

Morgan Stanley

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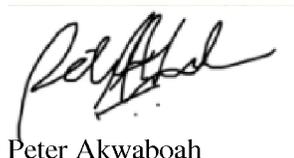
Ann Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
regs.comments@federalreserve.gov

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

Dear Ms. Misback,

On behalf of Morgan Stanley, I respectfully submit the following comments on the Request for Comment on Potential Federal Reserve Actions to Support Interbank Settlement of Faster Payments (the “**Request**”). We appreciate the opportunity to provide the Board of Governors of the Federal Reserve System (the “**Federal Reserve**”) with feedback on the important questions posed for the further development of ubiquitous, safe, and efficient faster payments services in the United States. In addition, we also support the views expressed by the Securities Industry and Financial Markets Association (“**SIFMA**”) in its responses to the Request, but we are submitting this letter to highlight matters of particular concern for Morgan Stanley and its clients.

Respectfully submitted,



Peter Akwaboah
Managing Director
Head of Shared Services Operations

Questions

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

Yes, real-time gross settlement (“RTGS”) is the appropriate approach to enable faster payments in the United States. We believe RTGS will help to reduce interbank credit risk as compared to current deferred net settlement (“DNS”) alternatives by tightly coupling clearance and settlement.

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

Yes, the Reserve Banks could develop 24x7x365 RTGS settlement service.

There is currently only one provider in the United States for faster payments. An RTGS settlements service developed by the Reserve Banks would create needed competition on price and quality of services. Furthermore, there is precedent for the Reserve Banks to provide payments solutions that complement private sector solutions; e.g., FedWire, the National Settlement Service (“NSS”), and the Automated Clearing House (“ACH”).

As the Request itself points out, a key consideration for faster payments systems is ubiquity, i.e., that the system would generally allow any two end users (individuals or businesses) with accounts at banks to exchange payments. The Reserve Banks could link a new RTGS settlement service to their existing “hook ups” for FedWire, NSS, and/or ACH, which are currently used for payment services by approximately 11,000 banks. Therefore, a Reserve Bank solution could quickly expand into the market to provide ubiquitous end-user access to faster payments services.

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

We believe there will 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.

Faster payments systems are currently being developed across the globe. Given contemporary consumer expectations for real-time delivery across a variety of electronic services, an RTGS settlement service developed by the Reserve Banks will become a valuable tool for payments processing. There are a number of person-to-person (“P2P”) payment applications currently available in the United States that promote immediate payment user interfaces. However, such applications ultimately rely on legacy payment systems, thereby creating possible operational frictions between, and risks arising from, the immediate end-user access to funds and the delayed back-end settlement and clearance of payments. These frictions and risks would likely be obviated where faster payments were supported by a 24x7x365 RTGS settlement service.

We believe applications will likely continue to evolve over the next decade, and some applications that may not exist today could disrupt the industry by leveraging the immediacy of faster payments. The initial

applications that we anticipate include invoicing (both business-to-people (“B2P”) and business-to-business (“B2B”)), P2P low value payments, bill pay, and payroll, among others.

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

There are many considerations to take into account in order to operate in a 24x7x365 settlement environment, whether or not the solution is provided by the Reserve Banks or the private sector. Considerations include: (1) the availability of technical infrastructure to support the payments processes; (2) adjustments to anti-fraud and required regulatory checks; and (3) operations support modeling for extended hours, a point-in-time to close the books, and calculations of fees, among other things.

An in-depth analysis of a concrete proposal with proposed operating rules would be required to do a full examination of the additional costs of making adjustments for a 24x7x365 operating environment. However, we anticipate that faster payments support will likely become a client expectation.

The Federal Reserve should also consider the costs for the industry to adopt and maintain new infrastructure and systems. We believe the potential costs will likely be substantial. These costs would include, but not be limited to, additional staffing, investments in new IT infrastructure, investments in optimizing control functions, and additional maintenance costs for systems to operate continuously in a 24x7x365 environment.

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

Given the rapid changes within payments and fintech, if the Reserve Banks were to embark on a solution, it would need to be implemented rapidly and may require partnering with a private sector technology company. There are private sector faster payments solutions currently in the market, albeit with limited availability. Over the past several years, we have seen growing adoption of these solutions among major financial institutions. Without a rapid development and deployment, we believe the existing incumbents may move past the Federal Reserve’s proposed solution, reducing its benefit or need.

If the Reserve Banks develop a 24x7x365 RTGS settlement service, regarding auxiliary services or other service options, 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?

The industry will benefit greatly from fraud prevention and risk management tools. Fraud prevention services will be very important for the adoption of faster payments given the expedited processing time. It would be optimal for some parts of these services to be provided by banks and other parts to be provided by third-party providers.

If the Reserve Banks develop a 24x7x365 RTGS settlement service, how critical is interoperability between RTGS services for faster payments to achieving ubiquity?

Interoperability will be critical for RTGS services to achieve ubiquity. Given the likely high adoption and investment costs, non-interoperable faster payments services may delay wider adoption if the market does not see a clear “winning” solution to achieve ubiquity, which may create market fragmentation. Examples of interoperable services are Swift and The Clearing House (“TCH”). The Federal Reserve should make the FedWire terminal available outside of the United States in order to achieve a global operating model.

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

Liquidity management and the ability to ensure the continuous cycle of payments receipts and disbursements will be essential to facilitate the orderly execution of a 24x7x365 faster payments program. The Federal Reserve should look to develop such a program in tandem with, or independently of, the development of the faster payments network itself, since Banks will need the real-time tooling and the option to prefund their payment obligations to ensure continuous operability.

Should the Federal Reserve develop a liquidity management tool that would enable transfers between Federal Reserve accounts on a 24x7x365 basis to support services for real-time interbank settlement of faster payments, whether those services are provided by the private sector or the Reserve Banks?

Yes, the industry will require a liquidity management tool to support 24x7x365 faster payments.

If the Reserve Banks develop a liquidity management tool, 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**
- v. An alternative approach**

We believe that a combination of approaches would be preferable.

Assuming that an agent would be a clearing institution within any faster payments network, it would be in the best interest of the industry and its participants to develop a tool that would provide the agent with the ability to originate a transfer on behalf of one or more banks, effectively facilitating the ongoing movement of liquidity across the sector and its institutions. In addition, to ensure that a U.S. faster payments network is able to operate continuously, it would be in the best interest of participating institutions to have a tool that would automatically transfer balances based on pre-established thresholds and limits, enabling proper management of liquidity during potential stress events, and effectively preventing a run on liquidity under volatile market conditions.

If the Reserve Banks develop a liquidity management tool, 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?

A 24x7x365 liquidity management tool would be preferable, since the payments network would be operating on the same cycle. The ability for institutions to manage their cash positions in real time will be critical to ensure a consistent flow of payments to avoid overdraft charges or disruption in the settlement flow. However, overdrafts and other disruptions could potentially be avoided if the faster payments network participants agreed to a cap on the payment flows between the banks.