



BANKERS' BANK OF THE WEST

December 14, 2018

Via Email: regs.comments@federalreserve.gov
Ms. Ann Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Regarding Docket No. OP-1625, Interbank Settlement of Faster Payments

Dear Ms. Misback;

Bankers' Bank of the West and the 71 community financial institution signatories to this comment letter (collectively "Responders") appreciate the opportunity to comment on potential actions of the Federal Reserve Bank to support interbank settlement of faster payments. The Responders agree, as the Federal Reserve Bank asserts, the expectations for payments (both business and consumer) are in flux and developing. Users have pinned their hopes on a faster system that's easy to use and readily available. We believe now is the time to make real time payments a priority for the U.S. An advance of this magnitude will improve the country's payment system and establish the infrastructure to support economic progress.

The Responders are supportive of the Federal Reserve playing a role in the evolution toward faster payments in the U.S. as proposed in the October 3, 2018 Federal Register Notice.

Introduction

Bankers' Bank of the West has been a partner to hundreds of community financial institutions for over 38 years, providing solutions across all U.S. payment systems, allowing those financial institutions to remain competitive as the market evolves, while maintaining a proud legacy as a champion of community banking. Community financial institutions have relied on bankers' banks, corporate credit unions, and other correspondent service providers as trusted partners. Bankers' Bank of the West is one of 12 Bankers' Banks in the nation that collectively serve the correspondent banking needs of approximately 5,000 community financial institutions across the U.S.

Part of the role played by Bankers' Bank of the West with its respondent financial institutions is in assisting and managing credit risk and liquidity through avenues such as daily transaction settlement, pass-through reserves, and excess balance account agent with the Federal Reserve.

From the perspective of a fully engaged participant in the Federal Reserve's Faster Payments Initiative, Bankers' Bank of the West endorses working with the Federal Reserve for real time payments and recommends its inclusion in an operational role. The involvement of the FRB, with its

unparalleled role in ensuring a safe, flexible and stable financial system, is believed necessary to ensuring fairness and maintaining public confidence in the U.S. payment system.

The emergence of faster payments is of interest to our respondent community financial institutions, which principally operate in the Rocky Mountain, Southwest, and Great Plains regions – 24% of states in the U.S. These respondents are diverse in terms of asset size, charter type, geographic location and business focus.

Comments on Actions to Support Interbank Settlement

There are many considerations regarding the Federal Reserve's involvement in faster payments. While efforts in this matter have been ongoing for some time, there is a significant knowledge gap for many smaller financial institutions that may not have had the resources or awareness to dedicate to this topic. This comment letter is representative only of Bankers' Bank of the West and other signatories, however we believe the general opinions of community financial institutions are reflected in the following three sections.

The Federal Reserve Should Play a Role in Faster Payments Settlement

The Federal Reserve already has connections with all financial institutions and processors. It is currently providing payment service to more than 11,000 financial institutions across the U.S. and is the only provider of interbank settlement functions for every financial institution. This reflects a benefit to all participants in the payment system by limiting monopolistic and/or quasi-closed network systems that inhibit the ubiquity of faster payments. So, while the private sector has the ability to implement faster payments solutions, its role as gatekeeper may prove more limiting to achieving the goals of the Faster Payments Initiative. Moreover, a private sector led solution may result in more barriers to the ubiquity of access and interoperability of systems for the marketplace.

Further, community banks currently have no meaningful role in rule-making, pricing, and interoperability determinations. This lack of diversity and transparency will degrade both the payments industry and the public's confidence in it. The market needs real choice and the Federal Reserve's involvement will evoke confidence in the system, as seen in countries that have adopted faster payments that show generally increasing consumer acceptance. U.S. consumers would reasonably be expected to respond to such a system.

There is precedent of the impact of the Federal Reserve's involvement in emerging payment systems that further supports the benefits of its involvement in faster payments:

- For ACH transactions, both the Federal Reserve and the Electronic Payments Network owned by The Clearing House provide ACH payment networks, allowing for widespread access to this payment network and reasonable costs for participants.
- The Federal Reserve did not play the same role in the evolution of the card payment network, which evolved from large banks offering an "open-loop" solution. The card network evolved into the four major card providers that offer member-only interoperability to merchants that to access multiple networks. Those providers also dictate pricing and rules and control where credit cards can be accepted, with preference accessible to larger retailers. It is only now that we are seeing an emerging network that does not rely on one of these providers.

