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Submitted via email: regs.comments@federalreserve.gov

December 14, 2018

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

Re: Docket Number: OP-1625
Potential Federal Reserve Actions to Support Interbank Settlement of
Faster Payments

Dear Ms. Misback:

The Independent Community Bankers of America (“ICBA”)¹ is pleased to submit comments regarding the Federal Reserve Board’s (“Board”) request for comment on potential actions that the Federal Reserve could take to promote ubiquitous, safe, and efficient faster payments in the United States by facilitating real-time interbank settlement of faster payments.

While not committing to any specific actions, the Board seeks input on two potential actions the Federal Reserve Banks (“Reserve Banks” or “Federal Reserve”) could take to help achieve ubiquitous, nationwide access to safe and efficient faster payments: 1) the development of a service for 24x7x365 real-time gross settlement (“RTGS”) of faster payments; and 2) the creation of 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

¹ The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 52,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 760,000 Americans and are the only physical banking presence in one in five U.S. counties. Holding more than \$4.9 trillion in assets, \$3.9 trillion in deposits, and \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers’ dreams in communities throughout America. For more information, visit ICBA’s website at www.icba.org.

private sector or the Reserve Banks. The Board is also seeking comments on any alternative approaches that would help achieve ubiquitous, nationwide access to safe and efficient faster payments.

Summary of ICBA Comments

ICBA is a long-time committed and vocal proponent of the Federal Reserve System (“FRS” or “System”) taking actions to maintain efficient, accessible, reliable, relevant and safe payment systems for all stakeholders. These actions encompass the System’s roles as payments systems regulator, operator/provider of services and a leader/catalyst. In support of the System’s various roles, ICBA and its member banks actively participated in all aspects of the Federal Reserve’s payments system improvement initiative, including the Faster Payments Task Force, the Secure Payments Task Force, the Faster Payments proposal process, the Governance Framework Formation Team, as well as efforts predating the Federal Reserve’s payments system improvement initiative.

ICBA strongly appreciates the Board’s decision to seek comments on a RTGS service and a liquidity management service consistent with the infrastructure recommendations in The U.S. Path to Faster Payments, Final Report Part Two.

ICBA strongly supports the development of ubiquitous, real-time payment systems and the need for ubiquitous access for every financial institution and their customers. Such a system would give customers/end-users (consumers and businesses) the ability to make last-minute payments and receive good funds in a safe and secure manner.

Highlights from our comment letter are noted below.

- ICBA strongly urges the Federal Reserve to assist in achieving ubiquitous, nationwide access to safe and efficient faster payments for all financial institutions and most importantly, their customers by serving three roles:
 - 1) operator of a real-time gross settlement service,
 - 2) operator of liquidity management tools,
 - 3) operator of a payments directory switch or hub linking financial institutions to other payments directories.
- ICBA strongly urges the Federal Reserve to develop and operate a RTGS service in order to provide access and foster ubiquity for all financial institutions regardless of size and charter.
- ICBA maintains that the development and operation of a real-time gross settlement system is consistent with the Board’s statutory responsibility for payments.

- ICBA believes that demand for RTGS will escalate as soon as all financial institutions are able to receive RTGS payments, and that RTGS can be managed as a sub-account of a financial institution's master reserve account.
- ICBA strongly urges the Federal Reserve to begin development of the RTGS system as soon as a decision is published. The Faster Payments Task Force goal of 2020 for ubiquitous faster payments would be ideal and provides community banks and their technology partners sufficient time to develop faster end-user payment applications.
- The Federal Reserve should develop functions, including directory linkage and liquidity management tools, to support faster payments prior to the rollout of the live RTGS service.
- ICBA strongly contends industry-wide ubiquity is a distant possibility and may never be achieved without the Federal Reserve developing and operating a RTGS service *and* interoperating with the private-sector solution. While Federal Reserve action may slow adoption of the private-sector solution, it will hasten the development of end-user interfaces by providing the access and ubiquity needed to enable them.
- ICBA urges the Federal Reserve to build the RTGS service with a clear path toward interoperability with private sector settlement solutions.
- ICBA urges the Federal Reserve to adopt a nimble, yet transparent, project plan that encourages input from its account holders and dialogue with developers of end-user interfaces. Additionally, the Federal Reserve should not slow the development process with extended public comment periods.
- ICBA strongly urges the Federal Reserve to operate and host a central payments directory switch or hub that links financial institutions as well as other private-sector payment systems and directories. The Federal Reserve should leverage the work of the Directories Workgroup wherein the Federal Reserve would serve as a central switch, linking directories of recipient aliases that end-user products can use to ensure that customer financial information is not exposed during the transaction.
- ICBA strongly urges the Federal Reserve to continue to focus on ways to improve the functionality and speed of existing service offerings — such as wire, cash, paper and image check collection and ACH processing — with a particular focus on processing windows and weekend and holiday settlement.
- ICBA strongly supports the Federal Reserve developing 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. The Federal Reserve should make this tool available on a 24x7x365 basis, to avoid possible confusion among financial institutions and to decrease the Federal Reserve's burden of maintaining and posting hours of availability.
- ICBA strongly urges the Federal Reserve to make these liquidity tools available not only for the Federal Reserve's RTGS service but also for any bank-centric private

