulatory oversight. Agent access to FedNow must not allow nonbank participants to circumvent controls and supervisory expectations that would apply to chartered depository institutions.
The FedNow proposal does not address the additional risks that nonbank agents bring to this faster payments system. The Federal Reserve must do so to ensure that all participants in FedNow, direct or indirect, meet similar robust prudential, security, and consumer protection standards.

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[2] Faster Payments Effectiveness Criteria, January 26, 2016, The Faster Payments Task Force, https://fedpaymentsimprovement.org/wp-content/uploads/fptf-payment-criteria.pdf

The Federal Reserve should make clear that nonbank agent access will require that they meet both the security and compliance requirements similar to depository institutions. The Federal Reserve should consider initially limiting FedNow participation to depository institutions only to allow time to evaluate any additional risk presented by other nonbank agents.[3]

Implementation Timeline

The FedNow Notice projects that the first live transaction will take place in 2023 or 2024. FedNow is a technology product that will involve significant changes and resource demands on the Federal Reserve and on all of the depository institutions that choose to connect to it. In addition, it is likely that third parties will assist the Federal Reserve, adding to the complexity of the project. Given the size and scope of FedNow, the four-to-five year timeline is probably not inaccurate. However, it is very important to note that the longer the period of time before live processing, the greater the market share gains of earlier adopters.

Banks recognize opportunities in providing faster payment solutions to their customers sooner will opt for private-sector solutions before FedNow goes live. Similarly, customers that want to participate in faster payments will move accounts to banks that offer them that service before the 2023-2024 target date.

There is also the possibility that some depository institutions will decide to wait for FedNow launching in 2023-2024. If the FedNow date slips beyond the four to five year timeline these banks will be harmed if they cannot provide desired services to their customers. This may put them at risk of losing deposits if customers move to depository institutions that offer faster payments products.

The Federal Reserve should strive to get FedNow operational and interoperable on a faster timeline to maximize the number of possible endpoints in the shortest time possible. This increased speed to market, especially if it is with a solution that is interoperable with solutions already in existence, will benefit the entire payments ecosystem.

Disparity Between FedNow and TCH RTP Regarding Earning Interest, Reserve Requirements, Intraday Credit and a Liquidity Management Tool (LMT)

The Notice asks for comment regarding the legal and structural differences between FedNow solution and private-sector solutions such as TCH RTP. The Notice states that FedNow transactions would be funded directly from depository institution master accounts. Using master accounts would enable funds held for use for FedNow to be eligible to earn interest and count towards reserve requirements. Furthermore, the Federal Reserve notes that depository institutions have access to intraday credit to provide temporary liquidity to cover shortages when payment inflows and outflows are out of balance and that similar access to this service could support smooth functioning of FedNow transactions.

[3] The RTP Network recognized the unique risks posed by nonbank agent risks and thus has just begun to provide access to nonbank agents and service providers, two years after launching the network. These risks, and the need for similar caution, are even greater with FedNow given the direct access to participating banks' Federal Reserve accounts.

Alternatively, the TCH RTP product uses a pooled account held at the FRB-New York where participating depository institutions must prefund balances for faster payments services. These funds, intended for the same services as FedNow funds, are not eligible to earn interest or count towards reserve balances under current Federal Reserve policies. This creates an uneven playing field between the two services giving FedNow a direct and material advantage based on its own structure and policies.

According to the Notice, depository institutions would have access to intraday credit to fund the private-sector solution, but it would be limited to the current operating hours of Fedwire.

The Notice asks for input regarding the different benefits offered to depository institutions and possible options to mitigate any disparity. ABA believes that these differences will have a direct and material effect on the private-sector solution that would give FedNow a significant advantage.

An LMT would help depository institutions manage fund balances in a “real-time” environment. The private-sector TCH RTP solution requires that banks participating in the service prefund their account. There is the possibility that some payments will not be completed if the prefunded balance drops to zero due to there being an imbalance in funds being paid out and those being received. If this happens overnight or on a weekend when Fedwire is closed, then outgoing payments cannot be made by the bank affected. We live in a world that does not stop at night or on weekends and our payment systems should reflect that fact.

The benefits of 24/7/365 Fedwire and NSS to facilitate a continuous LMT go far beyond helping one narrow segment of the faster payments marketplace. Continuous Fedwire and NSS will allow for better risk management of card transactions by decreasing the time between transactions and settlement between depository institutions. Similarly, additional ACH windows could be implemented during the day, and it would increase the number of days when transactions are possible from five to seven. Extending Fedwire and NSS will also allow for wire services to operate seven days a week.

Other options to mitigate disparity between the two payment services would include allowing balances held in the pooled FRB-New York account to have the benefit of funds held in the depository institution master accounts. Earning interest and having those funds count towards reserve requirements would make a material difference in removing the disparity.

The Federal Reserve should begin the process to implement a 24x7x365 LMT solution as soon as possible. There is no need to link this directly with FedNow development. The LMT would be a great asset to faster payment solutions and beyond. Moving the central bank to continuous payments processing is essential for modernizing the U.S. payments system.

The Federal Reserve should amend its policy to allow for funds held at the FRB-New York for the purposes of funding faster payments solutions to be allowed to earn interest, count towards reserve requirements, and be able to access intraday credit in a manner consistent with funds held in Federal Reserve master accounts.

