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The Federal Reserve's Role in Supporting Responsible Innovation

Remarks by

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at

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Thank you for the opportunity to speak today, in the midst of a wave of innovation in the payments system. There are a range of important players in the payments system and the Federal Reserve has important roles as a supervisor as well as a payments operator.

Regardless of who is providing the service, our payments system needs to meet fundamental principles. Among those core principles is ensuring that the payments infrastructure supports broad access and promotes financial inclusion. Payments are essential for everyday life, and too often, low- and moderate-income households and small businesses don't have access to the payments services they need at a reasonable cost. Moreover, as the payments system evolves, it needs to provide strong consumer protections. The payments system needs to welcome competition, provide consumers with choices, and support innovation. The payments system should empower consumers to have better control over their financial lives, including their identity and financial data. And more broadly, our payments system should promote efficiency, convenience, speed, low cost, resiliency, privacy, and security. Finally, our payments system must and does rely on trust, and this trust must be maintained as the system is updated. This includes trust that the payments system is not used for illicit purposes, that lawful payments will always be honored, and that neither the government nor private actors will act improperly based on use of the payments infrastructure.

Not that long ago, the Federal Reserve was facilitating payments by moving bundles of checks around the country on trucks and trains! And we still have important work to do to ensure that those who rely on checks can get their funds in a timely way and that the system is not exposed to fraud.

But more recently the focus has been on improving our electronic payments infrastructure. The Fed has long operated the Fedwire Funds Service, used by banks to conduct large-value, same-day transactions among themselves. In addition, the automated clearinghouse (ACH) service supports batch payments of more modest value. While the Fedwire Funds Service and ACH transactions have served the economy well for decades, the economy has changed dramatically over that time. There is a demand for faster payments, and the Fed has recognized that today's households and businesses would benefit from ready availability of funds 24x7.

So, in July, the Fed launched the FedNow Service®, a new service to make instant payments secure and convenient. FedNow enables instant payments to be processed on any day of the year for a broad array of transactions. The FedNow Service is core payments infrastructure available to all depository institutions, including large banks, regional banks, community banks, and credit unions. It is those institutions that will determine whether real-time payments are available to everyone. We have provided the rails. Innovation by private depository institutions will determine whether these services reach a broad range of households and businesses. While current volumes on FedNow are small, I expect that participation will grow over time and be a significant addition to, and advance on, the existing payments infrastructure.

I view the FedNow Service as complementary to the private sector instant payments services offered today, and as banks build on these rails, customers can get better service. Individuals could have instant access to their paychecks and be able to spend them same day, rather than waiting several days for checks to process. Or consumers could pay bills at the last minute on the due date, potentially avoiding late fees. And small businesses would benefit from timely payment as well. The benefits could be far-reaching and will be especially significant for low- and moderate-income households.

Banks and their service providers are already thinking creatively about how they can leverage these new payments rails to meet customer needs for immediate funds availability. Efforts by banks to meet the demands of their customers will support more robust offerings, and I look forward to engaging with banks about how they could be advancing financial inclusion objectives with faster payments services.

Separately, we are engaged in efforts to understand the next generation of payments technology and how it can be used to support a secure and efficient payments system. As the pace of innovation increases, the payments landscape continues to evolve with the emergence of new programmable payments platforms, including those built on distributed ledger technology and blockchain technology, and new forms of digital assets, such as cryptocurrencies, stablecoins, and central bank digital currencies (CBDCs). Given the new capabilities they could enable, we are seeing increased interest in and experimentation with these innovative technologies. This experimentation is happening in the private and public sectors, both domestically and internationally. In my view, as both the issuer of U.S. currency and an operator in the payments system, the Federal Reserve must understand these developments and the tradeoffs they introduce. Our engagement with innovation is crucial so that we can continue to support a safe and efficient payments system into the future.

We continue to speak to a broad range of stakeholders and conduct basic research in emerging technologies that might support a CBDC payments backbone, or for other purposes in the existing payments system. For example, the Fed's CBDC research program is currently focused on system architecture, notably how ledgers that record ownership of and transactions in digital assets are maintained, secured, and verified, as well as tokenization models—that is, the design of the digital analog to the paper bank note that permits a transfer of value between two parties without direct facilitation by the issuing central bank.