sector RTGS service. As a central bank, the Federal Reserve System has a natural role in providing and monitoring settlement accounts.

- ICBA supports the development of multiple approaches to liquidity management to enable banks flexibility in managing liquidity associated with a 24x7x365 RTGS service.
- ICBA urges the Federal Reserve Banks to develop liquidity management tools on an accelerated schedule, separate from the Federal Reserve’s RTGS settlement service, in order to foster community bank adoption of faster payments.
- ICBA is extremely concerned about the repercussions if the Federal Reserve System does not commit to serving in an operational role in support of ubiquitous, safe and efficient faster payments.

Background

The Federal Reserve System’s role in the payments system remains a source of disagreement after decades of debate. From 1996-1998, the Committee on the Federal Reserve in the Payments Mechanism, known as the Rivlin Committee, conducted a fundamental review of the Federal Reserve’s role in providing check and ACH services and considered the impact of various roles on the integrity, efficiency and accessibility of the payments system. ICBA enthusiastically applauded the conclusions reached by the Rivlin Committee and noted below.²

- 1) The Federal Reserve should continue as a provider of check collection and automated clearing house (“ACH”) services with the explicit goal of enhancing the efficiency, effectiveness and convenience of both systems, while ensuring access for all depository institutions.
- 2) The Federal Reserve should play a more active role, working closely and collaboratively with providers and users of the payments system, both to enhance the efficiency of check and ACH services and to help evolve strategies for moving to the next generation of payment instruments.

ICBA viewed these conclusions as an indicator of the Federal Reserve’s commitment to becoming a more proactive service provider and a crucial strategist in the rapidly evolving electronic payments arena.

The Board embraced its leadership and catalyst role³ to convene industry stakeholders to discuss ways for improving the efficiency of the nation’s paper-based check clearing system resulting in the passage of a new law, the Check Clearing for the 21st Century Act (“Check

² “The Federal Reserve in the Payments Mechanism,” January 1998, prepared by the Committee on the Federal Reserve in the Payments Mechanism, Federal Reserve System.

<https://www.federalreserve.gov/boarddocs/press/general/1998/19980105/19980105.pdf>

³ Rivlin Committee Recommendation No. 2.

21”) in October 2004. ICBA played a leadership role in securing passage of Check 21. By establishing a new legal framework authorizing the creation of substitute checks to speed up check processing, Check 21 paved the way for bank-to-bank electronic check processing as well as depositor-to-bank electronic check processing. Today, electronic check collection is the primary method for collecting checks.

In October 2012, the Federal Reserve Financial Services Policy Committee (“FSPC”) announced plans to collaborate more closely with payments system end-users including banks, consumers, businesses and governments to “foster innovation and place new emphasis on a faster and more efficient flow of payments and payment information from end to end, that is from the initiator to the ultimate receiver of the payment.”⁴ ICBA strongly welcomed the Federal Reserve’s new strategic direction, highlighting the intent to pursue improvement in the end-to-end speed, safety and efficiency of the payments system.

This new strategic focus was the impetus for the Federal Reserve System collaborative journey to develop a roadmap with the issuance of “The U.S. Path to Faster Payments, Final Report Part Two: A Call to Action”⁵ for ensuring safe, ubiquitous faster payments by 2020. The roadmap includes infrastructure recommendations to support faster payments:

- 1) establishing a directory work group to identify and recommend a delivery design for solutions to interoperate in the faster payments system;
- 2) asking the Federal Reserve to determine the design of and implement a 24x7x365 settlement service; and
- 3) asking the Federal Reserve to explore and assess the need for Federal Reserve operational role(s) in faster payments to support ubiquity, competition and equitable access to faster payments.

