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Via Email

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

Re: Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments, Request for Comments (Docket No. OP-1625)

Dear Ms. Misback:

The Board of Governors of the Federal Reserve has requested comment on potential actions that the Federal Reserve Banks could take to promote ubiquitous, safe, and efficient faster payments in the United States by facilitating real-time settlement. TransferWise appreciates the opportunity to respond to the Request for Comments (the “**Request**”) and to share its experience as the first non-bank member of the UK’s Faster Payments Scheme and the first non-bank to maintain a central bank account for settlement at the Bank of England.

Background

TransferWise is a financial technology company that was created in 2011 by Taavet Hinrikus, the first employee of Skype, and Kristo Käärmann, an ex-Deloitte consultant, out of their personal frustration with unfairness in international money transmission. Since that time, TransferWise has raised more than \$397 million from investors such as Andreessen Horowitz, Sir Richard Branson, and Peter Thiel, the co-founder of PayPal.

TransferWise addresses the challenges and costs associated with international money transmission — specifically the lack of transparency regarding fees and the calculation of foreign exchange rates — as well as the reliance on inefficient systems and technology. In

response to these issues, TransferWise operates a robust international money transfer and multi-currency account product that offers fair exchange rates and a transparent fee structure, and that uses onshore liquidity when possible through multilateral netting. It also it offers modern technology, sound customer service practices, and manages with care liquidity, compliance and other risks.

Each month, the TransferWise group handles over \$4 billion USD equivalent in monthly transaction volume for over 4 million customers worldwide, with approximately \$800M in monthly USD volume alone. More importantly, Transferwise estimates that it saves customers over \$1 billion dollars per year in fees as compared to traditional means of international money transfer. TransferWise has over 1400 employees and nine offices, including sizable offices in New York and Tampa.

General Comments

TransferWise recognizes that establishing a faster payments system has been a priority for the Federal Reserve since it established the Faster Payments Task Force in 2015. However, despite various initiatives, no such ubiquitous system has materialized. As the Request mentions, this means that the US, which is generally technologically advanced, has fallen behind other countries.¹ Thus, we are pleased to see that the Federal Reserve is prepared to play a strong role in the creation of a faster payment scheme and wish to comment on the importance of: (i) faster payments for the public benefit, and how that can be achieved; (ii) accessibility and the inclusion of non-banks in a faster payment system, (iii) moving toward a real-time 24x7x365 system and the elimination of credit risk, while appropriately addressing liquidity risk, and (iv) interoperability.

Public Benefit

As we move toward a more digital, less cash-oriented society, something that regulators are generally in favor of in terms of increased tax collection and enhanced fraud prevention, consumers need the protection of a payment network that works for them — and not only financial services companies. The system to support consumer payments today is complicated and slow, and imposes punitive fees that consumers in many cases cannot understand or avoid, such as fees for overdraft, overdraft protection, bounced checks, and collections. In addition, banks do not pay customers interest on their money while it is in transit, even though those funds still remain on a bank's balance sheet, and banks charge large fees for wires, the current

¹ For example, the UK launched its Faster Payments Scheme (FPS) in 2008, which enables payments to be made on a 24x7x365 basis. Similarly, India launched its 24x7x365 electronic funds transfer service, Immediate Payment Service (IMPS), in November 2010, the Single European Payments Area Instant Credit Transfer (SCT Inst) scheme launched in Europe in 2017, and Australia rolled out its own New Payments Platform (NPP) faster payments system in February of 2018. Other nations — including Belgium, the Democratic Republic of the Congo, Hong Kong, Malaysia, Portugal, Slovenia and Spain — also have plans for their own faster payments systems later this year or next year. Even more countries, including France, Hungary and the Netherlands, have announced that their own national offerings will be live by 2019, and Colombia and Peru are also exploring launching South American faster payments schemes next year.

faster method of payment. For these reasons, banks may not have the correct incentives to pass along the benefits of speed, and indeed, competition has not flourished in this area. In order to ensure that the public benefits from a faster payments system, TransferWise strongly supports the Federal Reserve playing a key leadership role, as central banks have done successfully in other jurisdictions.

