



Kentucky Bankers Association

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November 7, 2019

SENT VIA FIRST CLASS MAIL AND E-MAIL

Federal Reserve System
Attn: Ms. Ann E. Misback, Secretary
20th Street and Constitution Avenue NW
Washington, D.C. 20551
Email: regs.comments@federalreserve.gov

Re: Notice of Proposed Rulemaking: Federal Reserve Actions to Support Interbank Settlement of Faster Payments, Docket No. OP-1670.¹

Dear Board of Governors of the Federal Reserve,

The Kentucky Bankers Association (KBA) appreciates the opportunity to submit comments to the Notice of Proposed Rulemaking (Proposal) from the Board of Governors of the Federal Reserve System (Fed), which proposes to adopt: “i) An interbank 24x7x365 RTGS service with integrated clearing functionality to support faster payments; and (ii) a liquidity management tool that would enable transfers between accounts held at the Reserve Banks on a 24x7x365 basis to support services for real-time interbank settlement of faster payments” as part of a real time gross settlement (RTGS) initiative (Purpose).²

Initially, on behalf of the KBA’s one hundred and sixty-one (161) member institutions ranging in asset size from twenty-one million dollars (\$21,000,000) to over three hundred and seventy billion dollars (\$370,000,000.00), the KBA supports the majority of the proposed amendments and emphatically agrees with the need for regulatory clarity and structure in the area of “real time payments.

We do believe, however, that some changes and additions to the proposal would better align with the Purpose. Accordingly, we issue the following comments to the Proposal:

- KBA supports the implementation of FedNow and a liquidity management tool;
- FedNow and the liquidity management tool should be available now or as soon as possible, but in either instance, long before 2023 or 2024;³

¹ Board of Governors of the Federal Reserve System, Notice of Proposed Rulemaking: Federal Reserve Actions to Support Interbank Settlement of Faster Payments, 84 Federal Register 39297, August 8, 2019 (<https://www.govinfo.gov/content/pkg/FR-2019-08-09/pdf/2019-17027.pdf>).

² Proposal, page 39298.

³ Proposal, page 39301.

- FedNow should be made available only to chartered financial institutions;⁴
- FedNow should offer an equitable pricing model;⁵
- FedNow should seek interoperability with the private sector's Electronic Payment Network to the extent possible;
- That the Purpose focus on safety and security.⁶

These recommendations and analysis of the Proposal follow.

1. FedNow and the Liquidity Tool Must be Implemented

The Proposal suggests the adoption of the FedNow service and liquidity tool is not necessary, the clear dichotomy between large banks and other institutions set forth in previous comments to rulemaking and in media reports makes it necessary to revisit this issue.

With more than 250 commenters addressing whether the Federal Reserve should develop a RTGS service for faster payments, approximately 320 commenters, from all segments, supported the Fed initiative.⁷ “Approximately 30 commenters, mostly comprising large bank and private-sector operators, including many that have been involved in the recent development of private sector RTGS service for faster payments, were not supportive of the Federal Reserve’s development of such a service.”⁸

As stated in the Proposal, “the Board expects that a single private-sector provider or such services is unlikely to connect to the thousands of small and midsize banks necessary to yield nationwide reach, even in the long term. No traditional payment system, including checks, ACH, funds transfers, or payment cards, has ever achieved nationwide reach through a single private-sector provider.”⁹ These comments were reiterated by Chairman Jerome Powell in stating, “Acting alone, a single private-sector service will face significant challenges in establishing infrastructure for faster payments with nationwide reach.”¹⁰ “For a number of reasons, it is unlikely that the private-sector RTGS service for faster payments alone will reach the thousands of small banks necessary to yield nationwide scope, even in the long term.”¹¹

The Proposal words it best in stating, “Serving an operational role in the payment system also allows the Federal Reserve to provide stability and support to the banking system and the broader economy in normal times and times of stress.”¹² The Board believes that, on balance, other providers cannot be expected to provide the service with reasonable effectiveness, scope, and equity.”¹³

⁴ Proposal, page 39318.

⁵ Proposal, page 39320.

⁶ Proposal, page 39320.

⁷ Proposal, page 39302.

⁸ Proposal, page 39302.

⁹ Proposal, page 39300.

¹⁰ Victor Guida, *Fed to Offer Faster Payment System, Setting Up Clash with Big Banks*, POLITICO, August 5, 2019.