The Board heeded roadmap’s call to action with the issuance of this request for comment.

Real-Time Gross Settlement

Community Banks Strongly Support the Development of Real-Time Gross Settlement

ICBA strongly urges the Federal Reserve develop and operate a RTGS service to provide access and foster ubiquity for all financial institutions and most importantly, their customers. This role is consistent with the roles the Federal Reserve currently plays in providing integrity, safety, transparency, equitable access, and ubiquity among all of the

⁴ Collaborating to Improve the U.S. Payments System, Sandra Pianalto speech, October 22, 2012.

⁵ Infrastructure Recommendations, Faster Payments Task Force, July 2017 Part 2, page 31.

<https://fasterpaymentstaskforce.org/wp-content/uploads/faster-payments-task-force-final-report-part-two.pdf>

nearly 11,000 financial institutions,⁶ , regardless of size and charter, for checks, ACH payments, and wire transfers.

The addition of RTGS rails for the settlement of faster payments would complement present-day clearing and settlement systems by providing immediate funds settlement transaction-by-transaction 24x7x365 basis. It is critical that all payments system end-users have the ability to obtain faster, more efficient and more secure payments irrespective of their bank's size or charter type. Such a platform would serve as a foundation for innovation, not just for payments today, but as payments evolve well into the future.

By developing and operating a RTGS service, the Federal Reserve: 1) provides financial institutions an infrastructure option for clearing and settling faster payments, 2) ensures access for all financial institutions; 3) provides a settlement option that is not affiliated or owned by larger competitors; 4) serves as a backbone to ensure settlement continuity in event of disruption in the private-sector; 5) provides a settlement option with transparent rules; and 6) maintains a competitively-balanced marketplace regarding universal access, pricing and industry innovation.

The Board Has Responsibility and Authority to Offer RTGS

The development and operation of a real-time gross settlement system is certainly consistent with the Board's statutory responsibility for payments. Additionally, this role is in keeping with the Federal Reserve's *Policies: The Federal Reserve in the Payments System*⁷ ("Payments System Policy Statement"), which stated goal is: "to promote the integrity and efficiency of the payments mechanism and to ensure the provision of payment services to all depository institutions on an equitable basis, and to do so in an atmosphere of competitive fairness."

The Payments System Policy Statement also establishes three criteria that must be met before the Federal Reserve introduces a new service or a major service enhancement. First, the Federal Reserve must expect to achieve full recovery of costs over the long run. Second, the service will yield a clear public benefit in the areas of payments system integrity, effectiveness of financial markets, risk reduction or improving payments system efficiency. Third, the service should be one that other providers, alone, cannot be expected to provide with reasonable effectiveness, scope and equity.

ICBA believes that developing and operating a RTGS service fulfills all the referenced criteria. Providing ubiquity and access for all financial institutions and end-users is a clear public benefit that only the Federal Reserve can provide and is a role that the Federal

⁶ The FDIC's [Quarterly Banking Profile for Q3 2018](#) reports 5,477 insured depository institutions. The NCUA's [Quarterly Credit Union Data Summary for Q3 2018](#) reports 5,436 federally insured credit unions.

⁷ "Policies: The Federal Reserve in the Payments System"
https://www.federalreserve.gov/paymentsystems/pfs_frpaysys.htm

Reserve currently provides for checks, ACH payments and wire transfers. No other entity has the breadth to reach every financial institution, regardless of size and charter. The Federal Reserve is a trusted payments partner dedicated to offering service to all financial institutions in a fair, equitable and transparent manner.

Under the Monetary Control Act, the Reserve Banks are required to recover the cost of services in the long run and in the aggregate. However, the Board's more stringent pricing principles require each service line to cover all operating, float and imputed taxes and return on capital. Additionally, each service line must be marginally profitable and all services in the aggregate must yield full-cost recovery. ICBA contends the pricing principles afford the flexibility for Reserve Banks to offer RTGS and maintain compliance with the pricing principles. Theoretically, initial compliance could be achieved by allowing the revenue from existing service lines to offset initial RTGS service line losses. We believe this is the likely model the Board embraced with regard to the rollout of Check 21 services which quickly spurred check clearing efficiency, innovation and a rapid path to cost recovery. ICBA strongly encourages the Board to adopt a similar strategy for the development and rollout of RTGS.