The Role of Core Service Providers
Community banks rely on technology infrastructure that supports everything from accepting deposits to originating loans, all of which tie into operating the core ledger that keeps track of customer accounts. Three companies control the delivery of core services to approximately 80-90% of community and mid-size banks and several smaller organizations service the rest of the market. Often products like FedNow must be integrated into the core service provider systems to allow banks to offer the service to its customers. This integration process can take time and delay implementation timelines for large technology projects like FedNow. Some core service providers are still working on establishing partnerships with the P2P service Zelle and TCH RTP. Implementation of these payment solutions has been slower than projected.

The Federal Reserve must work closely with, and provide close oversight of, the core service providers to ensure that they have all of the specifications and technical requirements they need, when they need it, to ensure that all banks have fair access to faster payments solutions within a reasonable amount of time at a fair cost. The Federal Reserve must commit to providing all of the required specifications to the core service providers far enough in advance to allow adequate time for the building and testing of the systems. Where possible, the Federal Reserve should let simplicity be its guide.

To ensure that FedNow implementation is smooth, the Federal Reserve must closely monitor and coordinate with core service provider progress to ensure that any potential delays are identified and rectified in a timely manner. The Federal Reserve should focus on making sure that depository institutions do not have different access to FedNow because they are using different core service providers.

Equitable Pricing
The Federal Reserve employs volume discounts for some current payment products like FedACH. This means prices are lower for banks that transact in bulk while smaller banks with lower transaction volumes pay higher per-unit costs. The FedNow notice provided very little insight into the future pricing structure other than to state that more information would be made available closer to the implementation date in 2023 or 2024.

The Federal Reserve should provide more information regarding the proposed pricing structure and commit to a flat per-transaction pricing scheme that will not disadvantage depository institutions with lower FedNow volume.

ISO 20022 Message Standard
The ISO 20022 message standard is becoming the standard across payment platforms including a Fedwire migration that will be complete in 2023. SWIFT, The Bank of England, EBA CLEARING, and other large payment systems are also migrating towards this common standard of ISO 20022 Real-Time Payments Group usage guidelines. It is important to note that TCH RTP has adopted this format and it would assist the two services in achieving interoperability if they use the same message formats.

The Federal Reserve should adopt the ISO 20022 Real-Time Payments Group usage guidelines standard to allow for greater efficiency for the banks using the platform and to increase the possibility of interoperability with other payment systems.

Request for Payment

FedNow will allow for credit transactions only and not allow debits. However, it is considering whether it should offer a "Request for Payment" (RFP) feature in lieu of debit transactions. This would allow for one party to send a message to another party requesting that it make a payment to the entity that sent the message. This is anticipated to be used by commercial end users to existing customers. For example, a utility could send an RFP to customers on the day a balance is due asking that they pay immediately via FedNow to avoid any late fees. The customer could then choose to push a credit payment to the utility. The RFP function is part of the TCH RTP service and it has been found attractive to businesses.

The Federal Reserve should adopt a RFP feature for its FedNow service. However, this can be a complex function to implement. It would help FedNow if it could offer RFP receipt services on the first day of processing, and if necessary, RFP origination services could be phased in later.

Fraud Prevention Services

The Federal Reserve states in the Notice that it will offer payment alert services regarding unusual transactions to depository institutions. It has committed to working with the industry to identify the best methods to mitigate fraud. The Federal Reserve can develop effective services for the benefit of all depository institutions. Operating FedNow will give the Federal Reserve greater insight into the entire market that individual depository institutions do not have. Seeing all transactions will allow the Federal Reserve to offer services like transaction scoring of individual payments to assist banks in deciding whether to process payments.

The Federal Reserve should leverage its position as the operator of the network and its broad knowledge of the universe of FedNow transactions to offer enhanced fraud prevention services to depository institutions.

Seven-Day Accounting Regime

FedNow will operate 24/7/365 leading the Federal Reserve to interpret the Financial Accounting Standards Board principles to mean that the payments will record and report transactions as they occur, including weekends and holidays.

Individual depository institutions may adopt a five-day accounting regime based on their interpretation of the account principles, reporting weekend transactions on Monday or adopt a seven-day approach. Depository institutions would be able to receive accounting reports from the Federal Reserve to support either method.

The Federal Reserve should implement this practice giving depository institutions the choice of the accounting regime that is best for the individual bank.

Business Day

The Federal Reserve has determined that FedNow should align its business days with Fedwire. However, FedNow will operate 24/7/365 and Fedwire will be closing at 7 pm each day for two hours, opening for the "next day" at 9 pm. Fedwire transactions that occur at 10 pm on Monday are posted as Tuesday transactions.

The Federal Reserve recognizes that this is not entirely consistent with FedNow which will not stop processing during the day. Participating depository institutions will be allowed to record transactions that occur between 7 pm and midnight the next day or in real time.

The Federal Reserve should adopt this policy that allows depository institutions to adopt the business day policy that is most appropriate for the bank.

Conclusion

ABA appreciates the opportunity to provide comments on the FedNow Notice. This is a significant initiative for the Federal Reserve to undertake and it is important that it take an inclusive approach to support ongoing private-sector initiatives as well as its own. Working together the Federal Reserve and the private sector can help the U.S. achieve nationwide reach of faster payments services sooner and with a greater benefit for all users and providers. If we can be of any assistance or provide clarification regarding these issues please contact the undersigned at (202) 663-5147.

Sincerely,

Stephen K. Kenneally
Senior Vice President, Center for Payments and Cybersecurity