¹¹ Proposal, page 39307.

¹² Proposal, page 39300.

¹³ Proposal, page 39308.

Large banks that want their own RTGS service should be able to do so. However, it should not come at the expense of smaller institutions seeking similar services. Systems options need not be mutually exclusive. “In a payment system with multiple operators, banks would have a choice whether to join a single service or multiple services such that an RTGS infrastructure for faster payments could achieve nationwide reach.”¹⁴ Furthermore, there is no justification in protecting the large bank-owned Clearing House Payments Co. monopoly from outside competition, even if that competition is the Federal Reserve serving a larger constituency of interests.

If the Federal Reserve does not open FedNow, it is unlikely small and medium-sized banks will receive similar services, providing large banks with an insurmountable competitive advantage. “As described earlier, a likely market outcome is that only a portion of banks in the United States would actually connect to the sole private-sector RTGS service.”¹⁵

“Unlike the private sector, the Federal Reserve has a unique mission and demonstrated history of providing nationwide access to payment services, noting the Federal Reserve’s check and ACH services as specific examples.”¹⁶ The “Federal Reserve has historically extended access to banks of all sizes, including smaller banks in rural areas of the country.”¹⁷ “Enabling virtually all banks to gain access to nationwide RTGS infrastructure for faster payments would support the core objective of ubiquitous faster payment services for individuals and businesses in the United States.”¹⁸

For these reasons, the KBA requests that the Fed reject the political pressure from larger institutions and continue in developing FedNow and the liquidity tool for all its constituents and stakeholders.

2. The FedNow and Liquidity Management Tool Need to Be Available Now

The Proposal states that, “the Board anticipates the FedNow Service will be available in 2023 or 2024.”¹⁹ This is simply too long of an implementation period and requests that the Fed implement the FedNow Service and a liquidity management tool immediately.

“A new study released by the prepaid issuer MetaBank finds that most consumers want businesses to use faster payment methods when sending them money for refunds, rebates and claim payments.”²⁰

“Almost half (47%) of the survey participants stated that their preferred payment method with which to receive funds was a direct deposit. Almost one-quarter (24%) chose one of the three leading digital P2P services to receive funds – PayPal, Zelle and Venmo (which is owned by PayPal). The study also found that a quarter of respondents would be willing to pay a small fee if they could receive payments such as rebates, refunds or credits within a few minutes.”²¹

¹⁴ Proposal, page 39311.

¹⁵ Proposal, page 39308.

¹⁶ Proposal, page 38309.

¹⁷ Proposal, page 39310.

¹⁸ Proposal, page 39310.

¹⁹ Proposal, page 39301.

²⁰ Michael Moeser, *MetaBank Sees Customer Demand for Faster Payments*, AMERICAN BANKER, August 27, 2019.

²¹ Michael Moeser, *MetaBank Sees Customer Demand for Faster Payments*, AMERICAN BANKER, August 27, 2019.

One reporter stated:

Community-based financial institutions are between a rock and hard place. They can choose to wait for the Fed to develop a system, or participate in The Clearing House.

We're heading down a path where either: 1) FedNow is deployed in five years and customers realize few of the promised benefits, calling into question the wisdom of spending all that time and money to develop the system, or 2) the benefits are realized through other means, which will also call into question the wisdom of building a system.

Here's to hoping for a speedy deployment of FedNow. I can't help but think it should be called FedTooLate.²²

While the comments from that author are harsh, even the Fed realizes the importance of an immediate FedNow. As Federal Reserve Board Governor Leal Brainard noted, "Immediate access to funds could be especially important for households on fixed incomes or living paycheck to paycheck, when waiting days for the funds to be available to pay a bill can mean overdraft fees or late fees that can compound."²³

The need for speed with FedNow is real. If FedNow is not implemented until 2023 or 2024, a myriad of systems will have long surpassed FedNow and the benefits will have been lost. Community banks will have been left behind in payment systems and may be forced to be obsolete or succumb to the immense costs and profits of large banks that own The Clearing House. Either way, community banks and their customer lose.

