



December 13, 2018

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

Regarding: Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, Request for Comment, Docket No. OP-1625

Dear Ms. Misback:

The Community Bankers Association of Illinois (“CBAI”), which proudly represents 320 Illinois community banks, appreciates the opportunity to provide our thoughts regarding the Board of Governors of Federal Reserve System’s (“Federal Reserve” or “Fed”) Request for Comments (“Request”) seeking input on potential actions the Federal Reserve could take to promote ubiquitous, safe, and efficient faster payments in the United States by facilitating real-time interbank settlement of faster payments through Real Time Gross Settlement (“RTGS”) and a Liquidity Management Tool (“LMT”) (combined “Proposed Improvements” or “Improvements”). CBAI agrees with the introductory statement in the Summary of the Request when it stated, “As part of its overall mission, the Federal Reserve has a fundamental interest in ensuring there is a safe and robust U.S. payments system (“Payments System” or “System”),

**CBAI is one of the largest state banking associations in the nation. CBAI is a professional trade association representing 320 Illinois commercial banks and thrifts, and their 880 Illinois bank branches. Its members have nearly \$80 billion in assets and employ approximately 16,000 individuals. CBAI is headquartered in Springfield, Illinois, and was founded in 1974 to exclusively represent and serve the community-banking profession. For more information, visit [www.cbai.com](http://www.cbai.com).**

including a settlement infrastructure on which the private sector can provide innovative faster payment services that serve the broad public interest.”

To fulfill this mission, **CBAI urges the Federal Reserve to follow the recommendations contained in this letter in developing and implementing the Proposed Improvements, to ensure fast and secure payments which will benefit the financial system and the economy. An essential feature of these Improvements, and which we believe only the Federal Reserve is uniquely positioned to provide, is open and fair access to the Payments System for all community banks regardless of size, charter type or location, to meet the existing and evolving payment needs of their customers and communities.**

## **Introduction**

The CBAI formed a Payments Task Force (“Task Force”), consisting of 12 leadership community bankers and senior staff, for the purpose of advising the CBAI Board of Directors on matters relating to payments, emphasizing the need for community banks to have multiple viable options for access to the Payments System on a non-discriminatory basis. The Task Force met with associations, system experts and regulators to discuss the broader payment landscape and to assess various developments, including options and improvements, to enhance the speed, safety and efficiency of the System from the community bank perspective.

Members of the Task Force attended the Payments System Forum and Faster Payment Town Hall Meetings in Chicago, IL, Cedar Rapids, IA, St. Louis, MO and Washington, D.C. The Task Force reported its recommendations to the CBAI Board of Directors which approved responding to this Request. Additionally, copies of this comment letter will be sent to the Federal Reserve Bank of Chicago, St. Louis and Kansas City, the Federal Deposit Insurance Corporation, the Office of Comptroller of the Currency, and the Illinois Department of Financial and Professional Regulation. Copies of this letter are being sent to these banking regulators as it is clearly also their responsibility to ensure a fast and secure Payments System to maintain the safety and soundness of the community banks they regulate.

## **Background**

CBAI gratefully recognizes the Federal Reserve’s historic role in the Payments System and encourages the Fed to maintain its leadership role by developing and implementing the Proposed

Improvements. The Federal Reserve's continued involvement in payments is critically important to provide fair access and safeguards to the System for the nation's thousands of community banks and their customers and communities in both urban and rural areas.

CBAI acknowledges the Federal Reserve's efforts which began approximately three and one-half years ago (May of 2015) with the formation of the Faster and Secure Payments Task Forces to encourage and facilitate dialogue from a broad and inclusive group of stakeholders to ensure that both speed and security are appropriately considered in an improved Payments System. In January and July of 2017, the Faster Payments Task Force published its two part report, The U.S. Path to Faster Payments, which "calls upon all stakeholders to seize this historic opportunity to realize the vision for a payment system in the United States that is faster, ubiquitous, broadly inclusive, safe, highly secure and efficient by 2020." The Secure Payments Task Force was established to provide a forum for stakeholders to advise the Federal Reserve on promoting Payment System security, public confidence, protections and responses that keep pace with rapidly evolving threats on payment security matters. In March of 2018, the Secure Payments Task Force concluded its efforts with a final publication consisting of a collection of educational materials outlining the lifecycles and security profiles of today's primary payment methods. These task force members have transitioned into the Federal Reserve's FedPayments Improvement Community which provides stakeholders with opportunities to engage in the Federal Reserve's ongoing payment improvement initiatives.