Accessibility

TransferWise supports an RTGS system as the strategic foundation for the settlement of faster payments so long as membership opportunities include non-bank financial institutions. As the Request points out, trends in society and commerce have evolved as a result of technological advances, and non-bank financial institutions, in many cases, service those trends. Indeed, payment systems in many jurisdictions are modernizing and evolving their membership² and TransferWise and has been part of several important initiatives in this regard, including the rise of cross-border payments in the Single European Payment Area, the launch of the Australian Payments Network's New Payments Platform to enable faster payments, and the Bank of England's decision to modernize and open up its core systems. The latter culminated in TransferWise, in April 2018, becoming the first non-bank direct member of the UK's Faster Payments Scheme. To facilitate settlement in central bank funds, TransferWise also holds an RTGS account at the Bank of England.

There are several reasons for the trend toward inclusion of non-banks:

- Risk. Banks' size and interconnectedness can contribute to systemic risk, and when non-banks that are growing in size use banks to send their payments, this further concentrates risk. To make matters worse, it is often the case that only a few banks host all of the indirect non-bank participants. Moreover, direct access for non-banks fosters safety and soundness for their customers' settlement funds by avoiding bank credit and systemic risk and allowing for settlement in central bank funds.³ Finally, when a non-bank participant uses an intermediary to submit payments, this increases operational risks, as it must rely on its intermediaries' connection and resilience.
- Competition. In many respects, banks are subsidized by governments and insulated from competition, and exclusive access to payment systems is one of the ways competitors find themselves on unequal footing. When firms face excessive barriers to entering a market, competition stagnates, prices remain high and innovation remains low. In practice, banks are also often asked to both facilitate access to payment systems and to compete with challenger companies, creating further conflict and undue control

² For example, Payments Canada (*see*, Consultation on the Review of the Canadian Payments Act at <https://www.fin.gc.ca/activty/consult/rcpa-elcp-eng.asp>), the UK Faster Payments Scheme Limited (*see*, <http://www.fasterpayments.org.uk/membership/criteria-faster-payments-membership>), and Singapore's Fast and Secure Transfers system (*see*, <https://abs.org.sg/about-us/membership>). For some time, the international regulatory community has called for access to payment systems, to be "open and risk-based", which is consistent with CPMI-IOSCO's Principles for Financial Market Infrastructures (2013) (the "**PFMIs**"). *See* PFMI, Principle 18, Key Consideration 2 ("Subject to maintaining acceptable risk control standards, a [payment system, including generally those operated by central banks] should endeavour to set requirements that have the least-restrictive impact on access that circumstances permit.").

³ It is well understood and stated that in the PFMIs, that final settlement of obligations in central bank money reduces risk. PFMIs at Principle 9: Money settlements.

by the traditional financial services sector. This is inefficient, as transactions settled through an intermediary come with an increased cost for the end user.

- **Control.** When non-banks grow, they will need to undertake large value transfers and will need safe and inexpensive methods of doing so. For example, there is a possibility that non-bank payments companies will facilitate peer-to-peer corporate treasury FX transactions.⁴ In order to manage risk, these companies should be required to meet risk-related standards to join payment systems as direct members,⁵ and will in this way be contractually obliged to comply with the system's rules and standards, participate in loss allocations, and meet other requirements, and both the payment system and the member can communicate directly information about incidents and risks.

