High Level Overview – Real Time Payments

The Federal Register Request for Comment contemplates two major roles for the Federal Reserve in support of real time payments in the United States:

1. Real Time Gross Settlement (RTGS) - Providing a real time gross settlement service whereby each transaction is settled in real time and robust data flows with the transaction. Today even when we process what appears to be real time transactions (i.e. debit card, credit card, and Zelle), there is real time messaging and a commitment to debit and or make funds available via memo posting credits/debits, but the actual settlement between financial institutions still happens on a net settlement deferred basis after the fact. In addition the amount of data that can travel with the payment is limited in current payment systems.

2. Liquidity Management Tools - In support of the proposed Fed RTGS system, or an existing private sector solution like The Clearing House's Real Time Payment system (RTP), the Fed would create liquidity management capabilities to help a financial institution ensure they had sufficient funds in their Fed account to fund real time payments 24x7.

Page 8 of the Federal Register highlights the criteria the Fed has to meet in order to offer a new service (Monetary Control Act of 1980) - These include expectations that (i) the Federal Reserve will achieve full cost recovery over the long run, (ii) the service will yield a clear public benefit, and (iii) the service is one that other providers alone cannot be expected to provide with reasonable effectiveness, scope, and equity.

In general the Fed would like as many banks as possible to write a response to the Federal Register to ensure all voices are heard as the Fed contemplates its role in the faster payments ecosystem. Fed has made it clear you do not need to answer every question at the end of the Federal Register. Letters written on behalf of banks by trade associations while valuable will not be as effective as individual letters from banks.

Below is an outline of the possible high level positions various members of the payment ecosystem may take as they evaluate the Fed's role in faster payments:

Industry Positions - Opposition and Support

Opposition Views (in parenthesis response from the supporters)

1. Private sector free market vs government based solutions - Private sector solutions such as The Clearing House Real Time Payments (TCH RTP) have yet to have time to succeed or fail. Owner banks of TCH's solution have invested significant capital to build TCH's RTP and therefore do not want to compete with a solution funded by the Federal Government. The Fed should wait to see if there is another free market solution that emerges, or if the TCH RTP system is able to meet the market's needs. (Having only one option owned by your largest competitors is not a competitive free market - given remaining volume after top 25 banks hard for a nongovernment entity to obtain enough volume to build a competing solution. Today a similar market exists for checks and ACH where there are private sector solutions competing with the Fed so why not have a similar approach with real time payments)
2. Bank centric system - A system built by the Fed runs the risk of being hijacked in Congress by Fintechs and Retailers - built by taxpayers so why should they have to go through banks to get access. (Fed has been successful in beating this back for years and is not interested

in mixing commerce and banking - hence why they have yet to comment on whether or not they will allow a special purpose OCC charter to gain access to payment rails)

3. Fed will be able to compete on price more effectively - Significant investment by private sector will be competing with a government subsidized service that will manipulate required cost recovery calculations. (Fed has to answer to GAO scrutiny and has been challenged in the past for check and ACH processing)
4. Fed will push revenues down - Given it is government funded it will not operate with a disciplined ROI approach when compared to private sector solutions. For example the interbank ACH fee for same day ACH was reduced from the NACHA proposed $.08 to $.04 largely as a result of Fed. (Many retailers and consumer groups would argue this is a good thing - keeping cost down for end users - especially when compared to cards where Fed is not an operator)
5. Fed does not state interoperability as a priority - will cause industry to connect to two disparate systems (TCH RTP and Fed RTGS) costing all banks more money in the end. (Hard to imagine where Fed has stated ubiquity is a priority as part of the faster payments task force effort and been standing up several work groups in support of this outcome - industry comment letters should push the Fed to interoperate with existing solutions)
6. Fed's entry will freeze the market - Fed's entering will slow down progress as some banks wait for the Fed to either make a final decision and or build their solution. Owner banks of TCH RTP have put up their money and are looking for a return on investment. (If market forces support RTP, Fed entering will not slow down progress as competitors will not sit and wait for the Fed. Incumbent on the Fed to make a quick decision to minimize this impact. However a long term outcome should be the focus given this is the first new set of payment rails in 40 years.)

Support Views (in parenthesis response from the opposition)

1. Level the playing field between small FIs and large FIs - Small and medium FIs need the Fed as an option to make sure large banks do not control the cost of real time payments - (TCH RTP is a nonprofit, engaging an economist to complete a cost recovery study on a periodic basis, charging same fee to all, no volume discounts, aligned as volume goes up TCH lowers costs for all, DOJ approved the approach from an anti-trust perspective. Worth noting the Fed is not always the low cost provider of services today such as check and ACH processing.)
2. Fed has connections to all 11,000+ FIs - TCH cannot onboard the large number of FIs in the system, supported by problems EWS is having today onboarding banks for Zelle. Will give large banks a competitive advantage initially and whenever there are major enhancements. (TCH claims to be able to onboard the industry, core providers are currently working with TCH, will be years before Fed has anything in market so Fed operator may be so far out you need to connect to TCH RTP to remain competitive)
3. Fed brings resiliency to the market - can step in and do things to keep the system functioning that a private sector solution cannot - for example provided liquidity when checks were stuck on the ground post 9/11. Two solutions also creates resiliency vs one private sector option. (TCH has made significant investments to ensure system is resilient and banks could collaborate. Fed could still offer some liquidity support.)
4. Fed's settlement and liquidity solution is better - central bank master accounts where it counts towards reserve requirements, can earn interest, and a bank could access borrowing options. (TCH uses the Fed's joint account system whereby they move money between bank accounts within TCH's joint account structure. TCH is solving some of these issues with bilateral credit agreements between banks to provide borrowing facilities, but not as good as being able access discount window or the full balance in your Fed master account)

5. Societal benefit - Federal Reserve is a better leader catalyst and partner given they are not competing for retail and commercial deposits/loans. (Fees are the same for all users of TCH RTP with no volume discounts)

Common Ground For Large and Small FIs

1. Interoperability - solutions need to meet effectiveness criteria established by Faster Payments Task Force (need to insist Fed make this a priority and should consider in market solutions when designing their system - makes TCH RTP investment more valuable for all)
2. Settlement and Liquidity Management - all FIs would support Fed playing role in settlement - use of central bank accounts, reserve requirements, pay interest, borrowing services. Fed liquidity services should be made available to TCH RTP private sector solution as well.
3. Bank Centric - service needs to be owned and controlled by the banking system - safety and soundness, separation of commerce and banking, data security, etc...

Differences Between Small/Medium FIs and Large FIs

1. Small and Medium FIs - Fed should not only offer settlement and liquidity but also RTGS - small banks want a full solution from the Fed. Competition/choice/similar to what exists today for check and ACH. Level the playing field and extend reach of system more quickly.
2. TCH Owners and Large FIs - Government competing with private sector, market has not failed, Fed cannot achieve a cost recovery given the volume of 25 owner banks already in TCH RTP, and not the primary role of the Fed (monetary policy).

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