Demand for Faster Settlement Is Here and Growing

The demand for faster payments is clearly evident in the evolution of the payment systems toward real-time authorization and memo posted transactions. According to The Federal Reserve Payments Study (2016), the fastest growing payment systems, debit and credit cards,⁸ have real time verification and memo-posting. Additionally, customers are using nonbank applications for person-to-person transactions, such as Paypal's Venmo and Square's Cash. Large banks have made a significant investment in developing Early Warning Service's Zelle brand and The Clearing House's Real Time Payments (RTP) service. Until RTP, every service focused on provisional, memo posted transactions.

ICBA believes that demand for real-time settlement will escalate as soon as all financial institutions are able to receive RTGS payments. Once that ubiquity is achieved new use cases will emerge such as real-time payroll, immediate bill payment, person-to-person payments and business-to-business payments. These use cases are reliant on ubiquitous receipt, which will only be achieved when the Federal Reserve mandates ubiquitous receipt to its RTGS system *and* interoperates with the private sector.

⁸ The Federal Reserve Payments Study 2016, page 2

<https://www.federalreserve.gov/newsevents/press/other/2016-payments-study-20161222.pdf>

Community Bank Operational Adjustments Will Vary

Community banks will need to make significant adjustments to provide RTGS payments to their customers. Once the Federal Reserve develops the technology, standards and processes to support RTGS, community banks directly or through technology partners and processors will need to build and test end-user applications before offering them to their customers. While this will cause significant short-term disruption for community banks, this will position community banks at the center of a dynamic, yet secure, payments system that will yield benefits for years to come.

While there will be adjustments needed to agreements and accounting, ICBA believes that RTGS can be managed as a sub-account of the master account. Community banks will rely on correspondent banks, other liquidity management tools and funding agents to facilitate a seven-day accounting regime, in addition to services provided by technology partners and processors.

Timely and Transparent RTGS Implementation Is Critical to Ubiquitous, Safe and Efficient Faster Payments

ICBA strongly urges the Federal Reserve to begin development of the RTGS system as soon as a decision is published. While ICBA strongly believes that the Faster Payment Task Force's goal of 2020 would be ideal to give community banks and their technology partners and processors sufficient time to develop RTGS-based end-user applications, it recognizes that development could take longer. Moreover, the Federal Reserve should develop functions to support faster payments prior to the rollout of the live RTGS service. The table below maps out a timeline that ICBA believes is reasonable.

Action	Timeframe
Federal Register Notice (go-no-decision on RTGS, liquidity tools, directory recommendations)	2 nd Quarter 2019
Liquidity tools released	3 rd Quarter 2019
RTGS technical specification and draft	3 rd Quarter 2019
RTGS alpha development and testing	1 st Quarter 2020
RTGS beta development with user-interface testing	3 rd Quarter 2020
Interoperability testing	4 th Quarter 2020
First version RTGS live	1 st Quarter 2021

ICBA strongly urges the Federal Reserve to consider that ubiquity among financial institutions should be the primary measure of success for establishing a RTGS service. ICBA contends industry-wide ubiquity is a distant possibility and may never be achieved without the Federal Reserve developing and operating an RTGS service and interoperating with the private sector solution. Additionally, ICBA strongly contends that while Federal Reserve action may slow adoption of the private sector solution, it will hasten the development of end-user interfaces by providing the access and ubiquity needed to enable them.

ICBA urges the Federal Reserve to build the RTGS service with a clear path toward interoperability to private sector settlement solutions. Interoperability with the private sector settlement service is critical in the long term, but efforts toward interoperability should not delay initial service development, but the inability to interoperate with the private sector will impact ubiquity and hamper the long-term success of the Federal Reserve's RTGS service. The Federal Reserve should employ the same standards and protocols as the private sector settlement service to ensure interoperability.

In order to encourage agile development of RTGS, ICBA urges the Federal Reserve to adopt a nimble, yet transparent, project plan, that encourages input from its account holders, dialogue with developers of end-user interfaces. Stakeholder communication is vital to achieving a smooth implementation to RTGS. The financial services industry should receive updates via faster payments community meetings, Federal Reserve Services communications and Reserve Bank town hall meetings. ICBA strongly urges the Federal Reserve not to slow the development process with extended public comment periods. Feedback should also focus on providing banks and their technology partners and processors design information, so they can evaluate and build to the Federal Reserve's RTGS system.