Response to Select Questions

1. Is RTGS the appropriate strategic foundation for interbank settlement of faster payments? Why or why not?

Yes. TransferWise agrees that payment systems are essential to support economic activity and therefore we strongly support a Federal Reserve-led RTGS solution. We recognize that other countries have chosen to implement "multiple batch" systems with clearing cycles that are designed in the same manner as traditional systems, but repeat many a times a day, for example the Interbanking Electronic Payment System (SPEI), of the Banco de Mexico clears low value transactions every 20 seconds during working hours and the UK Faster Payment Scheme currently batches payments in 20 minute windows. However, given the choice between a real-time system and a batching solution, we tend to believe that instant payments are consistent with modern technology and are where industry is headed. For example, the Eurosystem is developing the TARGET instant payment settlement (TIPS) service that will enable fund transfers in real time around the clock, 365 days a year. For these reasons, we believe that systems that cannot operate instantly, may not be worthwhile to develop, and a better project would be to work with participants in instant systems like Fedwire to understand how queing and backlog can be reduced and how liquidity issues can be addressed, while tightening the gap between end-user, clearing and settlement processes and eliminating settlement risk.

If the decision is taken to adopt a netting system, it should be created with tight batching windows that can be narrowed even further in the future to reduce settlement risk and push participants in the direction of addressing liquidity needs in an "instant" world.

⁴Basel Committee on Banking Supervision, *Consultative Document, Sound Practices: Implications of fintech developments for banks and bank supervisors* (August 2017) Page 6, Observation 6 ("in the payments and cross-border remittance businesses...the potential for [Fintech] firms to expand their cross-border operations is high.")

⁵ Currently, as implied through the Federal Reserve Act, nonbanks cannot make deposits or otherwise open or hold an account at a Federal Reserve Bank. Thus, if a Federal Reserve Bank is the settlement bank for a faster payments system, a nonbank would most likely not be able to directly settle payments sent through such a system as the law is written today.

2. Should the Reserve Banks develop a 24x7x365 RTGS settlement service? Why or why not?

Given that modernizing a payment systems is a significant industry and government effort that comes with significant cost, time, and risk, regardless of how it is undertaken, it should be done in a way that seeks to fully address all of the issues with the current system. Since commerce in the US is already operating on a 24x7x365 basis via technology, and many even small businesses operate across multiple time zones, business hours are conceptually obsolete, and we think that the Federal Reserve should aim for a payment system that keeps pace with those trends, and in turn eliminates settlement risk and addresses liquidity risk.

3. If the Reserve Banks develop a 24x7x365 RTGS settlement service,

- a. Will there be sufficient demand for faster payments in the United States in the next ten years to support the development of a 24x7x365 RTGS settlement service? What will be the sources of demand? What types of transactions are most likely to generate demand for faster payments?**

Yes. By way of example, the UK has had a faster payment scheme for more than 10 years, and it currently serves roughly 15 million members and has processed more than 9.1 billion payments since first going live. It is used to transmit over 1.4 billion payments valued at more than £1 trillion (\$1.32 trillion USD) each year⁶ and research predicts the size of the UK real-time payments market is likely to almost treble in the next five years.⁷

- b. What adjustments would the financial services industry and its customers be required to make to operate in a 24x7x365 settlement environment? Are these adjustments incremental or substantial? What would be the time frame required to make these adjustments? Are the costs of adjustment and potential disruption outweighed by the benefits of creating a 24x7x365 RTGS settlement service? Why or why not?**

Due to rapid technological change, consumers now expect almost everything to be available in real-time. However, a new system will still require adjustments to consumer behavior. Consumers are to some extent used to the idiosyncrasies associated with systems that are not instant (e.g., checks, ACH), for example it is sometimes possible to claw back payments when consumer are fraudulently induced to make them, or are later remorseful.

Therefore, although faster payments will ultimately benefit consumers in terms of better control over their funds, some education will be required. This may include proper education about the finality and speed of payments, and education may be necessary to aid ubiquity, since many consumers are used to a “pull” model of making payments (e.g., direct debit) and faster payments may require more engagement or encourage “push” payments. Credit-push payments allow the paying financial institution to authenticate the customer and confirm that

⁶ See, Faster Payments Statistics, at <http://www.fasterpayments.org.uk/statistics>.

