NAFCU
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

September 8, 2021

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

RE: Collection of Checks and Other Items by Federal Reserve Banks and Funds Transfers Through Fedwire (RIN: 7100-AG16)

Dear Ms. Misback:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Request for Comment (RFC) issued by the Board of Governors of the Federal Reserve System (Board) regarding proposed amendments and modifications to Regulation J, pertaining to the release of the FedNow service (FedNow), changes and clarifications to subpart B, governing the Fedwire Funds Service, and technical corrections to subpart A, governing the check service. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 125 million consumers with personal and small business financial service products. NAFCU strongly supports development of FedNow and urges the Board to consider NAFCU's recommendations on measures that would encourage adoption of the service by credit unions.

General Comments

NAFCU has long been supportive of the Board's involvement in developing a real time payments system. Accordingly, NAFCU appreciates the Board's continued engagement with credit unions and other industry stakeholders as it pursues development of FedNow. For credit unions, access to affordable faster payments capabilities will 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). Real-time capabilities provided through the Reserve Banks will help meet demand for faster payments and encourage a competitive market for real time payments. Moreover, a growing preference for mobile banking experiences could yield additional demand for faster payment options.

Nearly half of respondents to NAFCU's 2020 Federal Reserve Meeting Survey reported that FedNow's development will accelerate adoption of faster payments. Remarkably, only 7 percent of surveyed credit unions said that they were not considering real-time payments—a sign that the credit union industry is starting to ask critical questions about potential use cases for real-time transactions in an environment where faster payment capabilities are increasingly commonplace.

NAFCU was pleased to learn that many of the features credit unions had identified as critically important to FedNow adoption will be prioritized in the roll-out of the service. These include the liquidity management tool, fraud prevention tools, and request for payment functionality as day-one features. NAFCU is also appreciative of the Board's explicit commitment to conform FedNow's technical specifications to widely accepted industry standards to remove barriers to interoperability. As NAFCU has commented in the past, we encourage the Board of Governors to remain open-minded regarding ways to work with private service providers to advance the goal of interoperability while ensuring that credit unions have fair and affordable access to real time payments.

Interoperability

NAFCU supports the Board's desire to make FedNow interoperable with private sector networks to maximize the reach and accessibility of real time payments. Interoperability with private payment systems and clearinghouses could influence future adoption of FedNow for some credit unions. Achieving interoperability with private networks would not only enhance the resiliency of the nation's payment systems but likely speed faster payments adoption. To the extent that this interoperability depends on a consistent understanding of "immediate" in the context of funds availability, the Board should seek to adopt definitions that accommodate private network specifications, which could evolve over time.

Account Reconciliation

FedNow would establish a "business day" for account reconciliation purposes by setting opening and closing times in Eastern Time. The business day would be used to determine end-of-day balances, conduct associated reserve and interest calculations, and facilitate transaction reporting. The Board has determined that the business day of FedNow should align with the business day of the Fedwire Funds Service. NAFCU generally agrees with the proposed account reconciliation framework as it offers a logical mechanism for determining end-of-day balances for master accounts and would not affect FedNow's continuous processing of payments.

Fraud Prevention

An effective payments system must also be resilient to fraud. In NAFCU's 2020 Federal Reserve Meeting Survey, 70 percent of respondents reported that fraud prevention tools were the most important FedNow feature for their credit unions. NAFCU continues to advocate for appropriate controls to address persistent levels of fraud which cost the economy billions in losses each year.

In light of the elevated prevalence of fraud, NAFCU and its member credit unions harbor serious concerns about Regulation E's risk allocation framework in the context of instant payments. In the Consumer Financial Protection Bureau's (CFPB) recent FAQ on the application of the *Electronic Funds Transfer* Act (EFTA) and Regulation E, the CFPB describes a number of hypothetical transactions that would be considered unauthorized electronic fund transfers (EFTs) and therefore limited from consumer liability.[1] These included transactions involving consumer negligence, fraudulent inducement by a third party, as well as discussion of the limitations on waivers and investigations of errors. While NAFCU supports sensible consumer protections, the application of the Regulation E framework in the context of instant payments could have particularly dire consequences for smaller community institutions if they do not have adequate time to take countermeasures against suspected fraudulent activity. An enhanced effort to educate consumers on the risks involved with instant payments could also help to blunt the potential impacts to credit unions.

Credit unions frequently bear the brunt of costs associated with fraud prevention. This burden has been increased in recent years with fraudsters frequently targeting electronic transactions. The Board, in its 2018 Federal Reserve Payments Study found that from 2012 to 2015, the value of payments fraud grew faster than the value of total payments. The fraud rate, by value, increased by more than one-fifth.[2] The introduction of instant and irrevocable payments will only serve to increase this fraud risk and the associated prevention costs to credit unions. Therefore, NAFCU encourages the Board to coordinate with the CFPB on appropriate guardrails to ensure that consumers know they should be exercising heightened care when initiating instant payments.

