

Rodman K. Reef
Reef Karson Consulting, LLC
218 Larchmont Avenue
Larchmont, New York 10538
November 7, 2019

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

Re: Docket No. OP – 1670

Dear Ms. Misback:

Please remove the personally identifiable contact information at the top of this letter before making the comments publically available at the Board's web site or in paper form at the Board's offices.

As I said in my December, 2018 comments on the "Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments", the Federal Reserve should provide a real-time gross settlement system ("RTGS") much as described, but not as completely described, in the Federal Register notices. The goal should be to develop an infrastructure to process faster payments and on which the private sector can build innovative services.

The following are my comments on the "Federal Reserve Actions to Support Interbank Settlement of Faster Payments". The comments follow the structure of the August 2019 Federal Register notice.

Summary

Dates

Addresses

Supplementary Information

I. Introduction

A. Background

B. 2018 Federal Register Notice on Potential Federal Actions

C. Planned Actions

1. The FedNowSM Service

The reference in the second paragraph of page 11 stating that “the recently established private-sector RTGS is likely to remain the sole private-sector provider of RTGS services for faster payments in the United States” is too strong. It does not account for the RTGS service provided by Ripple and the RTGS service IBM announced, with a partner, at the last two SIBOS conferences. It also does not account for the potential for other players to emerge.

A single private-sector provider of RTGS services is “unlikely to connect the thousands of small and mid-size banks necessary to yield nationwide reach” alone. However, the possibility of a private-sector provider partnering with the companies such as Mastercard, Visa, FIS, Jack Henry, Fiserv, etc. who already have significant “reach” should not be ignored.

I agree with the last sentence of the first paragraph at the top of page 12 that “[t]he presence of multiple RTGS services for faster payments could yield efficiency benefits such as lower prices, higher service quality, and increased innovation.” This is typically the outcome of a competitive market.

The Federal Reserve brings two benefits to the market that are not easily provided by a private sector provider. First, the FedNow settlement is through the reserve or master accounts at the Federal Reserve banks. This allows the participating banks to have the balances supporting the RTGS system accrue to the banks’ reserve requirements and earn interest. It also minimizes the number of accounts the participants need to manage in real-time 24x7x365. Also, because most faster payment systems outside the U.S. are managed by the country’s central bank and central banks like to deal with other central banks and not commercial organizations, FedNow is in a better position to connect to non-U.S. faster payment systems than a private-sector RTGS.

The payments market is changing quickly due to both innovative new uses of technology and the changing demands of customers. The Federal Reserve should try to bring a version of FedNow into the market as soon as possible. The design should allow functions to be added and changed as the market changes. 2023 and 2024 are a long-time in the future from a payments market perspective. As an example four and five years ago there was no same day ACH

and EMV was just beginning to come into the card market. And, contactless transactions were just beginning to be discussed as an option for the U.S. market. All of these payment types are real and growing today. The design of FedNow needs to be flexible enough to accommodate significant change.

2. Expanded Operating Hours for Current Services

D. Organization of This Notice

Part One

II. Summary of Comments

A. Faster Payments

B. Real-Time Gross Settlement of Interbank Obligations

C. Federal Reserve RTGS Service and Liquidity Management Tool

III. Assessment of the FedNow Service

A. Other Providers Criterion: The service should be one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity. For example, it may be necessary for the Federal Reserve to provide a payment service to ensure that an adequate level of service is provided nationwide or to avoid undue delay in the development and implementation of the service

1. Relevant Measures

- a) Scope and Equity
- b) Effectiveness

2. Public Comments

- a) Scope and Equity
- b) Effectiveness

3. Board Analysis

- a) Scope and Equity
- b) Effectiveness

B. Public Benefits Criterion: The Federal Reserve must expect that its providing the service will yield a clear public benefit, including, for example, promoting the integrity of the payments system, improving the effectiveness of financial markets, reducing the risk associated with payments and securities-transfer services, or improving the efficiency of the payments system.

1. Relevant Measures

2. Public Comments
 - a) Accessibility
 - b) Safety
 - c) Efficiency

3. Board Analysis

- a) Accessibility

The design of FedNow should include the ability to directly exchange payments with other RTGS systems. Interoperability is critical for achieving ubiquitous access to the DDA and savings accounts in the U.S. The direct exchange of transactions might not be implemented on the day the system goes live but the design should allow an easy integration shortly after the live date. It is highly inefficient for a bank to participate in multiple faster payment systems as an alternative to participating in one and having it exchange transactions. Participating in multiple systems means duplicate operations and duplicate expenses. It also means maintaining balances in multiple locations, some earning interest and some possibly not earning interest. This means FedNow should use a message standard and message structure that has been or is likely to be adopted by the systems with which FedNow will likely interoperate.

