3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

December 14, 2018

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

RE: Potential Federal Reserve Actions To Support Interbank Settlement of Faster Payments, Request for Comments
(Docket No. OP-1625)

Dear Ms. Misback:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing in response to the request for comment (RFC) issued by the Board of Governors of the Federal Reserve System (Board) regarding potential Federal Reserve actions to support interbank settlement of faster payments.

NAFCU appreciates the Board's continued engagement with credit unions and other industry stakeholders as it pursues its Strategies for Improving the U.S. Payment System (SIPS) initiative. From 2015 to 2018, NAFCU served on both the Faster Payments Task Force (FPTF) and Secure Payments Task Force (SPTF), and has generally supported the Board's collaborative, consensus-driven approach to advancing faster, more secure payments. While the FPTF and SPTF were active, NAFCU worked closely with credit unions and other industry stakeholders to identify criteria and capabilities that would be desirable in a future, faster payments system, and we commend the Federal Reserve for seeking credit unions' perspectives throughout the payments improvement initiative.

In 2017, NAFCU formally asked the Reserve Banks to serve as an on-ramp to real time payments, serve as a real-time settlement service operator, and establish a payments directory to link financial institutions and other private sector payments directories together. With the publication of the RFC, we are pleased to see the Federal Reserve seriously considering potential actions that could make these recommendations a reality. As the Board contemplates a more concrete proposal, we ask that the Federal Reserve continue to advance its payments improvement goals through a public-private partnership that is responsive to the needs and concerns of the credit union industry. NAFCU believes that such a partnership will yield the best outcome for credit unions and the 114 million members they serve.

General Comments:

A future payment system must be cost-effective, operationally effective, and scalable for credit unions of all sizes. NAFCU believes that the general parameters of the proposed settlement service are compatible with these goals. As a result, NAFCU views the RFC as a promising next step in the SIPS initiative that could yield meaningful improvements to existing settlement capabilities and satisfy growing demand for faster payments.

NAFCU asks that the Board evaluate potential design choices in a way that prioritizes time to market and ubiquitous end-user adoption. A future, faster payments settlement service must be made accessible to as many financial institutions as possible in order to attract the interest of future credit union participants. NAFCU's members have expressed an interest in the Reserve Banks playing an operational role in a future faster payments system in order to achieve this objective. While NAFCU generally believes that the financial services industry should lead efforts aimed at developing faster, more secure payments services, the Reserve Banks should also play a role. The Reserve Banks already have experience connecting a large number of financial institutions to the Fedwire Funds Service and National Settlement Service (NSS), and are uniquely positioned to facilitate the transition from deferred net settlement to real-time gross settlement (RTGS). As discussed in further detail below, NAFCU believes that the Reserve Banks can and should:

1. Develop a faster payments service to conduct settlement on a 24x7x365 basis;
2. Develop a liquidity management tool that supports 24x7x365 transfers in support of real-time settlement; and
3. Develop and maintain a payments directory to connect financial institutions to a future, faster payments service.

While the general parameters of the RTGS service under consideration introduce certain technical and operational challenges, NAFCU believes that as long as such a service is competitively priced and accessible to credit unions and other chartered financial institutions, the Reserve Banks should be able to achieve the desired level of ubiquity to ensure long term cost recovery.

Expected Demand for Faster Payments

For credit unions, access to faster payments services could help attract new members and improve overall satisfaction with services such as online bill pay, peer-to-peer (P2P) payments, and business-to-business payments (B2B). Although current funds availability using credit-push systems may be adequate for many consumer transactions, NAFCU anticipates that real-time capabilities provided through the Reserve Banks could help satisfy latent demand for instantaneous payments, particularly in the context of P2P transfers.

Research suggests that increased smartphone adoption may be driving consumer expectations for easier access to faster payment solutions. According to industry data, about 36% of U.S. adults report already using at least one P2P payments service. In addition, U.S. consumer data suggests that a majority of adults most often access their bank accounts online through mobile applications. NAFCU believes that a growing preference for mobile banking could yield additional demand for faster payment options. In addition, a Reserve Bank-developed directory service linking financial institutions to a faster payments system could further drive demand and play a critical role in promoting end-user adoption, particularly among smaller institutions that have had difficulty connecting to private P2P networks.

In other countries, faster payments have already demonstrated initial success,[1] although pricing and adoption strategies have differed. The central banking authorities of the UK and Australia developed services for faster payments in 2008 and 2018 respectively, which demonstrates that both deferred net settlement (DNS) and RTGS systems for faster payments have support abroad. The European Central Bank also introduced an instantaneous payments settlement service in November 2018. The U.S. Department of the Treasury, having considered these international developments in its report titled “Nonbank Financials, Fintech and Innovation,” recommended that the Federal Reserve move quickly to facilitate a faster retail payments system, such as through the development of a real-time settlement service,” and emphasized the need to promote accessibility for smaller financial institutions, such as credit unions. NAFCU agrees with these recommendations.