⁷ Instant payments: What SEPA can learn from the UK Faster Payments experience, at <https://www.europeanpaymentscouncil.eu/news-insights/insight/instant-payments-what-sepa-can-learn-uk-faster-payments-experience>.

funds are available to support the transaction, thus creating a more predictable payment cycle from payer to payee.

Financial institutions and businesses generally will also need to adjust their practices as faster payments will require broad changes in both back and front office policies and practices and will have to be carefully thought through and implemented. However, making these adjustments will be worthwhile, as they will align businesses and financial institutions with commerce generally and connect them to wider digital transformation strategies. Financial institutions may choose to take a staged approach in their rollout strategies, to manage risk and fine-tune their systems and processes, but eventually, there are many risk management and efficiency benefits associated with real-time 24x7x365 payment systems.

- c. What is the ideal timeline for implementing a 24x7x365 RTGS settlement service? Would any potential timeline be too late from an industry adoption perspective? Would Federal Reserve action in faster payment settlement hasten or inhibit financial services industry adoption of faster payment services? Please explain.**

The US has not managed to develop a sufficiently ubiquitous faster payments service. This may well be because the no entity in the US other than the Federal Reserve has an RTGS system to power such a service. Therefore, the Federal Reserve should take action to lead in this area, taking into account the safety and soundness of systems and proper time to educate consumers. Currently, the Request states that “the Board is not committing to any further actions at this time or in the future,” (Request, at 12), but without commitment to action, it is difficult to see how the US will not fall further behind. One area for alignment could be with the payment system modernization in Canada, which is set for 2020 or 2021,⁸ so that all of North America (the Mexican system is complete) is on a faster payments rail.

- e. What incremental operational burden would banks face if a 24x7x365 RTGS settlement service were designed using accounts separate from banks’ master accounts? How would the treatment of balances in separate accounts (for example, ability to earn interest and satisfy reserve balance requirements) affect demand for faster payment settlement?**

There are likely good reasons to separate payment system accounts from master accounts, which may be used to hold liquidity for important purposes other than funding payments. With such a setup, a liquidity tool is likely to be helpful, whether it is in the form of overdraft protection or collateral.

- f. Regarding auxiliary services or other service options,**
- i. Is a proxy database or directory that allows faster payment services to route end-user payments using the recipient’s alias, such as e-mail address or phone number, rather than their bank routing and account information, needed for a 24x7x365 RTGS settlement service? How should such a database be provided to best facilitate nationwide adoption? Who should provide this service?**

⁸ The *Vision for the Canadian Payments Ecosystem*, at <https://modernization.payments.ca>.

In order to facilitate widespread adoption, the system should be created with the ability to address payments in a relatively simple way, such as to an email address or a phone number. This should be in addition to the existing model that requires the sender to correctly enter a bank account number and routing number, which is a series of digits. Additionally, a solution that is prepared for open APIs, and open banking more broadly, would be a logical step.

ii. Are fraud prevention services that provide tools to detect fraudulent transfers needed for a 24x7x365 RTGS settlement service? How should such tools be provided? Who should provide them?

Yes. Quick delivery of payments will not be a success if those payments are not secure, and in fact the speed of payments can easily become a disadvantage in cases of fraud. Many tools preventing fraud already exist and perhaps more are needed, such as mechanisms of confirmation of the payee, a strong liability model and good machine learning to protect consumers. There is an opportunity for financial services companies or overlay services to innovate and compete in this area and they should be encouraged to do so.

g. How critical is interoperability between RTGS services for faster payments to achieving ubiquity?

Interoperability is critical and adoption of global standards, such as ISO 20022, will reduce integration costs, and allow efficient interactions across financial institutions, as well as allow financial institutions to more effectively leverage data to run their businesses. Additionally, to help minimize the differences and friction associated with transacting in real-time around the globe, harmonized and consistent information should be present from payment initiation through reporting, regardless of region, currency, platform or channel. Finally, further regulatory changes for greater clarity are needed to alleviate the perceived burden on receiving depository financial institutions that clear and settle cross-border payments in a faster payments world.

h. Could a 24x7x365 RTGS settlement service be used for purposes other than interbank settlement of retail faster payments? If so, for what other purposes could the service be used? Should its use be restricted and, if so, how?

