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National Association of Federally-Insured Credit Unions

November 7, 2019

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

RE: Federal Reserve Actions To Support Interbank Settlement of Faster Payments
Docket No. OP–1670

Dear Ms. Misback:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Board of Governors of the Federal Reserve System (Board) request for comment regarding development of the FedNow Service. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 118 million consumers with personal and small business financial service products. NAFCU supports the Board's decision to move forward with plans to develop a new interbank real-time gross settlement (RTGS) service to achieve ubiquitous access to faster payments.

For credit unions, faster payments represent a distinct technology priority. Over half of the participants in NAFCU's 2018 *Federal Reserve Meeting Survey* (Survey) reported that they were considering a faster payments settlement option for their members. In addition, over 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. NAFCU's 2019 Survey revealed that over 45 percent of respondents expected that the introduction of the FedNow Service would accelerate their adoption for faster payments. NAFCU and its members have also met with five of the Reserve Banks in 2019, and there has been general recognition that faster payments are driving consumer expectations for minimum levels of speed and convenience.

Given strong credit union support for FedNow's development, NAFCU encourages the Board and the Reserve Banks to expedite delivery and launch at the earliest possible date. While it is understandable that the introduction of an entirely new payments rail requires careful and deliberate planning, private sector operators of real-time networks may fill interim gaps in demand by offering incentives to early adopters. To maintain a favorable array of cost-recovery options at launch, the Reserve Banks should consider whether introduction of the FedNow Service can be accelerated through a staged deployment.

General Comments

Any future, real-time payment system must be cost-effective, operationally effective, and scalable for credit unions of all sizes. To be operationally effective, a future real-time payments system must be able to reach all financial institutions and consumers—particularly those in Main Street

America who depend on credit unions for affordable access to financial products and services. NAFCU believes that the development of the FedNow Service is critical to achieving such ubiquity. At the same time, NAFCU supports the Federal Reserve's desire to make the FedNow Service interoperable with private sector networks to maximize the reach and accessibility of real-time payments. NAFCU has also supported incremental improvements to existing payments infrastructure to achieve faster settlement capabilities that do not require real-time speed.

It is also important that community institutions such as credit unions are able to secure fair access to real-time payments services; a goal that is currently shared by private sector operators, but best achieved with the participation of the Federal Reserve. As with its check and ACH services, the Federal Reserve maintains a policy of extending access to its payments services on fair and equitable terms to all institutions, including those in rural and remote areas. NAFCU believes the Reserve Banks are fully capable of developing the FedNow Service in a manner that is consistent with this objective.

For credit unions, access to affordable faster payments capabilities 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. NAFCU believes that a growing preference for mobile banking could yield additional demand for faster payment options. A robust directory service securely linking financial institutions and their customers to a faster payments system could also accelerate adoption and attract smaller institutions that have had difficulty connecting to private P2P networks.

While a majority of NAFCU-surveyed credit unions indicate that they are planning to invest in faster payment options for their members, some are uncertain of member demand for real-time payments, particularly in a retail environment that is already highly accommodating of deferred settlement systems. However, the success of faster payments in other countries such as the United Kingdom (which adopted real-time payments over a decade ago) suggests that it may be inevitable that consumers will eventually come to expect real-time or near real-time capabilities.

As consumer preferences gradually evolve, we encourage the Board to explore improvements to existing settlement capabilities in addition to developing the FedNow Service. Doing so will ensure that credit union liquidity management options can keep pace with an accelerating payments environment before 2023 or 2024—the approximate timeframe for the launch of the new service. Enhancements to the Fedwire Funds Service and National Settlement Service—while not the subject of immediate consideration—would provide additional support for private-sector RTGS arrangements that are based on a joint account. NAFCU supports the Board's decision to pursue such enhancements through a separate request for comment and encourages the Reserve Banks to conduct outreach at both natural person and corporate credit unions to understand the operational needs of our industry.

Pricing

For credit unions, the decision to participate in the FedNow Service will largely depend on member demand and pricing terms, variables which are difficult to quantify at present. NAFCU supports a pricing arrangement that grants credit unions fair and affordable access to the FedNow Service. NAFCU asks that the Board *avoid* a pricing structure that relies upon volume discounts or minimum volume requirements, or requires institutions that do not originate FedNow payments to pay fees. NAFCU regards these minimum and reasonable standards as essential for attracting small, community institutions such as credit unions and establishing ubiquitous access to real-time payments over the long term.

NAFCU generally agrees with the Board's assessment that the FedNow Service is capable of achieving long term cost recovery. On the other hand, the exact mechanisms used to achieve such recovery remain undetermined. NAFCU asks that the Board clearly communicate its general expectations for pricing as soon as possible so that credit unions can decide what the costs of FedNow adoption will be relative to private sector options. At the very least, the Board should seek industry input on pricing decisions well before deployment of the service, which may not occur until 2024.

The Board should also consider ways to reduce the expense of using the FedNow Service at startup. The *Monetary Control Act of 1980* (MCA) requires that services provided by the Federal Reserve adhere to certain pricing principles, including the principle that "(o)ver the long run, fees shall be established on the basis of all direct and indirect costs actually incurred in providing the Federal Reserve services."[1] As explained in the notice, the indirect costs that may be considered include imputed costs that a private-sector firm would incur if it were to provide the services. Another principle states that "[d]uring the initial start-up period, however, new operational requirements and variations in volume may temporarily change unit costs for some service categories."