Recent surveys of NAFCU members also indicate that a growing share of credit unions anticipate making investments in payment processing services in the next three years (49.4 percent, up from 35 percent last year). Over half of the participants surveyed in NAFCU’s 2018 Report on Credit Unions said they were considering a faster payments settlement option for their members, and more than two-thirds noted that they would have greater interest in a faster payments settlement option if it was developed under the direction of the Federal Reserve.

Real-Time Gross Settlement

While the Board favors an RTGS service from a risk and efficiency perspective, it should be noted that both DNS and RTGS services are capable of supporting faster payments, and the Board should weigh expected tradeoffs in interoperability with private settlement services before committing to a particular option.

NAFCU does not believe that real-time gross settlement would present insurmountable operational challenges. NAFCU agrees that an RTGS arrangement may be more liquidity intensive than deferred settlement, but an appropriately designed liquidity management tool that permits automated transfers could reduce the need for significant account monitoring or staffing adjustments. Should the Reserve Banks commit to developing an RTGS service, liquidity options should be designed to reduce overfunding of Federal Reserve Master Accounts or sub-accounts that support real-time settlement.

---

[1] For example, data from the UK’s Faster Payments Service (FPS) shows that faster payments grew by 24 percent in Q3 2018 when compared to Q3 2017, and the total value of FPS payments increased 22 percent to £431 billion during this same period. See http://www.fasterpayments.org.uk/statistics.

Interoperability

In general, NAFCU agrees with the Board's analysis that interoperability between services which adopt different risk and liquidity management arrangements may be challenging. NAFCU also agrees with the Board's view that for two settlement services to be interoperable, each should have the ability to receive transactions originated from the other service and to manage the associated cross-service settlement risks.

For some credit unions, interoperability with private payment systems and clearinghouses would be a significant consideration that would influence future adoption of a Reserve Bank-operated settlement service. For other credit unions, interoperability is less of a concern provided that a future RTGS service is widely adopted by other financial institutions, accessible, and reasonably priced. NAFCU believes that a Reserve Bank operated faster payments service would likely reach the widest possible group of customers and institutions, improve payments system stability in times of crisis, add value by promoting competition, and ultimately reduce long-term costs for the credit union industry. NAFCU encourages the Board to make interoperability with private settlement channels a critical end-goal should it choose to develop an RTGS service; however, such a goal should not hinder near-term efforts to bring a faster payments service online as soon as possible.

For credit unions that are looking to reduce the cost of cross-border transactions, an RTGS service may be preferable insofar as it may afford greater interoperability with faster payments services that exist in other countries. Although cross-border payments functionality does not appear to be a design consideration in the RFC, the Board should not neglect Strategy #4 of SIPS in future development efforts. Strategy #4 identified enhancements to cross-border payments as a desired outcome for an improved U.S. payment system. NAFCU encourages the Board to consider design choices that would facilitate cross-border functionality while preserving the safety and affordability of a future faster payments settlement service.

Operational Challenges

To adapt to a 24x7x365 settlement environment, credit unions would need to make programming changes, expand service hours, and potentially adjust staffing levels to appropriately manage liquidity needs during non-standard hours. If the Board does not develop a liquidity management tool, operational costs will likely be higher and prevent many smaller credit unions from accessing a future, RTGS service. Irrevocable settlement also presents unique fraud challenges in a 24x7x365 environment, which might require credit unions to implement specialized security controls, such as transaction limits or monitoring tools, to address fraud in real-time.

Auxiliary services to improve authentication and security of faster payments could also drive costs. For example, utilization of new fraud databases to support continuous monitoring or advanced heuristics might necessitate new forms of data collection and analytical capabilities. To reduce the operational burdens that these changes might entail, the Board should avoid the imposition of specific technology mandates and ensure that any proposed security enhancements will work for credit unions of all sizes. NAFCU urges the Board to present its plans for addressing payments fraud through a separate proposal if it intends to consider specific security technologies or standards.

Liquidity Management Tool

NAFCU believes that an improved liquidity management tool would be a necessary and highly desirable feature for a Reserve Bank-operated, real-time settlement service. Furthermore, demand for more flexible liquidity management options should prompt the Board to consider improvements to existing capabilities of the NSS—whether or not an RTGS service is ultimately developed—to support private settlement of faster payments. NAFCU also asks that the Board consider ways to better implement Strategy #5 of SIPS, which recommends that the Reserve Banks expand the operating hours and other capabilities of the NSS. NAFCU believes such action could support improvements to interbank settlement for existing types of payments, such as check and ACH, and make faster payments through other, established services an alternative option for credit unions.

NAFCU encourages the Board to consider improvements to liquidity management that go beyond the scope of the RFC. Based on information shared at the Federal Reserve town hall meetings, the Board envisions a future liquidity management tool as a way to move funds strictly between a Federal Reserve Master Account and a sub account used in support of either a private or Reserve Bank-operated settlement service. Such a design would mean that a participating institution would need to fund its Master Account in advance to ensure that it can manage liquidity across a potential faster payments sub account over the weekend and holidays.

