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Ann Misback  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20551  
[regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Re: Docket No. OP-1625

Dear Ms. Misback:

The Credit Union National Association (CUNA) appreciates the opportunity to submit comments to the Board of Governors of the Federal Reserve System (the "Fed") in response to the request for comment regarding potential Fed actions to support interbank settlement of faster payments. CUNA represents America's credit unions and their 110 million members.

### **Summary of CUNA's Comments**

- CUNA supports the Fed developing a real-time payments network;
- The Fed's real-time payments network should be interoperable with private sector real-time payments rails;
- The Fed should require all financial institutions to develop the capability to receive payments from the Fed's real-time payments network;
- The Fed should develop a liquidity management tool that is robust and can support other payments types such as automated clearing house (ACH);
- The Fed should continue to develop and support legacy payments systems; and
- The Fed should communicate a decision quickly on whether it will develop a real-time payments system and interoperability, as a lack of clarity risks freezing the market.

## **Background**

CUNA supports the Fed's continued leadership in convening a diverse group of payments stakeholders to work together on improving the U.S. payments system. This effort has facilitated dialogue that will shape the future of the payments system by improving speed and security. The Fed's sponsorship of the Faster and Secure Payments Task Forces, the governance Framework Formation Team and the Faster Payments Council demonstrates the Fed's strong commitment to ensuring that the U.S. payments system continues to develop and tackles the important issues of speed and security.

As CUNA continues to participate on the Fed's various task forces and engages in dialogue with our members and stakeholders that support our members, it has become clear that there is a role for the Fed to play in a new real-time payments system or payments "rail." This position was reflected in the April 18, 2017 letter sent jointly by CUNA, the National Association of Federal Credit Unions (NAFCU) and the Independent Community Bankers of America (ICBA) to key Fed leadership including then-Vice Chairman Powell and President and CEO of the Kansas City Federal Reserve Bank Esther George asking for the Fed to explore a role in providing and/or supporting faster payments for financial institutions.

This letter asked the Fed to consider three possible operational roles beyond settlement capability. These were to serve as an on-ramp to real-time payments, to serve as an operator, such as it does currently for ACH and wire transfers, or to operate a payments directory linking to financial institutions as well as other private sector payments directories. These roles are similar to those the Fed currently plays in providing integrity, safety, transparency, equitable access and ubiquity among all financial institutions regardless of size and sophistication for checks, ACH payments and wire transfers. This is a key role that the Fed is also uniquely positioned to fill in a real-time payments system.

We are aware of several real-time or near real-time payments systems that are operational or near operational, some of which have embraced credit unions and CUNA's participation as they build out their systems. CUNA's concern is that these private sector solutions may not be able to reach ubiquity, which we believe is the single most important issue in the development and operation of a real-time payments solution. It is very likely that ubiquity cannot be reached without Fed involvement, as there are challenges to achieving ubiquity that the private sector likely cannot overcome.

## **CUNA's Comments to the Fed's Published Request**

This comment letter will focus on the topline questions asked by the Fed as they impact support for a real-time payments network and a liquidity tool. As stated above, the single most important issue for all credit unions is practical access to a real-time payments network that is ubiquitous in operation. It is possible that there are other paths to ubiquity; nonetheless, ubiquity will require not only theoretical access by

all financial institutions to a real-payments network, but access at reasonable cost per transaction without undue technical burdens, e.g., complexity, upfront implementation cost or ongoing support challenges.

Credit unions are diverse financial institutions that vary greatly in size, product offerings, resources and technical sophistication to implement new technologies. Most credit unions- regardless of size- rely on vendors and partners to implement, support and provide technology for many of their operations; payments and liquidity are frequently among the areas of focus. The Fed should ensure that it develops its real-time payments network with industry service providers' role in mind, to ensure that credit unions have a clear path toward implementation. This is true for both the payments network and liquidity tools that CUNA supports the Fed developing.

The Fed must also ensure that any system it develops is cost competitive with other types of payments, such as ACH, or adoption will be slow and ubiquity difficult to achieve.