Then, on November 15, 2018, the Federal Reserve published a Request for Comments in the Federal Register requesting comments on Federal Reserve actions to support interbank settlement of faster payments [Proposed Improvements].

## **Observations**

A fast and secure Payments System is at the very foundation of our financial services industry and economy. The average consumer and business give little thought to the System as it has long been assumed to be consistently available and working properly at all times. Members of the Payments System, including community banks and the Federal Reserve, however, understand the complex nature of the System's operation, how it has evolved and been enhanced over time, and that the System's development and maintenance is not without considerable and necessary thought and effort.

The number of payment options and the speed of development within the financial system have increased dramatically and the pace of change is not expected to abate in the future. Community banks are particularly interested in the proper functioning of the System including fair access and safeguards. Unfortunately, both individually and even collectively, community banks do not account for a majority of System's transactions, and as a result are not able to more forcefully control of the evolution of the System. Therefore, community banks must rely on the Federal Reserve to provide access, speed and security for all members of the Payments System.

The importance of the Payments System to community banks and the customers and communities they serve cannot be overstated. While community banks account for only approximately 20% of banking assets, they extend almost 50% of the loans to small businesses and an ever higher percentage of agricultural loans; and approximately one in five counties in the nation are only served by the physical presence of a community bank. A Payments System that does not serve all banks equally or which disadvantages community banks will have a devastating impact on the nation's consumers, small business and agriculture.

CBAI is rightly concerned with private-sector financial institution solutions to Payments System improvements where the entities are owned and controlled by the nation's largest banks and financial firms. The recent and ongoing misdeeds of many of the largest financial institutions have greatly harmed consumers, endangered the entire financial system and resulted in the worst recession since the Great Depression. Despite new requirements under the Dodd-Frank Act, which were designed to mitigate the risks that these institutions pose, they will likely continue to act in their own best interests and regularly stumble. Several viable non-large-bank controlled alternatives [including the Fed's Proposed Improvements] should be incorporated into an improved Payments System. These alternatives will increase competition, reduce concentration risk, be less likely to disadvantage community banks, and will reduce the negative impact of future large bank and financial firm misdeeds on millions of consumers and small businesses, and many thousands of urban and rural communities across the nation.

CBAI is also concerned with the emergence of private sector non-bank solutions to Payment System improvements. These companies present significantly different risks and new threats to the System. These companies are not subject to the same safety and soundness regulations as community banks including examination and enforcement by prudential regulators. This regulatory double-standard creates an additional competitive imbalance in favor of these less regulated companies and to the detriment of the System, regulated financial institutions including community banks, consumers and the economy. Robust supervision and the enforcement of the same regulatory requirements imposed on financial institutions, including community banks, will

be required to level the playing field. Also, to be qualified to participate in the Payments System, these companies must be required to provide equal and fair access and not discriminate in favor of certain institutions to the detriment of community banks regardless of their size, charter type or location.

Community banks are justifiably concerned about fair treatment and a level playing field because there are a number of glaring examples to prove these threats are very real and ongoing, including: the unwarranted tax-exemption of bank-like credit unions; the Farm Credit System - which is the only GSE that is allowed to compete directly with community banks; the funding and other advantages still enjoyed by the nation's largest banks and financial firms; and various anti-competitive behaviors that undermine competition by the dominant debit card networks and their affiliated companies. While the Federal Reserve may not have direct control over much of this discrimination, inadequate or inappropriate Payments System improvements must not add to the already significant competitive disadvantages currently suffered by community banks.