Additionally, one of the concerns of having only limited, private sector providers is that it eliminates any public sector anchor to the payment system. Such an anchor was critical following the attacks of September 11 at which time the Federal Reserve was able to provide billions in liquidity to the banking system. In addition, private providers would be able to perform data mining on transactions, thereby limiting data privacy for customers of smaller financial institutions.

Implementation of a Real-Time Gross Settlement ("RTGS") could impact the current momentum of faster payments by starting the process well after some of the private sector solutions. However, RTGS should benefit the U.S. payment system and in the long-term ultimately all participants by providing greater accessibility to innovators. This will enhance the efficiency and interoperability of the network and increase provide non-bank solutions for the unbanked and underbanked populations of the economy. In addition, some of the more notable faster payment solution providers are behind in their own development and implementation. This means the momentum impact may not be as significant as previously thought and the Federal Reserve's participation would likely accelerate implementation of such a system across the U.S. The Federal Reserve already effectively manages a RTGS system for wire transfer, for which it is the only centralized provider.

A key benefit of RTGS implementation is avoidance of interbank credit risk by aligning the speed of interbank settlement with the speed of underlying payments, in contrast to the Deferred Net Settlement ("DNS") used by ACH and check images. RTGS will enhance the overall safety of the U.S. faster payment market, and the Federal Reserve's participation can provide a parallel system to the private sector, resulting in much-needed redundancy and resiliency.

The Federal Reserve should make this a strategic priority with the goal of being up and running within five years, including evaluation of its role, system design, and cost evaluation. The cost and timeline of implementation is difficult to determine. However, realization of Check 21's true value was not fully manifested until some years after implementation, once market efficiencies and complementary products and services emerged, accelerating cost recovery. The Federal Reserve has every reason to expect that a well-constructed, real time faster payments system will yield a complete recovery of its cost within a reasonable time after the system is implemented.

The Federal Reserve delaying or not participating in faster payments will discourage community financial institutions from offering new products and services based on a new real-time rail, putting them at a disadvantage. However, a Federal Reserve RTGS creates a nationwide routing and transit interbank settlement infrastructure that supports the development of private sector faster payment services. The will increase innovation and choice in the market, ultimately benefitting all participants by lowering costs, increasing choice, and improving quality.

For RTGS, we believe an account at the Federal Reserve separate from the financial institutions' master accounts provides the most effective solution for faster payment participation. It allows for correspondent service providers to manage transactions for financial institutions that are not members of the Federal Reserve, thus promoting wider participation and implementation from the industry.

The private sector cannot reasonably be expected to effectively provide faster payments with real-time settlement on its own. The Federal Reserve has capability to reach and equitably serve financial

institutions, regardless of size, charter type, or location. Security, integrity, and fairness of any new payments system offer additional benefits that only the Federal Reserve is in the position to prioritize above shareholder returns and market share.

The Federal Reserve Should Provide a Liquidity Management Tool as part of RTGS

For community financial institutions to remain competitive and profitable within faster payments on a real-time basis, a Liquidity Management Tool ("LMT") should be an option available to manage intraday balances outside of normal operating hours. As the use of faster payments expands, financial institutions will have to adapt to the needs of their customers to insure adequate funding is available at all times. As this normalizes, it may be easier to determine how much funding is necessary overnight or on a weekend, just as community financial institutions do today with ATMs. However, during the adoption phase, or for unexpected events, financial institutions' access to a LMT will prove invaluable from a reputational standpoint.

This LMT can take several forms. They include allowing financial institutions, or their agent, to originate a transfer on behalf, a tool that allows an automatic transfer of balances (or "sweep") based on pre-established thresholds and limits from another account at the Federal Reserve, or daylight overdraft related to current payment system risk limits or discount window collateral.

Regarding liquidity management, the needs of smaller community financial institutions are dissimilar in many ways from those of larger institutions. Having access to the Federal Reserve as an operator is critical to community banks and credit unions seeking to manage their settlement without surrendering control to bigger financial institutions. The option of working with the Federal Reserve directly (or indirectly through its chosen correspondent) will empower the community financial institution to effectively handle its 24x7x365 liquidity needs, to direct balances to be used for reserve requirements, and to earn interest on static balances.