### **The Fed's Solution Must Be Ubiquitous and Interoperable with Other Networks**

Any real-time payments network developed by the Fed must be ubiquitous and interoperable with other real-time payments rails. A top priority for credit unions is access to a real-time payments network on equal terms with other financial institutions. CUNA's members feel strongly that the best chance for credit unions to ensure access is for the Fed to develop and operate a real-time payments network that is both ubiquitous and interoperable with other real-time payments systems. Ubiquity ensures that consumers and businesses will realize the benefits of seamless transactions without worrying what system the receiver of a payments system<sup>1</sup> is using. Interoperability will further ensure that private market solutions can compete with the Fed solution, fostering both innovation and fair pricing- as usually happens in a competitive marketplace.

Ubiquity will be difficult to achieve without interoperability. We are aware of one real-time payments operator that claims the ability to reach 50% of all transaction accounts by the end of 2018. This early market penetration is driven by a handful of large banks which hold a disproportionate share of deposit accounts. This makes achieving a conceptual 50% penetration metric relatively simple. Enabling the remaining 50% will be exponentially more difficult, as each smaller financial institution delivers far fewer accounts. Bear in mind that the solution in question still faces the task of building connectivity to an additional 99.75% of U.S. financial institutions.

Even at the handful of large financial institutions currently enabled for real-time payments, actual volumes are exceedingly small- amounting to no more than "pilot" levels- and heavily concentrated in large-dollar business-to-business transactions. Building commercially viable volume levels- particularly for C2B, B2C and C2C use cases- will be heavily dependent on ubiquity, so that payors can transact with

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<sup>1</sup> One must look no further than major P2P providers where lack of interoperability makes it impossible to transfer funds between providers and thus requires both parties in a transaction to use the same provider.

confidence their payee can be reached. This is highly unlikely to occur as long as half (or even 20-30%) of U.S. accounts are not part of the network, reinforcing the argument for both a Fed role and for interoperability.

Interoperability with this nascent system- and any others that may eventually come online- would make adoption faster and the ability to reach ubiquity more likely. One concern that Fed staff and our members share is whether the Fed's signaling potential market entry as a real-time payments operator could "freeze" the market, causing possible participants not to develop products, or causing financial institutions to postpone decisions as they wait for the Fed. We believe a clear commitment to interoperability will not freeze the market for adoption of existing systems, as financial institutions will be able to move confidently toward adopting a current real-time payments solution with the knowledge that it will be interoperable with a Fed solution. Furthermore, interoperability of real-time payments networks will create competition- leading to innovation and cost reductions- as operators will be motivated to differentiate their offerings.

Although we see interoperability as critical to ubiquity, many of our members have suggested that the Fed could further spur ubiquity by requiring all financial institutions to establish the ability to receive payments from a Fed real-time payments network. This requirement would signal to the market- particularly vendors- that financial institutions must have real-time payments capability and therefore must develop and implement updates to current systems to foster receipt of such payments. This would ensure that all consumers could receive real-time payments but would leave to market discretion the means of transmission.

CUNA remains concerned about the terminology of some entities suggesting the Fed should operate an "open" payments system. Interoperability is not necessarily synonymous with an "open" system, which implies availability to any player. We believe interoperability should only be available to real-time payments network operators meeting strict requirements encompassing security, reliability and transparency. Again, such criteria would be consistent with those employed by the Fed regarding access to existing payments systems.

### **Fed Must Communicate a Decision on Strategy Soon**

Time to market is important for a Fed real-time payments solution; however, the Fed's decision to enter the market with firm commitments on its major details is even more central to moving the market toward faster payments in an orderly manner. Uncertainty in Fed direction poses the greatest risk of a market freeze or inefficient use of resources, as early market entrants would risk incurring additional development costs to meet future requirements.

Decisions on key details such as interoperability, settlement and the development of a liquidity management tool by the Fed are just as important as speed to market with a real-time payments solution. Because CUNA supports interoperability as the best way to achieve ubiquity, and the fact that the Fed's decisions will be the most influential

given the private market's need to work with the Fed, private sector solutions will be hamstrung in development and use until the Fed announces its plans.

Also, firm commitment regarding the Fed's liquidity management tools will likely be necessary for the development of real-time payments across all financial institutions, because some institutions will likely need such tools before they can offer real-time payments.