In testimony delivered before Congress, Esther George, President of the Federal Reserve Bank of Kansas City, noted that in 1981, when the pricing principles were first applied to ACH, "the Board recognized that the ACH service was still evolving and allowed fees to be set based on mature volume costs rather than current costs for a number of years."[2] NAFCU believes that the same approach should be taken with the FedNow Service as this aligns not only with historical precedent but reflects a common strategy used by other service providers within the financial sector.

Account Reconciliation

The FedNow Service 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

[1] See Board of Governors of the Federal Reserve System, ''Principles for the Pricing of Federal Reserve Bank Services,'' (Issued 1980). Available at https://www.federalreserve.gov/paymentsystems/pfs_principles.htm.
[2] Statement by Esther George, President, Federal Reserve Bank of Kansas City on behalf of the Federal Reserve System, Hearing Before the Task Force on Financial Technology of the House Committee on Financial Services (September 26, 2019), available at https://www.kansascityfed.org/~/media/files/publicat/speeches/2019/2019-george-washington-09-26.pdf.

reporting. The Board has determined that the business day of the FedNow Service 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 the FedNow Service's continuous processing of payments.

Request for Payment Functionality

The notice describes a request for payment feature, which would be a separate nonvalue message type that, when received through an end-user service, would prompt a sender to initiate a payment to the receiver who is requesting funds. The feature would allow a sender to authorize a credit transfer in real time, based on the receiver's request message. NAFCU believes that such a feature would be valuable to credit unions to the extent that members may wish to utilize faster bill pay options. The feature would also provide an additional layer of authentication and security for the benefit of senders. To promote early adoption, NAFCU recommends that the request for payment feature be made available at launch.

Liquidity and Credit

A 24x7x365 payments environment will introduce new liquidity management challenges for credit unions. NAFCU believes that the Board should extend discount window operations under the same terms and conditions as for current Federal Reserve services to ease account balance management, particularly at launch, when financial institution users will still be familiarizing themselves with real-time payment operations.

Directory Service

NAFCU strongly supports the creation of a secure directory to link sending and receiving institutions 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. For example, if a centralized, Fed-operated directory integrates more reliably with FedLine and reduces technical uncertainty when populating payment message fields, then this option would be preferable.

NAFCU also believes that a robust directory service should also promote a streamlined end-user experience by recognizing public identifiers, such as email or a telephone number. For smaller credit unions that have had difficulty joining existing P2P networks, a fully featured payments directory could provide an alternative 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 communicate its expectations as early as possible, before the FedNow Service is launched.

Fraud Prevention Services

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 the FedNow Service. Accordingly, NAFCU urges the Board and Reserve Banks 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 the FedNow Service 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.

In general, NAFCU supports the approach suggested in the notice, which indicates that the FedNow Service could offer "additional fraud mitigation features, such as payment monitoring to alert participating banks of unusual transactions." We also ask that the Board engage directly with credit unions and other industry stakeholders to determine whether payment message information should be enhanced or modified to improve fraud detection capabilities. NAFCU has no objection to the proposed $25,000 value limit on transfers as a fraud mitigation measure because it would still permit institutions to establish value limits below the threshold. However, we recommend that the Board periodically reevaluate this limit to ensure that it does not impose undue constraints as the FedNow Service matures.

Interoperability

Interoperability with private payment systems and clearinghouses could influence future adoption of the FedNow Service for some credit unions. For others, interoperability is less of a concern provided that the FedNow Service is widely adopted by other financial institutions, accessible, and reasonably priced. NAFCU supports the Board's general view that interoperability is a desired outcome that should be pursued alongside development of the FedNow Service. Achieving interoperability with private networks would not only enhance the resiliency of the nation's payment systems but likely speed faster payments adoption.

Enhancements to the Fedwire Funds Service and National Settlement Service (NSS)

In addition to developing the FedNow Service, the Board is considering enhancements to the existing Fedwire Funds Service and NSS to support private sector RTGS services. NAFCU supports these enhancements, which would facilitate liquidity management through a joint account structure. NAFCU also supports the expansion of the Fedwire Funds Service and NSS operating hours as a way to improve liquidity management in joint accounts and to accommodate incremental improvements in payment speed on existing ACH rails. We urge the Board to implement already proposed enhancements to the Fedwire Funds Service and NSS as soon as possible to accommodate expansion of same-day ACH settlement windows.

Outreach and Education

To improve understanding and adoption of faster payments, industry and government stakeholders should be given the flexibility to develop consumer education and outreach strategies through collaborative and voluntary partnerships. With access to real-time payments still at a nascent stage, it is critical that credit unions are empowered to determine best practices for access and disclosure based on experience rather than through the mandate of future regulatory intervention. Requiring a more prescriptive approach could chill adoption of faster payments and frustrate efforts to develop a modern and frictionless payment environment. NAFCU also recommends that the Board, in conjunction with other regulators, work together with payment providers and financial institutions to understand whether real-time payments may necessitate modernization of regulations, such a Regulation E and its error resolution provisions, to better reflect the responsibilities of all parties when settlement is instantaneous and irrevocable.

Conclusion

NAFCU strongly supports the Board's decision to move forward with development of the FedNow Service. While there are many technological challenges to overcome in terms of achieving security and interoperability, NAFCU stands ready to work with the Board, Reserve Banks, and industry partners to help ensure that the FedNow Service is effective, scalable, and accessible to credit unions and their members.

Should you have any questions or require additional information, 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