- b) Safety
 - c) Efficiency

C. Cost Recovery Criterion: The Federal Reserve must expect to achieve full recovery of costs over the long run.

1. Relevant Measures
 - a) The MCA
 - b) The Pricing Principles

2. Public Comments

3. Board Analysis

It is difficult to justify a cost recovery period of greater than ten years. A cost recovery period of greater than 10 years would certainly not be used in the private-sector. The Board should consider a goal of a shorter cost recovery period. It should also consider developing its pricing with the shorter period in mind. The decision to build FedNow should be reevaluated if competitive pricing cannot be developed to support a shorter cost recovery period.

IV. Assessment of Expanded Operating Hours for the Fedwire Funds Service and the National Settlement Service to Support Liquidity Management for Faster Payments and For Other Purposes

- A. Public Comments
- B. Board Analysis

PART TWO

V. FedNow Service Description

- A. Public Comments
- B. General Description of the FedNow Service
 - It is reasonable for the FedNow team to begin the design of the service with a \$25,000 per transaction limit. \$25,000 is the limit used today by most faster payment and same day payment systems. However, the market is already starting to change and it will continue to change in parallel with the development of the FedNow system. The FedNow team should follow the market and be prepared to use a different limit when the system goes live several years in the future.
- C. Discussion of Specific features and Functionality
 - 1. Message Standard
 - It is appropriate for FedNow to adopt the ISO 20022 message standard as its primary messaging standard. However, the FedNow team should evaluate the possibility of allowing, at least for a period of time, banks to connect with other messaging standards such as ISO 8583 or through FedNow designed APIs. The FedNow team might want to build or buy a message converter to support the banks that use a different standard while the FedNow system uses only the ISO 20022 standard. This could reduce the work, cost and time for certain banks to connect to FedNow.
 - 2. Settlement Account
 - 3. Seven-day Accounting Regime
 - 4. Business Day
 - The discussion of the business day hours for each service is confusing both in the text and in the footnotes. A chart might help. The Federal Reserve should consider aligning the closing time of all of its payment services with the change in the calendar day. This could reduce some of the confusion.

5. Liquidity and Credit

The Federal Reserve should align the hours of discount window operations with the operation of its payment systems, including nights, weekends and holidays. This will minimize the chance of a bank not having sufficient liquidity in its reserve account to process a credit push payment requested by a customer who has sufficient funds in its account at the bank. Technology and appropriate staffing policies may allow this to be done without requiring 7x24x365 on-site staffing.

6. Network Access

7. Service Pricing

8. Request for Payment

FedNow should be designed to pass messages, such as Request to Pay, through the system. It will need to support these messages to interoperate with other faster payment systems. However, it should leave the development of services around these messages to the private-sector. FedNow should have rules and standards that specify how private-sector developers can use the messaging capability to innovate and bring new products and services to market. The Request to Pay Transaction, which hides the payment credentials of both the sender and the receiver, can be the first of this type of message to be implemented. It is a very valuable tool and can, if marketed well, help reduce the amount of B2B and C2B paper checks in the market.

9. Directory service

The Federal Reserve should not, initially, build its own directory. Rather it should establish policies and procedures for the private-sector to build and operate directories that can be accessed through the FedNow system. The Federal Reserve should establish a centralized process for connecting the directories to eliminate the need for banks to directly connect to the directories themselves. If, over time, this does not work due to completeness, security, privacy or other concerns, the Federal Reserve should then consider building and maintaining its own directory service.

10. Fraud Prevention Services

At the payment system level, FedNow should use its view of the faster payment environment to help banks minimize fraud. For example, FedNow could look at transaction patterns across multiple participants and notify the

participating banks of patterns of fraudulent transactions. It could also gather data about fraudulent transactions from the participating banks and disseminate it to the participants after anonymizing the data, where appropriate. It is, however, appropriate for the participating banks to continue to serve as a primary line of defense against fraudulent transactions. FedNow can assist with the process where it has unique capabilities or a unique view of the environment.

D. Implementation

VI. Competitive Impact Analysis

A. Relevant Private-Sector Providers of Similar Services

The Actions to Support Interbank Settlement paper only addresses one private-sector provider of services similar to FedNow. In performing the competitive analysis, the Federal Reserve should be a little broader in its definition of competitive service providers and consider Ripple, IBM and its partner, Visa, Mastercard and others in this category too.

B. Material Adverse Effects on the Ability of Relevant Service Providers to Compete Effectively

The differences in the settlement process and the settlement account structure among the various faster payment service providers is relevant and will be a consideration in which service provider a bank will use. However, it will not be the only consideration. The ease of building and operating a connection, the available reports, the fee structure, access to data, etc. will be some of the other considerations.

C. Legal Differences between the FedNow Service and the Private-Sector Service

D. Achieving Potential Benefits with a Lesser, or No, Adverse Competitive Impact

The expansion of Fedwire and NSS hours will help reduce the competitive advantage FedNow will enjoy due to its settlement through the reserve accounts of participating banks.

Thank you for the opportunity to comment on these potential actions.

Please let me know if you have any questions.

Sincerely,

Rodman K. Reef

Rodman K. Reef