### **RTGS is the Best Option for Settlement**

CUNA agrees with the Fed's assessment that Real Time Gross Settlement (RTGS) is the best method for interbank settlement of real-time payments. RTGS will likely prove more efficient than the Deferred Net Settlement (DNS) option, and reduces risks from delayed or mismatched settlement times that may occur because of a shorter settlement period.

On the downside, the RTGS approach will drive additional liquidity needs, which are likely to disproportionately impact smaller institutions and potentially impede their willingness to market real-time payments services to their consumer and business customers. This reinforces the need for the Fed to also develop a liquidity management tool to complement and facilitate real-time payments capability.

Credit unions have voiced concern over the need to set aside additional funds (at potential opportunity cost to net interest income) to ensure sufficient liquidity for real-time transactions outside traditional banking hours. In an increasing number of communities, small institutions are the primary and/or sole source of banking services to the population. This fact amplifies the need to make the implementation of real-time payments feasible for the institutions serving these communities, otherwise we risk creating a two-tiered system of access similar to the dilemma regarding high-speed internet access that plagues economic development in some small towns.

### **Credit Unions Support a Fed Liquidity Management Tool That Incorporates Third Party Servicers Such as Corporate Credit Unions**

The Fed should develop a liquidity management tool that meets the needs of all financial institutions. This tool must be flexible and robust enough to support enhanced settlement for any payment type and support credit unions and community financial institutions that engage a correspondent financial institution such as a corporate credit union or bankers' bank.

CUNA is not commenting on whether the use of a separate account or sub-account is preferable for clearing and settlement. We do suggest, however, if the Fed requires a second account, the Fed's automated tool should be capable of automatically moving funds between the master and separate accounts when certain thresholds are hit. There should also be a credit line from the master account available to cover the separate account to avoid overdrafts of either account.

The Fed should consider these two accounts in aggregate for reserve balance requirements, interest calculation and overdraft prevention, otherwise the complexity and cost for these operations will increase. Liquidity management rules will need to be changed to address new risks related to RTGS, including new controls. Our credit union members have expressed concern over the additional liquidity requirements likely to be driven by real-time payments, and their likely disproportionate impact on smaller institutions. Steps should be taken to limit this burden, potentially including relaxation of short-term borrowing rules.

### **Small Institutions Have Resources Constraints Which Must Be Considered**

Although we believe that 24x7x365 availability is an essential feature of a successful real-time payments system, it is also true that smaller credit unions (and banks) are not presently staffed to support such capabilities. These institutions will face additional costs in establishing real-time payment processes, particularly in the areas of fraud prevention and liquidity. For this reason, simplicity will be a key to any solution. If the cost/effort is deemed too onerous, small financial institutions could elect not to adopt, thereby impeding the goal of ubiquity. Assuming financial institutions price these services to recoup incremental costs, higher price points could also become a barrier to broad market adoption. It seems plausible that many FIs will elect a service bureau model- such as through a corporate credit union- to address "after hours" needs. Any solution should accommodate enablement of such a model.

### **Fraud is a Concern for Credit Unions**

Fraud, in particular, is a concern of small credit unions, as the downside of faster payments is a limited timeframe to react- particularly if "payment finality" is a feature of the scheme. Again, this concern could become a barrier to ubiquity and must be addressed. Fortunately, the "credit push" model alleviates these concerns to some extent. In the interest of ubiquity, the Fed should consider making receipt of real-time payment transactions mandatory for all financial institutions- similar to the Same Day ACH model- at least after a "proving period." Institutions would retain discretion on whether to initiate payments, however.

### **Rules Need to Be Modernized for the Real-time Payments World**

As real-time payments are rolled out, it will also be necessary to revisit and likely revamp various regulations to account for the new operating environment- credit unions have pointed to Regulation D, Regulation E and daylight overdraft rules in particular. Such issues will need to be addressed even if the Fed elects not to embrace an operator role.

### **Conclusion**

We encourage the Fed to move forward as soon as possible on the development of a real-time payments rail and liquidity management tools. Quick action by the Fed will help credit unions plan for the future as they explore offering real-time payments to members. Furthermore, looming decisions by the Fed are likely to adversely impact the nascent market by slowing development.

Should you have any questions about CUNA's comments, please feel free to contact me at 202.508.6705.

Sincerely,

Lance Noggle

Senior Director of Advocacy for Payments and Cybersecurity and Senior Counsel