The Fed must be the leader in this service and must lead now. "This key role, given by Congress, stems from the Federal Reserve's unique ability, as the nation's central bank, to provide interbank settlement without introducing liquidity or credit risks."²⁴

With that unique ability comes the unique obligation to implement the FedNow System and liquidity tool in a timely and efficient manner. Without it, many banks and customers will suffer. As Robert Steen, chairman and CEO of Bridge Community Bank in Mount Vernon, Iowa, stated, "A monopoly in the payments space and especially in real-time payments, operated by the largest banks, would surely marginalize our bank and our industry, weaken our customer relationships, and ultimately speed the pace of consolidation that is changing in the American financial services landscape."²⁵

For these reasons, the KBA requests that the FedNow Service and Liquidity tool be implemented as soon as possible but long before the 2023 or 2024 scheduled timeline.

3. The FedNow System Should Only be Available to Chartered Financial Institutions

²² Ron Shevlin, *The Federal Reserve is Too Late to the Real-Time Payments Party*, FORBES, August 12, 2019.

²³ Ron Shevlin, *The Federal Reserve is Too Late to the Real-Time Payments Party*, FORBES, August 12, 2019..

²⁴ Proposal, page 39298.

²⁵ Neil Haggerty, *GOP Senators Skeptical of Fed's Faster Payments Network*, AMERICAN BANKER, September 25, 2019.

The Proposal states, “Like current Federal Reserve services, the FedNow Service would be available to banks eligible to hold accounts at the Reserve Banks under applicable federal statutes and Federal Reserve rules, policies and procedures. Participating banks would be able to designate a service provider or agent to submit or receive payment instructions on their behalf.”²⁶

While not directly discussed in the Proposal, there is the implication that entities other than financial institutions could access FedNow. The KBA opposes any such proposition.

The Federal Reserve statutes in place are effective in protecting payment systems. Institutions subject to these statutes consistently undergo examination and are scrutinized to ensure that no undue burden or risk is placed on the payment systems. Introducing third parties would place unacceptable risk to the Fed system.

For these reasons, the KBA requests that the FedNow Service be limited to eligible financial institutions in accordance with the Federal Reserve statutes.

4. FedNow Should Offer an Equitable Pricing Model

The Proposal states, “Before the FedNow Service is launched, the Board will announce the service’s fee structure and fee schedule.”²⁷

The Proposal is ambiguous as to cost. The Fed offers a tiered pricing model for its FedACH services. This means that financial institutions with high volumes pay less per item. The Proposal provides little clarity as to how FedNow will be priced except to note that more information will be available closer to the implementation date. These tiered pricing models provide advantages to financial institutions that can generate the largest number of transactions.

The Fed should commit to a flat pricing model offering the same per item fees to financial institutions of all sizes. This would ensure equity amongst all stakeholders and creating uniformity for consumers regardless of whether they are located in a rural or metropolitan area. This aligns directly with the Fed’s value of Public Interest which states, “In its actions and policies, the Board seeks to promote the public interest. It is accountable and responsive to the general public, the U.S. government and the financial community.”²⁸

For these reasons, the KBA requests that the Fed adopt an equitable pricing model to ensure fairness and equality amongst all stakeholders.

5. The Fed Should Seek Interoperability with the Private Sector as Possible

As noted in the Proposal, “The Board agrees with commenters that interoperability between RTGS services for faster payment services is a desirable outcome.”²⁹ “During its engagement with

²⁶ Proposal, page 39318.

²⁷ Proposal, page 39320.

²⁸ <https://www.federalreserve.gov/publications/gpra/2011-mission-values-and-goals-of-the-board-of-governors.htm> (October 32, 2019).

²⁹ Proposal, page 39311.

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the industry, the Federal Reserve intends to explore both interoperability and other paths to achieving nationwide reach.”³⁰

As Federal Reserve Governor Lael Brainard stated, “Such interoperability is an important goal that we will pursue as standards, technology and industry practices change over time, although it is not yet clear whether it will be an initial feature.”³¹

The KBA believes that the Federal Reserve should make all efforts to become interoperable with private sector solutions offering similar services to the extent possible. While interoperability is important for all stakeholders, the KBA does not believe it should delay the release of FedNow. Interoperability should remain a goal to satisfy all stakeholders but it should not come at the expense of the release of FedNow.

For these reasons, the KBA requests that the Fed seek interoperability to the extent possible.