Any LMT must operate on the same 24x7x365 basis as RTGS. Financial institutions are generally not staffed overnight or on weekends, and payments during those times may have a delayed effect on the financial institution's ability to fund deficiencies, resulting in reputational risk for both the institution and payment system.

Creation of a LMT could also be implemented to support Same Day ACH, especially financial institutions in the western U.S. time zones.

The Federal Reserve Should Consider Auxiliary and Service Options and Other Approaches in Support of Faster Payments and Other Areas of the U.S. Payment System

In our opinion, a proxy database or directory is not a requirement for a 24x7x365 settlement system. It is, however, a requirement for ubiquitous, real-time, end-user to end-user credit push payments. Currently, payment initiators must know, or have access to, the bank account information for every person or business. This requirement can be alleviated and reduce fraud potential through comprehensive databases or directories. It is a large task to create, maintain, and achieve, but existing efforts by the Federal Reserve, NACHA, and others that may be leveraged.

Fraud prevention services are necessary in all payment scenarios including faster payments and 24x7x365 RTGS settlement services. Participation by the Federal Reserve in the process does not

put the onus on it for prevention and early detection, but rather allows for more private market innovation by smaller providers of solutions for consumers, business users, financial institutions, and other application developers. Part of this is the notification process that alerts the user when the payment is issued. This enables the earliest possible detection of unauthorized debits since the user is in the best position to recognize an unauthorized payment.

Implementation of a proxy database or directory and/or fraud prevention services is not dependent on the Federal Reserve's participation in the settlement of faster payments. However, ease of use and payment risk threaten the wider acceptance of faster payments solutions, and risk diminishing trust and usage of the new system.

Other areas of the U.S. payment system the Federal Reserve should consider:

- The initial focus of the faster payments initiative is domestically based and will likely take years to evolve. If the Federal Reserve chooses to be involved in the processing and settlement, it should develop systems to also work for international payments.
As with wires, International payments require greater compliance and may result in new regulations. Building the system with that in mind will ease the expansion and allow financial institutions to better prepare for it along the way.
- As indicated in the LMT comment, expansion of the timeframes for Same Day ACH would be a benefit to western financial institutions and provide greater access for current users of that payment system.
- Solutions for the transmission and protection of data are ever evolving. As blockchain and distributed ledger technology evolves, there is a need for centralized validation. This technology may be used for faster payments or existing payment systems. Either way, public sector validation and oversight instills confidence in the system.

Conclusion

The vision and leadership of the Federal Reserve System deserves enormous credit for instigating the headway made thus far toward transforming the U.S. payments system and progressing to faster payments. Through sponsorship of the Faster Payments Task Force and the Secure Payments Task Force, the Federal Reserve and Board of Governors focused the financial services industry on laying the groundwork needed to transform the payments system. While the Task Force efforts were successful, the large format, size, and complex logistics was not sustainable for ongoing governance. This might make it difficult to effectively convene joint Federal Reserve and industry teams regarding liquidity management, interoperability, accounting processes, or payment routing. Industry input is useful, so long as it is impartial to a specific sector or business.

At this critical juncture in evolution of the U.S. faster payment system, activity and competition among private sector solution developers and providers is building momentum. Widespread adoption of faster payments appears to be just around the corner. The pivotal issue has yet to be resolved: Can the essential qualities of ubiquity and interoperability in faster payments be achieved without the participation of the Federal Reserve?

- The Federal Reserve's late decision to be involved may slow the faster payments momentum in the U.S. but should also stimulate greater long-term private sector innovation in this space and instill greater confidence and adoption in the system.
- The Responders are convinced the Federal Reserve must create a mechanism capable of interfacing with other faster payments solutions, facilitate settlement that can be utilized by legacy U.S. payments systems as well as new and emerging providers, and enable community financial systems to do business safely and cost-effectively.
- Ubiquity is improbable without the Federal Reserve's full participation as an operator providing RTGS and tools for liquidity management.
- As part of the development of RTGS and LTM, the Federal Reserve should assist in the development or administration of a payment database or directory; implementation of fraud prevention services; providing capability for cross-border faster payments; evolving modern technologies; and providing for the interoperability of the faster payment system with others used both domestically and overseas.

Bankers' Bank of the West and the signatories to this comment letter appreciate the opportunity to share our thoughts and would be happy to discuss our comments in further detail.

Sincerely,



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