Adoption of faster payments will require credit unions to invest in new or improved security controls to address the risk of real-time fraud in an environment where settlement is irrevocable. These investments could be significant and may increase the cost of accessing FedNow. This view is shared by the 50 percent of surveyed credit unions that said that managing fraud risk will be a "significant concern" over the next three years in NAFCU's 2020 Federal Reserve Meeting Survey. Accordingly, NAFCU urges the Board and Reserve Banks to continue 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 and provide the necessary tools for credit unions to anticipate fraud before it occurs. At the same time, if the Board intends to use FedNow as a platform for implementing industry-wide fraud mitigation standards, then it should also seek to preserve credit unions' ability to adopt fraud controls that are tailored to complexity, risk, and usage of real-time payments.

UCC 4A and Regulation E

NAFCU does not anticipate that the adoption of the Uniform Commercial Code (UCC) Article 4A will present interoperability concerns with real time payment services by private-service providers. However, NAFCU requests that the Board provide clarity on the delineation of applicability between UCC 4A and Regulation E to FedNow transactions. Specifically, NAFCU asks that the Board provide examples of instances in which a transaction would fall under the provisions of Regulation E and the actions or processes that would trigger Regulation E applicability.

---

[1] *Electronic Fund Transfers FAQs: Unauthorized Electronic Fund Transfers and Error Resolution,* Consumer Financial Protection Bureau (June 4, 2021), https://www.consumerfinance.gov/compliance/compliance-resources/deposit-accounts-resources/electronic-fund-transfers/electronic-fund-transfers-faqs

[2] Changes in U.S. Payments Fraud from 2012 to 2016: Evidence from the Federal Reserve Payments Study (Washington: Federal Reserve Board, October 2018)

The Board recognizes that consumer FedNow transactions that utilize payment networks subject to Regulation E at any point in the transaction would also be governed by Regulation E, such as in instances where a payment message is initiated through FedNow but a private network is used to deliver funds to the beneficiary. In those transactions, Regulation E limits the liability of a consumer that provides timely notice of an unauthorized electronic fund transfer. This liability limit, when combined with instant and irrevocable payments, would have the practical effect of ensuring that financial institutions initiating the transaction would bear the cost of fraudulent payments in virtually every unauthorized transaction.

To the extent that this would be the case, NAFCU requests that the Board provide financial institutions with the necessary tools to ensure that consumer initiated FedNow transactions can reach beneficiaries entirely through the FedNow network and allow these transactions to be treated exclusively as UCC 4A transactions. This type of direct access would provide clear rules of the road for credit unions and remove ambiguity from the allocation of liability. As a result, more credit unions would likely adopt FedNow.

Funds Availability

FedNow is designed for end-to-end transfer to be completed in a matter of seconds, which means that the beneficiary's bank would agree that it will make funds available to the beneficiary immediately after it has accepted the payment order. NAFCU is supportive of the Board's proposal to make funds available to the beneficiary immediately, however the Board should set accommodative time parameters to clarify the meaning of "immediately" as used in this funds availability requirement.

Credit unions vary significantly in size, resources, and operational capabilities. While many credit unions may be prepared to expend the resources necessary to successfully adopt FedNow on an operational level, the variability in fraud prevention capabilities of credit unions necessitates a sliding scale approach to the funds availability window. This will provide those credit unions with lesser bandwidth the time necessary to analyze incoming transactions. The speed of the transaction should not exceed the speed at which a transaction or series of transactions can be briefly evaluated as suspicious. In order to successfully adopt real-time payments, credit unions will require a reasonable time margin to ensure that when they are both the sending and beneficiary institution, they have enough time to determine whether intrabank transfers are the product of error or fraud. Additionally, while smaller credit unions may require more time to process each transaction, larger credit unions may be required to process a much larger volume of transactions and therefore similarly require more time to deal with that larger demand on their systems.

NAFCU requests an accommodative framework that provides credit unions sufficient time to determine whether to accept a payment order that takes into consideration evolving fraud prevention tools and industry practices. As the speed with which fraudsters are able to bypass prevention methods increases, the amount of time that credit unions will need to combat these fraud attempts will remain similarly variable. Furthermore, NAFCU requests that the Board provide data and feedback from participants from the FedNow Pilot Program regarding what constitutes reasonable timing parameters for funds availability and what circumstances might necessitate a credit union requiring more time to determine whether to accept a payment order.

Conclusion

NAFCU appreciates the opportunity to comment on the proposed amendments and modifications to Regulation J pertaining to the release of FedNow. NAFCU strongly supports the Board's efforts to bring FedNow into operational status and urges the Board to consider the recommendations made here. If you have any questions, please do not hesitate to contact me at 703-842-2268 or jakin@nafcu.org.

Sincerely,

James Akin
Regulatory Affairs Counsel