NAVY FEDERAL Credit Union®

Office of the President

7 November 2019

Via e-mail: regs.comments@federalreserve.gov

Ms. Ann Misback
Secretary, Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Re: Request for Comment Regarding Federal Reserve Actions to Support Interbank Settlement of Faster Payments (Docket No. OP-1670)

Dear Ms. Misback,

Navy Federal Credit Union ("Navy Federal" or "we") appreciates the opportunity to provide our response to the Request for Comment issued by the Federal Reserve Board of Governors ("Federal Reserve") regarding its proposed FedNow service and expanded hours of the Fedwire Funds Service/National Settlement Service for purposes of liquidity management. Navy Federal is the nation's largest natural person credit union, with more than $110 billion in assets and over 8.8 million members. We are committed to serving the financial needs and improving the financial condition of our members, and support the Federal Reserve's mission to ensure ubiquitous, safe, and efficient payments in the United States.

Navy Federal Credit Union's members are located across the United States and around the world. Serving the unique needs of the women and men of the US Armed Services wherever they serve is a mission we embrace. Our decision of which course to pursue is contingent upon the demand from our members for faster payments and the extent to which market-based solutions can help us to satisfy that demand.

Our comments immediately below reflect our general thoughts on the proposal and items that we believe should be considered in this FedNow effort.

Consideration of Existing Market Conditions/Participants: While Navy Federal may ultimately be able to support the development of a FedNow service, we continue to believe that market-based solutions will yield optimal results. We caution the Federal Reserve to carefully consider any changes that could disrupt or destabilize existing market conditions. As an example, the Clearing House's Real Time Payments (RTP), Same-Day ACH, Debit Cards, Zelle, and similar services already successfully provide means of satisfying the demand for faster payments. Depending on its features and levels of interoperability, the introduction of FedNow as an additional option could have unintended consequences on market participation to include significantly undermining industry incentives to innovate. We ask that the Federal Reserve be mindful of those possible consequences as it proceeds.

Optional and Leveled Participation: Navy Federal believes that participation in any proposed version of a FedNow service should be optional so that financial institutions can independently assess whether or not there is an adequate business case to use it. Further, financial institutions who opt in to use the FedNow service should be able to participate at a level that best suits their business needs, with consideration to risk tolerance, technology investments, and consumer demands. Based on the request for comments, the FedNow service will have three key participation approaches. For example, institutions could choose to participate as:

1. The beneficiary's financial institution (Receiver) only;
2. Both a Receiver and as the originator's financial institution (Sender); or
3. As a Receiver/Sender with the ability to receive "requests for payment."

We believe that this type of leveled approach would enable financial institutions to make choices most appropriate to their business needs, as each option carries increasing technological burdens and greater risks. However, the Federal Reserve must clarify the value proposition for participants. For instance, it would make sense for costs to be assessed on Senders because it is reasonable for them to monetize their participation. However, Receivers cannot in good faith charge beneficiaries to receive funds, so a financial institution operating solely as a Receiver could only recover its costs if the ecosystem recognizes the exchange of value garnered between the Sender and Receiver. Furthermore, for FedNow to achieve ubiquity it must entice financial institutions to join as Receivers.

2024 Implementation: While the Federal Reserve anticipates a 2024 implementation of FedNow, there are still many unknowns, as indicated in the Request for Comment regarding features, functionalities and cost structures. We urge the Federal Reserve to solicit feedback from industry participants at every stage of FedNow's design, development and implementation. We ask the Federal Reserve to publish its proposals through the Notice and Request for Comment process, and form working groups comprised of Federal Reserve and industry representatives to discuss disclosures, fraud prevention, operating rules, and warranties. We urge the Federal Reserve to be mindful that the FedNow proposal is still in its early development stages. Depending on its implementation path, it may be difficult for financial institutions to determine their level of participation (if any) and to co-develop proportionately, both of which could hinder 2024 market readiness.

Specific Recommendations

Notwithstanding our comments above, we believe that certain features would make the success of FedNow more likely, and believe that some features are so vital to FedNow's viability that they should be included at launch (even if their inclusion might delay implementation). These features are: a) a streamlined payment flow as outlined below; b) integrated fraud prevention with an automated recall/return mechanism to mitigate risk exposure; c) an expansive liquidity management tool with the flexibility for financial institutions to remain on a 5-day accounting regime with memo posting; d) a queuing system to accommodate financial institutions' maintenance windows; e) a directory for consumer payments managed by the Federal Reserve; and f) interoperability with existing faster payments solutions. We discuss these points more in depth below:

A. Payment Flow

Navy Federal suggests that the Federal Reserve amend its proposed payment flow in order to streamline the process. In our view, separating FedNow's request for validation to the Receiver from the settlement/rejection is unnecessary. Rather, once a payment order is authenticated by the Sender, FedNow should simply attempt to settle the transaction with the Receiver; if successful, the Receiver would send a confirmation; if unsuccessful (due to there not being a valid account or failure to respond after a certain period of time), FedNow would reject the transaction and re-credit the Sender's master account. These status messages from the Receiver might be to the effect of "transaction accepted," "transaction declined," "undergoing maintenance—will respond when back in service," or "error—try again later." This messaging should be displayed to end users.