To address potential liquidity issues when managing Master Account reserves, NAFCU recommends that the Board consider expanded operating hours and intraday credit options for accounts that directly or indirectly support real-time payments. Doing so could help credit unions manage their liquidity with greater confidence and reduce the need to overfund Master Accounts during nonstandard business hours. However, liquidity options should also be tailored to reduce Reserve Bank exposure to unmanageable levels of intraday credit risk.

To reduce operational complexity and promote wide adoption, the Board should also ensure that a future liquidity management tool can accommodate transfers initiated by individual credit unions and those initiated by authorized agents—such as a correspondent. In addition, the tool should permit automatic transfers to reduce staffing burdens. NAFCU believes the Reserve Banks may also wish to support preapproved, automatic transfer logic to promote greater efficiency. Such logic might fulfill basic needs using simple parameters (e.g., replenishment at certain times in the day). In essence, NAFCU supports development of a fully featured liquidity management tool that would help credit unions minimize the operational burden of 24x7x365 accounting for real-time payments.

Time to Market

NAFCU believes that the Board should aim to develop and launch a faster payments service as soon as possible. Even if the Reserve Banks were to commence work immediately, meeting the

SIPS goal of developing an RTGS capability and achieving ubiquitous receipt of faster payments by 2020 would likely prove challenging. However, NAFCU believes that the Reserve Banks could still meet this goal if core settlement functionality is prioritized while new features or auxiliary services are added at different stages. NAFCU believes that development of a fully-featured RTGS service should—at the very least—coincide with the effective date for migrating to the ISO 20022 standard in 2023.

If credit unions must wait several years for a Reserve Bank-operated RTGS service, they may decide to use private clearinghouses to meet faster payment demand. In such a scenario, the Reserve Banks will face greater difficulty achieving widespread adoption and recovering costs. Furthermore, if a future RTGS system is not ultimately interoperable with existing, real-time settlement services offered by the private sector, the consequences of delaying time to market would likely be magnified. Accordingly, NAFCU encourages the Board to bring a functional RTGS service online as quickly as possible in order to mitigate potential market fragmentation.

Payments Directory

NAFCU strongly supports the creation of a common directory to link financial institutions and other private payments directories together. The design of the directory should facilitate the greatest level of interoperability between existing services to ensure ubiquitous connectivity. Whether this is accomplished through a centralized database or a federated directory model should be decided on the basis of cost and ease of use.

NAFCU also believes that a highly interoperable directory service could alleviate certain technical challenges that exist when settlement occurs across RTGS- and DNS-based solutions. For smaller credit unions that have had difficulty joining existing P2P networks, a Reserve Bank settlement option that includes a robust payments directory could also provide a path for P2P connectivity that does not involve attaining a particular volume of payments or reaching a certain asset size. Given the critical importance a directory is likely to play in driving end-user adoption, NAFCU believes that the Board should present its design choices in a separate proposal.

Fraud Risk

Adoption of faster payments may require credit unions to invest in new or improved security controls to address the risk of real-time fraud. These investments could be significant and may increase the cost of accessing a future RTGS service depending on whether the Board decides to utilize auxiliary services to implement new security controls or develops internal solutions. Accordingly, NAFCU urges the Board to work closely with individual credit unions, aggregators, and other service providers to identify an appropriate security framework that will ensure strong authentication and safety of payments, but permit flexibility in terms of how enhancements are implemented.

An ideal framework for addressing payments fraud in real-time should be designed to accommodate financial institutions of all types and sizes, and should avoid a one-size-fits all approach. To achieve this goal, NAFCU encourages the Board to pursue future payments security strategies through a transparent partnership with industry to facilitate full and open discussion of possible solutions.

Conclusion

NAFCU appreciates the Board's consideration of a potential real-time settlement service, liquidity management tool, and payments directory to facilitate adoption of faster payments. The Federal Reserve's close engagement with the credit union industry is also commendable, and we would like to thank the Federal Reserve staff who have worked closely with NAFCU to educate our members about the progress of the SIPS initiative, the output of the FPTF and the SPTF, and the technical challenges presented by faster payments.

Through these outreach efforts, our members have expressed a keen interested in the possibility of the Reserve Banks introducing a faster payments service. Likewise, NAFCU is excited about the possibilities discussed in the RFC and encourages the Board to develop a more concrete proposal as a next step. We also hope that a future proposal will address in greater detail the liquidity, accessibility and security challenges that might impact credit unions. We also ask that the Board express a more definite commitment to operating a payments directory to support a future real-time settlement service.

While there are many technological challenges to overcome in terms of achieving security, reliability, and interoperability, NAFCU stands ready to work with the Board, Reserve Banks, and industry partners to develop a faster payments system that is effective, scalable, and accessible to credit unions and their members.

If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2266 or amorris@nafcu.org.

Sincerely,

Andrew Morris

Andrew Morris
Senior Counsel for Research and Policy