Linking Payments Directories is an Essential Component to Ubiquitous Faster Payments

ICBA strongly urges the Federal Reserve to operate and host a central payments directory switch or hub that links financial institutions as well as other private-sector payment systems and directories. This is a vital step toward ubiquity and access for all financial institutions and end-users. This directory should facilitate messages to route payments to other private-sector solutions. Directories are necessary to connect seamless end-user interfaces and facilitate clearing and settlement. A central directory could also facilitate interoperability in clearing and settlement between the Federal Reserve's RTGS and private sector settlement systems.

The Federal Reserve should leverage the work of the Directories Workgroup⁹ wherein the Federal Reserve would serve as a central switch, linking directories of recipient aliases that end-user products can use to ensure that customer financial information is not exposed during the transaction. Without directories that link end-user services to clearing and settlement services, interoperability is not achieved, resulting in the proliferation of closed-loops services.

As the Federal Reserve develops and operates the RTGS service, other ancillary services such as fraud detection are a possibility for future consideration. However, ICBA contends that while security should be one of the defining features of RTGS, financial institutions currently have access to fraud detection and monitoring services. Additional services, such as fraud detection and monitoring, could be added once the RTGS service is established.

The Federal Reserve Needs to Continue Improvement to All Legacy Services

ICBA strongly urges the Federal Reserve to continue to focus on ways to improve functionality and speed of existing service offerings — wire, cash, collection of check, check image and ACH processing — with a particular focus on processing windows and weekend and holiday settlement. These services will continue to be vital to the success of community banks and need continued improvement to adapt to a changing competitive environment.

Liquidity Management Tool

ICBA strongly supports the Federal Reserve developing 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. ICBA urges the Federal Reserve to make this tool available on a 24x7x365 basis, to avoid possible confusion amongst financial institutions and to decrease the Federal Reserve's burden of maintaining and posting hours of service availability.

ICBA strongly urges the Federal Reserve to make these liquidity tools available not only for the Federal Reserve's RTGS service but also for any bank-centric private sector RTGS service. As a central bank, the Federal Reserve System has a natural role in providing and monitoring settlement accounts. Banks already maintain funds with the Federal Reserve, either directly or through a correspondent bank for reserves and settlement. Private sector

⁹ This workgroup was established according to Recommendation #4 of the Faster Payments Task Force <https://fasterpaymentstaskforce.org/goals-and-recommendations/>

RTGS systems require prefunding, resulting in banks having to maintain additional funds with other participants to guarantee payment. These funding requirements would reduce liquidity in the banking industry and over time create unnecessary limits on small and medium size banks' ability to manage liquidity and ability to generate new loans.

ICBA supports the development of multiple approaches to liquidity management to enable banks flexibility in managing liquidity associated with a 24x7x365 RTGS settlement. Such tools should include account transfers, correspondent and agent transfers, automatic transfer of balances (or "sweeps") based on preestablished thresholds and limits and, if needed, the ability to borrow from the Federal Reserve's discount window.

ICBA urges the Federal Reserve Banks to develop these liquidity management tools on an accelerated schedule, separately of the Federal Reserve's RTGS settlement service in order to foster community bank adoption of faster payments.

Conclusion

Settlement systems for faster payments must be developed in a manner that ensures the payments are safe, secure, fast efficient and ubiquitous. By promoting bank-centric 24x7x365 RTGS settlement and liquidity management the Federal Reserve will ensure that all community banks and their customers have access to settlement services for faster payments.

This ensures a well-regulated payment system with consumer protections, safety and soundness and oversight and examination requirements. Payments systems should be safe and secure, adhere to the same regulations and consumer protections as banks, and enable banks, regardless of size, charter-type or location, to play an active role in the customer relationship.

ICBA is extremely concerned about the repercussions if the Federal Reserve System does not commit to serving in an operational role in support of ubiquitous, safe and efficient faster payments. Without the Federal Reserve linking together the nation's financial institutions, ubiquity will not be achieved, and community banks' consumer and business customers will be at a competitive disadvantage.

ICBA appreciates the opportunity to comment on this request for comment. Please do not hesitate to contact me at cary.whaley@icba.org or 202.659.8111 with any questions regarding our comments.

Sincerely,

/s/

Cary Whaley
First Vice President, Payments and Technology Policy