The system should be developed to work as broadly as possible and restrictions should only be risk based. Uses should include interbank wholesale settlement as well as all types of retail payments, for example in the way that Australia's new RTGS, the New Payments Platform (NPP), has been built to handle such payments.⁹

i. Are there specific areas, such as liquidity management, interoperability, accounting processes, or payment routing, for which stakeholders believe the Board should establish joint Federal Reserve and industry teams to identify approaches for implementation of a 24x7x365 RTGS settlement service?

As discussed in the responses above, there are challenges and non-bank and consumer advocates should be included in industry groups organized to meet those challenges.

4. Should the Federal Reserve develop a liquidity management tool that would enable transfers between Federal Reserve accounts on a 24x7x365 basis to support services

⁹ See, the New Payments Platform Page, <https://www.nppa.com.au/>.

for real-time interbank settlement of faster payments, whether those services are provided by the private sector or the Reserve Banks? Why or why not?

Yes. Especially if the settlement accounts in an RTGS are separated from the master accounts, or if DNS is used, then collateral accounts would potentially need handling during off-bank hours (e.g., a small financial institution that needs to handle increased payments over a three-day holiday weekend).

- 5. If the Reserve Banks develop a liquidity management tool, a. What type of tool would be preferable and why? i. a tool that requires a bank to originate a transfer from one account to another, ii a tool that allows an agent to originate a transfer on behalf of one or more banks, iii a tool that allows an automatic transfer of balances (or “sweep”) based on pre- established thresholds and limits, iv. a combination of the above, or v. an alternative approach. Would a liquidity management tool need to be available 24x7x365, or alternatively, during certain defined hours on weekends and holidays? During what hours should a liquidity management tool be available?**

While liquidity management tools are most likely to be useful during long weekends or outside of “business hours”, unless cost or other considerations far outweigh it, constant availability would be the safest and most straightforward method of offering liquidity management tools. We note by way of comparison, that in the UK, 49% of faster payment scheme transactions take place outside of “business hours.”

- 6. Should a 24x7x365 RTGS settlement service and liquidity management tool be developed in tandem or should the Federal Reserve pursue only one, or neither, of these initiatives? Why?**

In order for financial institutions to undertake instant settlement instead of batching, which generally requires less liquidity, liquidity support may be necessary. Solving for this is offset by a reduction in credit risk.

- 7. If the Federal Reserve pursues one or both of these actions, do they help achieve ubiquitous, nationwide access to safe and efficient faster payments in the long run? If so, which of the potential actions, or both, and in what ways?**

Yes. We support Federal Reserve leadership and feel that it is best positioned for the creation of a ubiquitous, nationwide safe and efficient faster payments scheme. Other market participants have tried to develop such systems without success.

- 8. What other approaches, not explicitly considered in this notice, might help achieve the broader goals of ubiquitous, nationwide access to faster payments in the United States?**

To achieve ubiquity, the Federal Reserve should take a stronger role in creating both the faster payment scheme and the corresponding settlement service, and run them in tandem to achieve instant settlement, rather than outsourcing the scheme to the private sector. The payment schemes created to date are not ubiquitous because there are too many of them, creating dissonance for consumers and businesses and not directly solving all of problems presented.

* * *

Again, we appreciate having the ability to provide comments, and TransferWise broadly supports the efforts of the Federal Reserve to create a faster payment scheme for the public benefit that is accessible to banks as well as non-banks and that is on real-time 24x7x365 rails, and which follows international standards for messaging to aid interoperability. Please do not hesitate to contact us if you have any questions regarding this letter or if we can be of any assistance as you move forward.

Yours faithfully,

Andrea Gildea, Head of Legal, TransferWise Inc.
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