## **Recommendations**

CBAI has identified desirable attributes for the Payments System and improvements which include the following:

- Provide for speed, security, efficiency and ubiquity;
- Guarantee that the Federal Reserve System maintains its dual role as the Payments System's regulator AND as an operator and service provider;
- Ensure equality in competition among financial institutions of all sizes and characteristics including community banks;
- Ensure that interoperability is a central feature of the Payments System to promote competition, reduce fixed costs and enable economies of scale to promote the viability of the service and make payment services more convenient;
- Provide the Federal Reserve with the ability and authority to identify and regulate systemically important payment, clearing and settlement systems and providers;
- Establish privacy and security standards for non-bank payment providers;
- Guarantee that examination and enforcement against large bank and non-bank payment providers are as equally stringent as they are for community banks;

- Ensure a meaningful and collaborative role for state regulators in the evolution of improvements and operation of the Payments System; and,
- Provide community banks with meaningful participation and influence in the development of rules to ensure fair, open and efficient access (including reasonable control of costs) to the Payments System and the ongoing governance and rulemaking to these groups.

Based on these desirable attributes, CBAI specifically recommends that the Federal Reserve develop and implement the Proposed Improvements including:

- Using its connectivity to provide all financial institutions with access to real-time payments;
- Providing central bank settlement (i.e., RTGS);
- Providing an LMT to support services for real-time interbank settlement for faster payments;
- Serving as an operator for real-time payments as it does for checks, ACH, and wire transfers; and,
- Operating as a payments directory that would link to financial and other private sector directories.

CBAI supports the Federal Reserve acting as a temporary “on-ramp” for other private sector solutions, while it is developing and implementing the Proposed Improvements. Furthermore, CBAI again states its support for the Federal Reserve exercising its full suite of regulatory examination and enforcement powers over the largest, most active and most influential financial institutions and non-bank participants in the Payments System to ensure equal access and fair treatment for all participants including community banks.

These desirable attributes and recommendations are consistent with the Federal Reserve’s own statement of functions, and support its active participation in the Payments System and improvements, when it states that its role is to:

- Promote the stability of the financial system;
- Minimize and contain systemic risks through active monitoring and engagement;
- Promote the safety and soundness of individual financial institutions;
- Foster payment and settlement system safety and efficiency; and

- Promote consumer protection and community development through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends.

These desirable attributes and recommendations also comply with the Federal Reserve's Payment System Policy Statement which states that its role is to:

- Promote payment system integrity;
- Ensure the provision of payment services to all financial institutions on an equitable basis and with competitive fairness; and,
- Maintain efficient, accessible, reliable and safe payment systems for all stakeholders.

In addition, the Federal Reserve requires the satisfaction of three criteria before introducing a new service or major service enhancement like the Proposed Improvements. Following are CBAI's comments, written in italics, supporting satisfaction of compliance.

- One, the service should be one that other providers, alone, cannot be expected to provide with reasonable effectiveness.

*There is no single entity within the private sector that has the proven reach to connect with every financial institution as the Federal Reserve does now with checks, ACH payments and wire transfers. The Federal Reserve has the proven ability to adapt to the evolution of the Payments System while continuing to serve all financial institutions regardless of size, charter type or location. There is every reason to believe that the Federal Reserve will be the only entity to continue to perform at this high level within the Payments System including the Proposed Improvements.*

*There are, however, many reasons to suspect the opposite from private-sector solutions. Either individually or collectively private-sector financial institutions do not have an unblemished history of successfully performing their core banking responsibilities let alone assigning them responsibility *for leading the nation's* Payments System. The recent taxpayer funded bailouts of the largest banks and financial firms are evidence of their lapses in performance. The non-bank private sector participants are less likely to succeed given their increased risk profile, lack of regulation, and lack of a successful track record across a number of economic cycles. The financial system and economy cannot rely on private-sector*

solutions to be either reasonable or acceptable substitutes for the Federal Reserve playing a preeminent role in the Payments System including the Proposed Improvements.

*The Federal Reserve is also the most likely to never put the nation's community banks at a competitive disadvantage in terms of pricing, availability and integration. The Federal Reserve is in a unique position to offer a more inclusive governance framework and appropriately consider the perspective of community banks. The Faster Payments Task Force's final report found that many proposals "recognized the need for an inclusive governance process" without suggesting a solution, so this is an area is where the Federal Reserve can demonstrate leadership.*

- Two, the service will yield a clear public benefit.

A properly functioning Payments System is clearly of immense benefit to consumers, small businesses, the financial system and economy because it serves as its very foundation. Developing and implementing the Proposed Improvements are then, by extension, similarly a public benefit. The Federal Reserve is *currently responsible for the success of the nation's Payment System* and diminishing that preeminent role cannot be reasonably construed as being in the *public's best interest*.