Of course, investigation and research are very different from decision making about next steps in terms of payments system development, and we are a long way from that. The Federal Reserve has made no decision on issuing a CBDC and would only proceed with the issuance of a CBDC with clear support from the executive branch and authorizing legislation from Congress. Given the importance of this infrastructure, investigating the potential opportunities, risks, and tradeoffs for payments innovation is just one way the Fed fulfills its role in supporting the responsible innovation that enables a safe and efficient U.S. payments system.

Now let me turn my attention to recent actions by the Federal Reserve that are aimed at promoting responsible innovation in financial services more broadly. Last month, the Federal Reserve announced that it has created a novel activities supervision program to focus on the supervision of risks posed by novel, technology-driven activities at banks.[1] At present, these activities include those involving crypto-assets, distributed ledger technology, and complex technology-driven bank partnerships with nonbank fintechs. That said, this program will grow as new technologies emerge. By dedicating a

[1] Board of Governors of the Federal Reserve System, "Federal Reserve Board Provides Additional Information on Its Program to Supervise Novel Activities in the Banks It Oversees," press release, August 8, 2023, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230808a.htm.

team of supervisory experts to the oversight of novel, technology-driven activities, our aim is to provide clarity as well as timely and relevant feedback to the institutions we supervise. We want them to continue to work to take advantage of innovations, while also supporting their ongoing safety and soundness.

One innovation that crosses both payments provision and bank safety and soundness issues is stablecoins, which can also be described as digital tokens that aim to maintain a stable value relative to a government-issued currency, such as the U.S. dollar. When an asset is pegged to a government-issued currency, it is a form of private money. When that asset is also used as a means of payment and a store of value, it borrows the trust of the central bank. So, the Federal Reserve has a strong interest in ensuring that any stablecoin offerings operate within an appropriate federal prudential oversight framework, so they do not threaten financial stability or payments system integrity.

To provide clarity for banks interested in engaging with these assets, we recently issued guidance on the process by which a Fed-supervised bank can seek to obtain a supervisory non-objection before issuing, holding, or transacting in "dollar tokens."[2] As the Board of Governors announced in January, before those banks engage in these activities, they are advised to obtain a written supervisory non-objection from the Fed verifying that they have appropriate risk management and systems in place to identify and control potential risks, such as those related to cybersecurity and compliance with anti-money-laundering laws.[3]

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[2] Board of Governors, "Federal Reserve Board Provides Additional Information on Its Program."

[3] This requirement is consistent with the supervisory nonobjection requirement applicable to national banks pursuant to interpretive letters issued by the Office of the Comptroller of the Currency. (See OCC Interpretive Letter No. 1174 (January 4, 2021) and OCC Interpretive Letter No. 1179 (November 18, 2021).)

The guidance only covers the activities of the banks over which we have supervisory authority. But there are big risks when the Federal Reserve does not have direct supervisory and regulatory authority. I remain deeply concerned about stablecoin issuance without strong federal oversight. As I mentioned earlier, stablecoins are a form of money, and the ultimate source of credibility in money is the central bank. If non-federally regulated stablecoins were to become a widespread means of payment and store of value, they could pose significant risks to financial stability, monetary policy, and the U.S. payments system. It is important to get the legislative and regulatory framework right before significant risks emerge. We appreciate the work Congress has been doing on this important issue and look forward to further engagement to ensure that there is a robust federal framework for all stablecoins.

As everyone in this room knows, innovation never stops. We are continuing to explore new technologies so we can continue to support a robust payments system that meets the needs of the public. We are committed to supporting responsible innovation, both through our provision of payments rails and through timely and relevant supervisory feedback to the institutions we supervise.

Looking ahead, we will continue to engage in exploring new technologies, including those that could be used to further advance our provision of payments rails. As I mentioned, this work involves continuing to study the next generation of ledger technology. In conclusion, I want to applaud the Federal Reserve Bank of Philadelphia for supporting the stakeholders coming together at these conferences, giving us opportunities to learn from each other as we engage in this important work.