6. The Purpose Should Focus on Safety and Security

As noted in the Proposal, “Providing the FedNow Service would allow the Federal Reserve to facilitate the safety of faster payments in the United States.”³² However, as noted in the Proposal, “For the FedNow Service, participating banks would continue to serve as a primary line of defense against fraudulent transactions, as they do today, with solutions to mitigate fraud enabled as part of the end-user services banks offer their customer.”³³

The KBA believes that the Fed is best suited to mitigate risk in the RTGS space. “Former Federal Deposit Insurance Corp. Chairman Sheila Bair warned that failure of one of the largest banks could threaten continuity of payments services for consumers in the industry run-service. She said the Fed providing its own network would be a good backup.”³⁴ She also added that, “the Federal Reserve will likely need to step in regardless.”³⁵

There is no question that the Fed is best suited to limit liquidity risk and dependence on a small number of large banking institutions for success. However, it is also important that the Fed ensure the highest level of security in the FedNow service operations.

In 2016, 3 billion Yahoo accounts were hacked in one of the biggest breaches of all time.³⁶ In 2016, Uber reported that hackers stole the information of over 57 million riders and drivers. In 2017, 412 million user accounts were stolen from Friendfinder’s sites³⁷ In 2017, 147.9 million

³⁰ Proposal, page 39311.

³¹ Victor Guida, *Fed to Offer Faster Payment System, Setting Up Clash with Big Banks*, POLITICO, August 5, 2019.

³² Proposal, page 39311.

³³ Proposal, page 39320.

³⁴ Neil Haggerty, *GOP Senators Skeptical of Fed’s Faster Payments Network*, AMERICAN BANKER, September 25, 2019.

³⁵ Neil Haggerty, *GOP Senators Skeptical of Fed’s Faster Payments Network*, AMERICAN BANKER, September 25, 2019.

³⁶ Rob Sobers, *60 Must-Know Cybersecurity Statistics for 2019*, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

³⁷ Rob Sobers, *60 Must-Know Cybersecurity Statistics for 2019*, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

consumers were affected by the Equifax Breach.³⁸ According to 2017 statistics, there are over 130 large-scale, targeted breaches in the U.S. per year, and that number is growing by 27 percent per year.³⁹ Thirty-one percent of organizations have experienced cyber-attacks on operational technology infrastructure.⁴⁰ 100,000 groups in at least 150 countries and more than 400,000 machines were infected by the WannaCry virus in 2017, at a total cost of around \$4 billion.⁴¹ Attacks involving cryptojacking increased by 8,500 percent in 2017.⁴² In 2017, 5.4 billion attacks by the WannaCry virus were blocked.⁴³ There are around 24,000 malicious mobile apps blocked every day.⁴⁴

In 2017, cyber-crime costs accelerated with organizations spending nearly 23 percent more than 2016 — on average about \$11.7 million.⁴⁵ The average cost of a malware attack on a company is \$2.4 million.⁴⁶ The average cost in time of a malware attack is 50 days.⁴⁷ From 2016 to 2017 there was an 22.7 percentage increase in cybersecurity costs.⁴⁸ The average global cost of cybercrime increased by over 27 percent in 2017.⁴⁹ The most expensive component of a cyber-attack is information loss, which represents 43 percent of costs.⁵⁰

The statistics could continue but the reality is that security is at the forefront of the financial services industry. It costs billions of dollars in protection and unfortunately, in some instances, actual losses.

As part of FedNow, it is imperative that the Fed incorporate some form of fraud prevention services. While banks will always serve at the forefront of protecting their customers, as a network operator, FedNow will have great and broader insight into transaction flow than individual banks. Because of this insight, the Fed is best positioned to provide some fraud services.

³⁸ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

³⁹ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴⁰ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴¹ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴² Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴³ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴⁴ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴⁵ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴⁶ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴⁷ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴⁸ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁴⁹ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019).

⁵⁰ Rob Sobers, 60 Must-Know Cybersecurity Statistics for 2019, April 17, 2019, <https://www.varonis.com/blog/cybersecurity-statistics/> (last visited November 1, 2019)..

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For these reasons, the KBA requests that the Fed offer some form of fraud protection services.

7. Adopt the Proposed Clarifications

The KBA supports the Proposal and its Purpose. The KBA believes that adopting the Proposal as written and incorporating the proposed changes will service Fed stakeholders and their communities with uniform and reliable products that will enhance the productivity, safety and soundness of the banking system.

Thank you for considering our suggestions. If there are any questions, please do not hesitate to contact the undersigned.

Sincerely,

A handwritten signature in black ink, appearing to read "Debra K. Stamper".

Debra K. Stamper
General Counsel
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