B. Fraud Prevention and Risk

In our view, the subject of fraud is not adequately addressed in the FedNow proposal. While somewhat mitigated by the $25,000 per transaction cap, there is potential for significant losses stemming from account takeover or kiting situations. It is true that other payment methods are also vulnerable to these illicit activities; however, FedNow is especially concerning due to its instant nature and the fact that availability is predicated on settlement rather than as a float. This means that there will be little to no time for an accountholder or a security team to become aware of suspicious transactions and stop them before the funds have been made available and possibly withdrawn.

The theory underlying any risk allocation system is to place potential loss on the entity that is in the best position to prevent it; for FedNow, that would be the Sender. This is consistent with comparable payment systems such as ACH credits and wire transfers. The risk to Senders would be lessened by features such as an automated recall/return mechanism and an embedded fraud detection program.

Adding to the overall risk profile of FedNow is the likely application of the Electronic Funds Transfer Act and the resulting Regulation E error resolution process. Our experience with existing faster payments applications shows that consumers have certain expectations with dispute rights, and financial institutions may end up taking a loss in the interests of member service or customer service. Further, Regulation E mandates an investigation process for error claims that will result in an additional strain on security resources.

C. Liquidity Management and Accounting

In whatever form it might ultimately take, Navy Federal views a proper liquidity management tool as integral to our participation in FedNow. However, the Federal Reserve's liquidity management tool as described in the proposal appears to be simply an expansion of the hours for the Fedwire Funds Service in order to inject funds into the Federal Reserve master account. This is a good start, but does not go far enough. The Federal Reserve should work closely with industry representatives to develop a more expansive liquidity management tool that allows for a financial institution to know its master account balance at any given moment. The Federal Reserve should also consider adding a line of credit or adjusting its intraday credit arrangements in order to provide coverage on holidays and weekends.

Regardless of the accounting methodology employed by the Federal Reserve, financial institutions should have the discretion to remain on a 5-day accounting regime with memo posting for as long as their FedNow transaction volume allows for effective liquidity management. In order for this to be possible, the Federal Reserve would have to supply a daily statement with transactional detail (including the transaction timestamp) so that the financial institutions can make adjustments to their books and records. Please note that the need for financial institutions to make these adjustments would be eliminated or reduced if the Federal Reserve were to adopt midnight Eastern Time as the end-of-day cutoff. In any event, the cutoff in a 24x7x365 operation serves only a bookkeeping purpose and should not affect the transactional functionality.

D. Queuing System

The use of a queuing system, similar to how wire transfers operate today, could significantly improve the FedNow experience. Many financial institutions require a period of system downtime in order to provide needed maintenance. For example, there might be a daily downtime for end-of-day processing and a longer period on a weekly basis for mainframe updates. FedNow should continue to be operable during these downtimes so that this necessary work can be done by participating financial institutions. The presentment, settlement, and funds availability would then occur after the maintenance is complete. The downtime for both sending and receiving FedNow transactions would be clearly disclosed by the financial institutions so that it is factored into the public's decision-making for making payments.

E. Directory

Navy Federal considers the development of a FedNow directory to be a prerequisite for payments with a consumer element, as consumers may not want to give out their account numbers and the likelihood of transposing digits would lead to increased error incidents. Nonetheless, a directory presents its own dangers; namely, a central repository of financial information would be a tempting target for hackers. The specter of data breaches of sensitive personal information such as account numbers and email addresses could upend many aspects of a person's life, not only their ability to conduct transactions with FedNow. Therefore, such a directory would have to be safeguarded by the cutting edge of cybersecurity.

F. Interoperability

FedNow's prospects for achieving ubiquity would be greatly enhanced if it is conceived and built as interoperable with RTP, as RTP already exists and successfully processes faster payments for a sizeable portion of the market. There would obviously be many challenges in configuring two systems to work together, but the reach and cost savings of a FedNow interoperable with RTP would benefit the entire payments industry.

Conclusion

Navy Federal appreciates the Federal Reserve's continuing efforts to ensure ubiquitous, safe, and efficient payments in the United States, and welcomes this opportunity to comment on the FedNow proposal. We look forward to reviewing future notices put out by the Federal Reserve with additional information about proposed FedNow features. If you have any questions, please contact Tynika Wilson, SVP, Debit Card and Funds Services by phone at 703-255-8151 or by email at tynika_wilson@navyfederal.org.

Sincerely,

Mary McDuffie

Mary McDuffie
President/CEO

MM/rtm