Notwithstanding the extent to which private sector financial institutions or non-banks are involved in an improved Payments System, a Federal Reserve solution that serves all financial institutions regardless of size, charter type or location will be of great public benefit in itself and by providing an alternate path for payments should/when these private-sector operators succumb to inevitable disruptions. As these disruptions occur, with little or no warning, the Federal Reserve's Proposed Improvements must already be fully operating so that it can immediately provide payment services for everyone.

*The Federal Reserve's participation in the Payment System and its Proposed Improvements is essential in providing competition and lowering prices for many*

consumers by preventing monopolistic or even oligopolistic pricing as currently exists with card-based transactions.

Precisely because of its proven ability to serve all financial institutions as it does now with checks, ACH and wire transfers, the Federal Reserve is best positioned to hasten the universal adoption of the Proposed Improvements which is clearly a public benefit that can only be affected by the Federal Reserve.

- Three, the service should ensure full recovery of costs over the long run.

The full value of the Proposed Improvements to the Payment System will not be realized until it is fully implemented as was the case regarding Check 21. The *Federal Reserve's linking together all banks in the nation's financial system* and playing an operational role will accelerate the adoption and ultimate cost recovery. *The Federal Reserve's track record in achieving its cost recovery goals* has been good according to a 2016 GAO study (covering 1996-2015), and the accounting system used by the Federal Reserve reasonably imputes the costs. There is every reason to believe that the Federal Reserve can accurately model and recover the costs of the Improvements to the Payments System in the long run as is required.

## **Federal Register Notice Discussion Questions**

The above thoughts serve as context to CBAI's responses and recommendations to the following Discussion Questions published in the Federal Register.

Questions 1 and 2 – Is RTGS an appropriate strategic foundation for interbank settlement of faster payments and should the Federal Reserve develop a 24x7x365 settlement service?

CBAI answers both questions with an enthusiastic “Yes”. RTGS is the required foundation for faster payments which is at the heart of necessary improvements to the Payments System for the United States to not fall behind the rest of the world and to meet current and future consumer expectations. The Federal Reserve is the logical choice to lead this effort to develop and implement the Proposed Improvements as it fulfills its statement of function and Payment System Policy Statement.

Question 3a - Will there be sufficient demand for faster payments in the United States in the next ten years?

If the rapid development of financial technology firms (“Fintechs”) is a guide – which we believe it is; and the positive experience of financial service providers here and around the world in implementing alternate payments systems is an indication of the rapid rate of adoption of this new technology – which we also believe it is; then there will undoubtedly be sufficient demand for faster payments in the United States in the next ten years (and beyond) to support the Federal Reserve’s Proposed Improvements.

CBAI acknowledges the need for the Federal Reserve to satisfy its ten year cost recovery requirement, which we believe is reasonably achievable, before a new service or major service enhancement like the Proposed Improvements can be developed and implemented. CBAI highlights the other required criteria which we believe the Federal Reserve can also satisfy, as the service is one that other providers, alone, cannot be expected to provide with reasonable effectiveness, and the service will yield a clear public benefit.

Question 3c – What is the ideal time to market? When will it be too late?

CBAI believes the ideal time for the Federal Reserve to deliver the Proposed Improvements to market is as soon as is practically possible and that it not too late for the Fed to fulfill its important mission. While CBAI appreciates the thoughtful and inclusive approach the Federal Reserve has taken in the exploration of faster and more secure payments, NOW is the time for the Federal Reserve to move forward with implementing the Proposed Improvements.

Question 3e – regarding required industry adjustments and operational burden.

CBAI believes the financial service industry, including community banks, has and will continue to make the required adjustments to meet the demands of its customers. There is abundant evidence of successful adaptation in the face rapidly changing technology, customer preferences and new products and services. Examples of these positive reactions to change include: ATMs, telephone banking, Check 21, internet account access, remote deposit capture, electronic delivery of statements, mobile banking including P2P and P2B, and many others. While there is no practical alternative to making the required adjustments, we do not expect the burden associated with the Proposed Improvements to be unreasonable if they are implemented in an appropriate manner.

The Federal Reserve must lead the way forward as it has done in the past in the evolution and operation of the Payments System. Community banks in particular are not in control of the development and delivery of their various technology platforms; they must rely on core processors and peripheral service providers. While these firms provide a vital service to community banks, they may not be as responsive to changes in the Payments System as will be required to support the rapid adoption of the Proposed Improvements by community banks. We urge the Federal Reserve and the other banking regulators to use their influence to impress on the core processors and peripheral service providers the need to be responsive to the needs of community banks in rapidly adopting the Proposed Improvements. The unfortunate consequence of not exerting this influence will be community banks that are willing and otherwise able to adopt the Improvements but unable to do so because their processors will not be able to provide the required support.

Questions 3f-i – Is a proxy database or directory that allows faster payment services to route end-user payments using the recipient’s alias, such as email address or phone number, rather than their bank routing and account information, needed for RTGS? How should such a database be provided to best facilitate nationwide adoption? Who should provide this service?

CBAI strongly believes the Federal Reserve must provide an open and interoperable directory service (database) that payment and financial service providers and financial institutions can access to determine how to route a faster payment. This directory would allow payments to perform as text messaging does now where individuals can send and receive text messages, regardless of the carriers used on either end of the text message.

If the Fed does not provide a directory service in which all faster payment solutions can integrate, the ability to determine how to access consumer accounts will be controlled by a single solution provider. Community banks will lose choice and innovation will be hampered. We believe such a directory is vital for establishing interoperability. It would provide all institutions access to real-time payments — regardless of their solution — further encouraging the adoption of real-time payments among all financial institutions.

Question 3g – How critical is interoperability between RTGS for faster payments to achieving ubiquity?

CBAI believes interoperability is the linchpin for the kind of faster payments ecosystem the Federal Reserve envisions and helps provides for a level playing field for community banks.

Currently, there are multiple P2P payment solutions in the marketplace and none are interoperable. To illustrate, P2P solutions like SHAZAM BOLT\$ are often denied routing P2P transactions to DDA accounts at large financial institutions. This effectively requires that their customers use the large institution's P2P solution to meet their payment needs. It is critical the Federal Reserve understand that the faster Payments System, as it currently exists, is fragmented. This fragmentation restricts access, limits competition and creates a burden for community banks. As a result of this fragmentation, many community banks, in order to serve their customers, may be forced to sign up for an option, like Zelle®, which is owned by the nation's largest banks. Obviously, this relationship presents tremendous risk to community banks, as taking this step will provide customer information to a consortium of the country's largest institutions. We do not believe it is acceptable for community banks to be forced to "default" to using these applications and technologies to meet the needs of their customers. If this occurs, community banks will lose choice and innovation will be hampered. Some would argue that allowing, or even promoting, this relationship is advantageous as it helps achieve ubiquity. However, if ubiquity is achieved by forcing community banks to use the large bank consortiums then the nation's payment needs are not properly being served. Only ubiquity obtained through multiple service provider interoperability properly serves the nation's payment needs.

Questions 4–7 – regarding liquidity management tool.

CBAI believes RTGS will require the support of a liquidity management tool ("LMT"), and as a result, there will be sufficient demand for the service. The Federal Reserve providing the service that accommodates the inevitable shortage/excess of funds with 24x7x365 settlement is a logical choice as the Fed will be providing the RTGS which necessitates the LMT. The LMT should be made available as needed which will be dependent on the construction of the RTGS system. The Federal Reserve performing these multiple functions will promote ubiquity and the more rapid adoption of the Proposed Improvements.

## **Conclusion**

CBAI appreciates the opportunity to provide our thoughts regarding potential Federal Reserve actions to support interbank settlement of faster payments. CBAI supports Payments System improvements that are progressive, competitive and secure, and that offer fair and open access to all community banks regardless of size, charter type or location so they can meet the existing and evolving payment needs of their customers and communities. The Federal Reserve has

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historically been and remains a critically important point of access to the Payments System that must be available to every community bank. The Fed's Proposed Improvements are entirely consistent with its mission and should be immediately developed and implemented. If you have any questions, please feel free to contact the undersigned at 1-847-909-8341 or at [dauids@cba.com](mailto:dauids@cba.com)

Sincerely,

/s/

David G. Schroeder  
Senior Vice President  
Federal Governmental Relations